

KOPIN CORP
Form 10-Q
August 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
☒ 1934

For the quarterly period ended June 30, 2018

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

For the transition period from _____ to _____

Commission file number 0-19882

KOPIN CORPORATION
(Exact name of registrant as specified in its charter)

Delaware 04-2833935
State or other jurisdiction of (I.R.S. Employer
incorporation or organization Identification No.)

125 North Drive, Westborough, MA 01581-3335
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (508) 870-5959

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
	(Do not check if a smaller reporting company)	Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
Yes ☐ No ☒

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Indicate the number of shares outstanding of each issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of August 6, 2018
Common Stock, par value \$0.01	76,627,503

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Part 1. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

KOPIN CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2018	December 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$22,742,575	\$24,848,227
Marketable debt securities, at fair value	30,681,129	43,907,457
Accounts receivable, net of allowance of \$353,000 in 2018 and \$149,000 in 2017	2,785,081	3,955,123
Contract assets and unbilled receivables	2,384,307	704,863
Inventory	4,257,702	5,080,797
Prepaid taxes	96,983	264,352
Prepaid expenses and other current assets	1,177,022	978,677
Total current assets	64,124,799	79,739,496
Property, plant and equipment, net	5,125,629	5,077,043
Goodwill	1,768,539	1,780,247
Intangible assets, net	441,818	883,636
Other assets	2,173,428	3,842,068
Equity investments	5,708,816	—
Total assets	\$79,343,029	\$91,322,490
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$3,894,049	\$4,918,605
Accrued payroll and expenses	1,722,559	1,636,512
Accrued warranty	615,000	649,000
Contract liabilities and billings in excess of revenue earned	317,094	896,479
Other accrued liabilities	1,716,612	2,066,025
Income tax payable	161,620	1,416,892
Deferred tax liabilities	863,000	520,000
Total current liabilities	9,289,934	12,103,513
Deferred revenue, net of current portion	153,844	374,171
Asset retirement obligations	264,238	269,877
Other long-term obligations	1,785,775	1,195,082
Stockholders' equity:		
Preferred stock, par value \$.01 per share: authorized, 3,000 shares; none issued	—	—
Common stock, par value \$.01 per share: authorized, 120,000,000 shares; issued 81,090,758 shares in 2018 and 80,201,313 shares in 2017; outstanding 73,135,253 shares in 2018 and 73,078,783 shares in 2017	776,485	775,720
Additional paid-in capital	333,794,962	331,119,340
Treasury stock (4,513,256 shares in 2018 and 2017, at cost)	(17,238,669)	(17,238,669)
Accumulated other comprehensive income	3,046,191	3,564,779
Accumulated deficit	(251,839,754)	(240,121,901)
Total Kopin Corporation stockholders' equity	68,539,215	78,099,269

Noncontrolling interest	(689,977)	(719,422)
Total stockholders' equity	67,849,238	77,379,847
Total liabilities and stockholders' equity	\$79,343,029	\$91,322,490

See notes to unaudited condensed consolidated financial statements

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KOPIN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Revenues:				
Net product revenues	\$4,472,079	\$4,979,400	\$9,516,888	\$8,912,543
Research and development revenues	1,471,819	948,069	2,080,630	1,393,054
	5,943,898	5,927,469	11,597,518	10,305,597
Expenses:				
Cost of product revenues	3,497,750	4,117,226	7,559,941	7,234,583
Research and development	4,526,156	4,678,221	8,977,809	8,960,090
Selling, general and administration	6,913,503	5,200,261	13,844,913	10,841,947
	14,937,409	13,995,708	30,382,663	27,036,620
Loss from operations	(8,993,511)	(8,068,239)	(18,785,145)	(16,731,023)
Other income (expense):				
Interest income	165,513	186,142	325,364	419,919
Other income	18,101	65,018	1,119,356	325,430
Foreign currency transaction (losses) gains	(235,776)	556,539	(27,168)	(634,743)
Gain on investments	—	—	2,849,816	274,000
	(52,162)	807,699	4,267,368	384,606
Loss before (provision) benefit for income taxes and net loss (income) attributable to noncontrolling interest	(9,045,673)	(7,260,540)	(14,517,777)	(16,346,417)
Tax (provision) benefit	(201,000)	—	(201,000)	1,146,000
Net loss	(9,246,673)	(7,260,540)	(14,718,777)	(15,200,417)
Net loss (income) attributable to noncontrolling interest	5,716	(71,431)	(58,458)	10,007
Net loss attributable to Kopin Corporation	\$(9,240,957)	\$(7,331,971)	\$(14,777,235)	\$(15,190,410)
Net loss per share				
Basic and diluted	\$(0.13)	\$(0.10)	\$(0.20)	\$(0.22)
Weighted average number of common shares outstanding				
Basic and diluted	73,095,253	70,626,542	73,086,752	67,582,615
See notes to unaudited condensed consolidated financial statements				

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KOPIN CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
 (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Net loss	\$(9,246,673)	\$(7,260,540)	\$(14,718,777)	\$(15,200,417)
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(211,217)	(666,343)	(335,697)	931,062
Unrealized holding (losses) gains on marketable securities	(73,262)	149,094	(210,136)	137,780
Reclassification of holding losses (gains) in net loss	2,982	(2,745)	(1,768)	(3,900)
Other comprehensive (loss) income, net of tax	(281,497)	(519,994)	(547,601)	1,064,942
Comprehensive loss	\$(9,528,170)	\$(7,780,534)	\$(15,266,378)	\$(14,135,475)
Comprehensive loss (income) attributable to the noncontrolling interest	38,488	(41,680)	(29,445)	16,354
Comprehensive loss attributable to controlling interest	\$(9,489,682)	\$(7,822,214)	\$(15,295,823)	\$(14,119,121)
See notes to unaudited condensed consolidated financial statements				

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KOPIN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock		Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Kopin Corporation Stockholders' Equity	Noncontrolling Interest
	Shares	Amount						
Balance, December 30, 2017	77,572,038	\$775,720	\$331,119,340	\$(17,238,669)	\$3,564,779	\$(240,121,901)	\$78,099,269	\$(719,420)
Stock-based compensation	—	—	2,687,789	—	—	—	2,687,789	—
Vesting of restricted stock	80,000	800	(800) —	—	—	—	—
Repurchases of restricted stock to satisfy tax withholding obligations	(3,530) (35) (11,367)	—	—	(11,402) —
Other comprehensive loss (income)	—	—	—	—	(518,588) —	(518,588) (29,013
Adoption of accounting standards (Note 2)	—	—	—	—	—	3,059,382	3,059,382	—
Net loss	—	—	—	—	—	(14,777,235) (14,777,235) 58,458
Balance, June 30, 2018	77,648,508	\$776,485	\$333,794,962	\$(17,238,669)	\$3,046,191	\$(251,839,754)	\$68,539,215	\$(689,970)
See notes to unaudited condensed consolidated financial statements								

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KOPIN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended	
	June 30, 2018	July 1, 2017
Cash flows from operating activities:		
Net loss	\$(14,718,777)	\$(15,200,417)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,130,169	1,142,506
Stock-based compensation	2,687,789	1,968,128
Foreign currency losses	19,534	656,613
Change in allowance for bad debt	219,937	—
Unrealized gain on investments	(2,849,816)	(274,000)
Deferred income taxes	196,252	(1,169,940)
Other non-cash items	301,499	608,672
Changes in assets and liabilities, net of acquired assets and liabilities:		
Accounts receivable	687,986	241,213
Contract assets	1,315,022	—
Inventory	(605,154)	(778,240)
Prepaid expenses and other current assets	113,537	(275,988)
Accounts payable and accrued expenses	(2,018,182)	358,388
Billings in excess of revenue earned	312,352	45,466
Net cash used in operating activities	(13,207,852)	(12,677,599)
Cash flows from investing activities:		
Other assets	(41,966)	(37,296)
Capital expenditures	(740,172)	(1,071,742)
Proceeds from sale of marketable debt securities	13,109,285	24,322,300
Purchase of marketable debt securities	—	(16,812,114)
Cash paid for equity investment	(1,000,000)	—
Cash paid for acquisition, net of cash acquired	—	(3,690,047)
Net cash provided by investing activities	11,327,147	2,711,101
Cash flows from financing activities:		
Sale of unregistered stock	—	24,664,250
Settlements of restricted stock for tax withholding obligations	(11,402)	—
Net cash (used in) provided by financing activities	(11,402)	24,664,250
Effect of exchange rate changes on cash	(213,545)	21,046
Net (decrease) increase in cash and cash equivalents	(2,105,652)	14,718,798
Cash and cash equivalents:		
Beginning of period	24,848,227	15,822,495
End of period	\$22,742,575	\$30,541,293
Supplemental disclosure of cash flow information:		
Income taxes paid	\$1,300,000	\$—
See notes to unaudited condensed consolidated financial statements		

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KOPIN CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The condensed consolidated financial statements of Kopin Corporation (the "Company") as of June 30, 2018 and for the three and six month periods ended June 30, 2018 and July 1, 2017 are unaudited and include all adjustments which, in the opinion of management, are necessary to present fairly the results of operations for the periods then ended. These condensed consolidated financial statements should be read in conjunction with the Company's financial statements and notes thereto, included in the Company's Annual Report on Form 10-K for the year ended December 30, 2017. The results of the Company's operations for any interim period are not necessarily indicative of the results of the Company's operations for any other interim period or for a full fiscal year. The Company reclassified certain prior period amounts to conform to the current period presentation.

2. ACCOUNTING STANDARDS

Recently Issued Accounting Pronouncements

Leases

In February 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-02 (Topic 842) Leases, which requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. The new standard is effective for fiscal years beginning after December 15, 2018, with early adoption permitted, and must be adopted using the modified retrospective approach. The Company intends to adopt the standard on the effective date of December 30, 2018. Interpretations are on-going and could have a material impact on the Company's implementation. Currently, the Company expects that the adoption of the ASU 2016-02 (Topic 842) Leases will have a material impact on its consolidated balance sheet due to the recognition of right-of-use assets and lease liabilities principally for certain leases currently accounted for as operating leases, but we do not expect it to have a material impact on our results of operations or liquidity.

Recently Adopted Accounting Pronouncements

Recognition and Measurement of Financial Assets and Liabilities

The Company adopted ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities and the related amendments on December 31, 2017 (the first day of the Company's fiscal year 2018). This standard amends various aspects of the recognition, measurement, presentation, and disclosure of financial instruments. The Company adopted the measurement alternative for equity investments without readily determinable fair values (often referred to as cost method investments) on a prospective basis. As a result, these investments will be revalued upon occurrence of an observable price change for similar investments and for impairments. The Company expects that the adoption of this guidance may have a material effect on its financial statements on an ongoing basis.

Revenue from Contracts with Customers

The Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) effective December 31, 2017 and applied the modified retrospective method. The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company expects the impact of the adoption of the new standard to be material to the Company's results of operations on an ongoing basis.

Significant Accounting Policies Update

The Company's significant accounting policies are detailed in "Note 1: Summary of Significant Accounting Policies" of our Annual Report on Form 10-K for the year ended December 30, 2017. Significant changes to the Company's accounting policies as a result of adopting Topic 606 are discussed below.

Revenue Recognition

Substantially all of our revenues are from orders received from our customers for the purchase of wearable technology components that can be integrated to create headset systems. We also have development contracts for the design,

manufacture and modification of products for the U.S. government or a prime contractor for the U.S. government (“U.S. government”) or for a customer that sells into the industrial or consumer markets. The Company's contracts with the U.S. government are typically subject to the Federal Acquisition Regulations (“FAR”) and are priced based on estimated or actual costs of producing

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goods. The FAR provides guidance on the types of costs that are allowable in establishing prices for goods provided under U.S. government contracts. The pricing for non-U.S. government contracts is based on the specific negotiations with each customer.

Our fixed-price contracts with the U.S. government may result in revenue recognized in excess of amounts actually billed. We disclose the in excess of revenues over amounts actually billed as Contract assets on the balance sheet. Amounts billed and due from our customers are classified as accounts receivable on the balance sheet. In some instances, the U.S. government retains a small portion of the contract price until completion of the contract. The portion of the payments retained until final contract settlement is not considered a significant financing component because the intent is to protect the customer. For contracts with the U.S. government, we typically receive interim payments either as work progresses, we achieve certain milestones or based on a schedule in the contract. We recognize a liability for these advance payments in excess of revenue recognized and present it as billings in excess of revenue earned on the balance sheet. The advanced payment typically is not considered a significant financing component because it is used to meet working capital demands that can be higher in the early stages of a contract and to protect us from the other party failing to adequately complete some or all of its obligations under the contract. For industrial and consumer purchase orders, we typically receive payments within 30 to 60 days of shipments of the product, although for some purchase orders, we may require an advanced payment prior to shipment of the product. To determine the proper revenue recognition method for complex contracts with the same customer, we evaluate whether two or more contracts should be combined and accounted for as one single contract and whether the combined or single contract should be accounted for as more than one performance obligation. This evaluation requires significant judgment and the decision to combine a group of contracts or separate the combined or single contract into multiple performance obligations could change the amount of revenue and profit recorded in a given period. For most of our development contracts and contracts with the U.S government, the customer contracts with us to provide a significant service of integrating a set of components into a single unit. Hence, the entire contract is accounted for as one performance obligation. Less common, however, we may promise to provide distinct goods or services within a contract in which case we separate the contract into more than one performance obligation. If a contract is separated into more than one performance obligation, we allocate the total transaction price to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised goods or services underlying each performance obligation. In cases where we sell standard products, the observable standalone sales are used to determine the standalone selling price.

The Company recognizes revenue from a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable. For certain contracts that meet the foregoing requirements, primarily international direct commercial and military sale contracts, we recognize revenue once we have obtained all regulatory approvals. Commencing in 2018 for certain contracts with the U.S. government, the Company recognizes revenue over time as we perform because of continuous transfer of control to the customer and the lack of an alternative use for the product. The continuous transfer of control to the customer is supported by liability clauses in the contract that allow the U.S. government to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit and take control of any work in process. For contracts with commercial customers while the contract may have a similar liability clause, our products historically have an alternative use and thus, revenue is recognized at a point in time.

In situations where control transfers over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. We generally use the cost-to-cost approach to measure the extent of progress towards completion of the performance obligation for our contracts because we believe it best depicts the transfer of assets to the customer, which occurs as we incur costs on our contracts. Under the cost-to-cost measure approach, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenues are recorded proportionally as costs are incurred.

Accounting for design, development and production contracts requires judgment relative to assessing risks, estimating contract revenues and costs, and making assumptions for schedule and technical issues. Due to the size and nature of the work required to be performed on many of our contracts, the estimation of total revenue and cost at completion is complicated and subject to many variables. Contract costs include material, labor and subcontracting costs, as well as an allocation of indirect costs. We have to make assumptions regarding the number of labor hours required to complete a task, the complexity of the work to be performed, the availability and cost of materials, and performance by our subcontractors. For contract change orders, claims or similar items, we apply judgment in estimating the amounts and assessing the potential for realization. These amounts are only included in contract value when they can be reliably estimated and realization is considered probable. If our estimate of total contract costs or our determination of whether the customer agrees that a milestone is achieved is incorrect, our revenue could be overstated or understated and the profits or loss reported could be wrong.

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For our commercial customers, the Company's revenue is recognized when obligations under the terms of a contract with our customer is satisfied; generally this occurs with the transfer of control of the Company's products or services. Revenue is recorded as the amount of consideration we expect to receive in exchange for transferring goods or providing services. Provisions for product returns and allowances are recorded in the same period as the related revenues. We analyze historical returns, current economic trends and changes in customer demand and acceptance of product when evaluating the adequacy of sales returns and other allowances. Certain product sales are made to distributors under agreements allowing for a limited right of return on unsold products. Sales to distributors are primarily made for sales to the distributors' customers and not for stocking of inventory. We delay revenue recognition for our estimate of distributor claims of right of return on unsold products based upon our historical experience with our products and specific analysis of amounts subject to return based upon discussions with our distributors or their customers. Sales, value add and other taxes we collect concurrent with revenue-producing activities are excluded from revenue.

The rights and benefits to the Company's intellectual property are conveyed to certain customers through technology license agreements. These agreements may include other performance obligations including the sale of product to the customer. When the license is distinct from other obligations in the agreement, the Company treats the license and other performance obligations as separate performance obligations. Accordingly, the license is recognized at a point in time or over time based on the standalone selling price. The sale of materials are recognized at a point in time, which occurs with the transfer of control of the Company's products or services. In certain instances, the Company is entitled to sales-based royalties under license agreements. These sales-based royalties are recognized when they are earned. The cumulative effect of the changes made to the Company's consolidated December 31, 2017 balance sheet for the adoption of ASU 2014-09, Revenue from Contracts with Customers (Topic 606) was as follows:

Balance Sheet	Balance at December 30, 2017	Adjustments due to Topic 606	Balance at December 31, 2017
Assets			
Contract assets and unbilled receivables	\$704,863	\$2,850,274	\$3,555,137
Inventory	5,080,797	(1,082,629)	3,998,168
Other assets	3,842,068	400,000	4,242,068
Liabilities			
Contract liabilities and billings in excess of revenue earned	1,555,883	(891,737)	664,146
Stockholders' equity			
Accumulated Deficit	\$(240,121,901)	\$3,059,382	\$(237,062,519)

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In accordance with the new revenue standard requirements, the impact of adoption on the Company's condensed consolidated statement of operations was as follows:

Statement of Operations	As Reported	Three Months Ended June 30, 2018	
		Balances Without Adoption of Topic 606	Effect of Change Higher/(Lower)
Net product revenues	\$4,472,079	\$4,483,933	\$ (11,854)
Research and development revenues	1,471,819	1,558,363	(86,544)
Cost of product revenues	3,497,750	3,495,042	2,708
Net loss attributable to Kopin Corporation	\$(9,240,957)	\$(9,139,851)	\$ (101,106)

Statement of Operations	Six Months Ended June 30, 2018	
	As Reported	

Ü Long-Term Incentives

The long-term incentive plan is designed to align the goals of our NEOs with those of our shareholders. Long-term incentive compensation is provided through the Company's 2013 LTIP, which authorized the issuance of a maximum 450,000 shares of Company common stock, of which 401,000 shares remained available at year-end 2015.

The 2013 LTIP allows for multiple equity forms, such as restricted stock and stock options. Historically, the Company has provided long-term incentive compensation only in the form of stock options, which only provide value to our NEOs or any eligible recipients if the Company's stock price increases. The long-term incentive component of our executive compensation program is intended to recognize Management collaboration and drive shareholder value creation, which encourages alignment of our NEOs' interests with those of our shareholders. Equity awards are discretionary and when awarded by the Compensation Committee, typically reflect, to some degree, the Company's and the individual's prior-year performance. Stock options granted under our long-term incentive plan normally vest 25% per year over a four-year period, which reinforces the long-term nature of the grant and promotes retention of our top performers. The exercise price for stock option awards is set at 100% of the market closing price of the stock on the date of grant. The Company's annual stock option awards are generally granted at the same time each year, in January, shortly after the close of the Company's fiscal year. Furthermore, the provisions of our long-term incentive plan do not allow "backdating" or "reloading" of option grants. Repricing of our stock option grants is only permitted with shareholder approval.

Ü Stock Ownership Guidelines

In order to better align the interests of the NEOs with those of our shareholders, the Company adopted stock ownership requirements for our NEOs in January 2011. Under our Stock Ownership Guidelines, the NEOs are required to own a number of shares of the Company's common stock equal to three times base salary for the CEO and one time base salary for other NEOs. Until the required ownership is attained, this policy restricts the NEO's ability to sell shares of the Company's common stock obtained through the LTIP. These stock ownership requirements are measured by the Compensation Committee each year, using holdings valued as of December 31 of the previous year. Common shares owned outright or vested shares held through benefit plans are currently counted toward the stock ownership requirement. Conversely, unexercised stock options do not count toward the stock ownership requirement. Individuals have five years from appointment or promotion as an NEO to meet these requirements. The independent members of the Board have the discretion to address and approve exceptions on a case-by-case basis.

Ü Executive Benefits

The executive benefit program is intended to provide appropriate security and benefits for our NEOs, allowing them to focus on managing the business. Generally, NEOs are eligible for the benefits package we offer to our full-time

employees, which includes medical, dental, life/long-term disability insurance and qualified retirement plans. In addition, our executive compensation program includes other select benefits summarized below. These benefits are provided in furtherance of the goal of providing NEOs with a comprehensive and competitive compensation package, taking into consideration both market and best practices. All forms of executive benefits are reviewed and approved by the Compensation Committee.

Broad-based and Select Executive Retirement Plans: The Company provides a qualified retirement plan (with a non-matching 401(k) feature) as well as an ESOP to all eligible full-time employees, including NEOs. The Company may provide additional retirement benefits to NEOs on a case-by-case basis, either through the Company's non-qualified Supplemental Executive Retirement Plan ("SERP") or through individual awards to NEOs of additional retirement benefits under some other tax-qualified or nonqualified plan or program. There are two types of awards under the SERP, each of which may be granted at the Compensation Committee's discretion: (i) a "makeup" benefit that is designed to provide the recipients with a level of benefit that they would have received under the Retirement Plan if there were no limitations on eligible compensation in the Internal Revenue Code, and (ii) an additional award of special retirement benefits to any NEO or other senior executive prior to his or her retirement to reward special service and contribution to the Company. As of December 31, 2015, Messrs. T. Murphy, Goodemote and DeMarco were all designated to participate in the makeup benefit feature under the first part of the SERP.

Deferred Compensation Plan: The Company maintains a nonqualified deferred compensation plan for NEOs, under which they may elect to defer some or all of their salary and bonus until retirement. The deferred amounts accumulate interest at a rate equal to the highest rate currently being paid on individual retirement accounts by GFNB. Although all of the NEOs were eligible to participate, none did in 2015. This deferral plan is further discussed in "Nonqualified Deferred Compensation" within the Executive Compensation section.

Executive Perquisites: The Company provides very limited perquisites to its NEOs. In 2015, Messrs. T. Murphy, Goodemote, DeMarco and Kaiser each received the personal use of a company automobile and reimbursement of country club dues or a golf course membership. No other perquisites were provided.

Employment Agreements with Named Executive Officers: Historically, the Company has entered into employment agreements or limited change-of-control agreements with its NEOs. The Company currently has three-year employment agreements with Messrs. T. Murphy and Goodemote and two-year agreements with Messrs. DeMarco and Kaiser. In January of each year, the Compensation Committee reviews the key terms of each NEO employment agreement and determines whether to offer the NEO a replacement agreement of at least the same duration and is otherwise at least as favorable to the NEO as his current agreement. Effective February 1, 2016, the Company entered into new employment agreements with the NEOs.

The replacement employment agreements entered into with each of the NEOs contain standard terms relating to salary, position, duties and benefits, as well as special cash payments following a change of control of the Company accompanied or followed by a termination of the NEO's employment by the Company other than for cause or by the NEO himself for good reason. These agreements do not provide any right to receive a payment under the STIP, to receive stock awards under the LTIP, or to receive any additional retirement benefits under our retirement plan or SERP. The Compensation Committee and our Board will continue to review the appropriateness of employment agreements on a case-by-case basis. These employment agreements are described in more detail in the Agreements with Named Executive Officers section.

The Company from time to time enters into consulting agreements with retiring Executive Officers to ensure a smooth transition of an operating function from the retiree to his or her successor and/or to ensure the Company has access to the retiree's expertise for a period of time. Mr. Hoy, the Company's former CEO, serves under such a post-retirement consulting arrangement until December 31, 2018; this agreement is further described in "Mr. Hoy's Consulting Agreement" within the Voting Item 1 – Election of Directors section.

The Company believes these five components – base salary, annual incentives, long-term incentives, ownership guidelines and executive benefits – comprise a total compensation program that both aligns pay and performance and supports a total rewards approach to executive compensation. Our executive compensation program is reviewed at least annually by the Compensation Committee to ensure that various considerations such as security versus

performance, fixed versus variable, short-term versus long-term, cash versus equity-based compensation, and benefits provided are and remain appropriate in light of market trends and the Company's primary business objectives. Our policy and practice is to consider the Company's performance compared to peer and industry performance, as well as market compensation levels, when making our short- and long-term compensation decisions to ensure our compensation package effectively reflects performance.

2015 Process for Determining Executive Compensation:

Ü Role of the Compensation Committee, Independent Consultants and Management

The Compensation Committee oversees our executive compensation policies and process, is responsible for the final decisions on many components of executive compensation for the CEO and the other NEOs, and makes recommendations to the full Board on other components such as employment agreements. The Compensation Committee is responsible for reviewing and approving all aspects of compensation of our CEO and other NEOs, and it receives input from the CEO and the full Board on key compensation policy issues. Each of the five Directors who serve on the Compensation Committee meet the general independence test for directors, as well as the particular independence qualifications for Compensation Committee members under the NASDAQ® listing requirements.

The Compensation Committee is authorized to seek the assistance of independent compensation consultants. These consultants are paid by the Company, but are hired by, directed by and report directly to the Compensation Committee. During 2015, the Compensation Committee retained the services of Pearl Meyer & Partners, LLC (“Pearl Meyer”), an independent outside consulting firm specializing in executive and board compensation, to provide assistance regarding executive compensation and support with compensation policies and proxy disclosure. Pearl Meyer provides no other consulting services for the Company.

Our CEO provides the Compensation Committee with an annual review of his own goals for the Company, including broad performance and personal goals, as well as a performance assessment for each of the other NEOs. Management also provides information and data on Company and individual performance and executive compensation to the Compensation Committee. Although our CEO provides insight and recommendations regarding NEO compensation, it is the Compensation Committee that votes on decisions regarding NEO compensation. Where appropriate, the Board will also make recommendations or determinations or give its approval regarding NEO compensation. Although the Compensation Committee meets with our CEO to obtain his views, goals and assessments regarding compensation matters, as discussed above, the decisions regarding his compensation package are made solely by the Compensation Committee without the CEO or other NEOs present.

Ü Benchmarking

In setting program targets and making compensation decisions, the Compensation Committee uses a variety of data sources and information related to market practices for bank holding companies similar to the Company. The Compensation Committee may engage independent compensation consultants on a periodic basis to conduct comprehensive competitive reviews.

The Compensation Committee relies on three key reports, as summarized below, to ascertain market-competitive guidelines for base salary, short- and long-term incentive targets, and estimated total direct compensation, with ranges for performance. The guidelines allow the Compensation Committee to see the potential pay and range of pay for each executive role and provide a framework for consideration by the Compensation Committee in setting targeted pay levels going forward.

Each year, the Compensation Committee reviews peer group data – from the Executive Compensation Review for Banks and Thrifts prepared annually by SNL Financial (“SNL”) – to obtain executive compensation and performance data relative to a peer group. Further, the Compensation Committee reviews annually a survey compiled by Management of the executive compensation paid by regional and local financial institutions based on the most recent proxy statements filed by those institutions with the SEC. Both the SNL and Management surveys are updated annually.

In addition, the Compensation Committee periodically commissions an independent outside consulting firm to conduct a comprehensive review of the Company’s executive compensation program. In 2015, Pearl Meyer was hired to revise and update the comprehensive review it previously prepared in 2012. The purpose of the 2015 Pearl Meyer

report (the “Pearl Meyer Report”) was to provide an independent and objective analysis of all elements of compensation, individually and in aggregate, relative to market and peer group practices. Pay mix and an assessment of the pay-for-performance relationship were also presented to the Compensation Committee to provide foundational information to support compensation decisions for Management.

A primary data source used in the Pearl Meyer Report for determining the competitive market for the compensation of our NEOs was the information publicly disclosed by a peer group of other publicly traded banks. This peer group, which is larger than the peer group that Management has used in its recent annual reviews for the Committee of the executive compensation being paid by our peers, was developed by Pearl Meyer using objective parameters that reflect bank holding companies of similar asset size located in our general geographic region.

The 2015 peer group contained in the Pearl Meyer Report, which is listed below, consisted of 18 bank holding companies in Connecticut, Maine, Massachusetts, New Jersey, Ohio, Pennsylvania, Virginia and Vermont that ranged from approximately \$1 billion to \$3 billion in assets, positioning the Company at approximately the median for size (\$2.2 billion in assets):

Blue Hills Bancorp, Inc.	First Connecticut Bancorp, Inc.	Peapack-Gladstone Financial Corp.
Camden National Corp.	First Defiance Financial Corp.	Peoples Bancorp Inc.
Citizens & Northern Corp.	Hampton Roads Bankshares, Inc.	Peoples Financial Services Corp.
CNB Financial Corp.	Merchants Bancshares, Inc.	Sun Bancorp, Inc.
Enterprise Bancorp, Inc.	OceanFirst Financial Corp.	Univest Corporation of Pennsylvania
First Community Bancshares, Inc.	Orrstown Financial Services, Inc.	Westfield Financial, Inc.

In addition to the regional peer group data, the Pearl Meyer Report used data from other banking industry surveys that reviewed bank holding companies of similar asset size and regions to that of the Company.

Ü Performance Analysis

In addition to benchmarking, the Compensation Committee and Board also review the Company's performance relative to other bank holding companies in a broader peer group as defined in the Federal Reserve Bank's "Bank Holding Company Performance Report," which contains data from a peer group consisting of all U.S. bank holding companies with between \$1.0 billion and \$3.0 billion in total assets (the "Fed Peer Group").

Set forth below is a comparison between the Company's financial performance across several key performance metrics for the 12-month period ended December 31, 2015, and the performance across these same metrics for the nine-month period ended September 30, 2015, by the Fed Peer Group – the most recent information available at the time the Compensation Committee met in January to review performance.

This comparison shows that the Company continued to be among the top-performers and that our operating results and asset quality ratios withstood the ongoing stresses of the financial sector, including the historically low interest rate environment that continued in 2015 better than many of our competitors in this national peer group.

Key Performance Metric	Arrow Financial Corporation 12/31/2015	Federal Reserve Bank Peer Data 09/30/2015
Profitability Ratios (Higher is Better)		
ROA – Return on Average Assets	1.05%	0.93%
ROE – Return on Average Equity	11.86%	8.61%
Asset Quality (Lower is Better)		
Net Loans Charged-Off as a Percentage of Average Loans	0.06%	0.08%
Nonperforming Loans as a Percentage of Period-End Loans	0.44%	0.87%
Efficiency Ratio (Lower is Better)	58.09%	68.24%

Executive Compensation Decisions:

Ü January 2015 Base Salary Decisions

The Compensation Committee met in January 2015 to review corporate and individual executive performance for 2014. Please see our 2015 Proxy Statement and our 2014 Annual Report on Form 10-K for a detailed review of the Company's 2014 financial performance.

Based on the performance of the Company and the individuals, the Compensation Committee approved the base salaries below for the Named Executive Officers effective January 1, 2015. In addition to merit, Mr. DeMarco's 2015 salary increase included the second in a two-part market adjustment.

Named Executive Officer	2014 Salary	January 2015 Raise % of Base Salary	Amount	2015 Salary
Thomas J. Murphy	\$306,000	4.6%	\$14,000	\$320,000
Terry R. Goodemote	\$235,000	—	—	\$235,000
David S. DeMarco	\$225,000	7.6%	\$17,000	\$242,000

Ü January 2016 Base Salary Decisions

The Compensation Committee met in January 2016 to review corporate and individual executive performance for 2015. Please see "2015 Business Performance" earlier in this section and our 2015 Annual Report on Form 10-K for a detailed review of the Company's 2015 financial performance.

Based on the performance of the Company and the individuals, the Compensation Committee approved the base salaries below for the Named Executive Officers effective January 1, 2016.

Named Executive Officer	2015 Salary	January 2016 Raise % of Base Salary	Amount	2016 Salary
Thomas J. Murphy	\$320,000	3.75%	\$12,000	\$332,000
Terry R. Goodemote	\$235,000	2.13%	\$5,000	\$240,000
David S. DeMarco	\$242,000	3.31%	\$8,000	\$250,000
David D. Kaiser	\$200,000	5.00%	\$10,000	\$210,000

Ü Short-Term Incentive Award Decisions

In determining the short-term incentive bonus awards for NEOs at any year-end, the Compensation Committee carefully considers the recent financial performance of the Company, strategic results such as product and market expansion, as well as individual performance factors such as leadership and commitment to the community. The amounts of such awards are principally determined based on the achievement of pre-established Company performance targets, as well as an overall individual assessment. See "Annual Incentives" earlier in this section for further detail.

At a meeting in January 2016, the Compensation Committee reviewed the parameters and results of the 2015 short-term incentive bonus award goals for its NEOs. Based on the final results of the Company's performance, the amounts of the short-term incentive bonus awards to be paid under the STIP were determined for Messrs. T. Murphy, Goodemote, DeMarco and Kaiser. As noted earlier in this section, the Compensation Committee uses an Internal NOE calculation to measure its performance goals. Internal NOE is calculated on a basis other than GAAP, in that Internal NOE represents the net income of the Company before significant nonrecurring items, net of tax. The decision by the Compensation Committee to eliminate significant nonrecurring items from the award review process could result in an Internal NOE that is higher or lower than net income reported in conformity with GAAP.

In 2015, the Internal NOE was lower than GAAP net income (i.e., GAAP net income was \$24.662 million while the Internal NOE used to calculate the short-term incentive bonus awards was \$24.461 million, or approximately \$201,000 less). This was the result of the exclusion of net gains recognized by the Company on the sale of long-term investments. The Compensation Committee determined that exclusion of these items and the consideration of

additional factors were appropriate for purposes of determining the annual STIP bonus awards and resulted in lower annual awards to the NEOs than would have been the case without the exclusion and factors.

The following table provides a comparison of the Company's 2015 target performance goals, the 2015 actual results and 2015 peer data (through September 30, 2015) drawn from the Federal Reserve Bank's Bank Holding Company Performance Report. The weighting used by the Compensation Committee in determining annual awards is described earlier in this section. The Federal Reserve Bank Peer Group Data provided in this table consisted of all U.S. Bank Holding Companies having between \$1.0 billion and \$3.0 billion in total assets. The September 30, 2015, peer group data was the most recent available during the Compensation Committee's review at the January 2016 meeting.

Performance Measure	2015 Goal	2015 Actual	Federal Reserve Bank Peer Data 09/30/15
Net Operating Earnings "Internal NOE"	\$24.0 million	\$24.461 million	N/A
ROE using Internal NOE (Higher is Better)	> 12%	11.76%	8.61%
Efficiency Ratio (Lower is Better)	< 57%	58.21%	68.24%
Non-Performing Loans (Lower is Better)	< .50%	0.44%	0.87%
Net Charge-Offs (Lower is Better)	< .15%	0.06%	0.08%

The Company's financial performance for 2015 was above many of the established target levels and exceeded peer group performance across these metrics, based on the performance of the Fed Peer Group. The amount of the STIP award for each individual NEO was based upon these corporate considerations, as well as individual performance toward the established 2015 goals. The Compensation Committee approved the following 2015 STIP awards at its January 2016 meeting:

Named Executive Officer	2015 Annual Incentive Target Award		2015 Annual Incentive Actual Awards	
	Amount	% of Base Salary	Amount	% of Base Salary
Thomas J. Murphy	\$128,000	40%	\$125,000	39.1%
Terry R. Goodemote	\$70,500	30%	\$60,000	25.5%
David S. DeMarco	\$72,600	30%	\$72,500	30.0%
David D. Kaiser	\$60,000	30%	\$60,000	30.0%

January 2015 Long-Term Incentive Award Decisions

At its January 2015 meeting, the Compensation Committee decided to make stock option awards consistent with the grants of January 2014. The following stock option awards were granted at an exercise price of \$25.86, the closing price of our common stock on the date of grant, and vest ratably over a four-year period:

Named Executive Officer	Stock Option Grants in January 2015 (# shares)	Grant Date Fair Value of January 2015 Option Awards
Thomas J. Murphy	10,000	\$57,827
Terry R. Goodemote	5,000	\$28,913
David S. DeMarco	5,000	\$28,913
David D. Kaiser	2,500	\$14,457

Ü January 2016 Long-Term Incentive Award Decisions

At its January 2016 meeting, the Compensation Committee decided to make stock option awards consistent with the grants of January 2015. The following stock option awards were granted at an exercise price of \$25.85, the closing price of our common stock on the date of grant and vest ratably over a four-year period:

Named Executive Officer	Stock Option Grants in January 2016 (# shares)	Grant Date Fair Value of January 2016 Option Awards
Thomas J. Murphy	10,000	\$57,707
Terry R. Goodemote	5,000	\$28,853
David S. DeMarco	5,000	\$28,853
David D. Kaiser	5,000	\$28,853

Other Compensation-Related Matters:

Ü Risk Oversight

The Company carefully monitors its compensation levels to ensure they reflect an appropriate balance of pay-for-performance within acceptable risk parameters. We believe incentive compensation awards should be aligned with the institution's overall business strategy and support its desired risk profile. To that end, each year Management conducts an internal compensation risk assessment to understand the various elements of its overall compensation program, including all incentives. As part of the exercise, in 2015, Management completed an inventory of our existing compensation programs, including incentives; evaluated the plans; determined the existence of Management and Committee oversight; considered appropriate risk mitigants; and assigned a risk rating based on documentation to support these controls. The Company recognizes that an effective incentive program should encourage and reward appropriate performance and requires an appropriate amount of risk-taking, which is in the long-term benefit of the Company and shareholders. Based on our evaluation, the Company has determined its compensation programs and policies do not create excessive and unnecessary risk taking. Our determination is supported by the following key attributes:

• Our compensation program contains an appropriate balance of fixed and variable compensation.

• The Company offers incentive compensation in multiple forms, including, historically, the award of stock options that are tied to multi-year performance.

• Our STIP contains both a threshold and maximum payment, protecting the Company from the extreme levels of risk that accompany unlimited upside incentive compensation programs and inappropriate pay and performance alignment. Although there is a formula for determining the dollar amount of the annual STIP bonus awards, the Compensation Committee retains full discretion for making STIP bonus awards to all our Executive Officers. There have been years in which these awards could have been made based on the formula but were not given to the Executive Officers.

• The Company has share ownership guidelines that further promote and incentivize long-term thinking to serve the best interests of the Company.

• Our benefits programs are competitive with the market and provide for reasonable base line levels of health, welfare and security, further enhancing the risk-mitigating aspects of our overall program.

• We have adopted a "clawback" policy that will allow us to seek to recover any incentive paid or payable to an Executive Officer on the achievement of financial or operational goals that subsequently are deemed by the Company to be inaccurate, misstated or misleading.

The Company and its Board, including the Compensation Committee, will continue to ensure that proper policies are maintained to monitor ongoing risk management and assessment of compensation practices.

Ü Hedging and Pledging Policies

The Board has hedging and pledging policies for its Directors and Executive Officers who are subject to the SEC's Section 16 reporting requirements. The policy prohibits Directors and Section 16 Officers from entering into financial transactions designed to hedge or offset any decrease in market value of Company common stock. In addition, Directors and Section 16 Officers must obtain Board approval prior to entering into any agreement involving the pledge or other use of Company stock as collateral in a financial arrangement.

Ü Impact of Accounting and Tax on the Form of Compensation

The Compensation Committee and Management consider the accounting and individual and corporate tax consequences of the compensation plans prior to making changes. The Compensation Committee has considered the impact of the expense, which will be recognized by the Company in accordance with FASB ASC TOPIC 718, on the Company's use of equity incentives.

Section 162(m) of the Internal Revenue Code limits deductibility by the Company of non-exempt taxable compensation paid to NEOs to a maximum of \$1 million per annum. Taxable compensation is exempt from this limit on deductibility if it is "performance-based." In the Company's case, neither base salary nor STIP payments are considered performance-based, hence neither would be exempt from "compensation" for purposes of measuring an NEO's compensation in any year against the \$1 million deductible limit. Conversely, compensation income realized by NEOs upon exercise of stock options granted under our LTIP is deductible from the definition of "compensation." Based on the current salaries being paid to our NEOs and the expected range of possible future performance awards that might be paid to our NEOs in upcoming years, the Company does not believe that the non-deductibility for tax purposes of any component of the compensation payable to its NEOs under Section 162(m) is a likely concern but will continue to evaluate this issue in future years.

Compensation Committee Report:

The Compensation Committee of the Board has reviewed and discussed with Management the Compensation Discussion and Analysis section, as required by Item 402(b) of the SEC's Regulation S-K and the Compensation Committee's Charter. Based on its review and discussion, the Compensation Committee has recommended to the Board that the Compensation Discussion and Analysis be included in this Proxy Statement.

David G. Kruczynski, Chairman Michael B. Clarke
Gary C. Dake Elizabeth O'Connor Little
William L. Owens

Executive Compensation

This Executive Compensation section includes several tables with details of the compensation actually paid and/or awarded to certain Named Executive Officers of the Company (the NEOs) for each of the last three fiscal years.

Tables included in this section are:

Summary Compensation

Grants of Plan-Based Awards

Outstanding Equity Awards at Fiscal Year-End

Option Exercises and Stock Vested

Pension Benefits

Summary Compensation Table:

The following table sets forth information concerning total compensation paid to and compensatory awards received by each of the NEOs in each of the relevant years:

Name and Principal Position	Year	Salary	Bonus	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation	All Other Compensation	Total
							Earnings		
					(a)	(b)	(c)	(d)	
Thomas J. Murphy	2015	\$320,000	—	—	\$57,827	\$125,000	\$59,397	\$12,756	\$574,980
President and	2014	\$306,000	—	—	\$60,432	\$137,000	\$42,133	\$11,455	\$557,020
CEO	2013	\$300,000	—	—	—	\$100,000	\$17,299	\$9,154	\$426,453
Terry R.	2015	\$235,000	—	—	\$28,913	\$60,000	\$29,904	\$11,556	\$365,373
Goodemote	2014	\$235,000	—	—	\$30,216	\$69,000	\$41,663	\$10,255	\$386,134
Executive Vice									
President,	2013	\$230,000	—	—	—	\$56,500	\$17,369	\$8,057	\$311,926
Treasurer									
and CFO									
David S. DeMarco	2015	\$242,000	—	—	\$28,913	\$72,500	\$31,778	\$11,651	\$386,842
Senior Vice	2014	\$225,000	—	—	\$30,216	\$75,500	\$36,415	\$10,350	\$377,481
President	2013	\$210,000	—	—	—	\$53,000	\$24,318	\$7,962	\$295,280
David D. Kaiser									
Senior Vice	2015	\$200,000	—	—	\$14,457	\$60,000	\$28,993	\$11,054	\$314,504
President (e)									

This column sets forth the dollar value of option awards granted under the Company's compensatory stock plans for each of the listed years, calculated in accordance with FASB ASC TOPIC 718. No stock options were granted to NEOs or other employees in 2013. The estimated value of each stock option granted in 2014 was \$6.04 per option share (all grants made on January 29, 2014, under the 2013 LTIP) and the estimated value of each stock option granted in 2015 was \$5.78 per option share (all grants made on January 28, 2015, under the 2013 LTIP), in each case using the Black-Scholes model to estimate fair value. All such stock options vest ratably in equal installments over the first four anniversaries following the date of grant.

- (b) This column sets forth the short-term incentive bonus payments made under the Company's STIP for each of the listed years, based on the financial performance of the Company, strategic Company results and individual performance factors during that year. STIP amounts payable for a given year are generally paid in January of the succeeding year.

- (c) This column sets forth the actuarial increase during each of the listed years in the present value of the retirement benefits under qualified pension plans and nonqualified deferred compensation plans established by the Company that cover such NEO, determined using interest rate, mortality rate and other assumptions consistent with those used in the Company's financial statements. The increase in present value of retirement benefits reported for each of the NEOs for 2015 includes (i) under the Company's Employees' Pension Plan ("Pension Plan"), \$30,510 for Mr. T. Murphy, \$23,128 for Mr. Goodemote, \$26,234 for Mr. DeMarco, and \$28,993 for Mr. Kaiser and (ii) under the Company's SERP, \$28,887 for Mr. T. Murphy, \$6,776 for Mr. Goodemote and \$5,544 for Mr. DeMarco.

- (d) All Other Compensation includes the following components for 2015:

Name	Company Contribution to ESOP	Life Insurance Premiums Paid by Company for Benefit of NEO	Dollar Value of Discount in Share Price for Company Common Stock Purchased Under Employees' Stock Purchase Plan	Total Other Compensation
Thomas J. Murphy	\$11,108	\$385	\$1,263	\$12,756
Terry R. Goodemote	\$11,108	\$385	\$63	\$11,556
David S. DeMarco	\$11,108	\$385	\$158	\$11,651
David D. Kaiser	\$10,490	\$375	\$189	\$11,054

(e) Mr. Kaiser became an Executive Officer of the Company on January 28, 2015.

Grants of Plan-Based Awards Table:

As noted in the Compensation Discussion and Analysis, the Company provides officers and key employees with both an annual short-term incentive plan (STIP) and a long-term incentive plan (LTIP) to attract and retain such officers and employees and to motivate them to improve the Company's short- and long-term performance, respectively.

The STIP bonus payable to covered individuals, including NEOs, is based on a comprehensive quantitative and qualitative assessment of both Company and individual performance. The target incentive awards, if awards are made for the year, are defined as a percentage of the covered person's base salary. For 2015, the STIP bonus target incentive awards for the NEOs were 40% of base salary for Mr. T. Murphy and 30% of base salary for Messrs. Goodemote, DeMarco and Kaiser. The amounts listed in the table below represent each NEO's 2015 target incentive award, as well as his threshold incentive award (50% of target) and maximum incentive award (150% of target). The Compensation Committee, in its sole discretion, will determine on a case-by-case basis whether an NEO will receive a STIP bonus payment for the year and, if so, the amount of this bonus, which typically falls within the limits set forth above. Because a STIP bonus payment is discretionary, no NEO has a contractual right to a bonus under the STIP, even if the pre-established quantitative performance standards for the Company or the Company function for which the NEO is responsible have been met, or the NEO's individual performance standards have been met. There have been years in which the Company and the NEOs have satisfied their quantitative or individual performance targets but no STIP bonuses have been declared or paid, as determined by the Compensation Committee.

Historically, the Company has limited its grants of stock-based awards under its long-term incentive plans to stock options. The Company's 2013 LTIP and its predecessor plans allow for the granting of stock options and other stock-based awards as a long-term incentive component within our overall compensation program.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares or Units	All Other Option Awards: Number of Securities Underlying Options	Grant Exercise or Base Price of Option (\$/Share)	Grant Date Fair Value of Stock and Option Awards
		Threshold (a)	Target	Maximum	Threshold	Target	Maximum				
Thomas J. Murphy	— 1/28/15	\$64,000	\$128,000	\$192,000	—	—	—	—	— 10,000	— \$25.86	— \$57,827
Terry R. Goodemote	— 1/28/15	\$35,250	\$70,500	\$105,750	—	—	—	—	— 5,000	— \$25.86	— \$28,913
	—	\$36,300	\$72,600	\$108,900	—	—	—	—	—	—	—

David S. DeMarco	1/28/15								5,000	\$25.86	\$28,913
David D. Kaiser	1/28/15	—	\$30,000	\$60,000	\$90,000	—	—	—	—	—	—
									2,500	\$25.86	\$14,457

The threshold incentive award to any covered person under the STIP, including an NEO, is not the minimum bonus payment such person may receive under the STIP. The Compensation Committee may choose to pay a bonus under (a) the STIP to any covered person, including an NEO, that is less than the threshold incentive award for such person, or not to pay such person any bonus under the STIP, even if applicable performance thresholds or targets have been met by the Company and/or such person for the year in question.

Outstanding Equity Awards at Fiscal Year-End Table:

The following table shows all outstanding stock-based awards held by each NEO as of December 31, 2015. All such awards consist of stock options to acquire the Company's common stock granted under the Company's 2013 LTIP or its predecessor plans. The number of shares and exercise prices on this table have been adjusted for the 2% stock dividend distributed on September 28, 2015.

Name	Securities Underlying Unexercised Options (Exercisable)	Securities Underlying Unexercised Options (a)	Equity Incentive Plan Awards: Securities Underlying Unexercised Options	Option Exercise Price	Option Expiration Date	Shares or Units of Stock Not Vested	Market Value of Shares or Units of Stock Not Vested	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights Not Vested	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights Not Vested
Thomas J. Murphy	2,789	—	—	\$22.85	1/26/2021	—	—	—	—
	8,118	2,706	—	\$23.48	1/25/2022	—	—	—	—
	2,601	7,804	—	\$24.03	1/29/2024	—	—	—	—
	—	10,200	—	\$25.35	1/28/2025	—	—	—	—
	3,000	—	—	\$18.35	11/28/2017	—	—	—	—
Terry R. Goodemote	4,139	—	—	\$19.10	1/21/2019	—	—	—	—
	4,019	—	—	\$21.40	1/27/2020	—	—	—	—
	3,903	—	—	\$22.85	1/26/2021	—	—	—	—
	4,059	1,353	—	\$23.48	1/25/2022	—	—	—	—
	1,300	3,902	—	\$24.03	1/29/2024	—	—	—	—
David S. DeMarco	—	5,100	—	\$25.35	1/28/2025	—	—	—	—
	4,019	—	—	\$21.40	1/27/2020	—	—	—	—
	3,903	—	—	\$22.85	1/26/2021	—	—	—	—
	2,841	947	—	\$23.48	1/25/2022	—	—	—	—
	1,300	3,902	—	\$24.03	1/29/2024	—	—	—	—
David D. Kaiser	—	5,100	—	\$25.35	1/28/2025	—	—	—	—
	3,046	—	—	\$20.41	11/29/2016	—	—	—	—
	2,958	—	—	\$18.35	11/28/2017	—	—	—	—
	2,958	—	—	\$19.10	1/21/2019	—	—	—	—
	2,870	—	—	\$21.40	1/27/2020	—	—	—	—
David D. Kaiser	2,789	—	—	\$22.85	1/26/2021	—	—	—	—
	2,029	677	—	\$23.48	1/25/2022	—	—	—	—
	650	1,951	—	\$24.03	1/29/2024	—	—	—	—
	—	2,550	—	\$25.35	1/28/2025	—	—	—	—

(a) All stock options vest ratably in equal installments over the first four anniversaries following the date of the grant.

Option Exercises and Stock Vested Table:

The following table sets forth information regarding the stock options that were exercised by each NEO during 2015:

Name	Option Awards		Stock Awards	
	Number Shares Acquired on Exercise	Value Realized on Exercise (b)	Number Shares Acquired on Vesting	Value Realized on Vesting
	(a)			
Thomas J. Murphy	—	—	—	—
Terry R. Goodemote	4,794	\$39,116	—	—
David S. DeMarco	4,264	\$34,325	—	—
David D. Kaiser	—	—	—	—

(a) Represents the total number of shares subject to stock options that the NEO exercised during the year.

Represents the “spread” of options on the date of exercise, i.e., the difference between the dollar value of the shares

(b) of common stock for which options were exercised, based on the market price of our common stock on the date of exercise, and the exercise price (purchase price) of such shares under the options.

Pension Benefits Table:

The Company maintains a qualified retirement plan for eligible employees who have attained the age of 18, completed one year of service and work a minimum of 1,000 hours per calendar year. Eligible compensation under the retirement plan includes salary, overtime, sick pay, bonuses and other cash and non-cash benefits.

Participants in the retirement plan with 25 years of service may retire at any age, participants with 10 years of service may retire at or after age 55, and participants with five years of service may retire at or after age 65. For early retirement prior to age 65, annuity payments, if elected, would be reduced by 0.25% for each month the participant elects to retire before age 65. Participants who are eligible to retire may not commence receipt of their benefit prior to age 55.

The Company maintains an unfunded, non-qualified SERP, in part for the benefit of NEOs, as determined by the Compensation Committee on a case-by-case basis. The SERP contains both a qualified retirement plan “makeup” benefit feature and a special additional SERP benefit feature. For those NEOs who are selected to receive the “makeup” benefit feature, it provides enhanced installment payments post-retirement that are designed to give the NEO the overall level of retirement payments he would have received under the retirement plan if there were no limitations on eligible compensation to high-paid personnel in the Internal Revenue Code. Under the additional SERP benefit feature, the Company is authorized to grant to selected NEOs additional payments upon their retirement, typically structured as post-retirement installment payments, the amounts of which are determined on a case-by-case basis by the Compensation Committee at or before the time of retirement. At this time, Messrs. T. Murphy, Goodemote, and DeMarco have been selected by the Compensation Committee to participate in the “make-up” benefit feature of the SERP. None of the NEOs participate in the special additional benefit feature of the SERP.

The following table sets forth the present value of accumulated benefits under qualified and non-qualified retirement plans of the Company payable to each NEO as of December 31, 2015, and the number of years of service credited to them under the plans. The present value was determined using interest rate and mortality rate assumptions consistent with those described in Note 13 in Item 8 of the Company’s consolidated financial statements as of and for the fiscal year ended December 31, 2015, as included in the Company’s Annual Report on Form 10-K.

Name	Plan Name	Years of Credited Service	Value of Accumulated Benefit as of 12/31/15	Payments During Last Fiscal Year
Thomas J. Murphy	Retirement Plan	10.00	\$ 138,387	—
	SERP	3.00	\$ 50,511	—
Terry R. Goodemote	Retirement Plan	23.08	\$ 249,281	—
	SERP	3.00	\$ 13,547	—
David S. DeMarco	Retirement Plan	28.08	\$ 363,429	—
	SERP	3.00	\$ 5,762	—
David D. Kaiser	Retirement Plan	15.00	\$ 223,595	—
	SERP	N/A	N/A	N/A

Nonqualified Deferred Compensation:

The Company has an Executive Officer Deferred Compensation Plan (“Officers’ Deferral Plan”) under which an Executive Officer may elect on a year-to-year basis to defer until retirement all or a portion of his salary or bonus payments otherwise payable to him during and for such year. Amounts deferred earn interest at a rate equal to the highest rate currently being paid on individual retirement accounts by the Company’s principal subsidiary, GFNB. None of the NEOs elected to defer salary or bonus payments under the plan in 2015 or in previous years.

Agreements with Named Executive Officers

Employment Agreements:

The Company has employment agreements with Messrs. T. Murphy, Goodemote, DeMarco and Kaiser. Mr. T. Murphy serves as President and CEO; Mr. Goodemote serves as Executive Vice President, Treasurer and CFO; Mr. DeMarco serves as a Senior Vice President of the Company and President and CEO of SNB; and Mr. Kaiser serves as Senior Vice President. Effective February 1, 2016, each of these NEOs entered into new employment agreements with the Company, which replaced their prior employment agreements. The agreements of Messrs. T. Murphy and Goodemote are each for a three-year term and the agreements of Messrs. DeMarco and Kaiser are each for a two-year term. At the beginning of each calendar year, the Board is required under these agreements to consider and vote upon a proposal to replace each of the agreements with new, comparable agreements having similar terms, conditions and benefits.

Under each agreement, the NEO is guaranteed his current base annual salary and certain other benefits for the duration of the agreement. Also under each agreement, the NEO is entitled to participate in certain other benefit plans, including medical, dental and life insurance plans; is eligible (although not entitled to receive) cash awards under the short-term annual incentive bonus plan and equity-based awards under the long-term incentive plan; and is also eligible to participate in various retirement and supplemental retirement plans. In the event the NEO is terminated other than for cause or terminates his own employment for good reason, the NEO will receive a lump-sum payment equal to the greater of (i) the dollar amount of base salary payable during the remaining term of the agreement or (ii) one year’s base salary.

Additionally, under the agreements, if during the term of the agreement there is a change of control of the Company and, within 12 months after such change of control, either (i) the Company terminates the employment of the NEO other than for cause or (ii) such NEO terminates his own employment with the Company for good reason, the NEO will be entitled to receive an aggregate dollar amount, payable in installments over a two-year period following the date of his termination (or in a lump sum, in the event of unforeseeable emergency), equal to a multiple of 2.99 or two

times his average annual taxable compensation for the five years preceding the change of control, subject to downward adjustment to reflect the value of any other “change of control” payments or benefits he might receive following such change of control. In the cases of Messrs. T. Murphy and Goodemote, the multiple is 2.99 times such five-year average annual taxable compensation, and in the case of Messrs. DeMarco and Kaiser, two times such five-year average, subject, in each case, to downward adjustment to reflect the value of any other “change-of-control” payment or benefits the NEO might receive under other compensatory arrangements then in effect. In such circumstances, the NEO shall be entitled to receive medical, dental and life insurance coverage that is generally equivalent to the coverage then held by him on the date of

his termination, subject to employee cost-sharing, for a period of two years following such date. Under each agreement, the NEO will not receive any payment following a change of control to the extent such payment constitutes an “excess parachute payment” under the Internal Revenue Code.

Each of the employment agreements for Messrs. T. Murphy, Goodemote, DeMarco and Kaiser contain non-compete and non-solicitation provisions. For a period of two years following the termination of the NEO’s employment, for any reason, he is generally precluded from being employed by, an owner of, or adviser to any bank or insured financial institution located in any New York county in which the Company or its subsidiaries provide financial services, maintain a branch or office or have acted to establish a branch or office. Under the non-solicitation provision, for a period of two years following the NEO’s termination of employment for any reason, he is generally precluded from soliciting customers or clients of the Company or its subsidiaries on behalf of any other financial institution that provides financial services. The NEO is also precluded from employing or soliciting employees of the Company or its subsidiaries on behalf of another corporation or entity. The agreements also contain confidentiality and non-disparagement covenants in favor of the Company.

Potential Payments Upon Termination or Change of Control:

Ü Termination for Cause

In the event of a termination of any NEO for cause, the NEO in question would not receive any cash severance payment or enhanced retirement benefits beyond the benefits described in the “Pension Benefits Table” within the Executive Compensation section. Eligibility for regular Company severance or retirement payments is determined in a manner consistent with all employees of the Company under applicable Company plans and policies.

Ü Termination by the Company Other Than for Cause

If there is a termination of any of the NEOs by the Company other than for cause, the NEO is entitled under his current employment agreement with the Company to receive a lump-sum payment in an amount equal to the greater of (i) his base salary payable during the remaining term of the agreement or (ii) one year’s base salary. The table later in this section shows the estimated payout for Messrs. T. Murphy, Goodemote, DeMarco and Kaiser, had they been terminated by the Company other than for cause as of December 31, 2015. The Company does not have a formal written severance plan or policy that generally covers employees or executives who are terminated by the Company other than for cause; therefore, none of the NEOs would be entitled to any additional severance payments under any such policy or plan if terminated by the Company other than for cause. However, the Company does have a SERP, in which Executive Officers such as NEOs are eligible to participate, if so determined by the Compensation Committee. To date, Messrs. T. Murphy, Goodemote and DeMarco have been selected by the Compensation Committee to participate in the “make-up” benefits feature of the SERP, and none of the current NEOs have been selected to participate in the additional special benefits feature. For further information concerning the SERP, see the discussion accompanying the “Pension Benefits Table” in the Executive Compensation section. In the past, the Company has, from time to time at the discretion of the Board or its Compensation Committee, awarded severance payments to NEOs in differing amounts, determined on a case-by-case basis, even in cases where such payments were not required under the SERP or under the terms of any employment agreement between the Company and such officer. Except as discussed above, any termination by the Company of an NEO other than for cause would not generally result in enhanced retirement benefits beyond the benefits described in the “Pension Benefits Table” in the Executive Compensation section. (The foregoing discussion assumes that the hypothetical termination of an NEO by the Company other than for cause is not preceded by a change of control. Any such termination following a change of control may result in a greater payment to the NEO, as discussed later in this section.)

Ü Termination for Good Reason

Each of the current NEO employment agreements provides for payments to the NEO if he were to voluntarily terminate his employment for “good reason.” Good reason is defined as a (i) failure by the Company to offer the NEO an annual replacement agreement on terms, conditions and benefits comparable to his existing employment

agreement; (ii) material diminution in his title, authority, duties or responsibilities; (iii) required relocation of the NEO more than 100 miles from his existing base location of employment; or (iv) material breach by the Company of the NEO's employment agreement. Under each NEO's agreement, the amount due to the NEO if he were to terminate his employment for good reason during the term of the agreement, is a lump-sum payment equal to the greater of the amount of (i) his base salary payable during the remaining term of the agreement or (ii) one year's base salary. For a discussion of the impact of a voluntary termination by an NEO of his own employment on any retirement benefits due him under the Company's qualified retirement plan or under the Company's nonqualified SERP or any payments under any other severance plan or policy, see the discussion in the preceding section, "Termination by the Company Other Than for Cause." (The foregoing discussion assumes that the hypothetical termination of the NEO by the

Company other than for cause is not preceded by a change of control. Any such termination following a change of control may result in a greater payment to the NEO, as discussed later in this section.)

Ü Termination in Connection with a Change of Control

Under the employment agreements with each of the NEOs, certain payments are to be made by the Company to each NEO if, following a change of control of the Company, his employment is terminated without cause or he voluntarily terminates his employment for good reason. For the NEOs, the amounts that would have been payable to each had his employment been terminated as of December 31, 2015, by the Company or by such officer himself for good reason following a change of control are identified in tables later in this section. In addition, all of the outstanding stock options granted to these NEOs, to the extent not fully vested, would under the terms of such options vest immediately upon a change of control, regardless of whether the employment of such person is terminated or terminates on or after such change of control. Other than the foregoing, termination of any of the NEOs following a change of control would generally not result in enhanced retirement benefits beyond the benefits described in the “Pension Benefits Table” in the Executive Compensation section. Eligibility for other payments would be determined in a manner consistent with all Company employees under applicable plans and policies.

A “change of control” of the Company is defined in the employment agreements with NEOs as follows: (i) the acquisition by one person, or more than one person acting as a group, of ownership of stock of the Company that, together with stock held by such person or group, constitutes more than 50% of the total fair market value or total voting power of the stock of the Company; (ii) the acquisition by one person, or more than one person acting as a group, of ownership of stock of the Company that, together with stock of the Company acquired during the 12-month period ending on the date of the most recent acquisition by such person or group, constitutes 30% or more of the total voting power of the stock of the Company; (iii) a majority of the members of the Board are replaced during any 12-month period by Directors whose appointment or election is not endorsed by a majority of the members of the Board before the date of the appointment or election; or (iv) one person, or more than one person acting as a group, acquires, or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or group, assets from the Company that have a total gross fair market value, determined without regard to any liabilities associated with such assets, equal to or more than 40% of the total gross fair market value of all of the assets of the Company immediately before such acquisition(s).

Ü Voluntary Termination or Early Retirement

The early retirement or voluntary termination of employment by any NEO (other than a voluntary termination of employment by the NEO for “good reason,” which is discussed separately above) would generally not result in any enhanced retirement benefits beyond the benefits described in “Pension Benefits Table” in the Executive Compensation section. To the extent that any NEO may hold unvested stock options as of the date of his self-termination or early retirement, the Board might choose to accelerate the vesting of such options as of the date of such termination or early retirement. Eligibility for regular Company severance or retirement payments by an NEO is determined in a manner consistent with all Company employees under applicable plans and policies. Participation in either the “makeup” benefit feature or the special additional benefit feature of the SERP, including in the event of early retirement, is limited to select Executive Officers, as determined from time to time by the Compensation Committee acting in its sole discretion. Messrs. T. Murphy, Goodemote and DeMarco are currently eligible for SERP payments upon their termination of employment or early retirement.

Ü Death or Disability

In the event of death or disability, the NEO would generally not receive any cash severance payment or enhanced retirement benefits beyond those described in “Pension Benefits Table” within the Executive Compensation section. Eligibility for regular Company severance or retirement payments is determined in a manner consistent with all employees of the Company under applicable plans and policies. However, under our standard stock option award agreements applicable to all option recipients, including NEOs, upon the death or permanent disability of a recipient who holds unvested stock option awards, any such awards will be subject to accelerated vesting as of such date.

Potential Payments Table:

The table below shows the estimated potential payments and benefits to each of the NEOs upon various "termination of employment" scenarios, assuming, in each case, that the NEO's employment terminated as of December 31, 2015; the value of the Company's common stock was \$27.17, the closing price of our common stock on that day; and in the case of a post change-in-control termination, the triggering change-in-control event occurred in 2015.

Name and Principal Position	Type of Payment	Involuntary Termination Without Cause or Voluntary Termination with Good Reason	Change of Control (e)	Retirement	Death or Disability
Thomas J. Murphy President and CEO	Cash Compensation ^(a)	\$666,667	\$969,991	—	—
	Stock Options ^(b)	—	\$53,054	—	\$53,054
	SERP – Pension & ESOP ^(c)	\$69,348	\$69,348	\$69,348	\$69,348
	Health and Welfare Benefits ^(d)	—	\$21,034	—	—
	Total	\$736,015	\$1,113,427	\$69,348	\$122,402
Terry R. Goodemote Executive Vice President, Treasurer and CFO	Cash Compensation ^(a)	\$489,583	\$795,436	—	—
	Stock Options ^(b)	—	\$26,527	—	\$26,527
	SERP – Pension & ESOP ^(c)	\$17,748	\$17,748	\$17,748	\$17,748
	Health and Welfare Benefits ^(d)	—	\$28,596	—	—
	Total	\$507,331	\$868,307	\$17,748	\$44,275
David S. DeMarco Senior Vice President	Cash Compensation ^(a)	\$262,167	\$526,176	—	—
	Stock Options ^(b)	—	\$25,029	—	\$25,029
	SERP – Pension & ESOP ^(c)	\$9,034	\$9,034	\$9,034	\$9,034
	Health and Welfare Benefits ^(d)	—	\$27,568	—	—
	Total	\$271,201	\$587,807	\$9,034	\$34,063
David D. Kaiser Senior Vice President	Cash Compensation ^(a)	\$216,667	\$405,734	—	—
	Stock Options ^(b)	—	\$13,265	—	13,265
	SERP – Pension & ESOP ^(c)	—	—	—	—
	Health and Welfare Benefits ^(d)	—	\$28,596	—	—
	Total	\$216,667	\$447,595	—	13,265

Messrs. T. Murphy, Goodemote, DeMarco and Kaiser will each receive a lump-sum payment equal to the greater (a) of the amount of (i) their base salary payable during the remaining term of the agreement in effect on December 31, 2015 or (ii) one year's base salary.

(b) Reflects accelerated vesting of stock options.

Represents \$50,511 for benefits under the SERP pension plan and \$18,837 for SERP ESOP account value for Mr. T. Murphy; \$13,547 for benefits under the SERP pension plan and \$4,201 for SERP ESOP account value for Mr.

(c) Goodemote; and \$5,762 for benefits under the SERP pension plan and \$3,272 for SERP ESOP account value for Mr. DeMarco. SERP pension plan benefits are payable in the form of an annuity and SERP ESOP account values are payable in a lump sum.

Represents the projected cost for 24 months of medical and dental insurance coverage under the Company's fully (d) insured medical and self-insured dental plans, assuming continued cost-sharing by the NEO, plus continued premium payments for 24 months of term life insurance and split-dollar insurance policies.

(e) Assuming a termination of an NEO's employment by the Company without cause or by the NEO for good reason within 12 months following a change of control, Messrs. T. Murphy, Goodemote, DeMarco and Kaiser will each receive an amount payable in installments or, in the event of unforeseeable emergency, in a lump-sum equal to, for

Messrs. T. Murphy and Goodemote, 2.99 times their average annual taxable compensation for the five years preceding the event, and in the case of Messrs. DeMarco and Kaiser, two times such five-year average, adjusted downward in each case to reflect any other change-of-control payment or benefits they might receive under other compensatory arrangements then in effect, such as the value they might receive from accelerated vesting of stock options. For Mr. T. Murphy, the lump-sum amount \$1,023,045 is adjusted downward by \$53,054 as a result of accelerated vesting of stock options. For Mr. Goodemote, the lump-sum amount \$821,963 is adjusted downward by \$26,527 as a result of accelerated vesting of stock options. For Mr. DeMarco, the lump-sum amount \$551,205 is adjusted downward by \$25,029 as a result of accelerated vesting of stock options. For Mr. Kaiser, the lump-sum amount \$418,999 is adjusted downward by \$13,265 as a result of accelerated vesting of stock options. Their agreements further provide that under no circumstances will Messrs. T. Murphy, Goodemote, DeMarco and Kaiser receive any payments under the employment agreement if such payments would constitute an “excess parachute payment” under the tax laws.

Section 16(a) Beneficial Ownership Reporting

The Company's Executive Officers and Directors, as well as any 10% shareholders of the Company, are required by Section 16(a) of the Securities Exchange Act of 1934 to file reports with the SEC regarding their ownership of our stock, including changes in their stock ownership. The Company has received and reviewed copies of these reports filed by the Company's Directors and Executive Officers during 2015, along with written statements received from the Directors and Executive Officers stating they were not required to file any additional reports. Based solely on our review of these 2015 reports and statements, all but one of the Section 16(a) reports required to be filed by our Directors and Executive Officers during 2015 were timely filed. Mr. Goodemote filed one late report, disclosing six transactions.

Additional Voting Information

Frequently Asked Questions:

Ü Who is entitled to vote?

The Company has one class of stock outstanding, common stock, \$1 par value per share. At the close of business on our record date of March 7, 2016, there were 13,000,580 shares outstanding. The holders of these shares are our shareholders of record and will be entitled to vote at the Annual Meeting or any adjournment or postponement thereof. Each of these shareholders will receive notice of the Annual Meeting and instructions on how to vote their shares. Each share outstanding on the record date is entitled to one vote. Shares held in treasury by the Company are not eligible to vote and do not count toward a quorum.

Ü What are "broker non-votes" and how are they voted at the Annual Meeting?

Shares of our common stock can be held in (i) certificate form; (ii) by "book entry" at our transfer agent, American Stock Transfer & Trust Company, LLC; or (iii) in "street name" at a broker. When shares owned by you are held in street name, the broker will solicit your vote and provide us with the results of the vote for all of the Company shares it holds in your account. On "routine" matters, if you as the owner of the shares do not provide the broker with voting instructions, the broker has the right to vote these shares in its own discretion. However, a broker is not allowed to exercise its discretion on voting shares held in street name on any "non-routine" matter. On such matters, these shares may only be voted by the broker in accordance with express voting instructions received by it from you, the owner of the shares. The votes attached to such shares, that is, shares that may not be voted by a broker except in accordance with the owner's voting instructions, are referred to as "broker non-votes."

This year, the only matter that will be considered a routine matter is Item 2, the ratification of the Company's independent registered public accounting firm. Item 1, the election of Directors, is a non-routine matter; therefore, shares held by a broker in street name cannot be voted on by the broker at his or her discretion for that item. If your shares are held at a broker, the Company urges you to provide voting instructions to your broker so that your vote may be counted.

Ü How are Dividend Reinvestment Plan and other plan shares voted?

Shares owned by you in the Arrow Financial Corporation Automatic Dividend Reinvestment Plan ("DRIP") on our record date will be combined with all other shares owned by you directly on that date and presented to you with voting instructions. Shares owned by Company employees, Directors and other participants in the Company's 2011 Employee Stock Purchase Plan on the March 7, 2016, record date will be presented to the participants for voting on a separate voting form and will be voted in accordance with their instructions.

Shares owned by Company employees in the ESOP on the March 7, 2016, record date on a fully vested basis will be voted by the ESOP Trustee on behalf of such employees in accordance with any voting instructions received from the employees. Participants will receive a separate voting form from the ESOP's plan administrator for this purpose. If a participant does not provide the Trustee with voting instructions for his or her ESOP shares, the Trustee will vote the participant's shares in accordance with the "mirror voting" provisions of the ESOP. Under the "mirror voting" provisions, all such shares will be voted in a pro rata manner calculated to reflect most accurately the instructions received from those account holders who did provide voting instructions to the Trustee.

Ü What constitutes a quorum at the meeting?

There will be a quorum at the Annual Meeting if one-third of the total number of outstanding shares of our common stock are present, either in person or represented by proxy. Consistent with applicable state law and our Certificate of Incorporation and By-Laws, the Company will treat all shares present in person or represented by proxy at the Annual Meeting, including so-called “broker non-votes”, as shares present or represented by proxy for purposes of determining the meeting quorum. Shares held in treasury by the Company are not deemed outstanding and thus are ignored for purposes of calculating the quorum.

Ü How many votes are required for approval of Item 1?

The first item on the agenda is the election of four Class C Directors. The affirmative vote of the holders of a plurality of the shares of common stock present in person or represented by proxy at the Annual Meeting and eligible to vote on such matter is required for the election of each Director. A “plurality” means receiving a higher number of votes for such position than any other candidate, up to the maximum number of Directors to be chosen at the Annual Meeting. Because, at this year’s meeting, there are only as many nominees (four) as there are Directors to be elected (four), a Director nominee is assured of being elected if he or she receives any “For” votes, regardless of how many negative votes (“Withhold Authority”) are cast for that Director. Broker non-votes are ineligible to vote on Item 1.

The Company’s Majority Voting Policy states that if an election of Directors is uncontested, as is the case this year, and a nominee’s negative votes (“Withhold Authority”) exceed 50% of the total number of shares outstanding and entitled to vote at the Annual Meeting with respect to the election of Directors, that Director must tender his or her resignation to the Company following the meeting. The Governance Committee of the Board is then required to evaluate the tendered resignation and make a recommendation to the full Board on appropriate action, which may or may not include the acceptance of such resignation. In determining the appropriate action to be taken by the Company, the Board will take into account the best interests of the Company and its shareholders.

Ü What is the impact of a vote to “Withhold Authority” on Item 1?

In one respect, a proxy or ballot marked “Withhold Authority” will be the equivalent of an abstention from voting on Item 1. As discussed in the preceding section, because there are only as many nominees for Director as there are Directors to be elected, if each of the nominees receives any votes in favor of their election, each will be elected and a ballot marked “Withhold Authority,” like an abstention from voting, will not affect the outcome of this election. However, a ballot marked “Withhold Authority,” (which is a negative vote), unlike an abstention from voting, may nevertheless have a negative impact under our Majority Voting Policy because a “Withhold Authority” vote, unlike a shareholder’s abstention from voting, will be treated as a negative vote under the Company’s Majority Voting Policy and thus will make it somewhat more likely that the nominee will be required to submit his or her resignation under that policy, even though such person may in fact have been elected. (See the description of the Majority Voting Policy in the preceding paragraph.)

Ü How many votes are required for approval of Item 2?

The second item on the agenda is ratification of our independent registered public accounting firm, KPMG LLP. The affirmative vote of a majority of the shares of common stock present in person or represented by proxy at the Annual Meeting and voting on this proposal is required for ratification. Broker non-votes will be eligible to vote on Item 2.

Ü What is the impact of a vote to “Abstain” on Item 2?

In order for Item 2 to be ratified by the shareholders, it must receive the affirmative vote of a majority of the shares present in person or represented by proxy at the Annual Meeting and voting on the proposal. A proxy or ballot marked “Abstain” on Item 2 will not have the same effect as a vote “Against” such item. A proxy or ballot marked “Against” on Item 2 is an actual vote (and counts in the total number of votes on the item) whereas a vote to “Abstain” on Item 2 is not an actual vote (and does not get counted in the total votes on the item). Therefore, a vote “Against” Item 2 makes it more difficult to achieve shareholder approval or ratification than a vote to “Abstain.”

Ü How do I submit my proxy?

Shareholders of record as of the close of business on March 7, 2016, will be entitled to vote at the Annual Meeting, or any adjournment or postponement thereof. You can ensure that your shares are voted properly at the Annual Meeting by submitting your proxy by telephone, online or by completing, signing and dating the proxy card that will be provided to you upon request. Shareholders of record should receive a notice with voting instructions and the ability to request Proxy Materials, except those shareholders who have previously requested printed or electronic copies of our Proxy Materials will receive a printed or electronic copy of the proxy card, as applicable. If your shares are held by a broker or bank, you must follow the voting instructions on the form you receive from your broker or bank.

Ü May I revoke my proxy?

A proxy may be revoked at any time prior to the Annual Meeting by submitting a later vote of your shares either by Internet or by telephone prior to the Annual Meeting or by attending and voting your shares in person at the Annual Meeting. You may also revoke your proxy by delivering a written notice of revocation of proxy prior to the Annual Meeting to: Corporate Secretary, Arrow Financial Corporation, 250 Glen Street, Glens Falls, New York 12801.

Ü How are proxies being solicited?

Proxies are being solicited electronically, by telephone and by mail. Proxies may also be solicited without additional compensation by our Directors, Officers and other employees personally, by telephone or other means. The Company will bear all costs of proxy solicitation. If the Company utilizes the services of other financial institutions, brokerage houses, custodians, nominees or fiduciaries to solicit proxies, the Company will reimburse them for their out-of-pocket expenses.

Householding of Notices to Shareholders:

In some instances, only one copy of the Notice of Internet Availability of Proxy Materials concerning this Proxy Statement is being delivered for shareholder accounts that contain the same primary Social Security number, unless the Company has received instructions from one or more of the shareholders to continue to deliver multiple copies. The Company will deliver a copy of the Notice of Internet Availability of Proxy Materials to any shareholder upon request by email to corporatesecretary@arrowbank.com or in writing to: Householding of Notice, c/o Corporate Secretary, Arrow Financial Corporation, 250 Glen Street, Glens Falls, New York 12801.

Additional Matters for Consideration at the Annual Meeting:

Please note the deadline for submission of proposals by shareholders for consideration at the Annual Meeting has passed. This applies to proposals that shareholders might wish to include in the Company's Proxy Statement for the Annual Meeting (this Proxy Statement), proposals that shareholders might wish to include in their own Proxy Materials, which they would prepare, file with the SEC and disseminate to shareholders, or proposals that shareholders might wish to submit directly to a shareholder vote, in person, at the Annual Meeting. Therefore, no additional matters may be proposed by any shareholder for submission, or submitted, to a vote of the shareholders generally at the Annual Meeting, other than procedural issues such as adjournment, postponement or continuation. On such procedural issues, all shares represented at the Annual Meeting by proxy may be voted at the discretion of the attorneys-in-fact named in the proxies, to the extent permitted by law.

Proxy Cards Returned Without Specific Voting Instructions:

If you return a proxy card without specific voting instructions for any or all items, your shares will be voted on Item 1 "For" each of the Board's four Class C nominees, on Item 2 "For" ratification of the appointment of KPMG LLP as our independent registered public accounting firm for 2016, and on any other procedural matter properly submitted for shareholder consideration, in such manner as the shareholders' attorneys-in-fact may determine, in their discretion, to be appropriate and in the best interests of shareholders generally.

Additional Shareholder Information

Shareholder Submissions of Director Nominees for the 2017 Annual Meeting:

Any shareholder submission of a candidate for the Board to consider as one of its nominees for Director at the 2017 Annual Meeting of Shareholders must be in writing and contain certain information about the candidate and comply

with certain procedures, which are described in detail in the Company's By-Laws. All candidates who are properly submitted by shareholders will first be considered by the Governance Committee of the Board at the time of its normal Director nomination review, and if the Governance Committee recommends such candidate, he or she will subsequently be considered by the full Board. Such submissions must be in writing and addressed to: Board of Director Candidates, c/o Corporate Secretary, Arrow Financial Corporation, 250 Glen Street, Glens Falls, New York 12801.

A shareholder may act directly to nominate his or her own Director candidates at our 2017 Annual Meeting of Shareholders by following the procedures set forth in the subsection below titled “Shareholder Proposals for Presentation at the 2017 Annual Meeting.” Such direct nominations by shareholders not involving the Board’s nomination are subject to the deadlines and procedures described and set forth in our By-Laws and applicable rules of the SEC, including minimum advance notice to the Board.

Annual Meeting Shareholder Proposal Process:

• Shareholder Proposals for Inclusion in the 2017 Proxy Statement

To be considered for inclusion in our 2017 Proxy Statement next year, shareholder proposals must be submitted in accordance with SEC’s Rule 14a-8 and must be received by our Corporate Secretary, Arrow Financial Corporation, 250 Glen Street, Glens Falls, New York 12801, no later than November 25, 2016. Additionally, our Company By-Laws require the name and address of record of the proposing shareholder, appropriate information regarding the matter sought to be presented or person to be nominated, as well as the number of shares of our common stock that are owned by the proposing shareholder.

• Shareholder Proposals for Presentation at the 2017 Annual Meeting

If a shareholder wishes to have a proposal presented at our 2017 Annual Meeting but not included in the Company’s 2017 Proxy Statement, including a nomination for the Board of Directors, the shareholder must satisfy the requirements established under our Company By-Laws. The shareholder must give notice to the Corporate Secretary of the Company of any such proposal for next year’s Annual Meeting not later than January 4, 2017, and the notice provided by the shareholder must contain information required by our By-Laws including the name and address of record of the proposing shareholder, appropriate information regarding the matter sought to be presented or the proposed nominee, as well as the number of shares of our common stock that are owned by the proposing shareholder.

Your Vote is Very Important
