

Shareholder Votes and Proxy Advisors: Evidence from Say on Pay

Yonca Ertimur
Duke University
yertimur@duke.edu

Fabrizio Ferri^{*}
Columbia University
ff2270@columbia.edu

David Oesch
University of St. Gallen
david.oesch@unisg.ch

^{*} Corresponding Author: Columbia Business School, Columbia University, Uris Hall 618, 3022 Broadway, New York, NY 10027, phone: (212) 854-0425.

We thank Glass, Lewis & Co. for providing us with their 2011 proxy season reports, Carol Bowie (at Institutional Shareholder Services) and Robert McCormick (at Glass Lewis & Co.) for insightful conversations, Edward A. Hauder at Exequity LLP, Independent Board and Management Advisors for providing data on SWOP adoptions, Yaniv Grinstein for helpful comments, Zhenhua Chen, Miguel Duras, Thomas Steffan and Forrester Wong for research assistance. All errors remain our own.

Shareholder Votes and Proxy Advisors: Evidence from Say on Pay

Abstract:

We study the role of proxy advisors (ISS and Glass Lewis & Co.) in the context of mandatory “say on pay” votes, a novel and complex item requiring significant firm-specific analysis. After describing the analysis underlying each proxy advisor’s recommendations, we examine the effect of these recommendations on shareholder votes, stock prices and firms’ behavior. As in prior studies, negative recommendations have a strong association with voting outcomes, but the effect varies with the reasons behind the recommendation. 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. The few firms that change their compensation practices obtain a revision in the recommendation and avoid voting dissent. We also present novel evidence on the (substantial) influence of management recommendations on shareholder votes in the context of the “say when on pay” vote, i.e. the vote on whether to hold say on pay votes every one, two or three years. Our findings contribute to the literature on shareholder voting and the related policy debate.

JEL Classification: G34, G38, J33, M12

Keywords: Say on pay, proxy advisors, shareholder votes, say when on pay, CEO compensation, shareholder activism

1. Introduction

In this study 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 2011.¹ We then investigate the effect of these recommendations on shareholder votes, stock prices and firm’s behavior.

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,² this trend calls for a better understanding of the drivers of shareholder votes. Prior studies identify proxy advisors’ recommendations as a key determinant of voting outcomes (e.g. Cai et al., 2009). However, we know little about the “black box” underlying these recommendations.

The highly firm-specific, complex and inherently subjective nature of executive pay makes SOP a powerful setting to investigate the depth of the analysis proxy advisors perform, the extent to which their recommendations reflect firm-specific considerations, as well as the extent (and sources) of disagreement among proxy advisors. These characteristics of SOP contrast with other

¹ 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 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. For a more detailed discussion, see Choi, Fisch and Kahan (2009).

² 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.

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, leading to the criticism that to reduce their costs proxy advisors promote “one-size-fits-all” governance practices (e.g. Gordon, 2009).

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. The difference also reflects the different approaches ISS and GL follow in assessing the “pay for performance” category, a key driver of the final recommendation, with ISS emphasizing poor performance more than GL. Interestingly, the firms receiving an *Against* from ISS are not a subset of those receiving an *Against* from GL. On the contrary, in the subset of firms with questionable executive compensation practices (i.e. firms with an *Against* from at least one proxy advisor), ISS and GL agree on which firms warrant an *Against* only 17.9% of the time. This 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. In numerous cases, the proxy advisors identify similar controversial provisions yet issue different recommendations, based on firm-specific circumstances and the other elements of the pay plan.

Our analysis of the SOP votes shows that 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. When both recommend *Against*, voting dissent is higher by 37.9%. 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,³ the estimate for GL is higher (e.g. ~3% in Choi et al., 2010). This 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.

A key insight that emerges from the analysis of SOP votes is that not all *Against* recommendations have the same effect on shareholder votes—the severity and type of concerns underlying the recommendation matter. For example, given an *Against* recommendation, dissent is higher when ISS identifies a problem in the pay for performance and change in control agreements categories, and when it identifies a problem in more than one category. In the case of GL, given an *Against* recommendation, dissent is higher for firms with the worst pay for performance rating. Hence, investors do not mechanically follow the advisors' recommendations but seem to use the information in the reports to decide which recommendations to support.

³ 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., 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%).

Next, we examine the market reaction to the release of proxy advisors' SOP recommendations, a powerful setting given the characteristics of SOP. As discussed earlier, proxy advisors' voting policy is often known ahead of time for many items on the ballot (e.g. shareholder proposals). Hence, the incremental information conveyed by the report may be limited and the final recommendation largely anticipated. In contrast, we argue that in the case of SOP proposals, the subjectivity involved in assessing complex executive pay plans leads to greater uncertainty regarding proxy advisors' recommendations and analyses with respect to SOP, a novel item on the ballot in 2011. We document 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 report and other 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).⁴

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. These protests neither led to a change in recommendation nor did it result in lower voting dissent. Eight firms changed the compensation provisions criticized in ISS's reports, causing ISS to revise

⁴ 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.

its recommendation and resulting in low voting dissent. The other four firms provided additional disclosure (obtaining a revised, favorable recommendation in two cases).⁵

Finally, we explore another provision of the Dodd-Frank Act which required firms to hold a non-binding shareholder vote in 2011 on the frequency of future SOP votes (known as say-when-on-pay, or SWOP), with a choice between annual, biennial or triennial frequency. This is a unique setting to explore the influence of management recommendations on shareholder votes, because, while proxy advisors' recommendations were the same across all firms (in favor of annual), management recommendations varied. In contrast, usually management recommendations are the same across firms (e.g. in favor of (against) management (shareholder) proposals)).

We find that management recommended holding an annual (triennial) SOP vote at 61.8% (33%) of the firms. The annual frequency option was supported by 75.8% of the votes cast and won the highest number of votes in more than 90% of the firms. Management's recommendations played a key role. Management's support for triennial frequency was associated with 27.6% less voting support for the annual frequency (relative to the case where management recommended annual). However, shareholders were less likely to follow management's recommendation for triennial when concerned about the firm's compensation practices as proxied for by high SOP voting dissent, suggesting that management's influence on shareholder votes depends on its credibility. Interestingly, while the votes were non-binding, when the annual frequency won the highest number of votes, the firm always adopted it, even when management had recommended triennial—another example of the influence of non-binding shareholder votes on boards' choices.

⁵ Interestingly, 19 firms engaged with ISS *before* the release of the report to discuss the issues raised in the report (ISS provides S&P 500 firms with an opportunity to review their draft report before its public release to ensure factual accuracy). Nine of these firms had an *Against* recommendation in the draft report. Two of them filed an 8-K to announce changes to their compensation practices and obtained a favorable recommendation in the final ISS report.

In interpreting our results, a caveat is important. Throughout the paper we refer to proxy advisors' "influence" on shareholder votes, implying that voting shareholders use 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). The costly nature of the analysis in the SOP setting and its novelty make it more likely that proxy advisors influence (at least some) shareholders' votes. Nonetheless, the evidence we present is important even under the alternative scenarios. If proxy advisors' recommendations simply coincide with shareholder preferences, their strong association with shareholder votes speaks to what compensation issues shareholders care about. If they aggregate shareholder views, it speaks to the ability of proxy advisors to synthesize shareholder preferences.

Our study contributes to the literature on shareholder voting, and in particular, on the role of proxy advisors. This is the first study to examine the analysis underlying proxy advisors' recommendations and its influence on shareholder votes, in a setting where such analysis is especially complex. It is also the first study to document the stock price reaction to the release of proxy advisors' "routine" reports ahead of the annual meeting, and the firms' responses to proxy advisors' negative recommendations (as well as the effect of such responses on shareholder

votes).⁶ Finally, our study provides the first direct estimate of the influence of management recommendations on shareholder votes, adding to the indirect evidence in prior literature.⁷

Our study also contributes to the literature on say on pay, 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).⁸ 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 compensation plans

Our sample includes S&P 1500 firms with annual meetings between January and November 2011 and for which we are able to obtain voting data and management recommendations (for the SOP and SWOP proposals) as well as the proxy reports issued by ISS and GL, resulting in 1,275 firms. In this section we provide a discussion of the SOP-related portion of these reports based on data we hand collected and manually coded.

⁶ 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.

⁷ Bebchuk and Kamar (2010) show that management is able to use bundling to obtain shareholder approval for pro-management arrangements that shareholders would not support on a stand-alone basis. Listokin (2010) documents that close-call management proposals are more likely to pass by a small margin than to fail by a small margin.

⁸ 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; Thomas, Palmiter and Cotter, 2012). Another already visible consequence of say on pay in the US is the concurrent drop in other tools of compensation-related activism in 2011 (see Figures 1.A and 1.B). For example, in 2011 ISS recommended to withhold votes from compensation committees (CC) at only 5.5% of the firms where it recommended to vote against the compensation plan. At the same time, ISS has announced that in 2012 it will recommend withholding votes from CC at firms where more than 30% of the votes were cast against the compensation plan in 2011 if they do not address shareholder concerns. This threat is likely to further put pressure on firms to respond to negative SOP votes.

2.1 ISS's analysis of compensation plans

ISS structures the SOP section of its proxy reports around five categories: pay for performance evaluation (*Pay for Performance*), peer group benchmarking (*Peer Group*), non-performance-based pay elements such as perks and pensions (*Non-Performance Pay*), severance/change in control arrangements (*Severance*), compensation committee communication and effectiveness (*Communication*). For each category, the reports contain quantitative and qualitative information from the proxy statement, ISS's analysis and an overall rating: *High*, *Medium* or *Low Concern*. The reports conclude with a summary, including the recommendation (*For* or *Against*) and its rationale. As shown in Table 1, Panel A, ISS issued an *Against* recommendation at 11.3% of the sample firms. The table also shows the distribution of the ratings by category. Appendix 1 provides examples of *High Concern* in each category.

With respect to *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). 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 and discretionary, the quality of the related disclosures, etc. *Pay for Performance* has the highest incidence of *High Concern* ratings with 105 firms—8.2% of the sample and 72.9% of the 144 firms with an *Against* recommendation. While the details are firm-specific (see Appendix 1), our reading of these 105 cases indicates that they usually 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.

In the *Peer Group* section ISS evaluates the choice of peers and targets (e.g. median, 75th percentile) used for benchmarking purposes. Of the 12 firms rated as *High Concern* in this category, nine are penalized for their use of above median benchmarking at times of lagging performance. Tellingly, all 12 firms are rated as *High Concern* also in *Pay for Performance*, with the benchmarking issue often discussed in the *Pay for Performance* section as well. Essentially, ISS views and analyzes the peer benchmarking process as one particular mechanism that may contribute to a misalignment between pay and performance.

In the *Non-Performance Pay* section ISS assesses whether non-performance-based elements of pay and their amounts are justifiable. 13.2% (19 of 144) of the firms with an *Against* receive a *High Concern* in this category, mostly due to their use of perk-related tax gross-ups (seven cases), the level or nature of perks (six cases), or both (three cases).

In the *Severance* section ISS evaluates the provisions of change-in-control agreements. 20.1% (29 of 144) of the firms receiving an *Against* are rated as *High Concern* in this category. In most of these cases, ISS opposes the use of excise tax gross-ups in new or amended contracts (19 cases), modified single-trigger provisions (five cases), or both (four cases).

Finally, in the *Communication* section ISS assesses the quality of the disclosures the compensation committee provides (e.g. performance goals and metrics, the effect of pay on risk and the use of risk mitigating provisions, such as clawbacks) and its responsiveness to shareholder concerns. For 11 of the 13 firms that receive a *High Concern* in this category, the primary reason is 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). Not surprisingly, almost all of these firms are rated as *High Concern* also in another category.

Table 1, Panel B reveals that all firms with a *High Concern* rating also receive an *Against* recommendation compared to only two firms without a *High Concern*. That is, assigning a *High Concern* rating and issuing an *Against* recommendation are largely a joint decision. 77.8% (112 out of 144) of the firms with an *Against* recommendation received a *High Concern* rating only in one category with most of the other firms receiving two *High Concern* ratings. With respect to the former group, Panel B confirms that few firms (no firm) receive(s) a *High Concern* only in the *Communication (Peer Group)* category.

2.2 GL's analysis of compensation plans

The SOP section of the GL reports starts with a summary of quantitative and qualitative information from the proxy statement, followed by an analysis structured around three categories: *Pay for Performance*, *Structure* and *Disclosure*. For each firm GL assigns 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* (GL reports the grades for the prior two years as well). The report concludes with a summary of the main concerns and a recommendation. As shown in Table 1, Panel C, GL issued an *Against* recommendation at 21.7% of the sample firms, versus 11.3% for ISS (Panel A), consistent with prior evidence of GL being more aggressive in its recommendations.⁹ The table also shows the distribution of the ratings by category. Appendix 2 provides examples of the lowest ratings in each category.

⁹ Choi et al. (2010) report that GL issued withhold recommendations for 18.8% of directors up for elections 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.

GL's *Pay-for-Performance* grade is based on a proprietary methodology (see Appendix 3) that essentially measures the "gap" between relative pay and relative performance, using multiple performance metrics and different peer groups as a benchmark. GL grades companies on a forced curve, with firms in the top 10% of the "gap" distribution receiving an *F*. Table 1, Panel C, shows that 76 (6.0%) of sample firms receive an *F* and 255 (20.0%) receive a *D* for their pay-performance relation in 2010. With one exception, an *F* grade always translates into an *Against* recommendation, while 67.5% of the firms with a *D* grade receive an *Against* recommendation. Why does GL issue different recommendations for firms receiving the same grade (*D*) in pay for performance? Untabulated analysis suggests that this decision depends on GL's assessment of the rest of the compensation plan. Specifically, a *D* grade combined with a *Poor* (non-*Poor*) rating in *Disclosure* or *Structure* results in an *Against* recommendation 95% (only 58%) of the time. The type of non-*Poor* rating matters too, with 75% (only 25%) of firms with a *D* grade and *Fair* (*Good*) in both *Disclosure* and *Structure* receiving an *Against*. History also plays a role: among firms with a *D* and a non-*Poor* rating in *Structure* and *Disclosure*, 67% (only 25%) of those with an *Against* (*For*) recommendation were given a *D* or *F* pay-for-performance grade in 2009.

In the *Structure* section GL lists concerns about the design of the compensation scheme. 214 firms (16.8% of the sample) get a *Poor* rating.¹⁰ But only slightly more than half of them receive an *Against* recommendation, which seems to depend on GL's assessment of the other categories. In particular, 80% of the firms with a *Poor* in *Structure* and an *Against* received a *D* (53%) or *F* (27%), versus only one case of *D* (and no cases of *F*) for firms with a *For*

¹⁰ Our examination of these 214 cases yields more than fifty different compensation issues giving rise to concerns (untabulated). The most common are lack of clawback provisions (156 cases), limited performance-based nature of incentive plans (144), various types of tax gross-ups (107), controversial features of change in control plans (99), lack of ownership requirements (89), discretionary elements of pay (79), concerns with the 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. The frequency of each concern does not differ significantly between firms with *For* and *Against* recommendations (unreported).

recommendation (untabulated). Conversely, less than 2% (none) of the firms with *Poor* in *Structure* and an *Against* received a *B* (*A*). That is, *Poor Structure* almost always (almost never) results in an *Against* recommendation if combined with a poor (good) performance grade.

The *Disclosure* section includes a list of concerns with the adequacy of compensation-related disclosures. Our (untabulated) examination of the 76 firms (6.0% of the sample) that receive a *Poor* rating suggests that lack of disclosure of performance goals or metrics is the most common reason for the *Poor* rating (66 cases). In more than a third of these cases, an additional concern is the lack of disclosure of how equity awards are determined. Only 28 of the 76 firms rated as *Poor* in *Disclosure* receive an *Against*. A closer (untabulated) inspection reveals that all 28 firms are also rated as *Poor* in *Structure* or as *D* or *F* in *Pay for Performance*. Instead, none of the 48 firms with a *For* recommendation is rated as *Poor* in *Structure* and only three are rated as *D* in *Pay for Performance*. That is, *Poor Disclosure* almost always (never) results in an *Against* if combined with poor (non-poor) ratings on *Pay for Performance* or *Structure*.

Table 1, Panel, D reveals that, as with ISS (see Panel B), it is extremely rare for a firm without a *High Concern* (herein defined as *Poor Structure*, *Poor Disclosure* or a *D* or *F* grade in *Pay for Performance*) to receive an *Against* (only one case). Unlike ISS, GL does not give an *Against* recommendation to all firms with a *High Concern*. In particular, only 41.1% (146 of 355) of the firms with a *Single High Concern* receive an *Against*. Hence, assigning a *High Concern* rating and issuing an *Against* recommendation are separate decisions for GL. However, *Multiple High Concern* firms almost always receive an *Against* recommendation (106 of 110).

2.3 Differences between ISS and GL's recommendations and analyses

Given the inherent complexity and firm-specific nature of compensation plans, as well as proxy advisors' incentives to differentiate their products, it is natural 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. However, most of the agreement comes from the *For* cases (72%), whereas GL and ISS recommend *Against* together only in 5% of the cases. To the extent that an *Against* from either proxy advisor is indicative of potential executive compensation issues, GL and ISS agree on which of these firms warrant an *Against* recommendation in only 17.9% of the cases (64/(64+80+213)).

Panel B shows a similar pattern in the *Pay for Performance* category.¹¹ Treating a *Poor* rating from ISS or a *D/F* grade from GL as a symptom of potential problems, GL and ISS agree on which of these firms warrant a poor rating in only 15.5% of the cases. More strikingly, when we cross-tabulate the distribution of all ratings in the pay-for-performance categories, we see that only 20 firms receive the lowest rating from both advisors (*F* from GL, *High Concern* from ISS). Cases where ISS strongly disagrees with GL (*F* or *D* from GL and *Low Concern* from ISS) are more numerous. Instead, it is rare for GL to disagree with ISS's lowest ratings (no case of *High Concern* from ISS and *A* from GL, six cases of *High Concern* from ISS and *B* from GL).

We conjecture that these differences reflect (at least partly) the different methodologies employed by ISS and GL. As discussed earlier, ISS tends to focus its pay for performance analysis on firms with poor performance relative to the industry. Instead, GL's methodology may identify a "pay-performance" gap even at well-performing firms. This has two implications. First, all else equal, GL will tend to identify more cases of pay-for-performance disconnect, explaining the higher frequency of grades *D/F* relative to ISS *High Concerns* (26.0% versus 8.2%, see Table 2, Panel A and C), and, thus of GL *Against* recommendations relative to ISS (21.7% versus 11.3%, see Table 1, Panel A and C). Second, there will be more disagreement at firms with good

¹¹ We focus on the *Pay for Performance* category because it is the main driver of recommendations for both proxy advisors 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*.

performance. Indeed, untabulated analysis shows that the rate of agreement in poor pay-for-performance ratings estimated above (15.5%) is lower in the sub-sample with above median stock returns (7.5%) than in the subsample with below median stock returns (23.2%).¹²

To shed further light on this issue, Panel C shows the frequency of poor pay-for-performance ratings by quartiles of total CEO pay and one-year raw returns. For both ISS and GL, poor pay-for-performance ratings are more frequent for firms with low performance and high CEO pay. But performance plays a larger role in ISS's ratings. For example, for the top quartile of CEO pay, the frequency of ISS *High Concern* increases 3.2 times (from 9.1% to 29.1%) as stock performance goes from the top to the bottom quartile, whereas the increase for GL is only 1.6 (from 34.9% to 55.8%).¹³ ISS's emphasis on performance may reflect the preferences of institutional investors with limited time and resources and may thus be an effective way to reduce the cost of analysis, but it may be concerning if the "seeds" of bad governance are sown at times of good performance, as suggested by Schoar and Washington (2010).

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

Proxy advisors are often criticized for employing "one-size-fits-all" methods, arguably to avoid the cost of firm-specific analyses. This concern is especially relevant for say on pay votes, due to the challenge of making recommendations on thousands of complex and idiosyncratic compensation plans. Our reading of the reports suggests that this concern may be over-stated.

With respect to ISS, we find that many firms exhibiting some of the "triggers" typically associated with an *Against* recommendation (poor performance coupled with a CEO pay increase,

¹² Accordingly, while the frequency of GL *Against* recommendations is twice as that of ISS in the full sample (21.7% versus 11.3%), it is only 1.6 times in the sample of firms with below-median stock returns (24.5% versus 15.3%).

¹³ A similar pattern emerges if we use growth in CEO pay rather than level or industry-adjusted returns (based on two- and three-digit SIC codes) rather than stock returns. Also, a similar pattern emerges if we look at the frequency of *Against* recommendations rather than the frequency of poor rating on pay for performance.

excise tax gross-ups, perks, discretionary awards, etc.) are rated as *Medium Concern* in the corresponding category and receive a *For* recommendation. In these cases, ISS makes a subjective decision based on mitigating firm-specific circumstances, the rationale provided by the firm and the overall quality of the compensation plan. In a similar vein, as noted in Section 2.2, GL takes into account all the compensation categories' ratings in making a recommendation decision. Besides, there are numerous firms with similar ratings but different recommendations which are based on firm-specific factors. An interesting example is Methode Electronics, the only firm with an *F* grade in pay for performance but a *For* recommendation (Appendix 4). Rather than a “one-size-fits-all” approach, the concern may be the subjectivity involved in these assessments.

3. Shareholder votes on Say-on-Pay (SOP) and the role of proxy advisors

In this section we examine the extent to which shareholder votes respond to the recommendation and the analyses contained in the proxy advisors' reports.

3.1 Distribution of the voting outcome

Table 3 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%).¹⁴ 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).

¹⁴ Mean and median voting turnout is about 80%, consistent with other studies (e.g. Ferri and Sandino, 2009).

Table 3 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 presence of a *For* recommendation. Even more tellingly, 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. Thus, consistent with prior literature on the importance of proxy advisors' recommendations for shareholder votes (footnote 3), these data suggest that an *Against* recommendation by ISS (GL) is associated with approximately 28% (17%) more dissent. However, these estimates do not account for the concurrent effect of the other proxy advisor's recommendation and other determinants, an issue we address in the multivariate analysis.

3.2 Determinants of SOP votes - Multivariate analysis

To analyze the determinants of the SOP votes in a multivariate setting, following prior studies on compensation-related activism (e.g., Ertimur et al., 2011), 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),¹⁵ and independent variables include proxies for CEO pay and firm performance. Specifically, we include *CEO Total Pay* and *Growth in CEO Total Pay*, respectively, the level and growth of CEO total direct pay, *Abnormal Returns* and *Return on Assets*. Similar to other studies on shareholder votes (e.g. Gillan and Starks, 2000; Ertimur, Ferri, and Stubben, 2010), we control for size ($\ln(MV\ Equity)$), as well as the percentage of votes controlled by institutional investors and by insiders (proxied for, respectively, by *% Institutional Ownership* and *% Insider Ownership*). We capture

¹⁵ 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.

shareholders' past concerns with the compensation plan 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). 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 compensation-related concerns at these firms may have already been addressed.¹⁶ More detailed variable definitions are in the notes to Table 4.

Table 4, Panel A, Model (1) shows the results for this benchmark model. As expected, voting dissent is higher when the level and growth of CEO pay are higher and when performance is lower.¹⁷ Also, dissent is higher by 4.5% at firms targeted by *Past Compensation Activism* whereas it is slightly lower at firms with a *Prior SOP Vote*, consistent with our conjectures. Similar to earlier studies, 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.

To gain more insights into the effect of CEO pay and firm performance on voting dissent, first, 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. 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). 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.

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 does not affect our inferences.

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 we include 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 additional variable is not a significant determinant of the voting dissent. Finally, following Core, Guay and Larcker (2008) and Ertimur et al. (2011) 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.

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) we add an interaction term for firms in the top quartile of *CEO Total Pay* and in the bottom quartile of *Abnormal Returns*, and one for firms in the top quartile of *Growth in CEO Total Pay* and in the bottom quartile of *Abnormal Returns*, to better capture the notion of a pay-performance misalignment at the center of the debate leading to the adoption of SOP. 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 more than 22% (4.9% + 11.2% + 6.4%).

3.2.1 *The role of proxy advisors' recommendations*

The evidence in Table 1 suggests that proxy advisors' recommendations have a significant influence on SOP votes. In Table 4, 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 or GL issue an *Against* recommendation for SOP. In Model (1) the coefficient of *ISS Against* is positive and significant at 0.267 and the R^2 is 65.9% (compared to 20.8% 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 increases to 81.9%.

The substantial increase in explanatory power indicates that proxy advisors have greater influence on issues, like SOP, that require costly firm-specific analyses of highly technical matter. For comparison, the inclusion of an indicator for ISS recommendation in the analysis of shareholder votes on director elections and compensation-related shareholder proposals only increases the R^2 , respectively, from 11% to 19% and from 49% to 73% (Choi et al. 2010; Ertimur

et al, 2011). Alternatively, if proxy advisors' recommendations only reflect rather than influence shareholder views, the stark increase in explanatory power is a measure of proxy advisors' ability to synthesize shareholder preferences.

Notably, relative to Models (1) and (2), the coefficients of *ISS Against* and *GL Against* decrease only slightly to 0.247 and 0.129, respectively, suggesting that the two proxy advisors' recommendations capture different factors and/or appeal 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 similar to estimates by practitioners (Nathan, Barral and Chung 2011). Hence, it appears that while mandatory say on pay has not increased the influence of ISS (a concern expressed by critics of say on pay 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 0.379. 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).

In Model (5) we examine the difference in the influence of proxy advisors' recommendations on institutional and individual investors. In particular, from Model (3), we replace *ISS Against (GL Against)* with interaction terms between *ISS Against (GL Against)* and both *% Institutional Ownership* and *% Individual Ownership* (estimated as one minus the percentages of institutional and insider ownership). For both proxy advisors, the coefficients on the interaction with *% Institutional Ownership* are significantly higher than the coefficients on the interaction with *% Individual Ownership* at the 1% level (unreported tests), consistent with the fact that proxy advisors' reports are mostly used by institutional investors. Following the methodology in Choi et al. (2010), we estimate that these coefficients imply that 90.6% (96.5%) of the effect of ISS (GL) recommendations is driven by the influence on institutional investors.¹⁸ In other words, of the 24.7% votes associated with an *ISS Against*, 22.3% (90.6% x 24.7%) are from institutional investors, and 2.4% from individual investors. Of the 12.9% votes associated with a *GL Against*, 12.4% (96.5% x 12.9%) are from institutional investors, and only 0.5% from individual investors.

Given that in our sample the mean institutional (individual) ownership is 78.9% (12.6%), an *ISS Against* recommendation, on average, is associated with a vote against by 28.4% (=22.3%/78.9%) of the institutional and 18.5% (=2.4%/12.6%) of the individual investors. The

¹⁸ For example, 90.6% is calculated as follows: for a firm with *% Institutional Ownership* at the sample mean (78.9%), an *ISS Against* recommendation is associated with a 23.1% (the product of 78.9% and the coefficient of *ISS Against x % Institutional Ownership*, 29.3%) increase in voting dissent. Similarly, for a firm with *% Individual Ownership* at the sample mean (12.6%) an *ISS Against* recommendation is associated with a 2.4% (the product of 12.6% and the coefficient of *ISS Against x % Individual Ownership*, 19.1%) increase in voting dissent. Therefore, for an "average" firm, 90.6% (= 23.1%/(23.1% +2.4%)) of the effect of ISS recommendations is due to institutional investors.

corresponding figures for GL are 15.8% and 3.6%. Thus, for both GL and ISS, there is a 10-12% spread in the relative influence between institutional and individual investors.¹⁹

As for the control variables (untabulated for ease of exposition), when *ISS Against* and *GL Against* are included, the significance of some of the coefficients of the quartiles of *CEO Total Pay* and *Abnormal Returns* is reduced or eliminated. This is not surprising since pay-performance misalignment is an important driver of the recommendations (Table 2, Panel C).

3.2.2 Inside the black box: does the analysis underlying the recommendation matter?

While the influence of proxy advisors' recommendations is well recognized in the literature, less is known about whether (and how) such influence varies depending on the underlying analysis and the issues identified in it. To shed light on whether investors' voting behavior varies with the content of proxy advisors' reports, we focus on the number and type of concerns identified by each proxy advisor, starting with ISS. In Panel B, 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 the 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

¹⁹ Under the assumptions that individual investors vote without access to proxy advisors' reports and that, absent proxy advisors, institutional investors would vote in the same manner as individual investors, Choi et al. (2010) interpret this spread as a proxy for the causal effect of proxy advisors' recommendations on shareholder votes. While these assumptions are debatable, it is interesting to note that our estimate for ISS influence, at 9.9%, is similar to their estimate in the context of director elections during the 2005-2006 period. Hence, even by this measure, we do not find that mandatory SOP votes have increased the influence of ISS recommendations.

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 2, Panel B). 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 compensation problem, 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* (untabulated) significantly higher than *Non-Performance Pay* at the 5% level (but not significantly different from each other; p-value=0.12). 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. The GL analysis requires an additional adjustment. Recall from Table 2, Panel C, that (unlike the case of 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*.

In contrast to ISS, investors' voting behavior does not vary with the number of serious concerns underlying the *GL Against* recommendations—the coefficients of *GL Against—Multiple High Concern* and *GL Against—Single High Concern* in Model (3) 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—the coefficient of *GL For—Single High Concern* is positive and significant, but economically small and not significantly different from the coefficient of *GL For—Multiple High Concern*.

In Model (4), we further replace *GL Against—Single High Concern* and *GL For—Single High Concern* with indicator variables capturing the underlying category.²⁰ In the case of *Against* recommendations, we find that investors mostly respond to concerns with pay for performance and that, as with ISS, 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 (as proxied for by an *F* grade) are particularly acute. 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 (see discussion in Section 2.4).²¹

²⁰ Note that there is no case of *Poor Disclosure* as *Single High Concern* within *Against* recommendations (Table 2, Panel C) and only one case of a firm with grade *F* and *For* recommendation (which drops out due to missing control variables). Hence in Model (5), there are no indicators capturing these combinations.

²¹ 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.

As noted in the Introduction, it is possible that proxy advisors' recommendations and analyses simply coincide with independently formed shareholder views, or aggregate them. If so, our evidence of significant explanatory power and association with shareholder votes speaks, respectively, to what compensation issues shareholders care about, or the proxy advisors' effectiveness in aggregating shareholder views on executive pay.

4. 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.

4.1 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.²² Table 5, 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%).²³

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:

$$\begin{aligned}
 \text{Abnormal Returns} = & \alpha + \beta_1 \text{ISS Against} + \beta_2 \text{ISS Withhold} & (1) \\
 & + \beta_3 \text{ISS For—Shareholder Proposals} \\
 & + \beta_4 \text{ISS Against—Management Proposals} + \varepsilon
 \end{aligned}$$

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 shareholder proposals); and *ISS Against—Management Proposals* (equal to one if ISS recommends against one or more management proposals). As shown in Table 5, Panel B, the

²² These windows allow us to incorporate the effect of any leakage of information ahead of the release date (ISS often sends a draft of the report to the company, see Section 4.2) 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)).

²³ 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 5 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%)

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.

4.2 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 revised, 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 institutional investors.

We provide some evidence on this new trend through two analyses. First, we examine 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. During this review, sometimes firms engage with ISS to discuss the report, particularly when the recommendation is negative. This engagement is then described by ISS in a section of the report called "key engagement activities." In our sample, there are 24 such cases, 19 of which are related to SOP. Nine of these firms had an *Against* recommendation in the draft report. Two of them filed an 8-K addressing the concerns raised by ISS (see example in Appendix 5) and obtained a favorable recommendation. For seven firms the engagement was not successful: ISS issued an *Against* recommendation and the disclosed engagement did not result in lower voting dissent.²⁴ The other 10 firms had a *For* recommendation in the draft report, yet engaged with ISS to clarify some issues raised in the report.

In our second analysis we focus on firms' responses *after* the public release of proxy advisors' reports. In particular, we search for documents that the 144 firms targeted by a negative ISS recommendation filed with the SEC between the release of the recommendation and the

²⁴ On the contrary, relative to cases of *Against* recommendations with no disclosure of engagement activities, these cases are associated with significantly higher dissent (30.5% versus 24.4%, p-value=0.03, untabulated), suggesting that firms unsuccessfully engaging with ISS may be those with more serious problems and higher expected dissent.

annual meeting date. As shown in Table 6, we find that 52 (36.1%) of these firms filed an amendment to the proxy statement (46 firms) or 8-K (six firms).²⁵

Most of these firms (40 out of 52) voice their disagreement with ISS's rationale for its recommendation, usually criticizing the pay-for-performance evaluation (34 firms). In particular, 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 (13 cases); that 4-digit GICS codes used by ISS do not properly capture the firm's peers and understate its relative stock performance (13 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).²⁶ To strengthen their arguments, some firms also emphasize that they received a favorable GL recommendation (when they did so).

Four of the 52 firms provided additional, clarifying information on severance provisions (three cases) and pay-for-performance issues (one case). The remaining eight firms made changes to their compensation plans, by introducing performance conditions in equity grants (five firms) or removing certain provisions from their change-in-control agreements (excise tax gross-ups, two cases; modified single trigger, one case). Not surprisingly, in virtually all of the 52 cases the focus

²⁵ In untabulated analysis find no significant market reaction over the [-1,+1], [-2,+2] and [-3,+3] windows around the filing dates. Note that we focus only on responses to 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.

²⁶ The "Other issues" sub-category of pay for performance in Table 6 includes cases where there is significant disagreement as to what should be considered as part of CEO pay for a given year. As for the six severance-related 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.

of the firm response is on the issue underlying the *High Concern* rating (and, thus, the *Against* recommendation). Examples are provided in Appendix 6.

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 slightly higher dissent (26.1% versus 24.1%, p-value<0.001, untabulated), perhaps an indication that firms protesting against ISS tend to be those with higher expected dissent. However, perhaps as a reaction to this disagreement, ISS has revised its approach to pay for performance evaluations for the 2012 proxy seasons. 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).

5. Shareholder votes on Say-When-On-Pay (SWOP) and the role of management recommendations

The Dodd-Frank Act mandated firms to hold an advisory vote on the frequency of future SOP votes (a say-when-on-pay vote, or SWOP) in 2011, and, after that, once every six years. SWOP allows shareholders the option to choose between holding an annual, biennial or triennial SOP vote, or abstain. Firms are required to disclose their decision about frequency of future SOP votes in an 8-K within 150 days from the annual meeting. Early in the proxy season ISS and GL announced their support for an annual SOP vote, on the ground that it would provide greater accountability, be easier to interpret and favor management-shareholder communication on a regular basis.²⁷ Instead, management recommendations on SWOP, reported in the proxy statement released ahead of the meeting, varied across companies. This setting allows for a powerful and novel analysis of the influence of management recommendations, which usually do not vary across firms (they are in favor of management proposals and board's nominees in uncontested elections, and against shareholder proposals).

5.1 Sample description and voting outcome

Table 7 reports the distribution of SWOP votes and management recommendations. Management recommended an annual SOP vote in 61.8% of the sample firms, with the triennial (biennial) vote recommended in 33.0% (2.2%) of firms and few cases of no recommendation (3.0%). As shown in Figure 2, management support for an annual SOP vote increased as the proxy season progressed, perhaps in response to early evidence of shareholders' preference for this

²⁷ GL stated it would consider supporting a biennial or triennial frequency vote if management provided persuasive arguments in its favor, but in our sample, with the exception of Berkshire Hathaway and Amazon, always recommended an annual SOP vote.

option.²⁸ Investors overwhelmingly favored an annual SOP vote (75.8% of the votes, versus 21.1% in favor of triennial and only 1.7% in favor of biennial). Even more strikingly, in 91.6% of the cases (1,149 out of 1,254) the annual option received the highest voting support (almost always also representing the majority of votes cast). Interestingly, in our sample, when it won, the annual frequency was always adopted by the firm, even when management had recommended biennial or triennial and in spite of the advisory nature of the SWOP vote (unreported analysis).

Table 7 also speaks to the influence of management recommendations on voting outcomes. Relative to the case of no management recommendation, voting support for an annual SOP vote increases by about 15% (from 71.4% to 86.5%) when management recommends annual, and decreases by about 14% (from 71.4% to 57.4%) when management recommends triennial. With one exception, the biennial and triennial options win only when recommended by management.²⁹

5.2 Multivariate analysis

To examine the determinants of the SWOP votes, we estimate an OLS regression, where the dependent variable is *SWOP Votes for Annual* (i.e., the percentage of votes cast in favor of holding an annual SOP vote) and the control variables include the typical determinants of shareholder votes, namely performance (*Abnormal Returns* and *Return on Assets*), ownership composition (*% Institutional Ownership* and *% Insider Ownership*) and size ($\ln(MV\ Equity)$).

²⁸ Boards may also have been concerned that a fight over the vote frequency would negatively affect the SOP vote. However, when we include an indicator for management support for a bi- or triennial vote in the analysis of SOP votes in Section 3 it is insignificant, in the full sample as well as in the subsample of annual meetings taking place in early part of the proxy season (January – March). Hence, it seems more likely that some boards simply learned from the early votes in the season that the biennial and triennial options had limited support among their shareholder base.

²⁹ Some institutional investors (e.g. Capital Research, BlackRock) have adopted a policy to support a triennial SOP vote at all firms (for a list of institutional investors' policy on SWOP, see <http://say-on-pay.com/shareholder-positions/>). This explains why support for an annual SOP vote is not 100% even when management itself recommends it and may explain the one case (Schweitzer-Mauduit International) where the triennial option won the highest number of votes in spite of management support for the annual option.

Table 8, Model (1) shows the results for this benchmark model.³⁰ Support for annual SOP votes is higher in firms with higher institutional ownership, consistent with (most) institutional investors' stated preference for the annual frequency (Hauder, 2011). The negative coefficient of *% Insider Ownership* is likely to reflect management's votes against the annual option when they recommend biennial or triennial.³¹ The explanatory power of the benchmark model is fairly low ($R^2=15.1\%$). This is not surprising given that many institutional investors have chosen to vote in favor of annual or triennial at all firms (Hauder, 2011). Hence, firm-specific characteristics have only limited influence on the voting outcome.

To capture the influence of management recommendations, in Model (2) we include *Management SWOP Rec: Bi- or Triennial*, an indicator variable equal to one if management recommends a biennial or triennial SOP vote (we combine the biennial and triennial options, in view of the evidence in Table 7). The coefficient indicates that management's support for a biennial/triennial SOP vote is associated with 27.6% less voting support for the annual SOP vote (relative to the case where management recommends annual). Notably, the R^2 jumps to 66.6%.

If shareholders view an annual SOP vote as a means to impose greater accountability, support for an annual SOP vote should be higher when there is a perceived problem with the current compensation practices, as proxied for by higher SOP voting dissent. To test this prediction, in Model (3), we include an indicator variable, *High SOP Dissent*, equal to one if SOP voting dissent at the concurrent annual meeting is greater than 20%, as well as its interaction with *Management SWOP Rec: Bi- or Triennial*. The results show that a higher level of concern with the

³⁰ To facilitate the interpretation of the coefficients and comparisons with the SOP votes' analysis (where proxy advisors recommend either *For* or *Against*), we exclude the few cases where management makes no recommendations. The results are qualitatively similar when those cases are included.

³¹ Indeed, when we re-run the analysis separately for the subsample of firms with annual (biennial or triennial) management recommendations, the coefficient of *% Insider Ownership* is actually positive (negative) and significant at 0.163 (-0.356) (results not tabulated).

firm's pay practices (as proxied for by *High SOP Dissent*) is associated with 7.7% greater support for annual SOP votes when management recommends biennial or triennial. Hence, when the firm's compensation practices are controversial, management's influence is reduced and shareholders favor greater accountability (annual frequency).

Finally, in Model (4), similar to earlier analysis in the case of SOP votes, to capture the relative influence of management recommendations on different types of investors, we interact *Management SWOP Rec: Bi- or Triennial* with the percentage ownership by institutional and individual investors. The results indicate a more negative coefficient on the interaction with individual ownership. Using the methodology in Choi et al. (2010) presented earlier in Section 3.2.1, the coefficients imply that when management recommends against annual, on average 28.9% of the institutional investors and 48.4% of the individual investors also vote against annual. Hence, it appears that, contrary to proxy advisors, management has more influence on individual investors than institutional investors.

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 analysis underlying such recommendations. 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 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.

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. Importantly, this influence depends on the severity and type of concerns underlying the recommendation.

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. Instead, the few firms that change the practice criticized by ISS obtain a change in recommendation and avoid voting dissent.

Finally, we examine the non-binding shareholder vote on the frequency of future SOP votes (known as say-when-on-pay, or SWOP), also required by the Dodd-Frank Act. This is a unique setting to explore the influence of management recommendations on shareholder votes, because, while proxy advisors' recommendations are the same across all firms (in favor of annual frequency), management recommendations vary. We find that management's support for triennial frequency is associated with 27.6% less voting support for the annual frequency. However, this influence is lower when SOP voting dissent is higher, suggesting that shareholders prefer an annual vote (greater accountability) when they are concerned with the quality of the pay plan.

References

- Aggarwal R., P. Saffi and J. Sturgess, 2011. The Role of Institutional Investors in Voting: Evidence from the Securities Lending Market. Working Paper, Georgetown University.
- Alexander, C., M. Chen, D. Seppi and C. Spatt, 2010. Interim News and the Role of Proxy Voting Advice. *Review of Financial Studies* 23, 4419–4454.
- Bainbridge S., 2006. The Case for Limited Shareholder Voting Rights. *UCLA Law Review* 53, 601–636.
- Bebchuk, L. A., 2005. The Case for Increasing Shareholder Power. *Harvard Law Review* 118, 835–914.
- Bebchuk, L. A., M. Cremers and U. Peyer, 2011. The CEO Pay Slice. *Journal of Financial Economics* 102, 199–221.
- Bebchuk, L. A. and E. Kamar, 2010. Bundling and Entrenchment. *Harvard Law Review* 123, 1551–1595.
- Becker, B., D. B. Bergstresser and G. Subramanian, 2010. Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge. Working Paper, Harvard Business School.
- Bethel, J. and S. Gillan, 2002. The Impact of the Institutional and Regulatory Environment on Shareholder Voting. *Financial Management* 31, 29–54.
- Bethel, J.E., G. Hu and Q. Wang, 2009. The Market for Shareholder Voting Rights around Mergers and Acquisitions: Evidence from Institutional Daily Trading and Voting. *Journal of Corporate Finance*, 15, 129–145.
- Cai, J., J. Garner and R. Walkling, 2009. Electing Directors. *Journal of Finance* 64, 2389–2421.
- Cai, J. and R. Walkling, 2011. Shareholders' Say on Pay: Does it Create Value? *Journal of Financial and Quantitative Analysis* 46, 299–339.
- Carhart, M. 1997, On persistence in mutual fund performance, *Journal of Finance*, 52, 57–82.
- Christoffersen, S. E. K., C. C. Geczy, D. K. Musto and A. V. Reed, 2007. Vote Trading and Information Aggregation. *Journal of Finance*, 62, 2897–2929.
- Choi, S., J. Fisch and M. Kahan, 2009. Director Elections and the Role of Proxy Advisors. *Southern California Law Review* 82, 649–702.
- Choi, S., J. Fisch and M. Kahan, 2010. The Power of Proxy Advisors: Myth or Reality? *Emory Law Journal* 59, 101–151.

- Cohn, J., S. Gillan and J. Hartzell, 2011. On Enhancing Shareholder Control: A (Dodd-) Frank Assessment of Proxy Access, Working Paper, University of Texas at Austin.
- Core, J. E., W. Guay and D. F. Larcker, 2008. The Power of the Pen and Executive Compensation. *Journal of Financial Economics* 88:1–25.
- Cuñat, V., M. Gine and M. Guadalupe, forthcoming. The Vote is Cast: The Effect of Corporate Governance on Shareholder Value. *Journal of Finance*.
- Del Guercio, D., L. Seery and T. Woitke, 2008. Do Boards Pay Attention When Institutional Investors “Just Vote No”? *Journal of Financial Economics* 90, 84–103.
- Ertimur, Y., F. Ferri and D. Maber, 2012. Reputation Penalties for Poor Monitoring of Executive Pay: Evidence from Option Backdating, *Journal of Financial Economics* 104, 118–144.
- Ertimur, Y., F. Ferri and V. Muslu, 2011. Shareholder Activism and CEO Pay, *Review of Financial Studies* 24, 535–592.
- Ertimur, Y., F. Ferri and S. Stubben, 2010. Board of Directors’ Responsiveness to Shareholders: Evidence from Shareholder Proposals, *Journal of Corporate Finance* 16, 53–72.
- Fama, E.F. and French, K.R., 1996. Multifactor explanations of asset pricing anomalies. *The Journal of Finance*, 51, 55–84.
- Ferri, F., forthcoming. “Low-Cost” Activism: A Review of the Evidence. Research Handbook on the Economics of Corporate Law, *Claire Hill & Brett McDonnell, eds., Elgar Publishers*.
- Ferri, F. and T. Sandino, 2009. The Impact of Shareholder Activism on Financial Reporting and Compensation: The Case of Employee Stock Options Expensing. *Accounting Review* 84:433–66.
- Ferri, F. and D. Maber. 2011. Say on Pay Votes and CEO Compensation: Evidence from the UK. *Review of Finance* (Forthcoming).
- Gordon, J., 2009. “Say on Pay”: Cautionary Notes on the U.K. Experience and the Case for Shareholders Opt-in. *Harvard Journal on Legislation* 46:323–64.
- Gillan, S. and L. Starks, 2000. Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors. *Journal of Financial Economics* 57, 275–305.
- Hauder E., 2011. Shareholders’ Position on Say on Pay, available at <http://say-on-pay.com/shareholder-positions/>
- Hu, H. and B. Black, 2007. Hedge Funds, Insiders and the Decoupling of Economic and Voting Ownership: Empty Voting and Hidden (Morphable) Ownership. *Journal of Corporate Finance*, 13, 343–367.

- ISS, Institutional Shareholder Services, 2011a. 2011 U.S. Proxy Voting Guidelines Summary
- ISS, Institutional Shareholder Services, 2011b. 2011 Evaluating Pay Performance Alignment
- Kahan M. and E.B. Rock, 2011. The Insignificance of Proxy Access, *Virginia Law Review* 97, p.1347–1434.
- Larcker D. F., A. L. McCall and G. Ormazabal, 2011. Proxy Advisory Firms and Stock Option Exchanges. Working Paper, Stanford University
- Larcker, D., G. Ormazabal and D. Taylor, 2011. The market reaction to corporate governance regulation, *Journal of Financial Economics* 101, 431–448.
- Listokin, Y., 2009. Corporate Voting vs. Market Price Setting. *American Law and Economics Review* 11(2):608-635.
- Listokin, Y., 2010. Management Always Wins the Close Ones. *American Law and Economics Review* 10(2):159-184.
- Lublin, Joann S., 2012. Executive Pay Vote Spur Shifts in Policies, March 1, *Wall Street Journal*.
- Morgan, A.G. and A.B. Poulsen, 2001. Linking Pay to Performance - Compensation Proposals in the S&P 500, *Journal of Financial Economics* 62, 489-523.
- Nathan C., J. D. C. Barrall and A. Chung, 2011. Say on Pay 2011: Proxy Advisors on Course for Hegemony. *New York Law Journal*, November 28.
- Schoar A. and E. Washington, 2010. Are the Seeds of Bad Governance Sown in Good Times? Working Paper, Massachusetts Institute of Technology.
- Schulte, Roth & Zabel, 2011. “The Votes Are In — Deconstructing the 2011 Say on Pay Vote”
- SEC, Securities and Exchange Commission, 2010. Concept Release No. 34-62495, available at: <http://www.sec.gov/rules/concept/2010/34-62495.pdf>
- The Conference Board, Director Notes, 2011. SOP Drives Compensation Program Changes to Enhance Pay/Performance Link, available at: <http://www.clearbridgecomp.com/our-point-of-view/articles>
- Thomas, R., A. Palmiter and J. Cotter, 2012. Dodd-Frank's Say on Pay: Will it Lead to a Greater Role for Shareholders in Corporate Governance?, *Cornell Law Review* 27.

Appendix 1 Excerpts from ISS proxy reports – Examples of ‘High Concern’ Ratings

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. As seen in the Components of Pay table above, 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 and continued employment of the executive. 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. Note that ISS has identified a similar pay-for-performance disconnect at the company since 2009.

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 (*from Pay for Performance section of the report*)

...The Compensation Committee targets above median levels for both short-term and long-term incentives. Shareholders may find this practice concerning, as targeting pay significantly above median peer group can ratchet up executive compensation without linking it to improvements in company performance (*from Peer Group section of the report*)

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. No other NEOs receive this benefit. ISS raises concerns with respect to the excessive tax gross-up on Kilroy, Jr.'s life insurance premium. 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. In addition, the mechanics behind life insurance dictate a one-to-one correlation between the increase in the cost of insurance and age, which consequently will continue to elevate the total cost of the perquisite.

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. In 2008, directors received on average 23.8 percent WITHHOLD votes with Compensation Committee members receiving 27.9 percent WITHHOLD votes. In 2009, directors received an average of 37.7 percent WITHHOLD votes with Compensation Committee members receiving 40.2 percent WITHHOLD votes...the Compensation Committee and the board continues to ignore significant WITHHOLD votes at the last two annual meetings.”

Appendix 2 Excerpts from Glass Lewis proxy reports- Examples of ‘Poor’ Ratings

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. A company's choice of a peer group can have a significant impact on the size and structure of compensation. 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 Company discloses that 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, such discretionary bonuses indicate a lack of resolve on the part of the compensation committee to put incentive awards truly "at risk," especially considering the Company has in place incentive plans that are formula-based and objective. We believe the compensation committee's behavior during the past year undermines the integrity of the Company's incentive plans and 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. We believe shareholders benefit when equity or long-term incentive awards are determined and vest on the basis of metrics with pre-established goals and are thus demonstrably linked to the performance of the company, aligning the long-term interests of management with those of shareholders. In this case, shareholders should be concerned with the Company's failure to implement a performance-based long-term incentive plan with objective metrics and goals.

No Clawback Provision. To the best of our knowledge, the Company's incentive plans currently lack a clawback provision, whereby any bonus awarded may be recouped by the Company in the event of material fraud or misconduct by the recipient of a bonus award. We believe emerging best practice has come to promote the use of clawback provisions to safeguard against the receipt of unwarranted bonuses and to similarly encourage executives and senior management to take a more comprehensive view of risk when making business decisions. In addition, we note that 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). However, at the time this report was written, the SEC had not finalized the rules regarding clawback policies.

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. In this case, we

believe the Company has done a disservice to shareholders by agreeing to grant Mr. Workman substantial performance-insensitive bonuses.

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. We are concerned that 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 their positions with the Company. In short, we believe that 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. Lastly, as a general principle, we believe executives, like all employees, should themselves shoulder all taxes associated with the bonuses and benefits they receive.”

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 (STI) 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 (LTI) plan. Lastly, the Company has not fully explained how the specific performance levels against targets translated into payouts for Named Executive Officers in 2010 under the STI plan and the 2008-2010 performance cycle of the LTI plan. 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. Without such disclosure, shareholders are unable to evaluate the extent to which the Company strives to align long-term executive compensation with performance.”

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 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 5 Example of “key engagement activities” before the release of ISS’s reports

ISS Proxy Voting Report for MeadWestvaco Corp, March 28, 2011

Pay –for-Performance Evaluation

“... total CEO compensation has increased by 156.4 percent year-over-year despite the company's lagging shareholder returns. The 156.4 percent increase pertained mostly to long-term incentive grants made in fiscal 2010, which consisted primarily of an increase in front-loaded performance-based restricted stock units (PSRUs – increased 898 percent) as well as a 242.5 percent increase in the grant date value of stock options. The PSRUs are “front-loaded” stock because the company states they represent a three-year grant and that the CEO will not receive additional restricted stock units in 2011 or 2012. In that regard, ISS notes that if only one-third of the value of the stock award amounts reported for the CEO's FY10 compensation is included, his total FY10 compensation amount would be approximately \$11,797,000 compared with \$6,137,000 for FY09 (a 92 percent increase). In communications with ISS, the company also noted that, due to its depressed stock price in 2009, the resulting low Black-Scholes option valuation (approximately 10 percent of the stock price) would have resulted in a very large grant (based on the targeted grant value) and excessive dilution to shareholders. Instead, the company relied on its historic Black-Scholes valuation of approximately 25 percent of stock price to determine the number of options granted, but this resulted in a lower reported value in its compensation disclosures with respect to 2009.

[With respect to the PSRU...] ISS notes that the company did not disclose either threshold, target, or maximum performance levels for the 2010–2014 cycle in its proxy statement filed March 17, 2011 (although retrospective disclosure was made for the past 2008–2010 long-term incentive awards). However, in response to concerns raised by ISS during the draft review process the company subsequently filed an 8-K (March 28, 2011) providing more detail about the metrics set for the front-loaded 2010-2014 cycle. ..

In light of the additional disclosure about performance requirements for the front-loaded PSRU grants, ISS concludes that the majority of the increase in the CEO's pay is performance-based and no pay-for-performance misalignment is identified at this time.

Conclusions

While the company's TSRs have lagged its GICS peer group median for the last 1- and 3-year periods, and the CEO's pay significantly increased due to front-loaded PSRU awards, the company's disclosure in a Form 8-K filed March 28, 2011, of threshold and maximum cumulative economic profit growth goals governing those awards alleviates concern about a pay-for-performance disconnect at this time. We further note that plan participants, including the CEO, will not receive additional restricted stock units until 2013. As such, a vote FOR this proposal is warranted.”

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 cyclicity 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, 2011; 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, 2011; 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”

Figure 1.A Number of compensation-related shareholder proposals over 2003 – 2011

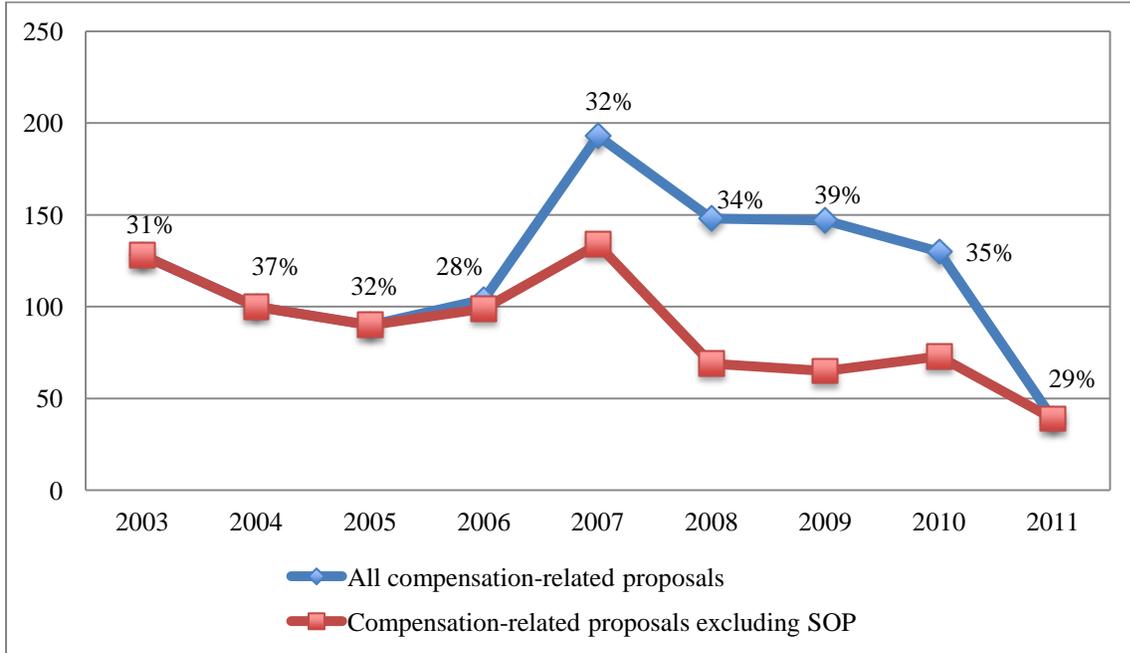


Figure 1.B Number of firms with ISS withhold recommendations for compensation committee members over 2003 – 2011

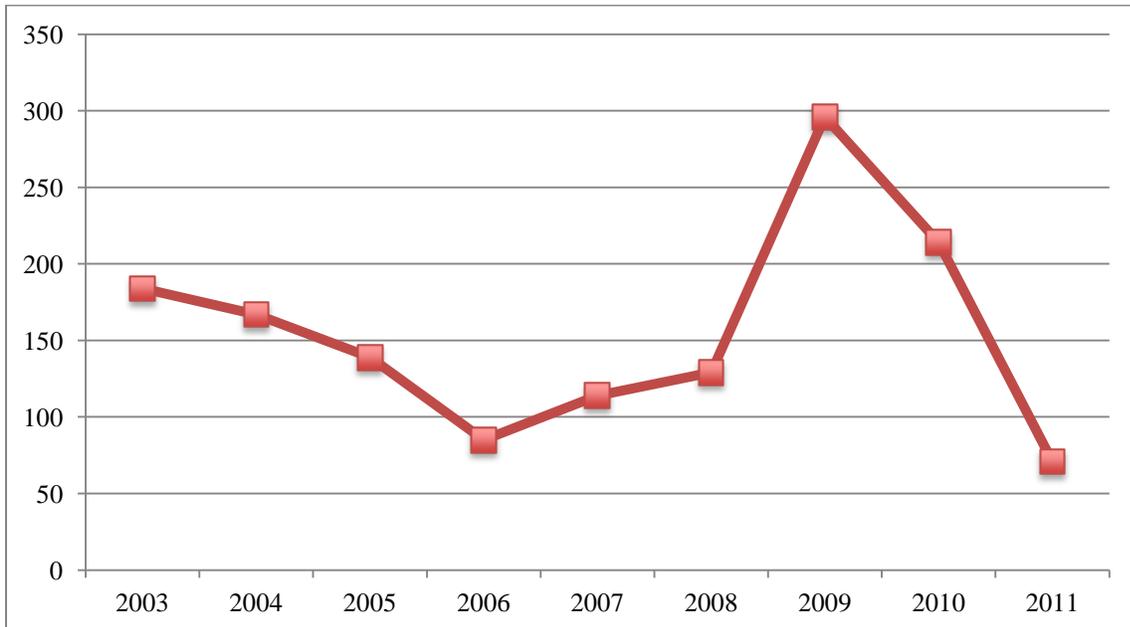


Figure 1.A displays the number of compensation-related shareholder proposals over the 2003 – 2011 period. The figure also displays average voting support for compensation-related proposals for each of these years (right above the trend line). Voting support is calculated as number of votes cast in favor of the proposal scaled by the sum of votes cast in favor or against the proposal. Figure 1.B displays the number of firms where at least one compensation committee member received a withhold recommendation from ISS over the 2003 – 2011 period.

Figure 2 Frequency of Say-When-On-Pay (SWOP) management recommendations in favor of holding annual SOP votes annual during the 2011 proxy season

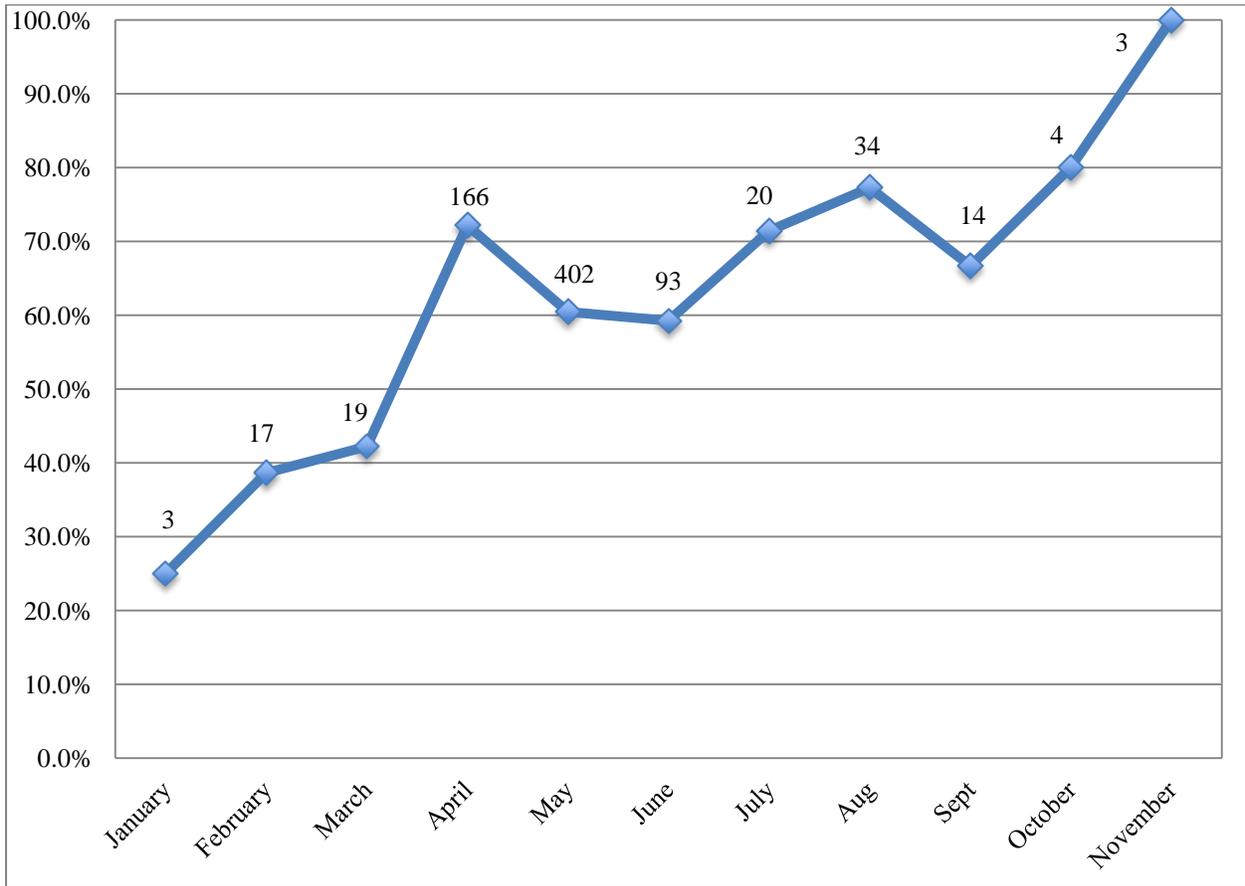


Figure 2 presents the frequency of management say-when-on-pay (SWOP) recommendations in favor of holding annual SOP votes by month for the annual meeting dates between January and November 2011. The figure also displays the number of meetings where SWOP was voted upon for each month (right above the trend line).

Table 1 The content of ISS and GL reports

Panel A: The distribution of ISS ratings by category

ISS category	ISS rating	All		ISS For	ISS Against
		N	%	N	N
All Firms		1,275		1,131 (88.7%)	144 (11.3%)
<i>Pay for Performance</i>	<i>High Concern</i>	105	8.2%	-	105
	<i>Medium Concern</i>	287	22.5%	262	25
	<i>Low Concern</i>	881	69.1%	867	14
	<i>NA</i>	2	0.2%	2	-
<i>Peer Group</i>	<i>High Concern</i>	12	0.9%	-	12
	<i>Medium Concern</i>	229	18.0%	194	35
	<i>Low Concern</i>	1,032	80.9%	935	97
	<i>NA</i>	2	0.2%	2	-
<i>Non-Performance Pay</i>	<i>High Concern</i>	19	1.5%	-	19
	<i>Medium Concern</i>	131	10.3%	113	18
	<i>Low Concern</i>	1,123	88.1%	1,016	107
	<i>NA</i>	2	0.2%	2	-
<i>Severance</i>	<i>High Concern</i>	29	2.3%	-	29
	<i>Medium Concern</i>	432	33.9%	381	51
	<i>Low Concern</i>	812	63.7%	748	64
	<i>NA</i>	2	0.2%	2	-
<i>Communication</i>	<i>High Concern</i>	13	1.0%	-	13
	<i>Medium Concern</i>	397	31.1%	342	55
	<i>Low Concern</i>	863	67.7%	787	76
	<i>NA</i>	2	0.2%	2	-

Table 1 (cont.)

Panel B: The distribution of ISS high concern ratings

	Number of firms with <i>ISS High Concern</i> categories		
	All	<i>ISS For</i>	<i>ISS Against</i>
<i>No High Concern</i>	1,131	1,129	2
<i>Single High Concern</i>	112	-	112
<i>Multiple High Concern</i>	30	-	30
Total	1,273	1,129	144
<u>Distribution of <i>Single High Concern</i></u>			
<i>Pay for Performance</i>	82	-	82
<i>Peer Group</i>	-	-	-
<i>Non-Performance Pay</i>	8	-	8
<i>Severance</i>	20	-	20
<i>Communication</i>	2	-	2
<u>Distribution of <i>Multiple High Concern</i></u>			
<i>2 High Concerns</i>	25	-	25
<i>3 High Concerns</i>	4	-	4
<i>4 High Concerns</i>	1	-	1

Table 1 (cont.)

Panel C: The distribution of GL ratings by category

GL category	GL rating	All		GL For	GL Against
		N	%	N	N
All Firms		1,275		998 (78.3%)	277 (21.7%)
<i>Pay for Performance</i>	<i>Grade F</i>	76	6.0%	1	75
	<i>Grade D</i>	255	20.0%	83	172
	<i>Grade C</i>	581	45.6%	559	22
	<i>Grade B</i>	250	19.6%	248	2
	<i>Grade A</i>	84	6.6%	84	-
	<i>NA</i>	29	2.3%	23	6
<i>Structure</i>	<i>Poor</i>	214	16.8%	102	112
	<i>Fair</i>	828	64.9%	681	147
	<i>Good</i>	126	9.9%	126	-
	<i>NA</i>	107	8.4%	89	18
<i>Disclosure</i>	<i>Poor</i>	76	6.0%	48	28
	<i>Fair</i>	837	65.6%	634	203
	<i>Good</i>	255	20.0%	227	28
	<i>NA</i>	107	8.4%	89	18
Total		1,275		998	277

Table 1 (cont.)

Panel D: The distribution of GL high concern ratings

	Number of firms with GL <i>High Concern</i> categories		
	All	GL For	GL Against
<i>No High Concern</i>	683	682	1
<i>Single High Concern</i>	355	209	146
<i>Multiple High Concern</i>	110	4	106
Total	1,148	895	253
<u>Distribution of <i>Single High Concern</i></u>			
<i>Pay for Performance</i>	191	65	126
<i>Structure</i>	119	99	20
<i>Disclosure</i>	45	45	-
<u>Distribution of <i>Multiple High Concern</i></u>			
<i>2 High Concerns</i>	103	4	99
<i>3 High Concerns</i>	7	-	7

Table 1 summarizes the content of ISS and GL reports with respect to SOP. Panel A (Panel C) displays the distribution of ISS (GL) ratings by category. Panel B (Panel D) provide information on the distribution of ISS (GL) ‘high concern’ ratings. 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* (analysis of level and growth in executive pay and its composition relative to peers vis-a-vis the firm’s relative performance), *Peer Group* (evaluation of the choice of peers and targets used for benchmarking compensation), *Non-Performance Pay* (analysis of perks and related tax gross-up and retirement benefits), *Severance* (assessment of severance and change-in-control agreements), *Communication* (evaluation of the compensation committee’s effectiveness in disclosures and responsiveness to shareholders’ concerns). GL structures the SOP section of its reports around three categories (*Pay for Performance, Structure* and *Disclosure*) 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*). The *Pay for Performance* grade measures the gap between relative pay and relative performance (Appendix 3). *Structure* and *Disclosure* focus on the design of executive pay and the adequacy of compensation disclosures, respectively. In Panel D we treat a GL rating of *Poor* on *Disclosure* and *Structure* and a *Grade D* or *F* in *Pay for Performance* as “high” concern. We treat cases where ISS or GL does not assign a rating as “NA.” 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).

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

Panel A: Joint distribution of ISS and GL recommendations

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

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

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

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

Table 2 (cont.)

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

% of ISS High Concern with <i>Pay for Performance</i>		<i>Returns</i>				
		High Q4	→ Q3	→ Q2	Low Q1	
<i>CEO Total Pay</i>	Low	Q1	1.3%	2.5%	2.8%	16.3%
	↓	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 <i>Pay for Performance</i>						
<i>CEO Total Pay</i>	Low	Q1	2.7%	10.0%	15.5%	14.1%
	↓	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%

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 displays the frequency of ISS *High Concern* ratings and GL *D* and *F* grades 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* is 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 Distribution of Say-On-Pay (SOP) voting dissent

	<i>SOP Voting Dissent</i>			Number of firms with <i>SOP Voting Dissent</i> 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%
<i>ISS For</i>	6.4%	4.1%	N	1,131	899	163	57	10	2	-
			%	88.7%	79.5%	14.4%	5.0%	0.9%	0.2%	-
<i>ISS Against</i>	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%
<i>GL For</i>	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%
<i>GL Against</i>	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 3 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: Institutional Shareholder Services (ISS)). *ISS Against (For)* and *GL Against (For)* are defined as in Table 1.

Table 4 Determinants of Say-on-Pay (SOP) voting dissent

Panel A: Benchmark regression

	Model (1) Coefficient (<i>t</i> -statistic)	Model (2) Coefficient (<i>t</i> -statistic)	Model (3) Coefficient (<i>t</i> -statistic)
Intercept	0.131 *** (4.089)	0.146 *** (4.773)	0.155 *** (4.987)
<i>Abnormal Returns</i>	-0.062 *** (-5.728)		
<i>Return on Assets</i>	-0.183 *** (-3.016)	-0.185 *** (-3.195)	-0.184 *** (-3.122)
<i>% Institutional Ownership</i>	0.042 ** (2.378)	0.020 (1.145)	0.020 (1.107)
<i>% Insider Ownership</i>	-0.087 *** (-4.313)	-0.068 *** (-3.789)	-0.066 *** (-3.641)
<i>ln(MV Equity)</i>	-0.011 *** (-2.666)	-0.018 *** (-5.020)	-0.018 *** (-5.075)
<i>Prior SOP Vote</i>	-0.022 * (-1.746)	-0.016 (-1.328)	-0.015 (-1.256)
<i>Past Compensation Activism</i>	0.045 *** (2.686)	0.058 *** (3.483)	0.059 *** (3.591)
<i>CEO Total Pay</i>	0.006 *** (4.065)		
<i>Growth in CEO Total Pay</i>	0.004 ** (2.011)		
<i>Abnormal Returns Q3</i>		0.010 (1.345)	0.010 (1.271)
<i>Abnormal Returns Q2</i>		0.027 *** (3.431)	0.026 *** (3.285)
<i>Abnormal Returns Q1</i>		0.066 *** (6.415)	0.049 *** (4.474)
<i>CEO Total Pay Q4</i>		0.123 *** (9.725)	0.112 *** (8.827)
<i>CEO Total Pay Q3</i>		0.069 *** (6.490)	0.067 *** (6.366)
<i>CEO Total Pay Q2</i>		0.011 (1.462)	0.011 (1.409)
<i>Growth in CEO Total Pay Q4</i>		0.027 *** (2.878)	0.022 ** (2.265)
<i>Growth in CEO Total Pay Q3</i>		0.016 * (1.806)	0.014 (1.560)
<i>Growth in CEO Total Pay Q2</i>		0.000 (0.009)	-0.002 (-0.248)
<i>Abnormal Returns Q1 x CEO Total Pay Q4</i>			0.064 ** (2.370)
<i>Abnormal Returns Q1 x Growth in CEO Total Pay Q4</i>			0.018 (0.783)
N	1,259	1,259	1,259
R ²	16.0%	20.0%	20.8%
Adjusted R ²	15.3%	19.0%	19.7%

Table 4 (cont.)

Panel B: The role of proxy advisors' recommendations

	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)
	Coefficient	Coefficient	Coefficient	Coefficient	Coefficient
	(<i>t</i> -statistic)				
<i>ISS Against</i>	0.267 *** (25.716)		0.247 *** (29.304)		
<i>GL Against</i>		0.153 *** (17.379)	0.129 *** (26.205)		
<i>ISS & GL Against</i>				0.379 *** (24.507)	
<i>Only ISS Against</i>				0.244 *** (27.367)	
<i>Only GL Against</i>				0.127 *** (28.012)	
<i>% Institutional Ownership x ISS Against</i>					0.293 *** (23.454)
<i>% Individual Ownership x ISS Against</i>					0.191 *** (3.637)
<i>% Institutional Ownership x GL Against</i>					0.157 *** (22.943)
<i>% Individual Ownership x GL Against</i>					0.036 (1.143)
Controls	Included	Included	Included	Included	Included
N	1,259	1,259	1,259	1,259	1,259
R ²	65.9%	43.8%	81.9%	81.9%	85.1%
Adjusted R ²	65.4%	43.0%	81.6%	81.6%	84.8%

Table 4 (cont.)**Panel C: The role of the analysis underlying proxy advisors' recommendations**

	Model (1)	Model (2)	Model (3)	Model (4)
	Coefficient	Coefficient	Coefficient	Coefficient
	(<i>t</i> -statistic)	(<i>t</i> -statistic)	(<i>t</i> -statistic)	(<i>t</i> -statistic)
<i>ISS Against—Multiple High Concern</i>	0.292 *** (14.493)	0.292 *** (14.452)		
<i>ISS Against—Single High Concern</i>	0.236 *** (24.056)			
<i>ISS Against—Only Pay for Performance High Concern</i>		0.232 *** (21.124)		
<i>ISS Against—Only Non-Performance Pay High Concern</i>		0.171 *** (6.350)		
<i>ISS Against—Only Severance High Concern</i>		0.270 *** (12.323)		
<i>ISS Against—Only Communication High Concern</i>		0.305 *** (47.594)		
<i>GL Against—Multiple High Concern</i>			0.128 *** (18.569)	0.129 *** (18.675)
<i>GL Against—Single High Concern</i>			0.132 *** (20.692)	
<i>GL Against—Only Structure Poor</i>				0.121 *** (9.141)
<i>GL Against—Only Pay for Performance Grade F</i>				0.178 *** (11.820)
<i>GL Against—Only Pay for Performance Grade D</i>				0.117 *** (16.748)
<i>GL For—Multiple High Concern</i>			0.005 (0.395)	0.007 (0.582)
<i>GL For—Single High Concern</i>			0.008 *** (2.782)	
<i>GL For—Only Structure Poor</i>				0.006 (1.539)
<i>GL For—Only Disclosure Poor</i>				0.011 ** (2.302)
<i>GL For—Only Pay for Performance Grade D</i>				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 4 presents the results for the determinants of SOP voting dissent. Panel A reports the results for a benchmark model. Panel B explores the role of proxy advisors' SOP recommendations. Panel C examines the effect of the number and type of concerns underlying the negative SOP recommendations. The dependent variable in Panels A – C, *SOP Voting Dissent*, is 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). 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. *ISS Against* is an indicator variable that is equal to one if ISS issues an *Against* recommendation for SOP ahead of the 2011 annual meeting (source: ISS). *GL Against* is an indicator variable that is equal to one if GL issues an *Against* recommendation for SOP ahead of the 2011 annual meeting (source: GL). *% Individual Ownership* is defined as one minus the sum of *% Institutional Ownership* and *% Insider Ownership*. *ISS & GL Against* is 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. *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/(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.

Table 5 Abnormal returns around ISS report release date

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

Window	<i>ISS For</i> (<i>N</i> = 1,051)		<i>ISS Against</i> (<i>N</i> = 144)		<i>ISS Against versus ISS For</i>			
	Mean	Median	Mean	Median	Mean (t-test)		Median (Wilcoxon)	
					Difference	<i>t</i> -statistic	Difference	<i>z</i> -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 5 (cont.)

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

	Model (1) <i>Abnormal</i> <i>Returns over</i> [-1, +1]	Model (2) <i>Abnormal</i> <i>Returns over</i> [-2, +2]	Model (3) <i>Abnormal</i> <i>Returns over</i> [-3, +3]
Variable	Coefficient (<i>t</i> -statistic)	Coefficient (<i>t</i> -statistic)	Coefficient (<i>t</i> -statistic)
<i>Intercept</i>	0.0022 ** (2.21)	0.0030 ** (2.27)	0.0023 (1.60)
<i>ISS Against</i>	-0.0062 ** (-2.51)	-0.0095 *** (-2.82)	-0.0084 ** (-2.39)
<i>ISS Withhold</i>	-0.0028 (-0.98)	-0.0004 (-0.12)	-0.0010 (-0.29)
<i>ISS For—Shareholder Proposals</i>	-0.0028 (-1.13)	-0.0022 (-0.79)	0.0008 (0.24)
<i>ISS Against—Management Proposals</i>	-0.0007 (-0.24)	-0.0037 (-1.04)	0.0010 (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) <i>Abnormal</i> <i>Returns over</i> [-1, +1]	Model (2) <i>Abnormal</i> <i>Returns over</i> [-2, +2]	Model (3) <i>Abnormal</i> <i>Returns over</i> [-3, +3]
Variable	Coefficient (<i>t</i> -statistic)	Coefficient (<i>t</i> -statistic)	Coefficient (<i>t</i> -statistic)
<i>Intercept</i>	0.0023 ** (2.34)	0.0031 ** (2.37)	0.0024 * (1.66)
<i>ISS Against—Expected</i>	0.0016 (0.43)	-0.0019 (-0.38)	-0.0024 (-0.51)
<i>ISS Against—Unexpected</i>	-0.0088 *** (-2.98)	-0.0121 *** (-3.21)	-0.0105 ** (-2.49)
<i>ISS Withhold</i>	-0.0032 (-1.10)	-0.0008 (-0.23)	-0.0013 (-0.38)
<i>ISS For—Shareholder Proposals</i>	-0.0035 (-1.39)	-0.0029 (-1.02)	0.0003 (0.08)
<i>ISS Against—Management Proposals</i>	-0.0012 (-0.45)	-0.0043 (-1.21)	0.0005 (0.11)
N	1,195	1,195	1,195
Adjusted R ²	0.54%	0.61%	0.11%

Table 5 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 6 Firm responses to negative ISS recommendations

	N	ISS changes recommendation from <i>Against</i> to <i>For</i>
Total	52	10
Disagree with ISS	40	-
Disclose additional information	4	2
Change compensation plan	8	8
Disagree with ISS on (N=40)		
<i>Pay for Performance</i>	34	-
<i>Severance</i>	6	-
<i>Non-Performance Pay</i>	3	-
Stated reasons for disagreement with <i>Pay for Performance</i>		
Peer group used to assess relative TSR is inappropriate	12	
Value of equity awards is overstated	12	
Excessive focus on TSR over 1- and 3-year as key measure	10	
Time-based vesting of equity awards should be deemed as performance-based	9	
Focus on 1-year CEO pay change is misleading	5	
Other issues	19	
Disclose additional information about (N=4)		
<i>Pay for Performance</i>	1	-
<i>Severance</i>	3	2
Change compensation plan with respect to (N=8)		
<i>Pay for Performance</i>	5	5
<i>Severance</i>	3	3

Table 6 displays the distribution of firm responses to negative ISS recommendations for the 52 firms that responded to ISS's *Against* recommendation for SOP.

Table 7 Distribution of Say-When-On-Pay (SWOP) votes by management recommendation

	All	By Management Recommendation			
		Annual	Biennial	Triennial	None
N	1,254	775	28	414	37
%	100.0%	61.8%	2.2%	33.0%	3.0%
Mean <i>SWOP Votes for Annual</i>	75.8%	86.5%	60.4%	57.4%	71.4%
Mean <i>SWOP Votes for Biennial</i>	1.7%	0.9%	26.8%	1.4%	2.6%
Mean <i>SWOP Votes for Triennial</i>	21.1%	11.4%	11.0%	39.8%	22.6%
Number of firms with					
Highest voting support for annual	1,149	774	26	315	34
Highest voting support for biennial	2	-	2	-	-
Highest voting support for triennial	103	1	0	99	3

Table 7 presents the distribution of say-when-on-pay (SWOP) votes by management recommendation. *SWOP Votes for Annual (Biennial, Triennial)* is defined as number of SWOP votes cast in favor of annual (biennial, triennial) votes scaled by total number of votes cast (i.e., the sum of votes cast in favor of annual, biennial or triennial votes plus abstention votes (source: ISS)).

Table 8 Determinants of SWOP votes

	Model (1) Coefficient (<i>t</i> -statistic)	Model (2) Coefficient (<i>t</i> -statistic)	Model (3) Coefficient (<i>t</i> -statistic)	Model (4) Coefficient (<i>t</i> -statistic)
<i>Intercept</i>	0.457 *** (8.771)	0.676 *** (21.891)	0.684 *** (22.329)	0.725 *** (19.598)
<i>Abnormal Returns</i>	0.001 (0.037)	0.011 (1.053)	0.017 * (1.652)	0.010 (0.852)
<i>Return on Assets</i>	-0.195 *** (-2.923)	0.025 (0.570)	0.038 (0.905)	-0.002 (-0.045)
<i>% Institutional Ownership</i>	0.292 *** (7.334)	0.228 *** (9.703)	0.220 *** (9.505)	0.171 *** (6.199)
<i>% Insider Ownership</i>	-0.156 ** (-2.212)	-0.113 ** (-2.517)	-0.108 ** (-2.458)	-0.303 *** (-5.015)
<i>ln(MV Equity)</i>	0.012 *** (3.123)	0.001 (0.622)	0.001 (0.438)	0.002 (0.595)
<i>Management SWOP Rec: Bi- or Triennial</i>		-0.276 *** (-37.302)	-0.287 *** (-34.542)	
<i>High SOP Dissent</i>			0.004 (0.665)	
<i>High SOP Dissent x Management SWOP Rec: Bi- or Triennial</i>			0.077 *** (5.417)	
<i>% Institutional Ownership x Management SWOP Rec: Bi- or Triennial</i>				-0.247 *** (-23.072)
<i>% Individual Ownership x Management SWOP Rec: Bi- or Triennial</i>				-0.433 *** (-9.015)
N	1,209	1,209	1,209	1,209
R ²	15.1%	66.6%	67.4%	58.8%
Adjusted R ²	14.7%	66.4%	67.2%	58.5%

Table 8 presents the results for the determinants of SWOP votes. The dependent variable, *SWOP Votes for Annual* is defined as number of SWOP votes cast in favor of annual votes scaled by total number of votes cast, i.e., sum of votes cast in favor of annual, biennial or triennial votes plus abstention votes (source: ISS). 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 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). *Management SWOP Rec: Bi- or Triennial* is an indicator variable that is equal to one if the management recommends voting in favor of holding a biennial or triennial SOP vote (source: ISS). *High SOP Dissent* is an indicator variable that is equal to one if *SOP Voting Dissent* at the concurrent meeting is greater than 20% (source: ISS). ***, **, 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.