

Glass Lewis Changes Its Say-on-Pay Analysis

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For the past two proxy seasons, companies have criticized how proxy advisory services have selected company peer groups in order to evaluate “pay for performance” for purposes of making say-on-pay voting recommendations. Recently, Glass Lewis announced changes in their peer group selection methodology that will affect annual meetings held after July 1, 2012.

On July 12, 2012, Glass Lewis hosted a [“proxy talk”](#) during which they outlined enhancements to their proprietary pay-for-performance model. The most significant development is the change to peer groups. Since 2003, Glass Lewis has been using a process that is based on GICS codes, industry group and geographical region, but they will now use a “market-based” peer group approach developed with Equilar. Akin to social networking, Equilar starts with each subject company’s self-disclosed peers (direct peers). They also examine (a) the peers disclosed by the direct peers (second-degree peers), (b) the companies that use the subject company as a peer (incoming peers) and (c) the peers disclosed by incoming peers. The focus is on the direction of peer relationships and the similarity of peer groups, with peers ranked based on the strength of the connection, to ultimately identify up to 30 companies as the peer group for purposes of the say-on-pay analysis. The Glass Lewis report will display differences between the company’s self-disclosed peers and the Equilar-derived peer group.

Other enhancements include changes in performance metrics that Glass Lewis will consider (which includes total shareholder return, change in operating cash flow, EPS growth, return on equity and return on assets). In addition, there will be a slightly longer outlook of three-year weighted average of total compensation for CEO and Top 5 executives, instead of the prior test of one year. Glass Lewis’ dreaded letter grades will no longer be subject to a forced “curve” distribution, but will be assigned based on the relative level of compensation and performance against peers.

There is also a qualitative element to the analysis which Glass Lewis continues to emphasize, with the details largely similar to ISS in terms of the focus on the mix of pay, targets and metrics and best practices. Glass Lewis does tend to criticize companies for perceived poor or lack of disclosure.

Glass Lewis recommended against 16% of companies it reviewed in 2012 so far. While Glass Lewis does not offer any consulting services, companies can subscribe to Equilar to obtain the peer group information.

In related news, ISS, which also uses a GICS code-based peer group selection system (albeit different from Glass Lewis), announced that they will be changing their process for the upcoming proxy season, with effect for companies with annual meetings after February 1, 2013. We understand that this will be covered in ISS’s policy survey, which is expected to come out shortly.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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