FINANCIAL INSTITUTIONS INC
Form 10-Q
May 04, 2010

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, 2010
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 registrant 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	Smaller reporting company o
		(Do not check if a smaller company)	

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 10,924,052 shares of Common Stock, $0.01 par value, outstanding as of April 30, 2010.

FINANCIAL INSTITUTIONS, INC.
Form 10-Q
For the Quarterly Period Ended March 31, 2010
TABLE OF CONTENTS

Table of Contents

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, 2010**	**December 31, 2009**
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 38,081	$ 42,874
Federal funds sold and interest-bearing deposits in other banks	33,793	85
Total cash and cash equivalents	71,874	42,959
Securities available for sale, at fair value	648,667	580,501
Securities held to maturity, at amortized cost (fair value of $35,545 and $40,629, respectively)	34,556	39,573
Loans	1,268,181	1,264,427
Less: Allowance for loan losses	20,586	20,741
Loans, net	1,247,595	1,243,686
Company owned life insurance	25,143	24,867
Premises and equipment, net	34,330	34,783
Goodwill	37,369	37,369
Other assets	56,521	58,651
Total assets	$ 2,156,055	$ 2,062,389
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 308,822	$ 324,303
Interest-bearing demand	409,094	363,698
Savings and money market	426,330	368,603
Certificates of deposit	705,628	686,351
Total deposits	1,849,874	1,742,955
Short-term borrowings	36,608	59,543
Long-term borrowings	46,846	46,847
Other liabilities	19,124	14,750
Total liabilities	1,952,452	1,864,095
Shareholders equity:		
Series A 3% Preferred Stock, $100 par value, 1,533 shares authorized and issued	153	153
Series A Preferred Stock, $100 par value, 7,503 shares authorized and issued, aggregate liquidation preference of $37,515; net of $1,582 and $1,672 discount, respectively	35,933	35,843

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	53,508	53,418
Common stock, $0.01 par value, 50,000,000 shares authorized, 11,348,122 shares issued	113	113
Additional paid-in capital	25,308	26,940
Retained earnings	134,688	131,371
Accumulated other comprehensive loss	(2,029)	(3,702)
Treasury stock, at cost - 428,084 and 527,854 shares, respectively	(7,985)	(9,846)
Total shareholders equity	203,603	198,294
Total liabilities and shareholders equity	$ 2,156,055	$ 2,062,389

See accompanying notes to the consolidated financial statements.

Table of Contents

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

(Dollars in thousands, except per share amounts)	Three months ended March 31, 2010	Three months ended March 31, 2009
Interest income:		
Interest and fees on loans	$ 18,618	$ 17,059
Interest and dividends on investment securities	5,199	6,007
Other interest income	7	27
Total interest income	23,824	23,093
Interest expense:		
Deposits	3,784	5,015
Short-term borrowings	78	38
Long-term borrowings	710	713
Total interest expense	4,572	5,766
Net interest income	19,252	17,327
Provision for loan losses	418	1,906
Net interest income after provision for loan losses	18,834	15,421
Noninterest income:		
Service charges on deposits	2,230	2,320
ATM and debit card	934	811
Loan servicing	280	257
Company owned life insurance	269	260
Broker-dealer fees and commissions	380	269
Net gain on sale of loans held for sale	62	170
Net gain on investment securities	6	54
Impairment charges on investment securities	(526)	(50)
Net gain on sale and disposal of other assets	2	158
Other	446	442
Total noninterest income	4,083	4,691
Noninterest expense:		
Salaries and employee benefits	8,247	8,731
Occupancy and equipment	2,771	2,876
Professional services	606	849
FDIC assessments	602	680
Computer and data processing	571	617
Supplies and postage	445	465
Advertising and promotions	187	174
Other	1,309	1,686

Total noninterest expense		14,738		16,078
Income before income taxes		8,179		4,034
Income tax expense		2,851		1,067
Net income	$	5,328	$	2,967
Preferred stock dividends, net of amortization		929		918
Net income applicable to common shareholders	$	4,399	$	2,049
Earnings per common share (Note 2):				
Basic	$	0.41	$	0.19
Diluted	$	0.40	$	0.19

See accompanying notes to the consolidated financial statements.

Table of Contents

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Shareholders Equity (Unaudited)

(Dollars in thousands, except per share data)	Preferred Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders Equity
Balance at January 1, 2010	**$ 53,418**	**$ 113**	**$ 26,940**	**$ 131,371**	**$ (3,702)**	**$ (9,846)**	**$ 198,294**
Comprehensive income:							
Net income				5,328			5,328
Other comprehensive income, net of tax					1,673		1,673
Total comprehensive income							7,001
Share-based compensation plans:							
Share-based compensation			221				221
Stock options exercised			(4)			12	8
Restricted stock awards issued, net			(1,849)			1,849	
Accrued undeclared cumulative dividend on Series A Preferred Stock, net of amortization	90			(90)			
Cash dividends declared:							
Series A 3% Preferred-$0.75 per share				(1)			(1)
Series A Preferred-$62.50 per share				(469)			(469)
Series B-1 8.48% Preferred-$2.12 per share				(369)			(369)
Common-$0.10 per share				(1,082)			(1,082)
Balance at March 31, 2010	**$ 53,508**	**$ 113**	**$ 25,308**	**$ 134,688**	**$ (2,029)**	**$ (7,985)**	**$ 203,603**

See accompanying notes to the consolidated financial statements.

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

(Dollars in thousands)	Three months ended March 31, 2010	2009
Cash flows from operating activities:		
Net income	$ 5,328	$ 2,967
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	898	1,025
Net amortization of premiums and discounts on investment securities	508	252
Provision for loan losses	418	1,906
Amortization of unvested stock-based compensation	221	247
Deferred income tax expense	759	3,810
Proceeds from sale of loans held for sale	6,031	27,951
Originations of loans held for sale	(5,651)	(29,058)
Increase in company owned life insurance	(269)	(260)
Net gain on investment securities	(6)	(54)
Impairment charge on investment securities	526	50
Net gain on sale of loans held for sale	(62)	(170)
Net gain on sale and disposal of other assets	(2)	(158)
Decrease (increase) in other assets	463	(4,568)
(Decrease) increase in other liabilities	(522)	331
Net cash provided by operating activities	8,640	4,271
Cash flows from investing activities:		
Purchase of investment securities:		
Available for sale	(110,252)	(101,293)
Held to maturity	(2,654)	(5,801)
Proceeds from principal payments, maturities and calls on investment securities:		
Available for sale	35,731	84,309
Held to maturity	7,567	3,309
Proceeds from sale of securities available for sale	12,950	10,375
Net loan originations	(4,715)	(38,242)
Purchase of company owned life insurance	(7)	(7)
Proceeds from sales of other assets	56	767
Purchase of premises and equipment	(471)	(355)
Net cash used in investing activities	(61,795)	(46,938)
Cash flows from financing activities:		
Net increase in deposits	106,919	104,017
Net (decrease) increase in short-term borrowings	(22,935)	8,419
Repayment of long-term borrowings	(1)	(478)
Issuance of preferred and common shares		(68)
Stock options exercised	8	

Cash dividends paid to preferred shareholders	(839)	(641)
Cash dividends paid to common shareholders	(1,082)	(1,080)
Net cash provided by financing activities	82,070	110,169
Net increase in cash and cash equivalents	28,915	67,502
Cash and cash equivalents, beginning of period	42,959	55,187
Cash and cash equivalents, end of period	$ 71,874	$ 122,689

See accompanying notes to the consolidated financial statements.

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 2009 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, 2010	Three months ended March 31, 2009
Cash payments:		
Interest	$ 5,315	$ 5,645
Income taxes		
Noncash investing and financing activities:		
Real estate and other assets acquired in settlement of loans	$ 70	$ 379
Accrued and declared unpaid dividends	1,692	1,691
Increase (decrease) in net unsettled security transactions	4,896	(571)

Recent Accounting Pronouncements

FASB ASC 810 Consolidation (ASC 810) was amended to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. The new authoritative accounting guidance requires additional disclosures about the reporting entity s involvement with variable-interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity s financial statements. The new authoritative accounting guidance under ASC 810 was adopted effective January 1, 2010 and did not have a significant impact on the Company s consolidated financial statements.

Table of Contents

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

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

FASB ASC 860 Transfers and Servicing (ASC 860) was amended to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a qualifying special-purpose entity and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC 860 was adopted effective January 1, 2010 and did not have a significant impact on the Company s consolidated financial statements.

FASB ASC 820 Fair Value Measurements and Disclosures (ASC 820) was amended to require some new disclosures and clarify some existing disclosure requirements about fair value measurement. It requires separate presentation of significant transfers into and out of Levels 1 and 2 of the fair value hierarchy and disclosure of the reasons for such transfers. It will also require the presentation of purchases, sales, issuances and settlements within Level 3 on a gross basis rather than a net basis. The amendments also clarify that disclosures should be disaggregated by class of asset or liability and that disclosures about inputs and valuation techniques should be provided for both recurring and non-recurring fair value measurements. These new disclosure requirements were adopted by the Company during the current period, with the exception of the requirement concerning gross presentation of Level 3 activity, which is effective for fiscal years beginning after December 15, 2010. With respect to the portions of this amendment that were adopted during the current period, the adoption of this standard did not have a significant impact on the Company s consolidated financial statements. The Company believes that the adoption of the remaining portion of this amendment will not have a significant impact on the Company s consolidated financial statements.

(2.) EARNINGS PER COMMON SHARE

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, 2010 and 2009 (in thousands, except per share amounts).

	Three months ended March,	
	2010	**2009**
Net income applicable to common shareholders	$ 4,399	$ 2,049
Less: Earnings allocated to participating securities	30	10
Earnings allocated to common shares outstanding	$ 4,369	$ 2,039
Weighted average common shares used to calculate basic EPS	10,746	10,716
Add: Effect of common stock equivalents	55	31
Weighted average common shares used to calculate diluted EPS	10,801	10,747
Earnings per common share:		
Basic	$ 0.41	$ 0.19
Diluted	$ 0.40	$ 0.19

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	451	580
Restricted stock awards		41

Warrant	378	378
	829	999

The accounting guidance under ASC Topic 260, Earnings Per Share, provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The outstanding non-vested stock awards issued prior to 2010 are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The outstanding non-vested stock awards issued during the first quarter of 2010 do not have rights to dividends or dividend equivalents and are not considered participating securities.

Table of Contents

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, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 203,030	$ 913	$ 151	$ 203,792
State and political subdivisions	78,785	2,379	2	81,162
Mortgage-backed securities:				
Federal National Mortgage Association	70,226	577	211	70,592
Federal Home Loan Mortgage Corporation	42,527	373	11	42,889
Government National Mortgage Association	107,975	461	389	108,047
Collateralized mortgage obligations:				
Federal National Mortgage Association	14,180	275	56	14,399
Federal Home Loan Mortgage Corporation	18,103	456	7	18,552
Government National Mortgage Association	102,911	622	200	103,333
Privately issued	4,875	582	320	5,137
Total collateralized mortgage obligations	140,069	1,935	583	141,421
Total mortgage-backed securities	360,797	3,346	1,194	362,949
Asset-backed securities	733	83	52	764
Total available for sale securities	$ 643,345	$ 6,721	$ 1,399	$ 648,667
Securities held to maturity:				
State and political subdivisions	$ 34,556	$ 989	$	$ 35,545

	December 31, 2009			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 134,564	$ 86	$ 545	$ 134,105
State and political subdivisions	80,812	2,850	3	83,659
Mortgage-backed securities:				
Federal National Mortgage Association	75,108	629	259	75,478
Federal Home Loan Mortgage Corporation	37,321	413	56	37,678
Government National Mortgage Association	110,576	97	342	110,331
Collateralized mortgage obligations:				
Federal National Mortgage Association	16,274	250	94	16,430
Federal Home Loan Mortgage Corporation	20,879	504	14	21,369
Government National Mortgage Association	95,886	56	873	95,069

Privately issued		5,087		403		330		5,160
Total collateralized mortgage obligations		138,126		1,213		1,311		138,028
Total mortgage-backed securities		361,131		2,352		1,968		361,515
Asset-backed securities		1,295		171		244		1,222
Total available for sale securities	$	577,802	$	5,459	$	2,760	$	580,501
Securities held to maturity:								
State and political subdivisions	$	39,573	$	1,056	$		$	40,629

Table of Contents

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

(3.) INVESTMENT SECURITIES (Continued)

Sales of securities available for sale were as follows (in thousands):

	Three months ended March 31, 2010	Three months ended March 31, 2009
Proceeds from sales	$ 12,950	$ 10,375
Gross realized gains	6	415
Gross realized losses		361

The scheduled maturities of securities available for sale and securities held to maturity at March 31, 2010 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	$ 49,206	$ 49,546
Due from one to five years	143,205	146,077
Due after five years through ten years	92,716	93,527
Due after ten years	358,218	359,517
	$ 643,345	$ 648,667
Debt securities held to maturity:		
Due in one year or less	$ 25,662	$ 25,862
Due from one to five years	6,951	7,430
Due after five years through ten years	1,570	1,800
Due after ten years	373	453
	$ 34,556	$ 35,545

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, 2010 and December 31, 2009 (in thousands).

	March 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	$	$	$ 9,562	$ 151	$ 9,562	$ 151
State and political subdivisions	50	1	100	1	150	2
Mortgage-backed securities:						
	30,556	210	511	1	31,067	211

Federal National Mortgage Association						
Federal Home Loan Mortgage Corporation	6,592	10	420	1	7,012	11
Government National Mortgage Association	52,389	389			52,389	389
Collateralized mortgage obligations:						
Federal National Mortgage Association	338	1	4,755	55	5,093	56
Federal Home Loan Mortgage Corporation	633	1	723	6	1,356	7
Government National Mortgage Association	28,761	200			28,761	200
Privately issued			2,982	320	2,982	320
Total collateralized mortgage obligations	29,732	202	8,460	381	38,192	583
Total mortgage-backed securities	119,269	811	9,391	383	128,660	1,194
Asset-backed securities	123	52			123	52
Total temporarily impaired securities	$ 119,442	$ 864	$ 19,053	$ 535	$ 138,495	$ 1,399

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(3.) INVESTMENT SECURITIES (Continued)

	December 31, 2009					
	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	$ 83,480	$ 360	$ 10,003	$ 185	$ 93,483	$ 545
State and political subdivisions			150	3	150	3
Mortgage-backed securities:						
Federal National Mortgage Association	24,964	258	643	1	25,607	259
Federal Home Loan Mortgage Corporation	5,627	56			5,627	56
Government National Mortgage Association	55,304	342			55,304	342
Collateralized mortgage obligations:						
Federal National Mortgage Association	353	2	5,384	92	5,737	94
Federal Home Loan Mortgage Corporation	490	1	814	13	1,304	14
Government National Mortgage Association	79,645	873			79,645	873
Privately issued			2,985	330	2,985	330
Total collateralized mortgage obligations	80,488	876	9,183	435	89,671	1,311
Total mortgage-backed securities	166,383	1,532	9,826	436	176,209	1,968
Asset-backed securities	278	244			278	244
Total temporarily impaired securities	$ 250,141	$ 2,136	$ 19,979	$ 624	$ 270,120	$ 2,760

The Company reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) with formal reviews performed quarterly. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit issues or concerns, or the security is intended to be sold. The amount of the impairment related to non-credit related factors is recognized in other comprehensive income. Evaluating whether the impairment of a debt security is other than temporary involves assessing i.) the intent to sell the debt security or ii.) the likelihood of being required to sell the security before the recovery of its amortized cost basis. In determining whether the other-than-temporary impairment includes a credit loss, the Company uses its best estimate of the present value of cash flows expected to be collected from the debt security considering factors such as: a.) the length of time and the extent to which the fair value has been less than the amortized cost basis, b.) adverse conditions specifically related to the security, an industry, or a geographic area, c.) the historical and implied volatility of the fair value of the security, d.) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future, e.) failure of the issuer of the security to make scheduled interest or principal payments, f.) any changes to the rating of the security by a rating agency, and g.) recoveries or additional declines in fair value subsequent to the balance sheet date.

During the first quarter of 2010, the Company recorded OTTI charges totaling $526 thousand on four pooled trust preferred securities, all of which were designated as impaired due to reasons of credit quality. The OTTI charges reduced the amortized cost on these securities to their fair value as of March 31, 2010. Accordingly, these securities are no longer in a loss position as of March 31, 2010. The Company recorded an OTTI charge of $50 thousand during the first quarter of 2009 related to an asset backed security considered to be other-than-temporarily impaired.

At March 31, 2010, the number of investment securities in an unrealized loss position totaled 73. As of March 31, 2010, management does not have the intent to sell any of the securities in a loss position and believes that it is likely that it will not be required to sell any such securities before the anticipated recovery of amortized cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities in a loss position are impaired due to reasons of credit quality. Accordingly, as of March 31, 2010, management has concluded that unrealized losses on its investment securities are temporary and no further impairment loss has been realized in the Company s consolidated statements of income.

Table of Contents

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

(4.) LOANS

Loans outstanding, including net unearned income and net deferred fees and costs of $16.8 million and $16.5 million as of March 31, 2010 and December 31, 2009, respectively, are summarized as follows (in thousands):

	March 31, 2010	December 31, 2009
Commercial	$ 208,976	$ 206,383
Commercial mortgage	331,870	330,748
Residential mortgage	142,406	144,636
Home equity	200,287	200,684
Consumer indirect	356,873	352,611
Other consumer	27,769	29,365
Total loans	1,268,181	1,264,427
Less: Allowance for loan losses	20,586	20,741
Total loans, net	$ 1,247,595	$ 1,243,686

Loans held for sale (included in residential mortgage), totaled $103 thousand and $421 thousand as of March 31, 2010 and December 31, 2009, respectively.

(5.) COMPREHENSIVE INCOME

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,					
	2010			2009		
	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	$ 2,103	$ 813	$ 1,290	$ 69	$ 27	$ 42
Reclassification adjustments:						
Realized net gains included in income	(6)	(2)	(4)	(54)	(21)	(33)
Impairment charges included in income	526	204	322	50	19	31
	2,623	1,015	1,608	65	25	40
Pension and post-retirement benefit liabilities	106	41	65	172	67	105
Other comprehensive income	$ 2,729	$ 1,056	1,673	$ 237	$ 92	145
Net income			5,328			2,967
Comprehensive income			$ 7,001			$ 3,112

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

	March 31, 2010	December 31, 2009
Net actuarial loss and prior service cost on defined benefit pension and post-retirement plans	$ (5,292)	$ (5,357)
Net unrealized gain on securities available for sale	3,263	1,655
Accumulated other comprehensive loss	$ (2,029)	$ (3,702)

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

(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 99,340 restricted shares to certain members of management during the three months ended March 31, 2010. The weighted average market price of the restricted shares on the date of grant was $12.20. 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, 2010. The share-based payment awards granted in 2010 do not have rights to dividends or dividend equivalents.

The following is a summary of restricted stock award activity for the three months ended March 31, 2010:

	Number of Shares	Weighted Average Market Price at Grant Date
Outstanding at beginning of year	77,772	$ 15.05
Granted	99,340	12.20
Released	(4,600)	19.22
Forfeited	(194)	13.21
Outstanding at end of period	172,318	$ 13.30

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, 2010	2009
Stock options:		
Management Stock Incentive Plan	$ 26	$ 74
Director Stock Incentive Plan	11	11
	37	85
Restricted stock awards:		
Management Stock Incentive Plan	170	162
Director Stock Incentive Plan	14	
	184	162

Total share-based compensation	$	221	$	247

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

(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, 2010	Three months ended March 31, 2009
Service cost	$ 408	$ 422
Interest cost on projected benefit obligation	483	457
Expected return on plan assets	(611)	(462)
Amortization of unrecognized prior service cost	3	3
Amortization of unrecognized loss	115	182
Net periodic pension cost	$ 398	$ 602

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 2009, the Company contributed $3.5 million to the pension plan for fiscal year 2010, which exceeds the minimum required contribution of $1.5 million.

(8.) FAIR VALUE MEASUREMENTS

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.

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.

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

(8.) FAIR VALUE MEASUREMENTS (Continued)

Investment Securities. 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.

Assets Measured at Fair Value on a Recurring Basis

Assets measured and recorded at fair value on a recurring basis as of March 31, 2010 and December 31, 2009 were as follows (in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
March 31, 2010:		&		