Delek US Holdings, Inc.
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January 13, 2014

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MANAGEMENTS DISCUSSION AND ANALYSIS

LENDING ACTIVITIES

Total loans were $1.485 billion at December 31, 2011, an increase of $138.8 million or 10% from December 31, 2010. Commercial loans increased $63.1 million or 11% and represented 42.2% of total loans at the end of 2011. Residential mortgage loans were $113.9 million, down $15.7 million or 12% and represented 7.7% of total loans compared to 9.6% at December 31, 2010 while consumer loans increased $91.3 million to represent 50.1% of total loans at December 31, 2011 and 48.5% at December 31, 2010. The composition of our loan portfolio, excluding loans held for sale and including net unearned income and net deferred fees and costs, is summarized as follows (in thousands):

	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX
					Loan Portfolio Composition At December 31,					
	2011		2010		2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Commercial business	$ 233,836	15.7%	$ 211,031	15.7%	$ 206,383	16.3%	$ 180,100	16.1%	$ 157,550	16.3%
Commercial mortgage	393,244	26.5	352,930	26.2	330,748	26.2	285,383	25.5	272,394	28.3
Total commercial	627,080	42.2	563,961	41.9	537,131	42.5	465,483	41.6	429,944	44.6
Residential mortgage	113,911	7.7	129,580	9.6	144,215	11.4	177,683	15.8	166,863	17.3
Home equity	231,766	15.6	208,327	15.5	200,684	15.9	189,794	16.9	194,144	20.1
Consumer indirect	487,713	32.9	418,016	31.1	352,611	27.9	255,054	22.8	134,977	14.0
Other consumer	24,306	1.6	26,106	1.9	29,365	2.3	33,065	2.9	38,245	4.0
Total consumer	743,785	50.1	652,449	48.5	582,660	46.1	477,913	42.6	367,366	38.1
Total loans	1,484,776	100.0%	1,345,990	100.0%	1,264,006	100.0%	1,121,079	100.0%	964,173	100.0%
Allowance for loan losses	23,260		20,466		20,741		18,749		15,521	
Total loans, net	$ 1,461,516		$ 1,325,524		$ 1,243,265		$ 1,102,330		$ 948,652	

The decrease in residential mortgage loans from $144.2 million to $129.6 million to $113.9 million for the periods ending December 31, 2009, 2010 and 2011, respectively, and the increase in consumer indirect loans from $352.6 million to $418.0 million to $487.7 million for the same periods reflects a strategic shift to increase our consumer indirect loan portfolio, while placing less emphasis on expanding our residential mortgage loan portfolio, coupled with our practice of selling the majority of our fixed-rate residential mortgages in the secondary market with servicing rights retained.

Commercial loans are generally viewed as having more inherent risk of default than residential mortgage or consumer loans. Also, the commercial loan balance per borrower is typically larger than that for residential mortgage and consumer loans, inferring higher potential losses on an individual customer basis. Commercial loans increased during 2011 as we continued our commercial business development efforts. 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.

The Company participates in various lending programs in which guarantees are supplied by U.S. government agencies, such as the SBA, U.S. Department of Agriculture, Rural Economic and Community Development and Farm Service Agency, among others. As of December 31, 2011, the principal balance of such loans (included in commercial loans) was $60.1 million and the guaranteed portion amounted to $42.5 million. Most of these loans were guaranteed by the SBA.

Commercial business loans were $233.8 million at the end of 2011, up $22.8 million or 11% since year-end 2010, and comprised 15.7% of total loans outstanding at December 31, 2011 and 2010. We typically originate business loans of up to $15.0 million for small to mid-sized businesses in our market area for working capital, equipment financing, inventory financing, accounts receivable financing, or other general business purposes. Loans of this type are in a diverse range of industries. Within the commercial business classification, loans to finance agricultural production totaled approximately 1% of commercial business loans as of December 31, 2011. As of December 31, 2011, commercial business SBA loans accounted for a total of $32.9 million or 14% of our commercial business loan portfolio.

Commercial mortgage loans totaled $393.2 million at December 31, 2011, up $40.3 million or 11% from December 31, 2010, and comprised 26.5% of total loans, compared to 26.2% at December 31, 2010. Commercial mortgage includes both owner occupied and non-owner occupied commercial real estate loans. Approximately 45% and 51% of the commercial mortgage portfolio at December 31, 2011 and 2010, respectively, was owner occupied commercial real estate. The majority of our commercial real estate loans are secured by office buildings, manufacturing facilities, distribution/warehouse facilities, and retail centers, which are generally located in our local market area. As of December 31, 2011, commercial mortgage SBA loans accounted for a total of $20.5 million or 5% of our commercial mortgage loan portfolio.

MANAGEMENTS DISCUSSION AND ANALYSIS

Our current lending standards for commercial real estate and real estate construction lending are determined by property type and specifically address many criteria, including: maximum loan amounts, maximum loan-to-value (LTV), requirements for pre-leasing and / or pre-sales, minimum debt-service coverage ratios, minimum borrower equity, and maximum loan to cost. Currently, the maximum standard for LTV is 85%, with lower limits established for certain higher risk types, such as raw land which has a 65% LTV maximum. Our LTV guidelines are in compliance with regulatory supervisory limits.

Residential mortgage loans totaled $113.9 million at the end of 2011, down $15.7 million or 12% from the prior year and comprised 7.7% of total loans outstanding at December 31, 2011 and 9.6% at December 31, 2010. Residential mortgage loans include conventional first lien home mortgages and we generally limit the maximum loan to 85% of collateral value without credit enhancement (e.g. PMI insurance). As part of management s historical practice of originating and servicing residential mortgage loans, the majority of our fixed-rate residential mortgage loans are sold in the secondary market with servicing rights retained.

Our underwriting guidelines for consumer-related real estate loans include a combination of borrower FICO (credit score), the LTV of the property securing the loan and evidence of the borrower having sufficient income to repay the loan. Currently, for home equity products, the maximum acceptable LTV is 90%. The average FICO score for new home equity production in 2011 was 755 comparable to 759 in 2010. Residential mortgage products continue to be underwritten using FHLMC and FNMA secondary marketing guidelines.

Consumer loans totaled $743.8 million at December 31, 2011, up $91.3 million or 14% compared to 2010, and represented 50.1% of the 2011 year-end loan portfolio versus 48.5% at year-end 2010. Loans in this classification include indirect consumer, home equity and other consumer installment loans. 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. Risks of loss are generally on smaller average balances per loan spread over many borrowers. Once charged off, there is usually less opportunity for recovery on these smaller retail loans. Credit risk is primarily controlled by reviewing the creditworthiness of the borrowers, monitoring payment histories, and taking appropriate collateral and guaranty positions.

Consumer indirect loans amounted to $487.7 million at December 31, 2011 up $69.7 million or 17% compared to 2010, and represented 32.9% of the 2011 year-end loan portfolio versus 31.1% at year-end 2010. The loans are primarily for the purchase of automobiles (both new and used) and light duty trucks primarily to individuals, but also to corporations and other organizations. The loans are originated through dealerships and assigned to us with terms that typically range from 36 to 84 months. During the year ended December 31, 2011, we originated $266.7 million in indirect loans with a mix of approximately 46% new auto and 54% used vehicles. This compares with $204.4 million in indirect loans with a mix of approximately 33% new auto and 67% used vehicles for the same period in 2010. The increase in loans for new autos reflects changes in market conditions in 2011. We do business with nearly 400 franchised auto dealers located in Western and Central New York, the Capital District of New York and Northern Pennsylvania.

Home equity consists of home equity lines, as well as home equity loans, some of which are first lien positions. Home equities amounted to $231.8 million at December 31, 2011 up $23.4 million or 11% compared to 2010, and represented 15.6% of the 2011 year-end loan portfolio versus 15.5% at year-end 2010. The portfolio had a weighted average LTV at origination of approximately 53% and 52% at December 31, 2011 and 2010, respectively. Approximately 69% of the loans in the home equity portfolio are first lien positions at December 31, 2011, compared to 63% at December 31, 2010.

Other consumer loans totaled $24.3 million at December 31, 2011, down $1.8 million or 7% compared to 2010, and represented 1.6% of the 2011 year-end loan portfolio versus 1.9% at year-end 2010. Other consumer consists of personal loans (collateralized and uncollateralized) and deposit account collateralized loans.

Factors that are important to managing overall credit quality are sound loan underwriting and administration, systematic monitoring of existing loans and commitments, effective loan review on an ongoing basis, early identification of potential problems, an appropriate allowance for loan losses, and sound nonaccrual and charge off policies.

An active credit risk management process is used for commercial loans to further ensure that sound and consistent credit decisions are made. Credit risk is controlled by detailed underwriting procedures, comprehensive loan administration, and periodic review of borrowers outstanding loans and commitments. Borrower relationships are formally reviewed and graded on an ongoing basis for early identification of potential problems. Further analyses by customer, industry, and geographic location are performed to monitor trends, financial performance, and concentrations.

The loan portfolio is widely diversified by types of borrowers, industry groups, and market areas within our core footprint. Significant loan concentrations are considered to exist for a financial institution when there are amounts loaned to numerous borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. At December 31, 2011, no significant concentrations, as defined above, existed in our portfolio in excess of 10% of total loans.

MANAGEMENTS DISCUSSION AND ANALYSIS

Loans Held for Sale and Loan Servicing Rights. Loans held for sale (not included in the loan portfolio composition table) were entirely comprised of residential real estate mortgages and totaled $2.4 million and $3.1 million as of December 31, 2011 and 2010, respectively.

We sell certain qualifying newly originated or refinanced residential real estate mortgages on the secondary market. Residential real estate mortgages serviced for others, which are not included in the consolidated statements of financial condition, amounted to $297.8 million and $328.9 million as of December 31, 2011 and 2010, respectively.

During 2011, we sold $13.0 million of indirect auto loans, recognizing a gain of $153 thousand. The loans were reclassified from portfolio to loans held for sale during the second quarter of 2011. As of December 31, 2011, a loan servicing asset for the sold and serviced indirect auto loans of $574 thousand is included in other assets in the consolidated statements of financial condition.

Allowance for Loan Losses

The following table summarizes the activity in the allowance for loan losses (in thousands).

	September 30, 2011	September 30, 2010	September 30, Loan Loss Analysis Year Ended December 31, 2009	September 30, 2008	September 30, 2007
Allowance for loan losses, beginning of year	$ 20,466	$ 20,741	$ 18,749	$ 15,521	$ 17,048
Charge-offs:					
Commercial business	1,346	3,426	2,360	720	618
Commercial mortgage	751	263	355	1,192	439
Residential mortgage	152	290	225	320	319
Home equity	449	259	195	110	255
Consumer indirect	4,713	4,669	3,637	2,011	988
Other consumer	877	909	1,058	1,106	1,276
Total charge-offs	8,288	9,816	7,830	5,459	3,895
Recoveries:					
Commercial business	401	326	428	684	1,140
Commercial mortgage	245	501	150	315	216
Residential mortgage	90	21	12	26	50
Home equity	44	36	20	19	12
Consumer indirect	2,066	1,485	1,030	548	235
Other consumer	456	485	480	544	599
Total recoveries	3,302	2,854	2,120	2,136	2,252
Net charge-offs	4,986	6,962	5,710	3,323	1,643
Provision for loan losses	7,780	6,687	7,702	6,551	116
Allowance for loan losses, end of year	$ 23,260	$ 20,466	$ 20,741	$ 18,749	$ 15,521
Net charge-offs to average loans	0.36%	0.54%	0.47%	0.32%	0.18%
Allowance to end of period loans	1.57%	1.52%	1.64%	1.67%	1.61%
Allowance to end of period non-performing loans	329%	270%	239%	229%	192%

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MANAGEMENTS DISCUSSION AND ANALYSIS

The following table sets forth the allocation of the allowance for loan losses by loan category as of the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which actual losses may occur. The total allowance is available to absorb losses from any segment of the loan portfolio (in thousands).

	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX
	Allowance for Loan Losses by Loan Category At December 31,									
	2011		2010		2009		2008		2007	
	Loan Loss Allowance	Percentage of loans by category to total loans	Loan Loss Allowance	Percentage of loans by category to total loans	Loan Loss Allowance	Percentage of loans by category to total loans	Loan Loss Allowance	Percentage of loans by category to total loans	Loan Loss Allowance	Percentage of loans by category to total loans
Commercial business	$ 4,036	15.7%	$ 3,712	15.7%	$ 4,407	16.3%	$ 3,300	16.1%	$ 2,505	16.3%
Commercial mortgage	6,418	26.5	6,431	26.2	6,638	26.2	4,635	25.5	4,640	28.3
Residential mortgage	858	7.7	1,013	9.6	1,251	11.4	2,516	15.8	1,763	17.3
Home equity	1,242	15.6	972	15.5	1,043	15.9	2,374	16.9	1,869	20.1
Consumer indirect	10,189	32.9	7,754	31.1	6,837	27.9	5,152	22.8	2,284	14.0
Other consumer	517	1.6	584	1.9	565	2.3	772	2.9	798	4.0
Unallocated [(1)]									1,662	
Total	$ 23,260	100.0%	$ 20,466	100.0%	$ 20,741	100.0%	$ 18,749	100.0%	$ 15,521	100.0%

(1) During 2008, management revised estimation techniques related to allocation of the allowance to specific loan segments. The result was the elimination of the unallocated portion of the allowance for loan losses and allocation of the entire balance to specific loan segments.

Management believes that the allowance for loan losses at December 31, 2011 is adequate to cover probable losses in the loan portfolio at that date. Factors beyond our control, however, such as general national and local economic conditions, can adversely impact the adequacy of the allowance for loan losses. As a result, no assurance can be given that adverse economic conditions or other circumstances will not result in increased losses in the portfolio or that the allowance for loan losses will be sufficient to meet actual loan losses. See Part I, Item 1A Risk Factors for the risks impacting this estimate. Management presents a quarterly review of the adequacy of the allowance for loan losses to our Board of Directors based on the methodology that is described in further detail in Part I, Item I Business under the section titled Lending Activities . See also Critical Accounting Estimates for additional information on the allowance for loan losses.

Non-performing Assets and Potential Problem Loans

The following table sets forth information regarding non-performing assets (in thousands):

	September 30,	September 30,	September 30,	September 30,	September 30,
	Non-performing Assets At December 31,				
	2011	2010	2009	2008	2007
Non-accruing loans:					
Commercial business	$ 1,259	$ 947	$ 650	$ 510	$ 839

Commercial mortgage	2,928	3,100	2,288	2,670	3,294
Residential mortgage	1,644	2,102	2,376	3,365	2,987
Home equity	682	875	880	1,143	661
Consumer indirect	558	514	621	445	278
Other consumer		41	7	56	16
Total non-accruing loans	7,071	7,579	6,822	8,189	8,075
Restructured accruing loans					
Accruing loans contractually past due over 90 days	5	3	1,859	7	2
Total non-performing loans	7,076	7,582	8,681	8,196	8,077
Foreclosed assets	475	741	746	1,007	1,421
Non-performing investment securities	1,636	572	1,015	49	
Total non-performing assets	$ 9,187	$ 8,895	$ 10,442	$ 9,252	$ 9,498
Non-performing loans to total loans	0.48%	0.56%	0.69%	0.73%	0.84%
Non-performing assets to total assets	0.39%	0.40%	0.51%	0.48%	0.51%

MANAGEMENTS DISCUSSION AND ANALYSIS

Non-performing assets include non-performing loans, foreclosed assets and non-performing investment securities. Non-performing assets at December 31, 2011 were $9.2 million, an increase of $292 thousand from the $8.9 million balance at December 31, 2010. The primary component of non-performing assets is non-performing loans, which were $7.1 million at December 31, 2011, a decrease of $508 thousand from the $7.6 million balance at December 31, 2010.

Approximately $3.1 million, or 44%, of the $7.1 million in non-performing loans as of December 31, 2011 were current with respect to payment of principal and interest, but were classified as non-accruing because repayment in full of principal and/or interest was uncertain. For non-accruing loans outstanding as of December 31, 2011, the amount of interest income forgone totaled $438 thousand. Included in nonaccrual loans are troubled debt restructurings (TDRs) of $90 thousand at December 31, 2011. We had no TDRs that were accruing interest as of December 31, 2011.

The ratio of non-performing loans to total loans was 0.48% at December 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 3.26% of total loans at September 30, 2011, the most recent period for which information is available (Source: Federal Financial Institutions Examination Council Bank Holding Company Performance Report as of September 30, 2011 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 $475 thousand at December 31, 2011 and 13 properties totaling $741 thousand at December 31, 2010.

Non-performing investment securities for which we have stopped accruing interest were $1.6 million at December 31, 2011, compared to $572 thousand at December 31, 2010. Non-performing investment securities are included in non-performing assets at fair value and represent pooled trust preferred securities. The market for these securities began to improve during the second quarter of 2011, resulting in substantial increases to their fair value since the beginning of the year. There have been no securities transferred to non-performing status since the first quarter of 2009. During 2011, we recognized gains of $2.3 million from the sale of four of the 14 securities classified as non-performing at December 31, 2010. The securities had a fair value of $251 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 $8.6 million and $11.5 million in loans that continued to accrue interest which were classified as substandard as of December 31, 2011 and 2010, respectively.

MANAGEMENTS DISCUSSION AND ANALYSIS

FUNDING ACTIVITIES

Deposits

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

	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,
			At December 31,			
	2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent
Noninterest-bearing demand	$ 393,421	20.3%	$ 350,877	18.6%	$ 324,303	18.6%
Interest-bearing demand	362,555	18.8	374,900	19.9	363,698	20.9
Savings and money market	474,947	24.6	417,359	22.2	368,603	21.1
Certificates of deposit < $100,000	486,496	25.2	555,840	29.5	512,969	29.5
Certificates of deposit of $100,000 or more	214,180	11.1	183,914	9.8	173,382	9.9
Total deposits	$ 1,931,599	100.0%	$ 1,882,890	100.0%	$ 1,742,955	100.0%

We offer a variety of deposit products designed to attract and retain customers, with the primary focus on building and expanding long-term relationships. At December 31, 2011, total deposits were $1.932 billion, representing an increase of $48.7 million for the year. Certificates of deposit were approximately 36% and 39% of total deposits at December 31, 2011 and 2010, respectively. Depositors were hesitant to invest in certificates of deposit for long periods due to the low rate environment and, as a result, reduced both the amount they placed in time deposits and the maturity terms.

Nonpublic deposits, the largest component of our funding sources, represented 80% of total deposits and totaled $1.541 billion and $1.501 billion as of December 31, 2011 and 2010, respectively. We have managed this segment of funding through a strategy of competitive pricing that minimizes the number of customer relationships that have only a single service high cost deposit account.

We had no traditional brokered deposits at December 31, 2011 or 2010, however, we do participate in the Certificate of Deposit Account Registry Service (CDARS) program, which enables depositors to receive FDIC insurance coverage for deposits otherwise exceeding the maximum insurable amount. Through the CDARS program, deposits in excess of the maximum insurable amount are placed with multiple participating financial institutions. Reciprocal CDARS deposits totaled $46.5 million at December 31, 2011.

As an additional source of funding, we offer a variety of public deposit products to the many towns, villages, counties and school districts within our market. Public deposits generally range from 20% to 25% of our total deposits. There is a high degree of seasonality in this component of funding, because the level of deposits varies with the seasonal cash flows for these public customers. We maintain the necessary levels of short-term liquid assets to accommodate the seasonality associated with public deposits. As of December 31, 2011, total public deposits were $390.2 million or 20% of total deposits, compared to $382.2 million or 20% of total deposits, as of December 31, 2010. In general, the number of public relationships remained stable in comparison to the prior year.

Borrowings

Outstanding borrowings are summarized as follows as of December 31 (in thousands):

	September 30, 2011	September 30, 2010
Short-term borrowings:		
Federal funds purchased	$ 11,597	$ 38,200
Repurchase agreements	36,301	38,910
Short-term FHLB borrowings	102,800	
Total short-term borrowings	150,698	77,110
Long-term borrowings:		
FHLB advances and repurchase agreements		10,065
Junior subordinated debentures		16,702
Total long-term borrowings		26,767
Total borrowings	$ 150,698	$ 103,877

We classify borrowings as short-term or long-term in accordance with the original terms of the agreement.

MANAGEMENTS DISCUSSION AND ANALYSIS

We have credit capacity with the FHLB and can borrow through facilities that include amortizing and term advances or repurchase agreements. We had approximately $36 million of immediate credit capacity with FHLB as of December 31, 2011. We had approximately $387 million in secured borrowing capacity at the Federal Reserve Bank (FRB) Discount Window, none of which was outstanding at December 31, 2011. The FHLB and FRB credit capacity are collateralized by securities from our investment portfolio and certain qualifying loans. We had approximately $107 million of credit available under unsecured federal funds purchased lines with various banks as of December 31, 2011.

Funds are borrowed on an overnight basis through retail repurchase agreements with bank customers and federal funds purchased from other financial institutions. Retail repurchase agreement borrowings are collateralized by securities of U.S. Government agencies. Federal funds purchased are short-term borrowings that typically mature within one to ninety days. Federal funds purchased totaled $11.6 million and $38.2 million at December 31, 2011 and 2010, respectively. Repurchase agreements are secured overnight borrowings with customers. These short-term repurchase agreements amounted to $36.3 million and $38.9 million as of December 31, 2011 and 2010, respectively. Short-term FHLB borrowings have original maturities of less than one year and include overnight borrowings which we typically utilizes to address short term funding needs as they arise. Short-term FHLB borrowings at December 31, 2011 consisted of $65.0 million in overnight borrowings and $37.8 million in short-term advances.

The following table summarizes information relating to our short-term borrowings (dollars in thousands).

	September 30,	September 30,	September 30,
	At or for the Year Ended December 31,		
	2011	2010	2009
Year-end balance	$ 150,698	$ 77,110	$ 59,543
Year-end weighted average interest rate	0.39%	0.21%	0.59%
Maximum outstanding at any month-end	$ 188,355	$ 77,110	$ 85,912
Average balance during the year	$ 99,122	$ 49,104	$ 43,092
Average interest rate for the year	0.50%	0.74%	0.63%

Long-term borrowings totaled $26.8 million at December 31, 2010 and consisted of $10.0 million in FHLB repurchase agreements, $65 thousand of FHLB amortizing advances and $16.7 million in 10.20% junior subordinated debentures. The $10.1 million of outstanding FHLB advances and repurchase agreements at December 31, 2010 were repaid upon maturity during 2011. During the third quarter of 2011, we redeemed all of the junior subordinated debentures and recognized a $1.1 million loss on the extinguishment of debt.

Shareholders Equity

Total shareholders equity was $237.2 million at December 31, 2011, an increase of $25.1 million from $212.1 million at December 31, 2010. During February 2011, we redeemed $12.5 million of Series A preferred stock issued to the U.S. Treasury. During March 2011, we 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, we received net proceeds of approximately $43.1 million. Prior to the end of the first quarter of 2011, we utilized a portion of the net proceeds to redeem the remaining $25.0 million in Series A preferred stock. The warrant issued to the Treasury was repurchased for $2.1 million during the second quarter of 2011 and recorded as a reduction of additional paid-in capital. For detailed information on shareholders equity, see Note 11, Shareholders Equity, of the notes to consolidated financial statements.

The Company and Bank are subject to various regulatory capital requirements. At December 31, 2011, both the Company and the Bank exceeded all regulatory requirements. For detailed information on regulatory capital, see Note 10, Regulatory Matters, of the notes to consolidated financial statements.

GOODWILL

The carrying amount of goodwill totaled $37.4 million as of December 31, 2011 and 2010. The goodwill relates to our primary subsidiary and reporting unit, Five Star Bank. We perform a goodwill impairment test on an annual basis or more frequently if events and circumstances warrant. We performed the annual goodwill impairment test as of September 30, 2011 and determined the estimated fair value of our reporting unit to be in excess of its carrying amount. Accordingly, as of the annual impairment test date, there was no indication of goodwill impairment. We test goodwill for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of our reporting unit below its carrying amount.

Declines in the market value of our publicly traded stock price or declines in our ability to generate future cash flows may increase the potential that goodwill recorded on our consolidated statements of financial condition be designated as impaired and that we may incur a goodwill write-down in the future.

MANAGEMENTS DISCUSSION AND ANALYSIS

LIQUIDITY AND CAPITAL RESOURCES

The objective of maintaining adequate liquidity is to assure that we meet our financial obligations. These obligations include the withdrawal of deposits on demand or at their contractual maturity, the repayment of matured borrowings, the ability to fund new and existing loan commitments and the ability to take advantage of new business opportunities. We achieve liquidity by maintaining a strong base of core customer funds, maturing short-term assets, our ability to sell or pledge 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. FSIS relies on cash flows from operations and funds from FII when necessary.

Our cash and cash equivalents were $57.6 million as of December 31, 2011, up from $39.1 million as of December 31, 2010. Our net cash provided by operating activities totaled $32.0 million and the principal source of operating activity cash flow was net income adjusted for noncash income and expense items. Net cash used in investing activities totaled $104.9 million, which included outflows for net loan origination funding of $157.1 million and inflows from net securities transactions of $60.3 million. Net cash provided by financing activities of $91.4 million was attributed to a $48.7 million increase in deposits, a $73.6 million increase in short-term borrowings 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, $26.8 million of long-term debt repayments and $7.6 million in dividend payments.

Contractual Obligations and Other Commitments

The following table summarizes the maturities of various contractual obligations and other commitments (in thousands):

	September 30,	September 30,	September 30, At December 31, 2011	September 30,	September 30,
	Within 1 year	Over 1 to 3 years	Over 3 to 5 Years	Over 5 years	Total
On-Balance sheet:					
Certificates of deposit [1]	$ 547,874	$ 102,661	$ 50,000	$ 141	$ 700,676
Supplemental executive retirement plans	159	318	318	549	1,344
Off-Balance sheet:					
Limited partnership investments [2]	$ 594	$ 1,187	$ 593	$	$ 2,374
Commitments to extend credit [3]	374,266				374,266
Standby letters of credit [3]	5,488	2,512	855		8,855
Operating leases	1,242	2,066	1,889	4,963	10,160

(1) Includes the maturity of certificates of deposit amounting to $100 thousand or more as follows: $77.7 million in three months or less; $32.4 million between three months and six months; $57.7 million between six months and one year; and $46.4 million over one year.

(2) We have committed to capital investments in several limited partnerships of up to $6.1 million, of which we have contributed $3.7 million as of December 31, 2011, including $407 thousand during 2011.

(3)

We do not expect all of the commitments to extend credit and standby letters of credit to be funded. Thus, the total commitment amounts do not necessarily represent our future cash requirements.

Off-Balance Sheet Arrangements

With the exception of obligations in connection with our irrevocable loan commitments, operating leases and limited partnership investments, we had no other off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors. For additional information on off-balance sheet arrangements, see Note 1, Summary of Significant Accounting Policies and Note 9, Commitments and Contingencies, in the notes to the accompanying consolidated financial statements.

MANAGEMENTS DISCUSSION AND ANALYSIS

Security Yields and Maturities Schedule

The following table sets forth certain information regarding the amortized cost (Cost), weighted average yields (Yield) and contractual maturities of our debt securities portfolio as of December 31, 2011. Mortgage-backed securities are included in maturity categories based on their stated maturity date. Actual maturities may differ from the contractual maturities presented because borrowers may have the right to call or prepay certain investments. We have stopped accruing interest on our asset-backed securities. No tax-equivalent adjustments were made to the weighted average yields (in thousands).

	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX
	Due in one year or less		Due from one to five years		Due after five years through ten years		Due after ten years		Total	
	Cost	Yield	Cost	Yield	Cost	Yield	Cost	Yield	Cost	Yield
Available for sale debt securities:										
U.S. Government agencies and government-sponsored enterprises	$ 13,574	1.42%	$ 32,137	2.21%	$ 34,289	2.32%	$ 14,947	0.86%	$ 94,947	1.93%
State and political subdivisions	9,573	3.57	43,534	2.67	65,992	2.44			119,099	2.62
Mortgage-backed securities	878	4.52	5,812	3.82	83,358	1.77	300,654	3.49	390,702	3.13
Asset-backed securities							297		297	
	24,025	2.39	81,483	2.57	183,639	2.11	315,898	3.49	605,045	2.91
Held to maturity debt securities:										
State and political subdivisions	18,496	2.35	3,763	4.26	905	4.90	133	5.53	23,297	2.77
	$ 42,521	2.37%	$ 85,246	2.64%	$ 184,544	2.13%	$ 316,031	3.49%	$ 628,342	2.90%

Contractual Loan Maturity Schedule

The following table summarizes the contractual maturities of our loan portfolio at December 31, 2011. Loans, net of deferred loan origination costs, include principal amortization and non-accruing loans. Demand loans having no stated schedule of repayment or maturity and overdrafts are reported as due in one year or less (in thousands).

	September 30,	September 30,	September 30,	September 30,
	Due in less than one year	Due from one to five years	Due after five years	Total
Commercial business	$ 135,627	$ 82,926	$ 15,283	$ 233,836
Commercial mortgage	109,782	187,205	96,257	393,244
Residential mortgage	28,673	56,585	28,653	113,911
Home equity	46,468	105,726	79,572	231,766
Consumer indirect	161,053	310,214	16,446	487,713
Other consumer	10,375	12,509	1,422	24,306
Total loans	$ 491,978	$ 755,165	$ 237,633	$ 1,484,776

Loans maturing after one year:			
With a predetermined interest rate	$ 225,553	$ 157,596	$ 383,149
With a floating or adjustable rate	529,612	80,037	609,649
Total loans maturing after one year	$ 755,165	$ 237,633	$ 992,798

MANAGEMENTS DISCUSSION AND ANALYSIS

Capital Resources

The FRB has adopted a system using risk-based capital guidelines to evaluate the capital adequacy of bank holding companies on a consolidated basis. The guidelines require a minimum Tier 1 leverage ratio of 4.00%, a minimum Tier 1 capital ratio of 4.00% and a minimum total risk-based capital ratio of 8.00%. The following table reflects the ratios and their components (in thousands):

	September 30, 2011	September 30, 2010
Total shareholders equity	$ 237,194	$ 212,144
Less: Unrealized gain on securities available for sale, net of tax	13,570	1,877
Unrecognized net periodic pension & postretirement benefits (costs), net of tax	(12,625)	(6,599)
Disallowed goodwill and other intangible assets	37,369	37,369
Disallowed deferred tax assets	1,794	14,608
Plus: Qualifying trust preferred securities		16,200
Tier 1 capital	$ 197,086	$ 181,089
Adjusted average total assets (for leverage capital purposes)	$ 2,282,755	$ 2,177,911
Tier 1 leverage ratio (Tier 1 capital to adjusted average total assets)	8.63%	8.31%
Total Tier 1 capital	$ 197,086	$ 181,089
Plus: Qualifying allowance for loan losses	20,239	18,363
Total risk-based capital	$ 217,325	$ 199,452
Net risk-weighted assets	$ 1,616,119	$ 1,466,957
Tier 1 capital ratio (Tier 1 capital to net risk-weighted assets)	12.20%	12.34%
Total risk-based capital ratio (Total risk-based capital to net risk-weighted assets)	13.45%	13.60%

CRITICAL ACCOUNTING ESTIMATES

Our consolidated financial statements are prepared in accordance with GAAP and are consistent with predominant practices in the financial services industry. Application of critical accounting policies, which are those policies that management believes are the most important to our financial position and results, requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes and are based on information available as of the date of the financial statements. Future changes in information may affect these estimates, assumptions and judgments, which, in turn, may affect amounts reported in the financial statements.

We have numerous accounting policies, of which the most significant are presented in Note 1, Summary of Significant Accounting Policies, of the notes to consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets, liabilities, revenues and expenses are reported in the consolidated financial statements and how those reported amounts are determined. Based on the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has determined that the accounting policies with respect to the allowance for loan losses, valuation of goodwill and deferred tax assets, the valuation of securities and determination of OTTI, and accounting for defined benefit plans require particularly subjective or complex judgments important to our financial position and results of operations, and, as such, are considered to be critical accounting policies as discussed below. These estimates and assumptions are based on management s best estimates and judgment and are evaluated on an ongoing basis using historical experience and other factors, including the current economic environment. We adjust these estimates and assumptions when facts and circumstances dictate. Illiquid credit markets and volatile equity have combined with declines in consumer spending to increase the uncertainty inherent in these estimates and assumptions. As future events cannot be determined with precision, actual results could differ significantly from our estimates.

MANAGEMENTS DISCUSSION AND ANALYSIS

Adequacy of the Allowance for Loan Losses

The allowance for loan losses represents management s estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of subjective measurements including management s assessment of the internal risk classifications of loans, changes in the nature of the loan portfolio, industry concentrations, existing economic conditions, the fair value of underlying collateral, and other qualitative and quantitative factors which could affect probable credit losses. Because current economic conditions can change and future events are inherently difficult to predict, the anticipated amount of estimated loan losses, and therefore the appropriateness of the allowance for loan losses, could change significantly. As an integral part of their examination process, various regulatory agencies also review the allowance for loan losses. Such agencies may require additions to the allowance for loan losses or may require that certain loan balances be charged off or downgraded into criticized loan categories when their credit evaluations differ from those of management, based on their judgments about information available to them at the time of their examination. We believe the level of the allowance for loan losses is appropriate as recorded in the consolidated financial statements.

For additional discussion related to our accounting policies for the allowance for loan losses, see the sections titled Allowance for Loan Losses in Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 1, Summary of Significant Accounting Policies, of the notes to consolidated financial statements.

Valuation of Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. We complete our annual goodwill impairment test as of September 30 of each year. The impairment testing process is conducted by assigning net assets and goodwill to each reporting unit. Currently, our goodwill is evaluated at the entity level as there is only one reporting unit. The fair value of each reporting unit is compared to the recorded book value step one . If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and step two is not considered necessary. If the carrying value of a reporting unit exceeds its fair value, the impairment test continues (step two) by comparing the carrying value of the reporting unit s goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill. An impairment charge is recognized if the carrying fair value of goodwill exceeds the implied fair value of goodwill.

Valuation of Deferred Tax Assets

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of our net deferred tax assets assumes that we will be able to generate sufficient future taxable income based on estimates and assumptions (after consideration of historical taxable income as well as tax planning strategies). If these estimates and related assumptions change, we may be required to record valuation allowances against our deferred tax assets resulting in additional income tax expense in the consolidated statements of income. Management evaluates deferred tax assets on a quarterly basis and assesses the need for a valuation allowance, if any. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in valuation allowance from period to period are included in our tax provision in the period of change. For additional discussion related to our accounting policy for income taxes see Note 14, Income Taxes, of the notes to consolidated financial statements.

Valuation and Other Than Temporary Impairment of Securities

We record all of our securities that are classified as available for sale at fair value. The fair value of equity securities are determined using public quotations, when available. Where quoted market prices are not available, fair values are estimated based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant judgment or estimation. Fair values of public bonds and those private securities that are actively traded in the secondary market have been determined through the use of third-party pricing services using market observable inputs. Private placement securities and other corporate fixed maturities for which we do not receive a public quotation are valued using a variety of acceptable valuation methods. Market rates used are applicable to the yield, credit quality and average maturity of each security. Private equity securities may also utilize internal valuation methodologies appropriate for the specific asset. Fair values might also be determined using broker quotes or through the use of internal models or analysis.

Securities are evaluated quarterly to determine whether a decline in their fair value is other than temporary. Management utilizes criteria such as, the current intent or requirement to hold or sell the security, the magnitude and duration of the decline and, when appropriate, consideration of negative changes in expected cash flows, creditworthiness, near term prospects of issuers, the level of credit subordination, estimated loss severity, and delinquencies, to determine whether a loss in value is other than temporary. The term other than temporary is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable. Declines in the fair value of investment 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 impairment related to non-credit related factors on securities not intended to be sold is recognized in other comprehensive income.

Defined Benefit Pension Plan

Management is required to make various assumptions in valuing its defined benefit pension plan assets and liabilities. These assumptions include, but are not limited to, the expected long-term rate of return on plan assets, the weighted average discount rate used to value certain liabilities and the rate of compensation increase. We use a third-party specialist to assist in making these estimates and assumptions. Changes in these estimates and assumptions are reasonably possible and may have a material impact on our consolidated financial statements, results of income or liquidity.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 1, Summary of Significant Accounting Policies Recent Accounting Pronouncements, in the notes to consolidated financial statements for a discussion of recent accounting pronouncements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Asset-Liability Management

The principal objective of our interest rate risk management is to evaluate the interest rate risk inherent in assets and liabilities, determine the appropriate level of risk to us given our business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with the guidelines approved by our Board of Directors. Management is responsible for reviewing with the Board of Directors our 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 has developed an Asset-Liability Policy that meets strategic objectives and regularly reviews the activities of the Bank.

Net Interest Income at Risk Analysis

The primary tool we use to manage interest rate risk is a rate shock simulation to measure the rate sensitivity of the statement of financial condition. 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 following table sets forth the results of the modeling analysis as of December 31, 2011 (dollars in thousands):

	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,
Changes in	**Net Interest Income**			**Economic Value of Equity**		
interest rate	**Amount**	**Change**		**Amount**	**Change**	
+ 300 basis points	$ 85,243	$ 2,621	3.17%	$ 343,691	$ (19,853)	(5.46)%
+ 200 basis points	84,298	1,676	2.03	354,626	(8,918)	(2.45)
+ 100 basis points	83,050	429	0.52	361,887	(1,656)	(0.46)
- 100 basis points	80,484	(2,138)	(2.59)	385,220	21,677	5.96

We measure 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 12 months. As of December 31, 2011, a 100 basis point increase in rates would increase net interest income by $429 thousand, or 0.5%, over the next twelve-month period. A 100 basis point decrease in rates would decrease net interest income by $2.1 million, or 2.6%, over a twelve-month period. As of December 31, 2011, a 100 basis point increase in rates would decrease the economic value of equity by $1.7 million, or 0.5%, over the next twelve-month period. A 100 basis point decrease in rates would increase the economic value of equity by $21.7 million, or 6.0%, over a twelve-month period. 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, we typically run other scenarios to measure interest rate risk, which vary depending on the economic and interest rate environments.

The following table presents an analysis of our interest rate sensitivity gap position at December 31, 2011. All interest-earning assets and interest-bearing liabilities are shown based on the earlier of their contractual maturity or re-pricing date. The expected maturities are presented on a contractual basis or, if more relevant, based on projected call dates. Investment securities are at amortized cost for both securities available for sale and securities held to maturity. Loans, net of deferred loan origination costs, include principal amortization adjusted for estimated prepayments (principal payments in excess of contractual amounts) and non-accruing loans. Because the interest rate sensitivity levels shown in the table could be changed by external factors such as loan prepayments and liability decay rates or by factors controllable by us, such as asset sales, it is not an absolute reflection of our potential interest rate risk profile (in thousands).

	September 30,	September 30,	September 30,	September 30,	September 30,
			At December 31, 2011		
	Three Months or Less	Over Three Months Through One Year	Over One Year Through Five Years	Over Five Years	Total
INTEREST-EARNING ASSETS:					
Federal funds sold and interest-earning deposits in other banks	$	$ 94	$	$	$ 94
Investment securities	117,520	144,472	254,640	111,710	628,342
Loans	469,602	257,217	667,411	92,956	1,487,186
Total interest-earning assets	$ 587,122	$ 401,783	$ 922,051	$ 204,666	2,115,622
Cash and due from banks					57,489
Other assets [(1)]					163,242
Total assets					$ 2,336,353
INTEREST-BEARING LIABILITIES:					
Interest-bearing demand, savings and money market	$ 837,502	$	$	$	$ 837,502
Certificates of deposit	183,321	364,553	152,661	141	700,676
Borrowings	130,698	20,000			150,698
Total interest-bearing liabilities	$ 1,151,521	$ 384,553	$ 152,661	$ 141	1,688,876
Noninterest-bearing deposits					393,421
Other liabilities					16,862
Total liabilities					2,099,159
Shareholders equity					237,194
Total liabilities and shareholders equity					$ 2,336,353
Interest sensitivity gap	$ (564,399)	$ 17,230	$ 769,390	$ 204,525	$ 426,746
Cumulative gap	$ (564,399)	$ (547,169)	$ 222,221	$ 426,746	
Cumulative gap ratio [(2)]	51.0%	64.4%	113.2%	125.3%	
Cumulative gap as a percentage of total assets	(24.2)%	(23.4)%	9.5%	18.3%	

(1) Includes net unrealized gain on securities available for sale and allowance for loan losses.

(2) Cumulative total interest-earning assets divided by cumulative total interest-bearing liabilities.

For purposes of interest rate risk management, we direct more attention on simulation modeling, such as net interest income at risk as previously discussed, rather than gap analysis. The net interest income at risk simulation modeling is considered by management to be more informative in forecasting future income at risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Index to Consolidated Financial Statements

Management s Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for Financial Institutions, Inc. and its subsidiaries (the Company), as such term is defined in Exchange Act Rules 13a-15(f). The Company s system of internal control over financial reporting has been designed to provide reasonable assurance to the Company s management and board of directors regarding the reliability of financial reporting and the preparation and fair presentation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Any system of internal control over financial reporting, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation and presentation.

The Company s management has assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2011. To make this assessment, we used the criteria for effective internal control over financial reporting described in *Internal Control Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment and based on such criteria, we believe that, as of December 31, 2011, the Company s internal control over financial reporting was effective.

The Company s independent registered public accounting firm that audited the Company s consolidated financial statements has issued an attestation report on internal control over financial reporting as of December 31, 2011. That report appears herein.

/s/ Peter G. Humphrey
President and Chief Executive Officer
March 9, 2012

/s/ Karl F. Krebs
Executive Vice President and Chief Financial Officer
March 9, 2012

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Financial Institutions, Inc.:

We have audited Financial Institutions, Inc. and subsidiaries (the Company) internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also includes performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of the Company as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2011, and our report dated March 9, 2012 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Rochester, New York

March 9, 2012

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Financial Institutions, Inc.:

We have audited the accompanying consolidated statements of financial condition of Financial Institutions, Inc. and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 9, 2012 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

Rochester, New York

March 9, 2012

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Financial Condition

(Dollars in thousands, except share and per share data)	September 30, 2011	September 30, December 31, 2010
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 57,489	$ 38,964
Federal funds sold and interest-bearing deposits in other banks	94	94
Total cash and cash equivalents	57,583	39,058
Securities available for sale, at fair value	627,518	666,368
Securities held to maturity, at amortized cost (fair value of $23,964 and $28,849, respectively)	23,297	28,162
Loans held for sale	2,410	3,138
Loans (net of allowance for loan losses of $23,260 and $20,466, respectively)	1,461,516	1,325,524
Company owned life insurance	45,556	26,053
Premises and equipment, net	33,085	33,263
Goodwill	37,369	37,369
Other assets	48,019	55,372
Total assets	$ 2,336,353	$ 2,214,307
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 393,421	$ 350,877
Interest-bearing demand	362,555	374,900
Savings and money market	474,947	417,359
Certificates of deposit	700,676	739,754
Total deposits	1,931,599	1,882,890
Short-term borrowings	150,698	77,110
Long-term borrowings		26,767
Other liabilities	16,862	15,396
Total liabilities	2,099,159	2,002,163
Commitments and contingencies (Note 9)		
Shareholders equity:		
Series A 3% preferred stock, $100 par value; 1,533 shares authorized; 1,500 and 1,533 shares issued, respectively	150	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; 173,235 and 174,223 shares issued, respectively	17,323	17,422
Total preferred equity	17,473	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	67,247	26,029
Retained earnings	158,079	144,599
Accumulated other comprehensive income (loss)	945	(4,722)
Treasury stock, at cost 358,481 and 410,616 shares, respectively	(6,692)	(7,660)

Total shareholders equity		237,194		212,144
Total liabilities and shareholders equity	$	2,336,353	$	2,214,307

See accompanying notes to the consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Income

(Dollars in thousands, except per share amounts)	September 30, 2011	September 30, 2010	September 30, 2009
	Years ended December 31,		
Interest income:			
Interest and fees on loans	$ 77,105	$ 75,877	$ 72,706
Interest and dividends on investment securities	18,013	20,622	21,694
Other interest income		10	82
Total interest income	95,118	96,509	94,482
Interest expense:			
Deposits	11,434	14,853	19,090
Short-term borrowings	500	365	270
Long-term borrowings	1,321	2,502	2,857
Total interest expense	13,255	17,720	22,217
Net interest income	81,863	78,789	72,265
Provision for loan losses	7,780	6,687	7,702
Net interest income after provision for loan losses	74,083	72,102	64,563
Noninterest income:			
Service charges on deposits	8,679	9,585	10,065
ATM and debit card	4,359	3,995	3,610
Broker-dealer fees and commissions	1,829	1,283	1,022
Company owned life insurance	1,424	1,107	1,096
Loan servicing	835	1,124	1,308
Net gain on sale of loans held for sale	880	650	699
Net gain on sales and calls of investment securities	3,003	169	3,429
Impairment charges on investment securities	(18)	(594)	(4,666)
Net gain (loss) on sale and disposal of other assets	67	(203)	180
Other	2,867	2,338	2,052
Total noninterest income	23,925	19,454	18,795
Noninterest expense:			
Salaries and employee benefits	35,439	32,811	33,634
Occupancy and equipment	10,868	10,818	11,062
Computer and data processing	2,437	2,487	2,340
Professional services	2,617	2,197	2,524
Supplies and postage	1,778	1,772	1,846
FDIC assessments	1,513	2,507	3,651
Advertising and promotions	1,259	1,121	949
Loss on extinguishment of debt	1,083		
Other	6,800	7,204	6,771
Total noninterest expense	63,794	60,917	62,777
Income before income taxes	34,214	30,639	20,581
Income tax expense	11,415	9,352	6,140

Net income	$	22,799	$	21,287	$	14,441
Preferred stock dividends		1,877		3,358		3,160
Accretion of discount on Series A preferred stock		1,305		367		537
Net income available to common shareholders	$	19,617	$	17,562	$	10,744
Earnings per common share (Note 15):						
Basic	$	1.50	$	1.62	$	0.99
Diluted	$	1.49	$	1.61	$	0.99
Cash dividends declared per common share	$	0.47	$	0.40	$	0.40
Weighted average common shares outstanding:						
Basic		13,067		10,767		10,730
Diluted		13,157		10,845		10,769

See accompanying notes to the consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders Equity

Years ended December 31, 2011, 2010 and 2009

(Dollars in thousands, except per share data)	September 30, Preferred Equity	September 30, Common Stock	September 30, Additional Paid-in Capital	September 30, Retained Earnings	September 30, Accumulated Other Comprehensive Income (Loss)	September 30, Treasury Stock	September 30, Total Shareholders Equity
Balance at January 1, 2009	**$ 53,074**	**$ 113**	**$ 26,397**	**$ 124,952**	**$ (4,013)**	**$ (10,223)**	**$ 190,300**
Comprehensive income:							
Net income				14,441			14,441
Other comprehensive income, net of tax					311		311
Total comprehensive income							14,752
Issuance costs of Series A preferred stock			(68)				(68)
Share-based compensation plans:							
Share-based compensation			852	2			854
Stock options exercised			(4)			19	15
Restricted stock awards issued, net			(207)			207	
Directors retainer			(30)			151	121
Accrued undeclared cumulative dividend on Series A preferred stock, net of accretion	344			(537)			(193)
Cash dividends declared:							
Series A 3% preferred-$3.00 per share				(5)			(5)
Series A preferred-$223.61 per share				(1,678)			(1,678)
Series B-1 8.48% preferred-$8.48 per share				(1,477)			(1,477)
Common-$0.40 per share				(4,327)			(4,327)
Balance at December 31, 2009	**$ 53,418**	**$ 113**	**$ 26,940**	**$ 131,371**	**$ (3,702)**	**$ (9,846)**	**$ 198,294**
Comprehensive income:							
Net income				21,287			21,287
Other comprehensive loss, net of tax					(1,020)		(1,020)
Total comprehensive income							20,267
Purchases of treasury stock						(69)	(69)
Share-based compensation plans:							
Share-based compensation			1,031				1,031

Stock options exercised			(74)			290	216
Restricted stock awards issued, net			(1,853)			1,853	
Directors retainer			(15)			112	97
Accrued undeclared cumulative dividend on Series A preferred stock, net of accretion	367			(367)			
Cash dividends declared:							
Series A 3% preferred-$3.00 per share				(5)			(5)
Series A preferred-$250.00 per share				(1,876)			(1,876)
Series B-1 8.48% preferred-$8.48 per share				(1,477)			(1,477)
Common-$0.40 per share				(4,334)			(4,334)
Balance at December 31, 2010	**$ 53,785**	**$ 113**	**$ 26,029**	**$ 144,599**	**$ (4,722)**	**$ (7,660)**	**$ 212,144**

Continued on next page

See accompanying notes to the consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders Equity (Continued)

Years ended December 31, 2011, 2010 and 2009

(Dollars in thousands, except per share data)	September 30, Preferred Equity	September 30, Common Stock	September 30, Additional Paid-in Capital	September 30, Retained Earnings	September 30, Accumulated Other Comprehensive Income (Loss)	September 30, Treasury Stock	September 30, Total Shareholders Equity
Balance at December 31, 2010	**$ 53,785**	**$ 113**	**$ 26,029**	**$ 144,599**	**$ (4,722)**	**$ (7,660)**	**$ 212,144**
Balance carried forward							
Comprehensive income:							
Net income				22,799			22,799
Other comprehensive income, net of tax					5,667		5,667
Total comprehensive income							28,466
Issuance of common stock		29	43,098				43,127
Purchases of treasury stock						(215)	(215)
Repurchase of Series A 3% preferred stock	(3)						(3)
Repurchase of warrant issued to U.S. Treasury			(2,080)				(2,080)
Redemption of Series A preferred stock	(37,515)		68				(37,447)
Repurchase of Series B-1 8.48% preferred stock	(99)						(99)
Share-based compensation plans:							
Share-based compensation			1,105				1,105
Stock options exercised			(28)			119	91
Restricted stock awards issued, net			(954)			954	
Excess tax benefit on share-based compensation			21				21
Directors retainer			(12)			110	98
Accretion of discount on Series A preferred stock	1,305			(1,305)			
Cash dividends declared:							
Series A 3% preferred-$3.00 per share				(5)			(5)
Series A preferred-$53.24 per share				(399)			(399)
Series B-1 8.48% preferred-$8.48 per share				(1,473)			(1,473)
Common-$0.47 per share				(6,137)			(6,137)

Balance at December 31, 2011	**$ 17,473**	**$ 142**	**$ 67,247**	**$ 158,079**	**$ 945**	**$ (6,692)**	**$ 237,194**

See accompanying notes to the consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Dollars in thousands)	**September 30, 2011**	**Years ended December 31,** **September 30, 2010**	**September 30, 2009**
Cash flows from operating activities:			
Net income	$ 22,799	$ 21,287	$ 14,441
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	3,466	3,537	4,067
Net amortization of premiums on securities	5,722	3,005	2,587
Provision for loan losses	7,780	6,687	7,702
Share-based compensation	1,105	1,031	854
Deferred income tax expense	6,510	2,468	7,470
Proceeds from sale of loans held for sale	32,839	42,195	90,290
Originations of loans held for sale	(31,231)	(44,262)	(88,999)
Net gain on sale of loans held for sale	(880)	(650)	(699)
Increase in company owned life insurance	(1,424)	(1,107)	(1,096)
Net gain on sales and calls of investment securities	(3,003)	(169)	(3,429)
Impairment charges on investment securities	18	594	4,666
Net (gain) loss on sale and disposal of other assets	(67)	203	(180)
Loss on extinguishment of debt	1,083		
Increase in other assets	(7,756)	(353)	(8,773)
(Decrease) increase in other liabilities	(4,943)	961	(6,633)
Net cash provided by operating activities	32,018	35,427	22,268
Cash flows from investing activities:			
Purchases of investment securities:			
Available for sale	(158,013)	(430,952)	(602,259)
Held to maturity	(17,188)	(19,791)	(29,280)
Proceeds from principal payments, maturities and calls on investment securities:			
Available for sale	168,976	219,974	353,545
Held to maturity	21,986	30,885	46,891
Proceeds from sales and calls of securities available for sale	44,514	122,090	224,928
Net increase in loans, excluding sales	(157,110)	(89,507)	(165,716)
Loans sold	13,033		
Purchases of company owned life insurance	(18,079)	(79)	(79)
Proceeds from sales of other assets	705	611	1,709
Purchases of premises and equipment	(3,678)	(2,438)	(1,959)
Net cash used in investing activities	(104,854)	(169,207)	(172,220)
Cash flows from financing activities:			
Net increase in deposits	48,709	139,935	109,692
Net increase in short-term borrowings	73,588	17,567	36,078
Repayments of long-term borrowings	(26,767)	(20,080)	(508)
Proceeds from issuance of common stock, net of issuance costs	43,127		
Purchases of common stock for treasury	(215)	(69)	
Repurchase of Series A 3% preferred stock	(3)		
Issuance costs of Series A preferred stock			(68)
Repurchase of warrant issued to U.S. Treasury	(2,080)		
Redemption of Series A preferred stock	(37,447)		
Repurchase of Series B-1 8.48% preferred stock	(99)		
Proceeds from stock options exercised	91	216	15
Excess tax benefit on share-based compensation	21		

Cash dividends paid to preferred shareholders	(2,118)	(3,358)	(3,160)
Cash dividends paid to common shareholders	(5,446)	(4,332)	(4,325)
Net cash provided by financing activities	91,361	129,879	137,724
Net increase (decrease) in cash and cash equivalents	18,525	(3,901)	(12,228)
Cash and cash equivalents, beginning of period	39,058	42,959	55,187
Cash and cash equivalents, end of period	$ 57,583	$ 39,058	$ 42,959

See accompanying notes to the consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(1.) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 has also expanded its indirect lending network to include relationships with franchised automobile dealers in the Capital District of New York and Northern Pennsylvania. 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 and investment advisor subsidiary offering noninsured investment products. References to the Company mean the consolidated reporting entities and references to the Bank mean Five Star Bank.

The accounting and reporting policies conform to general practices within the banking industry and to U.S. generally accepted accounting principles (GAAP). Prior years consolidated financial statements are re-classified whenever necessary to conform to the current year s presentation.

The Company has evaluated events and transactions for potential recognition or disclosure through the day the financial statements were issued.

The following is a description of the Company s significant accounting policies.

(a.) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

(b.) Use of Estimates

In preparing the consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities as of the date of the statement of financial condition and reported amounts of revenue and expenses during the reporting period. Material estimates relate to the determination of the allowance for loan losses, the carrying value of goodwill and deferred tax assets, the valuation and other than temporary impairment (OTTI) considerations related to the securities portfolio, and assumptions used in the defined benefit pension plan accounting,. These estimates and assumptions are based on management s best estimates and judgment and are evaluated on an ongoing basis using historical experience and other factors, including the current economic environment. The Company adjusts these estimates and assumptions when facts and circumstances dictate. As future events cannot be determined with precision, actual results could differ significantly from the Company s estimates.

(c.) Cash Flow Reporting

Cash and cash equivalents include cash and due from banks, federal funds sold and interest-bearing deposits in other banks. Net cash flows are reported for loans, deposit transactions and short-term borrowings.

Supplemental cash flow information is summarized as follows for the years ended December 31 (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Cash paid (received) during the year for:			
Interest expense	$ 15,668	$ 17,676	$ 21,682
Income taxes, net of income tax refunds	5,191	6,923	(1,312)
Non-cash activity:			
Real estate and other assets acquired in settlement of loans	$ 305	$ 561	$ 1,096
Dividends declared and unpaid	2,144	1,694	1,692
Decrease in net unsettled security purchases	(67)	(317)	(1,348)

Loans securitized	15,983

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

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

(d.) Investment Securities

Investment securities are classified as either available for sale or held to maturity. Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and are recorded at amortized cost. Other investment securities are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported as a component of shareholders equity.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Securities are evaluated periodically to determine whether a decline in their fair value is other than temporary. Management utilizes criteria such as, the current intent to hold or sell the security, the magnitude and duration of the decline and, when appropriate, consideration of negative changes in expected cash flows, creditworthiness, near term prospects of issuers, the level of credit subordination, estimated loss severity, and delinquencies, to determine whether a loss in value is other than temporary. The term other than temporary is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable. Declines in the fair value of investment 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 impairment related to non-credit related factors is recognized in other comprehensive income. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

(e.) Loans Held for Sale and Mortgage Servicing Rights

The Company generally makes the determination of whether to identify a mortgage as held for sale at the time the loan is closed based on the Company s intent and ability to hold the loan. Loans held for sale are recorded at the lower of cost or market computed on the aggregate portfolio basis. The amount, by which cost exceeds market value, if any, is accounted for as a valuation allowance with changes included in the determination of results of operations for the period in which the change occurs. The amount of loan origination cost and fees are deferred at origination of the loans and recognized as part of the gain and loss on sale of the loans, determined using the specific identification method, in the consolidated statement of income.

The Company originates and sells certain residential real estate loans in the secondary market. The Company typically retains the right to service the mortgages upon sale. Mortgage-servicing rights (MSRs) represent the cost of acquiring the contractual rights to service loans for others. MSRs are recorded at their fair value at the time a loan is sold and servicing rights are retained. MSRs are reported in other assets in the consolidated statements of financial position and are amortized to noninterest income in the consolidated statements of income in proportion to and over the period of estimated net servicing income. The Company uses a valuation model that calculates the present value of future cash flows to determine the fair value of servicing rights. In using this valuation method, the Company incorporates assumptions to estimate future net servicing income, which include estimates of the cost to service the loan, the discount rate, an inflation rate and prepayment speeds. On a quarterly basis, the Company evaluates its MSRs for impairment and charges any such impairment to current period earnings. In order to evaluate its MSRs the Company stratifies the related mortgage loans on the basis of their predominant risk characteristics, such as interest rates, year of origination and term, using discounted cash flows and market-based assumptions. Impairment of MSRs is recognized through a valuation allowance, determined by estimating the fair value of each stratum and comparing it to its carrying value. Subsequent increases in fair value are adjusted through the valuation allowance, but only to the extent of the valuation allowance. The Company recognized an impairment loss of $35 thousand during the year ended December 31, 2011. No impairment loss was recognized during the years ended December 31, 2010 or 2009.

Mortgage loan servicing includes collecting monthly mortgagor payments, forwarding payments and related accounting reports to investors, collecting escrow deposits for the payment of mortgagor property taxes and insurance, and paying taxes and insurance from escrow funds when due. Loan servicing income (a component of noninterest income in the consolidated statements of income) consists of fees earned for servicing mortgage loans sold to third parties, net of amortization expense and impairment losses associated with capitalized mortgage servicing assets.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

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

(f.) Loans

Loans are classified as held for investment when management has both the intent and ability to hold the loan for the foreseeable future, or until maturity or payoff. Loans are carried at the principal amount outstanding, net of any unearned income and unamortized deferred fees and costs on originated loans. Loan origination fees and certain direct loan origination costs are deferred, and the net amount is amortized into net interest income over the contractual life of the related loans or over the commitment period as an adjustment of yield. Interest income on loans is based on the principal balance outstanding computed using the effective interest method.

A loan is considered delinquent when a payment has not been received in accordance with the contractual terms. The accrual of interest income for commercial loans is discontinued when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, while the accrual of interest income for retail loans is discontinued when loans reach specific delinquency levels. Loans are generally placed on nonaccrual status when contractually past due 90 days or more as to interest or principal payments, unless the loan is well secured and in the process of collection. Additionally, whenever management becomes aware of facts or circumstances that may adversely impact the collectability of principal or interest on loans, it is management s practice to place such loans on a nonaccrual status immediately, rather than delaying such action until the loans become 90 days past due. When a loan is placed on nonaccrual status, previously accrued and uncollected interest is reversed, amortization of related deferred loan fees or costs is suspended, and income is recorded only to the extent that interest payments are subsequently received in cash and a determination has been made that the principal balance of the loan is collectible. If collectability of the principal is in doubt, payments received are applied to loan principal. A nonaccrual loan may be returned to accrual status when all delinquent principal and interest payments become current in accordance with the terms of the loan agreement, the borrower has demonstrated a period of sustained performance (generally a minimum of six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

The Company s loan policy dictates the guidelines to be followed in determining when a loan is charged-off. All charge offs are approved by the Bank s senior loan officers or loan committees, depending on the amount of the charge off, and are reported in aggregate to the Bank s Board of Directors. Commercial business and commercial mortgage loans are charged-off when a determination is made that the financial condition of the borrower indicates that the loan will not be collectible in the ordinary course of business. Residential mortgage loans and home equities are generally charged-off or written down when the credit becomes severely delinquent and the balance exceeds the fair value of the property less costs to sell. Indirect and other consumer loans, both secured and unsecured, are generally charged-off in full during the month in which the loan becomes 120 days past due, unless the collateral is in the process of repossession in accordance with the Company s policy.

A loan is accounted for as a troubled debt restructuring if the Company, for economic or legal reasons related to the borrower s financial condition, grants a significant concession to the borrower that it would not otherwise consider. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan, or a modification of terms such as a reduction of the stated interest rate or face amount of the loan, a reduction of accrued interest, an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. Troubled debt restructurings generally remain on nonaccrual status until there is a sustained period of payment performance (usually six months or longer) and there is a reasonable assurance that the payments will continue. See Allowance for Loan Losses below for further policy discussion and see Note 4 for additional information on loans.

(g.) Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Company enters into off-balance sheet financial instruments consisting of commitments to extend credit, standby letters of credit and financial guarantees. Such financial instruments are recorded in the consolidated financial statements when they are funded or when related fees are incurred or received. The Company periodically evaluates the credit risks inherent in these commitments and establishes loss allowances for such risks if and when these are deemed necessary.

The Company recognizes as liabilities the fair value of the obligations undertaken in issuing the guarantees under the standby letters of credit, net of the related amortization at inception. The fair value approximates the unamortized fees received from the customers for issuing the standby letters of credit. The fees are deferred and recognized on a straight-line basis over the commitment period. Standby letters of credit outstanding at December 31, 2011 had original terms ranging from one to five years.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

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

Fees received for providing loan commitments and letters of credit that result in loans are typically deferred and amortized to interest income over the life of the related loan, beginning with the initial borrowing. Fees on commitments and letters of credit are amortized to other income as banking fees and commissions over the commitment period when funding is not expected.

(h.) Allowance for Loan Losses

The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. When a loan or portion of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis and is based upon periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. Specific allowances are established for impaired loans. Impaired commercial business and commercial mortgage loans are individually evaluated and measured for impairment based on the present value of expected future cash flows discounted at the loan s effective interest rate, a loan s observable market price, or the fair value of the collateral if the loan is collateral dependent. Regardless of the measurement method, impairment is based on the fair value of the collateral when foreclosure is probable. If the recorded investment in impaired loans exceeds the measure of estimated fair value, a specific allowance is established as a component of the allowance for loan losses. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. The Company determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loans obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures unless the loan has been subject to a troubled debt restructure.

General allowances are established for loan losses on a portfolio basis for loans that do not meet the definition of impaired. The portfolio is grouped into similar risk characteristics, primarily loan type. The Company applies an estimated loss rate to each loan group. The loss rate is based on historical experience and as a result can differ from actual losses incurred in the future. The historical loss rate is adjusted for qualitative factors such as levels and trends of delinquent and non-accruing loans, trends in volume and terms, effects of changes in lending policy, the experience, ability and depth of management, national and local economic trends and conditions, concentrations of credit risk, interest rates, highly leveraged borrowers, information risk and collateral risk. The qualitative factors are reviewed at least quarterly and adjustments are made as needed.

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.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

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

(i.) Other Real Estate Owned

Other real estate owned consists of properties acquired through foreclosure or by acceptance of a deed in lieu of foreclosure. These assets are recorded at the lower of fair value of the asset acquired less estimated costs to sell or cost (defined as the fair value at initial foreclosure). At the time of foreclosure, or when foreclosure occurs in-substance, the excess, if any, of the loan over the fair market value of the assets received, less estimated selling costs, is charged to the allowance for loan losses and any subsequent valuation write-downs are charged to other expense. In connection with the determination of the allowance for loan losses and the valuation of other real estate owned, management obtains appraisals for properties. Operating costs associated with the properties are charged to expense as incurred. Gains on the sale of other real estate owned are included in income when title has passed and the sale has met the minimum down payment requirements prescribed by GAAP. The balance of other real estate owned at December 31, 2011 was $475 thousand.

(j.) Company Owned Life Insurance

The Company holds life insurance policies on certain current and former employees. The Company is the owner and beneficiary of the policies. The cash surrender value of these policies is included as an asset on the consolidated statements of financial condition, and any increase in cash surrender value is recorded as noninterest income on the consolidated statements of income. In the event of the death of an insured individual under these policies, the Company would receive a death benefit which would be recorded as noninterest income.

(k.) Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. The Company generally amortizes buildings and building improvements over a period of 15 to 39 years and software, furniture and equipment over a period of 3 to 10 years. Leasehold improvements are amortized over the shorter of the lease term or the useful life of the improvements. Premises and equipment are periodically reviewed for impairment or when circumstances present indicators of impairment.

(l.) Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. The Company completes the annual goodwill impairment test as of September 30 of each year. The impairment testing process is conducted by assigning net assets and goodwill to each reporting unit. Currently, the Company s goodwill is evaluated at the entity level as there is only one reporting unit. The fair value of each reporting unit is compared to the recorded book value step one . If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and step two is not considered necessary. If the carrying value of a reporting unit exceeds its fair value, the impairment test continues (step two) by comparing the carrying value of the reporting unit s goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill. An impairment charge is recognized if the carrying fair value of goodwill exceeds the implied fair value of goodwill.

The company had other intangible assets, consisting entirely of core deposit intangibles, which were fully amortized as of December 31, 2009. Amortization expense for these other intangible assets for the year ended December 31, 2009 was $280 thousand. Amortization of other intangible assets was computed using the straight-line method over the estimated lives of the respective assets (primarily 5 and 7 years).

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

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

(m.) Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) Stock

The non-marketable investments in FHLB and FRB stock are included in other assets in the consolidated statements of financial condition at par value or cost and are periodically reviewed for impairment. The dividends received relative to these investments are included in other noninterest income in the consolidated statements of income.

As a member of the FHLB system, the Company is required to maintain a specified investment in FHLB of New York (FHLBNY) stock in proportion to its volume of certain transactions with the FHLB. FHLBNY stock totaled $6.8 million and $2.5 million as of December 31, 2011 and 2010, respectively.

As a member of the FRB system, the Company is required to maintain a specified investment in FRB stock based on a ratio relative to the Company s capital. FRB stock totaled $3.9 million as of December 31, 2011 and 2010.

(n.) Equity Method Investments

The Company has investments in limited partnerships and accounts for these investments under the equity method. These investments are included in other assets in the consolidated statements of financial condition and totaled $4.0 million and $3.6 million as of December 31, 2011 and 2010, respectively.

(o.) Treasury Stock

Acquisitions of treasury stock are recorded at cost. The reissuance of shares in treasury is recorded at weighted-average cost.

(p.) Employee Benefits

The Company participates in a non-contributory defined benefit pension plan for certain employees who previously met participation requirements. The Company also provides post-retirement benefits, principally health and dental care, to employees of a previously acquired entity. The Company has closed the pension and post-retirement plans to new participants. The actuarially determined pension benefit is based on years of service and the employee s highest average compensation during five consecutive years of employment. The Company s policy is to at least fund the minimum amount required by the Employment Retirement Income Security Act of 1974. The cost of the pension and post-retirement plans are based on actuarial computations of current and future benefits for employees, and is charged to noninterest expense in the consolidated statements of income.

The Company recognizes an asset or a liability for a plans overfunded status or underfunded status, respectively, in the consolidated financial statements and reports changes in the funded status as a component of other comprehensive income, net of applicable taxes, in the year in which changes occur.

(q.) Share-Based Compensation Plans

Compensation expense for stock options and restricted stock awards is based on the fair value of the award on the measurement date, which, for the Company, is the date of grant and is recognized ratably over the service period of the award. The fair value of stock options is estimated using the Black-Scholes option-pricing model. The fair value of restricted stock awards is generally the market price of the Company s stock on the date of grant.

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.

(r.) Income Taxes

Income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. A valuation allowance is recognized on deferred tax assets if, based upon the weight of available evidence, it is more likely than not that some or all of the assets may not be realized. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

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

(s.) Earnings Per Common Share

The Company calculates earnings per common share (EPS) using the two-class method in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 260, Earnings Per Share . The two-class method requires the Company to present EPS as if all of the earnings for the period are distributed to common shareholders and any participating securities, regardless of whether any actual dividends or distributions are made. All outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities. Certain of the restricted shares issued under the Company s share-based compensation plan are entitled to dividends at the same rate as common stock. The Company has determined that these outstanding non-vested stock awards qualify as participating securities.

Basic EPS is computed by dividing distributed and undistributed earnings available to common shareholders by the weighted average number of common shares outstanding for the period. Distributed and undistributed earnings available to common shareholders represent net income reduced by preferred stock dividends and distributed and undistributed earnings available to participating securities. Common shares outstanding include common stock and vested restricted stock awards. Diluted EPS reflects the assumed conversion of all potential dilutive securities. A reconciliation of the weighted-average shares used in calculating basic earnings per common share and the weighted average common shares used in calculating diluted earnings per common share for the reported periods is provided in Note 15 Earnings Per Common Share.

(t.) Recent Accounting Pronouncements

In December 2011, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU) 2011-12 *Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.* ASU 2011-12 defers changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments to allow the FASB time to reconsider whether to require presentation of such adjustments on the face of the financial statements to show the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. ASU 2011-12 allows entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No. 2011-05. All other requirements in ASU No. 2011-05 are not affected by ASU No. 2011-12. ASU 2011-12 is effective for annual and interim periods beginning after December 15, 2011 and is not expected to have a material impact on the Company s consolidated financial statements.

In November 2011, the FASB issued ASU 2011-11 *Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities.* ASU 2011-11 amends Topic 210, *Balance Sheet,* to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and is not expected to have a material impact on the Company s consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08 *Testing Goodwill for Impairment.* The provisions of ASU 2011-08 permit an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further impairment testing is required. ASU No. 2011-08 includes examples of events and circumstances that may indicate that a reporting unit s fair value is less than its carrying amount. The provisions of ASU No. 2011-08 are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted provided that the entity has not yet performed its annual impairment test for goodwill. The Company performs its annual impairment test for goodwill as of September 30 of each year. The adoption of ASU No. 2011-08 is not expected to have a material impact on the Company s consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

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

In June 2011, the FASB issued ASU 2011-05 *Comprehensive Income (Topic 220) Presentation of Comprehensive Income.* ASU 2011-05 amends Topic 220, Comprehensive Income, to require that all non-owner changes in stockholders equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders equity was eliminated. ASU 2011-05 is effective for annual and interim periods beginning after December 15, 2011; however, certain provisions related to the presentation of reclassification adjustments have been deferred by ASU 2011-12 Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05, as further discussed above. The adoption of ASU 2011-05 is not expected to have a significant impact on the Company s consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04 *Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* ASU 2011-04 changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in GAAP and IFRSs (International Financial Reporting Standards). ASU 2011-04 is effective prospectively during interim and annual periods beginning on or after December 15, 2011. Early adoption by public entities is not permitted. The adoption of ASU 2011-04 is not expected to have a significant impact on the Company s consolidated financial statements.

In April 2011, the FASB issued ASU 2011-03 *Transfers and Servicing (Topic 860) Reconsideration of Effective Control for Repurchase Agreement.* ASU 2011-03 removes from the assessment of effective control the criterion relating to the transferor s ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The adoption of ASU 2011-03 is not expected to have a significant impact on the Company s consolidated financial statements.

In April 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. A provision in ASU No. 2011-02 also ends the FASB s deferral of the additional disclosures related to troubled debt restructurings as required by ASU No. 2010-20. The Company adopted the provisions of ASU No. 2010-20 retrospectively to all modifications and restructuring activities that have occurred from January 1, 2011. See Note 4 to the Consolidated Financial Statements for the disclosures required by ASU No. 2010-20.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(2.) INVESTMENT SECURITIES

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

	September 30,	September 30,	September 30,	September 30,
	December 31, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 94,947	$ 2,770	$ 5	$ 97,712
State and political subdivisions	119,099	5,336	11	124,424
Mortgage-backed securities:				
Federal National Mortgage Association	98,679	2,944		101,623
Federal Home Loan Mortgage Corporation	63,838	1,017		64,855
Government National Mortgage Association	73,226	3,376		76,602
Collateralized mortgage obligations:				
Federal National Mortgage Association	28,339	581	7	28,913
Federal Home Loan Mortgage Corporation	22,318	675	1	22,992
Government National Mortgage Association	103,975	2,654	18	106,611
Privately issued	327	1,762		2,089
Total collateralized mortgage obligations	154,959	5,672	26	160,605
Total mortgage-backed securities	390,702	13,009	26	403,685
Asset-backed securities	297	1,400		1,697
Total available for sale securities	$ 605,045	$ 22,515	$ 42	$ 627,518
Securities held to maturity:				
State and political subdivisions	$ 23,297	$ 667	$	$ 23,964

	September 30,	September 30,	September 30,	September 30,
	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

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(2.) INVESTMENT SECURITIES (Continued)

Interest and dividends on securities for the years ended December 31 are summarized as follows (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Taxable interest and dividends	$ 14,185	$ 17,101	$ 16,466
Tax-exempt interest and dividends	3,828	3,521	5,228
Total interest and dividends on securities	$ 18,013	$ 20,622	$ 21,694

Sales and calls of securities available for sale for the years ended December 31 were as follows (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Proceeds from sales and calls	$ 44,514	$ 122,090	$ 224,928
Gross realized gains	3,051	173	6,826
Gross realized losses	48	4	3,397

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

	September 30, Amortized Cost	September 30, Fair Value
Debt securities available for sale:		
Due in one year or less	$ 24,025	$ 24,166
Due from one to five years	81,483	84,008
Due after five years through ten years	183,639	190,461
Due after ten years	315,898	328,883
	$ 605,045	$ 627,518
Debt securities held to maturity:		
Due in one year or less	$ 18,496	$ 18,631
Due from one to five years	3,763	4,062
Due after five years through ten years	905	1,096
Due after ten years	133	175
	$ 23,297	$ 23,964

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(2.) INVESTMENT SECURITIES (Continued)

There were no unrealized losses in held to maturity securities at December 31, 2011 or December 31, 2010. Unrealized losses on investment securities available for sale and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31 are summarized as follows (in thousands):

	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,
	December 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	$ 2,177	$ 1	$ 5,246	$ 4	$ 7,423	$ 5
State and political subdivisions	452	2	646	9	1,098	11
Mortgage-backed securities:						
Collateralized mortgage obligations:						
Federal National Mortgage Association			1,817	7	1,817	7
Federal Home Loan Mortgage Corporation			388	1	388	1
Government National Mortgage Association	6,138	18			6,138	18
Total collateralized mortgage obligations	6,138	18	2,205	8	8,343	26
Total mortgage-backed securities	6,138	18	2,205	8	8,343	26
Total temporarily impaired securities	$ 8,767	$ 21	$ 8,097	$ 21	$ 16,864	$ 42

	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,

	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

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(2.) INVESTMENT SECURITIES (Continued)

The following summarizes the amounts of OTTI recognized during the years ended December 31 by investment category (in thousands).

	September 30, 2011	September 30, 2010	September 30, 2009
Mortgage-backed securities Privately issued whole loan CMOs	$ 18	$	$ 2,353
Asset-backed securities Trust preferred securities		526	1,787
Asset-backed securities Other		68	526
Total OTTI	$ 18	$ 594	$ 4,666

The Company reviews investment securities on an ongoing basis for the presence of 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 total number of security positions in the investment portfolio in an unrealized loss position at December 31, 2011 was 14 compared to 156 at December 31, 2010. At December 31, 2011, the Company had positions in 9 investment securities with an amortized cost of $8.1 million and an unrealized loss of $21 thousand that have been in a continuous unrealized loss position for more than 12 months. There were a total of 5 securities positions in the Company s investment portfolio, with an amortized cost of $8.8 million and a total unrealized loss of $21 thousand at December 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 December 31, 2011, the debt securities with unrealized losses were not considered to be OTTI. As of December 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 the Company expects to recover the entire amortized cost of these impaired securities. Accordingly, as of December 31, 2011, 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.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(3.) LOANS HELD FOR SALE AND LOAN SERVICING RIGHTS

Loans held for sale were entirely comprised of residential real estate mortgages and totaled $2.4 million and $3.1 million as of December 31, 2011 and 2010, respectively.

The Company sells certain qualifying newly originated or refinanced residential real estate mortgages on the secondary market. Residential real estate mortgages serviced for others, which are not included in the consolidated statements of financial condition, amounted to $297.8 million and $328.9 million as of December 31, 2011 and 2010, respectively. In connection with these mortgage-servicing activities, the Company administered escrow and other custodial funds which amounted to approximately $5.9 million and $6.2 million as of December 31, 2011 and 2010, respectively.

The activity in capitalized mortgage servicing assets is summarized as follows for the years ended December 31 (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Mortgage servicing assets, beginning of year	$ 1,642	$ 1,534	$ 925
Originations	319	408	952
Amortization	(352)	(300)	(343)
Mortgage servicing assets, end of year	1,609	1,642	1,534
Valuation allowance	(210)	(175)	(185)
Mortgage servicing assets, net, end of year	$ 1,399	$ 1,467	$ 1,349

The Company did not securitize any residential mortgage loans in 2011 or 2010. During 2009, the Company pooled $16.0 million of one-to-four family residential mortgage loans and converted the loans to FHLMC securities. The Company retained servicing responsibilities for this securitization. The mortgage-backed securities received in exchange for the loans were classified as available-for-sale and subsequently sold. The $564 thousand gain recognized on the sale of the securities is included in the consolidated statements of income under net gain on sales and calls of investment securities.

Automobile loan servicing rights are accounted for using the amortization method. A servicing asset is established at fair value at the time of the sale. The servicing asset is reported in other assets in the consolidated statements of financial position and amortized to noninterest income in the consolidated statements of income in proportion to and over the period of estimated net servicing income. Impairment, if any, is recognized when carrying value exceeds the fair value as determined by calculating the present value of expected net future cash flows. The primary risk characteristic for measuring servicing assets is payoff rates of the underlying loan pools. Valuation calculations rely on the predicted payoff assumption and, if actual payoff is quicker than expected, then future value would be impaired.

During 2011, the Company sold $13.0 million of indirect auto loans under a 90%/10% participation agreement, recognizing a gain of $153 thousand. The loans were reclassified from portfolio to loans held for sale during the second quarter of 2011. As of December 31, 2011, a loan servicing asset for these loans of $574 thousand is included in other assets in the consolidated statements of financial condition. Management reviewed the servicing asset for impairment as of December 31, 2011 and determined that no valuation allowance was necessary. The Company will continue to service the loans for a fee in accordance with the participation agreement.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(4.) LOANS

The Company s loan portfolio consisted of the following at December 31 (in thousands):

	September 30, Loans, Gross	September 30, Net Deferred Loan (Fees) Costs	September 30, Loans, Net
2011			
Commercial business	$ 233,727	$ 109	$ 233,836
Commercial mortgage	394,034	(790)	393,244
Residential mortgage	113,865	46	113,911
Home equity	227,853	3,913	231,766
Consumer indirect	465,807	21,906	487,713
Other consumer	24,138	168	24,306
Total	$ 1,459,424	$ 25,352	1,484,776
Allowance for loan losses			(23,260)
Total loans, net			$ 1,461,516
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

The Company s significant concentrations of credit risk in the loan portfolio relate to a geographic concentration in the communities that the Company serves.

Certain executive officers, directors and their business interests are customers of the Company. Transactions with these parties are based on substantially the same terms as similar transactions with unrelated third parties and do not carry more than normal credit risk. Borrowings by these related parties amounted to $378 thousand and $609 thousand at December 31, 2011 and 2010, respectively. During 2011, new borrowings amounted to $4 thousand (including borrowings of executive officers and directors that were outstanding at the time of their election), and repayments and other reductions were $235 thousand.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(4.) LOANS (Continued)

Past Due Loans Aging

The following table provides an analysis, by loan class, of the Company s delinquent and nonaccrual loans as of December 31 (in thousands):

	September 30, 30-59 Days Past Due	September 30, 60-89 Days Past Due	September 30, Greater Than 90 Days	September 30, Total Past Due	September 30, Nonaccrual	September 30, Current	September 30, Total Loans
2011							
Commercial business	$ 35	$	$	$ 35	$ 1,259	$ 232,433	$ 233,727
Commercial mortgage	165			165	2,928	390,941	394,034
Residential mortgage	517			517	1,644	111,704	113,865
Home equity	749	68		817	682	226,354	227,853
Consumer indirect	984	92		1,076	558	464,173	465,807
Other consumer	106	10	5	121		24,017	24,138
Total loans, gross	$ 2,556	$ 170	$ 5	$ 2,731	$ 7,071	$ 1,449,622	$ 1,459,424
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

There were no loans past due greater than 90 days and still accruing interest as of December 31, 2011 and December 31, 2010. There were $5 thousand and $3 thousand in consumer overdrafts which were past due greater than 90 days as of December 31, 2011 and December 31, 2010, respectively. Consumer overdrafts are overdrawn deposit accounts which have been reclassified as loans but by their terms do not accrue interest.

Interest income on nonaccrual loans, if recognized, is recorded using the cash basis method of accounting. There was no interest income recognized on nonaccrual loans during the years ended December 31, 2011, 2010 and 2009. For the years ended December 31, 2011, 2010 and 2009, estimated interest income of $438 thousand, $474 thousand, and $388 thousand, respectively, would have been recorded if all such loans had been accruing interest according to their original contractual terms.

Troubled Debt Restructurings

A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company offers various types of concessions when modifying loans, however, forgiveness of principal is rarely granted. Commercial loans modified in a TDR may involve temporary interest-only payments, term extensions, reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, requesting additional collateral, releasing collateral for consideration, or substituting or adding a new borrower or guarantor. The following presents, by loan class, information related to loans modified in a TDR during the year ended December 31, 2011 (in thousands).

	September 30,	September 30,	September 30,
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial business	6	$ 142	$ 142
Commercial mortgage	1	280	280
Total	7	$ 422	$ 422

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(4.) LOANS (Continued)

All of the loans identified as TDRs by the Company were previously on nonaccrual status and reported as impaired loans prior to restructuring. The modifications primarily related to extending the amortization periods of the loans. All loans restructured during the year ended December 31, 2011 are on nonaccrual status as of December 31, 2011. Nonaccrual loans that are restructured remain on nonaccrual status, but may move to accrual status after they have performed according to the restructured terms for a period of time. The TDR classification did not have a material impact on the Company s determination of the allowance for loan losses because the modified loans were impaired and evaluated for a specific reserve both before and after restructuring.

For purposes of this disclosure, a loan modified as a TDR is considered to have defaulted when the borrower becomes 90 days past due. As of December 31, 2011, one commercial real estate loan restructured in 2011 with a balance of $261 thousand at December 31, 2011 was in default. This default did not significantly impact the Company s determination of the allowance for loan losses.

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 at December 31 (in thousands):

	September 30, Recorded Investment	September 30, Unpaid Principal Balance	September 30, Related Allowance	September 30, Average Recorded Investment	September 30, Interest Income Recognized
2011					
With no related allowance recorded:					
Commercial business	$ 342	$ 1,266	$	$ 361	$
Commercial mortgage	605	696		583	
	947	1,962		944	
With an allowance recorded:					
Commercial business	917	917	436	1,033	
Commercial mortgage	2,323	2,323	644	2,172	
	3,240	3,240	1,080	3,205	
	$ 4,187	$ 5,202	$ 1,080	$ 4,149	$
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	$

During the year ended December 31, 2009, the Company s average investment in impaired loans was $3.8 million. The Company recognized $69 thousand of interest income on impaired loans during the year ended December 31, 2009. At December 31, 2011, there were no commitments to lend additional funds to those borrowers whose loans were classified as impaired.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(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 December 31 (in thousands):

	September 30, Commercial Business	September 30, Commercial Mortgage
2011		
Uncriticized	$ 221,477	$ 383,700
Special mention	7,445	2,388
Substandard	4,805	7,946
Doubtful		
Total	$ 233,727	$ 394,034
2010		
Uncriticized	$ 194,510	$ 338,061
Special mention	11,479	4,931
Substandard	4,959	10,545
Doubtful		

Total	$	210,948	$	353,537

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(4.) LOANS (Continued)

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 December 31 (in thousands):

	September 30, Residential Mortgage	September 30, Home Equity	September 30, Consumer Indirect	September 30, Other Consumer
2011				
Performing	$ 112,221	$ 227,171	$ 465,249	$ 24,138
Non-performing	1,644	682	558	
Total	$ 113,865	$ 227,853	$ 465,807	$ 24,138
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

Allowance for Loan Losses

The following tables set forth the changes in the allowance for loan losses for the years ended December 31 (in thousands):

	September 30, Commercial	September 30, Commercial Mortgage	September 30, Residential Mortgage	September 30, Home Equity	September 30, Consumer Indirect	September 30, Other Consumer	September 30, Total
2011							
Allowance for loan losses:							
Beginning balance	$ 3,712	$ 6,431	$ 1,013	$ 972	$ 7,754	$ 584	$ 20,466
Charge-offs	(1,346)	(751)	(152)	(449)	(4,713)	(877)	(8,288)
Recoveries	401	245	90	44	2,066	456	3,302
Provision (credit)	1,269	493	(93)	675	5,082	354	7,780
Ending balance	$ 4,036	$ 6,418	$ 858	$ 1,242	$ 10,189	$ 517	$ 23,260

Evaluated for impairment:														
Individually	$	436	$	644	$		$		$		$		$	1,080
Collectively	$	3,600	$	5,774	$	858	$	1,242	$	10,189	$	517	$	22,180
Loans:														
Ending balance	$	233,727	$	394,034	$	113,865	$	227,853	$	465,807	$	24,138	$	1,459,424
Evaluated for impairment:														
Individually	$	1,259	$	2,928	$		$		$		$		$	4,187
Collectively	$	232,468	$	391,106	$	113,865	$	227,853	$	465,807	$	24,138	$	1,455,237

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(4.) LOANS (Continued)

	September 30, Commercial	September 30, Commercial Mortgage	September 30, Residential Mortgage	September 30, Home Equity	September 30, Consumer Indirect	September 30, Other Consumer	September 30, Total
2010							
Allowance for loan losses:							
Beginning balance	$ 4,407	$ 6,638	$ 1,251	$ 1,043	$ 6,837	$ 565	$ 20,741
Charge-offs	(3,426)	(263)	(290)	(259)	(4,669)	(909)	(9,816)
Recoveries	326	501	21	36	1,485	485	2,854
Provision (credit)	2,405	(445)	31	152	4,101	443	6,687
Ending balance	$ 3,712	$ 6,431	$ 1,013	$ 972	$ 7,754	$ 584	$ 20,466
Evaluated for impairment:							
Individually	$ 149	$ 883	$	$	$	$	$ 1,032
Collectively	$ 3,563	$ 5,548	$ 1,013	$ 972	$ 7,754	$ 584	$ 19,434
Loans:							
Ending balance	$ 210,948	$ 353,537	$ 129,553	$ 205,070	$ 400,221	$ 25,937	$ 1,325,266
Evaluated for impairment:							
Individually	$ 948	$ 3,100	$	$	$	$	$ 4,048
Collectively	$ 210,000	$ 350,437	$ 129,553	$ 205,070	$ 400,221	$ 25,937	$ 1,321,218

2009	September 30, Total
Allowance for loan losses:	
Beginning balance	$ 18,749
Charge-offs	(7,830)
Recoveries	2,120
Provision	7,702

Ending balance	$	20,741

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.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(5.) PREMISES AND EQUIPMENT, NET

Major classes of premises and equipment at December 31 are summarized as follows (in thousands):

	September 30, 2011	September 30, 2010
Land and land improvements	$ 4,330	$ 4,335
Buildings and leasehold improvements	40,590	39,215
Furniture, fixtures, equipment and vehicles	23,414	23,645
Premises and equipment	68,334	67,195
Accumulated depreciation and amortization	(35,249)	(33,932)
Premises and equipment, net	$ 33,085	$ 33,263

Depreciation and amortization expense, included in occupancy and equipment expense in the consolidated statements of income, amounted to $3.5 million for the years ended December 31, 2011 and 2010, and $3.8 million for the year ended December 31, 2009.

(6.) GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amount of goodwill totaled $37.4 million as of December 31, 2011 and 2010. The goodwill relates to the Company s primary subsidiary and reporting unit, Five Star Bank. The Company performs a goodwill impairment test on an annual basis or more frequently if events and circumstances warrant. As of September 30, 2011, the Company performed the annual goodwill impairment test and determined the estimated fair value of our reporting unit to be in excess of its carrying amount. Accordingly, as of the Company s annual impairment test date, there was no indication of goodwill impairment. The Company tests its goodwill for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of our reporting unit below its carrying amount.

Declines in the market value of the Company s publicly traded stock price or declines in the Company s ability to generate future cash flows may increase the potential that goodwill recorded on the Company s consolidated statement of financial condition be designated as impaired and that the Company may incur a goodwill write-down in the future.

(7.) DEPOSITS

A summary of deposits as of December 31 are as follows (in thousands):

	September 30, 2011	September 30, 2010
Noninterest-bearing demand	$ 393,421	$ 350,877
Interest-bearing demand	362,555	374,900
Savings and money market	474,947	417,359
Certificates of deposit, due:		
Within one year	547,874	554,104
One to two years	84,687	126,955
Two to three years	17,974	14,653
Three to five years	50,000	43,888

Thereafter	141	154
Total certificates of deposit	700,676	739,754
Total deposits	$ 1,931,599	$ 1,882,890

Certificates of deposit in denominations of $100,000 or more at December 31, 2011, 2010 and 2009 amounted to $214.2 million, $183.9 million and $173.4 million, respectively.

Interest expense by deposit type for the years ended December 31 is summarized as follows (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Interest-bearing demand	$ 614	$ 705	$ 772
Savings and money market	1,056	1,133	1,090
Certificates of deposit	9,764	13,015	17,228
Total interest expense on deposits	$ 11,434	$ 14,853	$ 19,090

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(8.) BORROWINGS

Outstanding borrowings are summarized as follows as of December 31 (in thousands):

	September 30, 2011	September 30, 2010
Short-term borrowings:		
Federal funds purchased	$ 11,597	$ 38,200
Repurchase agreements	36,301	38,910
Short-term FHLB borrowings	102,800	
Total short-term borrowings	150,698	77,110
Long-term borrowings:		
FHLB advances and repurchase agreements		10,065
Junior subordinated debentures		16,702
Total long-term borrowings		26,767
Total borrowings	$ 150,698	$ 103,877

The Company classifies borrowings as short-term or long-term in accordance with the original terms of the agreement. At December 31, 2011, the Company s short-term borrowings had a weighted average rate of 0.39%.

Short-term Borrowings

Federal funds purchased are short-term borrowings that typically mature within one to ninety days. Federal funds purchased totaled $11.6 million and $38.2 million at December 31, 2011 and 2010, respectively. Repurchase agreements are secured overnight borrowings with customers. These short-term repurchase agreements amounted to $36.3 million and $38.9 million as of December 31, 2011 and 2010, respectively. Short-term FHLB borrowings have original maturities of less than one year and include overnight borrowings which the Company typically utilizes to address short term funding needs as they arise. Short-term FHLB borrowings at December 31, 2011 consisted of $65.0 million in overnight borrowings and $37.8 million in short-term advances.

Long-term Borrowings

The Company has credit capacity with the FHLB and can borrow through facilities that include an overnight line of credit, amortizing and term advances, and repurchase agreements. The FHLB credit capacity is collateralized by securities from the Company s investment portfolio and certain qualifying loans. FHLB advances totaled $65 thousand as of December 31, 2010. FHLB repurchase agreements are stated at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. FHLB repurchase agreements totaled $10.0 million as of December 31, 2010. The $10.1 million of outstanding FHLB advances and repurchase agreements at December 31, 2010 were repaid upon maturity during 2011.

In February 2001, the Company formed Financial Institutions Statutory Trust I (the Trust) for the sole purpose of issuing trust preferred securities. The Company s $502 thousand investment in the common equity of the Trust was classified in the consolidated statements of financial condition as other assets and $16.7 million of related 10.20% junior subordinated debentures were classified as long-term borrowings. In 2001, the Company incurred costs relating to the issuance of the debentures totaling $487 thousand. These costs, which were included in other assets on the consolidated statements of financial condition, were deferred and were being amortized to interest expense using the straight-line method over a twenty year period.

In August 2011, the Company redeemed all of the 10.20% junior subordinated debentures at a redemption price equaling 105.1% of the principal amount redeemed, plus all accrued and unpaid interest. As a result of the redemption, the Company recognized a loss on extinguishment of debt of $1.1 million, consisting of the redemption premium of $852 thousand and the write-off of the remaining unamortized issuance costs of $231 thousand.

Interest expense on borrowings for the years ended December 31 is summarized as follows (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Short-term borrowings	$ 500	$ 365	$ 270
Long-term borrowings	1,321	2,502	2,857
Total interest expense on borrowings	$ 1,821	$ 2,867	$ 3,127

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(9.) COMMITMENTS AND CONTINGENCIES

Financial Instruments with Off-Balance Sheet Risk

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 as of December 31 consist of the following (in thousands):

	September 30, 2011	September 30, 2010
Commitments to extend credit	$ 374,266	$ 357,240
Standby letters of credit	8,855	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 $2.9 million and $8.0 million at December 31, 2011 and 2010, respectively. In addition, the net change in the fair values of these derivatives was recognized as other noninterest income or other noninterest expense in the consolidated statements of income.

Lease Obligations

The Company is obligated under a number of noncancellable operating lease agreements for land, buildings and equipment. Certain of these leases provide for escalation clauses and contain renewal options calling for increased rentals if the lease is renewed. Future minimum payments by year and in the aggregate, under the noncancellable leases with initial or remaining terms of one year or more, are as follows at December 31, 2011 (in thousands):

	September 30,
2012	$ 1,242
2013	1,049
2014	1,017
2015	962

2016		927
Thereafter		4,963
	$	10,160

Rent expense relating to these operating leases, included in occupancy and equipment expense in the statements of income, was $1.5 million, $1.4 million and $1.5 million in 2011, 2010 and 2009, respectively.

Contingent Liabilities

In the ordinary course of business there are various threatened and pending legal proceedings against the Company. Based on consultation with outside legal counsel, management believes that the aggregate liability, if any, arising from such litigation would not have a material adverse effect on the Company s consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(10.) REGULATORY MATTERS

General

The supervision and regulation of financial and bank holding companies and their subsidiaries is intended primarily for the protection of depositors, the deposit insurance funds regulated by the FDIC and the banking system as a whole, and not for the protection of shareholders or creditors of bank holding companies. The various bank regulatory agencies have broad enforcement power over financial holding companies and banks, including the power to impose substantial fines, operational restrictions and other penalties for violations of laws and regulations and for safety and soundness considerations.

Capital

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 initiate 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. As of December 31, 2011, Tier 1 capital for the Company includes, subject to limitation, $17.5 million of preferred stock. As of December 31, 2010, Tier 1 capital for the Company also includes, subject to limitation, $16.7 million of trust preferred securities issued by FISI Statutory Trust I (see Note 8, Borrowings) and $37.5 million of preferred stock issued to the U.S. Department of Treasury (the Treasury) through the Treasury s Troubled Asset Relief Program (TARP) (see Note 11, Shareholders Equity). 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 risk-based 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.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(10.) REGULATORY MATTERS (Continued)

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

	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,
		Actual		For Capital Adequacy Purposes		Well Capitalized	
		Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2011:							
Tier 1 leverage:	Company	$ 197,086	8.63%	$ 91,310	4.00%	$ 114,138	5.00%
	Bank	184,639	8.10	91,192	4.00	113,990	5.00
Tier 1 capital:	Company	197,086	12.20	64,645	4.00	96,967	6.00
	Bank	184,639	11.46	64,445	4.00	96,667	6.00
Total risk-based capital:	Company	217,325	13.45	129,290	8.00	161,612	10.00
	Bank	204,817	12.71	128,890	8.00	161,112	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

As of December 31, 2011, the Company and Bank were considered well capitalized under all regulatory capital guidelines. Such determination has been made based on the Tier 1 leverage, Tier 1 capital and total risk-based capital ratios.

Federal Reserve Requirements

The Bank is required to maintain a reserve balance at the FRB of New York. The reserve requirement for the Bank totaled $1.0 million as of December 31, 2011 and 2010.

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. The Company is no longer subject to the limitations prescribed by the terms of the Treasury s TARP Capital Purchase Program (see Note 11, Shareholders Equity).

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(11.) SHAREHOLDERS EQUITY

The Company s authorized capital stock consists of 50,210,000 shares of capital stock, 50,000,000 of which are common stock, par value $0.01 per share, and 210,000 of which are preferred stock, par value $100 per share, which is designated into two classes, Class A of which 10,000 shares are authorized, and Class B of which 200,000 shares are authorized. There are two series of Class A preferred stock: Series A 3% preferred stock and the Series A preferred stock. There is one series of Class B preferred stock: Series B-1 8.48% preferred stock. There were 174,735 shares and 183,259 shares of preferred stock issued and outstanding as of December 31, 2011 and 2010, respectively.

Common Stock

The following table sets forth the changes in the number of shares of common stock for the years ended December 31 (in thousands):

	September 30, Outstanding	**September 30, Treasury**	**September 30, Issued**
2011			
Shares outstanding at beginning of year	10,937,506	410,616	11,348,122
Shares issued in common stock offering	2,813,475		2,813,475
Restricted stock awards issued, net of forfeitures	51,070	(51,070)	
Stock options exercised	6,357	(6,357)	
Treasury stock purchases	(11,181)	11,181	
Directors retainer	5,889	(5,889)	
Shares outstanding at end of year	13,803,116	358,481	14,161,597
2010			
Shares outstanding at beginning of year	10,820,268	527,854	11,348,122
Restricted stock awards issued, net of forfeitures	99,324	(99,324)	
Stock options exercised	15,563	(15,563)	
Treasury stock purchases	(3,658)	3,658	
Directors retainer	6,009	(6,009)	
Shares outstanding at end of year	10,937,506	410,616	11,348,122

Issuance of Common Stock

In March 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 and the 10.20% junior subordinated debentures.

Preferred Stock

Series A 3% Preferred Stock. There were 1,500 shares and 1,533 shares of Series A 3% preferred stock issued and outstanding as of December 31, 2011 and 2010, respectively. Holders of Series A 3% preferred stock are entitled to receive an annual dividend of $3.00 per share, which is cumulative and payable quarterly. Holders of Series A 3% preferred stock have no pre-emptive right in, or right to purchase or subscribe for, any additional shares of the Company s capital stock and have no voting rights. Dividend or dissolution payments to the Class A shareholders must be declared and paid, or set apart for payment, before any dividends or dissolution payments can be declared and paid, or set apart for payment, to the holders of Class B preferred stock or common stock. The Series A 3% preferred stock is not convertible into any other of the Company s securities.

Series B-1 8.48% Preferred Stock. There were 173,235 shares and 174,223 shares of Series B-1 8.48% preferred stock issued and outstanding as of December 31, 2011 and 2010, respectively. Holders of Series B-1 8.48% preferred stock are entitled to receive an annual dividend of $8.48 per share, which is cumulative and payable quarterly. Holders of Series B-1 8.48% preferred stock have no pre-emptive right in, or right to purchase or subscribe for, any additional shares of the Company s common stock and have no voting rights. Accumulated dividends on the Series B-1 8.48% preferred stock do not bear interest, and the Series B-1 8.48% preferred stock is not subject to redemption. Dividend or dissolution payments to the Class B shareholders must be declared and paid, or set apart for payment, before any dividends or dissolution payments are declared and paid, or set apart for payment, to the holders of common stock. The Series B-1 8.48% preferred stock is not convertible into any other of the Company s securities.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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December 31, 2011, 2010 and 2009

(11.) SHAREHOLDERS EQUITY (Continued)

Redemption of Series A Preferred Stock and Warrant

In December 2008, under the Treasury s 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 were 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.

In February 2011, the Company redeemed one-third, or $12.5 million, of the Series A preferred stock. In March 2011, the remaining $25.0 million of the Series A 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.

In May 2011, the Company repurchased the Warrant issued to the Treasury. The repurchase price of $2.1 million was recorded as a reduction of additional paid-in capital.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(12.) COMPREHENSIVE INCOME

Total comprehensive income is reported in the accompanying consolidated statements of changes in shareholders equity. Information related to comprehensive income for the years ended December 31 was as follows (in thousands):

	September 30, Pre-tax Amount	September 30, Tax Expense (Benefit)	September 30, Net-of-tax Amount
2011			
Securities available for sale:			
Change in net unrealized gain/loss during the period	$ 22,350	$ 8,855	$ 13,495
Reclassification adjustment for gains included in income	(3,003)	(1,190)	(1,813)
Reclassification adjustment for impairment charges included in income	18	7	11
	19,365	7,672	11,693
Change in net actuarial gain/loss and prior service benefit (cost) on defined benefit pension and post-retirement plans	(9,979)	(3,953)	(6,026)
Other comprehensive income	$ 9,386	$ 3,719	5,667
Net income			22,799
Comprehensive income			$ 28,466
2010			
Securities available for sale:			
Change in net unrealized gain/loss during the period	$ (16)	$ 19	$ (35)
Reclassification adjustment for gains included in income	(169)	(67)	(102)
Reclassification adjustment for impairment charges included in income	594	235	359
	409	187	222
Change in net actuarial gain/loss and prior service benefit (cost) on defined benefit pension and post-retirement plans	(2,192)	(950)	(1,242)
Other comprehensive loss	$ (1,783)	$ (763)	(1,020)
Net income			21,287
Comprehensive income			$ 20,267
2009			
Securities available for sale:			
Change in net unrealized gain/loss during the period	$ (4,186)	$ (1,619)	$ (2,567)
Reclassification adjustment for gains included in income	(3,429)	(1,327)	(2,102)
Reclassification adjustment for impairment charges included in income	4,666	1,805	2,861

		(2,949)		(1,141)	(1,808)
Change in net actuarial gain/loss and prior service benefit (cost) on defined benefit pension and post-retirement plans		3,457		1,338	2,119
Other comprehensive income	$	508	$	197	311
Net income					14,441
Comprehensive income				$	14,752

The components of accumulated other comprehensive income (loss), net of tax, as of December 31 were as follows (in thousands):

		September 30, 2011		September 30, 2010
Net actuarial loss and prior service cost on defined benefit pension and post-retirement plans	$	(12,625)	$	(6,599)
Net unrealized gain on securities available for sale		13,570		1,877
	$	945	$	(4,722)

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(13.) SHARE-BASED COMPENSATION

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. In May 2009, the shareholders of the Company approved two share-based compensation plans, the 2009 Management Stock Incentive Plan (Management Plan) and the 2009 Directors Stock Incentive Plan (Director s Plan). An aggregate of 690,000 shares has been reserved for issuance by the Company under the terms of the Management Plan pursuant to the grant of incentive stock options (not to exceed 500,000 shares), non-qualified stock options and restricted stock grants, all which are defined in the plan. An aggregate of 250,000 shares has been reserved for issuance by the Company under the terms of the Director s Plan pursuant to the grant of non-qualified stock options and restricted stock grants, all which are defined in the plan. Under both plans, for purposes of calculating the number of shares of common stock available for issuance, each share of common stock granted pursuant to a restricted stock grant shall count as 1.64 shares of common stock. As of December 31, 2011, there were approximately 213,000 and 451,000 shares available for grant under the Director s Plan and Management Plan, respectively, of which 61% were available for issuance as restricted stock grants.

Under the Management Plan and the Director s Plan (the Plans), the Board (or the Compensation Committee) may establish and prescribe grant guidelines including various terms and conditions for the granting of stock-based compensation. For stock options, the exercise price of each option equals the market price of the Company s stock on the date of the grant. All options expire after a period of ten years from the date of grant and generally become fully exercisable over a period of 3 to 5 years from the grant date. When option recipients exercise their options, the Company issues shares from treasury stock and records the proceeds as additions to capital. For restricted stock, shares generally vest over 2 to 3 years from the grant date. Vesting of the shares may be based on years of service, established performance measures or both. If restricted stock grants are forfeited before they vest, the shares are reacquired into treasury stock.

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 share-based compensation expense for the years ended December 31 was as follows (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Stock options:			
Management Stock Incentive Plan	$ 55	$ 110	$ 222
Director Stock Incentive Plan	14	43	46
Total stock option expense	69	153	268
Restricted stock awards:			
Management Stock Incentive Plan	917	761	488
Director Stock Incentive Plan	119	117	98
Total restricted stock award expense	1,036	878	586
Total share-based compensation	$ 1,105	$ 1,031	$ 854

The Company uses the Black-Scholes valuation method to estimate the fair value of its stock option awards. There were no stock options awarded during 2011, 2010 or 2009. The following is a summary of stock option activity for the year ended December 31, 2011 (dollars in thousands, except per share amounts):

	September 30, Number of Options	September 30, Weighted Average Exercise Price	September 30, Weighted Average Remaining Contractual Term	September 30, Aggregate Intrinsic Value
Outstanding at beginning of year	409,893	$ 20.64		
Granted				
Exercised	(6,357)	14.26		
Forfeited	(550)	15.85		
Expired	(34,928)	21.28		
Outstanding at end of year	368,058	$ 20.70	3.65 years	$ 9
Exercisable at end of year	361,033	$ 20.79	3.60 years	$ 7

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(13.) SHARE-BASED COMPENSATION (Continued)

As of December 31, 2011, there was $13 thousand of unrecognized compensation expense related to unvested stock options, all of which is expected to be recognized during 2012.

The aggregate intrinsic value (the amount by which the market price of the stock on the date of exercise exceeded the market price of the stock on the date of grant) of option exercises for the years ended December 31, 2011, 2010 and 2009 was $31 thousand, $59 thousand, and $1 thousand, respectively. The total cash received as a result of option exercises under stock compensation plans for the years ended December 31, 2011, 2010 and 2009 was $91 thousand, $216 thousand, and $14 thousand, respectively. The tax benefits realized in connection with these stock option exercises were not significant.

The following is a summary of restricted stock award activity for the year ended December 31, 2011:

	September 30, Number of Shares	September 30, Weighted Average Market Price at Grant Date
Outstanding at beginning of year	150,796	$ 12.76
Granted	53,070	18.88
Vested	(35,212)	14.38
Forfeited	(2,000)	15.44
Outstanding at end of year	166,654	$ 14.34

As of December 31, 2011, there was $804 thousand of unrecognized compensation expense related to unvested restricted stock awards that is expected to be recognized over a weighted average period of 1.48 years.

(14.) INCOME TAXES

Total income tax expense was allocated as follows for the years ended December 31 (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Income tax expense	$ 11,415	$ 9,352	$ 6,140
Shareholder s equity	3,718	(763)	197

The income tax expense (benefit) for the years ended December 31 consisted of the following (in thousands):

September 30, 2011	September 30, 2010	September 30, 2009

Current tax expense (benefit):						
Federal	$	3,747	$	5,781	$	(1,355)
State		1,158		1,103		25
Total current tax expense (benefit)		4,905		6,884		(1,330)
Deferred tax expense (benefit):						
Federal		5,584		2,852		6,189
State		926		(384)		1,281
Total deferred tax expense		6,510		2,468		7,470
Total income tax expense	$	11,415	$	9,352	$	6,140

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(14.) INCOME TAXES (Continued)

Income tax expense differed from the statutory federal income tax rate for the years ended December 31 as follows:

	September 30, 2011	September 30, 2010	September 30, 2009
Statutory federal tax rate	35.0%	35.0%	34.0%
Increase (decrease) resulting from:			
Tax exempt interest income	(4.3)	(4.2)	(8.6)
Non-taxable earnings on company owned life insurance	(1.5)	(1.3)	(1.8)
State taxes, net of federal tax benefit	4.0	1.5	4.2
Nondeductible expenses	0.4	0.6	1.0
Disallowed interest expense	0.2	0.2	0.5
Other, net	(0.4)	(1.3)	0.5
Effective tax rate	33.4%	30.5%	29.8%

The Company s net deferred tax asset is included in other assets in the Consolidated Statements of Condition. The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities are as follows at December 31 (in thousands):

	September 30, 2011	September 30, 2010
Deferred tax assets:		
Other than temporary impairment of investment securities	$ 11,326	$ 15,418
Allowance for loan losses	9,106	8,108
Share-based compensation	1,437	1,250
Interest on non-accruing loans	716	781
Accrued pension costs	538	
Tax attribute carryforward benefits	463	2,033
Core deposit intangible	79	158
Other	1,172	665
Gross deferred tax assets	24,837	28,413
Deferred tax liabilities:		
Net unrealized gain on securities available for sale	8,903	1,231
Depreciation and amortization	1,741	1,489
Deferred loan origination costs	930	2,263
Loan servicing assets	781	581
Prepaid pension costs		139
Gross deferred tax liabilities	12,355	5,703
Net deferred tax asset	$ 12,482	$ 22,710

The Company recognizes deferred income taxes for the estimated future tax effects of differences between the tax and financial statement bases of assets and liabilities considering enacted tax laws. These differences result in deferred tax assets and liabilities, which are included in other assets in the Company s consolidated statements of condition. The Company also assesses the likelihood that deferred tax assets will be realizable based on, among other considerations, future taxable income and establishes, if necessary, a valuation allowance for those deferred tax assets determined to not likely be realizable. A deferred tax asset valuation allowance is recognized if, based on the weight of available evidence (both positive and negative), it is more likely than not that some portion or all of the deferred tax assets will not be realized. The future realization of deferred tax benefits depends upon the existence of sufficient taxable income within the carry-back and carry-forward periods. Management s judgment is required in determining the appropriate recognition of deferred tax assets and liabilities, including projections of future taxable income.

Based upon the Company s historical and projected future levels of pre-tax and taxable income, the scheduled reversals of taxable temporary differences to offset future deductible amounts, and prudent and feasible tax planning strategies, management believes it is more likely than not that the deferred tax assets will be realized. As such, no valuation allowance has been recorded as of December 31, 2011 or 2010.

The Company and its subsidiaries are subject to federal and New York State (NYS) income taxes. The federal income tax years currently open for audits are 2007 through 2011. The NYS income tax years currently open for audits are 2009 through 2011.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(14.) INCOME TAXES (Continued)

At December 31, 2011, the Company had no federal or NYS net operating loss carryforwards. The Company has federal tax credits of approximately $463 thousand which have an unlimited carryforward period.

The Company s unrecognized tax benefits and changes in unrecognized tax benefits were not significant as of or for the years ended December 31, 2011 and 2010. There were no interest or penalties recorded in the income statement in income tax expense for the year ended December 31, 2011. As of December 31, 2011, there were no amounts accrued for interest or penalties related to uncertain tax positions.

(15.) EARNINGS PER COMMON SHARE

The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted EPS for each of the years ended December 31 (in thousands, except per share amounts).

	September 30, 2011	September 30, 2010	September 30, 2009
Net income available to common shareholders	$ 19,617	$ 17,562	$ 10,744
Less: Earnings allocated to participating securities	38	105	87
Net income available to common shareholders for EPS	$ 19,579	$ 17,457	$ 10,657
Weighted average common shares outstanding:			
Total shares issued	13,599	11,348	11,348
Unvested restricted stock awards	(166)	(154)	(92)
Treasury shares	(366)	(427)	(526)
Total basic weighted average common shares outstanding	13,067	10,767	10,730
Incremental shares from assumed:			
Exercise of stock options	3	6	
Vesting of restricted stock awards	65	27	39
Exercise of warrant	22	45	
Total diluted weighted average common shares outstanding	13,157	10,845	10,769
Basic earnings per common share	$ 1.50	$ 1.62	$ 0.99
Diluted earnings per common share	$ 1.49	$ 1.61	$ 0.99

For each of the periods presented, average shares subject to the following instruments were excluded from the computation of diluted EPS because the effect would be antidilutive:

	September 30,	September 30,	September 30,
Stock options	339	353	459
Restricted stock awards			
Warrant			378
	339	353	837

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(16.) EMPLOYEE BENEFIT PLANS

Defined Benefit Pension Plan

The Company participates in The New York State Bankers Retirement System (the Plan), 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 following table provides a reconciliation of the changes in the plan s benefit obligations, fair value of assets and a statement of the funded status as of and for the year ended December 31 (in thousands):

	September 30, 2011	September 30, 2010
Change in projected benefit obligation:		
Projected benefit obligation at beginning of period	$ 38,381	$ 33,441
Service cost	1,756	1,633
Interest cost	2,027	1,933
Actuarial loss	7,939	2,969
Benefits paid and plan expenses	(1,800)	(1,595)
Projected benefit obligation at end of period	48,303	38,381
Change in plan assets:		
Fair value of plan assets at beginning of period	38,731	33,203
Actual return on plan assets	12	2,823
Employer contributions	10,000	4,300
Benefits paid and plan expenses	(1,800)	(1,595)
Fair value of plan assets at end of period	46,943	38,731
Funded (unfunded) status at end of period	$ (1,360)	$ 350

The accumulated benefit obligation was $43.3 million and $34.3 million at December 31, 2011 and 2010, respectively.

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. The Company satisfied the minimum required contribution to its pension plan of $1.7 million for the 2012 fiscal year by contributing $10.0 million prior to December 31, 2011.

Estimated benefit payments under the pension plan over the next ten years at December 31, 2011 are as follows (in thousands):

	September 30,
2012	$ 1,553

2013	1,623
2014	1,733
2015	1,876
2016	2,101
2017 - 2021	12,782

Net periodic pension cost consists of the following components for the years ended December 31 (in thousands):

	September 30, 2011	September 30, 2010	September 30, 2009
Service cost	$ 1,756	$ 1,633	$ 1,689
Interest cost on projected benefit obligation	2,027	1,933	1,826
Expected return on plan assets	(2,653)	(2,444)	(1,848)
Amortization of unrecognized loss	608	458	728
Amortization of unrecognized prior service cost	19	11	11
Net periodic pension cost	$ 1,757	$ 1,591	$ 2,406

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(16.) EMPLOYEE BENEFIT PLANS (Continued)

The actuarial assumptions used to determine the net periodic pension cost were as follows:

	September 30, 2011	September 30, 2010	September 30, 2009
Weighted average discount rate	5.38%	5.89%	6.03%
Rate of compensation increase	3.00%	3.50%	3.50%
Expected long-term rate of return	7.00%	7.50%	7.50%

The actuarial assumptions used to determine the projected benefit obligation were as follows:

	September 30, 2011	September 30, 2010	September 30, 2009
Weighted average discount rate	4.27%	5.38%	5.89%
Rate of compensation increase	3.00%	3.00%	3.50%

The weighted average discount rate was based upon the projected benefit cash flows and the market yields of high grade corporate bonds that are available to pay such cash flows.

The weighted average expected long term rate of return is estimated based on current trends in the Plan s assets as well as projected future rates of return on those assets and reasonable actuarial assumptions based on the guidance provided by Actuarial Standard of Practice No. 27, Selection of Economic Assumptions for Measuring Pension Obligations , for long term inflation, and the real and nominal rate of investment return for a specific mix of asset classes. The following assumptions were used in determining the long term rate of return:

Equity securities	Dividend discount model, the smoothed earnings yield model and the equity risk premium model
Fixed income securities	Current yield-to-maturity and forecasts of future yields
Other financial instruments	Comparison of the specific investment s risk to that of fixed income and equity instruments and using judgment

The long term rate of return considers historical returns. Adjustments were made to historical returns in order to reflect expectations of future returns. These adjustments were due to factor forecasts by economists and long-term U.S. Treasury yields to forecast long-term inflation. In addition forecasts by economists and others for long-term GDP growth were factored into the development of assumptions for earnings growth and per capital income. The Plan s overall investment strategy is to achieve a mix of approximately 97% of investments for long-term growth and 3% for near-term benefit payments with a wide diversification of asset types, fund strategies, and fund managers. The target allocations for Plan assets are shown in the table below. Cash equivalents consist primarily of short term investment funds. Equity securities primarily include investments in common stock and depository receipts. Fixed income securities include corporate bonds, government issues and mortgage backed securities. Other financial instruments primarily include rights and warrants.

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(16.) EMPLOYEE BENEFIT PLANS (Continued)

Effective September 2011, the Plan revised its investment guidelines. The Plan currently prohibits its investment managers from purchasing any security greater than 5% of the portfolio at the time of purchase or greater than 8% at market value in any one issuer. In addition, the following are prohibited:

Equity securities	Short sales
	Unregistered securities
	Margin purchases
Fixed income securities	Mortgage backed derivatives that have an inverse floating rate coupon or that are interest only securities
	Any ABS that is not issued by the U.S. Government or its agencies or its instrumentalities
	Generally securities of less than Baa2/BBB quality may not be purchased
	Securities of less than A-quality may not in the aggregate exceed 10% of the investment manager s portfolio
Other financial instruments	Unhedged currency exposure in countries not defined as high income economies by the World Bank

Prior to September 2011 investments in emerging countries as defined by the Morgan Stanley Emerging Markets Index and structured notes were prohibited.

All other investments not prohibited by the Plan are permitted. At December 31, 2011, the Plan holds certain investments which are no longer deemed acceptable to acquire. These positions will be liquidated when the investment managers deem that such liquidation is in the best interest of the Plan.

	September 30, 2012	September 30,	September 30,	September 30,
		Percentage of Plan Assets at December 31,		Weighted Average

	Target Allocation		2011	2010	Expected Long-term Rate of Return
Asset category:					
Cash equivalents	0	20%	10.6%	11.2%	0.39%
Equity securities	40	60	47.9	48.2	4.62
Fixed income securities	40	60	41.5	40.6	1.85
Other financial instruments	0	5			

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(16.) EMPLOYEE BENEFIT PLANS (Continued)

Assets are segregated by the level of the valuation inputs within the fair value hierarchy established by ASC Topic 820 utilized to measure fair value (see Note 17 Fair Value Measurements). There were no assets classified as Level 3 assets during the years ended December 31, 2011 and 2010. The major categories of Plan assets measured at fair value on a recurring basis are presented in the following table (in thousands).

	September 30, Level 1 Inputs	September 30, Level 2 Inputs	September 30, Level 3 Inputs	September 30, Total Fair Value
December 31, 2011:				
Cash equivalents:				
Foreign currencies	$ 81	$	$	$ 81
Short term investment funds		4,901		4,901
Total cash equivalents	81	4,901		4,982
Equity securities:				
U.S. Large Cap	13,993			13,993
U.S. Mid Cap	1,903			1,903
U.S. Small Cap	44			44
International	6,553			6,553
Total equity securities	22,493			22,493
Fixed income securities:				
Corporate bonds:				
Rated single A or higher by S&P		1,949		1,949
Rated below single A by S&P		2,281		2,281
Government issues		10,651		10,651
Collateralized mortgage obligations:				
Rated single A or higher by S&P		4,233		4,233
Rated below single A by S&P		354		354
Total fixed income securities		19,468		19,468
Total Plan investments	$ 22,574	$ 24,369	$	$ 46,943
December 31, 2010:				
Cash equivalents:				
Foreign currencies	$ 84	$	$	$ 84
Short term investment funds		4,266		4,266
Total cash equivalents	84	4,266		4,350
Equity securities:				
U.S. Large Cap	10,800			10,800
U.S. Mid Cap	1,103			1,103
U.S. Small Cap	82			82

International	6,698			6,698
Total equity securities	18,683			18,683
Fixed income securities:				
Corporate bonds:				
Rated single A or higher by S&P		2,113		2,113
Rated below single A by S&P		1,483		1,483
Government issues		11,259		11,259
Collateralized mortgage obligations:				
Rated single A or higher by S&P		582		582
Rated below single A by S&P		261		261
Total fixed income securities		15,698		15,698
Total Plan investments	$ 18,767	$ 19,964	$	$ 38,731

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(16.) EMPLOYEE BENEFIT PLANS (Continued)

At December 31, 2011 the portfolio was managed by two investment firms, with control of the portfolio split approximately 46% and 52% under the control of the investment managers with the remaining 2% under the direct control of the Plan. A portfolio concentration in the State Street Bank & Trust Co. Short Term Investment Fund of 10% and 11% existed at December 31, 2011 and 2010, respectively.

Postretirement Benefit Plan

An entity acquired by the Company provided health and dental care benefits to retired employees who met specified age and service requirements through a postretirement health and dental care plan in which both the acquired entity and the retirees shared the cost. The plan provided for substantially the same medical insurance coverage as for active employees until their death and was integrated with Medicare for those retirees aged 65 or older. In 2001, the plan s eligibility requirements were amended to curtail eligible benefit payments to only retired employees and active participants who were fully vested under the Plan. In 2003, retirees under age 65 began contributing to health coverage at the same cost-sharing level as that of active employees. The retirees aged 65 or older were offered new Medicare supplemental plans as alternatives to the plan historically offered. The cost sharing of medical coverage was standardized throughout the group of retirees aged 65 or older. In addition, to be consistent with the administration of the Company s dental plan for active employees, all retirees who continued dental coverage began paying the full monthly premium. The accrued liability included in other liabilities in the consolidated statements of financial condition related to this plan amounted to $122 thousand and $162 thousand as of December 31, 2011 and 2010, respectively. The postretirement expense for the plan that was included in salaries and employee benefits in the consolidated statements of income was not significant for the years ended December 31, 2011, 2010 and 2009. The plan is not funded.

The components of accumulated other comprehensive loss related to the defined benefit plan and postretirement benefit plan, on a pre-tax basis as of December 31 are summarized below (in thousands):

	September 30, 2011	September 30, 2010
Defined benefit plan:		
Net actuarial loss	$ (21,160)	$ (11,188)
Prior service cost	(113)	(132)
	(21,273)	(11,320)
Postretirement benefit plan:		
Net actuarial loss	(210)	(252)
Prior service credit	575	643
	365	391
Total recognized in accumulated other comprehensive loss	$ (20,908)	$ (10,929)

Changes in plan assets and benefit obligations recognized in other comprehensive income (loss) on a pre-tax basis during the years ended December 31 are as follows (in thousands):

	September 30, 2011	September 30, 2010
Defined benefit plan:		
Net actuarial loss	$ (10,580)	$ (2,590)
Amortization of net loss	608	458
Amortization of prior service cost	19	11
	(9,953)	(2,121)
Postretirement benefit plan:		
Net actuarial gain (loss)	42	(4)
Amortization of prior service credit	(68)	(67)
	(26)	(71)
Total recognized in other comprehensive income (loss)	$ (9,979)	$ (2,192)

For the year ending December 31, 2012, the estimated net loss and prior service cost for the plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost is $1.4 million and $20 thousand, respectively.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(16.) EMPLOYEE BENEFIT PLANS (Continued)

Defined Contribution Plan

Employees that meet certain age and service requirements are eligible to participate in the Company sponsored 401(k) plan. Under the plan, participants may make contributions, in the form of salary deferrals, up to the maximum Internal Revenue Code limit. The Company matches a participant s contributions up to 4.5% of compensation, calculated as 100% of the first 3% of compensation and 50% of the next 3% of compensation deferred by the participant. The Company may also make additional discretionary matching contributions, although no such additional discretionary contributions were made in 2011, 2010 or 2009. The expense included in salaries and employee benefits in the consolidated statements of income for this plan amounted to $1.0 million, $936 thousand and $914 thousand in 2011, 2010 and 2009, respectively.

Supplemental Executive Retirement Plans

The Company has a non-qualified Supplemental Executive Retirement Plan (SERP) covering three former executives. At December 31, 2011, there was a $1.0 million unfunded pension liability related to the SERP. SERP expense was $67 thousand, $262 thousand, and $648 thousand for 2011, 2010 and 2009, respectively.

(17.) 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.

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

December 31, 2011, 2010 and 2009

(17.) FAIR VALUE MEASUREMENTS (Continued)

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.

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 December 31, 2011 (in thousands).

	September 30, Level 1 Inputs	September 30, Level 2 Inputs	September 30, Level 3 Inputs	September 30, Total Fair Value
Measured on a recurring basis:				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$	$ 97,712	$	$ 97,712
State and political subdivisions		124,424		124,424
Mortgage-backed securities		403,685		403,685
Asset-backed securities:				

Trust preferred securities			1,636	1,636
Other		61		61
	$	$ 625,882	$ 1,636	$ 627,518
Measured on a nonrecurring basis:				
Loans:				
Loans held for sale	$	$ 2,410	$	$ 2,410
Collateral dependent impaired loans			2,160	2,160
Other assets:				
Mortgage servicing rights			1,973	1,973
Other real estate owned			475	475
	$	$ 2,410	$ 4,608	$ 7,018

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(17.) FAIR VALUE MEASUREMENTS (Continued)

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).

	September 30, Level 1 Inputs	September 30, Level 2 Inputs	September 30, Level 3 Inputs	September 30, 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 years ended December 31, 2011 and 2010.

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) for the years ended December 31 is as follows (in thousands):

	September 30, 2011	September 30, 2010
Securities available for sale (Level 3), beginning of year	$ 572	$ 1,015
Transfers into Level 3		
Sales	(2,478)	
Principal paydowns and other	(53)	263

Total gains (losses) realized/unrealized:				
Included in earnings		2,263		(526)
Included in other comprehensive income		1,332		(180)
Securities available for sale (Level 3), end of year	$	1,636	$	572

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(17.) FAIR VALUE MEASUREMENTS (Continued)

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

Junior subordinated debentures. The fair value for the junior subordinated debentures is 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 December 31, 2011 and December 31, 2010 may not necessarily represent the underlying fair value of the Company.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(17.) FAIR VALUE MEASUREMENTS (Continued)

The carrying values and fair values of financial instruments as of December 31 are as follows (in thousands):

	September 30, December 31, 2011 Carrying Amount	September 30, Estimated Fair Value	September 30, December 31, 2010 Carrying Amount	September 30, Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 57,583	$ 57,583	$ 39,058	$ 39,058
Securities available for sale	627,518	627,518	666,368	666,368
Securities held to maturity	23,297	23,964	28,162	28,849
Loans held for sale	2,410	2,442	3,138	3,138
Loans	1,461,516	1,493,159	1,325,524	1,388,787
Accrued interest receivable	7,655	7,655	7,613	7,613
FHLB and FRB stock	10,674	10,674	6,353	6,353
Financial liabilities:				
Demand, savings and money market deposits	1,230,923	1,230,923	1,143,136	1,143,136
Certificate of deposit	700,676	702,720	739,754	740,440
Short-term borrowings	150,698	150,698	77,110	77,110
Long-term borrowings (excluding junior subordinated debentures)			10,065	10,244
Junior subordinated debentures			16,702	10,564
Accrued interest payable	5,207	5,207	7,620	7,620

(18.) PARENT COMPANY FINANCIAL INFORMATION

Condensed financial statements pertaining only to the Parent are presented below (in thousands).

Condensed Statements of Condition

	September 30, December 31, 2011	September 30, 2010
Assets:		
Cash and due from subsidiary	$ 11,621	$ 23,894
Investment in and receivables due from subsidiary	223,577	202,754
Other assets	4,337	4,623
Total assets	$ 239,535	$ 231,271
Liabilities and shareholders equity:		
Junior subordinated debentures	$	$ 16,702
Other liabilities	2,341	2,425

Shareholders equity		237,194		212,144
Total liabilities and shareholders equity	$	239,535	$	231,271

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(18.) PARENT COMPANY FINANCIAL INFORMATION (Continued)

Condensed Statements of Income

	September 30,	September 30,	September 30,
	Years ended December 31,		
	2011	2010	2009
Dividends from subsidiary and associated companies	$ 9,233	$ 23,151	$ 5,051
Management and service fees from subsidiary	1,161	1,163	603
Other income (loss)	78	(134)	182
Total income	10,472	24,180	5,836
Operating expenses	3,787	4,005	4,436
Loss on extinguishment of debt	1,083		
Total expenses	4,870	4,005	4,436
Income before income tax benefit and equity in undistributed earnings(excess distributions) of subsidiary	5,602	20,175	1,400
Income tax benefit	1,539	1,323	1,286
Income before equity in undistributed earnings (excess distributions) of subsidiary	7,141	21,498	2,686
Equity in undistributed earnings (excess distributions) of subsidiary	15,658	(211)	11,755
Net income	$ 22,799	$ 21,287	$ 14,441

Condensed Statements of Cash Flows

	September 30,	September 30,	September 30,
	Years ended December 31,		
	2011	2010	2009
Cash flows from operating activities:			
Net income	$ 22,799	$ 21,287	$ 14,441
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in (undistributed earnings) excess distributions of subsidiary	(15,658)	211	(11,755)
Depreciation and amortization	116	193	318
Share-based compensation	1,105	1,031	854
Decrease in other assets	771	980	797
(Decrease) increase in other liabilities	(534)	8	(230)
Net cash provided by operating activities	8,599	23,710	4,425

Cash flows from investing activities:			
Purchase of investment assets, net of disposals			(1,323)
Capital investment in subsidiary			(15,000)
Net cash used in investing activities			(16,323)
Cash flows from financing activities:			
Redemption of junior subordinated debentures	(16,702)		
Proceeds from issuance of preferred and common shares, net of issuance costs	43,127		(68)
Purchase of preferred and common shares	(37,764)	(69)	
Proceeds from issuance of common stock warrant	(2,080)		
Proceeds from stock options exercised	91	216	15
Dividends paid	(7,564)	(7,690)	(7,485)
Other	20		
Net cash used in financing activities	(20,872)	(7,543)	(7,538)
Net (decrease) increase in cash and cash equivalents	(12,273)	16,167	(19,436)
Cash and cash equivalents as of beginning of year	23,894	7,727	27,163
Cash and cash equivalents as of end of the year	$ 11,621	$ 23,894	$ 7,727

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

(19.) SUBSEQUENT EVENT (Unaudited)

On January 19, 2012, Five Star Bank entered into an agreement to acquire four retail banking branches currently owned by HSBC Bank USA, N.A. and four retail banking branches currently owned by First Niagara Bank, N.A. The deposits associated with these branches total approximately $376 million, while loans total approximately $94 million. The transactions are subject to customary closing conditions, including regulatory approvals, and are expected to close by the end of the third quarter of 2012.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE
None.

ITEM 9A. CONTROLS AND PROCEDURES
Effectiveness of Controls and Procedures

As of the end of the period covered by this report, 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 (Principal Executive Officer) and Chief Financial Officer (Principal Accounting 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 Annual Report on Form 10-K.

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.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management Report on Internal Control over Financial Reporting and Attestation Report of Independent Registered Public Accounting Firm

Management of Financial Institutions, Inc. (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting. Management assessed the Company s internal control over financial reporting based on criteria established in the Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has concluded that, as of December 31, 2011, the Company maintained effective internal control over financial reporting. Management s Report on Internal Control over Financial Reporting is included under Item 8 Financial Statements and Supplementary Data in Part II of this Form 10-K.

KPMG LLP, an independent registered public accounting firm, has audited the consolidated financial statements included in this Annual Report on Form 10-K, and has issued an attestation report on the effectiveness of the Company s internal control over financial reporting. The Report of Independent Registered Public Accounting Firm that attests the effectiveness of internal control over financial reporting is included under Item 8 Financial Statements and Supplementary Data in Part II of this Form 10-K.

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 December 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

ITEM 9B. OTHER INFORMATION
Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

In response to this Item, the information set forth in the Company s Proxy Statement for its 2012 Annual Meeting of Shareholders (the 2012 Proxy Statement) to be filed within 120 days following the end of the Company s fiscal year, under the headings Election of Directors, Business Experience and Qualification of Directors, and Section 16(a) Beneficial Ownership Reporting Compliance is incorporated herein by reference.

The information under the heading Executive Officers of the Registrant in Part I, Item 1 of this Form 10-K is also incorporated herein by reference.

Information concerning the Company s Audit Committee and the Audit Committee s financial expert is set forth under the caption Corporate Governance Information in the 2012 Proxy Statement and is incorporated herein by reference.

The Company has adopted a Code of Business Conduct and Ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. The Code of Business Conduct and Ethics is posted on the Company s internet website at www.fiiwarsaw.com under the Corporate Overview/Governance Documents tabs if the Investor Relations drop down menu. In addition, the Company will provide a copy of the Code of Business Conduct and Ethics to anyone, without charge, upon request addressed to Director of Human Resources at Financial Institutions, Inc., 220 Liberty Street, Warsaw, NY 14569. The Company intends to disclose any amendment to, or waiver from, a provision of its Code of Business Conduct and Ethics that applies to the Company s principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and that relates to any element of the Code of Business Conduct and Ethics, by posting such information on the Company s website.

ITEM 11. EXECUTIVE COMPENSATION

In response to this Item, the information set forth in the 2012 Proxy Statement under the heading Elements of Executive Compensation is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

In response to this Item, the information set forth in the 2012 Proxy Statement under the heading Beneficial Ownership of Common Stock is incorporated herein by reference. The information under the heading Equity Compensation Plan Information in Part II, Item 5 of this Form 10-K is also incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

In response to this Item, the information set forth in the 2012 Proxy Statement under the headings Certain Relationships and Related Party Transactions and Corporate Governance Information is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

In response to this Item, the information set forth in the 2012 Proxy Statement under the headings Audit Committee Report and Independent Registered Public Accounting Firm is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) **FINANCIAL STATEMENTS**

Reference is made to the Index to Consolidated Financial Statements of Financial Institutions, Inc. and Subsidiaries under Item 8 Financial Statements and Supplementary Data in Part II of this Form 10-K.

(b) **EXHIBITS**

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

Exhibit Number	Description	Location
3.1	Amended and Restated Certificate of Incorporation of the Company	Incorporated by reference to Exhibits 3.1, 3.2 and 3.3 of the Form 10-K for the year ended December 31, 2008, dated March 12, 2009
3.2	Amended and Restated Bylaws of the Company	Incorporated by reference to Exhibit 3.4 of the Form 10-K for the year ended December 31, 2008, dated March 12, 2009
4.1	Warrant to Purchase Common Stock, dated December 23, 2008 issued by the Registrant to the United States Department of the Treasury	Incorporated by reference to Exhibit 4.2 of the Form 8-K, dated December 24, 2008
10.1	1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 of the S-1 Registration Statement
10.2	Amendment Number One to the FII 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1of the Form 8-K, dated July 28, 2006
10.3	Form of Non-Qualified Stock Option Agreement Pursuant to the FII 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated July 28, 2006
10.4	Form of Restricted Stock Award Agreement Pursuant to the FII 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.3 of the Form 8-K, dated July 28, 2006
10.5	Form of Restricted Stock Award Agreement Pursuant to the FII 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated January 23, 2008
10.6	1999 Directors Stock Incentive Plan	Incorporated by reference to Exhibit 10.2 of the S-1 Registration Statement
10.7	Amendment to the 1999 Director Stock Incentive Plan	Incorporated by reference to Exhibit 10.7 of the Form 10-K for the year ended December 31, 2008, dated March 12, 2009
10.8	2009 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.8 of the Form 10-Q for the quarterly period ended June 30, 2009, dated August 5, 2009
10.9	2009 Directors Stock Incentive Plan	Incorporated by reference to Exhibit 10.9 of the Form 10-Q for the quarterly period ended June 30, 2009, dated August 5, 2009
10.10	Form of Restricted Stock Award Agreement Pursuant to the FII 2009 Management Stock Incentive Plan (Special, one-time Award)	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated January 19, 2010
10.11		

	Form of Restricted Stock Award Agreement Pursuant to the FII 2009 Management Stock Incentive Plan (LTIP Award)	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated March 1, 2010
10.12	Form of Service Based Restricted Stock Award Agreement Pursuant to the FII 2009 Management Stock Incentive Plan	Filed Herewith

Exhibit Number	Description	Location
10.13	Form of 2012 Performance Program Master Agreement	Filed Herewith
10.14	Form of 2012 Performance Program Award Certificate	Filed Herewith
10.15	Amended Stock Ownership Requirements, dated December 14, 2005	Incorporated by reference to Exhibit 10.19 of the Form 10-K for the year ended December 31, 2005, dated March 15, 2006
10.16	Executive Agreement with Peter G. Humphrey	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated June 30, 2005
10.17	Executive Agreement with Martin K. Birmingham	Incorporated by reference to Exhibit 10.4 of the Form 8-K, dated June 30, 2005
10.18	Executive Agreement with John J. Witkowski	Incorporated by reference to Exhibit 10.7 of the Form 8-K, dated September 14, 2005
10.19	Executive Agreement with George D. Hagi	Incorporated by reference to Exhibit 10.7 of the Form 8-K, dated February 2, 2006
10.20	Voluntary Retirement Agreement with Ronald A. Miller	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated September 26, 2008
10.21	Amendment to Voluntary Retirement Agreement with Ronald A. Miller	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated March 3, 2010
10.22	Letter Agreement, dated December 23, 2008, including the Securities Purchase Agreement-Standard Terms attached thereto, by and between the Company and the United States Department of the Treasury	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated December 24, 2008
10.23	Underwriting Agreement dated March 9, 2011 between Financial Institutions, Inc. and Keefe, Bruyette & Woods, Inc., as representative of the underwriters	Incorporated by reference to Exhibit 1.1 of the Form 8-K, dated March 9, 2011
10.24	Assignment, Purchase and Assumption Agreement dated January 19, 2012 between First Niagara Bank, National Association and Five Star Bank	Filed Herewith
10.25	Purchase and Assumption Agreement dated January 19, 2012 between First Niagara Bank, National Association and Five Star Bank	Filed Herewith
11.1	Statement of Computation of Per Share Earnings	Incorporated by reference to Note 15 of the Registrant s audited consolidated financial statements under Item 8 filed herewith.
21	Subsidiaries of Financial Institutions, Inc.	Filed Herewith
23	Consent of Independent Registered Public Accounting Firm	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
99.1	Certification of Chief Executive Officer pursuant to Section 111(b)(4) of the Emergency Economic Stabilization Act	Filed Herewith
99.2	Certification of Chief Financial Officer pursuant to Section 111(b)(4) of the Emergency Economic Stabilization Act	Filed Herewith

Exhibit Number	Description	Location
*101.INS	XBRL Instance Document	
*101.SCH	XBRL Taxonomy Extension Schema Document	
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document	
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	

* Pursuant to Rule 406T of Regulation S-T, the information in this exhibit shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement, prospectus or other document filed under the Securities Act of 1933, or the Securities Exchange Act of 1934, except as shall be expressly set forth by specific reference in such filings.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FINANCIAL INSTITUTIONS, INC.

March 9, 2012

By: ***/s/ Peter G. Humphrey***
Peter G. Humphrey
President & Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ Peter G. Humphrey Peter G. Humphrey	Director, President and Chief Executive Officer (Principal Executive Officer)	March 9, 2012
/s/ Karl F. Krebs Karl F. Krebs	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 9, 2012
/s/ Karl V. Anderson, Jr. Karl V. Anderson, Jr.	Director	March 9, 2012
/s/ John E. Benjamin John E. Benjamin	Director, Chairman	March 9, 2012
/s/ Barton P. Dambra Barton P. Dambra	Director	March 9, 2012
/s/ Samuel M. Gullo Samuel M. Gullo	Director	March 9, 2012
/s/ Susan R. Holliday Susan R. Holliday	Director	March 9, 2012
/s/ Erland E. Kailbourne Erland E. Kailbourne	Director	March 9, 2012
/s/ Robert N. Latella Robert N. Latella	Director	March 9, 2012
/s/ James L. Robinson James L. Robinson	Director	March 9, 2012
/s/ James H. Wyckoff James H. Wyckoff	Director	March 9, 2012