

Glass Lewis Modifies Pay-For-Performance Methodology

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Glass, Lewis and Co., LLC (“Glass Lewis”), an independent proxy advisory service, recently modified its methodology to evaluate the alignment between executive pay and company performance for purposes of making say-on-pay voting recommendations. As discussed below, the changes include identifying smaller peer groups, creating a new model for determining pay-for-performance grades, utilizing fewer performance metrics, and measuring compensation with a three-year weighted average. These changes became effective with Glass Lewis’s recommendations for public companies holding annual shareholder meetings on or after July 1, 2012.

- **Peer Groups.** Under the former methodology, Glass Lewis developed a peer group of approximately 100 peer companies based upon enterprise value, industry sectors and geographic location. Now, they will utilize Equilar’s Market-Based Peer Group. The new peer group will consist of up to 30 companies based upon the target company’s self-disclosed peer group, the peers of the self-disclosed peers (i.e., “peers of peers”), the companies that use the target company as a peer (i.e., “incoming peers”), and the peers disclosed by incoming peers. The composition of the peer group will now be disclosed to the target company. In its Proxy Paper, Glass Lewis will disclose the specific companies that comprise the peer group.
- **Performance Metrics.** Performance will continue to be measured as the three-year weighted average of the performance of the company relative to the peer group. In determining company and peer performance, however, the change in stock price and change in book value per share will no longer be considered. Glass Lewis will consider total shareholder return, change in operating cash flow, earnings per share growth, return on equity and return on assets.
- **Measuring Compensation.** Glass Lewis will now consider the three-year weighted average of total compensation for the CEO and named executive officers, rather than the one-year total compensation for these executives.

- **Grading Pay-for-Performance.** Glass Lewis assigns a letter grade (A through F) to companies as scores for pay-for-performance. In determining the letter grade, the company's relative performance percentile ranking is compared with the relative ranking of the company's CEO and named executive officer pay against the peer group. The difference in the two percentiles is used to determine the letter grade assigned by Glass Lewis. Unlike the former model used by Glass Lewis, there will be no forced curve under this new model, and instead the letter grade will be assigned based on the relative level of compensation and performance against peers.

If you have any questions regarding these changes, other pay-for-performance methodologies, or any other executive compensation-related questions, please contact one of the authors listed or the Reed Smith attorney with whom you usually work.

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