Shareholder Votes and Proxy Advisors: Evidence from Say on Pay

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Abstract:

We investigate the economic role of proxy advisors (PA) in the context of mandatory "say on pay" votes, a novel and complex item requiring significant firm-specific analysis. PA are more likely to issue an *Against* recommendation at firms with poor performance and higher levels of CEO pay and do not appear to follow a "one-size-fits-all" approach. PA recommendations are the key determinant of voting outcome but the sensitivity of shareholder votes to these recommendations varies with the institutional ownership structure, the rationale behind the recommendation and certain firm characteristics, suggesting that at least some shareholders do not blindly follow these recommendations. More than half of the firms respond to the adverse shareholder vote triggered by a negative recommendation by engaging with investors and making changes to their compensation plan. However, we find no market reaction to the announcement of such changes, even when material enough to result in a favorable recommendation and vote the following year. Our findings suggest that, rather than identifying and promoting superior compensation practices, PA's key economic role is processing a substantial amount of executive pay information on behalf of institutional investors, hence reducing their cost of making informed voting decisions. Our findings contribute to the literature on shareholder voting and the related policy debate.

JEL Classification: G34, G38, J33, M12
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1. Introduction

In this study we examine the economic role of proxy advisors (PA).[1] Over the last decade, non-binding shareholder votes have increasingly affected firms' governance practices and PA recommendations have emerged as the key determinant of voting outcomes.[2] This evidence raises the following question: do PA mostly act as information intermediaries by gathering and processing information for institutional investors who need to fulfill their fiduciary duties to vote, or do they also identify and promote superior governance practices?

To shed light on this question, we follow the entire process surrounding PA activities. Specifically, we examine the analyses underlying PA recommendations, how stock prices and firms respond to their release, their influence on shareholder votes and on firms' actions in response to the vote and, ultimately, their impact on firm value. We do so by focusing on the analyses that the two most influential PA, 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. As a novel item on the ballot, and given the complex and controversial nature of CEO pay, SOP represents an ideal setting to examine the economic role of PA, at a time when concerns with lack of accountability and transparency, limited competition and potential conflicts of interest have led to calls for greater regulatory oversight of PA (Choi, Fisch and Kahan, 2009; Gordon, 2009; SEC, 2010).

[1] PA provide proxy-voting services to institutional investors on a subscription basis, including voting recommendations and reports detailing the analysis underlying these recommendations. Institutional Shareholder Services (ISS), founded in 1985, is the dominant player in the market for PA services. Glass Lewis (GL), founded in 2003, is regarded as the most influential competitor (Choi, Fisch and Kahan, 2010).

[2] See, among others, Del Guercio, Seery and Woidtke (2008), Cai, Garner and Walkling (2009), Ertimur, Ferri and Muslu (2011), Ertimur, Ferri and Maber (2012). The valuation consequences of greater shareholder involvement in corporate governance are the subject of ongoing debate, with empirical studies yielding mixed findings (Listokin, 2009; Becker, Bergstresser and Subramaniam, 2010; Cai and Walkling, 2011; Ferri and Maber, 2013; Cuñat, Gine and Guadalupe, 2012; Larcker, Ormazabal and Taylor, 2011; Cohn, Gillan and Hartzell, 2011). See Ferri (2012) for a review.

We begin by analyzing the SOP portion of the proxy reports ISS and GL issued for 1,275 firms in the S&P 1500 during 2011. Both PA 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 for 11.3% of the firms and GL for 21.7%. Firms receiving an *Against* from GL are not simply a superset of those receiving an *Against* from ISS, suggesting that the greater frequency of GL *Against* recommendations is (also) a reflection of different methodologies rather than (only) of a more aggressive stance by GL. In fact, among firms with an *Against* from at least one proxy advisor, ISS and GL agree only 17.9% of the time. Concerns with the "pay for performance" category are the most prevalent reason for *Against* recommendations. Indeed, both PA are significantly more likely to issue an *Against* at firms with poor performance and higher levels of CEO pay, and firms with the strongest disconnect between pay and performance are more likely to receive an *Against* from both PA.

Contrary to critics' concerns (e.g. Gordon, 2009) we find little evidence of a "one-size-fits-all" approach. That is, the presence of certain provisions in the compensation plan does not automatically translate into negative recommendations. In most cases, instead, firms with similar controversial provisions receive different ratings or recommendations, with PA taking into account mitigating firm-specific circumstances, the severity of the issue, the rationale provided by the firm and the overall quality of the compensation plan.

We also examine the market reaction to the release of PA negative recommendations. After controlling for other information in the reports and concurrent firm-specific news, we find small but significantly negative mean abnormal returns (-0.5% to -0.7%) in the case of ISS *Against* recommendations for firms where an *Against* recommendation was less expected. The result is not

driven by expected costs potentially associated with the effect of negative recommendations (e.g. sub-optimal changes to compensation plans) and, thus, is consistent with unexpected ISS *Against* recommendations providing information about the quality of the compensation plan.

Our second set of tests examines the association between the SOP content in PA reports and shareholder votes. Compensation plans are voted down only at 2% of the sample firms. However, votes against the plan exceed 20%, a threshold viewed as an indication of substantial dissatisfaction (e.g. Del Guercio et al., 2008), at more than 15% of the firms. PA recommendations are the key determinant of voting outcome. Negative ISS (GL) recommendations are associated with 24.7% (12.9%) more votes against the compensation plan. When both recommend *Against*, voting dissent is higher by 38.3%. The influence of each advisor declines only slightly when controlling for the recommendation issued by the other, suggesting that ISS's and GL's recommendations capture different factors or appeal to different sets of investors. The association between PA recommendations and shareholder votes is not higher for SOP than for other items (e.g. director elections, shareholder proposals), contrary to the notion that mandatory SOP, by requiring costly analyses of thousands of compensation plans, would cause more investors to rely on PA, increasing their influence (Gordon, 2009).

We also find that the sensitivity of shareholder votes to PA *Against* recommendations varies with the institutional ownership structure, the rationale behind the recommendation and certain firm characteristics. For example, the association between *Against* recommendations and shareholder votes is weaker for shareholders with larger holdings and, thus, presumably greater incentives to perform their own independent research. The association is stronger in smaller and poorly performing firms, and when PA identify a problem in certain categories (e.g. pay for performance). These findings suggest that at least some investors, rather than blindly following the

recommendations, take into account the underlying rationale and other factors. This more nuanced view of the way investors use PA analyses is consistent with recent evidence on mutual funds' voting policies (Iliev and Lowry, 2012) and contrasts with the "full causality" view implicitly assumed in prior studies and underlying the policy debate (SEC, 2010).[3]

Our third set of tests examines the influence of PA on firms' compensation practices by analyzing firms' responses to SOP votes triggered by negative recommendations. To do so, we expand the sample to firms in the Russell 3000 that received ISS *Against* recommendations in 2011. For each of the 269 resulting firms, we examine the 2012 proxy statement to identify whether the firm discloses changes to the compensation plan explicitly made in response to the 2011 SOP vote (as required by the Dodd-Frank Act). We find that 55% of the sample firms report compensation changes in response to the SOP vote, a remarkable figure given firms' reluctance to respond to non-binding votes unless supported by a majority of the votes cast (Ertimur, Ferri and Stubben, 2010). Firms' responsiveness increases with the extent of SOP voting dissent and exhibits a striking discontinuity: the frequency of compensation changes increases from 32% to 72% around a 30% SOP voting dissent. The discontinuity is evidence of the significant influence of ISS, which after the 2011 proxy season had indicated that firms failing to "adequately" respond to SOP voting dissent above 30% would receive a negative recommendation in 2012 on the SOP proposal and the election of compensation committee members. Hence, while the extent of the causal impact of ISS recommendations on shareholder votes remains open to debate, firms act as if

[3] Whether PA recommendations influence shareholder votes, aggregate shareholder preferences, or 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, making it difficult to assess the direction of causality). Either way, the evidence in this study remains important. If PA recommendations simply coincide with shareholder preferences, their strong association with shareholder votes speaks to what compensation issues shareholders care about. If the recommendations aggregate shareholder views, it speaks to the ability of PA to synthesize shareholder preferences.

they believe that ISS drives shareholder votes.[4] Finally, among firms reporting compensation changes, those that receive an ISS *For* recommendation in 2012 experience a large drop in voting dissent in 2012, while those that receive another ISS *Against* recommendation in 2012 (because ISS does not deem the compensation changes as material enough) continue to experience voting dissent above 40%.

The above analyses provide insights into the role of PA, but do not (nor do they intend to) address whether PA recommendations create or destroy shareholder value. This is a difficult question because, in contrast to other intermediaries such as analysts and credit rating agencies, where ex post realization of earnings and default rates can be used to assess the quality of the outputs, we do not have ex post direct measures of the quality of compensation plans. To shed some light on this issue, we examine the stock price reaction to the announcements of compensation changes triggered by PA recommendations and the ensuing SOP vote. We do not find a statistically significant positive or negative stock price reaction, even for the subset of compensation changes that led to a *For* recommendation and a significant drop in voting dissent in 2012 (and, thus, that PA and shareholders presumably perceived to be adequate and material). Combined with our other findings, we conclude that, with respect to SOP, PA's key economic role, rather than identifying and promoting superior compensation practices, is processing and organizing a substantial amount of executive pay information for institutional investors, reducing their cost of making informed voting decisions. Our event study results also imply that while SOP votes have an effect on compensation practices, they do not have a detectable impact on their quality. Perhaps the perceived problems with executive pay designs are overstated (Kaplan, 2012)

[4] Consistent with this notion, we find that 36% of the firms with an ISS *Against* recommendation file additional documents with the SEC *before* the vote at the annual meeting, usually to question ISS' assessment and to persuade shareholders to ignore it. These protests neither lead to a change in recommendation nor result in lower voting dissent.

and suggested improvements to pay design have minimal impact on firm value. This interpretation is consistent with the observation that only few SOP proposals have been voted down by investors.

Our study contributes to the literature on shareholder voting, and in particular, on the role of PA. While previous research has documented a strong association between PA recommendations and shareholder votes, this is the first study to examine the analyses underlying these recommendations and their influence on shareholder votes, firm behavior and stock prices, in a setting where such analysis is especially complex.[5] In doing so, our study sheds some light on a number of questions of interest to academics and policy-makers, such as how recommendations and the underlying analyses differ across PA, whether they reflect a "one-size-fits-all" approach, the extent to which they "cause" shareholder votes and the determinants of such influence. It is also the first study to examine the stock price reaction to the release of PA "routine" reports.

Our study also contributes to the literature on SOP. While prior work has focused on the stock price reaction around legislative events (e.g. Cai and Walkling 2011; Larcker et al., 2011), to the best of our knowledge this is the first study to examine compensation changes made by US firms in response to SOP votes and the market response to these changes.[6] Also, by shedding light on the preferences of shareholders as revealed through SOP votes, we add to the broader literature on executive pay, complementing previous studies of compensation-related shareholder votes (Morgan and Poulsen, 2001; Cai et al., 2009; Ertimur et al., 2011). Finally, we extend to a new

[5] In a concurrent paper, Larcker, McCall and Ormazabal (2012) examine the role of PA with respect to SOP votes. They find a negative stock price reaction to compensation changes made *before* the SOP vote, presumably to avoid PA negative recommendations, while our event study focuses on changes made *after* the SOP vote and explicitly tied to the PA recommendation and the SOP voting outcome. Our study also differs from Larcker et al. (2012) in that we examine the analyses and reports underlying the recommendations, the determinants of the association between recommendations and shareholder votes, the market reaction to the release of the PA reports and the effect of SOP votes on compensation practices.

[6] Ferri and Maber (2013) examine changes to compensation contracts made in response to SOP in the UK in 2003-2004. The US and UK present significant differences in terms of pay levels, pay practices and governance regimes.

setting the limited body of research on firms' responsiveness to non-binding shareholder votes (Del Guercio et al., 2008; Ertimur et al., 2010, 2011; Ferri and Maber, 2013).

2. Proxy advisors' analysis of say on pay

In this section we examine the SOP portion of the ISS and GL proxy reports, based on data we hand collected and manually coded. In particular, our sample includes 1,275 S&P 1500 firms with annual meetings between January and November 2011 for which we are able to obtain voting data and PA reports.

2.1 Proxy advisors' reports on say on pay

Both ISS and GL start the reports with a summary of quantitative and qualitative information from the proxy statement. ISS then organizes its analysis along five dimensions: *Pay for Performance* (CEO pay-performance alignment over time), *Peer Group* (choice of peers and targets for benchmarking purposes), *Non-Performance Pay* (e.g. perks and pensions), *Severance* (severance and change-in-control arrangements) and *Communication* (quality of disclosures and compensation committee's responsiveness to shareholders). ISS concludes the analysis of each category with an overall rating: *High, Medium* or *Low Concern.*

GL structures its analysis around three dimensions: *Pay for Performance* (CEO pay-performance alignment over time), *Structure* (design of compensation plan) and *Disclosure* (adequacy of pay disclosures). The analysis concludes with a rating (*Poor, Fair* or *Good*) for *Structure* and *Disclosure*, and a grade (*A, B, C, D* or *F*, with *F* being the worst) for *Pay for Performance*. In the analyses to follow, for comparison purposes, we treat a *Poor* rating *in Structure* or *Disclosure* and a *D* or *F* grade in *Pay for Performance* as equivalent to a *High Concern* in the ISS classification. Appendix 1 and 2 report the distribution of, respectively, ISS

and GL ratings by category, followed by examples of the lowest ratings in each category. Both ISS and GL reports conclude with the SOP recommendation (*For* or *Against*) and its key reasons.

2.2 Distribution of ratings and recommendations

Table 1 shows that GL issued an *Against* recommendation at 21.7% of the sample firms, versus 11.3% for ISS.[7] The difference is even more pronounced in terms of ratings. GL assigns at least one "high concern" at 40.5% of the rated sample firms (465 out of 1,148), versus 11.2% (142 out of 1,273) for ISS. For both PA, concerns with *Pay for Performance* are the most frequent reason for *Against* recommendations. Table 1 also provides insights on how the PA translate category ratings into a final recommendation. First, both PA almost never give an *Against* recommendation for firms without a *High Concern* rating. Second, while all firms with a *High Concern* rating receive an ISS *Against*, GL issues an *Against* recommendation for only 41.1% (146 of 355) of the firms with a *Single High Concern*. That is, assigning a *High Concern* rating and issuing an *Against* recommendation is a joint decision for ISS, but constitutes separate decisions for GL (except in the case of firms with *Multiple High Concern*, which almost always receive an *Against* recommendation—106 of 110).

Table 2, Panel A, examines the degree of overlap between ISS and GL recommendations and yields two insights. First, while GL issues a greater number of *Against* recommendations, the set of firms with a GL *Against* is not simply a superset of the firms with an ISS *Against*. 80 firms receive an *Against* from ISS and a *For* from GL, suggesting that GL is using different criteria (from ISS) and not just lowering the threshold for an *Against* recommendation.

[7] 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 practices accordingly and avoid a negative recommendation.

Second, ISS and GL issue the same recommendation in 77% of the cases. This figure is misleading, though, in that most of this agreement (72%) comes from the *For* cases, with both PA recommending *Against* only in 5% of the cases. Within the subset of controversial cases (firms with an *Against* from either PA, an indication of concerns with the compensation plan), PA agree on which firms warrant an *Against* recommendation only 17.9% of the time. The top portion of Panel B shows a similar pattern in the *Pay for Performance* category. Notably, only 20 firms receive the lowest rating from both PA (*F* from GL, *High Concern* from ISS), whereas there are 27 cases of strong disagreement (*F* from GL and *Low Concern* from ISS; bottom portion of Panel B).

These differences are partly due to the methodologies PA employ in assessing *Pay for Performance*. ISS focuses "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 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 the CEO pay increase, the extent to which such increase is performance-based or discretionary, performance conditions and the quality of the related disclosures (see Appendix 1 for examples). GL's proprietary methodology essentially measures the "gap" between relative pay and relative performance, using multiple performance metrics and peer groups as a benchmark (see Appendix 3). GL then grades firms on a forced curve, with those in the top 10% of the "gap" distribution receiving an *F*. Hence, while ISS tends to focus on firms with poor performance, GL's approach may identify a "pay-performance" gap even at well-performing firms.[8]

[8] This difference partly explains GL's higher frequency of negative ratings and recommendations (Table 1) as well as the low rate of agreement documented in Panels A and B. Untabulated analyses show that in a subsample of poorly performing firms (below-median stock returns), the relative frequency of GL to ISS *Against* recommendations is lower

This difference in PA methodologies is evident in Panels C and D, which show the frequency of poor *Pay for Performance* ratings and *Against* recommendations by quartiles of total CEO pay and one-year raw returns. Both PA single out firms with low performance and high CEO pay, but ISS's ratings and recommendations are more sensitive to performance. For example, for the top quartile of CEO pay, the frequency of a poor rating from ISS increases 3.2 times (from 9.1% to 29.1%) as stock performance goes from the top to the bottom quartile, whereas for GL it only increases 1.6 times (from 34.9% to 55.8%).

Finally, GL's higher propensity to issue negative recommendations and PA's low rate of agreement on SOP proposals is similar to other management proposals. For example, in 2011, GL (ISS) issued negative recommendations for 16.7% (9.4%) of equity incentive plan proposals and for 11.0% (4.4%) of directors up for election, with the rate of agreement for controversial cases at 19.3% for equity incentive plan proposals and 13.6% for director elections (untabulated analyses).

3. Determinants of proxy advisors' SOP recommendations

After describing the SOP analysis performed by PA, we turn to the question of what firm characteristics are more likely to result in an *Against* recommendation.

3.1 Determinants of the likelihood of SOP Against recommendations

To analyze the determinants of PA recommendations on SOP we estimate a logistic regression where the dependent variable, *ISS (GL) Against*, is an indicator variable equal to one if ISS (GL) recommends *Against*. Based on the evidence in Section 2, we predict that PA are more likely to issue negative recommendations at firms with a perceived disconnect between pay and performance. As proxies for compensation-related concerns, we include *CEO Total Pay* and *Growth in CEO Total Pay*, respectively, the level and growth of CEO total direct pay, as well as an

(1.6 times: 24.5% versus 15.3%) than in the full sample (1.9 times: 21.7% versus 11.3%, see Table 1) and the rate of agreement in poor pay-for-performance ratings is higher (at 23.2%) than in the full sample (15.5%; Table 2, Panel B).

indicator variable (*Past Compensation Activism*) equal to one if the firm was targeted by a compensation-related shareholder proposal that received at least 20% votes in favor in the prior fiscal year (Ertimur et al., 2011). As measures of performance, we use *Abnormal Returns* and *Return on Assets*. To capture firm characteristics that may affect PA decisions, we also control for size (ln(*MV Equity*)) and ownership structure (the percentage of votes controlled by institutional investors and by insiders, proxied for, respectively, by *% Institutional Ownership* and *% Insider Ownership*). Finally, we include an indicator variable (*Prior SOP Vote*) equal to one if the firm already had a SOP vote in the past, on the ground that compensation-related concerns at these firms may have already been addressed.[9] See the notes to Table 3 for detailed variable definitions.

Table 3, Panel A, Models (1) and (3) presents the results. Consistent with our predictions, firms with a higher level of and growth in CEO pay, higher compensation-related activism in the past and lower stock performance are more likely to receive an *Against* recommendation.[10] Operating performance only matters for GL, consistent with their pay for performance methodology which focuses on return on assets in addition to stock performance (see Appendix 3).

To gain more insight into the effect of CEO pay and firm performance on PA recommendations, in Models (2) and (4), we split *CEO Total Pay*, *Growth in CEO Total Pay* and *Abnormal Returns* into four groups each, based on the quartiles of their respective distributions. For example, we replace *CEO Total Pay* with *CEO Total Pay Q4*, *CEO Total Pay Q3* and *CEO Total Pay Q2* (with the intercept capturing the lowest quartile). Three main results emerge. First,

[9] 3.6% of the firms in our sample had a SOP vote in 2010 because it was required as a condition to receive TARP funds and 2.2% because they voluntarily adopted SOP. The exclusion of these firms from the analyses reported in this study does not affect the findings.

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

the likelihood of *Against* recommendations increases as CEO pay level increases (the coefficient of *CEO Total Pay Q4* and *CEO Total Pay Q3*, respectively, are significantly larger than the coefficients of *CEO Total Pay Q3* and *CEO Total Pay Q2*, in both Models (2) and (4), unreported tests). Second, consistent with our discussion in Section 2, the results also highlight ISS's prevalent focus on poorly performing firms (in Model (2) only the coefficient of *Abnormal Returns Q1* is significant), while GL's methodology tends to identify pay for performance disconnects at various levels of pay and performance (in Model (4) the coefficients of both *Abnormal Returns Q1* and *Abnormal Returns Q2* are significant). Finally, the top quartiles of *Growth in CEO Total Pay* are relevant only for ISS, consistent with its emphasis on *increases* in CEO pay (GL focuses on relative *levels* of pay, see Appendix 3). In terms of economic significance, the likelihood of an ISS (GL) *Against* recommendation increases from 1.5% (2.7%) at a firm in the top quartile of stock performance and bottom quartile in level of and growth in CEO total pay, to 53.5% (71.0%) at a firm in the bottom quartile of stock performance and top quartile in level of and growth in CEO total pay (keeping all other variables at their median).[11]

In Models (5) and (6) we examine whether firms targeted by both PA differ from those targeted by only one of them. We estimate a logistic regression where the dependent variable, *Both Against*, is equal to one if both PA recommend *Against*, and zero if only ISS or only GL recommends *Against*. We find that PA agree on the most extreme cases of pay-performance

[11] As for the other control variables, *Against* recommendations are less likely for larger firms (except in Model (2)), perhaps because these firms are more concerned about the reputation effects of an adverse vote and, thus, take greater care in adopting pay practices endorsed by PA. An *Against* recommendation is also more likely for firms with higher insider ownership (except in Model (3)), even though this will result in lower voting support for the recommendation (insiders presumably will vote in favor of the compensation plan), suggesting that higher insider ownership may be a proxy for entrenchment and, thus, magnify compensation-related concerns. In additional tests, we include three measures of governance quality: entrenchment index, percentage of independent directors and dual CEO-chairman indicator. None of these variables are significant, suggesting that traditional governance measures do not affect the recommendations. We exclude these variables from the reported models for parsimony and because their inclusion reduces the sample size.

disconnect: firms in the bottom quartile of stock performance and with above-median levels of CEO pay are more likely to be targeted by both PA. None of the other variables are significant.

As shown in Table 1, GL does not apply a one-to-one correspondence between *High Concern* ratings and *Against* recommendations, allowing for an analysis of how GL ratings map into the final recommendation. For this purpose, we first extend Model (4) from Table 3, Panel A by adding indicators for the categories' ratings. As shown in Panel B, Model (1) a poor rating in any category is associated with a significantly higher likelihood of a GL *Against* recommendation, with *Pay for Performance* being the most serious concern (particularly an *F* grade), followed by *Structure* and then *Disclosure* (all the other variables are suppressed for ease of exposition).[12]

Next, we examine how *combinations* of ratings map into the final recommendation. There are 45 potential combinations (three possible ratings each for *Structure* and *Disclosure* and five possible grades for *Pay for Performance*). However, for some combinations there is no variation in the dependent variable. For example, all firms with an *A* or *B* in *Pay for Performance* and a *Fair* or *Good* in *Structure* and *Disclosure* receive a *For* recommendation. Similarly, with one exception (see Table 1),[13] all firms with an *F* in *Pay for Performance* receive an *Against* recommendation. Thus, in Model (2) we present a parsimonious model capturing the most interesting combinations within grades *D* and *C*. We split grades *D* and *C* each into two depending on whether the firm receives a *Poor* rating in *Structure* and/or *Disclosure*, or a non-*Poor* (*Fair* or *Good*) rating in both *Structure* and *Disclosure*. The results indicate that the combination of ratings plays an important role in the recommendations. A grade *D* in *Pay for Performance* has a greater effect on the likelihood of an *Against* recommendation when combined with a *Poor* in *Structure* and/or

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

[13] For Methode Electronics GL took into account the multiyear and performance-based nature of the large equity grant that led the firm to receive an *F*, firm's past use of challenging performance-conditions and the recent removal of other controversial pay practices (see Appendix 4).

Disclosure than when combined with a non-*Poor* rating in both (difference is significant at the 1% level, unreported). A *C* grade increases the likelihood of an *Against* recommendation only when combined with a *Poor* in *Structure* and/or *Disclosure*. Finally, regardless of the rating in other categories, a *D* grade has always a stronger effect than a *C* grade.[14]

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

In summary, the above analyses suggest that GL does not mechanically translate ratings into recommendations but takes into account multiple factors, including the combination of different ratings and the firm's history.

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

PA are often criticized for employing a "one-size-fits-all" approach, as a means to avoid the cost of firm-specific analyses (Gordon, 2009). This concern is especially relevant for SOP, which requires the analysis of thousands of complex and idiosyncratic compensation plans. Did PA simply give negative recommendations based on whether a compensation plan includes one of the provisions that PA consider as 'bad' practices?

Two pieces of evidence suggest otherwise. First, based on our reading of the PA proxy voting guidelines and the reports of the firms receiving an *Against* recommendation, we found only one example of one-size-fits-all: ISS recommends to vote *Against* the SOP proposal if a firm

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

includes excise tax gross-ups and modified single triggers in severance agreements entered into or amended during the year prior to the SOP vote (but not necessarily for firms with such provisions in pre-existing severance agreements). However, these provisions were responsible for the negative recommendation only at 22 of 144 firms (15%) with an *Against* recommendation from ISS. Second, and relatedly, as discussed earlier, for both PA the most frequent stated rationale for a negative recommendation is a perceived historical disconnect between realized performance and pay, rather than the presence of certain provisions in the pay plan (see Table 1).

However, it is possible that PA use a one-size-fits-all approach in making their recommendations but do not disclose it explicitly. To examine this possibility, for all 144 firms with an *Against* recommendation from ISS and a control sample of 144 firms with a *For* recommendation (as well as for a sample of 100 firms with GL *Against* and 100 firms with a GL *For* recommendation), we hand collect from the PA reports data on a set of controversial practices that are often criticized in those reports and have been the subject of compensation-related activism in recent years (e.g. Ertimur et al., 2011).[15] In particular, we create indicators equal to one if the firm: pays discretionary bonuses, uses time-based (rather than performance-based) vesting in equity grants, pays perks, offers tax gross-ups on perks, uses above median benchmarking in setting pay targets, offers a non-qualified pension plan (such as a supplemental executive retirement plan, SERP), includes an excise tax gross-up and modified single triggers in (new or existing) change-in-control agreements, does not have a clawback policy, does not have minimum

[15] In the case of ISS, we construct two control samples, with similar results: one includes 144 random firms with a *For* recommendation, one includes 144 firms with a *For* recommendation with negative one-year abnormal returns and the highest CEO pay increase. This latter sample aims to capture firms that likely received the highest scrutiny from ISS because of a perceived misalignment between CEO pay and performance (see Section 2), allowing us to examine whether, conditional upon such misalignment, ISS applied a one-size-fits-all approach to determine which firms would warrant a negative recommendation.

ownership guidelines for executives and equity holding requirements, does not provide adequate disclosure of performance goals in the short-term and long-term incentive plans.

If PA employ a one-size-fits-all approach, we would expect to see a frequency of zero in the control sample for certain practices (i.e. we would expect certain practices to perfectly predict an *Against* recommendation). However, we find that this is the case only for the presence of excise tax gross ups and modified single trigger in new/amended severance agreements for ISS (consistent with their stated policy). In univariate and multivariate tests (where we add indicators for these provisions to the regression in Table 3, Panel A), we find that for both PA all the other provisions are fairly frequent in the control sample as well and that only a couple of them are statistically more frequent in the sample of firms with an *Against* recommendations, consistent with PA taking into account (but not relying exclusively) on the presence of these provisions.[16]

Overall, we find little evidence of a one-size-fits-all approach on SOP, in contrast to other settings where PA seem to employ a more mechanical check-the-box approach to their recommendations (e.g. governance ratings, shareholder proposals, management equity incentive plans). However, the fact that they are not based on a simple one-size-fits-all approach does not imply that PA recommendations are 'correct'. We will go back to this question in Section 7.

4. Market reaction to the release of SOP-related proxy advisors' reports

In Sections 2 and 3, we described the analyses underlying PA's SOP recommendations. We now turn our attention to the market's perception of PA reports, particularly those that contain

[16] We also collected data on the percentage of equity-based pay subject to time-based vesting (rather than performance-based vesting), the magnitude of the perks (scaled by CEO total pay) and of tax gross-ups on perks (scaled by the amount of perks), the present value of all pension plans offered to the CEO, scaled by firm size, the multiple used to estimate the cash payments (e.g. 3 times salary and bonus) under the change-in-control agreement and the magnitude of the estimated CIC payment, scaled by firm size. None of these variables differ significantly between the *Against* sample and the control sample, except that the severance multiple is higher for ISS in the Against sample (2.7 versus 2.5) and that the percentage of equity-based pay subject to time-based vesting is higher for GL in the *Against* sample (79% versus 70%).

Against recommendations. We rely on an event study around the release of the PA reports ahead of the 2011 annual meeting.[17] For most items on the ballot, because PA voting policies are usually known ahead of time (e.g. in favor of proposals to declassify the board), PA recommendations are largely anticipated and, thus, the incremental information their reports convey may be limited. That SOP is a novel item in 2011, combined with the subjectivity involved in assessing complex executive pay plans, arguably leads to greater uncertainty about PA recommendations and analyses, making an event study a powerful approach to glean market's perceptions.

For the subset of 1,195 (1,136) firms in our sample with available ISS (GL) report release dates, 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.[18] Table 4, Panel A shows that, across the three windows, the mean (median) returns around ISS *Against* recommendations are significantly negative, ranging between -0.52% and -0.73% (-0.36% and -0.49%), and significantly more negative than around *For* recommendations (mean differences range between -0.67% and -0.98%).[19] In contrast, in Panel B we do not find a market reaction around the release date of GL reports, likely a reflection of GL's smaller client base and less established position relative to ISS.[20] Given the lack of any market reaction around GL report release dates, in the remainder of this section we focus our attention on ISS reports' release dates.

[17] The only study analyzing the stock price reaction to the release of PA reports is Alexander, Chen, Seppi and Spatt (2010) in the context of proxy contests. They 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.

[18] These windows allow us to incorporate the effect of leakage of information ahead of the release date (as discussed in Section 6.1, ISS sends a draft of the report to S&P 500 firms before releasing the final version) as well as delayed reaction to the release itself. The results are similar when we use alternative abnormal returns measures (market-adjusted returns, returns computed using Fama and French (1996) and momentum factors (Carhart, 1997)).

[19] We do not have a prediction for ISS *For* recommendations. As shown in Table 6, Panel A, the mean (median) abnormal returns around positive recommendations are statistically positive, though very small in magnitude, ranging between 0.16% and 0.25% (0.12% and 0.28%). In untabulated tests we find that this effect disappears when we remove contaminated events (e.g. PA reports' release dates around earnings announcements).

[20] Alternatively, it may be interpreted as evidence of GL's lower ability in processing information relative to ISS and, thus, lower quality of the GL recommendations. However, in untabulated tests, we find no reaction around GL *Against*

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

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

The dependent variable, *Abnormal Returns*, is 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. We include three variables 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). Table 4, Panel C, shows that the coefficient of *ISS Against* remains negative and significant, while the other coefficients are not significant (consistent with the notion that on most other issues ISS recommendations are largely anticipated). In untabulated tests, we exclude 245 reports (27 of which are *Against* cases) preceded or followed by an earnings announcement within five days, and 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.

The negative market reaction may have different interpretations. One interpretation is that ISS *Against* recommendations help investors identify firms with low quality compensation practices (in absolute terms or relative to peers). This is possible if (i) ISS is a superior processor

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recommendations even for the subset of cases where, after the release of the GL reports, ISS issues an *Against* recommendation as well.

of publicly available executive compensation information (e.g., perhaps because they have more time to invest into research than their institutional investor clients), or (ii) ISS aggregates key market participants' views about executive compensation, informing the marginal investor about other investors' perceptions. Under this interpretation, we would expect stronger negative reaction for unexpected *Against* recommendations. Using past compensation-related activism as a proxy for investors' expectations, in Panel D 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).

An alternative interpretation is that ISS *Against* recommendations do not reveal information about low-quality compensation plans, but impose costs on firms such as the adoption of sub-optimal compensation policies in order to placate the ISS and activist shareholders. If that is the case, we expect the negative reaction to be concentrated in subsamples with higher expected costs. To address this possibility, we examine two types of costs: (i) the cost of activities firms may undertake to reduce the impact of the recommendation on the voting outcome, and (ii) the cost of suboptimal compensation changes the firms may make to cater to the PA and to shareholders. As proxies for these costs, we use, respectively, the subset of firms (i) filing an amended proxy statement before the 2011 vote to oppose the ISS analysis and recommendation (sample described in Section 6.1), and (ii) announcing changes to the compensation plan subsequent to the 2011 SOP vote (sample described in Section 6.2). However, the negative returns are not driven by (or more pronounced) in these subsamples (results not tabulated).

Overall, our analyses suggest that investors view unexpected, negative SOP recommendations as bad news, consistent with these recommendations revealing new information about the (low) quality of the firm's compensation plan.

5. Proxy advisors' recommendations and shareholder votes on SOP

The analysis so far suggests that PA's do not follow a one-size-fits-all approach to formulate their SOP recommendations and that ISS's *Against* recommendations provide value-relevant information to market participants. The next question we examine is whether PA recommendations predict voting shareholders' behavior.

5.1 Distribution of SOP votes

Table 5 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%). 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 2013).

The strong association between PA recommendations and shareholder votes documented in prior studies (e.g. Cai et al., 2009; Alexander et al., 2010; Choi et al., 2010; Ertimur et al., 2011, 2012) is also present in the SOP setting. Mean voting dissent when ISS (GL) recommends *Against* is 34.9% (23.2%), versus 6.4% (5.9%) in the presence of a *For* recommendation.

5.2 Determinants of SOP votes - Multivariate analysis

Following prior studies on compensation-related activism (e.g., Ertimur et al., 2011) and shareholder voting (e.g. Gillan and Starks, 2000; Ertimur et al., 2010), we estimate an 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).[21] We control for CEO pay, firm performance, size and ownership structure (*CEO Total Pay*, *Growth in CEO Total Pay*, *Abnormal Returns*, *Return on Assets*, ln(*MV Equity*), *% Institutional Ownership* and *% Insider Ownership*), shareholders' past concerns with pay practices (*Past Compensation Activism*) and for the past occurrence of a SOP vote (*Prior SOP Vote*).

Table 6, Panel A, Model (1) shows the results for this benchmark model. As expected, voting dissent is higher in firms with a higher level of and growth in CEO pay, in firms targeted by *Past Compensation Activism* and in poorly performing firms, while it is slightly lower at firms with a *Prior SOP Vote* (i.e., firms that may have already addressed compensation concerns).[22] Similar to earlier studies (e.g. Ertimur et al., 2010), dissent is higher in smaller firms and firms with higher institutional ownership, and it is lower in firms with higher insider ownership, presumably because insiders vote their shares in favor of the compensation plan. In Model (2) we split *CEO Total Pay*, *Growth in CEO Total Pay* and *Abnormal Returns* into four groups each, based on the quartiles of their respective distributions. The results indicate a generally monotonic relation between voting dissent and level and growth of CEO pay, as well as between voting

[21] 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.

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

dissent and poor performance. To capture extreme cases of pay-performance misalignment, in Model (3) we add two interaction terms for firms in the bottom quartile of *Abnormal Return* and the top quartile of *CEO Total Pay* and *Growth in CEO Total Pay*. The coefficient on the first interaction term is positive and significant. Overall, firms in the bottom quartile of *Abnormal Returns* and the top quartile of *CEO Total Pay* receive a voting penalty of 22.5% (5.0% + 11.1% + 6.4%).

5.3 The influence of proxy advisors' recommendations

To gauge the influence of PA's recommendations on the voting outcome in Table 6, Panel B, Model (1) (Model (2)) we augment Model (3) of Panel A by adding *ISS Against* (*GL Against*), an indicator variable that equals one if ISS (GL) issues an *Against* recommendation for SOP. In Model (1) the coefficient of *ISS Against* is positive and significant at 0.268 and the R^2 is 65.7% (compared to 20.9% in Model (3) of Panel A). Similarly, in Model (2) the coefficient of *GL Against* is positive and significant at 0.153 and the R^2 is 43.8%.

In Model (3) we include both *ISS Against* and *GL Against*. The R^2 further increases to 82.3%. Notably, relative to Models (1) and (2), in Model (3) the coefficients of *ISS Against* and *GL Against* decrease only slightly to 0.248 and 0.129, respectively, consistent with the two PA recommendations capturing different factors or appealing to different sets of investors. The two coefficients are significantly different from each other (1% level, unreported) and are consistent with the notion that ISS (the dominant player in the market) has a larger clientele.

To examine whether the concurrent presence of negative recommendations from both PA has an incremental impact, in Model (4), we replace the *ISS Against* and *GL Against* indicators with three indicators, denoting cases where only ISS, only GL, or both, issue an *Against* recommendation. The coefficient of *Both ISS & GL Against* is positive and significant at 0.383.

However, it is not statistically different from the sum of the coefficients on *Only ISS Against* (0.244) and *Only GL Against* (0.127) (unreported test). Hence, when both ISS and GL recommend *Against*, voting dissent reflects the sum of the votes cast by two different sets of institutional investors that ISS and GL appeal to. In other words, it does not appear that there is a third group of investors who only vote against on SOP when both advisors recommend against (even though many institutional investors are known to access reports from both PA).[23]

One concern with mandatory SOP is that it would increase the influence of PA (Gordon, 2009). Contrary to these concerns, in untabulated tests we find that for both PA the coefficients on the recommendations for SOP proposals are not systematically higher than the coefficients on other items on the ballot in 2011 (e.g. director elections, shareholder proposals).

5.4 Is there a causal relation between PA recommendations and shareholder votes?

The interpretation of the strong positive association between PA recommendations and shareholder votes, i.e., whether PA recommendations "cause" shareholder votes, aggregate shareholder preferences (e.g., ISS develops its voting guidelines in consultation with its institutional investor clientele), or simply coincide with them, is an open question (Choi et al., 2010).[24] We conjecture that these answers are not mutually exclusive, with some shareholders essentially outsourcing their voting decisions to PA and others independently gathering data and making informed voting decisions that simply coincide with PA recommendations (and, perhaps, influence them). If this is the case, we would expect the association between PA recommendations and shareholder votes to differ across types of shareholders based on their incentives to gather and

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

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

process information. A large body of research suggests that these incentives depend on the holdings, with blockholders investing more in costly monitoring activities (e.g. Cronqvist and Fahlenbrach, 2009; Agrawal and Nasser, 2012). Hence, in Model (5) we examine whether the association between PA recommendations and shareholder votes differs between block and non-block institutional holders. In particular, from Model (3), we replace *ISS Against* with interaction terms between *ISS Against* and both *% Blockholder Ownership* and *% Non-Blockholder Ownership* (estimated as *% Institutional Ownership* minus *% Blockholder Ownership*).

The resulting coefficients imply that, of the 24.8% votes associated with an *ISS Against* in Model (3), 19.8% are from non-blockholders and the remaining 5.0% from blockholders.[25] Given that in our sample the mean non-blockholder (blockholder) ownership is 57.5% (20.4%), this means that an ISS *Against* recommendation, on average, is associated with a vote against by 34.4% (=19.8%/57.5%) of the non-blockholders and 24.5% (=5.0%/20.4%) of the blockholders (the corresponding figures for GL are 17.6% and 13.7%). Hence, as conjectured, PA influence is stronger among institutional investors with lower incentives to do their own independent research. This result is consistent with recent research showing that mutual funds' votes tend to deviate from PA recommendations more often when the funds hold a large stake in the portfolio firm and have greater incentives to perform their own research (Iliev and Lowry, 2012; Schouten, 2012).

The results in Table 6, Panel B enable us to provide a lower-bound estimate for the causal effect of ISS under a set of assumptions. Specifically, we assume that (i) *all* institutional block-holders perform their own research and cast their votes independently of ISS recommendations (a

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

reasonable assumption given their significant holdings),[26] while only *some* of the institutional non-blockholders do (because it is not cost-efficient given their holdings), and (ii) institutional investors performing their own research on average reach the same conclusions (whether block or non-bock holders). Under these assumptions, our results suggest that about 24.5% of investors doing their own research will vote *Against* when ISS also recommends *Against* (presumably due to the same underlying factors). This means that at least about 10.0% of the non-block institutional holders (34.4%-24.5%) simply follow ISS recommendations, providing a lower bound estimate of the causal effect of ISS. If, instead, institutional non-blockholders do not perform their independent research and mechanically follow ISS (i.e., the second part of assumption (i) is violated), 34.4% represents the upper bound estimate of ISS causal influence. While it remains difficult to estimate the exact causal impact of PA, under the above assumptions we can rule out the possibility that the documented association is purely due to PA and shareholders focusing on the same factors and conclude instead that at least some of the association is causal.[27]

5.5 Do shareholders blindly follow proxy advisors' recommendations?

In this section, we examine whether shareholders blindly follow PA recommendations, a key concern in the policy debate on the role of PA. To shed light on this question, we perform two sets of tests. First, in Panel C, we examine whether the sensitivity of shareholder votes to its recommendations (that is, the coefficient of ISS and GL *Against* recommendations, a sort of "voting response coefficient") varies with the rationale for the recommendation, focusing on the number and type of concerns identified in the PA reports. In Model (1), we examine whether dissent is higher for *Against* recommendations where ISS identifies multiple aspects of the

[26] More precisely, we assume that they do not mechanically follow PA recommendations, even though they certainly access and use the PA analyses, among other things, in forming their voting decisions. Also note that blockholders, unlike PA, may have access to private information enabling them to better assess the executive compensation plan.

[27] In particular, since the mean non-blockholder ownership is 57.5%, if (at least) 10% of these investors follow ISS, it means that (at least) 5.7% of the 24.8% influence of ISS (almost one–fourth) is causal.

compensation plan to be of high concern by replacing *ISS Against* with *ISS Against—Single High Concern* and *ISS Against—Multiple High Concern* (to isolate the effect of ISS's analysis only, we exclude firms with an *Against* from GL, resulting in a sample of 985 observations). The coefficient of *ISS Against—Multiple High Concern* is higher by 5.6% (difference significant at the 1% level), suggesting a greater penalty for more severe compensation problems.

Next, in Model (2), we focus on the nature of concerns identified by ISS. We split *ISS Against—Single High Concern* into four mutually exclusive groups depending on the source of the high concern: *Pay for Performance* (N=44), *Non-Performance Pay* (N=6), *Severance* (N=15) and *Communication* (N=1) (there are no cases where *Peer Group* is the only high concern; see Table 1). A *High Concern* in the *Communication* category has the greatest incremental effect on shareholder votes (30.5%). Because this category captures the compensation committee's lack of responsiveness to past compensation-related votes, and not a specific concern with the current compensation plan, it may be viewed as proxy for the most severe cases, explaining the magnitude of the coefficient. However, note that the coefficient is driven by only one observation and hence should be interpreted with caution. As for the other categories, *High Concern* for *Severance* has the greatest influence on shareholder votes (27.0%) followed by *Pay for Performance* (23.2%) and *Non-Performance Pay* (17.1%), with the coefficients of *Severance* and *Pay for Performance* significantly higher than *Non-Performance Pay* at the 5% level (but not significantly different from each other; p-value=0.12, untabulated).

In Models (3) and (4) we repeat the same exercise for GL.[28] The most notable result is that more shareholders follow GL recommendations when due to an *F* grade in pay for performance

[28] Similar to Models (1) and (2), we exclude firms where ISS issued an *Against* recommendation from the analysis, so as to focus on the effect of the number and type of concerns identified by GL when only GL issues an *Against* recommendation, resulting in a sample of 1,009 observations. The GL analysis requires an additional adjustment. Recall from Table 2, Panel C, that (unlike with ISS) many firms with the equivalent of a high concern in the GL

(the coefficient on *Only Pay for Performance Grade F* is significantly higher than on *Only Structure Poor* and *Only Pay for Performance Grade D* at 1% level, unreported).[29]

In a second set of tests, we examine whether the voting response coefficient depends on firm characteristics, namely, size, stock performance, level of CEO pay and governance. Consistent with the general result in the shareholder voting literature (Gillan and Starks, 2000; Ertimur et al., 2010), Panel D shows that conditional on an *Against* recommendation, the influence of ISS recommendations on shareholder votes is stronger in smaller firms and firms with worse performance. The differences for the GL recommendations are not statistically significant.

The key insight from the above analyses is that the sensitivity of shareholder votes to PA recommendations varies with the rationale of the recommendation and certain firm characteristics, suggesting that at least some shareholders do not blindly follow PA recommendations.

6. Proxy advisors' recommendations and firm's compensation practices

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

Given the strong positive correlation between PA recommendations and voting outcome documented in Section 5, perhaps it is not surprising that during the first SOP season a number of firms explicitly responded to PA negative recommendations before their annual meetings, presumably in an attempt to obtain a favorable recommendation or persuade shareholders to ignore the negative recommendations. To provide some evidence on this phenomenon, we examine firms'

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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*.

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

responses disclosed in SEC filings between the public release of ISS reports and the annual meeting by 154 firms targeted by a negative ISS recommendation.[30]

Table 7 shows that 52 (33.8%) of these firms filed an amendment to the proxy statement or 8-K (the market reaction around the filing dates is not significant—untabulated tests). Most of these firms (40 out of 52) voiced their disagreement with ISS's rationale for its recommendation, usually criticizing the pay-for-performance evaluation (34 firms). Four of the 52 firms provided additional disclosures, while the remaining eight firms made changes to their compensation plans, by introducing performance conditions in equity grants or removing certain provisions from their change-in-control agreements (in untabulated tests, we find no significant market reaction around the filing dates). Not surprisingly, in virtually all of the 52 cases the focus of the firm response is on the issue causing the *Against* recommendation. Appendix 5 provides examples.[31]

Our next analysis suggests that the impact of firms' responses depends on the type of response. ISS changed the SOP recommendation (from *Against* to *For*) for all the eight firms that changed their compensation plans (explicitly linking its decision to such changes) and for two of the four firms that provided additional disclosure, but did not change it for any of the firms that expressed disagreement. The 10 firms with the ISS recommendation revised from *Against* to *For* eventually experienced the same dissent as firms that received a *For* recommendation right from the beginning (untabulated analyses). In other words, investors voted as if they agreed with the revised recommendation. As for the 40 firms expressing disagreement and continuing to receive an

[30] The 154 firms include the 144 firms in Table 1 plus ten firms with an ISS *Against* recommendation that was then revised to *For* (as shown in Table 7). We focus on ISS recommendations because of the evidence of its greater influence on shareholder votes (Section 5). However, a similar dynamic takes place with GL. For example, among the 40 firms filing amended documents to express disagreement with the PA recommendations, 18 also had a GL *Against* recommendation and four of them discuss their disagreement with GL as well.

[31] We also examine firms' decision to disagree with ISS *Against* recommendations in a logistic regression framework. We find that larger firms and firms with more independent boards are more likely to disagree with ISS. This is consistent with firms and boards more concerned with their reputation taking steps to try to reverse negative ISS recommendations or reduce their impact on shareholder votes.

ISS *Against*, their protest did not seem to influence shareholder votes. Relative to all other cases of ISS *Against*, these firms actually experienced higher dissent (26.1% versus 24.1%, p-value<0.001, untabulated), perhaps because firms protesting against ISS tend to be those facing more severe compensation issues.[32] However, perhaps as a reaction to this disagreement, ISS has revised its approach to pay for performance evaluations for the 2012 proxy seasons.[33]

6.2 Firms' response to SOP votes: changes to compensation practices

The previous section documents that firms try to mitigate the adverse impact of negative ISS recommendations on the voting outcome. A related question is whether firms respond to the SOP votes triggered by those recommendations. Studying the SOP experience in the UK, Ferri and Maber (2013) show that 75-80% of the firms with substantial voting dissent responded by removing the controversial provisions causing the adverse vote. In this section we examine the effect of SOP votes on pay practices in the US.

We expand our sample to Russell 3000 firms with an ISS Against recommendation in 2011 (293 firms with an average voting dissent of 29.7%). We examine the 2012 proxy statement of each firm to identify whether it discloses changes to the compensation plan explicitly made in response to the 2011 SOP vote (the Dodd-Frank Act requires firms to disclose each year in the proxy statement how they took into account the prior year's SOP vote in determining their

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

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

compensation policies for the year). We are able to obtain this information for 269 firms (attrition due to mergers and bankruptcies). Appendix 6 includes some examples of the relevant disclosures.

Table 8, Panel A, shows that 55% of the firms (147 out of 269) report compensation changes in response to the SOP vote.[34] Almost all describe these changes as the result of an engagement process with key investors after the vote (see Appendix 6), with a few firms also mentioning communications with PA.[35] Similar to prior literature on non-binding shareholder votes (Del Guercio et al., 2008; Ertimur et al., 2010), we find that firm responsiveness depends on the percentage of votes cast against the SOP proposal: firms reporting a compensation change had experienced 38.66% SOP voting dissent in 2011 versus 19.70% for firms reporting no changes (difference significant at the 1% level).

In its voting guidelines, ISS indicates that if a firm fails to "adequately respond to the company's previous say-on-pay proposal that received the support of less that 70 percent of votes cast", then in 2012 it may receive an Against recommendation on SOP and its compensation committee members may be the target of a withhold recommendation (ISS, 2012). To shed light on whether the 30% dissent threshold utilized by ISS plays an important role in firms' decision to respond to SOP votes, we partition firms into groups based on the degree of voting dissent in 2011 and examine the frequency of compensation changes for each group. Figure 1 shows that the rate of firm responsiveness increases with the degree of voting dissent, with a striking discontinuity around the ISS threshold. The frequency of compensation changes increases from 32.00% for firms with voting dissent in the 25-30% range to 72.22% for firms in the 30-35% range. Taken

[34] The changes cover a wide range of issues, reflecting the variety of concerns raised in the PA reports. The most frequent ones are the introduction of performance-based vesting conditions in part or all the equity grants, the toughening of performance goals in short- and long-term incentive plans, the reduction or elimination of certain perks (e.g. personal aircraft use) and tax gross-ups on perks (e.g. tax gross-ups upon the vesting of executives' outstanding restricted stock awards), and the removal of excise tax gross-ups and modified single-trigger provisions from change-in-control severance agreements.

[35] Among firms that do not report any compensation change, 17 disclose that they consulted with key shareholders and that this engagement led to a better understanding of the compensation policies, but no changes to them.

together, the results in Panel A and Figure 1 suggest that firms generally respond to high voting dissent and, especially, to the threat of future ISS adverse recommendations, consistent with firms perceiving ISS recommendations as a causal driver of future shareholder votes.

Next, we examine whether compensation changes made in response to the 2011 SOP votes are effective in addressing investor and PA concerns by analyzing the change in voting dissent from 2011 to 2012 and the likelihood of receiving an ISS *Against* recommendation on SOP in 2012.[36] Panel B shows that firms reporting compensation changes after the 2011 SOP vote experience a decrease in voting dissent from 39.8% to 19.7%. The decrease is economically and statistically significant and significantly higher than for firms reporting no compensation changes. These firms are also less likely to receive a new ISS *Against* recommendation in 2012 relative to those with no compensation changes: 32.31% vs. 45.16% (difference significant at the 1% level).[37] These figures also imply that (i) not all compensation changes are successful in obtaining a *For* recommendation in 2012,[38] (ii) a change in ISS recommendation may occur even without changes to the compensation plan (based on our reading of the reports, this occurs when ISS perceives an improvement in the pay-performance historical correlation, often due to better performance).

Finally, Panel C shows that the drop in voting dissent for firms with compensation changes is driven by the cases where ISS recommends *For* in 2012 (decrease from 38.8% to 7.1%). When ISS recommends *Against* also in 2012, voting dissent remains at more than 40%, confirming the strong association between ISS recommendations and shareholder votes documented in Section 5.

[36] The sample excludes firms that opted for biennial or triennial SOP votes, as allowed by the Dodd-Frank Act.

[37] Within the subset of firms with compensation changes, we find that the likelihood of an ISS *Against* in 2012 is lower (about 25%) when the compensation changes relate to issues raised in the 2011 ISS reports (117 firms) than in other cases (about 50%).

[38] Based on our reading of the relevant ISS 2012 reports, firms continue to receive an *Against* recommendation (in spite of the disclosed changes) when ISS does not consider the changes sufficient to address the concerns identified in 2011 (e.g. the firm introduces performance conditions viewed as not challenging enough) or (less frequently) when new concerns arise with respect to the 2012 compensation plan.

7. Proxy advisors' recommendations: effect on shareholder value

The analyses so far yield insights on the role of PA in gathering and processing data on behalf of voting institutional investors: PA provide a fairly comprehensive analysis of the compensation plans and do not follow a one-size-fits–all approach but try to take into account firm-specific circumstances in determining the final recommendations; investors take into account the recommendations and their rationale in casting their votes, which then have a significant influence on firm's compensation practices. However, these analyses do not speak to the quality of PA recommendations and their effect on firm value. For example, the association with shareholder votes may not be interpreted as an ex post certification of the quality of the recommendations if shareholders follow PA recommendations merely because it is more cost-effective than analyzing the compensation plans independently. Similarly, evidence on the rate of agreement between GL and ISS does not have obvious implications in terms of the quality of their recommendations (PA may agree and be both 'wrong'). Assessing the quality of PA recommendations with respect to CEO pay is particularly challenging because we do not have ex post direct measures of the quality of compensation plans.[39] We try to shed light on this question by examining the stock price reaction to changes in pay practices triggered by PA recommendations and the ensuing SOP vote.

In particular, we perform an event study where we treat as "events" the proxy filing dates of the 147 firms targeted by an ISS Against recommendation in 2011 that report changes to their compensation plan in the 2012 proxy statement (see Section 6.2). Since some of these changes may have been already disclosed in 8-Ks during the year, for each of the 147 firms we read all Form 8-K, Item 5.02s (where firms must report, among other things, material changes to compensation arrangements) filed between the 2011 vote and the 2012 proxy filing date, leading

[39] This is in contrast to other intermediaries, such as analysts, where ex post realization of earnings can be used to assess the quality of analysts' earnings forecasts.

us to identify 71 additional events (62 distinct firms), resulting in a sample of 218 SOP-related compensation change events.[40] For each event we calculate *Abnormal Returns* as size-adjusted returns calculated over the [0, +1], [0, +2] and [0, +3] trading day windows around the event date.

Table 9 shows no statistically significant stock price reaction for the pooled sample (first row). The results are similar when we drop 43 contaminated events.[41] One possibility is that some firms might have announced (some or all of) the compensation changes in 8-Ks filed earlier in the year. However, we continue to find no significant reaction around compensation changes in proxy filings not preceded by 8Ks (third row) and around the subset of 8-K events themselves, which, by definition, do not suffer from this problem (fourth row).

We note in Section 6.2 that some of the firms reporting changes to their compensation plans continue to receive *Against* recommendations in 2012, suggesting that these changes may be window dressing. Also, some changes may not be material enough to have a detectable impact on firm value (e.g. removing an excise tax gross-up provision from a severance contract of an executive). To address these concerns, we proceed as follows. First, we examine separately the subset of firms with a change in ISS SOP recommendation from *Against* in 2011 to *For* in 2012 (fifth row). As noted earlier, these firms experience a dramatic drop in dissent suggesting that both shareholders and PA considered the changes as adequate and material. Second, we identify 42 events, which, based on our subjective classification, represent the most substantial changes (sixth row). An example would be a firm that revamps multiple aspects of its compensation plan (the case of Umpqua Holdings in Appendix 6). Yet, we fail to find a significant stock price reaction.

[40] We also read the 8-K (Item 5.02) filings for the firms reporting no SOP-related compensation changes in the 2012 proxy statement and find no cases where the change was announced in an 8-K and not reported in the proxy statement.
[41] We define an event as contaminated if an earnings announcement occurs within the (-5,+5) window around the event or if there are other announcements via 8-K on the same day as the event date. Since proxy filings contain other information (and, thus, they are contaminated by definition), we also run a multivariate analysis with indicators for the type of proposals on the ballot. The inferences are unchanged.

Another concern is that the compensation changes are the result of an engagement process with institutional investors and inputs from compensation consultants, and do not reflect the views of ISS. However, as we have already noted, there is no significant reaction for the subset of firms with an ISS *For* recommendation in 2012 (which suggests ISS's approval of the changes to the compensation plan, no matter how they came into place). Also, when we focus on the sub-sample of events where at least one of the compensation changes addresses an issue raised in the ISS report (not surprisingly, given our focus on firms with a negative ISS recommendation, 190 out of 218 events fit this definition), we do not find a significant stock price reaction (seventh row).

Overall, we find no evidence that PA analyses of SOP plans lead to superior compensation practices.[42] At the same time, we do not find a negative impact, in contrast to Larcker et al. (2012), who document a negative stock price reaction to changes in compensation practices ahead of the 2011 SOP vote (presumably made to avoid a negative recommendation and an adverse vote).[43] Combined with our other findings in the paper, the picture that emerges is that, at least with respect to SOP, rather than identifying and promoting superior compensation practices, PA's key economic role is processing and organizing a substantial amount of executive pay information on behalf of institutional investors, reducing their cost of making informed voting decisions.

More generally, and perhaps more importantly, our findings also imply that SOP votes, while having an effect on compensation practices and spurring the engagement process expected by SOP supporters, do not have a detectable impact on the quality of compensation practices.

[42] Of course, there is an important caveat to our event study: since the compensation changes are the result of an engagement process with key institutional investors they may have been largely anticipated by some market participants, reducing the power of the event study. Our test implicitly assumes that these changes are not anticipated by all investors and/or that there is some uncertainty as to whether the firm would follow through and implement all the changes discussed during the engagement process.

[43] In a similar vein, 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.

Perhaps the perceived problems with executive pay designs are overstated (Kaplan, 2012) and suggested improvements to pay design (e.g. performance-based vesting conditions, minimum ownership requirements, clawbacks), even if beneficial, have minimal impact on firm value. This interpretation is consistent with the observation that, in spite of all the public outcry over executive pay, only a handful of compensation plans have been voted down by investors.

8. Conclusions

While proxy advisors' (PA) recommendations are recognized as the key determinant of shareholder votes, little is known about the analyses underlying these recommendations and their economic consequences. We fill this gap by examining the analyses that the two most influential PA, Institutional Shareholder Services (ISS) and Glass Lewis & Co. (GL), performed in 2011 to arrive at a voting recommendation on "say on pay" (SOP), the non-binding vote on executive pay mandated by the Dodd-Frank Act. We find that both PA perform a detailed analysis, emphasizing firm-specific considerations rather than resorting to one-size-fits-all approaches, and are more likely to issue an *Against* recommendation at firms with poor performance and higher levels of CEO pay. While they often disagree in their recommendations, both PA have significant influence on the voting outcome. This influence varies with the institutional ownership structure, the rationale behind the recommendation and certain firm characteristics, suggesting a nuanced use of PA reports. More than half of the firm with a negative recommendation report compensation changes in response to the recommendation and the ensuing SOP vote, with firms' responsiveness increasing with the extent of SOP voting dissent. However, we find no market reaction to the announcement of such changes, even when material enough to result in a favorable recommendation and vote the following year. Our findings contribute to the literature on shareholder voting and the related policy debate.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Disclosure Category

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

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

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

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

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

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

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

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

Appendix 4 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 Examples of company responses to negative ISS recommendations

Disagreement with ISS

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

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

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

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

Additional Disclosure – Severance

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

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

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

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

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

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

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

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

Appendix 6 Firm's responses to the 2011 say on pay vote: excerpts from the 2012 proxy statements.

"Our Response to Say on Pay Vote: A majority of the stockholders who voted on our 2011 "Say on Pay" proposal voted against the proposal. In response to that vote, our board of directors, the Committee and our executive team took immediate and thorough action:

a. The Committee engaged Towers Watson, a leading human resources consulting firm, to perform a review of our executive compensation program and make recommendations for enhancements.
b. Our executive team agreed to amend the equity grants issued in January 2011 to include a vesting condition that limits vesting to the extent that Umpqua's total shareholder return (TSR) does not exceed the KRX total return index, a regional bank index.
c. We met with representatives of Institutional Shareholder Services (ISS) and Glass Lewis to fully understand their view of the "pay for performance" aspect of our compensation program.
d. We engaged Phoenix Advisory Partners to advise on outreach to our institutional shareholders who voted against our say on pay resolution.
e. We met with many of our large institutional shareholders who voted against our 2011 say on pay resolution to advise them of our response and to understand their concerns with our program.
f. We strengthened our stock ownership policy to require that named executive officers acquire and maintain positions in company stock with a value ranging from 150% to 400% of base salary.
g. We enhanced our policy to require that at least 50% of all equity awards to executive officers will be "performance based". In 2011, 100% of the equity awards to executives were "performance-based".
h. We revised our "hold to retirement" policy to remove the age 62 exemption. 75% of all net equity awards must be held to retirement."

(*Umpqua Holdings Corp., Proxy Statement, April 17, 2012*)

"During fiscal 2011, the equity compensation component of the Company's pay programs was reevaluated, taking into account the outcome of the shareholder vote on executive compensation at the 2011 Annual Meeting of Shareholders, consultations with the independent consultant of the HR&C Committee, and discussions with major institutional shareholders. As a result of these considerations, the long-term equity based incentive program now has the following features:

- Instead of time-based restricted stock grants, which were a significant portion of the 2010 equity compensation program, performance-based market stock unit ("MSU") grants (the structure of the MSU grants is described below under "Compensation Discussion and Analysis—Compensation Elements—2011 Equity Awards"), were awarded to the NEOs;
- the CEO MSU grant includes a second performance condition based upon the Company's total shareholder return compared to its peer group over a three-year performance period;
- The proportion of long-term incentives delivered in the form of stock options granted to the NEOs was reduced so that MSUs comprise the majority of their equity compensation in both shares and value;
- In fiscal 2011 the Company increased the required CEO Company stock ownership guideline from five times to six times base salary;
- New equity award agreements were modified in fiscal 2011 to provide for accelerated vesting after a change in control only if the executive is terminated without cause or quits for good reason ("double trigger vesting");
- In fiscal 2011 the Company adopted a clawback policy that applies when inaccurate financial statements have affected incentive award payments to executive officers…"

(*Jacobs Engineering Group Inc., Proxy Statement, December 16, 2011*)

"At the 2011 Annual Meeting, our stockholders approved our Say on Pay resolution by a favorable vote of approximately 72% of the votes cast (including abstentions). In considering the prior year vote, our Compensation Committee conferred with management about the possible reasons the Company received an unfavorable vote on the prior year Say on Pay resolution of approximately 28%. Based on discussions with certain investors and rating agencies, the Company believes that a significant portion of the "no" or "abstention" vote on the prior year Say on Pay resolution related to the Company's exchange of certain outstanding options at the end of 2010 and that the negative Say on Pay votes did not necessarily relate to the Company's executive compensation programs in general"

(*Taser International, Proxy Statement, April 23, 2012*)

"Consideration of Last Year's Advisory Stockholder Vote on Executive Compensation
At the 2011 Annual Meeting of Stockholders, stockholders voted to approve the compensation of the Company's named executive officers…In considering the results of the 2011 advisory vote and feedback from stockholders, the Compensation Committee concluded that our stockholders generally support the compensation paid to our executive officers and the Company's overall compensation program and therefore determined to maintain the current program. The Compensation Discussion and Analysis in this proxy statement, however, reflects a number of revisions relative to the 2011 Proxy Statement to improve the clarity and understanding of our executive compensation program."

(*Mohawk Industries, Proxy Statement, April 3, 2012*)

Figure 1 Probability of compensation change as a function of 2011 SOP voting outcome

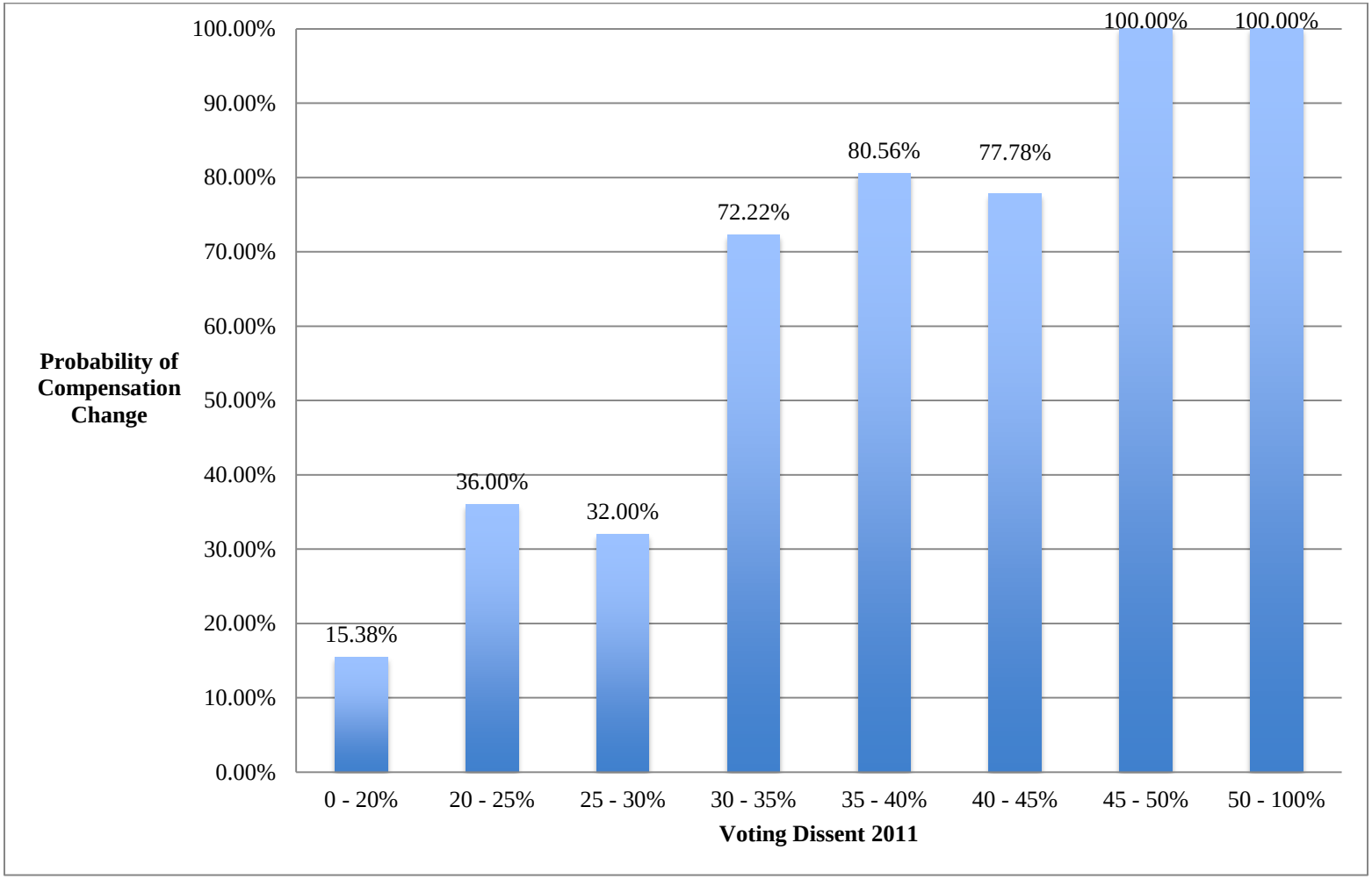

Figure 1 displays the probability of a change in the compensation plan made explicitly as a response to the 2011 SOP vote for the sample of 269 Russell 3000 firms that received an against recommendation from ISS in 2011 for SOP as a function of intervals of 2011 SOP voting outcome.

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

	Distribution of ISS ratings		
	All	*ISS For*	*ISS Against*
All Firms	1,275	1,131 (*88.7%*)	144 (*11.3%*)
No High Concern	1,131	1,129	2
Single High Concern	112	-	112
Pay for Performance	82	-	82
Peer Group	-	-	-
Non-Performance Pay	8	-	8
Severance	20	-	20
Communication	2	-	2
Multiple High Concern	30	-	30
NA	2	2	0
	Distribution of GL ratings		
	All	*GL For*	*GL Against*
All Firms	1,275	998 (*78.3%*)	277 (*21.7%*)
No High Concern	683	682	1
Single High Concern	355	209	146
Pay for Performance - Grade F	39	1	38
Pay for Performance - Grade D	152	64	88
Structure - Poor	119	99	20
Disclosure - Poor	45	45	-
Multiple High Concern	110	4	106
NA	127	103	24

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

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

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

Panel A: Joint distribution of ISS and GL recommendations

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

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

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

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

Table 2 (cont.)

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

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

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

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

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

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

Panel A: Benchmark Regression

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

Table 3 (cont.)

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

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

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

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

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

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

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

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

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

Table 4 Abnormal returns around proxy advisor report release dates

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

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

Panel B: Univariate analysis of abnormal returns around GL report release dates

	GL For (*N* = 887)		*GL Against* (*N* = 249)		*GL Against* versus *GL For*			
					Mean (t-test)		Median (Wilcoxon)	
Window	Mean	Median	Mean	Median	Difference	*t-statistic*	Difference	*z-statistic*
[-1,+1]	0.0003	-0.0004	-0.0001	-0.0002	0.0004	0.19	-0.0002	-0.03
[-2,+2]	-0.0002	0.0001	-0.0005	-0.0015	0.0003	0.10	0.0016	0.43
[-3,+3]	0.0010	0.0009	-0.0018	-0.0011	0.0027	0.86	0.0019	0.75

Table 4 (cont.)

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

	Model (1) *Abnormal Returns over* [-1, +1]		Model (2) *Abnormal Returns over* [-2, +2]		Model (3) *Abnormal Returns over* [-3, +3]	
Variable	Coefficient (*t-statistic*)		Coefficient (*t-statistic*)		Coefficient (*t-statistic*)	
Intercept	0.0022	**	0.0030	**	0.0023	
	(2.05)		(2.32)		(1.54)	
ISS Against	-0.0062	**	-0.0095	***	-0.0084	**
	(-2.23)		(-2.97)		(-2.36)	
ISS Withhold	-0.0028		-0.0004		-0.0010	
	(-1.00)		(-0.11)		(-0.27)	
ISS For—Shareholder Proposals	-0.0028		-0.0022		0.0008	
	(-1.08)		(-0.76)		(0.24)	
ISS Against—Management Proposals	-0.0007		-0.0037		0.0010	
	(-0.21)		(-0.94)		(0.19)	
N	1,195		1,195		1,195	
Adjusted R^2	0.36%		0.52%		0.11%	

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

	Model (1) *Abnormal Returns over* [-1, +1]		Model (2) *Abnormal Returns over* [-2, +2]		Model (3) *Abnormal Returns over* [-3, +3]	
Variable	Coefficient (*t-statistic*)		Coefficient (*t-statistic*)		Coefficient (*t-statistic*)	
Intercept	0.0023	**	0.0031	**	0.0024	*
	(2.18)		(2.42)		(1.61)	
ISS Against—Expected	0.0016		-0.0019		-0.0024	
	(0.41)		(-0.35)		(-0.46)	
ISS Against—Unexpected	-0.0088	***	-0.0121	***	-0.0105	**
	(-2.63)		(-3.24)		(-2.43)	
ISS Withhold	-0.0032		-0.0008		-0.0013	
	(-1.13)		(-0.23)		(-0.35)	
ISS For—Shareholder Proposals	-0.0035		-0.0029		0.0003	
	(-1.33)		(-0.99)		(0.08)	
ISS Against—Management Proposals	-0.0012		-0.0043		0.0005	
	(-0.39)		(-1.08)		(0.11)	
N	1,195		1,195		1,195	
Adjusted R^2	0.54%		0.61%		0.11%	

Table 4 displays the results of the analyses of abnormal returns around ISS report release dates. Panel A (B) presents the mean and median abnormal returns around the release date of 1,195 ISS (1,136 GL) reports, separately for reports that include *For* and *Against* recommendations for SOP. Panels C and D 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 robust standard errors.

Table 5 Distribution of Say-On-Pay (SOP) voting dissent

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

Table 5 presents the distribution of SOP voting dissent for the full sample and by proxy advisor recommendations on SOP. *SOP Voting Dissent* is defined as the number of votes cast against SOP scaled by the total number of votes cast, i.e., the sum of votes for, votes against and votes abstained (source: ISS). *ISS Against* (*For*) and *GL Against* (*For*) are defined as in Table 1.

Table 6 Determinants of Say-on-Pay (SOP) voting dissent

Panel A: Benchmark regression

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

Table 6 (cont.)

Panel B: The role of proxy advisors' recommendations

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

Table 6 (cont.)

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

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

Table 6 (cont.)

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

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

Table 6 presents the results for the determinants of SOP voting dissent.
Panel A reports the results for a benchmark model, where the dependent variable is *SOP Voting Dissent*, defined as the number of votes cast against the compensation plan scaled by the total number of votes cast (i.e., the sum of votes for, votes against and votes abstained; source: ISS) and the control variables are defined as in Table 3.

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

Panel C examines the influence of the concerns identified by the proxy advisors on the sensitivity of shareholder votes to proxy advisors' *Against* recommendations. The dependent variable is *SOP Voting Dissent*, as defined above. All the control variables in Panel A are included but suppressed for ease of exposition. Additional control variables include: *ISS Against—Single* (*Multiple*) *High Concern* is an indicator variable that is equal to one if ISS issues an *Against* recommendation and rates only one (more than one) category as high concern. *ISS Against—Only Pay-Performance* (*Only Non-Performance Pay, Only Severance, Only Communication) High Concern* is an indicator variable that is equal to one if ISS issues an *Against* recommendation for SOP and rates only *Pay-Performance* (*Non-Performance Pay, Severance, Communication*—all as defined in notes to Table 1) as *High Concern*.
GL Against—Single (*Multiple*) *High Concern* is an indicator variable that is equal to one if GL issues an *Against* recommendation and rates only one (more than one) category as high concern. *GL Against* (*For*)*—Only Structure* (*Only Disclosure) Poor* is an indicator variable that is equal to one if GL issues an *Against* (*For*) recommendation for SOP and rates only *Structure* (*Disclosure*—all as defined in notes to Table 1) as *Poor*. *GL Against* (*For*)*—Only Pay-Performance Grade F* (*Only Pay-Performance Grade D*) is an indicator variable that is equal to one if GL issues an *Against* (*For*) recommendation for SOP and rates only *Pay-Performance* (as defined in notes to Table 1) as *Grade F (Grade D)*.

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

***, **, 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 7 Firm responses to negative ISS recommendations

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

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

Table 8 Compensation changes in response to SOP votes

Panel A The role of past SOP voting dissent

	Compensation Changes			
	Yes	No	Yes vs. No	
N	147	122		
Mean *Voting Dissent 2011*	38.66%	19.70%	18.96%	***

Panel B The effect on subsequent SOP voting dissent and ISS recommendations

	Compensation Changes			
	Yes	No	Yes vs. No	
N	130	62		
Mean *Voting Dissent 2011*	39.85%	23.88%	15.97%	***
Mean *Voting Dissent 2012*	19.71%	15.69%	4.02%	
Change in Voting Dissent	-20.14%	-8.19%	-11.95%	***
ISS Against 2012	32.31%	45.16%	-12.85%	*

Panel C The effect on subsequent SOP voting dissent by 2012 ISS recommendation

	ISS Against 2012					
	Yes		No		Yes vs. No	
N	42		88			
Mean *Voting Dissent 2011*	41.97%	***	38.84%	***	3.13%	
Mean *Voting Dissent 2012*	46.10%	***	7.11%	***	38.99%	***
Change in Voting Dissent	4.13%		-31.73%	***	35.86%	***

Table 8 displays the changes to the compensation plan made explicitly as a response to the 2011 SOP vote for the sample of 269 Russell 3000 firms that received an against recommendation from ISS in 2011 for SOP. The analysis in Panel B focuses on the subset of 192 firms that adopted an annual SOP vote and therefore have voting data for 2012. The analysis in Panel C focuses on the subset of 130 firms with compensation changes and annual SOP vote. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 level, respectively, based on a two-tailed test.

Table 9 Market reaction to compensation changes in response to SOP votes

	All				Exclude Contaminated Events			
		Mean *Abnormal Returns*				Mean *Abnormal Returns*		
	N	[0, +1]	[0, +2]	[0, +3]	N	[0, +1]	[0, +2]	[0, +3]
All compensation changes	218	-0.0025	-0.0020	-0.0005	175	-0.0026	-0.0022	0.0002
Subset of compensation changes								
…disclosed in the 2012 proxy	147	-0.0030	-0.0010	0.0002	135	-0.0026	-0.0015	0.0006
…disclosed in the 2012 proxy and not preceded by an 8-K	98	-0.0006	0.0015	0.0036	88	0.0004	0.0013	0.0034
…disclosed in an 8-K	71	-0.0015	-0.0039	-0.0019	40	-0.0027	-0.0047	-0.0009
…followed by an ISS *For* recommendation in 2012	150	-0.0030	-0.0024	0.0000	118	-0.0025	-0.0014	0.0021
…most substantial	42	-0.0066	-0.0030	0.0028	37	-0.0067	-0.0033	0.0017
…addressing an issue raised in ISS report	190	-0.0020	-0.0020	-0.0004	149	-0.0018	-0.0018	0.0008

Table 9 displays the market reaction to the announcement of compensation changes made explicitly as a response to the 2011 SOP vote for the sample of 269 Russell 3000 firms that received an against recommendation from ISS in 2011 for SOP. *Abnormal Returns* is size-adjusted returns calculated over the [0, +1], [0, +2] and [0, +3] trading day windows around the announcement of the compensation change (proxy filing date or 8-K). ***, **, and * denote significance at the 0.01, 0.05, and 0.10 level, respectively, based on a two-tailed test.