FINANCIAL INSTITUTIONS INC
Form 10-Q
May 03, 2011

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

Form 10-Q

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

For the quarterly period ended March 31, 2011

or

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

Commission File Number: 000-26481

(Exact name of registrant as specified in its charter)

NEW YORK	**16-0816610**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
220 LIBERTY STREET, WARSAW, NEW YORK	**14569**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(585) 786-1100**

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 such filing requirements for the past 90 days. Yes þ No o

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 o No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller company)	Smaller reporting company o

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

The registrant had 13,792,741 shares of Common Stock, $0.01 par value, outstanding as of April 28, 2011.

FINANCIAL INSTITUTIONS, INC.
Form 10-Q
For the Quarterly Period Ended March 31, 2011
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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition (Unaudited)

(Dollars in thousands, except share and per share data)	March 31, 2011	December 31, 2010
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 94,441	$ 38,964
Federal funds sold and interest-bearing deposits in other banks	94	94
Total cash and cash equivalents	94,535	39,058
Securities available for sale, at fair value	692,812	666,368
Securities held to maturity, at amortized cost (fair value of $25,959 and $28,849, respectively)	25,284	28,162
Loans held for sale	1,666	3,138
Loans (net of allowance for loan losses of $20,119 and $20,466, respectively)	1,332,400	1,325,524
Company owned life insurance	26,326	26,053
Premises and equipment, net	32,617	33,263
Goodwill	37,369	37,369
Other assets	52,107	55,372
Total assets	$ 2,295,116	$ 2,214,307
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 354,312	$ 350,877
Interest-bearing demand	424,897	374,900
Savings and money market	464,076	417,359
Certificates of deposit	726,296	739,754
Total deposits	1,969,581	1,882,890
Short-term borrowings	42,060	77,110
Long-term borrowings	26,702	26,767
Other liabilities	33,950	15,396
Total liabilities	2,072,293	2,002,163
Shareholders equity:		
Series A 3% preferred stock, $100 par value; 1,533 shares authorized and issued	153	153
Series A preferred stock, $5,000 liquidation preference per share, 7,503 shares authorized; 7,503 shares issued at December 31, 2010		36,210
Series B-1 8.48% preferred stock, $100 par value, 200,000 shares authorized, 174,223 shares issued	17,422	17,422
Total preferred equity	17,575	53,785

Common stock, $0.01 par value, 50,000,000 shares authorized; 14,161,597 and 11,348,122 shares issued, respectively	142	113
Additional paid-in capital	68,605	26,029
Retained earnings	147,261	144,599
Accumulated other comprehensive loss	(3,879)	(4,722)
Treasury stock, at cost 368,407 and 410,616 shares, respectively	(6,881)	(7,660)
Total shareholders equity	222,823	212,144
Total liabilities and shareholders equity	$ 2,295,116	$ 2,214,307

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Income (Unaudited)

(Dollars in thousands, except per share amounts)	Three months ended March 31, 2011	2010
Interest income:		
Interest and fees on loans	$ 19,035	$ 18,618
Interest and dividends on investment securities	4,604	5,199
Other interest income		7
Total interest income	23,639	23,824
Interest expense:		
Deposits	3,197	3,784
Short-term borrowings	72	78
Long-term borrowings	532	710
Total interest expense	3,801	4,572
Net interest income	19,838	19,252
Provision for loan losses	810	418
Net interest income after provision for loan losses	19,028	18,834
Noninterest income:		
Service charges on deposits	2,105	2,230
ATM and debit card	1,016	934
Broker-dealer fees and commissions	386	380
Loan servicing	349	280
Company owned life insurance	266	269
Net gain on sale of loans held for sale	224	62
Net gain on disposal of investment securities	3	6
Impairment charges on investment securities		(526)
Net gain on sale and disposal of other assets	45	2
Other	754	446
Total noninterest income	5,148	4,083
Noninterest expense:		
Salaries and employee benefits	8,401	8,247
Occupancy and equipment	2,843	2,771
Professional services	682	606
FDIC assessments	607	602
Computer and data processing	603	571

Supplies and postage	452	445
Advertising and promotions	165	187
Other	1,597	1,309
Total noninterest expense	15,350	14,738
Income before income taxes	8,826	8,179
Income tax expense	3,006	2,851
Net income	$ 5,820	$ 5,328
Preferred stock dividends	770	839
Accretion of discount on preferred stock	1,305	90
Net income available to common shareholders	$ 3,745	$ 4,399
Earnings per common share (Note 2):		
Basic	$ 0.33	$ 0.41
Diluted	$ 0.33	$ 0.40

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Shareholders Equity (Unaudited)
Three months ended March 31, 2011

(Dollars in thousands, except per share data)	Preferred Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders Equity
Balance at January 1, 2011	**$ 53,785**	**$ 113**	**$ 26,029**	**$ 144,599**	**$ (4,722)**	**$ (7,660)**	**$ 212,144**
Comprehensive income:							
Net income				5,820			5,820
Other comprehensive income, net of tax					843		843
Total comprehensive income							6,663
Purchases of treasury stock						(197)	(197)
Issuance of common stock		29	43,098				43,127
Redemption of Series A preferred stock	(37,515)		68				(37,447)
Share-based compensation plans:							
Share-based compensation			231				231
Stock options exercised			(28)			119	91
Restricted stock awards issued, net			(857)			857	
Excess tax benefit on share-based compensation			64				64
Accretion of discount on Series A preferred stock	1,305			(1,305)			
Cash dividends declared:							
Series A 3% Preferred-$0.75 per share				(1)			(1)
Series A Preferred-$53.24 per share				(399)			(399)
Series B-1 8.48% Preferred-$2.12 per share				(370)			(370)

Common-$0.10 per share				(1,083)			(1,083)
Balance at March 31, 2011	**$ 17,575**	**$ 142**	**$ 68,605**	**$ 147,261**	**$ (3,879)**	**$ (6,881)**	**$ 222,823**

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)	Three months ended March 31, 2011	2010
Cash flows from operating activities:		
Net income	$ 5,820	$ 5,328
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	849	898
Net amortization of premiums on securities	1,378	508
Provision for loan losses	810	418
Share-based compensation	231	221
Deferred income tax expense	876	759
Proceeds from sale of loans held for sale	10,017	6,031
Originations of loans held for sale	(8,321)	(5,651)
Increase in company owned life insurance	(266)	(269)
Net gain on sale of loans held for sale	(224)	(62)
Net gain on disposal of investment securities	(3)	(6)
Impairment charges on investment securities		526
Net gain on sale and disposal of other assets	(45)	(2)
Decrease in other assets	1,917	463
Decrease in other liabilities	(566)	(522)
Net cash provided by operating activities	12,473	8,640
Cash flows from investing activities:		
Purchases of investment securities:		
Available for sale	(42,262)	(110,252)
Held to maturity	(1,920)	(2,654)
Proceeds from principal payments, maturities and calls on investment securities:		
Available for sale	33,990	35,731
Held to maturity	5,863	7,567
Proceeds from sales and calls of securities available for sale		12,950
Net loan originations	(7,686)	(4,715)
Purchases of company owned life insurance	(7)	(7)
Proceeds from sales of other assets	110	56
Purchases of premises and equipment	(205)	(471)
Net cash used in investing activities	(12,117)	(61,795)
Cash flows from financing activities:		
Net increase in deposits	86,691	106,919
Net decrease in short-term borrowings	(35,050)	(22,935)
Repayments of long-term borrowings	(65)	(1)
Proceeds from issuance of common stock, net of issuance costs	43,127	
Redemption of Series A preferred stock	(37,447)	

Purchases of common stock for treasury		(197)	
Proceeds from stock options exercised		91	8
Excess tax benefit on share-based compensation		64	
Cash dividends paid to preferred shareholders		(1,010)	(839)
Cash dividends paid to common shareholders		(1,083)	(1,082)
Net cash provided by financing activities		55,121	82,070
Net increase in cash and cash equivalents		55,477	28,915
Cash and cash equivalents, beginning of period		39,058	42,959
Cash and cash equivalents, end of period	$	94,535	71,874

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

(1.) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Financial Institutions, Inc., a financial holding company organized under the laws of New York State (New York or NYS), and its subsidiaries provide deposit, lending and other financial services to individuals and businesses in Central and Western New York. The Company owns all of the capital stock of Five Star Bank, a New York State chartered bank, and Five Star Investment Services, Inc., a broker-dealer subsidiary offering noninsured investment products. The Company also owns 100% of FISI Statutory Trust I (the Trust), which was formed in February 2001 for the purpose of issuing trust preferred securities. References to the Company mean the consolidated reporting entities and references to the Bank mean Five Star Bank.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting policies conform to U.S. generally accepted accounting principles (GAAP). Certain information and footnote disclosures normally included in financial statements prepared in conformity with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying consolidated financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly the consolidated balance sheet, statements of income, shareholders equity and cash flows for the periods indicated, and contain adequate disclosure to make the information presented not misleading. Prior years consolidated financial statements are re-classified whenever necessary to conform to the current year s presentation. These consolidated financial statements should be read in conjunction with the Company s 2010 Annual Report on Form 10-K. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year.

Use of Estimates

The preparation of these financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates relate to the determination of the allowance for loan losses, assumptions used in the defined benefit pension plan accounting, the carrying value of goodwill and deferred tax assets, and the valuation and other than temporary impairment considerations related to the securities portfolio.

Cash Flow Information

Supplemental cash flow information addressing certain cash payments and noncash investing and financing activities was as follows (in thousands):

	Three months ended March 31,	
	2011	**2010**
Cash payments:		
Interest	$ 4,367	$ 5,315
Income taxes	270	
Noncash investing and financing activities:		
Real estate and other assets acquired in settlement of loans	$	$ 70
Accrued and declared unpaid dividends	1,454	1,692
Increase in net unsettled security transactions	19,360	4,896
Accretion of preferred stock discount	1,305	90

Recent Accounting Pronouncements

FASB ASC 310 Receivables (ASC 310) was amended to enhance disclosures about credit quality of financing receivables and the allowance for credit losses. The amendments require an entity to disclose credit quality

information, such as internal risk grades, more detailed nonaccrual and past due information, and modifications of its financing receivables. The disclosures under ASC 310, as amended, were effective for interim and annual reporting periods ending on or after December 15, 2010. This amendment did not have a significant impact on the Company s statement of income and condition, but it has significantly expanded the disclosures that we are required to provide.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

(1.) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

On April 5, 2011, the FASB issued ASU 2011-02 A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring , which clarifies when creditors should classify loan modifications as troubled debt restructurings. The guidance is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the year. The guidance on measuring the impairment of a receivable restructured in a troubled debt restructuring, as clarified, is effective on a prospective basis. The adoption of this ASU is not expected to have a material impact on the Company s statement of income and condition.

(2.) EARNINGS PER COMMON SHARE (EPS)

The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted EPS for the three months ended March 31, 2011 and 2010 (in thousands, except per share amounts).

	Three months ended March,	
	2011	**2010**
Net income available to common shareholders	$ 3,745	$ 4,399
Less: Earnings allocated to participating securities	10	30
Earnings allocated to common shares outstanding	$ 3,735	$ 4,369
Weighted average common shares used to calculate basic EPS	11,336	10,746
Add: Effect of common stock equivalents	131	55
Weighted average common shares used to calculate diluted EPS	11,467	10,801
Earnings per common share:		
Basic	$ 0.33	$ 0.41
Diluted	$ 0.33	$ 0.40

Shares subject to the following securities, outstanding as of March 31 of the respective year, were excluded from the computation of diluted EPS because the effect would be antidilutive:

Stock options	352	451
Restricted stock awards	27	
Warrant		378
	379	829

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

(3.) INVESTMENT SECURITIES

The amortized cost and fair value of investment securities are summarized below (in thousands):

	March 31, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 135,621	$ 926	$ 2,246	$ 134,301
State and political subdivisions	118,496	1,584	1,172	118,908
Mortgage-backed securities:				
Federal National Mortgage Association	113,372	655	624	113,403
Federal Home Loan Mortgage Corporation	87,753	288	495	87,546
Government National Mortgage Association	98,304	2,445	68	100,681
Collateralized mortgage obligations:				
Federal National Mortgage Association	12,965	217	11	13,171
Federal Home Loan Mortgage Corporation	14,273	332	1	14,604
Government National Mortgage Association	106,319	1,897	90	108,126
Privately issued	784	671		1,455
Total collateralized mortgage obligations	134,341	3,117	102	137,356
Total mortgage-backed securities	433,770	6,505	1,289	438,986
Asset-backed securities	564	188	135	617
Total available for sale securities	$ 688,451	$ 9,203	$ 4,842	$ 692,812
Securities held to maturity:				
State and political subdivisions	$ 25,284	$ 675	$	$ 25,959

	December 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 141,591	$ 1,158	$ 1,965	$ 140,784
State and political subdivisions	105,622	1,516	1,472	105,666
Mortgage-backed securities:				
Federal National Mortgage Association	96,300	798	1,030	96,068
Federal Home Loan Mortgage Corporation	83,745	321	1,317	82,749
Government National Mortgage Association	102,633	2,422	7	105,048
Collateralized mortgage obligations:				
Federal National Mortgage Association	8,938	231	11	9,158
Federal Home Loan Mortgage Corporation	15,917	329	1	16,245
Government National Mortgage Association	106,969	1,761	289	108,441

Privately issued	981	591		1,572
Total collateralized mortgage obligations	132,805	2,912	301	135,416
Total mortgage-backed securities	415,483	6,453	2,655	419,281
Asset-backed securities	564	204	131	637
Total available for sale securities	$ 663,260	$ 9,331	$ 6,223	$ 666,368
Securities held to maturity:				
State and political subdivisions	$ 28,162	$ 687	$	$ 28,849

There were no sales of available for sale securities during the three months ended March 31, 2011. For the three months ended March 31, 2010, proceeds from sales of securities available for sale were $13.0 million and gross realized gains were $6 thousand.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

(3.) INVESTMENT SECURITIES (Continued)

The scheduled maturities of securities available for sale and securities held to maturity at March 31, 2011 are shown below (in thousands). Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	Amortized Cost	Fair Value
Debt securities available for sale:		
Due in one year or less	$ 36,981	$ 37,254
Due from one to five years	98,915	100,948
Due after five years through ten years	242,407	238,532
Due after ten years	310,148	316,078
	$ 688,451	$ 692,812
Debt securities held to maturity:		
Due in one year or less	$ 17,904	$ 18,036
Due from one to five years	6,180	6,529
Due after five years through ten years	1,022	1,180
Due after ten years	178	214
	$ 25,284	$ 25,959

The following tables show the investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2011 and December 31, 2010 (in thousands).

	March 31, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. Government agencies and government sponsored enterprises	$ 47,330	$ 2,208	$ 8,663	$ 38	$ 55,993	$ 2,246
State and political subdivisions	49,139	1,172			49,139	1,172
Mortgage-backed securities:						
Federal National Mortgage Association	44,523	624			44,523	624
Federal Home Loan Mortgage Corporation	58,450	495			58,450	495
Government National Mortgage Association	4,952	68			4,952	68
Collateralized mortgage obligations:						

Federal National Mortgage Association			2,097	11	2,097	11
Federal Home Loan Mortgage Corporation	492	1			492	1
Government National Mortgage Association	14,298	90			14,298	90
Total collateralized mortgage obligations	14,790	91	2,097	11	16,887	102
Total mortgage-backed securities	122,715	1,278	2,097	11	124,812	1,289
Asset-backed securities	109	63	95	72	204	135
Total temporarily impaired securities	$ 219,293	$ 4,721	$ 10,855	$ 121	$ 230,148	$ 4,842

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)
(3.) INVESTMENT SECURITIES (Continued)

	December 31, 2010					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. Government agencies and government sponsored enterprises	$ 47,752	$ 1,911	$ 8,821	$ 54	$ 56,573	$ 1,965
State and political subdivisions	38,398	1,472			38,398	1,472
Mortgage-backed securities:						
Federal National Mortgage Association	46,777	1,030			46,777	1,030
Federal Home Loan Mortgage Corporation	60,707	1,317			60,707	1,317
Government National Mortgage Association	5,135	7			5,135	7
Collateralized mortgage obligations:						
Federal National Mortgage Association			2,332	11	2,332	11
Federal Home Loan Mortgage Corporation	612	1			612	1
Government National Mortgage Association	17,798	289			17,798	289
Total collateralized mortgage obligations	18,410	290	2,332	11	20,742	301
Total mortgage-backed securities	131,029	2,644	2,332	11	133,361	2,655
Asset-backed securities	111	61	96	70	207	131
Total temporarily impaired securities	$ 217,290	$ 6,088	$ 11,249	$ 135	$ 228,539	$ 6,223

The Company reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) with formal reviews performed quarterly. When evaluating debt securities for OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intention to sell the debt security or whether it is more likely than not that it will be required to sell the debt security before its anticipated recovery. The assessment of whether OTTI exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

At March 31, 2011, the Company had positions in 17 investment securities with an amortized cost of $11.0 million and an unrealized loss of $121 thousand that have been in a continuous unrealized loss position for more than 12 months. Asset-backed securities accounted for $72 thousand of the unrealized loss on these securities.

There were a total of 160 securities positions in the Company s investment portfolio with an amortized cost of $224.0 million and a total unrealized loss of $4.7 million at March 31, 2011, that have been in a continuous unrealized loss position for less than 12 months. The unrealized loss on these investment securities was predominantly caused by changes in market interest rates, average life or credit spreads subsequent to purchase. The fair value of most of the investment securities in the Company s portfolio fluctuates as market interest rates change.

Based on management s review and evaluation of the Company s debt securities as of March 31, 2011, the debt securities with unrealized losses were not considered to be OTTI. As of March 31, 2011, the Company does not intend to sell any debt securities which have an unrealized loss, it is unlikely the Company will be required to sell these securities before recovery and expects to recover the entire amortized cost of these impaired securities.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

(4.) LOANS

The Company s loan portfolio consisted of the following as of the dates indicated (in thousands):

	Loans, Gross	Net Deferred Loan (Fees) Costs	Loans, Net
March 31, 2011			
Commercial business	$ 209,259	$ 120	$ 209,379
Commercial mortgage	362,282	(569)	361,713
Residential mortgage	123,572	22	123,594
Home equity	206,608	3,353	209,961
Consumer indirect	404,806	18,015	422,821
Other consumer	24,888	163	25,051
Total	$ 1,331,415	$ 21,104	1,352,519
Allowance for loan losses			(20,119)
Total loans, net			$ 1,332,400
December 31, 2010			
Commercial business	$ 210,948	$ 83	$ 211,031
Commercial mortgage	353,537	(607)	352,930
Residential mortgage	129,553	27	129,580
Home equity	205,070	3,257	208,327
Consumer indirect	400,221	17,795	418,016
Other consumer	25,937	169	26,106
Total	$ 1,325,266	$ 20,724	1,345,990
Allowance for loan losses			(20,466)
Total loans, net			$ 1,325,524

Loans held for sale (not included above) totaled $1.7 million and $3.1 million as of March 31, 2011 and December 31, 2010, respectively.

Past Due Loans Aging

The Company s recorded investment, by loan class, in current and nonaccrual loans, as well as an analysis of accruing delinquent loans is set forth as of the dates indicated (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Nonaccrual	Current	Total Loans
March 31, 2011							
Commercial business	$ 76	$	$	$ 76	$ 901	$ 208,282	$ 209,259

Commercial mortgage		28					28		2,736		359,518		362,282
Residential mortgage		355					355		2,192		121,025		123,572
Home equity		209					209		835		205,564		206,608
Consumer indirect		302		76			378		639		403,789		404,806
Other consumer		90		3		3	96		12		24,780		24,888
Total loans, gross	$	1,060	$	79	$	3	$ 1,142	$	7,315	$	1,322,958	$	1,331,415
December 31, 2010													
Commercial business	$	172	$	92	$		$ 264	$	947	$	209,737	$	210,948
Commercial mortgage		163					163		3,100		350,274		353,537
Residential mortgage		492		6			498		2,102		126,953		129,553
Home equity		428		47			475		875		203,720		205,070
Consumer indirect		656		107			763		514		398,944		400,221
Other consumer		82		1		3	86		41		25,810		25,937
Total loans, gross	$	1,993	$	253	$	3	$ 2,249	$	7,579	$	1,315,438	$	1,325,266

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(4.) LOANS (Continued)

There were no loans past due greater than 90 days and still accruing interest as of March 31, 2011 and December 31, 2010. As of March 31, 2011 and December 31, 2010, there were $3 thousand in consumer overdrafts which were past due greater than 90 days. Consumer overdrafts are overdrawn deposit accounts which have been reclassified as loans but by their terms do not accrue interest.

Troubled Debt Restructurings

Troubled debt restructurings (TDRs) are loans where the Company, for economic or legal reasons related to the borrower s financial condition, has granted a significant concession to the borrower that it would not otherwise consider. TDRs can be classified as either accrual or nonaccrual loans. The Company had no TDRs on which it continued to accrue interest at March 31, 2011 or December 31, 2010. Included in nonaccrual loans are commercial TDRs of $525 thousand and $534 thousand at March 31, 2011 and December 31, 2010, respectively. The Company assigned $90 thousand and $137 thousand of specific reserves to loans classified as TDRs as of March 31, 2011 and December 31, 2010, respectively. TDRs typically migrate from the Company s criticized and classified watch list and are assigned specific reserves in accordance with the Company s standard allowance for loan loss methodology.

Impaired Loans

Management has determined that specific commercial loans on nonaccrual status and all loans that have had their terms restructured in a troubled debt restructuring are impaired loans. The following table presents data on impaired loans as of the dates indicated (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
March 31, 2011					
With no related allowance recorded:					
Commercial business	$ 124	$ 269	$	$ 358	$
Commercial mortgage	468	468		443	
	592	737		801	
With an allowance recorded:					
Commercial business	778	778	261	615	
Commercial mortgage	2,267	2,275	522	2,611	
	3,045	3,053	783	3,226	
	$ 3,637	$ 3,790	$ 783	$ 4,027	$
December 31, 2010					
With no related allowance recorded:					
Commercial business	$ 372	$ 524	$	$ 275	$
Commercial mortgage	187	187		481	
	559	711		756	
With an allowance recorded:					
Commercial business	576	576	149	1,828	

Commercial mortgage	2,913	2,921	883	1,897	
	3,489	3,497	1,032	3,725	
	$ 4,048	$ 4,208	$ 1,032	$ 4,481	$

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(4.) LOANS (Continued)

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors such as the fair value of collateral. The Company analyzes commercial business and commercial mortgage loans individually by classifying the loans as to credit risk. Risk ratings are updated any time the situation warrants. The Company uses the following definitions for risk ratings:

Special Mention: Loans classified as special mention have a potential weakness that deserves management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company s credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as Substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the process described above are considered Uncriticized or pass-rated loans and are included in groups of homogeneous loans with similar risk and loss characteristics.

The following table sets forth the Company s commercial loan portfolio, categorized by internally assigned asset classification, as of the dates indicated (in thousands):

	Commercial Business	Commercial Mortgage
March 31, 2011		
Uncriticized	$ 193,971	$ 347,629
Special mention	8,549	5,233
Substandard	6,739	9,420
Doubtful		
Total	$ 209,259	$ 362,282
December 31, 2010		
Uncriticized	$ 194,510	$ 338,061
Special mention	11,479	4,931
Substandard	4,959	10,545
Doubtful		
Total	$ 210,948	$ 353,537

The Company utilizes payment status as a means of identifying and reporting problem and potential problem retail loans. The Company considers nonaccrual loans and loans past due greater than 90 days and still accruing interest to be non-performing. The following table sets forth the Company s retail loan portfolio, categorized by payment status, as of the dates indicated (in thousands):

	Residential Mortgage	Home Equity	Consumer Indirect	Other Consumer
March 31, 2011				
Performing	$ 121,380	$ 205,773	$ 404,167	$ 24,876
Non-performing	2,192	835	639	12
Total	$ 123,572	$ 206,608	$ 404,806	$ 24,888
December 31, 2010				
Performing	$ 127,451	$ 204,195	$ 399,707	$ 25,896
Non-performing	2,102	875	514	41
Total	$ 129,553	$ 205,070	$ 400,221	$ 25,937

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(4.) LOANS (Continued)

Allowance for Loan Losses

The following table sets forth the changes in the allowance for loan losses for the three months ended March 31, 2011 (in thousands):

	Commercial Business	Commercial Mortgage	Residential Mortgage	Home Equity	Consumer Indirect	Other Consumer	Total
March 31, 2011							
Allowance for loan losses:							
Beginning balance	$ 3,712	$ 6,431	$ 1,013	$ 972	$ 7,754	$ 584	$ 20,466
Charge-offs	90	344	2	107	1,290	211	2,044
Recoveries	154	16	27	10	552	128	887
Provision (credit)	245	(195)	(22)	155	598	29	810
Ending balance	$ 4,021	$ 5,908	$ 1,016	$ 1,030	$ 7,614	$ 530	$ 20,119
Evaluated for impairment:							
Individually	$ 261	$ 522	$	$	$	$	$ 783
Collectively	$ 3,760	$ 5,386	$ 1,016	$ 1,030	7,614	$ 530	$ 19,336
Loans:							
Ending balance	$ 209,259	$ 362,282	$ 123,572	$ 206,608	$ 404,806	$ 24,888	$ 1,331,415
Evaluated for impairment:							
Individually	$ 902	$ 2,735	$	$	$	$	$ 3,637
Collectively	$ 208,357	$ 359,547	$ 123,572	$ 206,608	$ 404,806	$ 24,888	$ 1,327,778

Activity in the allowance for loan losses during the three months ended March 31, 2010 was as follows (in thousands):

Beginning balance	$ 20,741
Charge-offs	1,613
Recoveries	1,040
Provision	418
Ending balance	$ 20,586

Risk Characteristics

Commercial business loans primarily consist of loans to small to mid-sized businesses in our market area in a diverse range of industries. These loans are of higher risk and typically are made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value. The credit risk related to commercial loans is largely

influenced by general economic conditions and the resulting impact on a borrower s operations or on the value of underlying collateral, if any.

Commercial mortgage loans generally have larger balances and involve a greater degree of risk than residential mortgage loans, inferring higher potential losses on an individual customer basis. Loan repayment is often dependent on the successful operation and management of the properties, as well as on the collateral securing the loan. Economic events or conditions in the real estate market could have an adverse impact on the cash flows generated by properties securing the Company s commercial real estate loans and on the value of such properties.

Residential mortgage loans and home equities (comprised of home equity loans and home equity lines) are generally made on the basis of the borrower s ability to make repayment from his or her employment and other income, but are secured by real property whose value tends to be more easily ascertainable. Credit risk for these types of loans is generally influenced by general economic conditions, the characteristics of individual borrowers, and the nature of the loan collateral.

Consumer indirect and other consumer loans may entail greater credit risk than residential mortgage loans and home equities, particularly in the case of other consumer loans which are unsecured or, in the case of indirect consumer loans, secured by depreciable assets, such as automobiles or boats. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, thus are more likely to be affected by adverse personal circumstances such as job loss, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

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(5.) SHAREHOLDERS EQUITY

Common Stock

The changes in shares of common stock were as follows for three months ended March 31, 2011:

	Outstanding	Treasury	Issued
Shares outstanding at December 31, 2010	10,937,506	410,616	11,348,122
Shares issued in common stock offering	2,813,475		2,813,475
Restricted stock awards issued	45,870	(45,870)	
Stock options exercised	6,357	(6,357)	
Treasury stock purchases	(10,018)	10,018	
Shares outstanding at March 31, 2011	13,793,190	368,407	14,161,597

Issuance of Common Stock

During the three months ended March 31, 2011, the Company completed the sale of 2,813,475 shares of its common stock through an underwritten public offering at a price of $16.35 per share. The net proceeds of the offering, after deducting underwriting discounts and commissions and offering expenses, were $43.1 million. A portion of the proceeds from this offering was used to redeem the Company s Series A preferred stock as described in greater detail below.

Redemption of Series A Preferred Stock

In December 2008, under the U.S. Department of the Treasury s (the Treasury) Troubled Asset Relief Program (TARP) Capital Purchase Program, the Company entered into a Securities Purchase Agreement Standard Terms with the Treasury pursuant to which, among other things, the Company sold to the Treasury for an aggregate purchase price of $37.5 million, 7,503 shares of fixed rate cumulative perpetual preferred stock, Series A (Series A preferred stock) and a warrant to purchase up to 378,175 shares of common stock, par value $0.01 per share, at an exercise price of $14.88 per share (the Warrant), of the Company.

Pursuant to the terms of the Purchase Agreement, the Company s ability to declare or pay dividends on any of its shares was limited. Specifically, the Company was prohibited from paying any dividend with respect to shares of common stock, other junior securities or preferred stock ranking *pari passu* with the Series A preferred stock or repurchasing or redeeming any shares of the Company s common stock, other junior securities or preferred stock ranking *pari passu* with the Series A preferred stock in any quarter unless all accrued and unpaid dividends are paid on the Series A preferred stock for all past dividend periods (including the latest completed dividend period), subject to certain limited exceptions.

The $37.5 million in proceeds was allocated to the Series A preferred stock and the Warrant based on their relative fair values at issuance ($35.5 million was allocated to the Series A preferred stock and $2.0 million to the Warrant). The resulting discount for the Series A preferred stock was to be accreted over five years through retained earnings as a preferred stock dividend. The Warrant was to remain in additional paid-in-capital at its initial book value until it was exercised or expired.

On February 23, 2011, the Company redeemed one-third, or $12.5 million, of the Series A preferred stock. On March 30, 2011, the remaining $25.0 million of the Series A Fixed Preferred Stock was redeemed. The unamortized discount related to the Series A preferred stock was charged to retained earnings upon redemption. The complete redemption of the Series A preferred stock removed the TARP restrictions pertaining to the Company s ability to declare and pay dividends and repurchase its common stock, as well as certain restrictions associated with executive compensation.

At the time of the redemption the Company announced its intent to repurchase the related warrant issued to the Treasury. The Company is currently negotiating with the Treasury to repurchase the outstanding Warrant. There can be no assurance that an acceptable price for repurchasing the Warrant from the Treasury can be negotiated.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
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(5.) SHAREHOLDERS EQUITY (Continued)

Comprehensive Income (Loss)

Presented below is a reconciliation of net income to comprehensive income including the components of other comprehensive income for the periods indicated (in thousands):

	Three months ended March 31,					
	2011			2010		
	Pre-tax Amount	Tax Expense (Benefit)	Net-of-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	Net-of-tax Amount
Securities available for sale:						
Net unrealized gains arising during the period	$ 1,255	$ 497	$ 758	$ 2,103	$ 813	$ 1,290
Reclassification adjustments:						
Realized net gains included in income	(3)	(1)	(2)	(6)	(2)	(4)
Impairment charges included in income				526	204	322
	1,252	496	756	2,623	1,015	1,608
Pension and post-retirement benefit liabilities	145	58	87	106	41	65
Other comprehensive income	$ 1,397	$ 554	843	$ 2,729	$ 1,056	1,673
Net income			5,820			5,328
Comprehensive income			$ 6,663			$ 7,001

The components of accumulated other comprehensive loss, net of tax, for the periods indicated were as follows (in thousands):

	March 31, 2011	December 31, 2010
Net actuarial loss and prior service cost on defined benefit pension and post-retirement plans	$ (6,512)	$ (6,599)
Net unrealized gain on securities available for sale	2,633	1,877
Accumulated other comprehensive income (loss)	$ (3,879)	$ (4,722)

(6.) SHARE-BASED COMPENSATION PLANS

The Company maintains certain stock-based compensation plans, approved by the Company s shareholders that are administered by the Board, or the Management Development and Compensation Committee of the Board. The share-based compensation plans were established to allow for the granting of compensation awards to attract, motivate and retain employees, executive officers and non-employee directors who contribute to the success and profitability of the Company and to give such persons a proprietary interest in the Company, thereby enhancing their personal interest in the Company s success.

The Company awarded grants of 45,870 restricted shares to certain members of management during the three months ended March 31, 2011. The weighted average market price of the restricted shares on the date of grant was $19.25. Either a service requirement or both service and performance requirements must be satisfied before the participant becomes vested in the shares. Where applicable, the performance period for the awards is the Company s fiscal year ending on December 31, 2011.

The following is a summary of restricted stock award activity for the three months ended March 31, 2011:

	Number of Shares	Weighted Average Market Price at Grant Date
Outstanding at beginning of year	150,796	$ 12.76
Granted	45,870	19.25
Released	(26,040)	14.14
Outstanding at end of period	170,626	$ 14.29

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
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(6.) SHARE-BASED COMPENSATION PLANS (Continued)

The Company amortizes the expense related to restricted stock awards over the vesting period. Share-based compensation expense is included in the consolidated statements of income under salaries and employee benefits for awards granted to management and in other noninterest expense for awards granted to directors. The share-based compensation expense included in the consolidated statements of income is as follows for the periods indicated (in thousands):

	Three months ended March 31,	
	2011	**2010**
Stock options:		
Management Stock Incentive Plan	$ 14	$ 26
Director Stock Incentive Plan	10	11
	24	37
Restricted stock awards:		
Management Stock Incentive Plan	192	170
Director Stock Incentive Plan	15	14
	207	184
Total share-based compensation	$ 231	$ 221

(7.) EMPLOYEE BENEFIT PLANS

Defined Benefit Pension Plan

The Company participates in The New York State Bankers Retirement System (the System), a defined benefit pension plan covering substantially all employees, subject to the limitations related to the plan closure effective December 31, 2006. The benefits are based on years of service and the employee s highest average compensation during five consecutive years of employment. The defined benefit plan was closed to new participants effective December 31, 2006. Only employees hired on or before December 31, 2006 and who met participation requirements on or before January 1, 2008 are eligible to receive benefits.

The components of the Company s net periodic benefit expense for its pension plan were as follows (in thousands):

	Three months ended March 31,	
	2011	**2010**
Service cost	$ 439	$ 408
Interest cost on projected benefit obligation	507	483
Expected return on plan assets	(663)	(611)
Amortization of unrecognized prior service cost	4	3
Amortization of unrecognized loss	152	115
Net periodic pension cost	$ 439	$ 398

The Company s funding policy is to contribute, at a minimum, an actuarially determined amount that will satisfy the minimum funding requirements determined under the appropriate sections of Internal Revenue Code. In

December 2010, the Company contributed $4.3 million to the pension plan for fiscal year 2011, which exceeded the minimum required contribution of $1.5 million.

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(8.) COMMITMENTS AND CONTINGENCIES

The Company has financial instruments with off-balance sheet risk established in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk extending beyond amounts recognized in the financial statements.

The Company s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is essentially the same as that involved with extending loans to customers. The Company uses the same credit underwriting policies in making commitments and conditional obligations as for on-balance sheet instruments.

Off-balance sheet commitments consist of the following (in thousands):

	March 31, 2011	December 31, 2010
Commitments to extend credit	$ 362,228	$ 357,240
Standby letters of credit	6,549	6,524

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Commitments may expire without being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash requirements. Each customer s creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if any, is based on management s credit evaluation of the borrower. Standby letters of credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. These standby letters of credit are primarily issued to support private borrowing arrangements. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loan facilities to customers.

The Company also extends rate lock agreements to borrowers related to the origination of residential mortgage loans. To mitigate the interest rate risk inherent in these rate lock agreements when the Company intends to sell the related loan, once originated, as well as closed residential mortgage loans held for sale, the Company enters into forward commitments to sell individual residential mortgages. Rate lock agreements and forward commitments are considered derivatives and are recorded at fair value. Forward sales commitments totaled $839 thousand and $8.0 million at March 31, 2011 and December 31, 2010, respectively.

(9.) FAIR VALUE MEASUREMENTS

Determination of Fair Value Assets Measured at Fair Value on a Recurring and Nonrecurring Basis

Valuation Hierarchy

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. ASC Topic 820, Fair Value Measurements and Disclosures, establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
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(9.) FAIR VALUE MEASUREMENTS (Continued)

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the company s creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company s valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein. A more detailed description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Investment securities available for sale: Pooled trust preferred securities are reported at fair value utilizing Level 3 inputs. Fair values for these securities are determined through the use of internal valuation methodologies appropriate for the specific asset, which may include the use of a discounted expected cash flow analysis or the use of broker quotes. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things.

Loans held for sale: The fair value of loans held for sale is determined using quoted secondary market prices and investor commitments. Loans held for sale are classified as Level 2 in the fair value hierarchy.

Collateral dependent impaired loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Other real estate owned (Foreclosed assets): Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Mortgage servicing rights: Mortgage servicing rights do not trade in an active market with readily observable market data. As a result, the Company estimates the fair value of mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The assumptions used in the discounted cash flow model are those that we believe market participants would use in estimating future net servicing income, including estimates of loan prepayment rates, servicing costs, ancillary income, impound account balances, and discount rates. Significant assumptions in the valuation of mortgage servicing rights include changes in interest rates, estimated loan repayment rates, and the timing of cash flows, among other factors. Mortgage servicing rights are classified as Level 3 measurements due to the use of significant unobservable inputs, as well as significant management judgment and estimation.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
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(9.) FAIR VALUE MEASUREMENTS (Continued)

Assets Measured at Fair Value

The following table presents for each of the fair-value hierarchy levels the Company s assets that are measured at fair value on a recurring and non-recurring basis as of March 31, 2011 (in thousands).

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Measured on a recurring basis:				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$	$ 134,301	$	$ 134,301
State and political subdivisions		118,908		118,908
Mortgage-backed securities		438,986		438,986
Asset-backed securities:				
Trust preferred securities			567	567
Other		50		50
	$	$ 692,245	$ 567	$ 692,812
Measured on a nonrecurring basis:				
Loans:				
Loans held for sale	$	$ 1,666	$	$ 1,666
Collateral dependent impaired loans			2,262	2,262
Other assets:				
Mortgage servicing rights			1,580	1,580
Other real estate owned			568	568
	$	$ 1,666	$ 4,410	$ 6,076

The following table presents for each of the fair-value hierarchy levels the Company s assets that are measured at fair value on a recurring and non-recurring basis as of December 31, 2010 (in thousands).

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Measured on a recurring basis:				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$	$ 140,784	$	$ 140,784
State and political subdivisions		105,666		105,666
Mortgage-backed securities		419,281		419,281
Asset-backed securities:				
Trust preferred securities			572	572
Other		65		65
	$	$ 665,796	$ 572	$ 666,368
Measured on a nonrecurring basis:				

Loans:				
Loans held for sale	$	$ 3,138	$	$ 3,138
Collateral dependent impaired loans			2,457	2,457
Other assets:				
Mortgage servicing rights			1,467	1,467
Other real estate owned			741	741
	$	$ 3,138	$ 4,665	$ 7,803

There were no liabilities measured at fair value on a recurring or nonrecurring basis during the three month periods ended March 31, 2011 and 2010.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
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(9.) FAIR VALUE MEASUREMENTS (Continued)

Changes in Level 3 Fair Value Measurements

The reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) is as follows for the periods indicated (in thousands):

	Three months ended March 31,	
	2011	**2010**
Securities available for sale (Level 3), beginning of period	$ 572	$ 1,015
Transfers into Level 3		
Capitalized interest	110	86
Coupon payments applied to principal		(35)
Total losses (realized/unrealized):		
Included in earnings		(526)
Included in other comprehensive income	(115)	121
Securities available for sale (Level 3), end of period	$ 567	$ 661

Fair Value of Financial Instruments

The Fair Value of Financial Instruments Subsection of the ASC requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis.

The following discussion describes the valuation methodologies used for assets and liabilities measured or disclosed at fair value. The techniques utilized in estimating the fair values of financial instruments are reliant on the assumptions used, including discount rates and estimates of the amount and timing of future cash flows. Care should be exercised in deriving conclusions about our business, its value or financial position based on the fair value information of financial instruments presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial instrument, including estimates of timing, amount of expected future cash flows and the credit standing of the issuer. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument.

The estimated fair value approximates carrying value for cash and cash equivalents, FHLB and FRB stock, company owned life insurance, accrued interest receivable, short-term borrowings and accrued interest payable. Fair value estimates for other financial instruments are discussed below.

Loans held for sale. The fair value is based on estimates, quoted market prices and investor commitments.

Loans. For variable rate loans that re-price frequently, fair value approximates carrying amount. The fair value for fixed rate loans is estimated through discounted cash flow analysis using interest rates currently being offered on loans with similar terms and credit quality. For criticized and classified loans, fair value is estimated by discounting expected cash flows at a rate commensurate with the risk associated with the estimated cash flows, or estimates of fair value discounts based on observable market information.

Deposits. The fair values for demand accounts, money market and savings deposits are equal to their carrying amounts. The fair values of certificates of deposit are estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments.

Long-term borrowings and junior subordinated debentures. The fair value for long-term borrowings and junior subordinated debentures are estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments.

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The accounting guidelines exclude certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented at March 31, 2011 and December 31, 2010 may not necessarily represent the underlying fair value of the Company.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

(9.) FAIR VALUE MEASUREMENTS (Continued)

The estimated fair values of financial instruments were as follows (in thousands):

	March 31, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 94,535	$ 94,535	$ 39,058	$ 39,058
Securities available for sale	692,812	692,812	666,368	666,368
Securities held to maturity	25,284	25,959	28,162	28,849
Loans held for sale	1,666	1,693	3,138	3,138
Loans	1,332,400	1,388,432	1,325,524	1,388,787
Accrued interest receivable	8,403	8,403	7,613	7,613
FHLB and FRB stock	6,350	6,350	6,353	6,353
Financial liabilities:				
Demand, savings and money market deposits	1,243,285	1,243,285	1,143,136	1,143,136
Certificate of deposit	726,296	726,337	739,754	740,440
Short-term borrowings	42,060	42,060	77,110	77,110
Long-term borrowings (excluding junior subordinated debentures)	10,000	10,098	10,065	10,244
Junior subordinated debentures	16,702	10,492	16,702	10,564
Accrued interest payable	7,053	7,053	7,620	7,620

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ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD LOOKING INFORMATION

This Quarterly Report on Form 10-Q should be read in conjunction with the more detailed and comprehensive disclosures included in our Annual Report on Form 10-K for the year ended December 31, 2010. In addition, please read this section in conjunction with our Consolidated Financial Statements and Notes to Consolidated Financial Statements contained herein.

Statements and financial analysis contained in this document that are not historical facts are forward looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the Act). In addition, certain statements may be contained in our future filings with SEC, in press releases, and in oral and written statements made by or with our approval that are not statements of historical fact and constitute forward-looking statement within the meaning of the Act. Forward looking statements describe our future plans, strategies and expectations and are based on certain assumptions. Words such as may, could, should, would, bel anticipate, estimate, expect, intend, plan, target, plan, projects, and other similar expressions are inter forward-looking statements but are not the exclusive means of identifying such statements.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advises readers that various factors, including those described above, could affect the Company s financial performance and could cause the Company s actual results or circumstances for future periods to differ materially from those anticipated or projected.

Except as required by law, the Company does not undertake, and specifically disclaims any obligation to publicly release any revisions to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

RECENT DEVELOPMENTS

Common Stock Offering

On March 15, 2011, we completed the sale of 2,813,475 shares of our common stock through an underwritten public offering at a price of $16.35 per share. The net proceeds of the offering, after deducting underwriting discounts and commissions and offering expenses, amounted to $43.1 million. A portion of the proceeds from this offering was used to redeem the Company s Series A preferred stock as described in greater detail below. The Company is also evaluating the potential of redeeming the $16.7 million of 10.20% junior subordinated debentures related to the trust preferred securities issued by an unconsolidated subsidiary. The Company expects to use the remaining proceeds of this offering for general working capital purposes.

Redemption of Series A Preferred Stock

In the first quarter of 2011, the Company fully redeemed $37.5 million of its fixed rate cumulative perpetual preferred stock, Series A (Series A preferred stock) issued in connection with the U.S. Department of the Treasury s (the Treasury) Troubled Asset Relief Program (TARP) Capital Purchase Program. The redemption was funded, in part, by the proceeds of the common stock offering discussed above and from excess liquidity at the parent company. The redemption resulted in a one-time, non-cash redemption charge of $1.2 million, reflecting the accelerated accretion of the remaining discount on the preferred stock, which reduced first quarter 2011 diluted earnings per common share by $0.11.

The complete redemption of the Series A preferred stock removed the TARP restrictions pertaining to the Company s ability to declare and pay dividends and repurchase its common stock, as well as certain restrictions associated with executive compensation.

At the time of the redemption, the Company announced its intent to repurchase the related warrant issued to the Treasury. The Company is currently negotiating with the Treasury to repurchase the outstanding warrant. There can be no assurance that an acceptable price for repurchasing the warrant can be negotiated.

RESULTS OF OPERATIONS

Summary of Performance

Net income for the first quarter of 2011 was $5.8 million compared to $5.3 million for the first quarter of 2010. Net income available to common shareholders for the first quarter of 2011 was $3.7 million, or $0.33 per basic and diluted share. Comparatively, net income available to common shareholders for the first quarter of 2010 was $4.4 million, or

$0.41 and $0.40 earnings per basic and diluted share, respectively. First quarter 2011 earnings per share was reduced by $1.2 million, or $0.11 per common share, for the accelerated discount accretion related to the Company s redemption of the Series A preferred stock that had been issued to the Treasury pursuant to the TARP Capital Purchase Program (the CPP preferred stock).

Return on average equity was 10.85% and return on average assets was 1.06% for the first quarter of 2011, compared to 10.67% and 1.02%, respectively, for the first quarter of 2010. The net interest margin for the first three months of 2011 was 4.05% compared to 4.12% for the first three months of 2010.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Net Interest Income and Net Interest Margin

Net interest income is the primary source of our revenue. Net interest income is the difference between interest income on interest-earning assets, such as loans and investment securities, and the interest expense on interest-bearing deposits and other borrowings used to fund interest-earning and other assets or activities. Net interest income is affected by changes in interest rates and by the amount and composition of earning assets and interest-bearing liabilities, as well as the sensitivity of the balance sheet to changes in interest rates, including characteristics such as the fixed or variable nature of the financial instruments, contractual maturities and repricing frequencies.

Interest rate spread and net interest margin are utilized to measure and explain changes in net interest income. Interest rate spread is the difference between the yield on earning assets and the rate paid for interest-bearing liabilities that fund those assets. The net interest margin is expressed as the percentage of net interest income to average earning assets. The net interest margin exceeds the interest rate spread because noninterest-bearing sources of funds (net free funds), principally noninterest-bearing demand deposits and stockholders equity, also support earning assets. To compare tax-exempt asset yields to taxable yields, the yield on tax-exempt investment securities is computed on a taxable equivalent basis. Net interest income, interest rate spread, and net interest margin are discussed on a taxable equivalent basis.

The following table reconciles interest income per the consolidated statements of income to interest income adjusted to a fully taxable equivalent basis:

	Three months ended March 31,	
	2011	**2010**
Interest income per consolidated statements of income	$ 23,639	$ 23,824
Adjustment to fully taxable equivalent basis	514	507
Interest income adjusted to a fully taxable equivalent basis	24,153	24,331
Interest expense per consolidated statements of income	3,801	4,572
Net interest income on a taxable equivalent basis	$ 20,352	$ 19,759

Net interest income on a taxable equivalent basis for the three months ended March 31, 2011, was $20.4 million, an increase of $593 thousand or 3% versus the comparable quarter last year. The increase in taxable equivalent net interest income was primarily attributable to favorable volume variances (as changes in the balances and mix of earning assets and interest-bearing liabilities added $1.7 million to taxable equivalent net interest income), partly offset by unfavorable rate variances (as the impact of changes in the interest rate environment and product pricing reduced taxable equivalent net interest income by $1.1 million).

The net interest margin for the first three months of 2011 was 4.05%, 7 basis points lower than 4.12% for the same period in 2010. This comparable period decrease was a function of a 5 basis point decrease in interest rate spread, combined with a 2 basis point lower contribution from net free funds (due principally to lower rates on interest-bearing liabilities reducing the value of noninterest-bearing deposits and other net free funds). The lower interest rate spread was a net result of a 28 basis point decrease in the yield on earning assets and a 23 basis point decrease in the cost of interest-bearing liabilities.

For the first quarter of 2011, the yield on average earning assets of 4.80% was 28 basis points lower than the first quarter of 2010. Loan yields decreased 26 basis points to 5.71%. Residential mortgage and consumer indirect loans in particular, down 47 and 53 basis points, respectively, experienced lower yields given the competitive pricing pressures in a low interest rate environment. The yield on investment securities dropped 47 basis points to 3.00%, also impacted by the lower interest rate environment and prepayments of mortgage-related investment securities. Overall, earning asset rate changes reduced interest income by $1.7 million.

The cost of average interest-bearing liabilities of 0.94% in the first quarter of 2011 was 23 basis points lower than the first quarter of 2010. The average cost of interest-bearing deposits was 0.83% in 2011, 20 basis points lower than 2010, reflecting the lower rate environment, mitigated by a focus on product pricing to retain balances. The cost of wholesale funding (comprised of short-term borrowings and long-term borrowings) decreased 22 basis points to 3.12% for the first quarter of 2011. The interest-bearing liability rate changes resulted in $637 thousand of lower interest expense.

Average interest-earning assets were $2.031 billion for first quarter 2011, an increase of $95.4 million or 5% from the comparable quarter last year, with average loans up $86.1 million and average securities up $23.4 million. The growth in average loans was comprised of increases in consumer loans (up $70.9 million, primarily indirect loans) and commercial loans (up $30.4 million), while residential mortgages declined (down $15.2 million).

Average interest-bearing liabilities of $1.641 billion in first quarter of 2011 were $62.4 million or 4% higher than the first quarter of 2010. On average, interest-bearing deposits grew $79.3 million (primarily attributable to $74.0 million higher retail deposits), while noninterest-bearing demand deposits (a principal component of net free funds) were up $36.8 million. Average wholesale funding balances decreased $16.9 million between the first quarter periods, with short-term borrowing higher by $3.2 million and long-term funding lower by $20.1 million.

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MANAGEMENT S DISCUSSION AND ANALYSIS

The following tables sets forth certain information relating to the consolidated balance sheets and reflects the average yields earned on interest-earning assets, as well as the average rates paid on interest-bearing liabilities for the periods indicated (in thousands).

	Three months ended March 31,					
	2011			2010		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Interest-earning assets:						
Federal funds sold and interest-earning deposits	$ 258	$	0.21%	$ 14,366	$ 7	0.21%
Investment securities [1]:						
Taxable	545,079	3,649	2.68	541,906	4,213	3.11
Tax-exempt [2]	136,525	1,469	4.30	116,275	1,493	5.14
Total investment securities	681,604	5,118	3.00	658,181	5,706	3.47
Loans:						
Commercial business	207,669	2,473	4.83	204,905	2,464	4.88
Commercial mortgage	361,228	5,231	5.87	333,579	4,976	6.05
Residential mortgage	128,567	1,835	5.71	143,780	2,222	6.18
Home equity	208,656	2,323	4.51	199,903	2,277	4.62
Consumer indirect	417,833	6,525	6.33	352,778	5,966	6.86
Other consumer	25,226	648	10.41	28,145	713	10.27
Total loans	1,349,179	19,035	5.71	1,263,090	18,618	5.97
Total interest-earning assets	2,031,041	24,153	4.80	1,935,637	24,331	5.08
Allowance for loan losses	(20,876)			(21,020)		
Other noninterest-earning assets	211,613			197,575		
Total assets	$ 2,221,778			$ 2,112,192		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand	$ 395,807	$ 162	0.17%	$ 392,896	$ 189	0.20%
Savings and money market	434,579	262	0.24	401,294	276	0.28
Certificates of deposit	732,414	2,773	1.54	689,284	3,319	1.95
Total interest-bearing deposits	1,562,800	3,197	0.83	1,483,474	3,784	1.03
Short-term borrowings	51,127	72	0.57	47,964	78	0.66
Long-term borrowings	26,743	532	7.98	46,847	710	6.09
Total borrowings	77,870	604	3.12	94,811	788	3.34
	1,640,670	3,801	0.94	1,578,285	4,572	1.17

Total interest-bearing liabilities				
Noninterest-bearing demand deposits	350,032		313,227	
Other noninterest-bearing liabilities	13,548		18,150	
Shareholders equity	217,528		202,530	
Total liabilities and shareholders equity	$ 2,221,778		$ 2,112,192	
Net interest income (tax-equivalent)		$ 20,352		$ 19,759
Interest rate spread		3.86%		3.91%
Net earning assets	$ 390,371		$ 357,352	
Net interest margin (tax-equivalent)		4.05%		4.12%
Ratio of average interest-earning assets to average interest-bearing liabilities		123.79%		122.64%

(1) Investment securities are shown at amortized cost and include non-performing securities.

(2) The interest on tax-exempt securities is calculated on a tax equivalent basis assuming a Federal tax rate of 35% and 34% for the three months ended March 31, 2011 and 2010, respectively.

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MANAGEMENT S DISCUSSION AND ANALYSIS

The following table presents, on a tax equivalent basis, the relative contribution of changes in volumes and changes in rates to changes in net interest income for the periods indicated. The change in interest not solely due to changes in volume or rate has been allocated in proportion to the absolute dollar amounts of the change in each (in thousands):

	Three months ended March 31, 2011 vs. 2010		
	Volume	Rate	Total
Increase (decrease) in:			
Interest income:			
Federal funds sold and interest-earning deposits	$ (7)	$	$ (7)
Investment securities:			
Taxable	25	(589)	(564)
Tax-exempt	238	(262)	(24)
Total investment securities	263	(851)	(588)
Loans:			
Commercial business	33	(24)	9
Commercial mortgage	403	(148)	255
Residential mortgage	(225)	(162)	(387)
Home equity	98	(52)	46
Consumer indirect	1,041	(482)	559
Other consumer	(75)	10	(65)
Total loans	1,275	(858)	417
Total interest income	1,531	(1,709)	(178)
Interest expense:			
Deposits:			
Interest-bearing demand	1	(28)	(27)
Savings and money market	22	(36)	(14)
Certificates of deposit	198	(744)	(546)
Total interest-bearing deposits	221	(808)	(587)
Short-term borrowings	5	(11)	(6)
Long-term borrowings	(360)	182	(178)
Total borrowings	(355)	171	(184)
Total interest expense	(134)	(637)	(771)
Net interest income	$ 1,665	$ (1,072)	$ 593

Provision for Loan Losses

The provision for loan losses is based upon credit loss experience, growth or contraction of specific segments of the loan portfolio, and the estimate of losses inherent in the current loan portfolio. The provision for loan losses for the first quarter of 2011 was $810 thousand, compared to $418 thousand for the same period in 2010. See Allowance for

Loan Losses under the section titled Lending Activities included herein for additional information.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Noninterest Income

The following table details the major categories of noninterest income for the periods presented (in thousands):

	Three months ended March 31,	
	2011	**2010**
Service charges on deposits	2,105	2,230
ATM and debit card	1,016	934
Broker-dealer fees and commissions	386	380
Loan servicing	349	280
Company owned life insurance	266	269
Net gain on sale of loans held for sale	224	62
Net gain on disposal of investment securities	3	6
Impairment charges on investment securities		(526)
Net gain on sale and disposal of other assets	45	2
Other	754	446
Total noninterest income	$ 5,148	$ 4,083

The components of noninterest income fluctuated as discussed below.

Service charges on deposit accounts declined 6% compared to the same period last year mainly due to a change in consumer behavior, triggered in part by heightened consumer protection regulations.

ATM and debit card income increased by $82 thousand during the first quarter of 2011 compared to first quarter of 2010, as the increased popularity of electronic banking and transaction processing has resulted in higher ATM and debit card point-of-sale usage income.

Higher origination volumes and increased income from mortgage banking activities during the first quarter of 2011, coupled with a favorable valuation adjustment to capitalized mortgage servicing assets, resulted in a combined increase of $231 thousand in loan servicing income and gains from the sale of loans held for sale in comparison to the first quarter of 2010.

Income from the Company s capital investment in several limited partnerships accounted for the majority of the $308 thousand increase in other noninterest income when comparing the first quarter of 2011 to the same quarter last year.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Noninterest Expense

The following table details the major categories of noninterest expense for the periods presented (in thousands):

	Three months ended March 31,	
	2011	**2010**
Salaries and employee benefits	8,401	8,247
Occupancy and equipment	2,843	2,771
Professional services	682	606
FDIC assessments	607	602
Computer and data processing	603	571
Supplies and postage	452	445
Advertising and promotions	165	187
Other	1,597	1,309
Total noninterest expense	$ 15,350	$ 14,738

The components of noninterest expense fluctuated as discussed below.

Salaries and employee benefits was $8.4 million for 2011, up $154 thousand or 2% from 2010. The increase reflects higher employee benefit costs and salaries due to annual merit increases. Full time equivalent employees totaled 574 and 581 at March 31, 2011 and 2010, respectively.

Other noninterest expense was $1.6 million for the first quarter of 2011, an increase of $288 thousand or 22% from the first quarter of 2010, due in part to higher lending expenses associated with increased loan application volumes.

The efficiency ratio for the first quarter of 2011 was 59.97% compared with 60.31% for the first quarter of 2010. The efficiency ratio equals noninterest expense less other real estate expense and amortization of intangible assets as a percentage of net revenue, defined as the sum of tax-equivalent net interest income and noninterest income before net gains and impairment charges on investment securities.

Income Taxes

For the three months ended March 31, 2011, the Company recorded income tax expense of $3.0 million, versus $2.9 million a year ago. The change in income tax was primarily due to higher pre-tax income during the first quarter of 2011. The effective tax rates for the first quarter of 2011 and 2010 were 34.1% and 34.9%, respectively. Effective tax rates are impacted by items of income and expense that are not subject to federal or state taxation. The Company s effective tax rates reflect the impact of these items, which include, but are not limited to, interest income from tax-exempt and tax-preferred securities and earnings on company owned life insurance.

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MANAGEMENT S DISCUSSION AND ANALYSIS

ANALYSIS OF FINANCIAL CONDITION

INVESTING ACTIVITIES

The following table sets forth selected information regarding the composition of the Company s investment securities portfolio as of the dates indicated (in thousands):

	Investment Securities Portfolio Composition			
	March 31, 2011		December 31, 2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale:				
U.S. Government agency and government-sponsored enterprise securities	$ 135,621	$ 134,301	$ 141,591	$ 140,784
State and political subdivisions	118,496	118,908	105,622	105,666
Mortgage-backed securities:				
Agency mortgage-backed securities	432,986	437,531	414,502	417,709
Non-Agency mortgage-backed securities	784	1,455	981	1,572
Asset-backed securities	564	617	564	637
Total available for sale securities	688,451	692,812	663,260	666,368
Securities held to maturity:				
State and political subdivisions	25,284	25,959	28,162	28,849
Total investment securities	$ 713,735	$ 718,771	$ 691,422	$ 695,217

Impairment Assessment

The Company reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) with formal reviews performed quarterly. When evaluating debt securities for OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intention to sell the debt security or whether it is more likely than not that it will be required to sell the debt security before its anticipated recovery. The assessment of whether OTTI exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

The table below summarizes unrealized losses in each category of the securities portfolio at the end of the periods indicated (in thousands).

	Unrealized Losses on Investment Securities			
	March 31, 2011		December 31, 2010	
	Unrealized Losses	% of Total	Unrealized Losses	% of Total
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 2,246	46.4%	$ 1,965	31.6%
State and political subdivisions	1,172	24.2	1,472	23.6
Mortgage-backed securities:				
Agency mortgage-backed securities	1,289	26.6	2,655	42.7
Non-Agency mortgage-backed securities				
Asset-backed securities	135	2.8	131	2.1

Total available for sale securities	$ 4,842	100.0	$ 6,223	100.0
Securities held to maturity:				
State and political subdivisions				
Total investment securities	$ 4,842	100.0%	$ 6,223	100.0%

U.S. Government Agencies and Government Sponsored Enterprises (GSE). As of March 31, 2011, there were 14 securities in the U.S. Government agencies and GSE portfolio that were in an unrealized loss position. Of these, 7 were in an unrealized loss position for 12 months or longer and had an aggregate amortized cost of $8.7 million and unrealized losses of $39 thousand. Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because we do not have the intent to sell these securities and it is likely that we will not be required to sell the securities before their anticipated recovery, we do not consider these securities to be other-than-temporarily impaired at March 31, 2011.

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MANAGEMENT S DISCUSSION AND ANALYSIS

State and Political Subdivisions. As of March 31, 2011, the state and political subdivisions portfolio (municipals) totaled $144.2 million, of which $118.9 million was classified as available for sale. As of that date, $25.3 million was classified as held to maturity, with a fair value of $26.0 million. As of March 31, 2011, there were 119 municipals in an unrealized loss position, all of which were available for sale. These securities had an aggregate amortized cost of $50.3 million and unrealized losses of $1.2 million.

Although there has been a considerable amount of negative information regarding municipal bond insurers, and several of the municipal bond insurers have been downgraded, there is no indication to date that the underlying credit issuers (counties, towns, villages, cities, schools, etc.) are likely to default on their debt. There have also been some highly publicized concerns over the New York State budget problems as well as a recent shortage in the state funding amounts sent by New York State to municipalities. At this time, management does not believe that the New York State budget problems will culminate in local municipalities defaulting on debt obligations. Additionally, most of the available for sale bonds are General Obligation issues which require the taxing authority to increase taxes as needed to repay the bond holders.

Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because we do not have the intent to sell these securities and it is likely that we will not be required to sell the securities before their anticipated recovery, we do not consider these securities to be other-than-temporarily impaired at March 31, 2011.

Agency Mortgage-backed Securities. With the exception of the non-Agency mortgage-backed securities (non-Agency MBS) discussed below, all of the mortgage-backed securities held by us as of March 31, 2011, were issued by U.S. Government sponsored entities and agencies (Agency MBS), primarily GNMA. The contractual cash flows of our Agency MBS are guaranteed by FNMA, FHLMC or GNMA. The GNMA mortgage-backed securities are backed by the full faith and credit of the U.S. Government.

As of March 31, 2011, there were 36 securities in the U.S. Government agencies and GSE portfolio that were in an unrealized loss position. Of these, only 4 were in an unrealized loss position for 12 months or longer and had an aggregate amortized cost of $2.1 million and unrealized losses of $12 thousand. Given the high credit quality inherent in Agency MBS, we do not consider any of the unrealized losses on such MBS to be credit related or other-than-temporary as of March 31, 2011. Furthermore, as of March 31, 2011, we did not intend to sell any of Agency MBS that were in an unrealized loss position, all of which were performing in accordance with their terms.

Non-Agency Mortgage-backed Securities. Our non-Agency MBS portfolio consists of positions in three privately issued whole loan collateralized mortgage obligations with a fair value of $1.5 million and net unrealized gains of $671 thousand as of March 31, 2011. As of that date, each of the 3 non-Agency MBS were rated below investment grade. None of these securities were in an unrealized loss position. To date, we have recognized aggregate OTTI charges of $6.0 million due to reasons of credit quality against these securities, all of which was recorded prior to 2010.

Asset-backed Securities (ABS). As of March 31, 2011, the fair value of the ABS portfolio totaled $617 thousand and consisted of positions in 15 securities, the majority of which are pooled trust preferred securities (TPS) issued primarily by financial institutions and, to a lesser extent, insurance companies located throughout the United States. As a result of some issuers defaulting and others electing to defer interest payments, we considered the TPS to be non-performing and stopped accruing interest on the investments during 2009.

Since the second quarter of 2008, we have written down each of the securities in the ABS portfolio, resulting in aggregate OTTI charges of $32.9 million through December 31, 2010. We expect to recover the remaining amortized cost of $564 thousand on the securities. As of March 31, 2011, each of the securities in the ABS portfolio was rated below investment grade. There were 8 ABS in a loss position with an aggregate amortized cost of $339 thousand and unrealized losses totaling $135 thousand as of March 31, 2011. Of these, 6 were in an unrealized loss position for 12 months or longer and had an aggregate amortized cost of $167 thousand and unrealized losses of $72 thousand.

Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because we do not have the intent to sell these securities and it is likely that we will not be required to sell the securities before their anticipated recovery, we do not consider these securities to be other-than-temporarily impaired at March 31, 2011.

Other Investments. As a member of the FHLB the Bank is required to hold FHLB stock. The amount of required FHLB stock is based on the Bank s asset size and the amount of borrowings from the FHLB. We have assessed the ultimate recoverability of our FHLB stock and believe that no impairment currently exists. As a member of the FRB system, we are required to maintain a specified investment in FRB stock based on a ratio relative to our capital. Our ownership of FHLB stock and FRB stock totaled $2.5 million and $3.9 million, respectively, at March 31, 2011. The FHLB stock and FRB stock are recorded at cost and included in other assets.

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MANAGEMENT S DISCUSSION AND ANALYSIS

LENDING ACTIVITIES

The following table sets forth selected information regarding the composition of the Company s loan portfolio as of the dates indicated (in thousands).

	Loan Portfolio Composition			
	March 31, 2011		December 31, 2010	
	Amount	% of Total	Amount	% of Total
Commercial business	$ 209,379	15.5%	$ 211,031	15.7%
Commercial mortgage	361,713	26.7	352,930	26.2
Total commercial	571,092	42.2	563,961	41.9
Residential mortgage	123,594	9.1	129,580	9.6
Home equity	209,961	15.5	208,327	15.5
Consumer indirect	422,821	31.3	418,016	31.1
Other consumer	25,051	1.9	26,106	1.9
Total consumer	657,833	48.7	652,449	48.5
Total loans	1,352,519	100.0%	1,345,990	100.0%
Allowance for loan losses	20,119		20,466	
Total loans, net	$ 1,332,400		$ 1,325,524	

Total loans increased $6.5 million to $1.353 billion as of March 31, 2011 from $1.346 billion as of December 31, 2010.

Commercial loans increased $7.1 million and represented 42.2% of total loans as of March 31, 2011, compared to 41.9% at December 31, 2010, a result of the Company s continued focus on commercial business development programs.

Residential mortgage loans decreased $6.0 million to $123.6 million as of March 31, 2011 in comparison to $129.6 million as of December 31, 2010. This category of loans decreased as the majority of newly originated and refinanced residential mortgages were sold to the secondary market rather than being added to the portfolio. The Company does not engage in sub-prime or other high-risk residential mortgage lending as a line-of-business.

The consumer indirect portfolio increased $4.8 million to $422.8 million as of March 31, 2011, from $418.0 million as of December 31, 2010. During the first quarter of 2011, the Company originated $45.6 million in indirect auto loans with a mix of approximately 41% new auto and 59% used auto. This compares with $35.2 million in indirect loan auto originations with a mix of approximately 29% new auto and 71% used auto for the same period in 2010.

Loans Held for Sale and Mortgage Servicing Rights. Loans held for sale (not included in the loan portfolio composition table) totaled $1.7 million and $3.1 million as of March 31, 2011 and December 31, 2010, respectively, all of which were residential real estate loans.

We sell certain qualifying newly originated and refinanced residential real estate mortgages on the secondary market. The sold and serviced residential real estate loan portfolio decreased to $322.6 million as of March 31, 2011 from $328.9 million as of December 31, 2010. The decrease in the sold and serviced portfolio resulted from a decrease in residential loan origination and refinancing volumes.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Allowance for Loan Losses

The following table sets forth an analysis of the activity in the allowance for loan losses for the periods indicated (in thousands).

	Loan Loss Analysis Three months ended March 31,	
	2011	**2010**
Balance as of beginning of period	$ 20,466	$ 20,741
Charge-offs:		
Commercial business	90	69
Commercial mortgage	344	45
Residential mortgage	2	12
Home equity	107	47
Consumer indirect	1,290	1,228
Other consumer	211	212
Total charge-offs	2,044	1,613
Recoveries:		
Commercial business	154	92
Commercial mortgage	16	432
Residential mortgage	27	4
Home equity	10	2
Consumer indirect	552	340
Other consumer	128	170
Total recoveries	887	1,040
Net charge-offs	1,157	573
Provision for loan losses	810	418
Balance at end of period	$ 20,119	$ 20,586
Net loan charge-offs to average loans (annualized)	0.35%	0.18%
Allowance for loan losses to total loans	1.49%	1.62%
Allowance for loan losses to non-performing loans	275%	308%

The allowance for loan losses represents the estimated amount of probable credit losses inherent in the Company s loan portfolio. The Company performs periodic, systematic reviews of the loan portfolio to estimate probable losses in the respective loan portfolios. In addition, the Company regularly evaluates prevailing economic and business conditions, industry concentrations, changes in the size and characteristics of the portfolio and other pertinent factors. The process used by the Company to determine the overall allowance for loan losses is based on this analysis. Based on this analysis the Company believes the allowance for loan losses is adequate as of March 31, 2011.

Assessing the adequacy of the allowance for loan losses involves substantial uncertainties and is based upon management s evaluation of the amounts required to meet estimated charge-offs in the loan portfolio after weighing a

variety of factors, including the risk-profile of the Company s loan products and customers. The Company does not engage in sub-prime or other high-risk residential mortgage lending as a line-of-business. The Company primarily originates fixed and variable rate one-to-four family residential mortgages collateralized by owner-occupied properties located within its central and western New York marketplace, which has been relatively stable in recent years. Residential mortgages collateralized by one-to-four family residential real estate generally have been originated in amounts of no more than 85% of appraised value or have mortgage insurance.

The adequacy of the allowance for loan losses is subject to ongoing management review. While management evaluates currently available information in establishing the allowance for loan losses, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution s allowance for loan losses. Such agencies may require the financial institution to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

Net charge-offs for the first quarter of 2011 amounted to $1.2 million, up $584 thousand in comparison to the same period a year ago. On an annualized basis, net charge-offs as a percentage of average loans were 0.35% for the first quarter of 2011, compared to 0.18% for the first quarter of 2010. In the first quarter of 2011, the Company s provision for loan losses increased to $810 thousand compared to $418 thousand in the first quarter of 2010. Net charge-offs and the provision for loan losses for the first quarter of 2010 were favorably impacted by a $354 thousand recovery on one commercial real estate relationship that was charged-off during 2008 and 2009.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Non-Performing Assets and Potential Problem Loans

The table below sets forth the amounts and categories of the Company s non-performing assets at the dates indicated (in thousands).

	Non-Performing Assets		
	March 31, 2011	December 31, 2010	March 31, 2010
Nonaccrual loans:			
Commercial business	$ 901	$ 947	$ 774
Commercial mortgage	2,736	3,100	2,513
Residential mortgage	2,192	2,102	2,056
Home equity	835	875	1,048
Consumer indirect	639	514	293
Other consumer	12	41	1
Total nonaccrual loans	7,315	7,579	6,685
Accruing loans 90 days or more delinquent	3	3	2
Total non-performing loans	7,318	7,582	6,687
Foreclosed assets	568	741	771
Non-performing investment securities	567	572	661
Total non-performing assets	$ 8,453	$ 8,895	$ 8,119
Non-performing loans to total loans	0.54%	0.56%	0.53%
Non-performing assets to total assets	0.37%	0.40%	0.38%

Information regarding the activity in nonaccrual loans for the three months ended March 31, 2011 is as follows (in thousands).

Nonaccrual loans, beginning of year	$ 7,579
Additions	3,165
Payments	(1,424)
Charge-offs	(1,916)
Returned to accruing status	(89)
Transferred to other real estate or repossessed assets	
Nonaccrual loans, end of period	$ 7,315

Non-performing assets include non-performing loans, foreclosed assets and non-performing investment securities. Non-performing assets at March 31, 2011 were $8.5 million, a decrease of $442 thousand from the $8.9 million balance at December 31, 2010. The primary component of non-performing assets is non-performing loans, which were $7.3 million at March 31, 2011, a decrease of $264 thousand from the $7.6 million balance at December 31, 2010. Included in nonaccrual loans are troubled debt restructurings (TDRs) of $525 thousand and $534 thousand at March 31, 2011 and December 31, 2010, respectively.

The ratio of non-performing loans to total loans was 0.54% at March 31, 2011, compared to 0.56% at December 31, 2010. This ratio continues to compare favorably to the average of our peer group, which was 3.57% of total loans at December 31, 2010, the most recent period for which information is available (Source: Federal Financial Institutions Examination Council Bank Holding Company Performance Report as of December 31, 2010 Top-tier bank holding companies having consolidated assets between $1 billion and $3 billion).

Foreclosed assets consist of real property formerly pledged as collateral to loans, which we have acquired through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. Foreclosed asset holdings represented 8 properties totaling $568 thousand at March 31, 2011 and 13 properties totaling $741 thousand at December 31, 2010.

Potential problem loans are loans that are currently performing, but information known about possible credit problems of the borrowers causes management to have concern as to the ability of such borrowers to comply with the present loan payment terms and may result in disclosure of such loans as nonperforming at some time in the future. These loans remain in a performing status due to a variety of factors, including payment history, the value of collateral supporting the credits, and/or personal or government guarantees. Management considers loans classified as substandard, which continue to accrue interest, to be potential problem loans. We identified $12.5 million and $11.5 million in loans that continued to accrue interest which were classified as substandard as of March 31, 2011 and December 31, 2010, respectively.

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MANAGEMENT S DISCUSSION AND ANALYSIS

FUNDING ACTIVITIES

Deposits

The following table summarizes the composition of our deposits at the dates indicated (dollars in thousands).

	Deposit Composition			
	March 31, 2011		December 31, 2010	
	Amount	% of Total	Amount	% of Total
Noninterest-bearing demand	$ 354,312	18.0%	$ 350,877	18.6%
Interest-bearing demand	424,897	21.6	374,900	19.9
Savings and money market	464,076	23.5	417,359	22.2
Certificates of deposit < $100,000	525,584	26.7	555,840	29.5
Certificates of deposit of $100,000 or more	200,712	10.2	183,914	9.8
Total deposits	$ 1,969,581	100.0%	$ 1,882,890	100.0%

The Company offers a broad array of deposit products including noninterest-bearing demand, interest-bearing demand, savings and money market accounts and certificates of deposit. As of March 31, 2011, total deposits were $1.970 billion, an increase of $86.7 million in comparison to $1.883 billion as of December 31, 2010.

Nonpublic deposits represent the largest component of the Company s funding. Total nonpublic deposits were $1.477 billion and $1.501 billion as of March 31, 2011 and December 31, 2010, respectively. The Company continues to manage this segment of funding through a strategy of competitive pricing and relationship-based sales and marketing that minimizes the number of customer relationships that have only a single high-cost deposit account.

The Company offers a variety of public deposit products to the many towns, villages, counties, school districts and other public entities within our market. Public deposits generally range from 20 to 25% of the Company s total deposits. As of March 31, 2011, total public deposits were $492.5 million in comparison to $382.2 million as of December 31, 2010. There is a high degree of seasonality in this component of funding, as the level of deposits varies with the seasonal cash flows for these public customers. The Company maintains the necessary levels of short-term liquid assets to accommodate the seasonality associated with public deposits.

Borrowings

The following table summarizes the Company s borrowings as of the dates indicated (in thousands):

	March 31, 2011	December 31, 2010
Customer repurchase agreements	$ 42,060	$ 38,910
Federal funds purchased		38,200
FHLB borrowings	10,000	10,065
Junior subordinated debentures	16,702	16,702
Total borrowings	$ 68,762	$ 103,877

The Company has credit capacity with the FHLB and can borrow through facilities that include an overnight line of credit, as well as amortizing and term advances. The Company had approximately $66 million of immediate credit capacity with FHLB as of March 31, 2011. The Company had approximately $347 million in secured borrowing capacity at the Federal Reserve Bank (FRB) Discount Window, none of which was outstanding at March 31, 2011. The FHLB and FRB credit capacity are collateralized by securities from the Company s investment portfolio and certain qualifying loans.

The Company also had $94.0 million of credit available under unsecured lines of credit with various banks as of March 31, 2011. There were no advances outstanding on these lines of credit as of March 31, 2011. The Company also utilizes short-term retail repurchase agreements with customers as a source of funds. These short-term repurchase agreements amounted to $42.1 million and $38.9 million as of March 31, 2011 and December 31, 2010, respectively.

Equity Activities

Total shareholders equity was $222.8 million at March 31, 2011, an increase of $10.7 million from $212.1 million at December 31, 2010. During February 2011, the Company redeemed $12.5 million of Series A preferred stock issued to the U.S. Treasury. During March 2011, the Company successfully completed a follow-on common equity offering, issuing 2,813,475 shares of common stock at a price of $16.35 per share before associated offering expenses. After deducting underwriting and other offering costs, the Company received net proceeds of approximately $43.1 million. Prior to the end of the first quarter of 2011, the Company utilized a portion of the net proceeds to redeem the remaining $25.0 million in Series A preferred stock.

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MANAGEMENT S DISCUSSION AND ANALYSIS

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

The objective of maintaining adequate liquidity is to assure the ability of the Company to meet its financial obligations. These obligations include the withdrawal of deposits on demand or at their contractual maturity, the servicing and repayment of debt and preferred equity obligations, the ability to fund new and existing loan commitments, to take advantage of new business opportunities and to satisfy other operating requirements. The Company achieves liquidity by maintaining a strong base of core customer funds, maturing short-term assets, its ability to sell securities, lines of credit, and access to the financial and capital markets.

Liquidity for the Bank is managed through the monitoring of anticipated changes in loans, the investment portfolio, core deposits and wholesale funds. The strength of the Bank s liquidity position is a result of its base of core customer deposits. These core deposits are supplemented by wholesale funding sources that include credit lines with the other banking institutions, the FHLB and the FRB.

The primary sources of liquidity for FII are dividends from the Bank and access to financial and capital markets. Dividends from the Bank are limited by various regulatory requirements related to capital adequacy and earnings trends. The Bank relies on cash flows from operations, core deposits, borrowings and short-term liquid assets. Five Star Investment Services relies on cash flows from operations and funds from FII when necessary.

The Company s cash and cash equivalents were $94.5 million as of March 31, 2011, an increase of $55.4 million from $39.1 million as of December 31, 2010. The Company s net cash provided by operating activities totaled $12.5 million. Net cash used in investing activities totaled $12.1 million, which included cash outflows of $7.7 million for net loan originations and $4.3 million from investment securities transactions. Net cash provided by financing activities of $55.1 million was attributed to a $86.7 million increase in deposits and $43.1 million in net proceeds from the issuance of common stock, partly offset by the $37.5 million payment to redeem the Series A preferred stock, a $35.1 million decrease in net borrowings, and $2.1 million in dividend payments.

Capital Resources

Banks and financial holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material impact on the Company s consolidated financial statements. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets (all as defined in the regulations). These minimum amounts and ratios are included in the table below.

The Company s and the Bank s Tier 1 capital consists of shareholders equity excluding unrealized gains and losses on securities available for sale (except for unrealized losses which have been determined to be other than temporary and recognized as expense in the consolidated statements of income), goodwill and other intangible assets and disallowed portions of deferred tax assets. Tier 1 capital for the Company includes, subject to limitation, $16.7 million of trust preferred securities issued by FISI Statutory Trust I and $17.5 million of preferred stock. The Company and the Bank s total capital are comprised of Tier 1 capital for each entity plus a permissible portion of the allowance for loan losses.

The Tier 1 and total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, excluding goodwill and other intangible assets and disallowed portions of deferred tax assets, allocated by risk weight category and certain off-balance-sheet items (primarily loan commitments and securities more than one level below investment grade that are subject to the low level exposure rules). The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets and disallowed portions of deferred tax assets.

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MANAGEMENT S DISCUSSION AND ANALYSIS

The following table reflects the ratios and their components (dollars in thousands).

	March 31, 2011	December 31, 2010
Total shareholders equity	$ 222,823	$ 212,144
Less: Unrealized gain on securities available for sale, net of tax	2,633	1,877
Unrecognized net periodic pension & postretirement benefits (costs), net of tax	(6,512)	(6,599)
Disallowed goodwill and other intangible assets	37,369	37,369
Disallowed deferred tax assets	6,680	14,608
Plus: Qualifying trust preferred securities	16,200	16,200
Tier 1 capital	$ 198,853	$ 181,089
Adjusted average total assets (for leverage capital purposes)	$ 2,182,469	$ 2,177,911
Tier 1 leverage ratio (Tier 1 capital to adjusted average total assets)	9.11%	8.31%
Total Tier 1 capital	$ 198,853	$ 181,089
Plus: Qualifying allowance for loan losses	18,459	18,363
Total risk-based capital	$ 217,312	$ 199,452
Net risk-weighted assets	$ 1,475,067	$ 1,466,957
Tier 1 capital ratio (Tier 1 capital to net risk-weighted assets)	13.48%	12.34%
Total risk-based capital ratio (Total risk-based capital to net risk-weighted assets)	14.73%	13.60%

The Company s and the Bank s actual and required regulatory capital ratios were as follows (in thousands):

	Actual		For Capital Adequacy Purposes		Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2011:						
Tier 1 leverage:						
Company	$ 198,853	9.11%	$ 87,299	4.00%	$ 109,123	5.00%
Bank	165,933	7.61	87,163	4.00	108,954	5.00
Tier 1 capital:						
Company	198,853	13.48	59,003	4.00	88,504	6.00
Bank	165,933	11.29	58,797	4.00	88,195	6.00

Total risk-based capital:						
Company	217,312	14.73	118,005	8.00	147,507	10.00
Bank	184,328	12.54	117,593	8.00	146,991	10.00
December 31, 2010:						
Tier 1 leverage:						
Company	$ 181,089	8.31%	$ 87,116	4.00%	$ 108,896	5.00%
Bank	156,957	7.22	86,958	4.00	108,697	5.00
Tier 1 capital:						
Company	181,089	12.34	58,678	4.00	88,017	6.00
Bank	156,957	10.74	58,450	4.00	87,674	6.00
Total risk-based capital:						
Company	199,452	13.60	117,357	8.00	146,696	10.00
Bank	175,250	11.99	116,899	8.00	146,124	10.00

Dividend Restrictions

In the ordinary course of business, the Company is dependent upon dividends from Five Star Bank to provide funds for the payment of interest expense on the junior subordinated debentures, dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years.

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ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

The principal objective of the Company s interest rate risk management is to evaluate the interest rate risk inherent in certain assets and liabilities, determine the appropriate level of risk to the Company given its business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with the guidelines approved by the Company s Board of Directors. The Company s management is responsible for reviewing with the Board its activities and strategies, the effect of those strategies on the net interest margin, the fair value of the portfolio and the effect that changes in interest rates will have on the portfolio and exposure limits. Management develops an Asset-Liability Policy that meets strategic objectives and regularly reviews the activities of the Bank.

The primary tool the Company uses to manage interest rate risk is a rate shock simulation to measure the rate sensitivity of the balance sheet. Rate shock simulation is a modeling technique used to estimate the impact of changes in rates on net interest income and economic value of equity. The Company measures net interest income at risk by estimating the changes in net interest income resulting from instantaneous and sustained parallel shifts in interest rates of different magnitudes over a period of twelve months. This simulation is based on management s assumption as to the effect of interest rate changes on assets and liabilities and assumes a parallel shift of the yield curve. It also includes certain assumptions about the future pricing of loans and deposits in response to changes in interest rates. Further, it assumes that delinquency rates would not change as a result of changes in interest rates, although there can be no assurance that this will be the case. While this simulation is a useful measure as to net interest income at risk due to a change in interest rates, it is not a forecast of the future results and is based on many assumptions that, if changed, could cause a different outcome.

In addition to the changes in interest rate scenarios listed above, the Company typically runs other scenarios to measure interest rate risk, which vary depending on the economic and interest rate environments.

The Company has experienced no significant changes in market risk due to changes in interest rates since the Company s Annual Report on Form 10-K for the year ended December 31, 2010, dated March 7, 2011, as filed with the Securities and Exchange Commission.

ITEM 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of March 31, 2011, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures pursuant to Rule 13a-15(b), as adopted by the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this report.

Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in internal control over financial reporting

There were no changes in the Company s internal control over financial reporting that occurred during the quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

The Company has experienced no material developments in its legal proceedings from the disclosure included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, dated March 7, 2011, as filed with the Securities and Exchange Commission.

ITEM 1A. Risk Factors

The Company has experienced no material changes in its risk factors from the disclosure included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, dated March 7, 2011, as filed with the Securities and Exchange Commission.

ITEM 6. Exhibits

(a) The following is a list of all exhibits filed or incorporated by reference as part of this Report.

Exhibit Number	Description	Location
10.1	2009 Management Stock Incentive Plan	Incorporated by reference to Exhibit 4.4 of the Form S-8 Registration Statement, dated March 7, 2011
10.2	2009 Directors Stock Incentive Plan	Incorporated by reference to Exhibit 4.4 of the Form S-8 Registration Statement, dated March 7, 2011
11.1	Statement of Computation of Per Share Earnings	Incorporated by reference to Note 2 of the Registrant s unaudited consolidated financial statements under Item 1 filed herewith.
12	Ratio of Earnings to Fixed Charges and Preferred Dividends	Filed Herewith
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Principal Executive Officer	Filed Herewith
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Principal Financial Officer	Filed Herewith
32	Certification pursuant to18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FINANCIAL INSTITUTIONS, INC.

/s/ Peter G. Humphrey , May 3, 2011

Peter G. Humphrey
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Karl F. Krebs , May 3, 2011

Karl F. Krebs
Executive Vice President and Chief Financial Officer
(Principal Financial and Principal Accounting Officer)