United States
& Canada

GLASS LEWIS

Find the Perfect Peer Group with Diligent & Glass Lewis

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About Glass Lewis

Glass Lewis is the world's choice for governance solutions. We enable institutional investors and publicly listed companies to make sustainable decisions based on research and data. We cover 30,000+ meetings each year, across approximately 100 global markets. Our team has been providing in-depth analysis of companies since 2003, relying solely on publicly available information to inform its policies, research, and voting recommendations.

Our customers include the majority of the world's largest pension plans, mutual funds, and asset managers, collectively managing over $40 trillion in assets. We have teams located across the United States, Europe, and Asia-Pacific giving us global reach with a local perspective on the important governance issues.

Investors around the world depend on Glass Lewis' **Viewpoint** platform to manage their proxy voting, policy implementation, recordkeeping, and reporting. Our industry leading **Proxy Paper** product provides comprehensive environmental, social, and governance research and voting recommendations weeks ahead of voting deadlines. Public companies can also use our innovative **Report Feedback Statement** to deliver their opinion on our proxy research directly to the voting decision makers at every investor client in time for voting decisions to be made or changed.

The research team engages extensively with public companies, investors, regulators, and other industry stakeholders to gain relevant context into the realities surrounding companies, sectors, and the market in general. This enables us to provide the most comprehensive and pragmatic insights to our customers.

Join the Conversation

Glass Lewis is committed to ongoing engagement with all market participants.

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Background: A New Who's Who

As part of Glass Lewis' partnership with Diligent, in 2020 we rolled out a new peer group methodology for our pay-for-performance model.

Peer groups are notoriously difficult both to construct and evaluate. Set the criteria too strictly, and you'll end up with a tiny group of companies. But if you cast a wide net, the resulting sample may be too inclusive to provide meaningful comparisons.

Glass Lewis' new methodology was intended to break the feedback loops that result from a disproportionate focus on companies' self-selected peer groups without losing the benefits of that methodology. The numbers for the first nine months demonstrated that the methodology was roundly successful. Even so, we are excited to announce minor improvements on a strong result to incrementally improve our research product.

Our journey from a 'peers of peers' approach to a new methodology started with engagement. Through more than 3,000 meetings with companies and countless discussions with investor clients, we gained a deep understanding of investor and issuer sentiments on peer groups.

- We found that investors tend to favor industry-based peers, followed by country-based peers.
- Public companies tend to prefer their self-disclosed peers, stemming from the unique position they feel they hold in the marketplace.

After listening to investors and issuers, we developed a new peer group methodology.

Proven Peers

In January 2020, we implemented our proprietary peer group methodology, a "proven peer" approach. Under this new methodology, we begin with the company's self-disclosed peers and run multiple tests against the independent views of other companies, investors and fundamental analysis, before ranking peers based on proven consensus across these views.

These tests include a dive into a peers-of-peers analysis; a look at GICS industry peers, as a representation of investor views on firm operations; a look at country peers, as a representation of market-relative compensation and performance; and quality tests, screening for market capitalization, revenue, and asset sizes to approximate complexity. After applying weightings based on source and confirmations, we aim to obtain fifteen peers.

After reviewing the data from the 2020 proxy season, in November 2020 we determined to make two changes to our methodology, effective immediately:

- First, the weighting of the country peers has been reduced. It remains at the same relative position among the other components, but the absolute weighting has been reduced.
- The second change relates to the size modifier. Specifically, in order to ensure a sufficient number of direct competitor peers, we have added a "floor" value on the size comparisons.

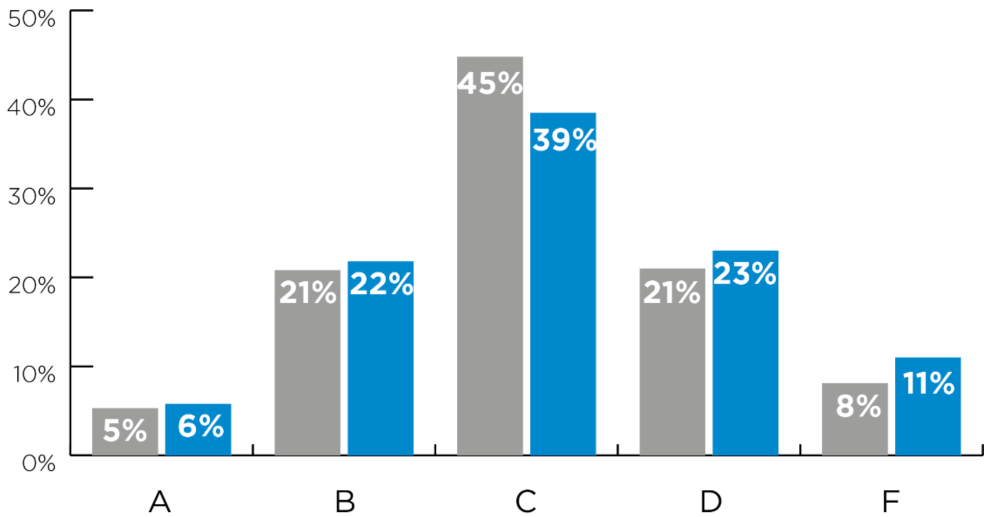
While the quantitative aspects of the model remain largely similar, the peer group methodology reflects a significant evolution in our pay-for-performance analysis. Our quantitative analysis relies on the ability to compare a given company's pay and performance against a reasonable comparator group. We take the percentile ranking of each company in terms of both pay and performance, and use the difference to determine a company's pay-for-performance grade, which indicates to what degree pay is aligned with performance.

<table>
<tr><th></th><th>High</th><th>Medium</th><th>Low</th></tr>
<tr><td>Weightings</td><td>• GL industry peers</td><td>• Mutually self-disclosed peers</td><td>• GL country peers
• Self-disclosed peers
• Incoming peers of peers (not self-disclosed)</td></tr>
<tr><td>Modifiers</td><td colspan="2">Primary: Strength in connections
• Peer of a peer</td><td>Secondary: Size modifier
• Rankings based on average ratios of market cap, revenue, and assets
• Now subject to a value floor</td></tr>
</table>

By the Numbers

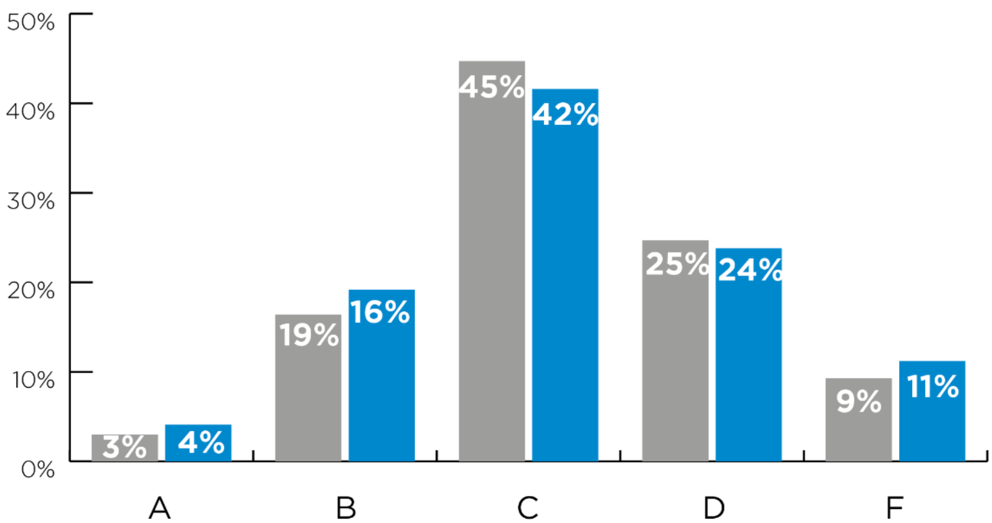
With the 2020 proxy season complete, we have dissected and analyzed the impact of this peer group methodological shift on pay-for-performance grades, evaluating it for any potential improvements. Comparing the 2020 proxy season to the 2019 proxy season we see a flattened bell curve for all firms and for S&P 500 companies. However, we note that there is an increase in "D" and "F" grades in 2020, while the number of "C" grades seems much lower.

CHANGE IN GRADE DISTRIBUTION: ALL FIRMS



The overall result was a slightly flatter curve, but as with the past there was variety in different cross-sections of our coverage. Indeed, it appears 61% companies with market capitalizations below $300 million received a grade of "C" or higher, while larger firms ($10 billion or more) received those passing grades 68% of the time.

CHANGE IN GRADE DISTRIBUTION: S&P 500



Smaller companies (<$300M market cap) were the least likely to have their pay-for-performance grades change, by a notable margin. But those small companies that did experience a grade change were slightly more likely to see a change of two or more grades (e.g. “D” to “B”), compared to larger companies (Table 1.2). These shifts are only slightly elevated compared to previous years' results, reflecting a combination of changes in pay levels, firms' performance, and the new methodology.

Market Cap	Changed by One Grade	Changed by Two+ Grades
<$300M	24%	9%
$300M to $1B	41%	8%
$1B to $10B	38%	7%
>$10B	40%	7%

Lastly, there was a decrease in the overlap with companies’ self-disclosed peers and the peers used in our pay-for-performance analysis. The percentage of companies with 80% or more overlap fell from 28% in 2019 to 6% in 2020. While we projected an average reduction of 2.0 overlapping companies stemming from our improved peer group methodology, our 2020 season results show a reduction of 2.6 instead. After analyzing these datapoints, we identified several minor refinements to improve our methodology going forward.

Why Change

We determined to review and update our approach following the 2020 season in order to make the methodology more robust and flexible. Our goal was a model that doesn't just fit the largest S&P 500 companies, but also the smallest firms in our coverage.

The changes were driven primarily by a handful of results (< 0.5% of coverage) where our analysts determined that peer group was simply not a good fit. These occurred almost exclusively for the smallest end of the size spectrum, and where country peers were disproportionately represented. We believe that the inclusion of some cross-industry peers can be healthy and reflects a standard practice among the larger firms in the North American market. Furthermore, same-industry peers accounted for on average over 75% of the Glass Lewis peers. Through focusing the edge cases that did not fit this frame, we managed to identify the lack of scaling in the size parameters as the key factor which eliminated more potential peers than preferable for small firms.

What Does it All Mean?

Though the changes were not drastic compared to fiscal 2019 data, we believe the results highlight the impact of using additional size-related screens when developing Glass Lewis peers. Moreover, 2020 data illustrates the potential concerns of "group think" and confirmation bias when using only a peers-of-peers methodology.

Smaller firms have an incentive to include larger companies in their peer groups so that they may pay higher sums to their executives, even if they are smaller in terms of size and complexity. If a company uses peers that are relatively larger, it may then ratchet up the median pay level for its peers, allowing the company to then pay their own executives at a higher level – and lowering the chance of them getting penalized for pay quantum.

Consequently, such companies may have an increased chance of aligning pay with performance when using solely a peers of peers approach.

Our methodology filters for outsized peers who would pay their executives more and potentially cause the median level of peer pay to be higher. It makes sense that this would impact smaller companies more so than larger ones. Lower levels of overlap with self-disclosed peers and the greater swing in grades for smaller companies combined with the increase in negative grades, despite the better grades for S&P 500 companies, indicates that the new methodology is working as intended. Using a proven peers approach, we effectively combat the ratcheting up effect on our pay-for-performance analysis. Resultingly, there are fewer "C" grades and greater numbers of "D" and "F" grades.

While industry peers were the most strongly represented in the final peer group, the guardrails for company size worked to ensure a narrower industry group in the end. On average, the fundamental analysis removed one out of eight companies from a company's aggregate self-disclosed peers based solely on relative size and financial strength. Meanwhile, 83% of the pay-for-performance grades had at least one country peer and 60% included three or fewer country peers.

Going Forward

Overall, the 2020 proxy season suggests our proven peer methodology is working as intended, by eliminating outsized and inappropriate peers, reducing the group think that results from overlapping with company self-disclosed peers, and producing a normal bell-shaped distribution for pay-for-performance grades that reduces the skew towards positive grades.

There were a few outlier cases, mainly reflecting the high variability of peer group quality in the small and microcap spaces. In reviewing these outliers, we have found opportunities for additional refinements to our approach. The results also highlight our broader approach, whereby our analysts apply their discretion and evaluate pay based both on quantitative and qualitative assessments. This is evident by companies receiving "D" and "F" grades but getting favorable recommendations from Glass Lewis 71.9% and 40.2% of the time, respectively.

Peer groups are a central component of how executive pay is determined and assessed. Glass Lewis' proven peer methodology successfully builds on the prior standard of self-selected peer groups to incorporate not only the company's industry, but also its size and complexity. This hybrid approach reflects both the reality of how companies choose their peers, and investor preferences for industry and country-based comparisons, providing a higher level of confidence in the integrity and independence of our peer assessment and pay analysis. We will continue to review and revise our approach, including minor refinements related to the weighting of country peers.

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