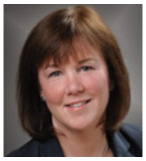

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COMPENSATION IN M&A

Addressing Compensation Issues In M&A

Consolidation in the banking industry continues, with more than 200 bank mergers in 2017. Whether your institution is a potential buyer or seller, there are several compensation matters that will need to be addressed proactively.

Change-in-Control (CIC) Protections

CIC arrangements are particularly important in the banking industry due to the significant consolidation activity. CIC arrangements typically cover the most senior executives driving strategic corporate transactions, or those that may be at risk of job loss in the event of a transaction. Preparing well in advance of a potential transaction is key to ensuring that executives remain neutral during consideration of a possible deal.

Although CIC arrangements are an expected, and necessary, protection, scrutiny of such practices at publicly traded companies has increased in the last decade due to enhanced proxy disclosure rules and the required shareholder advisory vote on executive compensation, known as say-on-pay. Shareholders, proxy advisory firms and media pundits continue to pressure companies to curb excessive CIC benefits.

Meridian's recent study of CIC arrangements observed the following trends:

- Reduction in cash severance multiples for top executives from 3x annual target cash compensation to 2x, except for CEOs, for whom 3x cash severance multiples remain a majority but declining practice.

- Elimination of single-trigger vesting of equity awards (i.e. awards that vest immediately when a deal closes), in favor of double-trigger vesting, which also requires a loss of employment for awards to vest. Some companies include provisions that vest equity awards if they are not assumed or replaced by the acquirer.

- Elimination of excise tax gross-up payments in favor of "best net" provisions, whereby the executive would be entitled to the greater of: full CIC benefits with responsibility to pay any excise tax, or a reduced CIC benefit sized to avoid the excise tax altogether.

Incentive Plan Considerations

How should you structure incentive plans before a deal is in place? Incentive plans should proactively and clearly define the terms for payout in the event of a CIC to avoid confusion at the time of a transaction. Annual incentive plans typically prorate the payout based on performance through the merger date. Performance shares typically vest in full when there is a termination following the CIC. Most performance shares vest based on target performance following a CIC, but an increasing practice is to vest based on actual performance.

Incentive measures should be clearly defined, in advance, to address whether the plan(s) will adjust results to account for merger-related activities. These adjustments are common, but ensuring they are identified in advance and incorporated into appropriate plan documentation can limit confusion and debate at payout.

Target incentive opportunities for senior executives and key positions may need to be adjusted. In merger-of-equals or significant acquisitions, incentive targets and total compensation can increase significantly. Developing a new peer group and conducting a competitive review is appropriate to ensure that compensation transitions appropriately.

Retaining Key Talent

With most transactions, the acquiring company views retaining key talent as critical for the deal's success. Several factors should be considered when evaluating potential retention awards:

Compensation received at deal close: While single-trigger arrangements are less common, some banks still vest outstanding awards that pay upon the deal close. This practice can result in key employees without retention hooks. Consider the awards that remain after a deal closes and whether those provide adequate retention hooks.

Role of employee following the deal: Some operational employees may be viewed as critical for deal integration, but may not have a role once integration is complete. Retention grants may be needed to secure those employees for the transition period.

Provisions in employment arrangements: If executives have change-in-control protections that allow them to potentially receive severance following a deal (e.g. due to a change in their role), a new compensation arrangement may need to be negotiated.

These and other M&A compensation issues are complex, but can be critical to the deal's success. As such, they should be proactively considered as part of an acquisition.

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