FINANCIAL INSTITUTIONS INC
Form 10-K
March 12, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2013

OR

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

For the transition period from __________ to __________

Commission file number 000-26481

FINANCIAL INSTITUTIONS, INC.

(Exact name of registrant as specified in its charter)

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

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

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	**Name of exchange on which registered**
Common stock, par value $.01 per share	**NASDAQ Global Select Market**

Securities registered under Section 12(g) of the Exchange Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

The aggregate market value of the registrant s common stock, par value $0.01 per share, held by non-affiliates of the registrant, as computed by reference to the June 30, 2013 closing price reported by NASDAQ, was approximately $236,055,000.

As of February 28, 2014, there were outstanding, exclusive of treasury shares, 13,848,258 shares of the registrant s common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s proxy statement for the 2014 Annual Meeting of Shareholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

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PART I

FORWARD LOOKING INFORMATION

Statements in this Annual Report on Form 10-K that are based on other than historical data are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements provide current expectations or forecasts of future events and include, among others:

- statements with respect to the beliefs, plans, objectives, goals, guidelines, expectations, anticipations, and future financial condition, results of operations and performance of Financial Institutions, Inc. (the parent or FII) and its subsidiaries (collectively the Company, we, our, us); and

- statements preceded by, followed by or that include the words may, could, should, would, believe, anticipate, estimate, expect, intend, plan, projects, or similar expressions.

These forward-looking statements are not guarantees of future performance, nor should they be relied upon as representing management s views as of any subsequent date. Forward-looking statements involve significant risks and uncertainties and actual results may differ materially from those presented, either expressed or implied, in this Annual Report on Form 10-K, including, but not limited to, those presented in the Management s Discussion and Analysis of Financial Condition and Results of Operations. Factors that might cause such differences include, but are not limited to:

- If we experience greater credit losses than anticipated, earnings may be adversely impacted;

- Geographic concentration may unfavorably impact our operations;

- We depend on the accuracy and completeness of information about or from customers and counterparties;

- We are subject to environmental liability risk associated with our lending activities;

- Our indirect lending involves risk elements in addition to normal credit risk;

- We are highly regulated and may be adversely affected by changes in banking laws, regulations and regulatory practices;

- The new Basel III Capital Standards may have an adverse effect on us;

New regulations could adversely impact our earnings due to, among other things, increased compliance costs or costs due to noncompliance;

New or changing tax, accounting, and regulatory rules and interpretations could significantly impact our strategic initiatives, results of operations, cash flows, and financial condition;

A breach in security of our information systems, including the occurrence of a cyber incident or a deficiency in cyber security, may result in a loss of customer business or damage to our brand image;

We rely on other companies to provide key components of our business infrastructure;

We use financial models for business planning purposes that may not adequately predict future result;

We may not be able to attract and retain skilled people and our ongoing leadership transition may be unsuccessful;

Acquisitions may disrupt our business and dilute shareholder value;

We are subject to interest rate risk;

Our business may be adversely affected by conditions in the financial markets and economic conditions generally;

Our earnings are significantly affected by the fiscal and monetary policies of the federal government and its agencies;

The soundness of other financial institutions could adversely affect us;

We may be required to recognize an impairment of goodwill:

We operate in a highly competitive industry and market area;

Severe weather, natural disasters, acts of war or terrorism, and other external events could significantly impact our business;

Liquidity is essential to our businesses;

We may need to raise additional capital in the future and such capital may not be available on acceptable terms or at all;

We rely on dividends from our subsidiaries for most of our revenue;

We may not pay dividends on our common stock;

We may issue debt and equity securities or securities convertible into equity securities, any of which may be senior to our common stock as to distributions and in liquidation, which could negatively affect the value of our common stock;

The market price of our common stock may fluctuate significantly in response to a number of factors; and

Our certificate of incorporation, our bylaws, and certain banking laws contain anti-takeover provisions.

We caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advise readers that various factors, including those described above, could affect our financial performance and could cause our actual results or circumstances for future periods to differ materially from those anticipated or projected. See also Item 1A, Risk Factors, in this Form 10-K for further information. Except as required by law, we do not undertake, and specifically disclaim any obligation to publicly release any revisions to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

ITEM 1. BUSINESS
GENERAL

Financial Institutions, Inc. is a financial holding company organized in 1931 under the laws of New York State (New York or NYS), and through its wholly-owned New York chartered banking subsidiary, Five Star Bank, Financial Institutions, Inc. offers a broad array of deposit, lending and other financial services to individuals, municipalities and businesses in Western and Central New York. We have also expanded our indirect lending network to include relationships with franchised automobile dealers in the Capital District of New York and Northern Pennsylvania. All references in this Annual Report on Form 10-K to the parent are to Financial Institutions, Inc. (FII). Unless otherwise indicated, or unless the context requires otherwise, all references in this Annual Report on Form 10-K to the Company, we, our or us means Financial Institutions, Inc. and its subsidiaries on a consolidated basis. Five Star Bank is referred to as Five Star Bank, FSB or the Bank . FII is a legal entity, separate and distinct from its subsidiaries, assisting those subsidiaries by providing financial resources and oversight. Our executive offices are located at 220 Liberty Street, Warsaw, New York.

During late 2013, our subsidiary, Five Star Investment Services, Inc. (FSIS) ceased operations as an active broker-dealer and the securities licenses of advisors associated with FSIS who elected to transfer, as well as their respective client accounts which had previously cleared through a third-party platform, were transferred to the LPL Financial (LPL) clearing platform. Following the completion of these transfer activities, FSB began offering investment and securities-related services, including brokerage and investment advice through a strategic partnership with LPL. FSB has employees who are LPL registered representatives, located throughout its branch network, offering customers insurance and investment products including stocks, bonds, mutual funds, annuities, and managed accounts through a program called Five Star Investment Services. FSIS withdrew its registration with the Financial Industry Regulatory Authority (FINRA) effective December 31, 2013, and is expected to be dissolved in 2014.

Our Business Strategy

Our business strategy has been to maintain a community bank philosophy, which consists of focusing on and understanding the individualized banking needs of individuals, municipalities and businesses of the local communities surrounding our banking centers. We believe this focus allows us to be more responsive to our customers needs and provide a high level of personal service that differentiates us from larger competitors, resulting in long-standing and broad based banking relationships. Our core customers are primarily comprised of small- to medium-sized businesses, individuals and community organizations who prefer to build a banking relationship with a community bank that offers and combines high quality, competitively-priced banking products and services with personalized service. Because of our identity and origin as a locally operated bank, we believe that our level of personal service provides a competitive advantage over larger banks, which tend to consolidate decision-making authority outside local communities.

A key aspect of our current business strategy is to foster a community-oriented culture where our customers and employees establish long-standing and mutually beneficial relationships. We believe that we are well-positioned to be a strong competitor within our market area because of our focus on community banking needs and customer service, our comprehensive suite of deposit and loan products typically found at larger banks, our highly experienced management team and our strategically located banking centers. A central part of our strategy is generating core deposits to support growth of a diversified and high-quality loan portfolio.

MARKET AREAS AND COMPETITION

We provide a wide range of banking and financial services to individuals, municipalities and businesses through a network of over 50 offices and an extensive ATM network in fifteen contiguous counties of Western and Central New York: Allegany, Cattaraugus, Cayuga, Chautauqua, Chemung, Erie, Genesee, Livingston, Monroe, Ontario, Orleans, Seneca, Steuben, Wyoming and Yates counties. Our banking activities, though concentrated in the communities where we maintain branches, also extend into neighboring counties. In addition, we have expanded our consumer indirect lending presence to the Capital District of New York and Northern Pennsylvania.

Our market area is economically diversified in that we serve both rural markets and the larger more affluent markets of suburban Rochester and suburban Buffalo. Rochester and Buffalo are the two largest metropolitan areas in New York outside of New York City, with a combined metropolitan area of over two million people. We anticipate continuing to increase our presence in and around these metropolitan statistical areas in the coming years.

We face significant competition in both making loans and attracting deposits, as both Western and Central New York have a high density of financial institutions. Our competition for loans comes principally from commercial banks, savings banks, savings and loan associations, mortgage banking companies, credit unions, insurance companies and other financial service companies. Our most direct competition for deposits has historically come from commercial banks, savings banks and credit unions. We face additional competition for deposits from non-depository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies. We generally compete with other financial service providers on factors such as: level of customer service, responsiveness to customer needs, availability and pricing of products, and geographic location.

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The following table presents the Bank s market share percentage for total deposits as of June 30, 2013, in each county where we have operations. The table also indicates the ranking by deposit size in each market. All information in the table was obtained from SNL Financial of Charlottesville, Virginia, which compiles deposit data published by the FDIC as of June 30, 2013 and updates the information for any bank mergers and acquisitions completed subsequent to the reporting date.

County	Market Share	Market Rank	Number of Branches (1)
Allegany	8.2%	3	1
Cattaraugus	24.6%	2	5
Cayuga	3.1%	11	1
Chautauqua	1.2%	9	1
Chemung	15.0%	3	3
Erie	0.4%	11	3
Genesee	21.6%	3	4
Livingston	32.3%	1	5
Monroe	1.3%	10	5
Ontario	13.6%	2	5
Orleans	24.5%	1	2
Seneca	20.7%	3	2
Steuben	27.5%	1	7
Wyoming	48.7%	1	4
Yates	38.3%	1	2

(1) Number of branches current as of December 31, 2013.

INVESTMENT ACTIVITIES

Our investment policy is contained within our overall Asset-Liability Management and Investment Policy. This policy dictates that investment decisions will be made based on the safety of the investment, liquidity requirements, potential returns, cash flow targets, need for collateral and desired risk parameters. In pursuing these objectives, we consider the ability of an investment to provide earnings consistent with factors of quality, maturity, marketability, pledgeable nature and risk diversification. Our Treasurer, guided by our Asset-Liability Committee (ALCO), is responsible for investment portfolio decisions within the established policies.

Our investment securities strategy centers on providing liquidity to meet loan demand and redeeming liabilities, meeting pledging requirements, managing credit risks, managing overall interest rate risks and maximizing portfolio yield. Our current policy generally limits security purchases to the following:

U.S. treasury securities;

U.S. government agency securities, which are securities issued by official Federal government bodies (e.g., the Government National Mortgage Association (GNMA) and U.S. government-sponsored enterprise (GSE) securities, which are securities issued by independent organizations that are in part sponsored by the federal government (e.g., the Federal Home Loan Bank (FHLB) system, the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), the Small Business Administration (SBA) and the Federal Farm Credit Bureau);

Mortgage-backed securities (MBS) include mortgage-backed pass-through securities (pass-throughs), collateralized mortgage obligations (CMO) and DUS (delegated underwriting & servicing) issued by GNMA, FNMA and FHLMC;

Investment grade municipal securities, including revenue, tax and bond anticipation notes, statutory installment notes and general obligation bonds;

Certain creditworthy un-rated securities issued by municipalities;

Certificates of deposit;

Equity securities at the holding company level; and

Limited partnership investments.

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LENDING ACTIVITIES

General

We offer a broad range of loans including commercial business and revolving lines of credit, commercial mortgages, equipment loans, residential mortgage loans and home equity loans and lines of credit, home improvement loans, automobile loans and personal loans. Newly originated and refinanced fixed rate residential mortgage loans are either retained in our portfolio or sold to the secondary market with servicing rights retained.

We continually evaluate and update our lending policy. The key elements of our lending philosophy include the following:

- To ensure consistent underwriting, employees must share a common view of the risks inherent in lending activities as well as the standards to be applied in underwriting and managing credit risk;
- Pricing of credit products should be risk-based;
- The loan portfolio must be diversified to limit the potential impact of negative events; and
- Careful, timely exposure monitoring through dynamic use of our risk rating system is required to provide early warning and assure proactive management of potential problems.

Commercial Business and Commercial Mortgage Lending

We originate commercial business loans in our primary market areas and underwrite them based on the borrower s ability to service the loan from operating income. We offer a broad range of commercial lending products, including term loans and lines of credit. Short and medium-term commercial loans, primarily collateralized, are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition of real estate, expansion and improvements) and the purchase of equipment. Commercial business loans are offered to the agricultural industry for short-term crop production, farm equipment and livestock financing. As a general practice, where possible, a collateral lien is placed on any available real estate, equipment or other assets owned by the borrower and a personal guarantee of the owner is obtained. As of December 31, 2013, $86.7 million, or 33%, of our aggregate commercial business loan portfolio were at fixed rates, while $179.1 million, or 67%, were at variable rates.

We also offer commercial mortgage loans to finance the purchase of real property, which generally consists of real estate with completed structures and, to a smaller extent, agricultural real estate financing. Commercial mortgage loans are secured by first liens on the real estate and are typically amortized over a 10 to 20 year period. The underwriting analysis includes credit verification, appraisals and a review of the borrower s financial condition and repayment capacity. As of December 31, 2013, $187.5 million, or 40%, of our aggregate commercial mortgage portfolio were at fixed rates, while $281.8 million, or 60%, were at variable rates.

We utilize government loan guarantee programs where available and appropriate.

Government Guarantee Programs

We participate in government loan guarantee programs offered by the SBA, U.S. Department of Agriculture, Rural Economic and Community Development and Farm Service Agency, among others. As of December 31, 2013, we had loans with an aggregate principal balance of $56.6 million that were covered by guarantees under these programs. The guarantees typically only cover a certain percentage of these loans. By participating in these programs, we are able to broaden our base of borrowers while minimizing credit risk.

Residential Mortgage Lending

We originate fixed and variable rate one-to-four family residential mortgages collateralized by owner-occupied properties located in our market areas. We offer a variety of real estate loan products, which are generally amortized over periods of up to 30 years. Loans collateralized by one-to-four family residential real estate generally have been originated in amounts of no more than 80% of appraised value or have mortgage insurance. Mortgage title insurance and hazard insurance are normally required. We sell certain one-to-four family residential mortgages to the secondary mortgage market and typically retain the right to service the mortgages. To assure maximum salability of the residential loan products for possible resale, we typically follow the underwriting and appraisal guidelines of the secondary market, including the FHLMC and the FHA, and service the loans in a manner that satisfies the secondary market agreements. As of December 31, 2013, our residential mortgage servicing portfolio totaled $237.9 million, the majority of which has been sold to the FHLMC. As of December 31, 2013, our residential mortgage loan portfolio totaled $113.0 million, or 6% of our total loan portfolio. We do not engage in sub-prime or other high-risk residential mortgage lending as a line-of-business.

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Consumer Lending

We offer a variety of loan products to our consumer customers, including home equity loans and lines of credit, automobile loans, secured installment loans and various other types of secured and unsecured personal loans. At December 31, 2013, outstanding consumer loan balances were concentrated in indirect automobile loans and home equity products.

We originate indirect consumer loans for a mix of new and used vehicles through franchised new car dealers. The consumer indirect loan portfolio is primarily comprised of loans with terms that typically range from 36 to 84 months. We have expanded our relationships with franchised new car dealers in Western, Central and the Capital District of New York, and Northern Pennsylvania. As of December 31, 2013, our consumer indirect portfolio totaled $636.4 million, or 35% of our total loan portfolio. The consumer indirect loan portfolio is primarily fixed rate loans with relatively short durations.

We also originate, independently of the indirect loans described above, consumer automobile loans, recreational vehicle loans, boat loans, home improvement loans, closed-end home equity loans, home equity lines of credit, personal loans (collateralized and uncollateralized) and deposit account collateralized loans. The terms of these loans typically range from 12 to 180 months and vary based upon the nature of the collateral and the size of loan. The majority of the consumer lending program is underwritten on a secured basis using the customer s home or the financed automobile, mobile home, boat or recreational vehicle as collateral. As of December 31, 2013, $201.3 million, or 62%, of our home equity portfolio was at fixed rates, while $124.8 million, or 38%, was at variable rates. Approximately 76% of the loans in our home equity portfolio are first lien positions at December 31, 2013. The other consumer portfolio totaled $23.1 million as of December 31, 2013, all but $1.1 million of which were fixed rate loans.

Credit Administration

Our loan policy establishes standardized underwriting guidelines, as well as the loan approval process and the committee structures necessary to facilitate and ensure the highest possible loan quality decision-making in a timely and businesslike manner. The policy establishes requirements for extending credit based on the size, risk rating and type of credit involved. The policy also sets limits on individual loan officer lending authority and various forms of joint lending authority, while designating which loans are required to be approved at the committee level.

Our credit objectives are as follows:

- Compete effectively and service the legitimate credit needs of our target market;
- Enhance our reputation for superior quality and timely delivery of products and services;
- Provide pricing that reflects the entire relationship and is commensurate with the risk profiles of our borrowers;
- Retain, develop and acquire profitable, multi-product, value added relationships with high quality borrowers;

Focus on government guaranteed lending and establish a specialization in this area to meet the needs of the small businesses in our communities; and

Comply with the relevant laws and regulations.

Our policy includes loan reviews, under the supervision of the Audit and Risk Oversight committees of the Board of Directors and directed by our Chief Risk Officer, in order to render an independent and objective evaluation of our asset quality and credit administration process.

Risk ratings are assigned to loans in the commercial business and commercial mortgage portfolios. The risk ratings are specifically used as follows:

Profile the risk and exposure in the loan portfolio and identify developing trends and relative levels of risk;

Identify deteriorating credits;

Reflect the probability that a given customer may default on its obligations; and

Assist with risk-based pricing.

Through the loan approval process, loan administration and loan review program, management seeks to continuously monitor our credit risk profile and assesses the overall quality of the loan portfolio and adequacy of the allowance for loan losses.

We have several procedures in place to assist in maintaining the overall quality of our loan portfolio. Delinquent loan reports are monitored by credit administration to identify adverse levels and trends. Loans, including impaired loans, are generally classified as non-accruing if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-collateralized and in the process of collection. Loans that are on a current payment status or past due less than 90 days may also be classified as non-accruing if repayment in full of principal and/or interest is uncertain.

Allowance for Loan Losses

The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. The allowance reflects management s estimate of the amount of probable loan losses in the portfolio, based on factors such as:

Specific allocations for individually analyzed credits;

Risk assessment process;

Historical net charge-off experience;

Evaluation of the loan portfolio with loan reviews;

Levels and trends in delinquent and non-accruing loans;

Trends in volume and terms of loans;

Effects of changes in lending policy;

Experience, ability and depth of management;

National and local economic trends and conditions;

Concentrations of credit;

Interest rate environment;

Customer leverage;

Information (availability of timely financial information); and

Collateral values.

Our methodology in the estimation of the allowance for loan losses includes the following:

1. Impaired commercial business and commercial mortgage loans, generally in excess of $50 thousand are reviewed individually and assigned a specific loss allowance, if considered necessary, in accordance with U.S. generally accepted accounting principles (GAAP).

2. The remaining portfolios of commercial business and commercial mortgage loans are segmented by risk rating into the following loan classification categories: uncriticized or pass, special mention, substandard and doubtful. Uncriticized loans, special mention loans, substandard loans and all doubtful loans not assigned a specific loss allowance are assigned allowance allocations based on historical net loan charge-off experience for each of the respective loan categories, supplemented with additional reserve amounts, if considered necessary, based upon qualitative factors. These qualitative factors include the levels and trends in delinquent and non-accruing loans, trends in volume and terms of loans, effects of changes in lending policy, experience, ability, and depth of management, national and local economic trends and conditions, concentrations of credit, interest rate environment, customer leverage, information (availability of timely financial information), and collateral values, among others.

3. The retail loan portfolio is segmented into the following types of loans: residential real estate, home equity (home equity loans and lines of credit), consumer indirect and other consumer. Allowance allocations for the real estate related loan portfolios (residential and home equity) are based on the average loss experience for the previous eight quarters, supplemented with qualitative factors similar to the elements described above. Allowance allocations for the consumer indirect and other consumer portfolios are based on vintage analyses performed with historical loss experience at 36 months and 24 months aging, respectively. The allocations on these portfolios are also supplemented with qualitative factors.

Management presents a quarterly review of the adequacy of the allowance for loan losses to our Board of Directors based on the methodology described above. See also the section titled Allowance for Loan Losses in Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K.

SOURCES OF FUNDS

Our primary sources of funds are deposits, borrowed funds, scheduled amortization and prepayments of principal from loans and mortgage-backed securities, maturities and calls of investment securities and funds provided by operations.

Deposits

We maintain a full range of deposit products and accounts to meet the needs of the residents and businesses in our primary service area. Products include an array of checking and savings account programs for individuals and businesses, including money market accounts, certificates of deposit, sweep investment capabilities as well as Individual Retirement Accounts and other qualified plan accounts. We rely primarily on competitive pricing of our deposit products, customer service and long-standing relationships with customers to attract and retain these deposits and seek to make our services convenient to the community by offering 24-hour ATM access at some of our facilities, access to other ATM networks available at other local financial institutions and retail establishments, and telephone banking services including account inquiry and balance transfers. We also take advantage of the use of technology by allowing our customers banking access via the Internet and various advanced systems for cash management for our business customers.

We had no traditional brokered deposits at December 31, 2013; however, we do participate in the Certificate of Deposit Account Registry Service (CDARS) and Insured Cash Sweep (ICS) programs, which enable depositors to receive FDIC insurance coverage for deposits otherwise exceeding the maximum insurable amount. Through these programs, deposits in excess of the maximum insurable amount are placed with multiple participating financial institutions. Reciprocal CDARS deposits and ICS deposits totaled $61.3 million and $56.4 million, respectively, at December 31, 2013.

Borrowings

We have access to a variety of borrowing sources and use both short-term and long-term borrowings to support our asset base. Borrowings from time-to-time include federal funds purchased, securities sold under agreements to repurchase, FHLB advances and borrowings from the discount window of the FRB. We also offer customers a deposit account that sweeps balances in excess of an agreed upon target amount into overnight repurchase agreements.

OPERATING SEGMENTS

Our only operating segment is our subsidiary bank, FSB.

OTHER INFORMATION

We also make available, free of charge, through our website, all reports filed with the SEC, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as any amendments to those reports, as soon as reasonably practicable after those documents are filed with, or furnished to, the SEC. These filings may be viewed by accessing the *Company Filings* subsection of the *SEC Filings* section under the *Investor Relations* tab on our website (www.fiiwarsaw.com). Information available on our website is not a part of, and is not incorporated into, this Annual Report on Form 10-K.

All of the reports we file with the SEC, including this Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as any amendments thereto may be accessed at www.sec.gov or at the public reference facility maintained by the SEC at its public reference room at 100 F. Street, N.E., Room 1580, Washington, DC 20549 and copies of all or any part thereof may be obtained from that office upon payment of the prescribed fees. You may call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room and you can request copies of the documents upon payment of a duplicating fee, by writing to the SEC.

SUPERVISION AND REGULATION

The Company and our subsidiaries are subject to an extensive system of laws and regulations that are intended primarily for the protection of customers and depositors and not for the protection of our security holders. These laws and regulations govern such areas as capital, permissible activities, allowance for loan losses, loans and investments, and rates of interest that can be charged on loans. Described below are elements of selected laws and regulations. The descriptions are not intended to be complete and are qualified in their entirety by reference to the full text of the statutes and regulations described.

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Holding Company Regulation. As a bank holding company and financial holding company, we are subject to comprehensive regulation by the Board of Governors of the Federal Reserve System, frequently referred to as the Federal Reserve Board (FRB), under the Bank Holding Company Act (the BHC Act), as amended by, among other laws, the Gramm-Leach-Bliley Act of 1999 (the Gramm-Leach-Bliley Act), and by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), enacted in 2010. We must file reports with the FRB and such additional information as the FRB may require, and our holding company and non-banking affiliates are subject to examination by the FRB. Under FRB policy, a bank holding company must serve as a source of strength for its subsidiary banks. Under this policy, the FRB may require, and has required in the past, a holding company to contribute additional capital to an undercapitalized subsidiary bank. The BHC Act provides that a bank holding company must obtain FRB approval before:

Acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares (unless it already owns or controls the majority of such shares);

Acquiring all or substantially all of the assets of another bank or bank holding company, or

Merging or consolidating with another bank holding company.

The BHC Act generally prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities which, by statute or by FRB regulation or order, have been identified as activities closely related to the business of banking or managing or controlling banks. The list of activities permitted by the FRB includes, among other things: lending; operating a savings institution, mortgage company, finance company, credit card company or factoring company; performing certain data processing operations; providing certain investment and financial advice; underwriting and acting as an insurance agent for certain types of credit related insurance; leasing property on a full-payout, non-operating basis; selling money orders, travelers checks and United States Savings Bonds; real estate and personal property appraising; providing tax planning and preparation services; and, subject to certain limitations, providing securities brokerage services for customers. These activities may also be affected by federal legislation.

The Gramm-Leach-Bliley Act amended portions of the BHC Act to authorize bank holding companies, such as us, directly or through non-bank subsidiaries to engage in securities, insurance and other activities that are financial in nature or incidental to a financial activity. In order to undertake these activities, a bank holding company must become a financial holding company by submitting to the appropriate Federal Reserve Bank a declaration that the company elects to be a financial holding company and a certification that all of the depository institutions controlled by the company are well capitalized and well managed.

The Dodd-Frank Act amends the BHC Act to require the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds), which is commonly called the Volcker Rule . The Federal Reserve adopted final rules implementing the Volcker Rule on December 10, 2013. The final rules are effective April 1, 2014, but the Federal Reserve issued an order extending the period during which institutions have to conform their activities and investments to the requirements of the Volcker Rule to July 21, 2015.

The Final Rules require each regulated entity to establish an internal compliance program that is consistent with the extent to which it engages in activities covered by the Volcker Rule, which must include (for the largest entities) making regular reports about those activities to regulators. Community banks, such as FSB, have been afforded some relief under the Final Rules. If such banks are engaged only in exempted proprietary trading, such as trading in U.S. government, agency, state and municipal obligations, they are exempt entirely from compliance program requirements. Moreover, even if a community bank engages in proprietary trading or covered fund activities under the rule, they need only incorporate references to the Volcker Rule into their existing policies and procedures. The Final Rules are effective April 1, 2014, but the conformance period has been extended from its statutory end date of July 21, 2014 until July 21, 2015. Although we are continuing to evaluate the impact of the Volcker Rule and the final rules adopted thereunder, we do not currently anticipate that the Volcker Rule will have a material effect on the operations of FII or the Bank, as we do not engage in the businesses prohibited by the Volcker Rule. We may incur costs to adopt additional policies and systems to ensure compliance with the Volcker Rule, but any such costs are not expected to be material.

The Dodd-Frank Act. The Dodd-Frank Act, significantly restructures the financial regulatory regime in the United States. Although the Dodd-Frank Act s provisions that have received the most public attention generally have been those applying to or more likely to affect larger institutions such as bank holding companies with total consolidated assets of $50 billion or more, it contains numerous other provisions that affect all bank holding companies and banks, including FII or the Bank, some of which are described in more detail below.

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Many of the Dodd-Frank Act s provisions are subject to final rulemaking by the U.S. financial regulatory agencies, and the implications of the Dodd-Frank Act for our businesses will depend to a large extent on how such rules are adopted and implemented by the primary U.S. financial regulatory agencies. We continue to analyze the impact of rules adopted under Dodd-Frank, on our business. However, the full impact will not be known until the rules, and other regulatory initiatives that overlap with the rules, are finalized and their combined impacts can be understood.

Depository Institution Regulation. The Bank is subject to regulation by the Federal Deposit Insurance Corporation (FDIC). This regulatory structure includes:

- Real estate lending standards, which provide guidelines concerning loan-to-value ratios for various types of real estate loans;
- Risk-based capital rules, including accounting for interest rate risk, concentration of credit risk and the risks posed by non-traditional activities;
- Rules requiring depository institutions to develop and implement internal procedures to evaluate and control credit and settlement exposure to their correspondent banks;
- Rules restricting types and amounts of equity investments; and
- Rules addressing various safety and soundness issues, including operations and managerial standards, standards for asset quality, earnings and compensation standards.

Capital Adequacy Requirements. The FRB and FDIC have issued substantially similar risk-based and leverage capital guidelines applicable to bank holding companies and banks. In addition, these regulatory agencies may from time to time require that a bank holding company or bank maintain capital above the minimum levels, based on its financial condition or actual or anticipated growth.

The FRB s risk-based guidelines establish a two-tier capital framework. Tier 1 capital generally consists of common shareholders equity, retained earnings, a limited amount of qualifying perpetual preferred stock, qualifying trust preferred securities and non-controlling interests in the equity accounts of consolidated subsidiaries, less goodwill and certain intangibles. Tier 2 capital generally consists of certain hybrid capital instruments and perpetual debt, mandatory convertible debt securities and a limited amount of subordinated debt, qualifying preferred stock, loan loss allowance, and unrealized holding gains on certain equity securities. The sum of Tier 1 and Tier 2 capital represents qualifying total capital, at least 50% of which must consist of Tier 1 capital.

Risk-based capital ratios are calculated by dividing Tier 1 and total capital by risk-weighted assets. Assets and off-balance sheet exposures are assigned to one of four categories of risk-weights, based primarily on relative credit risk. For bank holding companies, generally the minimum Tier 1 risk-based capital ratio is 4% and the minimum total risk-based capital ratio is 8%. Our Tier 1 and total risk-based capital ratios under these guidelines at December 31, 2013 were 10.82% and 12.08%, respectively.

The FRB s leverage capital guidelines establish a minimum leverage ratio determined by dividing Tier 1 capital by adjusted average total assets. The minimum leverage ratio is 3% for bank holding companies that meet certain specified criteria, including having the highest regulatory rating. All other bank holding companies generally are required to maintain a leverage ratio of at least 4%. At December 31, 2013, we had a leverage ratio of 7.63%. See also the section titled Capital Resources in Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 11, Regulatory Matters, of the notes to consolidated financial statements, included in this Annual Report on Form 10-K.

Basel III Capital Rules. In July 2013, the Federal Reserve approved final rules that substantially amend the regulatory risk-based capital rules applicable to FII and the Bank. The FDIC and the OCC have subsequently approved these rules. The final rules were adopted following the issuance of proposed rules by the Federal Reserve in June 2012, and implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. Basel III refers to two consultative documents released by the Basel Committee on Banking Supervision in December 2009, the rules text released in December 2010, and loss absorbency rules issued in January 2011, which include significant changes to bank capital, leverage and liquidity requirements.

The rules include new risk-based capital and leverage ratios, which would be phased in from 2015 to 2019, and would refine the definition of what constitutes capital for purposes of calculating those ratios. The new minimum capital level requirements applicable to FII and the Bank under the final rules would be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a capital conservation buffer above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Basel III provided discretion for regulators to impose an additional buffer, the countercyclical buffer, of up to 2.5% of common equity Tier 1 capital to take into account the macro-financial environment and periods of excessive credit growth. However, the final rules permit the countercyclical buffer to be applied only to advanced approach banks (i.e., banks with $250 billion or more in total assets or $10 billion or more in total foreign exposures), which currently excludes the Company and the Bank. The final rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that will no longer qualify as Tier 1 capital, some of which will be phased out over time. However, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Company) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The final rules set forth certain changes for the calculation of risk-weighted assets, which we will be required to utilize beginning January 1, 2015. The standardized approach final rule utilizes an increased number of credit risk exposure categories and risk weights, and also addresses: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; (iv) revised capital treatment for derivatives and repo-style transactions; and (v) disclosure requirements for top-tier banking organizations with $50 billion or more in total assets that are not subject to the advance approach rules that apply to banks with greater than $250 billion in consolidated assets. Based on our current capital composition and levels, we believe that we would be in compliance with the requirements as set forth in the final rules if they were presently in effect.

Prompt Corrective Action. The Federal Deposit Insurance Corporation Improvement Act of 1991, among other things, identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and requires the respective federal bank regulatory agencies to implement systems for prompt corrective action for insured depository institutions that do not meet minimum capital requirements within these categories. This act imposes progressively more restrictive constraints on operations, management and capital distributions, depending on the category in which an institution is classified. Failure to meet the capital guidelines could also subject a banking institution to capital raising requirements. An undercapitalized bank must develop a capital restoration plan and its parent holding company must guarantee that bank s compliance with the plan. The liability of the parent holding company under any such guarantee is limited to the lesser of five percent of the bank s assets at the time it became undercapitalized or the amount needed to comply with the plan. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent s general unsecured creditors. In addition, the Federal Deposit Insurance Corporation Improvement Act requires the various regulatory agencies to prescribe certain non-capital standards for safety and soundness relating generally to operations and management, asset quality and executive compensation and permits regulatory action against a financial institution that does not meet these standards.

The various federal bank regulatory agencies have adopted substantially similar regulations that define the five capital categories identified by the Federal Deposit Insurance Corporation Improvement Act, using the total risk-based capital, Tier 1 risk-based capital and leverage capital ratios as the relevant capital measures. These regulations establish various degrees of corrective action to be taken when an institution is considered undercapitalized. Under the regulations, a well capitalized institution must have a Tier 1 risk-based capital ratio of at least 6%, a total risk-based capital ratio of at least 10% and a leverage ratio of at least 5% and not be subject to a capital directive or order. An institution is adequately capitalized if it has a Tier 1 risk-based capital ratio of at least 4%, a total risk-based capital ratio of at least 8% and a leverage ratio of at least 4% (3% in certain circumstances). An institution is undercapitalized if it has a Tier 1 risk-based capital ratio of less than 4%, a total risk-based capital ratio of less than 8% or a leverage ratio of less than 4% (3% in certain circumstances). An institution is significantly undercapitalized if it has a Tier 1 risk-based capital ratio of less than 3%, a total risk-based capital ratio of less than 6% or a leverage ratio of less than 3%. An institution is critically undercapitalized if its tangible equity is equal to or less than 2% of total assets. Generally, an institution may be reclassified in a lower capitalization category if it is determined that the institution is in an unsafe or unsound condition or engaged in an unsafe or unsound practice.

As of December 31, 2013, the Bank met the requirements to be classified as well-capitalized .

The Basel III Capital Rules also contain revisions to the prompt corrective action framework, which are designed to place restrictions on insured depository institutions, including the Bank, if their capital levels begin to show signs of weakness. These revisions take effect January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions will be required to meet the following increased capital level requirements in order to qualify as well capitalized: (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

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Dividends. The FRB policy is that a bank holding company should pay cash dividends only to the extent that its net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company s capital needs, asset quality and overall financial condition, and that it is inappropriate for a bank holding company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, a bank that is classified under the prompt corrective action regulations as undercapitalized will be prohibited from paying any dividends.

Our primary source for cash dividends is the dividends we receive from the Bank. The Bank is subject to various regulatory policies and requirements relating to the payment of dividends, including requirements to maintain capital above regulatory minimums. Approval of the New York State Department of Financial Services is required prior to paying a dividend if the dividend declared by the Bank exceeds the sum of the Bank s net profits for that year and its retained net profits for the preceding two calendar years.

Federal Deposit Insurance Assessments. The Bank is a member of the FDIC and pays an insurance premium to the FDIC based upon its assessable assets on a quarterly basis. Deposits are insured up to applicable limits by the FDIC and such insurance is backed by the full faith and credit of the United States Government.

Under the Dodd-Frank Act, a permanent increase in deposit insurance was authorized to $250,000. The coverage limit is per depositor, per insured depository institution for each account ownership category.

The Dodd-Frank Act also set a new minimum Deposit Insurance Fund (DIF) reserve ratio at 1.35% of estimated insured deposits. The FDIC is required to attain this ratio by September 30, 2020. The Dodd-Frank Act also required the FDIC to define the deposit insurance assessment base for an insured depository institution as an amount equal to the institution s average consolidated total assets during the assessment period minus average tangible equity. Premiums for the Bank are now calculated based upon the average balance of total assets minus average tangible equity as of the close of business for each day during the calendar quarter.

The FDIC has the flexibility to adopt actual rates that are higher or lower than the total base assessment rates adopted without notice and comment, if certain conditions are met.

DIF-insured institutions pay a Financing Corporation (FICO) assessment in order to fund the interest on bonds issued in the 1980s in connection with the failures in the thrift industry. For the fourth quarter of 2013, the FICO assessment was equal to 0.62 basis points computed on assets as required by the Dodd-Frank Act. These assessments will continue until the bonds mature in 2019.

The FDIC is authorized to conduct examinations of and require reporting by FDIC-insured institutions. It is also authorized to terminate a depository bank s deposit insurance upon a finding by the FDIC that the bank s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the bank s regulatory agency. The termination of deposit insurance for the Bank would have a material adverse effect on our earnings, operations and financial condition.

Transactions with Affiliates. FII and FSB are affiliates within the meaning of the Federal Reserve Act. The Federal Reserve Act imposes limitations on a bank with respect to extensions of credit to, investments in, and certain other transactions with, its parent bank holding company and the holding company s other subsidiaries. Furthermore, bank loans and extensions of credit to affiliates also are subject to various collateral requirements.

Community Reinvestment Act. Under the Community Reinvestment Act, every FDIC-insured institution is obligated, consistent with safe and sound banking practices, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The Community Reinvestment Act requires the appropriate federal banking regulator, in connection with the examination of an insured institution, to assess the institution s record of meeting the credit needs of its community and to consider this record in its evaluation of certain applications, such as a merger or the establishment of a branch. An unsatisfactory rating may be used as the basis for the denial of an application and will prevent a bank holding company of the institution from making an election to become a financial holding company.

As of its last Community Reinvestment Act examination, the Bank received a rating of outstanding.

Interstate Branching. Pursuant to the Dodd-Frank Act, national and state-chartered banks may open an initial branch in a state other than its home state (e.g., a host state) by establishing a de novo branch at any location in such host state at which a bank chartered in such host state could establish a branch. Applications to establish such branches must still be filed with the appropriate primary federal regulator.

Privacy Rules. Federal banking regulators, as required under the Gramm-Leach-Bliley Act, have adopted rules limiting the ability of banks and other financial institutions to disclose nonpublic information about consumers to non-affiliated third parties. The rules require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to non-affiliated third parties. The privacy provisions of the Gramm-Leach-Bliley Act affect how consumer information is transmitted through diversified financial services companies and conveyed to outside vendors.

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Anti-Terrorism Legislation. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA Patriot Act), enacted in 2001:

- prohibits banks from providing correspondent accounts directly to foreign shell banks;
- imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals;
- requires financial institutions to establish an anti-money-laundering (AML) compliance program; and
- generally eliminates civil liability for persons who file suspicious activity reports.

The USA Patriot Act also increases governmental powers to investigate terrorism, including expanded government access to account records. The Department of the Treasury is empowered to administer and make rules to implement the Act, which to some degree, affects our record-keeping and reporting expenses. Should the Bank s AML compliance program be deemed insufficient by federal regulators, we would not be able to grow through acquiring other institutions or opening de novo branches.

Ability-to-Repay and Qualified Mortgage Rule. Pursuant to the Dodd Frank Act, the CFPB issued a final rule on January 10, 2013 (effective on January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and (8) credit history. Alternatively, the mortgage lender can originate qualified mortgages, which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a qualified mortgage is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Qualified mortgages that are higher-priced (e.g. subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not higher-priced (e.g. prime loans) are given a safe harbor of compliance.

Incentive Compensation Policies and Restrictions. In July 2010, the federal banking agencies issued guidance that applies to all banking organizations supervised by the agencies (thereby including both FII and the Bank). Pursuant to the guidance, to be consistent with safety and soundness principles, a banking organization s incentive compensation arrangements should: (1) provide employees with incentives that appropriately balance risk and reward; (2) be compatible with effective controls and risk management; and (3) be supported by strong corporate governance including active and effective oversight by the banking organization s board of directors. Monitoring methods and processes used by a banking organization should be commensurate with the size and complexity of the organization and its use of incentive compensation.

In addition, in March 2011, the federal banking agencies, along with the Federal Housing Finance Agency, and the SEC, released a proposed rule intended to ensure that regulated financial institutions design their incentive compensation arrangements to account for risk. Specifically, the proposed rule would require compensation practices at the Parent Company and at the Bank to be consistent with the following principles: (1) compensation arrangements appropriately balance risk and financial reward; (2) such arrangements are compatible with effective controls and risk management; and (3) such arrangements are supported by strong corporate governance. In addition, financial institutions with $1 billion or more in assets would be required to have policies and procedures to ensure compliance with the rule and would be required to submit annual reports to their primary federal regulator. The comment period has closed but a final rule has not yet been published.

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 implemented a broad range of corporate governance, accounting and reporting measures for companies that have securities registered under the Exchange Act, including publicly-held bank holding companies such as FII. Specifically, the Sarbanes-Oxley Act of 2002 and the various regulations promulgated thereunder, established, among other things: (i) requirements for audit committees, including independence, expertise, and responsibilities; (ii) responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) the forfeiture of bonuses or other incentive-based compensation and profits from the sale of the reporting company s securities by the Chief Executive Officer and Chief Financial Officer in the twelve-month period following the initial publication of any financial statements that later require restatement; (iv) the creation of an independent accounting oversight board; (v) standards for auditors and regulation of audits, including independence provisions that restrict non-audit services that accountants may provide to their audit clients; (vi) disclosure and reporting obligations for the reporting company and their directors and executive officers, including accelerated reporting of stock transactions and a prohibition on trading during pension blackout periods; (vii) a prohibition on personal loans to directors and officers, except certain loans made by insured financial institutions on non-preferential terms and in compliance with other bank regulatory requirements; and (viii) a range of civil and criminal penalties for fraud and other violations of the securities laws.

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Consumer Laws and Regulations. In addition to the laws and regulations discussed herein, the Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include, among others, the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act and the Real Estate Settlement Procedures Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing customer relations. The Check Clearing for the 21st Century Act (the Check 21 Act), which became effective on October 28, 2004, creates a new negotiable instrument, called a substitute check , which banks are required to accept as the legal equivalent of a paper check if it meets the requirements of the Check 21 Act. The Check 21 Act is designed to facilitate check truncation, to foster innovation in the check payment system, and to improve the payment system by shortening processing times and reducing the volume of paper checks.

Other Future Legislation and Changes in Regulations. In addition to the specific proposals described above, from time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes our operating environment in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. We cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on our financial condition or results of operations. A change in statutes, regulations or regulatory policies applicable to us or our subsidiaries could have a material effect on our business.

Impact of Inflation and Changing Prices

Our financial statements included herein have been prepared in accordance with GAAP, which requires us to measure financial position and operating results principally using historic dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on our operations is reflected in increased operating costs. We believe changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are generally influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude. Interest rates are sensitive to many factors that are beyond our control, including changes in the expected rate of inflation, general and local economic conditions and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities.

Regulatory and Economic Policies

Our business and earnings are affected by general and local economic conditions and by the monetary and fiscal policies of the U.S. government, its agencies and various other governmental regulatory authorities. The FRB regulates the supply of money in order to influence general economic conditions. Among the instruments of monetary policy available to the FRB are (i) conducting open market operations in U.S. government obligations, (ii) changing the discount rate on financial institution borrowings, (iii) imposing or changing reserve requirements against financial institution deposits, and (iv) restricting certain borrowings and imposing or changing reserve requirements against certain borrowings by financial institutions and their affiliates. These methods are used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. For that reason, the policies of the FRB could have a material effect on our earnings.

EMPLOYEES

At December 31, 2013, we had 645 employees. None of our employees are subject to a collective bargaining agreement and management believes our relations with employees are good.

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EXECUTIVE OFFICERS

The following table sets forth current information regarding our executive officers and certain other significant employees (ages are as of May 7, 2014, the date of the 2014 Annual Meeting of Shareholders).

Name	Age	Started In	Positions/Offices
Martin K. Birmingham	47	2005	President and Chief Executive Officer since March 2013. Previously, President and Chief of Community Banking of FII and the Bank from August 2012 to March 2013. Executive Vice President and Regional President/Commercial Banking Executive Officer of the Bank from 2005 to 2009. Senior Vice President and Regional President of the Bank from 2005 to 2009. Senior Team Leader and Regional President of the Rochester Market at Bank of America (formally Fleet Boston Financial) from 2000 to 2005.
Paula D. Dolan	60	2013	Senior Vice President and Director of Human Resources of FII and the Bank since September 2013. Before joining the Company, Ms. Dolan worked at Hillside Family of Agencies (Hillside), starting as a consultant in 2010, and most recently as Hillside s Manager of Compensation and Human Resource Information Systems. Previously, she was a Senior Human Resources Consultant with First Niagara Consulting/Burke Group from 2007 to 2010. Prior to working at First Niagara, Ms. Dolan held human resources positions at Unity Health Systems, HR Works, Eastman Kodak Company, Rochester Community Savings Bank and Jones & Laughlin Steel Corporation.
Sonia M. Dumbleton	52	1984	Senior Vice President, Controller and Corporate Secretary of FII and the Bank since May 2013. Senior Vice President and Controller of the Bank since 2006. Vice President and Controller of the Bank from 2001 to 2006.
Michael D. Grover	42	1999	Senior Vice President of Financial Reporting and Tax and Chief Accounting Officer of FII and the Bank since April 2013. Senior Vice President of Financial Reporting and Tax of the Bank since 2008.
Richard J. Harrison	68	2003	Executive Vice President and Chief Operating Officer of FII and the Bank since August 2012. Executive Vice President and Senior Retail Lending Administrator of the Bank since 2009. Senior Vice President and Senior Retail Lending Administrator of the Bank and its predecessor, National Bank of Geneva, from 2003 to 2009. Executive Vice President and Chief Credit Officer of Savings Bank of the Finger Lakes from 2001 to 2003. Director of Transcat, Inc., a publicly traded distributer and calibrator of hand held test and measurement equipment since 2004.
Jeffrey P. Kenefick	47	2006	Executive Vice President and Commercial Banking Executive of FII and the Bank since May 2013. Senior Vice President, Commercial

			Banking Executive and Regional President of the Bank from February 2006 until May 2013.
Kevin B. Klotzbach	61	2001	Executive Vice President, Chief Financial Officer and Treasurer of FII and the Bank since April 2013. Senior Vice President and Treasurer of the Bank since 2001. Prior to joining us, Mr. Klotzbach actively managed fixed income portfolios at several other financial institutions, including Merrill Lynch Asset Management and Empire of America.
R. Mitchell McLaughlin	56	1981	Executive Vice President and Information/Physical Security and Facilities Director of the Bank since January 2014. Executive Vice President and Chief Information Officer of the Bank from 2009 to January 2014. Senior Vice President and Chief Information Officer of the Bank from 2006 to 2009.
Kenneth V. Winn	56	2004	Executive Vice President and Chief Risk Officer of FII and the Bank since July 2012. Senior Vice President and Senior Credit and Compliance Administrator of the Bank since 2006.

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ITEM 1A. RISK FACTORS

An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that management believes could affect us are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below, together with all of the other information included or incorporated by reference herein. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our business operations. This Annual Report on Form 10-K is qualified in its entirety by these risk factors. Further, to the extent that any of the information contained in this Annual Report on Form 10-K constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important factors that could cause our actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of us.

If any of the following risks actually occur, our financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of our common stock could decline significantly, and you could lose all or part of your investment.

If we experience greater credit losses than anticipated, earnings may be adversely impacted.

As a lender, we are exposed to the risk that customers will be unable to repay their loans according to their terms and that any collateral securing the payment of their loans may not be sufficient to assure repayment. Credit losses are inherent in the business of making loans and could have a material adverse impact on our results of operations.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral, and we provide an allowance for estimated loan losses based on a number of factors. We believe that the allowance for loan losses is adequate. However, if our assumptions or judgments are wrong, the allowance for loan losses may not be sufficient to cover the actual credit losses. We may have to increase the allowance in the future in response to the request of one of our primary banking regulators, to adjust for changing conditions and assumptions, or as a result of any deterioration in the quality of our loan portfolio. The actual amount of future provisions for credit losses may vary from the amount of past provisions.

Geographic concentration may unfavorably impact our operations.

Substantially all of our business and operations are concentrated in the Western and Central New York region. As a result of this geographic concentration, our results depend largely on economic conditions in these and surrounding areas. Deterioration in economic conditions in our market could:

- increase loan delinquencies;
- increase problem assets and foreclosures;
- increase claims and lawsuits;

decrease the demand for our products and services; and

decrease the value of collateral for loans, especially real estate, in turn reducing customers borrowing power, the value of assets associated with non-performing loans and collateral coverage.

Generally, we make loans to small to mid-sized businesses whose success depends on the regional economy. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities. Adverse economic and business conditions in our market areas could reduce our growth rate, affect our borrowers ability to repay their loans and, consequently, adversely affect our business, financial condition and performance. For example, we place substantial reliance on real estate as collateral for our loan portfolio. A sharp downturn in real estate values in our market area could leave many of these loans inadequately collateralized. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, the impact on our results of operations could be materially adverse.

We depend on the accuracy and completeness of information about or from customers and counterparties.

In deciding whether to extend credit or enter into other transactions, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports, and other financial information. We may also rely on representations of those customers, counterparties, or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports, or other financial information could cause us to enter into unfavorable transactions, which could have a material adverse effect on our financial condition and results of operations.

We are subject to environmental liability risk associated with our lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage regardless of whether we knew, had reason to know of, or caused the release of such substance. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property s value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Our indirect lending involves risk elements in addition to normal credit risk.

A portion of our current lending involves the purchase of consumer automobile installment sales contracts from automobile dealers located in Western, Central and the Capital District of New York, and Northern Pennsylvania. These loans are for the purchase of new or used automobiles. We serve customers that cover a range of creditworthiness, and the required terms and rates are reflective of those risk profiles. While these loans have higher yields than many of our other loans, such loans involve risks elements in addition to normal credit risk. Potential risk elements associated with indirect lending include the limited personal contact with the borrower as a result of indirect lending through dealers, the absence of assured continued employment of the borrower, the varying general creditworthiness of the borrower, changes in the local economy, and difficulty in monitoring collateral. While indirect automobile loans are secured, such loans are secured by depreciating assets and characterized by LTV ratios that could result in us not recovering the full value of an outstanding loan upon default by the borrower. If the economic environment in our primary market area contracts, we may experience higher levels of delinquencies, charge-offs and repossessions.

We are highly regulated and may be adversely affected by changes in banking laws, regulations and regulatory practices.

We are subject to extensive supervision, regulation and examination. This regulatory structure gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies to address not only compliance with applicable laws and regulations (including laws and regulations governing consumer credit, and anti-money laundering and anti-terrorism laws), but also capital adequacy, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. As part of this regulatory structure, we are subject to policies and other guidance developed by the regulatory agencies with respect to capital levels, the timing and amount of dividend payments, the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Under this structure the regulatory agencies have broad discretion to impose restrictions and limitations on our operations if they determine, among other things, that our operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

This supervisory framework could materially impact the conduct, growth and profitability of our operations. Any failure on our part to comply with current laws, regulations, other regulatory requirements or safe and sound banking practices or concerns about our financial condition, or any related regulatory sanctions or adverse actions against us, could increase our costs or restrict our ability to expand our business and result in damage to our reputation.

The new Basel III Capital Standards may have an adverse effect on us.

In July 2013, the Federal Reserve Board released its final rules which will implement in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. Under the final rule, minimum requirements will increase for both the quality and quantity of capital held by banking organizations. Consistent with the international Basel framework, the rule includes a new minimum ratio of Common Equity Tier I Capital to Risk-Weighted Assets of 4.5% and a Common Equity Tier I Capital conservation buffer of 2.5% of risk-weighted assets that will apply to all supervised financial institutions. The rule also, among other things, raises the minimum ratio of Tier I Capital to Risk-Weighted Assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking organizations. We must begin transitioning to the new rules effective January 1, 2015. The impact of the new capital rules is likely to require us to maintain higher levels of capital, which will lower our return on equity.

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New regulations could adversely impact our earnings due to, among other things, increased compliance costs or costs due to noncompliance.

In March 2013, the Consumer Financial Protection Bureau (CFPB) issued supervisory guidance highlighting its concern that the practice of automotive dealers being compensated for arranging customer financing through discretionary markup of wholesale rates offered by financial institutions, such as us (dealer markup), results in a significant risk of pricing disparity in violation of The Equal Credit Opportunity Act (ECOA). The Consumer Financial Protection Bureau recommended that financial institutions under its jurisdiction take steps to ensure compliance with the ECOA, which may include imposing controls on dealer markup, monitoring and addressing the effects of dealer markup policies, and eliminating dealer discretion to markup buy rates and fairly compensating dealers using a different mechanism. In December 2013, the Consumer Financial Protection Bureau and the United States Department of Justice (the DOJ), based on a proxy methodology that combines geography-based and name-based probabilities, alleged that certain presumed-minority borrowers who had obtained automobile financing from a national lender were charged higher dealer markups as a result of such lender s policy and practice of allowing dealer markup. In connection with the investigation, the lender consented to the issuance of a consent order and agreed to pay damages, to implement a compliance plan, and to pay a monetary penalty. Additional investigations and actions by the Consumer Financial Protection Bureau and the DOJ against automotive lenders are likely to occur in the future. We have evaluated our indirect lending practices in light of these events and believe that we are currently conducting our indirect lending business in compliance with ECOA. However, any investigations or allegations of wrongdoing by the Consumer Financial Protection Bureau or DOJ against us could have material adverse impact on our indirect lending business, results of operations and financial condition.

The CFPB has issued a rule, effective as of January 10, 2014, designed to clarify for lenders how they can avoid monetary damages under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower s ability to repay a mortgage. Loans that satisfy this qualified mortgage safe-harbor will be presumed to have complied with the new ability-to-repay standard. Under the CFPB s rule, a qualified mortgage loan must not contain certain specified features, including but not limited to:

- excessive upfront points and fees (those exceeding 3% of the total loan amount, less bona fide discount points for prime loans);
- interest-only payments;
- negative-amortization; and
- terms longer than 30 years.

Also, to qualify as a qualified mortgage, a borrower s total monthly debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The CFPB s rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive and/or time consuming to make these loans, which could adversely impact our growth or profitability.

With the development of the CFPB, our consumer products and services are subject to increasing regulatory oversight and scrutiny with respect to compliance under consumer laws and regulations. We may face a greater number or wider scope of investigations, enforcement actions and litigation in the future related to consumer practices, thereby increasing costs associated with responding to or defending such actions. In addition, increased regulatory inquiries and investigations, as well as any additional legislative or regulatory developments affecting our consumer businesses, and any required changes to our business operations resulting from these developments, could result in significant loss of revenue, limit the products or services we offer, require us to increase our prices and therefore reduce demand for our products, impose additional compliance costs on us, cause harm to our reputation or otherwise adversely affect our consumer businesses.

New or changing tax, accounting, and regulatory rules and interpretations could significantly impact our strategic initiatives, results of operations, cash flows, and financial condition.

The financial services industry is extensively regulated. Federal and state banking regulations are designed primarily to protect the deposit insurance funds and consumers, not to benefit a company s stockholders. These regulations may sometimes impose significant limitations on operations. The significant federal and state banking regulations that affect us are described in the section captioned Supervision and Regulation included in Part I, Item 1, Business . These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies, and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies, and interpretations are constantly evolving and may change significantly over time.

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A breach in security of our or third party information systems, including the occurrence of a cyber incident or a deficiency in cybersecurity, may result in a loss of customer business or damage to our brand image.

We rely heavily on communications, information systems (both internal and provided by third parties) and the internet to conduct our business. Our business is dependent on our ability to process and monitor large numbers of daily transactions in compliance with legal, regulatory and internal standards and specifications. In addition, a significant portion of our operations relies heavily on the secure processing, storage and transmission of personal and confidential information, such as the personal information of our customers and clients. These risks may increase in the future as we continue to increase mobile payments and other internet-based product offerings and expand our internal usage of web-based products and applications.

While we have policies and procedures designed to prevent or limit the effect of a possible failure, interruption or breach of our information systems, there can be no assurance that such action will not occur or, if any does occur, that it will be adequately addressed. For example, although we maintain commercially reasonable measures to ensure the cybersecurity of our information systems, other financial service institutions and companies have reported breaches in the security of their websites or other systems. In addition, several U.S. financial institutions have recently experienced significant distributed denial-of-service attacks, some of which involved sophisticated and targeted attacks intended to disable or degrade service, or sabotage systems. Other potential attacks have attempted to obtain unauthorized access to confidential information or destroy data, often through the introduction of computer viruses or malware, cyber-attacks and other means. To date, none of these efforts has had a material effect on our business or operations. Such security attacks can originate from a wide variety of sources, including persons who are involved with organized crime or who may be linked to terrorist organizations or hostile foreign governments. Those same parties may also attempt to fraudulently induce employees, customers or other users of our systems to disclose sensitive information in order to gain access to our data or that of our customers or clients. We are also subject to the risk that our employees may intercept and transmit unauthorized confidential or proprietary information. An interception, misuse or mishandling of personal, confidential or proprietary information being sent to or received from a customer or third party could result in legal liability, remediation costs, regulatory action and reputational harm.

Third parties perform significant operational services on our behalf. These third-party vendors are subject to similar risks as us relating to cybersecurity, breakdowns or failures of their own systems or employees. One or more of our vendors may experience a cybersecurity event or operational disruption and, if any such event does occur, it may not be adequately addressed, either operationally or financially, by the third-party vendor. Certain of our vendors may have limited indemnification obligations or may not have the financial capacity to satisfy their indemnification obligations. Financial or operational difficulties of a vendor could also impair our operations if those difficulties interfere with the vendor s ability to serve us. If a critical vendor is unable to meet our needs in a timely manner or if the services or products provided by such a vendor are terminated or otherwise delayed and if we are not able to develop alternative sources for these services and products quickly and cost-effectively, it could have a material adverse effect on our business. Federal banking regulators recently issued regulatory guidance on how banks select, engage and manage their outside vendors. These regulations may affect the circumstances and conditions under which we work with third parties and the cost of managing such relationships.

We rely on other companies to provide key components of our business infrastructure.

Third party vendors provide key components of our business infrastructure such as internet connections, network access and core application processing. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including as a result of them not providing us their services for any reason or them performing their services poorly, could adversely affect our ability to deliver products and services to our customers or otherwise conduct our business efficiently and effectively. Replacing these third party vendors could also entail significant delay and expense.

We use financial models for business planning purposes that may not adequately predict future results.

We use financial models to aid in planning for various purposes including our capital and liquidity needs, interest rate risk, potential charge- offs, reserves, and other purposes. The models used may not accurately account for all variables that could affect future results, may fail to predict outcomes accurately and/or may overstate or understate certain effects. As a result of these potential failures, we may not adequately prepare for future events and may suffer losses or other setbacks due to these failures.

We may not be able to attract and retain skilled people and our ongoing leadership transition may be unsuccessful.

Our success depends, in large part, on our ability to attract and retain skilled people. Competition for the best people in most activities engaged in by us can be intense, and we may not be able to hire sufficiently skilled people or to retain them. Further, the rural location of our principal executive offices and many of our bank branches make it difficult for us to attract skilled people to such locations. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our markets, years of industry experience, and the difficulty of promptly finding qualified replacement personnel.

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Acquisitions may disrupt our business and dilute shareholder value.

A key component of our strategy to grow and improve profitability is to expand our branch network into communities within or adjacent to markets where we currently conduct business. We intend to continue to pursue a growth strategy for our business. As a result, negotiations may take place and future mergers or acquisitions involving cash, debt, or equity securities may occur at any time. We seek merger or acquisition partners that are culturally similar, have experienced management, and possess either significant market presence or have potential for improved profitability through financial management, economies of scale, or expanded services.

Acquiring other banks, businesses, or branches involves potential adverse impact to our financial results and various other risks commonly associated with acquisitions, including, among other things:

- difficulty in estimating the value of the target company;
- payment of a premium over book and market values that may dilute our tangible book value and earnings per share in the short and long term;
- potential exposure to unknown or contingent liabilities of the target company;
- exposure to potential asset quality issues of the target company;
- there may be volatility in reported income as goodwill impairment losses could occur irregularly and in varying amounts;
- challenge and expense of integrating the operations and personnel of the target company;
- inability to realize the expected revenue increases, cost savings, increases in geographic or product presence, and / or other projected benefits;
- potential disruption to our business;
- potential diversion of our management s time and attention;
- the possible loss of key employees and customers of the target company; and
- potential changes in banking or tax laws or regulations that may affect the target company.

We are subject to interest rate risk.

Our earnings and cash flows are largely dependent upon our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and investments and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits; (ii) the fair value of our financial assets and liabilities; and (iii) the average duration of our mortgage-backed securities portfolio and other interest-earning assets. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes we have implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on our results of operations, any substantial, unexpected or prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations. Also, our interest rate risk modeling techniques and assumptions likely may not fully predict or capture the impact of actual interest rate changes on our balance sheet.

Our business may be adversely affected by conditions in the financial markets and economic conditions generally.

From December 2007 through June 2009, the U.S. economy was in recession. Business activity across a wide range of industries and regions in the U.S. was greatly reduced. Although economic conditions have begun to improve, certain sectors, such as real estate, remain weak and unemployment remains high. Local governments and many businesses are still in serious difficulty due to lower consumer spending and reduced tax collections.

Market conditions also led to the failure or merger of several prominent financial institutions and numerous regional and community-based financial institutions. These failures had a significant negative impact on the capitalization level of the deposit insurance fund of the FDIC, which, in turn, has led to past increases in deposit insurance premiums paid by financial institutions.

Our financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services we offer, is highly dependent on the business environment in the markets where we operate, in the State of New York and in the United States as a whole. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, low unemployment, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment, natural disasters; or a combination of these or other factors.

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Our earnings are significantly affected by the fiscal and monetary policies of the federal government and its agencies.

The policies of the Federal Reserve impact us significantly. The Federal Reserve regulates the supply of money and credit in the United States. Its policies directly and indirectly influence the rate of interest earned on loans and paid on borrowings and interest-bearing deposits and can also affect the value of financial instruments we hold. Those policies determine to a significant extent our cost of funds for lending and investing. Changes in those policies are beyond our control and are difficult to predict. Federal Reserve policies can also affect our borrowers, potentially increasing the risk that they may fail to repay their loans. For example, a tightening of the money supply by the Federal Reserve could reduce the demand for a borrower s products and services. This could adversely affect the borrower s earnings and ability to repay its loan, which could have a material adverse effect on our financial condition and results of operations.

The soundness of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due us. Any such losses could have a material adverse effect on our financial condition and results of operations.

We may be required to recognize an impairment of goodwill.

Under current accounting standards, 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. Significant and sustained declines in our stock price and market capitalization, significant declines in our expected future cash flows, significant adverse changes in the business climate or slower growth rates could result in impairment of goodwill. During 2013, the annual impairment test performed as of September 30 indicated that the fair value of our single reporting unit exceeded the fair value of its assets and liabilities. In the event that we conclude that all or a portion of our goodwill may be impaired, a non-cash charge for the amount of such impairment would be recorded to earnings, which could have a material adverse impact on our results of operations or financial condition. Such a charge would have no impact on tangible capital. At December 31, 2013, we had goodwill of $48.5 million, representing approximately 19% of shareholders equity. For further discussion, see Note 1, Summary of Significant Accounting Policies, and Note 7, Goodwill and Other Intangible Assets, to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

We operate in a highly competitive industry and market area.

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional and internet banks within the various markets in which we operate. We also face competition from many other types of financial institutions, including, without limitation, savings and loan associations, credit unions, finance companies, brokerage firms, insurance companies and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting), and merchant banking. Also, technology has lowered barriers to entry and made it possible for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- the ability to expand our market position;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;
- customer satisfaction with our level of service; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

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Severe weather, natural disasters, acts of war or terrorism, and other external events could significantly impact our business.

Severe weather, natural disasters, acts of war or terrorism, and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue, and/or cause us to incur additional expenses. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Liquidity is essential to our businesses.

Our liquidity could be impaired by an inability to access the capital markets or unforeseen outflows of cash. This situation may arise due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects third parties or us. Our efforts to monitor and manage liquidity risk may not be successful or sufficient to deal with dramatic or unanticipated reductions in our liquidity. In such events, our cost of funds may increase, thereby reducing our net interest income, or we may need to sell a portion of our investment and/or loan portfolio, which, depending upon market conditions, could result in us realizing a loss.

We may need to raise additional capital in the future and such capital may not be available on acceptable terms or at all.

We may need to raise additional capital in the future to provide sufficient capital resources and liquidity to meet our commitments and business needs. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control, and our financial performance.

In addition, we are highly regulated, and our regulators could require us to raise additional common equity in the future. We and our regulators perform a variety of analyses of our assets, including the preparation of stress case scenarios, and as a result of those assessments we could determine, or our regulators could require us, to raise additional capital.

We cannot assure that such capital will be available on acceptable terms or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of debt purchasers, depositors of the Bank or counterparties participating in the capital markets, or a downgrade of our debt rating, may adversely affect our capital costs and ability to raise capital and, in turn, our liquidity. An inability to raise additional capital on acceptable terms when needed could have a material adverse impact on our business, financial condition, results of operations or liquidity.

We rely on dividends from our subsidiaries for most of our revenue.

We are a separate and distinct legal entity from our subsidiaries. A substantial portion of our revenue comes from dividends from our Bank subsidiary. These dividends are the principal source of funds we use to pay dividends on our common and preferred stock, and to pay interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that our Bank subsidiary may pay to us. Also, our right to participate in a distribution of assets upon a subsidiary s liquidation or reorganization is subject to the prior claims of the subsidiary s creditors. In the event our Bank subsidiary is unable to pay dividends to us, we may not be able to service debt, pay obligations, or pay dividends on our common and preferred stock. The inability to receive dividends from our Bank subsidiary could have a material adverse effect on our business, financial condition, and results of operations.

We may not pay dividends on our common stock.

Holders of our common stock are only entitled to receive such dividends as our Board of Directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and may reduce or eliminate our common stock dividend in the future. This could adversely affect the market price of our common stock.

We may issue debt and equity securities or securities convertible into equity securities, any of which may be senior to our common stock as to distributions and in liquidation, which could negatively affect the value of our common stock.

In the future, we may attempt to increase our capital resources by entering into debt or debt-like financing that is unsecured or secured by all or up to all of our assets, or by issuing additional debt or equity securities, which could include issuances of secured or unsecured commercial paper, medium-term notes, senior notes, subordinated notes, preferred stock or securities convertible into or exchangeable for equity securities. In the event of our liquidation, our lenders and holders of our debt and preferred securities would receive a distribution of our available assets before distributions to the holders of our common stock. Because our decision to incur debt and issue securities in our future offerings will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings and debt financings. Further, market conditions could require us to accept less favorable terms for the issuance of our securities in the future.

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The market price of our common stock may fluctuate significantly in response to a number of factors.

Our quarterly and annual operating results have varied in the past and could vary significantly in the future, which makes it difficult for us to predict our future operating results. Our operating results may fluctuate due to a variety of factors, many of which are outside of our control, including the changing U.S. economic environment and changes in the commercial and residential real estate market, any of which may cause our stock price to fluctuate. If our operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially. Our stock price can fluctuate significantly in response to a variety of factors including, among other things:

- volatility of stock market prices and volumes in general;
- changes in market valuations of similar companies;
- changes in conditions in credit markets;
- changes in accounting policies or procedures as required by the Financial Accounting Standards Board, or FASB, or other regulatory agencies;
- legislative and regulatory actions (including the impact of the Dodd-Frank Act and related regulations) subjecting us to additional regulatory oversight which may result in increased compliance costs and/or require us to change our business model;
- government intervention in the U.S. financial system and the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board;
- additions or departures of key members of management;
- fluctuations in our quarterly or annual operating results; and
- changes in analysts estimates of our financial performance.

Our certificate of incorporation, our bylaws, and certain banking laws may have an anti-takeover effect.

Provisions of our certificate of incorporation, our bylaws, and federal and state banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial to our shareholders. The combination of these provisions may discourage others from initiating a potential merger, takeover or other change of control transaction, which, in turn, could adversely affect the market price of our common stock.

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ITEM 1B. UNRESOLVED STAFF COMMENTS
None.

ITEM 2. PROPERTIES
We own a 27,400 square foot building in Warsaw, New York that serves as our headquarters, and principal executive and administrative offices. Additionally, we are obligated under a lease commitment through 2017 for a 22,200 square foot regional administrative facility in Pittsford, New York.

We are engaged in the banking business through 50 branch offices, of which 34 are owned and 16 are leased, in fifteen contiguous counties of Western and Central New York: Allegany, Cattaraugus, Cayuga, Chautauqua, Chemung, Erie, Genesee, Livingston, Monroe, Ontario, Orleans, Seneca, Steuben, Wyoming and Yates Counties. The operating leases for our branch offices expire at various dates through the year 2036 and generally include options to renew.

We believe that our properties have been adequately maintained, are in good operating condition and are suitable for our business as presently conducted, including meeting the prescribed security requirements. For additional information, see Note 6, Premises and Equipment, Net, and Note 10, Commitments and Contingencies, in the accompanying financial statements included in Part II, Item 8, of this Annual Report on Form 10-K.

ITEM 3. LEGAL PROCEEDINGS
From time to time we are a party to or otherwise involved in legal proceedings arising out of the normal course of business. Management does not believe that there is any pending or threatened proceeding against us, which, if determined adversely, would have a material adverse effect on our business, results of operations or financial condition.

ITEM 4. MINE SAFETY DISCLOSURES
Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the NASDAQ Global Select Market under the ticker symbol FISI. At December 31, 2013, 13,829,355 shares of our common stock were outstanding and held by approximately 2,000 shareholders of record. During 2013, the high sales price of our common stock was $26.59 and the low sales price was $17.92. The closing price per share of common stock on December 31, 2013, the last trading day of our fiscal year, was $24.71. We declared dividends of $0.74 per common share during the year ended December 31, 2013. See additional information regarding the market price and dividends paid in Part II, Item 6, Selected Financial Data .

We have paid regular quarterly cash dividends on our common stock and our Board of Directors presently intends to continue this practice, subject to our results of operations and the need for those funds for debt service and other purposes. See the discussions in the section captioned Supervision and Regulation included in Part I, Item 1, Business , in the section captioned Liquidity and Capital Resources included in Part II, Item 7, in Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 11, Regulatory Matters, in the accompanying financial statements included in Part II, Item 8, Financial Statements and Supplementary Data , all of which are included elsewhere in this report and incorporated herein by reference thereto.

Recent Sales of Unregistered Securities

We provide our directors who are not employees with a convenient way to purchase shares from us at fair market value. Each director may elect to receive half of their annual retainer in shares of our common stock on the date of our annual organizational meeting. Any portion of the annual retainer issued to our directors in the form of stock has historically been issued outside of our 2009 Directors Stock Incentive Plan (the DSIP) and without registration under the Securities Act of 1933 as amended (the Securities Act) in reliance on the exemption from registration pursuant to Section 4(a)(2) of the Securities Act based on our directors financial sophistication and knowledge of the Company. On May 8, 2013, we issued a total of 5,672 shares of our common stock as the stock component of our annual retainer to our non-employee directors without registration under the Securities Act. These shares of common stock are subject to the resale prohibition under the Securities Act and may not be sold or transferred without registration except in accordance with Rule 144 of the Securities Act.

Although any director retainer issued in the form of stock is issued outside of the DSIP, we still deduct these shares from the aggregate share limit under the DSIP. We expect that future director stock retainers will be issued pursuant to a shareholder approved plan and registered under the Securities Act.

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Stock Performance Graph

The stock performance graph below compares (a) the cumulative total return on our common stock for the period beginning December 31, 2008 as reported by the NASDAQ Global Select Market, through December 31, 2013, (b) the cumulative total return on stocks included in the NASDAQ Composite Index over the same period, and (c) the cumulative total return, as compiled by SNL Financial L.C., of Major Exchange (NYSE, NYSE MKT and NASDAQ) Banks with $1 billion to $5 billion in assets over the same period. Cumulative return assumes the reinvestment of dividends. The graph was prepared by SNL Financial, LC and is expressed in dollars based on an assumed investment of $100.

Total Return Performance

	Period Ending					
Index	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**	**12/31/12**	**12/31/13**
Financial Institutions, Inc.	100.00	85.77	141.45	123.93	147.89	203.38
NASDAQ Composite	100.00	145.36	171.74	170.38	200.63	281.22
SNL Bank $1B-$5B Index	100.00	71.68	81.25	74.10	91.37	132.87

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ITEM 6. SELECTED FINANCIAL DATA

ars in thousands, except selected ratios and per share data)	**At or for the year ended December 31,**				
	2013	**2012**	**2011**	**2010**	**2009**
ted financial condition data:					
assets	$ 2,928,636	$ 2,763,865	$ 2,336,353	$ 2,214,307	$ 2,062,3
s, net	1,806,883	1,681,012	1,461,516	1,325,524	1,243,2
tment securities	859,185	841,701	650,815	694,530	620,0
sits	2,320,056	2,261,794	1,931,599	1,882,890	1,742,9
owings	337,042	179,806	150,698	103,877	106,3
holders equity	254,839	253,897	237,194	212,144	198,2
mon shareholders equity (1)	237,497	236,426	219,721	158,359	144,8
ble common shareholders equity (2)	187,495	186,037	182,352	120,990	107,5
ted operations data:					
est income	$ 98,931	$ 97,567	$ 95,118	$ 96,509	$ 94,4
est expense	7,337	9,051	13,255	17,720	22,2
nterest income	91,594	88,516	81,863	78,789	72,2
sion for loan losses	9,079	7,128	7,780	6,687	7,7
nterest income after provision for loan losses	82,515	81,388	74,083	72,102	64,5
nterest income	24,833	24,777	23,925	19,454	18,7
nterest expense	69,441	71,397	63,794	60,917	62,7
ne before income taxes	37,907	34,768	34,214	30,639	20,5
ne tax expense	12,377	11,319	11,415	9,352	6,1
ncome	$ 25,530	$ 23,449	$ 22,799	$ 21,287	$ 14,4
rred stock dividends and accretion	1,466	1,474	3,182	3,725	3,6
ncome applicable to common shareholders	$ 24,064	$ 21,975	$ 19,617	$ 17,562	$ 10,7
and related per share data:					
ngs per common share:					
	$ 1.75	$ 1.60	$ 1.50	$ 1.62	$ 0.
ed	1.75	1.60	1.49	1.61	0.
dividends declared on common stock	0.74	0.57	0.47	0.40	0.
mon book value per share (1)	17.17	17.15	15.92	14.48	13.
ble common book value per share (2)	13.56	13.49	13.21	11.06	9.
et price (NASDAQ: FISI):					
	26.59	19.52	20.36	20.74	15.
	17.92	15.22	12.18	10.91	3.
	24.71	18.63	16.14	18.97	11.

rmance ratios:

ncome, returns on:					
age assets	0.91%	0.93%	1.00%	0.98%	0.
age equity	10.10	9.46	9.82	10.07	7.
age common equity (1)	10.23	9.53	9.47	11.14	7.
age tangible common equity (2)	13.00	11.74	11.55	14.59	10.
mon dividend payout ratio (3)	42.29	35.63	31.33	24.69	40.
nterest margin (fully tax-equivalent)	3.64	3.95	4.04	4.07	4.
ency ratio (4)	58.48%	62.87%	60.55%	60.36%	65.

(1) Excludes preferred shareholders equity.

(2) Excludes preferred shareholders equity, goodwill and other intangible assets.

(3) Common dividend payout ratio equals dividends declared during the year divided by earnings per share for the year.

(4) Efficiency ratio equals noninterest expense less other real estate expense and amortization of intangible assets as a percentage of net revenue, defined as the sum of tax-equivalent net interest income and noninterest income before net gains and impairment charges on investment securities and proceeds from company owned life insurance included in income (all from continuing operations).

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(Dollars in thousands, except per share data)	At or for the year ended December 31,				
	2013	**2012**	**2011**	**2010**	**2009**
Capital ratios:					
Leverage ratio	7.63%	7.71%	8.63%	8.31%	7.96%
Tier 1 capital ratio	10.82	10.73	12.20	12.34	11.95
Total risk-based capital ratio	12.08	11.98	13.45	13.60	13.21
Equity to assets (3)	9.01	9.84	10.20	9.75	9.55
Common equity to assets (1) (3)	8.39	9.15	9.10	7.28	6.94
Tangible common equity to tangible assets (2) (3)	6.72%	7.56%	7.58%	5.65%	5.19%
Asset quality:					
Non-performing loans	$ 16,622	$ 9,125	$ 7,076	$ 7,582	$ 8,681
Non-performing assets	17,083	10,062	9,187	8,895	10,442
Allowance for loan losses	26,736	24,714	23,260	20,466	20,741
Net loan charge-offs	$ 7,057	$ 5,674	$ 4,986	$ 6,962	$ 5,710
Non-performing loans to total loans	0.91%	0.53%	0.48%	0.56%	0.69%
Non-performing assets to total assets	0.58	0.36	0.39	0.40	0.51
Net charge-offs to average loans	0.40	0.36	0.36	0.54	0.47
Allowance for loan losses to total loans	1.46	1.45	1.57	1.52	1.64
Allowance for loan losses to non-performing loans	161%	271%	329%	270%	239%
Other data:					
Number of branches	50	52	50	50	50
Full time equivalent employees	608	628	575	577	572

(1) Excludes preferred shareholders equity.
(2) Excludes preferred shareholders equity, goodwill and other intangible assets.
(3) Ratios calculated using average balances for the periods shown.

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SELECTED QUARTERLY DATA

(Dollars in thousands, except per share data)	**Fourth Quarter**	**Third Quarter**	**Second Quarter**	**First Quarter**
2013				
Interest income	$ 25,218	24,623	24,342	24,748
Interest expense	1,838	1,820	1,818	1,861
Net interest income	23,380	22,803	22,524	22,887
Provision for loan losses	2,407	2,770	1,193	2,709
Net interest income, after provision for loan losses	20,973	20,033	21,331	20,178
Noninterest income	5,735	6,169	6,376	6,553
Noninterest expense	17,386	17,009	17,462	17,584
Income before income taxes	9,322	9,193	10,245	9,147
Income tax expense	2,955	3,029	3,395	2,998
Net income	$ 6,367	6,164	6,850	6,149
Preferred stock dividends	366	365	367	368
Net income applicable to common shareholders	$ 6,001	5,799	6,483	5,781
Earnings per common share (1):				
Basic	$ 0.44	0.42	0.47	0.42
Diluted	0.43	0.42	0.47	0.42
Market price (NASDAQ: FISI):				
High	$ 26.59	21.99	20.66	20.83
Low	20.14	18.39	17.92	18.51
Close	24.71	20.46	18.41	19.96
Dividends declared	$ 0.19	0.19	0.18	0.18
2012				
Interest income	$ 25,087	$ 25,299	$ 23,731	$ 23,450
Interest expense	1,999	2,200	2,343	2,509
Net interest income	23,088	23,099	21,388	20,941
Provision for loan losses	2,520	1,764	1,459	1,385
Net interest income, after provision for loan losses	20,568	21,335	19,929	19,556
Noninterest income	6,283	6,353	6,690	5,451
Noninterest expense	17,541	21,618	16,581	15,657
Income before income taxes	9,310	6,070	10,038	9,350
Income tax expense	2,978	1,805	3,382	3,154

Net income	$ 6,332	$ 4,265	$ 6,656	$ 6,196
Preferred stock dividends	369	368	368	369
Net income applicable to common shareholders	$ 5,963	$ 3,897	$ 6,288	$ 5,827
Earnings per common share [(1)]:				
Basic	$ 0.44	$ 0.28	$ 0.46	$ 0.43
Diluted	0.43	0.28	0.46	0.42
Market price (NASDAQ: FISI):				
High	$ 19.39	$ 19.52	$ 17.66	$ 17.99
Low	17.61	16.50	15.51	15.22
Close	18.63	18.64	16.88	16.17
Dividends declared	$ 0.16	$ 0.14	$ 0.14	$ 0.13

(1) Earnings per share data is computed independently for each of the quarters presented. Therefore, the sum of the quarterly earnings per common share amounts may not equal the total for the year.

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2013 FOURTH QUARTER RESULTS

Net income was $6.4 million for the fourth quarter of 2013 compared with $6.3 million for the fourth quarter of 2012. After preferred dividends, diluted earnings per share was $0.43 for the fourth quarters of 2013 and 2012.

Net interest income totaled $23.4 million for the three months ended December 31, 2013, an increase of $292 thousand or 1% over the fourth quarter of 2012. Average earning assets increased $243.7 million during the fourth quarter 2013 compared to the same quarter last year, the result of a $122.3 million increase in average loans combined with a $121.4 million increase in investment securities.

The net interest margin on a tax-equivalent basis was 3.61% in the fourth quarter of 2013, compared with 3.92% in the fourth quarter of 2012. Our yield on earning-assets decreased 37 basis points in the fourth quarter of 2013 compared with the same quarter last year, a result of cash flows being reinvested in the current low interest rate environment, which includes the impact of our leverage strategy implemented during the first quarter of 2013. The cost of interest-bearing liabilities decreased 7 basis points compared with the fourth quarter of 2012, primarily a result of the continued downward re-pricing of our certificates of deposit.

The provision for loan losses was $2.4 million for the fourth quarter of 2013 compared with $2.5 million for the fourth quarter of 2012. Net charge-offs for the fourth quarter of 2013 were $2.4 million, or 0.52% annualized, of average loans, compared to $2.1 million, or 0.50% annualized, of average loans in the fourth quarter of 2012. See the sections Allowance for Loan Losses and Non-performing Assets and Potential Problem Loans for additional information on net charge-offs and non-performing loans.

Noninterest income totaled $5.7 million for the fourth quarter of 2013, a 9% decrease over the fourth quarter of 2012. Decreases in net gain on loans held for sale and net gains from the sale of investment securities were partially offset by an increase in other income and lower losses attributed to the sale of other assets when comparing the fourth quarter 2013 compared with the same quarter last year.

Noninterest expense was $17.4 million for the fourth quarter of 2013, a decrease of $155 thousand or 1% from the fourth quarter of 2012. Lower salaries and employee benefits expense, computer and data processing and advertising and promotions expense was partially offset by increases in occupancy and equipment expense and professional services expense when comparing the fourth quarter 2013 compared with the same quarter last year.

Income tax expense was $3.0 million for the fourth quarters of 2013 and 2012, as pre-tax income was essentially unchanged between the periods.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of our financial position and results of operations and should be read in conjunction with the information set forth under Part I, Item 1A, Risks Factors , and our consolidated financial statements and notes thereto appearing under Part II, Item 8, Financial Statements and Supplementary Data of this Annual Report on Form 10-K.

INTRODUCTION

Financial Institutions, Inc. is a financial holding company headquartered in New York State, providing banking and nonbanking financial services to individuals and businesses primarily in our Western and Central New York footprint. We have also expanded our indirect lending network to include relationships with franchised automobile dealers in the Capital District of New York and Northern Pennsylvania. Through our wholly-owned banking subsidiary, Five Star Bank, we offer a wide range of services, including business and consumer loan and depository services, brokerage and investment advisory services, as well as other financial services and traditional banking services.

Our primary sources of revenue are net interest income (interest earned on our loans and securities, net of interest paid on deposits and other funding sources) and noninterest income, particularly fees and other revenue from financial services provided to customers or ancillary services tied to loans and deposits. Business volumes and pricing drive revenue potential, and tend to be influenced by overall economic factors, including market interest rates, business spending, consumer confidence, economic growth, and competitive conditions within the marketplace. We are not able to predict market interest rate fluctuations with certainty and our asset/liability management strategy may not prevent interest rate changes from having a material adverse effect on our results of operations and financial condition.

EXECUTIVE OVERVIEW

Industry Overview

In December 2013, the Federal Open Market Committee of the Federal Reserve Board (FOMC) kept the target range for federal funds rate at 0-25 basis points noting that a highly accommodative stance of monetary policy will remain appropriate after the economy strengthens to support maximum employment and price stability. The FOMC expects to maintain the target federal funds rate at 0-25 basis points for at least as long as the unemployment rate remains above 6.5%, inflation projections are no more than 0.5% above the FOMCs 2% long-run goal and longer-term inflation expectations continue to be well-anchored. The FOMC also announced that due to cumulative progress toward maximum employment and the improvement in the labor market outlook, it will reduce the purchase of agency mortgage-backed securities to $35 billion per month, down from the previous pace of $40 billion per month. The FOMC will also reduce the purchase of longer-term Treasury securities from its previous pace of $45 billion per month to $40 billion per month. These actions are intended to lower longer-term interest rates and support the mortgage and credit markets, among other things.

The actions by the FOMC have compressed net interest income and net interest margins for the banking industry by maintaining low rates on interest-earning assets. Throughout 2013, margins in the banking industry were pressured downward as higher-yielding legacy assets rolled off and were reinvested in the current low rate environment. Low interest rates, coupled with a competitive lending environment, have proven challenging for the profitability of the banking industry. It is expected that these challenges will continue until interest rates rise.

Although the expectation for capital spending increased during 2013, it is significantly lower than the pre-recession pace of 2006-2007. Reduced capital spending has resulted in record levels of deposits and tempered small businesses demand for loans. The high level of liquidity from the amount of deposits has exacerbated the pressure on net interest margins in the banking industry, as banks are challenged to deploy the excess liquidity at profitable spreads.

The banking industry continues to be impacted by new legislative and regulatory reform proposals. In July 2013, the Board of Governors of the Federal Reserve Bank, the FDIC, and the Office of the Comptroller of the Currency (OCC) approved the final U.S. version of the Basel III agreement. Basel III replaces the federal banking agencies general risk-based capital rules, includes a narrower definition of capital and requires higher minimum capital levels. Basel III will be effective for us in 2015. In December 2013, the federal banking agencies also adopted final rules implementing a provision of the Dodd-Frank Act known as the Volcker Rule, a complex regulation that prohibits banks from engaging in proprietary trading and investments in certain asset classes. Upon initial issuance, a significant unintended consequence emerged, as banks faced impairments on certain investments that were no longer allowed to be held. While the federal banking agencies issued additional guidance in January 2014 allowing banks to retain certain investments that were originally prohibited by the Volcker Rule, it underscored the complexity of the Rule and the potential ramifications to the industry. A comprehensive discussion of legislative and regulatory matters affecting us can be found in the Supervision and Regulation section included in Part 1, Item 1, of this Annual Report on Form 10-K.

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MANAGEMENT S DISCUSSION AND ANALYSIS

2013 Financial Performance Review

During 2013 we continued to strengthen our balance sheet, as measured by ongoing deposit growth and quality loan growth in commercial and consumer indirect lending. Our deposit and lending growth is the result of our execution on key strategic initiatives over the last few years. We have done all of this while controlling expenses through disciplined expense management.

In 2013, we reported net income of $25.5 million compared to $23.4 million for 2012. This resulted in a 0.91% return on average assets and a 13.00% return on average tangible common equity. Net income available to common shareholders was $24.1 million or $1.75 per diluted share for 2013, compared to $22.0 million or $1.60 per diluted common share for 2012. We declared cash dividends of $0.74 during 2013, an increase of $0.17 per common share or 30% compared to the prior year. In addition, we grew our base of consumer and business customers while our efficiency ratio improved to 58.48% in 2013 from 62.87% in 2012.

Fully-taxable equivalent net interest income was $94.2 million in 2013, an increase of $3.4 million, or 4%, compared with 2012. This reflected the impact of 19% growth in average investment securities and 10% average loan growth, offset by a 31 basis point decline in the net interest margin to 3.64%. The loan growth reflected a 7% increase in average commercial loans, an 18% increase in average home equities and a 13% increase in average automobile loans.

Noninterest income was $24.8 million in 2013, relatively unchanged from the prior year. Service charges on deposits increased $1.3 million and ATM and debit card income increased $382 thousand in 2013, reflecting volume growth resulting from the 2012 branch acquisitions and changes we made in the second quarter of 2013 to our fee waiver process. An increase in sales volume primarily contributed to a $241 thousand increase in investment advisory income in 2013. Mortgage banking income was down $1.4 million due to a reduction in volume, lower gains on sale, and a higher percentage of originations retained on our balance sheet.

Noninterest expense was $69.4 million in 2013, a 3% decrease compared with 2012. Noninterest expense for 2012 included expenses totaling $3.0 million related to the 2012 branch acquisitions and $2.6 million related to the retirement of our former CEO. These expenses were included in salaries and employee benefits ($2.9 million), occupancy and equipment ($56 thousand), professional services ($1.1 million), computer and data processing ($480 thousand), supplies and postage ($395 thousand), advertising and promotions ($56 thousand) and other expense ($591 thousand) for 2012. Excluding these expenses, which we consider to be non-recurring in nature, noninterest expense increased $3.6 million or 5% when comparing 2013 to 2012.

Asset quality related metrics remain strong despite the increase in nonaccrual and non-performing assets in 2013. Nonaccrual loans increased $7.5 million compared to a year ago to $16.6 million. Non-performing assets increased $7.0 million compared to a year ago to $17.1 million, or 0.58% of total assets. The increases primarily reflect the addition of one commercial mortgage loan with a principal balance of $6.9 million at December 31, 2013. The provision for loan losses increased $2.0 million, or 27%, from 2012 as we continue to maintain the allowance for loan losses consistent with the growth in our loan portfolio and trends in asset quality. Net charge-offs increased $1.4 million, or 24%, from the prior year to $7.1 million. Net charge-offs were an annualized 0.40% of average loans in the current year compared to 0.36% in 2012.

The tangible common equity to tangible assets ratio at December 31, 2013, was 6.51%, down 35 basis points from a year ago. Our leverage ratio at year end was 7.63%, down from 7.71% at the end of 2012. The decrease in the tangible common equity to tangible assets and leverage ratios reflect our asset growth outpacing the increase in retained earnings. Our tier 1 and total risk-based capital ratios were 10.82% and 12.08%, respectively, at December 31, 2013, up from 10.73% and 11.98%, respectively, at December 31, 2012.

Branch Consolidations

In October 2013, we closed our Pavilion and North Java branches and transferred customer accounts and employees into nearby branches. These branch consolidations are one component of our long term strategic plan, which provides for the optimal combination of branches and online/mobile banking technologies, supported by highly experienced bankers, to offer customers convenience and high service levels while maintaining an efficient, competitive cost structure. Expenses related to the consolidation of these two branches were not material. In January 2014, we consolidated one of our supermarket branches into a nearby location in Batavia.

Dissolution of Broker-Dealer

During late 2013, our subsidiary, Five Star Investment Services, Inc. (FSIS) ceased operations as an active broker-dealer and the securities licenses of advisors associated with FSIS who elected to transfer, as well as their respective client accounts which had previously cleared through a third-party platform, were transferred to the LPL Financial (LPL) clearing platform. Following the completion of these transfer activities, FSB began offering investment and securities-related services, including brokerage and investment advice through a strategic partnership with LPL. FSB has employees who are LPL registered representatives, located throughout its branch network, offering customers insurance and investment products including stocks, bonds, mutual funds, annuities, and managed accounts through a program called Five Star Investment Services. FSIS withdrew its registration with the Financial Industry Regulatory Authority (FINRA) effective December 31, 2013, and is expected to be dissolved in 2014.

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MANAGEMENT S DISCUSSION AND ANALYSIS

2012 Branch Acquisitions

During 2012, we successfully completed the acquisition of eight retail bank branch locations in Upstate New York. Former HSBC Bank USA, N.A. branches located in Albion, Elmira, Elmira Heights, and Horseheads were acquired in August, complementing the former First Niagara Bank, N.A. locations in Batavia, Brockport, Medina, and Seneca Falls acquired in June. Through the acquisition we assumed deposits of $286.8 million and acquired in-market performing loans of $75.6 million. The acquisition of these branch offices was a marked success. We were able to integrate the offices and customer accounts seamlessly. Through detailed planning, we ensured that our sales and support staff members were ready to assist customers with any questions or issues. The feedback we received from our customers was positive and executing on our detailed planning process ultimately resulted in deposit retention rates that were better than expected. We incurred approximately $3.0 million in pre-tax expense during 2012 related to the branch acquisitions.

The combined assets acquired and deposits assumed in the two transactions were recorded at their estimated fair values as follows:

Cash	$ 195,778
Loans	75,635
Bank premises and equipment	1,938
Goodwill	11,167
Core deposit intangible asset	2,042
Other assets	601
Total assets acquired	$ 287,161
Deposits assumed	$ 286,819
Other liabilities	342
Total liabilities assumed	$ 287,161

For detailed information on the accounting for the branch acquisitions, see Note 2, Branch Acquisitions, of the notes to consolidated financial statements.

2014 Expectations

Net interest income is expected to increase moderately in 2014. We anticipate an increase in earning assets as we remained focused on loan growth, which will be partly funded with expected paydowns and liquidity from our securities portfolio. However, those benefits to net interest income are expected to be partially offset by continued downward pressure on net interest margin. We plan to maintain a disciplined approach to loan pricing, but asset yields remain under pressure due to the low interest rate environment, while the opportunity for deposit repricing is limited.

The commercial loan portfolio is expected to grow consistent with our strategic initiatives and continued support of middle market lending. Automobile loan originations remain strong, reflecting the positive impact from our investment in automotive dealer relationships. The home equity portfolio is expected to increase as the lower origination cost to customers and the convenient application process has made these products an increasingly attractive alternative to conventional residential mortgage loans, accordingly we expect run-off to outpace new originations in the residential mortgage portfolio.

We anticipate the increase in total loans will modestly outpace growth in total deposits. This reflects our continued focus on the overall cost of funds, through the use of short-term borrowings as well as the continued shift towards low- and no-cost demand deposits and money market deposit accounts.

Noninterest income is expected to be slightly higher than recent levels, reflecting our continued efforts to increase both account and transaction-based fee income. Management will continue to explore opportunities to increase noninterest income from non-deposit related sources.

Noninterest expense is expected to remain around current levels as we remain committed to diligent expense control during 2014.

We do not expect significant changes in overall asset quality and allowance measurements.

The effective tax rate for 2014 is expected to be lower, primarily reflecting the impacts of tax-exempt income, tax advantaged investments, and the formation of our real estate investment trust in early 2014.

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MANAGEMENT S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS FOR THE YEARS ENDED

DECEMBER 31, 2013 AND DECEMBER 31, 2012

Significant Items Influencing Financial Performance Comparisons

Earnings comparisons among the years ended December 31, 2013 and 2012 were impacted by the significant items summarized below.

Retirement of Former CEO. In August 2012, Peter G. Humphrey our former President and Chief Executive Officer retired. We incurred approximately $2.6 million in pre-tax expense during 2012 related to the retirement of Mr. Humphrey.

2012 Branch Acquisitions. During 2012, we completed the acquisition of eight retail bank branch locations in Upstate New York. We incurred approximately $3.0 million in pre-tax expense during 2012 related to the branch acquisitions.

Net Interest Income and Net Interest Margin

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

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

The following table reconciles interest income per the consolidated statements of income to interest income adjusted to a fully taxable equivalent basis for the years ended December 31 (in thousands):

	2013	2012	2011
Interest income per consolidated statements of income	$ 98,931	$ 97,567	$ 95,118

Adjustment to fully taxable equivalent basis	2,650	2,284	2,062
Interest income adjusted to a fully taxable equivalent basis	101,581	99,851	97,180
Interest expense per consolidated statement of income	7,337	9,051	13,255
Net interest income on a taxable equivalent basis	$ 94,244	$ 90,800	$ 83,925

2013 Leverage Strategy

During the first quarter of 2013, we utilized the proceeds of short-term FHLB advances to purchase high-quality investment securities as part of a leverage strategy of approximately $100 million. Our purchase of investment securities was comprised of mortgage-backed securities, U.S. Government agencies and sponsored enterprise bonds and tax-exempt municipal bonds. All of the securities purchased were of high credit quality with a low to moderate duration. This strategy allowed us to increase net interest income by taking advantage of the positive interest rate spread between the FHLB advances and the newly acquired investment securities. While the underlying leverage strategy contributed to a lower net interest margin, it successfully increased net interest income by approximately $1.1 million for the year ended December 31, 2013.

Taxable equivalent net interest income of $94.2 million for 2013 was $3.4 million or 4% higher than 2012. The impact of a decline in average yields on our assets was diminished by a $288.7 million or 13% increase in interest-earning assets. The average balance of loans rose $158.1 million or 10% to $1.75 billion, reflecting growth in most loan categories. Consistent with our strategic plan, we continue to pursue loan development efforts in the commercial and consumer indirect lending portfolios in accordance with prudent underwriting standards.

MANAGEMENT S DISCUSSION AND ANALYSIS

The increase in taxable equivalent net interest income was a function of a favorable volume variance as balance sheet changes in both volume and mix increased taxable equivalent net interest income by $10.8 million, partially offset by an unfavorable rate variance that decreased taxable equivalent net interest income by $7.4 million. The change in mix and volume of earning assets increased taxable equivalent interest income by $10.8 million, while the change in volume and composition of interest-bearing liabilities decreased interest expense by $70 thousand, for a net favorable volume impact of $10.8 million on taxable equivalent net interest income. Rate changes on earning assets reduced interest income by $9.0 million, while changes in rates on interest-bearing liabilities lowered interest expense by $1.6 million, for a net unfavorable rate impact of $7.4 million.

The net interest margin for 2013 was 3.64% compared to 3.95% in 2012. As discussed in the industry overview above, the actions by the FOMC have compressed net interest income and net interest margins for the banking industry by maintaining low rates on interest-earning assets. Throughout 2013, margins in the banking industry were pressured downward as higher-yielding legacy assets rolled off and were reinvested in the current low rate environment. Low interest rates, coupled with a competitive lending environment, have proven challenging for the profitability of the banking industry. It is expected that these challenges will continue until interest rates rise.

The decrease in net interest margin was attributable to a 3 basis point lower contribution from net free funds (primarily attributable to lower rates on interest-bearing liabilities reducing the value of noninterest-bearing deposits and other net free funds). The interest rate spread decreased by 28 basis points to 3.57% for the year ended December 31, 2013, as a 42 basis point decrease in the yield on earning assets more than offset the 14 basis point decrease in the cost of interest-bearing liabilities.

For 2013, the yield on average earning assets of 3.93% was 42 basis points lower than 2012. Loan yields decreased 44 basis points to 4.65%. Commercial mortgage and consumer indirect loans in particular, down 45 and 66 basis points, respectively, continued to experience lower yields given the competitive pricing pressures and re-pricing of loans in a low interest rate environment. The yield on investment securities dropped 25 basis points to 2.41%, also impacted by the low interest rate environment, prepayments of mortgage-related investment securities and the previously mentioned 2013 leverage strategy. Overall, earning asset rate changes reduced interest income by $9.0 million.

The average cost of interest-bearing deposits was 0.36% in 2013, 14 basis points lower than 2012, reflecting the low interest rate environment, mitigated by a focus on product pricing to retain balances. The cost of borrowings decreased 9 basis points to 0.39% for 2013. The interest-bearing liability rate changes reduced interest expense by $1.6 million during 2013.

Average interest-earning assets of $2.59 billion in 2013 were $288.7 million or 13% higher than 2012. Average investment securities increased $130.6 million while average loans increased $158.1 million or 10%. The growth in average loans was comprised of increases in most loan categories, with consumer and commercial loans up $116.9 million and $45.2 million, respectively, partially offset by a $4.1 million decrease in residential mortgage loans.

Average interest-bearing liabilities of $2.03 billion in 2013 were up $203.0 million or 11% versus 2012. On average, interest-bearing deposits grew $134.5 million, while average noninterest-bearing demand deposits (a principal component of net free funds) increased by $79.1 million. The increase in average deposits reflects the full-year impact of the deposits acquired in the 2012 branch acquisitions. Average borrowings increased $68.6 million, largely due to the incremental borrowings associated with the previously mentioned 2013 leverage strategy.

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MANAGEMENT S DISCUSSION AND ANALYSIS

The following tables present, for the periods indicated, information regarding: (i) the average balance sheet; (ii) the amount of interest income from interest-earning assets and the resulting annualized yields (tax-exempt yields have been adjusted to a tax-equivalent basis using the applicable Federal tax rate in each year); (iii) the amount of interest expense on interest-bearing liabilities and the resulting annualized rates; (iv) net interest income; (v) net interest rate spread; (vi) net interest income as a percentage of average interest-earning assets (net interest margin); and (vii) the ratio of average interest-earning assets to average interest-bearing liabilities. Investment securities are at amortized cost for both held to maturity and available for sale securities. Loans include net unearned income, net deferred loan fees and costs and non-accruing loans. Dollar amounts are shown in thousands.

	Years ended December 31,								
	2013			2012			2011		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Interest-earning assets:									
Federal funds sold and other interest-earning deposits	$ 191	$	0.19%	$ 113	$	0.29%	$ 140	$	0.20%
Investment securities:									
Taxable	601,146	12,541	2.09	525,912	12,202	2.32	545,112	14,185	2.60
Tax-exempt	233,067	7,572	3.25	177,731	6,526	3.67	140,657	5,890	4.19
Total investment securities	834,213	20,113	2.41	703,643	18,728	2.66	685,769	20,075	2.93
Loans:									
Commercial business	256,236	11,311	4.41	242,100	11,263	4.65	215,598	10,311	4.78
Commercial mortgage	438,821	21,878	4.99	407,737	22,182	5.44	370,843	21,216	5.72
Residential mortgage	123,277	6,174	5.01	127,363	6,637	5.21	121,742	6,868	5.64
Home equity	304,868	12,446	4.08	257,537	10,984	4.27	216,428	9,572	4.42
Consumer indirect	604,148	26,976	4.47	533,589	27,371	5.13	444,527	26,549	5.97
Other consumer	24,089	2,683	11.14	25,058	2,686	10.72	24,686	2,589	10.49
Total loans	1,751,439	81,468	4.65	1,593,384	81,123	5.09	1,393,824	77,105	5.53
Total interest-earning assets	2,585,843	101,581	3.93	2,297,140	99,851	4.35	2,079,733	97,180	4.67

Less: Allowance for loan losses	26,000			24,305			21,567		
Other noninterest-earning assets	243,982			246,423			218,983		
Total assets	$ 2,803,825			$ 2,519,258			$ 2,277,149		
Interest-bearing liabilities:									
Deposits:									
Interest-bearing demand	$ 488,047	729	0.15	$ 423,096	598	0.14	$ 383,122	614	0.16
Savings and money market	727,737	978	0.13	586,329	998	0.17	451,030	1,056	0.23
Certificates of deposit	621,455	4,893	0.79	693,353	6,866	0.99	712,411	9,764	1.37
Total interest-bearing deposits	1,837,239	6,600	0.36	1,702,778	8,462	0.50	1,546,563	11,434	0.74
Short-term borrowings	190,310	737	0.39	121,735	589	0.48	99,122	500	0.50
Long-term borrowings							15,905	1,321	8.31
Total borrowings	190,310	737	0.39	121,735	589	0.48	115,027	1,821	1.58
Total interest-bearing liabilities	2,027,549	7,337	0.36	1,824,513	9,051	0.50	1,661,590	13,255	0.80
Noninterest-bearing deposits	509,383			430,240			368,268		
Other liabilities	14,207			16,506			15,041		
Shareholders equity	252,686			247,999			232,250		
Total liabilities and shareholders equity	$ 2,803,825			$ 2,519,258			$ 2,277,149		
Net interest income (tax-equivalent)		$ 94,244			$ 90,800			$ 83,925	
Interest rate spread			3.57%			3.85%			3.87%
Net earning assets	$ 558,294			$ 472,627			$ 418,143		
Net interest margin (tax-equivalent)			3.64%			3.95%			4.04%

Ratio of average interest-earning assets to average interest-bearing liabilities	127.54%	125.90%	125.17%

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MANAGEMENT S DISCUSSION AND ANALYSIS

Rate /Volume Analysis

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

	Change from 2013 to 2012			Change from 2012 to 2011		
Increase (decrease) in:	**Volume**	**Rate**	**Total**	**Volume**	**Rate**	**Total**
Interest income:						
Federal funds sold and other interest-earning deposits	$	$	$	$	$	$
Investment securities:						
Taxable	1,643	(1,304)	339	(487)	(1,496)	(1,983)
Tax-exempt	1,861	(815)	1,046	1,422	(786)	636
Total investment securities	3,504	(2,119)	1,385	935	(2,282)	(1,347)
Loans:						
Commercial business	640	(592)	48	1,239	(287)	952
Commercial mortgage	1,624	(1,928)	(304)	2,041	(1,075)	966
Residential mortgage	(209)	(254)	(463)	308	(539)	(231)
Home equity	1,948	(486)	1,462	1,763	(351)	1,412
Consumer indirect	3,383	(3,778)	(395)	4,879	(4,057)	822
Other consumer	(106)	103	(3)	39	58	97
Total loans	7,280	(6,935)	345	10,269	(6,251)	4,018
Total interest income	**10,784**	**(9,054)**	**1,730**	**11,204**	**(8,533)**	**2,671**
Interest expense:						
Deposits:						
Interest-bearing demand	96	35	131	60	(76)	(16)
Savings and money market	214	(234)	(20)	271	(329)	(58)
Certificates of deposit	(663)	(1,310)	(1,973)	(255)	(2,643)	(2,898)
Total interest-bearing deposits	(353)	(1,509)	(1,862)	76	(3,048)	(2,972)
Short-term borrowings	283	(135)	148	110	(21)	89
Long-term borrowings				(660)	(661)	(1,321)
Total borrowings	283	(135)	148	(550)	(682)	(1,232)
Total interest expense	**(70)**	**(1,644)**	**(1,714)**	**(474)**	**(3,730)**	**(4,204)**

Net interest income	**$ 10,854**	**$ (7,410)**	**$ 3,444**	**$ 11,678**	**$ (4,803)**	**$ 6,875**

Provision for Loan Losses

The provision for loan losses is based upon credit loss experience, growth or contraction of specific segments of the loan portfolio, and the estimate of losses inherent in the current loan portfolio. The provision for loan losses was $9.1 million for the year ended December 31, 2013 compared with $7.1 million for 2012. See the Allowance for Loan Losses section of this Management s Discussion and Analysis for further discussion.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Noninterest Income

The following table summarizes our noninterest income for the years ended December 31 (in thousands):

	2013	2012	2011
Service charges on deposits	$ 9,948	8,627	8,679
ATM and debit card	5,098	4,716	4,359
Investment advisory	2,345	2,104	1,829
Company owned life insurance	1,706	1,751	1,424
Loan servicing	570	617	835
Net gain on sale of loans held for sale	117	1,421	880
Net gain on disposal of investment securities	1,226	2,651	3,003
Impairment charges on investment securities		(91)	(18)
Net (loss) gain on sale and disposal of other assets	(103)	(381)	67
Other	3,926	3,362	2,867
Total noninterest income	$ 24,833	24,777	23,925

Service charges on deposits were $9.9 million for 2013, an increase of $1.3 million or 15%, compared to 2012. ATM and debit card income was $5.1 million for 2013, an increase of $382 thousand or 8%, compared to 2012. These increases reflect volume related growth in fees resulting from the 2012 branch acquisitions coupled with the second quarter 2013 retail checking account repositioning that involved simplifying the suite of products offered to customers and modifications to the fee structure for our accounts. Our fee waiver process was also reevaluated, which resulted in a reduction in the number of fee waivers and an increase in service charges.

Management continues to focus on diversifying its sources of revenue to further reduce our reliance on traditional spread-based interest income, as fee-based activities are a relatively stable revenue source during periods of changing interest rates.

Investment advisory income was $2.3 million for 2013, up $240 thousand or 11%, compared to 2012, as fees and commissions fluctuate with sales volume, which increased during 2013 as a result of favorable market conditions and new business opportunities.

Loan servicing income represents fees earned primarily for servicing mortgage loans sold to third parties, net of amortization expense and impairment losses, if any, associated with capitalized loan servicing assets. Loan servicing income was $570 thousand in 2013, down $47 thousand or 8%, compared to 2012. The decrease was a result of more rapid amortization of servicing rights due to loans paying off and lower fees collected due to a decrease in the sold and serviced portfolio partially offset by adjustments to the valuation allowance for capitalized mortgage servicing assets.

Gains from the sale of loans held for sale decreased $1.3 million in 2013 compared to 2012. The decrease was primarily due to a reduction in origination volume and margins resulting from higher interest rates in addition to a higher percentage of originations held on the balance sheet.

Net gains from the sales of investment securities were $1.2 million for the year ended December 31, 2013, compared to $2.7 million for the year ended December 31, 2012. During 2013, we recognized gains totaling $1.2 million from the sale of four pooled trust-preferred securities. Net gains for 2012 included $2.6 million from the sale of five pooled trust-preferred securities. The amount and timing of our sale of investments securities is dependent on a number of factors, including our prudent efforts to realize gains while managing duration, premium and credit risk.

Other noninterest income increased $564 thousand or 17% for the year ended December 31, 2013, compared to 2012. Merchant services income, rental income and income from our investment in several limited partnerships comprised the majority of the year-over-year increase.

MANAGEMENT S DISCUSSION AND ANALYSIS

Noninterest Expense

The following table summarizes our noninterest expense for the years ended December 31 (in thousands):

	2013	2012	2011
Salaries and employee benefits	$ 37,828	40,127	35,743
Occupancy and equipment	12,366	11,419	10,868
Professional services	3,836	4,133	2,617
Computer and data processing	2,848	3,271	2,437
Supplies and postage	2,342	2,497	1,778
FDIC assessments	1,464	1,300	1,513
Advertising and promotions	896	929	1,259
Loss on extinguishment of debt			1,083
Other	7,861	7,721	6,496
Total noninterest expense	$ 69,441	71,397	63,794

Salaries and employee benefits decreased $2.3 million or 6% when comparing 2013 to 2012. Included in salaries and employee benefits for the year ended December 31, 2012 are pre-tax costs of approximately $2.9 million that were incurred in association with the 2012 branch acquisitions and retirement of our former CEO. After adjusting for these expenses, the increase in salaries and employee benefits for 2013 when compared to the prior year is primarily attributable to annual merit increases. The number of full time equivalent employees decreased to 608 at December 31, 2013 from 628 at December 31, 2012.

Occupancy and equipment increased by $947 thousand or 8% when comparing 2013 to 2012. The increase was primarily related to the growth in the branch network related to the branch acquisitions combined with increased snow removal costs.

Professional services expense of $3.8 million in 2013 decreased $297 thousand or 7% from 2012. Excluding the expenses related to the 2012 branch acquisitions, the increase in professional fees was due in part to executive management transitions and other corporate governance initiatives.

Computer and data processing and supplies and postage expense decreased, collectively, by $578 thousand when comparing 2013 to 2012. Excluding the expenses related to the 2012 branch acquisitions, the increase was primarily due to higher printing costs resulting from the previously mentioned retail checking account repositioning.

FDIC assessments increased $164 thousand or 13% for the year ended December 31, 2013, compared to 2012. The increased assessments are a direct result of the growth in our balance sheet.

The efficiency ratio for the year ended December 31, 2013 was 58.48% compared with 62.87% for 2012. The 2012 efficiency ratio was elevated as a result of the aforementioned expenses associated with our 2012 branch acquisitions and the retirement of our former CEO. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same volume of income, while a decrease would indicate a more efficient allocation of resources.

Income Taxes

We recognized income tax expense of $12.4 million for 2013 compared to $11.3 million for 2012. The higher tax provision was primarily attributable to a $3.1 million increase in in pre-tax income when comparing 2013 to 2012. Our effective tax rate was 32.7% for 2013 compared to 32.6% for 2012. Effective tax rates are impacted by items of income and expense that are not subject to federal or state taxation. Our effective tax rates reflect the impact of these items, which include, but are not limited to, interest income from tax-exempt securities and earnings on company owned life insurance.

MANAGEMENT S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS FOR THE YEARS ENDED

DECEMBER 31, 2012 AND DECEMBER 31, 2011

Net Interest Income and Net Interest Margin

Net interest income was $88.5 million in 2012, compared to $81.9 million in 2011. The taxable equivalent adjustments of $2.3 million and $2.0 million for 2012 and 2011, respectively, resulted in fully taxable equivalent net interest income of $90.8 million in 2012 and $83.9 million in 2011.

Taxable equivalent net interest income of $90.8 million for 2012 was $6.9 million or 8% higher than 2011. The impact of a decline in average yields on our assets was diminished by a $217.4 million or 10% increase in interest-earning assets. The average balance of loans rose $199.6 million or 14% to $1.593 billion, reflecting growth in every loan category.

The increase in taxable equivalent net interest income was a function of a favorable volume variance as balance sheet changes in both volume and mix increased taxable equivalent net interest income by $11.7 million, partially offset by an unfavorable rate variance that decreased taxable equivalent net interest income by $4.8 million. The change in mix and volume of earning assets increased taxable equivalent interest income by $11.2 million, while the change in volume and composition of interest-bearing liabilities decreased interest expense by $474 thousand, for a net favorable volume impact of $11.7 million on taxable equivalent net interest income. Rate changes on earning assets reduced interest income by $8.5 million, while changes in rates on interest-bearing liabilities lowered interest expense by $3.7 million, for a net unfavorable rate impact of $4.8 million.

The net interest margin for 2012 was 3.95% compared to 4.04% in 2011. The decrease in net interest margin was attributable to a 7 basis point lower contribution from net free funds (primarily attributable to lower rates on interest-bearing liabilities reducing the value of noninterest-bearing deposits and other net free funds). The interest rate spread decreased by 2 basis points to 3.85% for the year ended December 31, 2012, as a 32 basis point decrease in the yield on earning assets more than offset the 30 basis point decrease in the cost of interest-bearing liabilities. The Federal Reserve left the Federal funds rate unchanged at 0.25% during 2011 and 2012.

For 2012, the yield on average earning assets of 4.35% was 32 basis points lower than 2011. Loan yields decreased 44 basis points to 5.09%. Commercial mortgage and consumer indirect loans in particular, down 28 and 84 basis points, respectively, continued to experience lower yields given the competitive pricing pressures and re-pricing of loans in a low interest rate environment. The yield on investment securities dropped 27 basis points to 2.66%, also impacted by the lower interest rate environment, prepayments of mortgage-related investment securities and the impact of investing the excess cash related to our branch acquisitions into low yielding securities. Overall, earning asset rate changes reduced interest income by $8.5 million.

The cost of average interest-bearing liabilities of 0.50% in 2012 was 30 basis points lower than 2011. The average cost of interest-bearing deposits was 0.50% in 2012, 24 basis points lower than 2011, reflecting the sustained low-rate environment. The cost of borrowings decreased 110 basis points to 0.48% for 2012, primarily a result of the redemption of our 10.20% junior subordinated debentures during the third quarter of 2011. The interest-bearing liability rate changes reduced interest expense by $3.7 million during 2012.

Average interest-earning assets of $2.297 billion in 2012 were $217.4 million or 10% higher than 2011. Average investment securities increased $17.9 million while average loans increased $199.6 million or 14%. The growth in average loans was comprised of increases in all loan categories, with consumer loans up $130.5 million, commercial loans up $63.4 million and residential mortgage loans up $5.6 million.

Average interest-bearing liabilities of $1.825 billion in 2012 were up $162.9 million or 10% versus 2011. On average, interest-bearing deposits grew $156.2 million, while average noninterest-bearing demand deposits increased by $62.0 million. Average borrowings increased $6.7 million, representing a $22.6 million increase and $15.9 million decrease in short-term and long-term borrowings, respectively.

Provision for Loan Losses

The provision for loan losses was $7.1 million for the year ended December 31, 2012 compared with $7.8 million for 2011.

Noninterest Income

Service charges on deposits decreased slightly during 2012 compared to 2011. An increase in the number of customer accounts, including those added from the branch acquisitions in June and August of 2012, helped offset decreases in service charge income related to changes in customer behavior and regulatory changes that included the requirement that customers opt-in for overdraft coverage for certain types of electronic banking activities.

ATM and debit card income was $4.7 million for 2012, an increase of $357 thousand or 8%, compared to 2011. The increased popularity of electronic banking and transaction processing resulted in higher ATM and debit card point-of-sale usage income.

MANAGEMENT S DISCUSSION AND ANALYSIS

Investment advisory income was up $275 thousand or 15%, compared to 2011. Investment advisory income fluctuates mainly due to sales volume, which continued to increase during 2012 as a result of improving market and economic conditions and our renewed focus on this line of business.

The full-year impact of an additional $18.0 million of company owned life insurance purchased during the third quarter of 2011 was largely responsible for the $327 thousand increase in company owned life insurance income for 2012.

Loan servicing income was down $218 thousand or 26% for the year ended December 31, 2012 compared to 2011. Loan servicing income decreased as a result of more rapid amortization of servicing rights due to loans paying off, lower fees collected due to a decrease in the sold and serviced portfolio and write-downs on capitalized mortgage servicing assets.

Net gain on loans held for sale was $1.4 million in 2012, an increase of $541 thousand or 61%, compared to 2011, mainly due to increased origination volume related primarily to refinancing activity, a result of low interest rates.

Net gains from the sales of investment securities were $2.7 million for the year ended December 31, 2012, compared to $3.0 million for the year ended December 31, 2011. During 2012, we recognized gains totaling $2.6 million from the sale of five pooled trust-preferred securities. Net gains for 2011 included $2.3 million from the sale of four pooled trust-preferred securities and $730 thousand from the sale of eight mortgage-backed securities.

Due to their proximity to our existing locations, we consolidated four branches as part of the branch acquisitions. The majority of the loss on the disposal of other assets for 2012 was due to write-off of leasehold improvements and other fixed assets for these branches that were closed.

Other noninterest income increased $495 thousand or 17% for the year ended December 31, 2012, compared to 2011. Income from our investment in several limited partnerships and dividends from FHLB stock comprised the majority of the year-over-year increase.

Noninterest Expense

Salaries and employee benefits was $40.1 million for 2012, up $4.4 million or 12% from 2011. As discussed earlier, salaries and employee benefits for 2012 included pre-tax costs of approximately $2.6 million that were incurred in association with the retirement of our former CEO. After adjusting for these expenses, the increase in salaries and employee benefits for 2012 when compared to the prior year is attributable to higher pension costs along with increased staffing levels. Full time equivalent employees increased by 9% to 628 at December 31, 2012 from 575 at December 31, 2011, primarily due to the branch acquisitions.

Occupancy and equipment increased by $551 thousand or 5% when comparing 2012 to 2011. The increase was primarily related to the growth in the branch network related to the branch acquisitions.

Professional services expense of $4.1 million in 2012 increased $1.5 million or 58% from 2011. Professional fees increased primarily due to legal expenses related to the branch acquisitions. The management transition described earlier also contributed to the increase in professional fees.

Computer and data processing and supplies and postage expense increased, collectively, by $1.6 million when comparing 2012 to 2011. The year-over-year increase was due to expenses related to the branch acquisition transactions.

FDIC assessments decreased $213 thousand for the year ended December 31, 2012, compared to 2011, primarily a result of changes implemented by the FDIC in the method of calculating assessment rates which became effective in the second quarter of 2011.

Advertising and promotions costs were $330 thousand or 26% lower in 2012 compared to 2011 due to the timing of marketing campaigns and promotions, coupled with cost management strategies.

We redeemed all of our 10.20% junior subordinated debentures during the third quarter of 2011. As a result of the redemption, we recognized a loss on extinguishment of debt of $1.1 million, consisting of a redemption premium of $852 thousand and a write-off of the remaining unamortized issuance costs of $231 thousand in 2011.

Other noninterest expense increased $1.2 million or 19% during 2012 compared to 2011. The increases in other noninterest expenses were primarily related to the branch acquisition transactions.

The efficiency ratio for the year ended December 31, 2012 was 62.87% compared with 60.55% for 2011. The higher efficiency ratio is attributable to the additional expenses related to the branch acquisitions and retirement of our former CEO, as previously discussed.

Income Taxes

We recognized income tax expense of $11.3 million for 2012 compared to $11.4 million for 2011. The lower tax provision was primarily attributable to a decrease in our effective tax rate to 32.6% for 2012 compared to 33.4% for 2011. The lower effective tax rate in 2012 was a result of the greater impact of tax-exempt income on lower taxable income.

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MANAGEMENT S DISCUSSION AND ANALYSIS

ANALYSIS OF FINANCIAL CONDITION

OVERVIEW

At December 31, 2013, we had total assets of $2.93 billion, an increase of 6% from $2.76 billion as of December 31, 2012, largely attributable to our continued loan growth. Net loans were $1.81 billion as of December 31, 2013, up $125.9 million, or 8%, when compared to $1.68 billion as of December 31, 2012. The increase in net loans was primarily attributed to the continued expansion of the indirect lending program and commercial business development efforts. Non-performing assets totaled $17.1 million as of December 31, 2013, up $7.0 million from a year ago. Total deposits amounted to $2.32 billion as of December 31, 2013, up $58.3 million or 3%, compared to December 31, 2012. As of December 31, 2013, borrowed funds totaled $337.0 million, compared to $179.8 million as of December 31, 2012. Book value per common share was $17.17 and $17.15 as of December 31, 2013 and 2012, respectively. As of December 31, 2013 our total shareholders equity was $254.8 million compared to $253.9 million a year earlier.

INVESTING ACTIVITIES

The following table summarizes the composition of the available for sale and held to maturity security portfolios (in thousands).

	Investment Securities Portfolio Composition At December 31,					
	2013		2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale:						
U.S. Government agency and government-sponsored enterprise securities	$ 135,840	$ 134,452	$ 128,097	$ 131,695	$ 94,947	$ 97,712
State and political subdivisions			188,997	195,210	119,099	124,424
Mortgage-backed securities:						
Agency mortgage-backed securities	482,308	473,082	479,913	494,770	390,375	401,596
Non-Agency mortgage-backed securities		1,467	73	1,098	327	2,089
Asset-backed securities	18	399	121	1,023	297	1,697
Total available for sale securities	618,166	609,400	797,201	823,796	605,045	627,518
Securities held to maturity:						
State and political subdivisions	249,785	250,657	17,905	18,478	23,297	23,964
Total investment securities	$ 867,951	$ 860,057	$ 815,106	$ 842,274	$ 628,342	$ 651,482

Our investment policy is contained within our overall Asset-Liability Management and Investment Policy. This policy dictates that investment decisions will be made based on the safety of the investment, liquidity requirements, potential returns, cash flow targets, need for collateral and desired risk parameters. In pursuing these objectives, we consider the ability of an investment to provide earnings consistent with factors of quality, maturity, marketability, pledgeable nature and risk diversification. Our Treasurer, guided by ALCO, is responsible for investment portfolio decisions within the established policies.

During the third quarter of 2013, we transferred $227.3 million of available for sale state and municipal debt securities to the held to maturity category, reflecting our intent to hold those securities to maturity. Transfers of investment securities into the held to maturity category from the available for sale category are made at fair value at the date of transfer. The related $78 thousand of net unrealized holding gains that were included in the transfer are retained in accumulated other comprehensive income and in the carrying value of the held to maturity securities. This amount will be amortized as an adjustment to interest income over the remaining life of the securities. This will offset the impact of amortization of the net premium created in the transfer. There were no gains or losses recognized as a result of this transfer.

The available for sale (AFS) investment securities portfolio decreased $214.4 million or 26%, from $823.8 million at December 31, 2012 to $609.4 million at December 31, 2013. The decrease was largely attributable to the transfer of available for sale state and municipal debt securities to the held to maturity category during the third quarter of 2013, combined with scheduled principal paydowns on amortizing securities and a change in the net unrealized gain/loss on the AFS portfolio.

The AFS portfolio had net unrealized losses totaling $8.8 million at December 31, 2013 compared to net unrealized gains of $26.6 million at December 31, 2012. The unrealized loss on the AFS portfolio was predominantly caused by changes in market interest rates. The fair value of most of the investment securities in the AFS portfolio fluctuates as market interest rates change. The transfer of securities from available for sale to held to maturity is expected to reduce the fair value fluctuations in the available for sale portfolio.

MANAGEMENT S DISCUSSION AND ANALYSIS

As previously discussed, we utilized the proceeds from short-term FHLB advances to purchase high-quality investment securities as part of our leverage strategy of approximately $100 million implemented during the first quarter of 2013. Our purchase of investment securities was comprised of mortgage-backed securities, U.S. Government agencies and sponsored enterprise bonds and tax-exempt municipal bonds. This strategy allowed us to increase net interest income by taking advantage of the positive interest rate spread between the FHLB advances and the newly acquired investment securities.

Impairment Assessment

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

As of December 31, 2013, management does not have the intent to sell any of the securities in a loss position and believes that it is not likely that it will be required to sell any such securities before the anticipated recovery of amortized cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date, repricing date or if market yields for such investments decline. Management does not believe any of the securities in a loss position are impaired due to reasons of credit quality. Accordingly, as of December 31, 2013, management has concluded that unrealized losses on its investment securities are temporary and no further impairment loss has been realized in our consolidated statements of income. The following discussion provides further details of our assessment of the securities portfolio by investment category.

U.S. Government Agencies and Government Sponsored Enterprises (GSE). As of December 31, 2013, there were 18 securities in an unrealized loss position in the U.S. Government agencies and GSE portfolio with unrealized losses totaling $2.8 million. Of these, three were in an unrealized loss position for 12 months or longer and had an aggregate fair value of $2.7 million and unrealized losses of $14 thousand. The decline in fair value is attributable to changes in interest rates, and not credit quality, and because we do not have the intent to sell these securities and it is likely that we will not be required to sell the securities before their anticipated recovery, we do not consider these securities to be other-than-temporarily impaired at December 31, 2013.

State and Political Subdivisions. As of December 31, 2013, the state and political subdivisions (municipals) portfolio totaled $249.8 million, all of which was classified as held to maturity. As of that date, each of the 234 municipals in an unrealized loss position had been in an unrealized loss position for less than 12 months. Those securities had an aggregate fair value of $72.3 million and unrealized losses totaling $468 thousand.

Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because we do not have the intent to sell these securities and it is not likely that we will be required to sell the securities before their anticipated recovery, we do not consider these securities to be other-than-temporarily impaired at December 31, 2013.

Agency Mortgage-backed Securities. With the exception of the non-Agency mortgage-backed securities (non-Agency MBS) discussed below, all of the mortgage-backed securities held by us as of December 31, 2013, were issued by U.S. Government sponsored entities and agencies (Agency MBS), primarily FNMA. The contractual cash flows of our Agency MBS are guaranteed by FNMA, FHLMC or GNMA. The GNMA mortgage-backed securities are backed by the full faith and credit of the U.S. Government.

As of December 31, 2013, there were 79 securities in the Agency MBS portfolio that were in an unrealized loss position. Of these, 11 were in an unrealized loss position for 12 months or longer and had an aggregate fair value of $48.2 million and unrealized losses of $2.8 million. Given the high credit quality inherent in Agency MBS, we do not consider any of the unrealized losses as of December 31, 2013 on such MBS to be credit related or other-than-temporary. As of December 31, 2013, we did not intend to sell any of Agency MBS that were in an unrealized loss position, all of which were performing in accordance with their terms.

Non-Agency Mortgage-backed Securities. Our non-Agency MBS portfolio consists of positions in two privately issued whole loan collateralized mortgage obligations with a fair value and net unrealized gains of $1.5 million as of December 31, 2013. As of that date, each of the two non-Agency MBS were rated below investment grade. None of these securities were in an unrealized loss position.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Asset-backed Securities (ABS). As of December 31, 2013, the fair value of our ABS portfolio totaled $399 thousand and consisted of positions in two securities, one of which is a pooled trust preferred security (TPS) issued by a U.S. financial institution and backed by preferred debt issued by dozens of companies, primarily banks. As a result of some issuers defaulting and others electing to defer interest payments, we considered the TPS to be non-performing and stopped accruing interest on these investments during 2009. As of December 31, 2013, each of the securities in the ABS portfolio was rated below investment grade. None of these securities were in an unrealized loss position.

During 2013, we recognized gains totaling $1.2 million from the sale of four TPS. The four securities had a fair value of $550 thousand at December 31, 2012. We continue to monitor the market for these securities and evaluate the potential for future dispositions.

Other Investments. As a member of the FHLB, the Bank is required to hold FHLB stock. The amount of required FHLB stock is based on the Bank s asset size and the amount of borrowings from the FHLB. We have assessed the ultimate recoverability of our FHLB stock and believe that no impairment currently exists. As a member of the FRB system, we are required to maintain a specified investment in FRB stock based on a ratio relative to our capital. At December 31, 2013, our ownership of FHLB and FRB stock totaled $15.8 million and $3.9 million, respectively and is included in other assets and recorded at cost, which approximates fair value.

LENDING ACTIVITIES

Total loans were $1.83 billion at December 31, 2013, an increase of $127.9 million or 8% from December 31, 2012. Commercial loans increased $63.1 million or 9% and represented 40.1% of total loans at the end of 2013. Residential mortgage loans were $113.0 million, down $20.5 million or 15% and represented 6.2% of total loans at December 31, 2013, while consumer loans increased $85.3 million to represent 53.7% of total loans at December 31, 2013 compared to 52.8% at December 31, 2012. 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):

Loan Portfolio Composition At December 31,

	2013		2012		2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
ommercial usiness	$ 265,766	14.5%	$ 258,675	15.2%	$ 233,836	15.7%	$ 211,031	15.7%	$ 206,383	16.3%
ommercial ortgage	469,284	25.6	413,324	24.2	393,244	26.5	352,930	26.2	330,748	26.2
otal ommercial	735,050	40.1	671,999	39.4	627,080	42.2	563,961	41.9	537,131	42.5
esidential ortgage	113,045	6.2	133,520	7.8	113,911	7.7	129,580	9.6	144,215	11.4
ome quity	326,086	17.8	286,649	16.8	231,766	15.6	208,327	15.5	200,684	15.9
	636,368	34.7	586,794	34.4	487,713	32.9	418,016	31.1	352,611	27.9

onsumer direct										
ther onsumer	23,070	1.2	26,764	1.6	24,306	1.6	26,106	1.9	29,365	2.3
otal onsumer	985,524	53.7	900,207	52.8	743,785	50.1	652,449	48.5	582,660	46.1
otal loans	1,833,619	100.0%	1,705,726	100.0%	1,484,776	100.0%	1,345,990	100.0%	1,264,006	100.0%
llowance r loan sses	26,736		24,714		23,260		20,466		20,741	
otal loans, et	$ 1,806,883		$ 1,681,012		$ 1,461,516		$ 1,325,524		$ 1,243,265	

As of December 31, 2013 and 2012, the residential mortgage portfolio included $19.3 million and $28.2 million, respectively, of loans acquired with the 2012 branch acquisitions and $93.7 million and $105.3 million of organic loans, respectively. The decrease in organic residential mortgage loans from $113.9 million to $105.3 million to $93.7 million for the periods ending December 31, 2011, 2012 and 2013, respectively, and the increase in consumer indirect loans from $487.7 million to $586.8 million to $636.4 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 increased during 2013 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.

We participate 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, 2013, the principal balance of such loans (included in commercial loans) was $56.3 million and the guaranteed portion amounted to $38.5 million. Most of these loans were guaranteed by the SBA.

MANAGEMENT S DISCUSSION AND ANALYSIS

Commercial business loans were $265.8 million at the end of 2013, up $7.1 million or 3% since the end of 2012, and comprised 14.5% of total loans outstanding at December 31, 2013. 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 8% of commercial business loans as of December 31, 2013. As of December 31, 2013, commercial business SBA loans accounted for a total of $35.5 million or 13% of our commercial business loan portfolio.

Commercial mortgage loans totaled $469.3 million at December 31, 2013, up $56.0 million or 14% from December 31, 2012, and comprised 25.6% of total loans, compared to 24.2% at December 31, 2012. Commercial mortgage includes both owner occupied and non-owner occupied commercial real estate loans. Approximately 44% and 46% of the commercial mortgage portfolio at December 31, 2013 and 2012, 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, 2013, commercial mortgage SBA loans accounted for a total of $16.2 million or 3% of our commercial mortgage loan portfolio.

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.

Residential mortgage loans totaled $113.0 million at the end of 2013, down $20.5 million or 15% from the end of the prior year and comprised 6.2% of total loans outstanding at December 31, 2013 and 7.8% at December 31, 2012. 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. Residential mortgage products continue to be underwritten using FHLMC and FNMA secondary marketing guidelines.

Consumer loans totaled $985.5 million at December 31, 2013, up $85.3 million or 10% compared to 2012, and represented 53.7% of the 2013 year-end loan portfolio versus 52.8% at year-end 2012. 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 $636.4 million at December 31, 2013 up $49.6 million or 8% compared to 2012, and represented 34.7% of the 2013 year-end loan portfolio versus 34.4% at year-end 2012. 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, 2013, we originated $306.4 million in indirect loans with a mix of approximately 47% new auto and 53% used vehicles. This compares with $324.6 million in indirect loans with a mix of approximately 49% new auto and 51% used vehicles for the same period in 2012. The decrease in loans for new autos reflects changes in market conditions in 2013. We do business with over 400 franchised auto dealers located in Western, Central, and the Capital District of New York, and Northern Pennsylvania.

Home equity consists of home equity lines as well as home equity loans. Home equities amounted to $326.1 million at December 31, 2013 up $39.4 million or 14% compared to 2012, and represented 17.8% of the 2013 year-end loan portfolio versus 16.8% at year-end 2012. The portfolio had a weighted average LTV at origination of approximately 55% and 54% at December 31, 2013 and 2012, respectively. Approximately 76% and 69% f the loans in the home equity portfolio were first lien positions at December 31, 2013 and 2012, respectively. We continue to grow our home equity portfolio as the lower origination cost and convenience to customers has made these products an increasingly attractive alternative to conventional residential mortgage loans.

Our underwriting guidelines for home equity products includes 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 was 758 in both 2013 and 2012.

Other consumer loans totaled $23.1 million at December 31, 2013, down $3.7 million or 14% compared to 2012, and represented 1.2% of the 2013 year-end loan portfolio versus 1.6% at year-end 2012. Other consumer loans consists of personal loans (collateralized and uncollateralized) and deposit account collateralized loans.

MANAGEMENT S DISCUSSION AND ANALYSIS

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, 2013, no significant concentrations, as defined above, existed in our portfolio in excess of 10% of total loans.

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 $3.4 million and $1.5 million as of December 31, 2013 and 2012, 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 $237.9 million and $273.3 million as of December 31, 2013 and 2012, respectively.

Allowance for Loan Losses

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

	Loan Loss Analysis Year Ended December 31,				
	2013	**2012**	**2011**	**2010**	**2009**
Allowance for loan losses, beginning of year	$ 24,714	$ 23,260	$ 20,466	$ 20,741	$ 18,749
Charge-offs:					
Commercial business	1,070	729	1,346	3,426	2,360
Commercial mortgage	553	745	751	263	355
Residential mortgage	411	326	152	290	225
Home equity	391	305	449	259	195
Consumer indirect	8,125	6,589	4,713	4,669	3,637
Other consumer	928	874	877	909	1,058
Total charge-offs	11,478	9,568	8,288	9,816	7,830

Recoveries:					
Commercial business	349	336	401	326	428
Commercial mortgage	319	261	245	501	150
Residential mortgage	54	130	90	21	12
Home equity	157	44	44	36	20
Consumer indirect	3,161	2,769	2,066	1,485	1,030
Other consumer	381	354	456	485	480
Total recoveries	4,421	3,894	3,302	2,854	2,120
Net charge-offs	7,057	5,674	4,986	6,962	5,710
Provision for loan losses	9,079	7,128	7,780	6,687	7,702
Allowance for loan losses, end of year	$ 26,736	$ 24,714	$ 23,260	$ 20,466	$ 20,741
Net charge-offs to average loans	0.40%	0.36%	0.36%	0.54%	0.47%
Allowance to end of period loans	1.46%	1.45%	1.57%	1.52%	1.64%
Allowance to end of period non-performing loans	161%	271%	329%	270%	239%

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MANAGEMENT S 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).

	Allowance for Loan Losses by Loan Category At December 31,									
	2013		2012		2011		2010		2009	
	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	$ 4,273	14.5%	$ 4,884	15.2%	$ 4,036	15.7%	$ 3,712	15.7%	$ 4,407	16.3%
Commercial mortgage	7,743	25.6	6,581	24.2	6,418	26.5	6,431	26.2	6,638	26.2
Residential mortgage	676	6.2	740	7.8	858	7.7	1,013	9.6	1,251	11.4
Home equity	1,367	17.8	1,282	16.8	1,242	15.6	972	15.5	1,043	15.9
Consumer indirect	12,230	34.7	10,715	34.4	10,189	32.9	7,754	31.1	6,837	27.9
Other consumer	447	1.2	512	1.6	517	1.6	584	1.9	565	2.3
Total	$ 26,736	100.0%	$ 24,714	100.0%	$ 23,260	100.0%	$ 20,466	100.0%	$ 20,741	100.0%

Management believes that the allowance for loan losses at December 31, 2013 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):

	Non-performing Assets At December 31,				
	2013	2012	2011	2010	2009
Non-accruing loans:					
Commercial business	$ 3,474	$ 3,413	$ 1,259	$ 947	$ 650
Commercial mortgage	9,663	1,799	2,928	3,100	2,288
Residential mortgage	1,078	2,040	1,644	2,102	2,376
Home equity	925	939	682	875	880
Consumer indirect	1,471	891	558	514	621
Other consumer	5	25		41	7
Total non-accruing loans	16,616	9,107	7,071	7,579	6,822
Restructured accruing loans					
Accruing loans contractually past due over 90 days	6	18	5	3	1,859
Total non-performing loans	16,622	9,125	7,076	7,582	8,681
Foreclosed assets	333	184	475	741	746
Non-performing investment securities	128	753	1,636	572	1,015
Total non-performing assets	$ 17,083	$ 10,062	$ 9,187	$ 8,895	$ 10,442
Non-performing loans to total loans	0.91%	0.53%	0.48%	0.56%	0.69%
Non-performing assets to total assets	0.58%	0.36%	0.39%	0.40%	0.51%

Non-performing assets include non-performing loans, foreclosed assets and non-performing investment securities. Non-performing assets at December 31, 2013 were $17.1 million, an increase of $7.0 million from the $10.1 million balance at December 31, 2012. The primary component of non-performing assets is non-performing loans, which were $16.6 million or 0.91% of total loans at December 31, 2013, an increase of $7.5 million from $9.1 million or 0.53% of total loans at December 31, 2012.

MANAGEMENT S DISCUSSION AND ANALYSIS

Approximately $10.7 million, or 64%, of the $16.6 million in non-performing loans as of December 31, 2013 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, 2013, the amount of interest income forgone totaled $531 thousand. Included in nonaccrual loans are troubled debt restructurings (TDRs) of $8.9 million at December 31, 2013. We had no TDRs that were accruing interest as of December 31, 2013. The increase in non-performing loans and TDRs was primarily due to a single commercial mortgage loan with a principal balance of $6.9 million at December 31, 2013. This loan was modified as a troubled debt restructuring and placed on nonaccrual status during the fourth quarter 2013. The Company had internally downgraded the loan to substandard status from special mention during the third quarter 2013. The loan, which is secured by income property and guaranteed by the owners, was current per the terms of the restructured loan agreement as of December 31, 2013.

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 four properties totaling $333 thousand at December 31, 2013 and five properties totaling $184 thousand at December 31, 2012.

Non-performing investment securities for which we have stopped accruing interest were $128 thousand at December 31, 2013, compared to $753 thousand at December 31, 2012. Non-performing investment securities are included in non-performing assets at fair value and are comprised of pooled trust preferred securities. There have been no securities transferred to non-performing status since the first quarter of 2009. During 2013, we recognized gains totaling $1.2 million from the sale of four TPS. The four securities had a fair value of $550 thousand at December 31, 2012. We continue to monitor the market for these securities and evaluate the potential for future dispositions.

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 $9.7 million and $13.8 million in loans that continued to accrue interest which were classified as substandard as of December 31, 2013 and 2012, respectively. The decrease in potential problem loans relates primarily to a $3.4 million credit relationship which migrated to non-performing during the first quarter of 2013.

FUNDING ACTIVITIES

Deposits

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

		At December 31,	
	2013	2012	2011

	Amount	Percent	Amount	Percent	Amount	Percent
Noninterest-bearing demand	$ 535,472	23.1%	$ 501,514	22.2%	$ 393,421	20.3%
Interest-bearing demand	470,733	20.3	449,744	19.9	362,555	18.8
Savings and money market	717,928	30.9	655,598	28.9	474,947	24.6
Certificates of deposit < $100,000	369,915	16.0	432,506	19.2	486,496	25.2
Certificates of deposit of $100,000 or more	226,008	9.7	222,432	9.8	214,180	11.1
Total deposits	$ 2,320,056	100.0%	$ 2,261,794	100.0%	$ 1,931,599	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, 2013, total deposits were $2.32 billion, representing an increase of $58.3 million for the year. Public deposit balances increased $79.2 million during 2013 due largely to the seasonality of municipal cash flows and successful business development efforts in our newly acquired branches. Time deposits were approximately 26% and 29% of total deposits at December 31, 2013 and 2012, respectively. Depositors remain hesitant to invest in time deposits, such as certificates of deposit, for long periods due to the low interest rate environment. This has resulted in lower amounts being placed in time deposits for generally shorter terms.

Nonpublic deposits, the largest component of our funding sources, totaled $1.79 billion and $1.81 billion at December 31, 2013 and 2012, respectively, and represented 77% and 80% of total deposits as of the end of each period, 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.

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MANAGEMENT S DISCUSSION AND ANALYSIS

As an additional source of funding, we offer a variety of public (municipal) deposit products to the many towns, villages, counties and school districts within our market. Public deposits generally range from 20% to 28% 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. Total public deposits were $533.5 million and $454.2 million at December 31, 2013 and 2012, respectively, and represented 23% and 20% of total deposits as of the end of each period, respectively.

We had no traditional brokered deposits at December 31, 2013 or 2012; however, we do participate in the Certificate of Deposit Account Registry Service (CDARS) and Insured Cash Sweep (ICS) programs, which enable depositors to receive FDIC insurance coverage for deposits otherwise exceeding the maximum insurable amount. CDARS and ICS deposits are considered brokered deposits for regulatory reporting purposes. Through these programs, deposits in excess of the maximum insurable amount are placed with multiple participating financial institutions. Reciprocal CDARS deposits and ICS deposits totaled $61.3 million and $56.4 million, respectively, at December 31, 2013.

Borrowings

There were no long-term borrowings outstanding as of December 31, 2013 and 2012. Outstanding short-term borrowings are summarized as follows as of December 31 (in thousands):

	2013	2012
Short-term borrowings:		
Repurchase agreements	$ 39,042	$ 40,806
Short-term FHLB borrowings	298,000	139,000
Total short-term borrowings	$ 337,042	$ 179,806

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

We have credit capacity with the FHLB and can borrow through facilities that include amortizing and term advances or repurchase agreements. We had approximately $12 million of immediate credit capacity with the FHLB as of December 31, 2013. We had approximately $480 million in secured borrowing capacity at the Federal Reserve Bank (FRB) Discount Window, none of which was outstanding at December 31, 2013. The FHLB and FRB credit capacity are collateralized by securities from our investment portfolio and certain qualifying loans. We had approximately $120 million of credit available under unsecured federal funds purchased lines with various banks as of December 31, 2013. Additionally, we had approximately $61 million of unencumbered liquid securities available for pledging.

Federal funds purchased are short-term borrowings that typically mature within one to ninety days. Short-term repurchase agreements are secured overnight borrowings with customers. Short-term FHLB borrowings have original maturities of less than one year and include overnight borrowings which we typically utilize to address short term funding needs as they arise. Short-term FHLB borrowings at December 31, 2013 consisted of $198.0 million in overnight borrowings and $100.0 million in short-term advances. Short-term FHLB borrowings at December 31, 2012 consisted of $99.0 million in overnight borrowings and $40.0 million in short-term advances.

As previously discussed, during the first quarter of 2013 we leveraged our balance sheet through the execution of short-term FHLB advances in order to acquire investment securities to take advantage of the positive interest rate spread and increase net interest income.

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

	At or for the Year Ended December 31,		
	2013	**2012**	**2011**
Year-end balance	$ 337,042	$ 179,806	$ 150,698
Year-end weighted average interest rate	0.38%	0.54%	0.39%
Maximum outstanding at any month-end	$ 337,042	$ 229,598	$ 188,355
Average balance during the year	$ 190,310	$ 121,735	$ 99,122
Average interest rate for the year	0.39%	0.48%	0.50%

There were no long-term borrowings outstanding at December 31, 2013 and 2012. In August 2011, we redeemed all of our 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, we 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.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Shareholders Equity

Total shareholders equity was $254.8 million at December 31, 2013, an increase of $942 thousand from $253.9 million at December 31, 2012. Net income for the year increased shareholders equity by $25.5 million, which was partially offset by common and preferred stock dividends declared of $11.6 million. Accumulated other comprehensive income included in shareholders equity decreased $13.4 million during the year due primarily to higher net unrealized losses on securities available for sale. For detailed information on shareholders equity, see Note 12, Shareholders Equity, of the notes to consolidated financial statements.

FII and the Bank are subject to various regulatory capital requirements. At December 31, 2013, both FII and the Bank exceeded all regulatory requirements. For detailed information on regulatory capital, see Note 11, Regulatory Matters, of the notes to consolidated financial statements.

GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying value of goodwill totaled $48.5 million as of December 31, 2013 and 2012. We performed a qualitative assessment of goodwill at the reporting unit level, the Bank, to determine if it was more likely than not that the fair value of the reporting unit is less than its carrying value. In performing a qualitative analysis, factors considered include, but are not limited to, business strategy, financial performance and market and regulatory dynamics. The results of the qualitative assessment for 2013 indicated that it was not more likely than not that the fair value of the reporting unit is less than its carrying value. Consequently, no additional quantitative two-step impairment test was required, and no impairment was recorded in 2013.

The change in the balance for goodwill during the years ended December 31 was as follows (in thousands):

	2013	2012
Goodwill, beginning of year	$ 48,536	$ 37,369
Branch acquisitions		11,167
Impairment		
Goodwill, end of year	$ 48,536	$ 48,536

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.

Our other intangible assets consisted entirely of a core deposit intangible asset. Changes in the accumulated amortization and net book value were as follows (in thousands):

	2013	2012

Gross carrying amount	$ 2,042	$ 2,042
Accumulated amortization	(576)	(189)
Net book value	$ 1,466	$ 1,853
Amortization during the year	$ 387	$ 189

There were no core deposit intangible assets or amortization expense for the year ended December 31, 2011.

For further discussion, see Note 1, Summary of Significant Accounting Policies, and Note 7, Goodwill and Other Intangible Assets, to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

MANAGEMENT S 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.

Our cash and cash equivalents were $59.7 million as of December 31, 2013, down $744 thousand from $60.4 million as of December 31, 2012. Our net cash provided by operating activities totaled $37.2 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 $242.2 million, which included outflows of $131.9 million for net loan originations and $107.3 million from net investment securities transactions. Net cash provided by financing activities of $204.3 million was attributed to a $58.3 million increase in deposits and a $157.2 million increase in short-term borrowings, partly offset by $11.2 million in dividend payments.

Contractual Obligations and Other Commitments

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

	At December 31, 2013				
	Within 1 year	Over 1 to 3 years	Over 3 to 5 Years	Over 5 years	Total
On-Balance sheet:					
Certificates of deposit (1)	$ 448,997	$ 100,861	$ 46,045	$ 20	$ 595,923
Supplemental executive retirement plans	197	618	618	1,093	2,526
Off-Balance sheet:					
Limited partnership investments (2)	$ 356	$ 713	$ 356	$	$ 1,425
Commitments to extend credit (3)	431,236				431,236
Standby letters of credit (3)	5,498	3,091	29		8,618

Operating leases	1,440	2,654	1,504	3,796	9,394

(1) Includes the maturity of certificates of deposit amounting to $100 thousand or more as follows: $67.9 million in three months or less; $32.3 million between three months and six months; $79.6 million between six months and one year; and $46.2 million over one year.

(2) We have committed to capital investments in several limited partnerships of up to $6.0 million, of which we have contributed $4.6 million as of December 31, 2013, including $121 thousand during 2013.

(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 as of December 31, 2013, 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 10, Commitments and Contingencies, in the notes to the accompanying consolidated financial statements.

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MANAGEMENT S 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, 2013. 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).

	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	$ 23,996	0.07%	$ 27,185	2.16%	$ 74,177	1.74%	$ 10,482	0.89%	$ 135,840	1.46%
Mortgage-backed securities	209	3.16	978	3.59	164,187	1.95	316,934	2.35	482,308	2.22
Asset-backed securities							18		18	
	24,205	0.10	28,163	2.21	238,364	1.88	327,434	2.30	618,166	2.05
Held to maturity debt securities:										
State and political subdivisions	25,289	1.46	109,911	1.55	114,543	2.25	42	5.54	249,785	1.86
	$ 49,494	0.79%	$ 138,074	1.69%	$ 352,907	2.00%	$ 327,476	2.30%	$ 867,951	2.00%

Contractual Loan Maturity Schedule

The following table summarizes the contractual maturities of our loan portfolio at December 31, 2013. 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).

Total

	Due in less than one year	**Due from one to five years**	**Due after five years**	
Commercial business	$ 143,899	$ 99,208	$ 22,659	$ 265,766
Commercial mortgage	154,586	220,073	94,625	469,284
Residential mortgage	19,426	48,468	45,151	113,045
Home equity	57,727	150,071	118,288	326,086
Consumer indirect	252,946	375,198	8,224	636,368
Other consumer	9,991	11,537	1,542	23,070
Total loans	$ 638,575	$ 904,555	$ 290,489	$ 1,833,619
Loans maturing after one year:				
With a predetermined interest rate		$ 661,458	$ 149,218	$ 810,676
With a floating or adjustable rate		243,097	141,271	384,368
Total loans maturing after one year		$ 904,555	$ 290,489	$ 1,195,044

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MANAGEMENT S 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 as of December 31 (in thousands):

	2013	2012
Total shareholders equity	$ 254,839	$ 253,897
Less: Unrealized (loss) gain on securities available for sale, net of tax	(5,293)	16,060
Net unrecognized gain on available for sale securities transferred to held to maturity, net of tax	(44)	
Unrecognized net periodic pension & postretirement benefits (costs), net of tax	(4,850)	(12,807)
Disallowed goodwill and other intangible assets	50,002	50,389
Tier 1 capital	$ 215,024	$ 200,255
Adjusted average total assets (for leverage capital purposes)	$ 2,816,491	$ 2,596,122
Tier 1 leverage ratio (Tier 1 capital to adjusted average total assets)	7.63%	7.71%
Total Tier 1 capital	$ 215,024	$ 200,255
Plus: Qualifying allowance for loan losses	24,854	23,355
Total risk-based capital	$ 239,878	$ 223,610
Net risk-weighted assets	$ 1,986,473	$ 1,867,032
Tier 1 capital ratio (Tier 1 capital to net risk-weighted assets)	10.82%	10.73%
Total risk-based capital ratio (Total risk-based capital to net risk-weighted assets)	12.08%	11.98%

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.

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MANAGEMENT S 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 has an indefinite useful life and is not amortized, but is tested for impairment. GAAP requires goodwill to be tested for impairment at our reporting unit level on an annual basis, which for us is September 30th, and more frequently if events or circumstances indicate that there may be impairment. Currently, our goodwill is evaluated at the entity level as there is only one reporting unit.

Impairment exists when a reporting unit s carrying value of goodwill exceeds its implied fair value. In testing goodwill for impairment, GAAP permits us to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If, after assessing the totality of events and circumstances, we determine it is not more likely than not that the fair value of a reporting unit is less than its carrying value, then performing the two-step impairment test would be unnecessary. However, if we conclude otherwise, we would then be required to perform the first step (Step 1) of the goodwill impairment test, and continue to the second step (Step 2), if necessary. Step 1 compares the fair value of a reporting unit with its carrying value, including goodwill. If the carrying value of the reporting unit exceeds its fair value, Step 2 of the goodwill impairment test is performed to measure the value of impairment loss, if any.

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 15, Income Taxes, of the notes to consolidated financial statements.

MANAGEMENT S DISCUSSION AND ANALYSIS

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.

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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 income, 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 Management and Investment Policy that meets the strategic objectives and regularly reviews the activities of the Bank.

Portfolio Composition

Our balance sheet assets are a mix of fixed and variable rate assets with consumer indirect loans, commercial loans, and MBSs comprising a significant portion of our assets. Our consumer indirect loan portfolio comprised 22% of assets and is primarily fixed rate loans with relatively short durations. Our commercial loan portfolio totaled 25% of assets and is a combination of fixed and variable rate loans, lines and mortgages. The MBS portfolio, including collateralized mortgages obligations, totaled 16% of assets with durations averaging three to five years.

Our liabilities are made up primarily of deposits, which account for 87% of total liabilities. Of these deposits, the majority, or 54%, is in nonpublic variable rate and noninterest bearing products including demand (both noninterest and interest- bearing), savings and money market accounts. In addition, fixed rate nonpublic certificate of deposit products make up 23% of total deposits. The bank also has a significant amount of public deposits, which represented 23% of total deposits as of December 31, 2013.

Net Interest Income at Risk

A primary tool used to manage interest rate risk is rate shock simulation to measure the rate sensitivity. Rate shock simulation is a modeling technique used to estimate the impact of changes in rates on net interest income as well as economic value of equity. At December 31, 2013, we are generally asset sensitive, meaning that, in most cases, net interest income tends to rise as interest rates rise and decline as interest rates fall.

Net interest income at risk is measured 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. The following table sets forth the estimated changes to net interest income over the 12-month period ending December 31, 2014 assuming instantaneous changes in interest rates for the given rate shock scenarios (dollars in thousands):

	Changes in Interest Rate			
	-100 bp	+100 bp	+200 bp	+300 bp
Change in net interest income	$ (1,764)	$ 698	$ 1,939	$ 1,251
% Change	(1.88)%	0.74%	2.06%	1.33%

In addition to the changes in interest rate scenarios listed above, other scenarios are typically modeled to measure interest rate risk. These scenarios vary depending on the economic and interest rate environment.

The simulations referenced above are 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.

Economic Value of Equity At Risk

The economic (or fair) value of financial instruments on our balance sheet will also vary under the interest rate scenarios previously discussed. This is measured by simulating changes in our economic value of equity (EVE), which is calculated by subtracting the estimated fair value of liabilities from the estimated fair value of assets. Fair values for financial instruments are estimated by discounting projected cash flows (principal and interest) at current replacement rates for each account type, while fair values of non-financial assets and liabilities are assumed to equal book value and do not vary with interest rate fluctuations. An economic value simulation is a static measure for balance sheet accounts at a given point in time, but this measurement can change substantially over time as the characteristics of our balance sheet evolve and as interest rate and yield curve assumptions are updated.

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The amount of change in economic value under different interest rate scenarios depends on the characteristics of each class of financial instrument, including the stated interest rate or spread relative to current market rates or spreads, the likelihood of prepayment, whether the rate is fixed or floating, and the maturity date of the instrument. As a general rule, fixed-rate financial assets become more valuable in declining rate scenarios and less valuable in rising rate scenarios, while fixed-rate financial liabilities gain in value as interest rates rise and lose value as interest rates decline. The longer the duration of the financial instrument, the greater the impact a rate change will have on its value. In our economic value simulations, estimated prepayments are factored in for financial instruments with stated maturity dates, and decay rates for non-maturity deposits are projected based historical data (back-testing).

The analysis that follows presents the estimated EVE resulting from market interest rates prevailing at a given quarter-end (Pre-Shock Scenario), and under other interest rate scenarios (each a Rate Shock Scenario) represented by immediate, permanent, parallel shifts in interest rates from those observed at December 31, 2013 and 2012. The analysis additionally presents a measurement of the interest rate sensitivity at December 31, 2013 and 2012. EVE amounts are computed under each respective Pre- Shock Scenario and Rate Shock Scenario. An increase in the EVE amount is considered favorable, while a decline is considered unfavorable.

	December 31, 2013			December 31, 2012		
Rate Shock Scenario:	**EVE**	**Change**	**Percentage Change**	**EVE**	**Change**	**Percentage Change**
Pre-Shock Scenario	466,008			392,732		
- 100 Basis Points	$ 476,323	$ 10,315	2.21%	$ 420,472	$ 27,740	7.06%
+ 100 Basis Points	452,155	(13,853)	(2.97)	396,416	3,684	0.94
+ 200 Basis Points	435,424	(30,584)	(6.56)	392,904	172	0.04

The Pre-Shock Scenario EVE was $466.0 million at December 31, 2013, compared to $392.7 million at December 31, 2012. The increase in the Pre-Shock Scenario EVE at December 31, 2013, compared to December 31, 2012 resulted primarily from a more favorable valuation of non-maturity deposits that reflected alternative funding rate changes used for discounting future cash flows.

The +200 basis point Rate Shock Scenario EVE increased from $392.9 million at December 31, 2012 to $435.4 million at December 31, 2013, reflecting the more favorable valuation of non-maturity deposits. The percentage change in the EVE amount from the Pre-Shock Scenario to the +200 basis point Rate Shock Scenario decreased from 0.04% at December 31, 2012 to (6.56)% at December 31, 2013. The increase in sensitivity resulted from a reduced benefit in the valuation of non-maturity deposits and greater sensitivity for investment securities in the +200 basis point Rate Shock Scenario EVE as of December 31, 2013, compared to December 31, 2012.

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Interest Rate Sensitivity Gap

The following table presents an analysis of our interest rate sensitivity gap position at December 31, 2013. 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).

	At December 31, 2013				
	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	71,302	133,987	387,246	275,416	867,951
Loans	553,634	327,257	791,637	164,472	1,837,000
Total interest-earning assets	$ 624,936	$ 461,338	$ 1,178,883	$ 439,888	2,705,045
Cash and due from banks					59,598
Other assets [(1)]					163,993
Total assets					$ 2,928,636
INTEREST-BEARING LIABILITIES:					
Interest-bearing demand, savings and money market	$ 1,188,661	$	$	$	$ 1,188,661
Certificates of deposit	145,654	303,344	146,905	20	595,923
Borrowings	310,142	26,900			337,042
Total interest-bearing liabilities	$ 1,644,457	$ 330,244	$ 146,905	$ 20	2,121,626
Noninterest-bearing deposits					535,472
Other liabilities					16,699
Total liabilities					2,673,797

Shareholders equity					254,839
Total liabilities and shareholders equity					$ 2,928,636
Interest sensitivity gap	$ (1,019,521)	$ 131,094	$ 1,031,978	$ 439,868	$ 583,419
Cumulative gap	$ (1,019,521)	$ (888,427)	$ 143,551	$ 583,419	
Cumulative gap ratio [2]	38.0%	55.0%	106.8%	127.5%	
Cumulative gap as a percentage of total assets	(34.8)%	(30.3)%	4.9%	19.9%	

(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.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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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, including the Company s principal executive officer and principal financial officer as identified below, assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2013. To make this assessment, we used the criteria for effective internal control over financial reporting described in *Internal Control - Integrated Framework (1992)*, 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, 2013, 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, 2013. That report appears herein.

/s/ Martin K. Birmingham
President and Chief Executive Officer
March 12, 2014

/s/ Kevin B. Klotzbach
Executive Vice President and Chief Financial Officer
March 12, 2014

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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, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* 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, Financial Institutions, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* 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 Financial Institutions, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2013, and our report dated March 12, 2014 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Rochester, New York

March 12, 2014

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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, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2013. 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 Financial Institutions, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, 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, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 12, 2014 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

Rochester, New York

March 12, 2014

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Financial Condition

(Dollars in thousands, except share and per share data)	December 31, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 59,598	$ 60,342
Federal funds sold and interest-bearing deposits in other banks	94	94
Total cash and cash equivalents	59,692	60,436
Securities available for sale, at fair value	609,400	823,796
Securities held to maturity, at amortized cost (fair value of $250,657 and $18,478, respectively)	249,785	17,905
Loans held for sale	3,381	1,518
Loans (net of allowance for loan losses of $26,736 and $24,714, respectively)	1,806,883	1,681,012
Company owned life insurance	49,171	47,386
Premises and equipment, net	36,009	36,618
Goodwill and other intangible assets, net	50,002	50,389
Other assets	64,313	44,805
Total assets	$ 2,928,636	$ 2,763,865
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 535,472	$ 501,514
Interest-bearing demand	470,733	449,744
Savings and money market	717,928	655,598
Certificates of deposit	595,923	654,938
Total deposits	2,320,056	2,261,794
Short-term borrowings	337,042	179,806
Other liabilities	16,699	68,368
Total liabilities	2,673,797	2,509,968
Commitments and contingencies (Note 10)		
Shareholders equity:		
Series A 3% preferred stock, $100 par value; 1,533 shares authorized; 1,496 and 1,499 shares issued, respectively	149	150
Series B-1 8.48% preferred stock, $100 par value, 200,000 shares authorized; 171,927 and 173,210 shares issued, respectively	17,193	17,321
Total preferred equity	17,342	17,471

Common stock, $0.01 par value, 50,000,000 shares authorized and 14,161,597 shares issued	142	142
Additional paid-in capital	67,574	67,710
Retained earnings	186,137	172,244
Accumulated other comprehensive (loss) income	(10,187)	3,253
Treasury stock, at cost 332,242 and 373,888 shares, respectively	(6,169)	(6,923)
Total shareholders equity	254,839	253,897
Total liabilities and shareholders equity	$ 2,928,636	$ 2,763,865

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Income

(Dollars in thousands, except per share amounts)	Years ended December 31, 2013	2012	2011
Interest income:			
Interest and fees on loans	$ 81,468	$ 81,123	$ 77,105
Interest and dividends on investment securities	17,463	16,444	18,013
Total interest income	98,931	97,567	95,118
Interest expense:			
Deposits	6,600	8,462	11,434
Short-term borrowings	737	589	500
Long-term borrowings			1,321
Total interest expense	7,337	9,051	13,255
Net interest income	91,594	88,516	81,863
Provision for loan losses	9,079	7,128	7,780
Net interest income after provision for loan losses	82,515	81,388	74,083
Noninterest income:			
Service charges on deposits	9,948	8,627	8,679
ATM and debit card	5,098	4,716	4,359
Investment advisory	2,345	2,104	1,829
Company owned life insurance	1,706	1,751	1,424
Loan servicing	570	617	835
Net gain on sale of loans held for sale	117	1,421	880
Net gain on disposal of investment securities	1,226	2,651	3,003
Impairment charges on investment securities		(91)	(18)
Net (loss) gain on sale and disposal of other assets	(103)	(381)	67
Other	3,926	3,362	2,867
Total noninterest income	24,833	24,777	23,925
Noninterest expense:			
Salaries and employee benefits	37,828	40,127	35,743
Occupancy and equipment	12,366	11,419	10,868
Professional services	3,836	4,133	2,617
Computer and data processing	2,848	3,271	2,437
Supplies and postage	2,342	2,497	1,778
FDIC assessments	1,464	1,300	1,513
Advertising and promotions	896	929	1,259

Loss on extinguishment of debt			1,083
Other	7,861	7,721	6,496
Total noninterest expense	69,441	71,397	63,794
Income before income taxes	37,907	34,768	34,214
Income tax expense	12,377	11,319	11,415
Net income	$ 25,530	$ 23,449	$ 22,799
Preferred stock dividends	1,466	1,474	1,877
Accretion of discount on Series A preferred stock			1,305
Net income available to common shareholders	$ 24,064	$ 21,975	$ 19,617
Earnings per common share (Note 16):			
Basic	$ 1.75	$ 1.60	$ 1.50
Diluted	$ 1.75	$ 1.60	$ 1.49
Cash dividends declared per common share	$ 0.74	$ 0.57	$ 0.47
Weighted average common shares outstanding:			
Basic	13,739	13,696	13,067
Diluted	13,784	13,751	13,157

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(Dollars in thousands)	Years ended December 31,		
	2013	**2012**	**2011**
Net income	$ 25,530	$ 23,449	$ 22,799
Other comprehensive (loss) income, before tax:			
Securities available for sale and transferred securities:			
Change in unrealized gain/loss during the period	(34,135)	6,682	22,350
Change in net unrealized gain on securities transferred to held to maturity	(72)		
Reclassification adjustment for net gains included in net income	(1,226)	(2,560)	(2,985)
Total securities available for sale and transferred securities	(35,433)	4,122	19,365
Pension and post-retirement obligations:			
Net actuarial gain (loss), net of amortization	13,223	(253)	(9,930)
Prior service cost, net of amortization	(47)	(47)	(49)
Total pension and post-retirement obligations	13,176	(300)	(9,979)
Other comprehensive (loss) income, before tax	(22,257)	3,822	9,386
Deferred tax expense (benefit) related to other comprehensive income	8,817	(1,514)	(3,719)
Other comprehensive (loss) income, net of tax	(13,440)	2,308	5,667
Comprehensive income	$ 12,090	$ 25,757	$ 28,466

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders Equity

Years ended December 31, 2013, 2012 and 2011

(Dollars in thousands, except per share data)	Preferred Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders Equity
Balance at January 1, 2011	**$ 53,785**	**$ 113**	**$ 26,029**	**$ 144,599**	**$ (4,722)**	**$ (7,660)**	**$ 212,144**
Comprehensive income:							
Net income				22,799			22,799
Other comprehensive income, net of tax					5,667		5,667
Issuance of common stock		29	43,098				43,127
Purchases of common stock for treasury						(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**
Comprehensive income:							
Net income				23,449			23,449
Other comprehensive income, net of tax					2,308		2,308
Purchases of common stock for treasury						(557)	(557)
Repurchase of Series B-1 8.48% preferred stock	(2)						(2)
Share-based compensation plans:							
Share-based compensation			526				526
Stock options exercised			(10)			79	69
Restricted stock awards issued, net			(140)			140	
Excess tax benefit on share-based compensation			97				97
Directors retainer			(10)			107	97
Cash dividends declared:							
Series A 3% Preferred $3.00 per share				(5)			(5)
Series B-1 8.48% Preferred $8.48 per share				(1,469)			(1,469)
Common $0.57 per share				(7,810)			(7,810)
Balance at December 31, 2012	**$ 17,471**	**$ 142**	**$ 67,710**	**$ 172,244**	**$ 3,253**	**$ (6,923)**	**$ 253,897**

Continued on next page

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders Equity (Continued)

Years ended December 31, 2013, 2012 and 2011

(Dollars in thousands, except per share data)	**Preferred Equity**	**Common Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Treasury Stock**	**Total Shareholders Equity**
Balance at December 31, 2012	**$ 17,471**	**$ 142**	**$ 67,710**	**$ 172,244**	**$ 3,253**	**$ (6,923)**	**$ 253,897**
Balance carried forward							
Comprehensive income:							
Net income				25,530			25,530
Other comprehensive loss, net of tax					(13,440)		(13,440)
Purchases of common stock for treasury						(229)	(229)
Repurchase of Series A 3% preferred stock	(1)						(1)
Repurchase of Series B-1 8.48% preferred stock	(128)		(2)				(130)
Share-based compensation plans:							
Share-based compensation			407				407
Stock options exercised			16			432	448
Restricted stock awards issued, net			(446)			446	
Excess tax expense on share-based compensation			(118)				(118)
Directors retainer			7			105	112
Cash dividends declared:							
Series A 3% Preferred $3.00 per share				(5)			(5)
Series B-1 8.48% Preferred $8.48 per share				(1,461)			(1,461)
Common $0.74 per share				(10,171)			(10,171)
Balance at December 31, 2013	**$ 17,342**	**$ 142**	**$ 67,574**	**$ 186,137**	**$ (10,187)**	**$ (6,169)**	**$ 254,839**

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Dollars in thousands)	Years ended December 31, 2013	2012	2011
Cash flows from operating activities:			
Net income	$ 25,530	$ 23,449	$ 22,799
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	4,181	3,828	3,466
Net amortization of premiums on securities	4,532	5,284	5,722
Provision for loan losses	9,079	7,128	7,780
Share-based compensation	407	526	1,105
Deferred income tax expense	1,547	6,343	6,510
Proceeds from sale of loans held for sale	26,184	55,067	32,839
Originations of loans held for sale	(31,657)	(52,754)	(31,231)
Increase in company owned life insurance	(1,706)	(1,751)	(1,424)
Net gain on sale of loans held for sale	(117)	(1,421)	(880)
Net gain on disposal of investment securities	(1,226)	(2,651)	(3,003)
Impairment charges on investment securities		91	18
Net loss (gain) on sale and disposal of other assets	103	381	(67)
Contributions to defined benefit pension plan		(8,000)	(10,000)
Loss on extinguishment of debt			1,083
Increase in other assets	(6,640)	(4,249)	(7,756)
Increase in other liabilities	6,981	7,429	5,057
Net cash provided by operating activities	37,198	38,700	32,018
Cash flows from investing activities:			
Purchases of investment securities:			
Available for sale	(246,874)	(322,191)	(158,013)
Held to maturity	(19,598)	(15,484)	(17,188)
Proceeds from principal payments, maturities and calls on investment securities:			
Available for sale	143,053	175,679	168,976
Held to maturity	14,784	20,819	21,986
Proceeds from sales of securities available for sale	1,327	2,823	44,514
Net increase in loans, excluding sales	(131,949)	(151,311)	(157,110)
Loans sold or participated to others			13,033
Purchases of company owned life insurance	(79)	(79)	(18,079)
Proceeds from sales of other assets	555	734	705
Purchases of premises and equipment	(3,411)	(5,840)	(3,678)
Net cash received in branch acquisitions		195,778	
Net cash used in investing activities	(242,192)	(99,072)	(104,854)

Cash flows from financing activities:			
Net increase in deposits	58,262	43,376	48,709
Net increase in short-term borrowings	157,236	29,108	73,588
Repayments of long-term borrowings			(26,767)
Proceeds from issuance of common stock, net of issuance costs			43,127
Purchases of common stock for treasury	(229)	(557)	(215)
Repurchase of preferred stock	(131)	(2)	(37,549)
Repurchase of warrant issued to U.S. Treasury			(2,080)
Proceeds from stock options exercised	448	69	91
Excess tax (expense) benefit on share-based compensation	(118)	97	21
Cash dividends paid to preferred shareholders	(1,468)	(1,474)	(2,118)
Cash dividends paid to common shareholders	(9,750)	(7,392)	(5,446)
Net cash provided by financing activities	204,250	63,225	91,361
Net (decrease) increase in cash and cash equivalents	(744)	2,853	18,525
Cash and cash equivalents, beginning of period	60,436	57,583	39,058
Cash and cash equivalents, end of period	$ 59,692	$ 60,436	$ 57,583

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(1.) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Institutions, Inc. (the Parent) is a financial holding company organized in 1931 under the laws of New York State (New York or NYS). Through its wholly-owned New York chartered banking subsidiary, Five Star Bank, Financial Institutions, Inc. offers a broad array of deposit, lending and other financial services to services to individuals, municipalities and businesses in Western and Central 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. 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).

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):

	2013	2012	2011
Cash payments:			
Interest expense	$ 7,750	$ 10,438	$ 15,668
Income taxes	8,095	4,014	5,191
Noncash investing and financing activities:			
Real estate and other assets acquired in settlement of loans	$ 726	$ 322	$ 305
Accrued and declared unpaid dividends	2,981	2,562	2,144
Accretion of preferred stock discount			1,305
(Decrease) increase in net unsettled security purchases	(51,112)	51,135	(67)
Securities transferred from available for sale to held to maturity	227,330		
Loans transferred from held for sale to held for investment	3,727		
Net transfer of portfolio loans to held for sale			13,576
Assets acquired and liabilities assumed in branch acquisition:			
Loans and other non-cash assets, excluding goodwill and core deposit intangible asset		77,912	
Deposits and other liabilities		287,331	

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(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 comprehensive income and 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 Loan 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 or loss on sale of the loans, determined using the specific identification method, in the consolidated statements 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. No impairment loss related to the MSRs was recognized during the years ended December 31, 2013 or 2012. The Company recognized an impairment loss related to the MSRs of $35 thousand during the year ended December 31, 2011.

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, 2013, 2012 and 2011

(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, if 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 5 - Loans for additional information.

(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, 2013 had original terms ranging from one to five years.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(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. At December 31, 2013, there were no commitments to lend additional funds to those borrowers whose loans were classified as impaired.

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.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(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 was $333 thousand and $184 thousand at December 31, 2013 and 2012, respectively.

(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 has an indefinite useful life and is not amortized, but is tested for impairment. GAAP requires goodwill to be tested for impairment at the Company s reporting unit level on an annual basis, which for the Company is September 30th, and more frequently if events or circumstances indicate that there may be impairment. Currently, the Company s goodwill is evaluated at the entity level as there is only one reporting unit.

Impairment exists when a reporting unit s carrying value of goodwill exceeds its implied fair value. In testing goodwill for impairment, GAAP permits the Company to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If, after assessing the totality of events and circumstances, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying value, then performing the two-step impairment test would be unnecessary. However, if the Company concludes otherwise, it would then be required to perform the first step (Step 1) of the goodwill impairment test, and continue to the second step (Step 2), if necessary. Step 1 compares the fair value of a reporting unit with its carrying value, including goodwill. If the carrying value of the reporting unit exceeds its fair value, Step 2 of the goodwill impairment test is performed to measure the amount of impairment loss, if any.

Intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. The Company s intangible assets relate to core deposits. Intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life of approximately nine and a half years. Intangible assets with indefinite useful lives are not amortized until their lives are determined to be definite. Intangible assets are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value. See Note 7 - Goodwill and Other Intangible Assets.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(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 $15.8 million and $8.4 million as of December 31, 2013 and 2012, 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, 2013 and 2012.

(n.) Equity Method Investments

The Company has investments in limited partnerships, primarily Small Business Investment Companies, 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 $4.8 million and $4.7 million as of December 31, 2013 and 2012, 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, 2013, 2012 and 2011

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

(s.) Comprehensive Income

Comprehensive income includes all changes in shareholders equity during a period, except those resulting from transactions with shareholders. In addition to net income, other components of the Company s comprehensive income include the after tax effect of changes in net unrealized gain / loss on securities available for sale and changes in net actuarial gain / loss on defined benefit post-retirement plans. Comprehensive income is reported in the accompanying consolidated statements of changes in shareholder s equity and consolidated statements of comprehensive income. See Note 13 - Accumulated Other Comprehensive Income (Loss) for additional information.

(t.) 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 16 - Earnings Per Common Share.

(u.) Reclassifications

Prior years consolidated financial statements are reclassified whenever necessary to conform to the current year s presentation. Certain reclassifications have been made to the prior years financial statements in order to reflect retrospective adjustments made to the balance of goodwill at December 31, 2012 to reflect the effect of these measurement period adjustments made in accordance with accounting requirements. The reclassifications had no impact on shareholders equity or net income.

(v.) Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU No. 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 requires an entity to disaggregate the total change of each component of other comprehensive income (e.g., unrealized gains or losses on available-for-sale investment securities) and separately present reclassification adjustments and current period other comprehensive income. The provisions of ASU No. 2013-02 also requires that entities present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source (e.g., unrealized gains or losses on available-for-sale investment securities) and the income statement line item affected by the reclassification (e.g., realized gains (losses) on sales of investment securities). If a component is not required to be reclassified to net income in its entirety (e.g., amortization of defined benefit plan items), entities would instead cross reference to the related note to the financial statements for additional information (e.g., pension footnote). The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. As the Company provided these required disclosures in the notes to the consolidated financial statements, the adoption of ASU No. 2013-02 had no impact on the Company s consolidated statements of income and condition. See Note 13 - Accumulated Other Comprehensive Income (Loss) to the consolidated financial statements for the disclosures required by ASU No. 2013-02.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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December 31, 2013, 2012 and 2011

(2.) BRANCH ACQUISITIONS

On January 19, 2012, the Bank entered into agreements with First Niagara Bank, National Association (First Niagara) to acquire four retail bank branches in Medina, Brockport, Batavia and Waterloo, New York (the First Niagara Branches) and four retail bank branches previously owned by HSBC Bank USA, National Association (HSBC) in Elmira, Elmira Heights, Horseheads and Albion, New York (the HSBC Branches). First Niagara assigned its rights to the HSBC branches in connection with its acquisition of HSBC s Upstate New York banking franchise. Under the terms of the agreements, the Bank assumed substantially all related deposits and purchased the related branch premises and certain performing loans. The transaction to acquire the First Niagara Branches was completed on June 22, 2012 and the transaction to acquire the HSBC Branches was completed on August 17, 2012. The combined assets acquired and deposits assumed in the two transactions were recorded at their estimated fair values as follows (in thousands):

Cash	$ 195,778
Loans	75,635
Bank premises and equipment	1,938
Goodwill	11,167
Core deposit intangible asset	2,042
Other assets	601
Total assets acquired	$ 287,161
Deposits assumed	$ 286,819
Other liabilities	342
Total liabilities assumed	$ 287,161

The transactions were accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at their estimated fair values on the acquisition dates. The Company acquired the loan portfolios at a fair value discount, net of market premium, of $824 thousand. The discount represented expected credit losses, net of market interest rate adjustments. The discount on loans receivable is being amortized to interest income over the estimated remaining life of the acquired loans using the level yield method. The time deposit premium of $335 thousand is being accreted over the estimated remaining life of the related deposits as a reduction of interest expense. The core deposit intangible asset is being amortized on an accelerated basis over the estimated average life of the core deposits.

During the year ended December 31, 2013, the Company recorded a decrease to the estimated fair value of liabilities assumed and an increase to the related deferred income taxes based upon information obtained subsequent to the acquisition. In addition to changes in those assets and liabilities, the revisions resulted in a reduction in goodwill of approximately $432 thousand. The final purchase price allocation was completed during the three months ended September 30, 2013, and the Company has recorded final goodwill totaling approximately $11.2 million in connection with the acquisitions. All goodwill and core deposit intangible assets arising from this acquisition are expected to be deductible for tax purposes.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(3.) INVESTMENT SECURITIES

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2013				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 135,840	$ 1,414	$ 2,802	$ 134,452
Mortgage-backed securities:				
Federal National Mortgage Association	173,507	1,511	4,810	170,208
Federal Home Loan Mortgage Corporation	36,737	562	205	37,094
Government National Mortgage Association	61,832	2,152	142	63,842
Collateralized mortgage obligations:				
Federal National Mortgage Association	63,838	261	3,195	60,904
Federal Home Loan Mortgage Corporation	102,660	169	5,856	96,973
Government National Mortgage Association	43,734	913	586	44,061
Privately issued		1,467		1,467
Total collateralized mortgage obligations	210,232	2,810	9,637	203,405
Total mortgage-backed securities	482,308	7,035	14,794	474,549
Asset-backed securities	18	381		399
Total available for sale securities	$ 618,166	$ 8,830	$ 17,596	$ 609,400
Securities held to maturity:				
State and political subdivisions	$ 249,785	$ 1,340	$ 468	$ 250,657
December 31, 2012				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 128,097	$ 3,667	$ 69	$ 131,695
State and political subdivisions	188,997	6,285	72	195,210
Mortgage-backed securities:				
Federal National Mortgage Association	147,946	4,394	188	152,152
Federal Home Loan Mortgage Corporation	65,426	1,430		66,856
Government National Mortgage Association	56,166	3,279		59,445

Collateralized mortgage obligations:				
Federal National Mortgage Association	60,805	1,865	2	62,668
Federal Home Loan Mortgage Corporation	78,581	1,911		80,492
Government National Mortgage Association	70,989	2,168		73,157
Privately issued	73	1,025		1,098
Total collateralized mortgage obligations	210,448	6,969	2	217,415
Total mortgage-backed securities	479,986	16,072	190	495,868
Asset-backed securities	121	902		1,023
Total available for sale securities	$ 797,201	$ 26,926	$ 331	$ 823,796
Securities held to maturity:				
State and political subdivisions	$ 17,905	$ 573	$	$ 18,478

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(3.) INVESTMENT SECURITIES (Continued)

During the year ended December 31, 2013, the Company transferred $227.3 million of available for sale state and municipal debt securities to the held to maturity category, reflecting the Company s intent to hold those securities to maturity. Transfers of investment securities into the held to maturity category from the available for sale category are made at fair value at the date of transfer. The related $78 thousand of unrealized holding gains that were included in the transfer are retained in accumulated other comprehensive income and in the carrying value of the held to maturity securities. This amount will be amortized as an adjustment to interest income over the remaining life of the securities. This will offset the impact of amortization of the net premium created in the transfer. There were no gains or losses recognized as a result of this transfer.

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

	2013	2012	2011
Taxable interest and dividends	$ 12,541	$ 12,202	$ 14,185
Tax-exempt interest and dividends	4,922	4,242	3,828
Total interest and dividends on securities	$ 17,463	$ 16,444	$ 18,013

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

	2013	2012	2011
Proceeds from sales	$ 1,327	$ 2,823	$ 44,514
Gross realized gains	1,226	2,651	3,051
Gross realized losses			48

The scheduled maturities of securities available for sale and securities held to maturity at December 31, 2013 are shown below. Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations (in thousands).

	Amortized Cost	Fair Value

Debt securities available for sale:		
Due in one year or less	$ 24,205	$ 24,204
Due from one to five years	28,163	28,932
Due after five years through ten years	238,364	232,854
Due after ten years	327,434	323,410
	$ 618,166	$ 609,400
Debt securities held to maturity:		
Due in one year or less	$ 25,289	$ 25,371
Due from one to five years	109,911	110,862
Due after five years through ten years	114,543	114,371
Due after ten years	42	53
	$ 249,785	$ 250,657

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(3.) INVESTMENT SECURITIES (Continued)

Unrealized losses on investment securities 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):

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2013						
Securities available for sale:						
U.S. Government agencies and government sponsored enterprises	$ 86,177	$ 2,788	$ 2,717	$ 14	$ 88,894	$ 2,802
Mortgage-backed securities:						
Federal National Mortgage Association	103,778	3,491	20,689	1,319	124,467	4,810
Federal Home Loan Mortgage Corporation	14,166	205			14,166	205
Government National Mortgage Association	14,226	142			14,226	142
Collateralized mortgage obligations:						
Federal National Mortgage Association	35,632	2,586	11,760	609	47,392	3,195
Federal Home Loan Mortgage Corporation	72,655	4,980	15,762	876	88,417	5,856
Government National Mortgage Association	8,396	586			8,396	586
Total collateralized mortgage obligations	116,683	8,152	27,522	1,485	144,205	9,637
Total mortgage-backed securities	248,853	11,990	48,211	2,804	297,064	14,794
Total available for sale securities	335,030	14,778	50,928	2,818	385,958	17,596
Securities held to maturity:						
State and political subdivisions	72,269	468			72,269	468

Total temporarily impaired securities	$ 407,299	$ 15,246	$ 50,928	$ 2,818	$ 458,227	$ 18,064
December 31, 2012						
U.S. Government agencies and government sponsored enterprises	$ 13,265	$ 67	$ 2,967	$ 2	$ 16,232	$ 69
State and political subdivisions	8,471	72			8,471	72
Mortgage-backed securities:						
Federal National Mortgage Association	25,200	188			25,200	188
Collateralized mortgage obligations:						
Federal National Mortgage Association			1,173	2	1,173	2
Total collateralized mortgage obligations			1,173	2	1,173	2
Total mortgage-backed securities	25,200	188	1,173	2	26,373	190
Total temporarily impaired securities	$ 46,936	$ 327	$ 4,140	$ 4	$ 51,076	$ 331

The total number of security positions in the investment portfolio in an unrealized loss position at December 31, 2013 was 331 compared to 52 at December 31, 2012. At December 31, 2013, the Company had positions in 14 investment securities with a fair value of $50.9 million and a total unrealized loss of $2.8 million that have been in a continuous unrealized loss position for more than 12 months. There were a total of 317 securities positions in the Company s investment portfolio, with a fair value of $407.3 million and a total unrealized loss of $15.2 million at December 31, 2013, that have been in a continuous unrealized loss position for less than 12 months. There were no unrealized losses in held to maturity securities at December 31, 2012. The unrealized loss on these investment securities was predominantly caused by changes in market interest rates subsequent to purchase. The fair value of most of the investment securities in the Company s portfolio fluctuates as market interest rates change.

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December 31, 2013, 2012 and 2011

(3.) INVESTMENT SECURITIES (Continued)

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

No impairment was recorded during the year ended December 31, 2013. During the years ended December 31, 2012 and 2011, the Company recognized OTTI charges of $91 thousand and $18 thousand, respectively, related to privately issued whole loan CMOs that were determined to be impaired due to credit quality.

Based on management s review and evaluation of the Company s debt securities as of December 31, 2013, the debt securities with unrealized losses were not considered to be OTTI. As of December 31, 2013, the Company does not have the intent to sell any of the securities in a loss position and believes that it is not likely that it will be required to sell any such securities before the anticipated recovery of amortized cost. Accordingly, as of December 31, 2013, 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.

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

Loans held for sale were entirely comprised of residential real estate mortgages and totaled $3.4 million and $1.5 million as of December 31, 2013 and 2012, 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 $237.9 million and $273.3 million as of December 31, 2013 and 2012, respectively. In connection with these mortgage-servicing activities, the Company administered escrow and other custodial funds which amounted to approximately $4.9 million and $5.6 million as of December 31, 2013 and 2012, respectively.

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

	2013	2012	2011
Mortgage servicing assets, beginning of year	$ 1,637	$ 1,609	$ 1,642
Originations	277	554	319
Amortization	(435)	(526)	(352)
Mortgage servicing assets, end of year	1,479	1,637	1,609
Valuation allowance	(3)	(168)	(210)
Mortgage servicing assets, net, end of year	$ 1,476	$ 1,469	$ 1,399

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(5.) LOANS

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

	Principal Amount Outstanding	Net Deferred Loan (Fees) Costs	Loans, Net
2013			
Commercial business	$ 265,751	$ 15	$ 265,766
Commercial mortgage	470,312	(1,028)	469,284
Residential mortgage	113,101	(56)	113,045
Home equity	320,658	5,428	326,086
Consumer indirect	609,390	26,978	636,368
Other consumer	22,893	177	23,070
Total	$ 1,802,105	$ 31,514	1,833,619
Allowance for loan losses			(26,736)
Total loans, net			$ 1,806,883
2012			
Commercial business	$ 258,706	$ (31)	$ 258,675
Commercial mortgage	414,282	(958)	413,324
Residential mortgage	133,341	179	133,520
Home equity	282,503	4,146	286,649
Consumer indirect	559,964	26,830	586,794
Other consumer	26,657	107	26,764
Total	$ 1,675,453	$ 30,273	1,705,726
Allowance for loan losses			(24,714)
Total loans, net			$ 1,681,012

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 $2.9 million and $292 thousand at December 31, 2013 and 2012, respectively. During 2013, new borrowings amounted to $2.7 million (including borrowings of executive officers and directors that were outstanding at the time of their election), and repayments and other reductions were $79 thousand.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(5.) LOANS (Continued)

Past Due Loans Aging

The Company s recorded investment, by loan class, in current and nonaccrual loans, as well as an analysis of accruing delinquent loans is set forth as of December 31 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Nonaccrual	Current	Total Loans
2013							
Commercial business	$ 558	$ 199	$	$ 757	$ 3,474	$ 261,520	$ 265,751
Commercial mortgage	800			800	9,663	459,849	470,312
Residential mortgage	542			542	1,078	111,481	113,101
Home equity	750	143		893	925	318,840	320,658
Consumer indirect	2,129	476		2,605	1,471	605,314	609,390
Other consumer	126	72	6	204	5	22,684	22,893
Total loans, gross	$ 4,905	$ 890	$ 6	$ 5,801	$ 16,616	$ 1,779,688	$ 1,802,105
2012							
Commercial business	$ 160	$	$	$ 160	$ 3,413	$ 255,133	$ 258,706
Commercial mortgage	331			331	1,799	412,152	414,282
Residential mortgage	376			376	2,040	130,925	133,341
Home equity	675	10		685	939	280,879	282,503
Consumer indirect	1,661	163		1,824	891	557,249	559,964
Other consumer	127	35	18	180	25	26,452	26,657
Total loans, gross	$ 3,330	$ 208	$ 18	$ 3,556	$ 9,107	$ 1,662,790	$ 1,675,453

There were no loans past due greater than 90 days and still accruing interest as of December 31, 2013 and December 31, 2012. There were $6 thousand and $18 thousand in consumer overdrafts which were past due greater than 90 days as of December 31, 2013 and December 31, 2012, 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, 2013, 2012 and 2011. For the years ended December 31, 2013, 2012 and 2011, estimated interest income of $531 thousand, $555 thousand, and $438 thousand, respectively, would have been recorded if all such loans had been accruing interest according to their original contractual terms.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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December 31, 2013, 2012 and 2011

(5.) LOANS (Continued)

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 years ended December 31 (in thousands).

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2013			
Commercial business	4	$ 1,465	$ 1,456
Commercial mortgage	2	7,335	6,935
Total	6	$ 8,800	$ 8,391
2012			
Commercial business	3	$ 536	$ 536
Commercial mortgage	4	648	648
Total	7	$ 1,184	$ 1,184

With the exception of one commercial mortgage loan modified during 2013, all of the loans identified as TDRs by the Company during the years ended December 31, 2013 and 2012 were on nonaccrual status and reported as impaired loans prior to restructuring. For the year ended December 31, 2013, restructured loan modifications of commercial business and commercial mortgage loans primarily included maturity date extensions, payment schedule modifications and forgiveness of principal. For the year ended December 31, 2012, restructured loan modifications of commercial business and commercial mortgage loans primarily included payment schedule modifications and releasing collateral in consideration of payment. All loans restructured during the years ended December 31, 2013 and 2012 were on nonaccrual status at the end of those respective years. 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 either classified as substandard, with an increased risk allowance allocation, or 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. There were no loans modified as a TDR during the previous 12 months which subsequently defaulted during the year ended December 31, 2013. One commercial business loan restructured during 2012 with a balance of $52 thousand defaulted during the year ended December 31, 2012. This default did not significantly impact the Company s determination of the allowance for loan losses.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(5.) LOANS (Continued)

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):

	Recorded Investment[(1)]	Unpaid Principal Balance[(1)]	Related Allowance	Average Recorded Investment	Interest Income Recognized
2013					
With no related allowance recorded:					
Commercial business	$ 1,777	$ 2,273	$	$ 659	$
Commercial mortgage	875	906		760	
	2,652	3,179		1,419	
With an allowance recorded:					
Commercial business	1,697	1,717	201	3,196	
Commercial mortgage	8,788	9,188	1,057	3,758	
	10,485	10,905	1,258	6,954	
	$ 13,137	$ 14,084	$ 1,258	$ 8,373	$
2012					
With no related allowance recorded:					
Commercial business	$ 963	$ 1,425	$	$ 755	$
Commercial mortgage	911	1,002		1,310	
	1,874	2,427		2,065	
With an allowance recorded:					
Commercial business	2,450	2,450	664	2,114	
Commercial mortgage	888	888	310	1,858	

		3,338		3,338		974		3,972	
	$	5,212	$	5,765	$	974	$	6,037	$

(1) Difference between recorded investment and unpaid principal balance represents partial charge-offs.

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.

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December 31, 2013, 2012 and 2011

(5.) LOANS (Continued)

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):

	Commercial Business	Commercial Mortgage
2013		
Uncriticized	$ 250,553	$ 449,447
Special mention	6,311	6,895
Substandard	8,887	13,970
Doubtful		
Total	$ 265,751	$ 470,312
2012		
Uncriticized	$ 240,291	$ 400,576
Special mention	6,591	6,495
Substandard	11,824	7,211
Doubtful		
Total	$ 258,706	$ 414,282

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):

	Residential Mortgage	Home Equity	Consumer Indirect	Other Consumer
2013				
Performing	$ 112,023	$ 319,733	$ 607,919	$ 22,882
Non-performing	1,078	925	1,471	11
Total	$ 113,101	$ 320,658	$ 609,390	$ 22,893
2012				
Performing	$ 131,301	$ 281,564	$ 559,073	$ 26,632
Non-performing	2,040	939	891	25
Total	$ 133,341	$ 282,503	$ 559,964	$ 26,657

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(5.) LOANS (Continued)

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):

	Commercial Business	Commercial Mortgage	Residential Mortgage	Home Equity	Consumer Indirect	Other Consumer	Total
2013							
Allowance for loan losses:							
Beginning balance	$ 4,884	$ 6,581	$ 740	$ 1,282	$ 10,715	$ 512	$ 24,714
Charge-offs	(1,070)	(553)	(411)	(391)	(8,125)	(928)	(11,478)
Recoveries	349	319	54	157	3,161	381	4,421
Provision	110	1,396	293	319	6,479	482	9,079
Ending balance	$ 4,273	$ 7,743	$ 676	$ 1,367	$ 12,230	$ 447	$ 26,736
Evaluated for impairment:							
Individually	$ 201	$ 1,057	$	$	$	$	$ 1,258
Collectively	$ 4,072	$ 6,686	$ 676	$ 1,367	$ 12,230	$ 447	$ 25,478
Loans:							
Ending balance	$ 265,751	$ 470,312	$ 113,101	$ 320,658	$ 609,390	$ 22,893	$ 1,802,105
Evaluated for impairment:							
Individually	$ 3,474	$ 9,663	$	$	$	$	$ 13,137
Collectively	$ 262,277	$ 460,649	$ 113,101	$ 320,658	$ 609,390	$ 22,893	$ 1,788,968

2012

Allowance for loan losses:							
Beginning balance	$ 4,036	$ 6,418	$ 858	$ 1,242	$ 10,189	$ 517	$ 23,260
Charge-offs	(729)	(745)	(326)	(305)	(6,589)	(874)	(9,568)
Recoveries	336	261	130	44	2,769	354	3,894
Provision	1,241	647	78	301	4,346	515	7,128
Ending balance	$ 4,884	$ 6,581	$ 740	$ 1,282	$ 10,715	$ 512	$ 24,714
Evaluated for impairment:							
Individually	$ 664	$ 310	$	$	$	$	$ 974
Collectively	$ 4,220	$ 6,271	$ 740	$ 1,282	$ 10,715	$ 512	$ 23,740
Loans:							
Ending balance	$ 258,706	$ 414,282	$ 133,341	$ 282,503	$ 559,964	$ 26,657	$ 1,675,453
Evaluated for impairment:							
Individually	$ 3,413	$ 1,799	$	$	$	$	$ 5,212
Collectively	$ 255,293	$ 412,483	$ 133,341	$ 282,503	$ 559,964	$ 26,657	$ 1,670,241

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(5.) LOANS (Continued)

	Commercial Business	Commercial Mortgage	Residential Mortgage	Home Equity	Consumer Indirect	Other Consumer	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

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, and 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

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(6.) PREMISES AND EQUIPMENT, NET

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

	2013	2012
Land and land improvements	$ 4,883	$ 4,883
Buildings and leasehold improvements	44,830	43,402
Furniture, fixtures, equipment and vehicles	25,464	24,440
Premises and equipment	75,177	72,725
Accumulated depreciation and amortization	(39,168)	(36,107)
Premises and equipment, net	$ 36,009	$ 36,618

Depreciation and amortization expense relating to premises and equipment, included in occupancy and equipment expense in the consolidated statements of income, amounted to $3.8 million, $3.6 million and $3.5 million for the years ended December 31, 2013, 2012 and 2011, respectively.

(7.) GOODWILL AND OTHER INTANGIBLE ASSETS

The change in the balance for goodwill during the years ended December 31, 2013 and 2012 was as follows (in thousands):

	2013	2012
Goodwill, beginning of year	$ 48,536	$ 37,369
Branch acquisitions		11,167
Impairment		
Goodwill, end of year	$ 48,536	$ 48,536

Pursuant to the adoption of ASU 2011-08 in 2012, the Company first performed a qualitative assessment of goodwill at the reporting unit level, the Bank, to determine if it was more likely than not that the fair value of the reporting unit is less than its carrying value. In performing a qualitative analysis, factors considered include, but are not limited to, business strategy, financial performance and market and regulatory dynamics. The results of the qualitative assessment for 2013 indicated that it was not more likely than not that the fair value of the reporting unit is less than its carrying value. Consequently, no additional quantitative two-step impairment test was required, and no impairment was recorded in 2013. In 2012 and 2011 (prior to the adoption of ASU 2011-08) the Company performed a quantitative impairment test that did not result in any impairment.

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.

The Company s other intangible assets consisted entirely of a core deposit intangible asset. Changes in the accumulated amortization and net book value were as follows (in thousands):

	2013	**2012**
Gross carrying amount	$ 2,042	$ 2,042
Accumulated amortization	(576)	(189)
Net book value	$ 1,466	$ 1,853
Amortization during the year	$ 387	$ 189

There were no core deposit intangible assets or amortization expense for the year ended December 31, 2011.

Estimated core deposit intangible amortization expense for each of the next five years is as follows:

2014	$ 341
2015	296
2016	251
2017	205
2018	160

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(8.) DEPOSITS

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

	2013	2012
Noninterest-bearing demand	$ 535,472	$ 501,514
Interest-bearing demand	470,733	449,744
Savings and money market	717,928	655,598
Certificates of deposit, due:		
Within one year	448,997	495,423
One to two years	77,219	91,052
Two to three years	23,642	35,993
Three to five years	46,045	31,721
Thereafter	20	749
Total certificates of deposit	595,923	654,938
Total deposits	$ 2,320,056	$ 2,261,794

Certificates of deposit in denominations of $100,000 or more at December 31, 2013 and 2012 amounted to $226.0 million and $222.4 million, respectively.

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

	2013	2012	2011
Interest-bearing demand	$ 729	$ 598	$ 614
Savings and money market	978	998	1,056
Certificates of deposit	4,893	6,866	9,764
Total interest expense on deposits	$ 6,600	$ 8,462	$ 11,434

(9.) BORROWINGS

There were no long-term borrowings outstanding as of December 31, 2013 and 2012. Outstanding short-term borrowings are summarized as follows as of December 31 (in thousands):

	2013	2012
Short-term borrowings:		
Repurchase agreements	$ 39,042	$ 40,806
Short-term FHLB borrowings	298,000	139,000
Total short-term borrowings	$ 337,042	$ 179,806

The Company classifies borrowings as short-term or long-term in accordance with the original terms of the agreement. At December 31, 2013 and 2012, the Company s short-term borrowings had a weighted average rate of 0.38% and 0.54%, respectively.

Short-term Borrowings

Federal funds purchased are short-term borrowings that typically mature within one to ninety days. Short-term repurchase agreements are secured overnight borrowings with customers. 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, 2013 consisted of $198.0 million in overnight borrowings and $100.0 million in short-term advances. Short-term FHLB borrowings at December 31, 2012 consisted of $99.0 million in overnight borrowings and $40.0 million in short-term advances.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(9.) BORROWINGS (Continued)

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. The Company may be required to provide additional collateral based on the fair value of the underlying securities. There were no FHLB long-term borrowings outstanding as of December 31, 2013 and 2012.

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.

(10.) 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):

	2013	2012
Commitments to extend credit	$ 431,236	$ 435,948
Standby letters of credit	8,618	9,223

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the agreement. 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. There were no forward sales commitments outstanding as of December 31, 2013 and $1.8 million outstanding as of December 31, 2012. 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.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(10.) COMMITMENTS AND CONTINGENCIES (Continued)

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, 2013 (in thousands):

2014	$ 1,440
2015	1,381
2016	1,273
2017	878
2018	626
Thereafter	3,796
	$ 9,394

Rent expense relating to these operating leases, included in occupancy and equipment expense in the statements of income, was $1.7 million, $1.6 million and $1.5 million in 2013, 2012 and 2011, 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.

(11.) 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. Tier 1 capital for the Company includes, subject to limitation, $17.3 million of preferred stock. The Company and the Bank s total capital are comprised of Tier 1 capital for each entity plus a permissible portion of the allowance for loan losses.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(11.) REGULATORY MATTERS (Continued)

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). 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.

The Company s and the Bank s actual and required regulatory capital ratios were as follows as of December 31 (in thousands):

		Actual		For Capital Adequacy Purposes		Well Capitalized	
		Amount	Ratio	Amount	Ratio	Amount	Ratio
2013							
Tier 1 leverage:	Company	$ 215,024	7.63%	$ 112,660	4.00%	$ 140,825	5.00%
	Bank	204,336	7.27	112,498	4.00	140,622	5.00
Tier 1 capital:	Company	215,024	10.82	79,459	4.00	119,188	6.00
	Bank	204,336	10.31	79,291	4.00	118,937	6.00
Total risk-based capital:	Company	239,878	12.08	158,918	8.00	198,647	10.00
	Bank	229,139	11.56	158,583	8.00	198,228	10.00
2012							
Tier 1 leverage:	Company	$ 200,255	7.71%	$ 103,845	4.00%	$ 129,806	5.00%
	Bank	192,136	7.41	103,681	4.00	129,601	5.00
Tier 1 capital:	Company	200,255	10.73	74,681	4.00	112,022	6.00
	Bank	192,136	10.31	74,526	4.00	111,789	6.00
Total risk-based capital:	Company	223,610	11.98	149,363	8.00	186,703	10.00
	Bank	215,443	11.56	149,052	8.00	186,315	10.00

As of December 31, 2013, 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, 2013 and 2012.

Dividend Restrictions

In the ordinary course of business, the Company is dependent upon dividends from the Bank to provide funds for the payment of 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.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(12.) 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 173,423 shares and 174,709 shares of preferred stock issued and outstanding as of December 31, 2013 and 2012, respectively.

Common Stock

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

	Outstanding	Treasury	Issued
2013			
Shares outstanding at beginning of year	13,787,709	373,888	14,161,597
Restricted stock awards issued, net of forfeitures	24,058	(24,058)	
Stock options exercised	23,265	(23,265)	
Treasury stock purchases	(11,349)	11,349	
Directors retainer	5,672	(5,672)	
Shares outstanding at end of year	13,829,355	332,242	14,161,597
2012			
Shares outstanding at beginning of year	13,803,116	358,481	14,161,597
Restricted stock awards issued, net of forfeitures	7,857	(7,857)	
Stock options exercised	4,250	(4,250)	
Treasury stock purchases	(33,330)	33,330	
Directors retainer	5,816	(5,816)	
Shares outstanding at end of year	13,787,709	373,888	14,161,597

Preferred Stock

Series A 3% Preferred Stock. There were 1,496 shares and 1,499 shares of Series A 3% preferred stock issued and outstanding as of December 31, 2013 and 2012, 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 171,927 shares and 173,210 shares of Series B-1 8.48% preferred stock issued and outstanding as of December 31, 2013 and 2012, 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.

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(12.) 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 the Company s 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.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(13.) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table presents the components of other comprehensive income (loss) for the years ended December 31 (in thousands):

	Pre-tax Amount	Tax Effect	Net-of-tax Amount
2013			
Securities available for sale and transferred securities:			
Change in unrealized gain/loss during the period	$ (34,135)	$ (13,522)	$ (20,613)
Change in net unrealized gain on securities transferred to held to maturity	(72)	(29)	(43)
Reclassification adjustment for net gains included in net income	(1,226)	(485)	(741)
Total securities available for sale and transferred securities	(35,433)	(14,036)	(21,397)
Pension and post-retirement obligations:			
Net actuarial gain (loss), net of amortization	13,223	5,238	7,985
Prior service cost, net of amortization	(47)	(19)	(28)
Total pension and post-retirement obligations	13,176	5,219	7,957
Other comprehensive loss	$ (22,257)	$ (8,817)	$ (13,440)
2012			
Securities available for sale:			
Change in unrealized gain/loss during the period	$ 6,682	$ 2,646	$ 4,036
Reclassification adjustment for gains included in income	(2,651)	(1,050)	(1,601)
Reclassification adjustment for impairment charges included in income	91	36	55
Total securities available for sale	4,122	1,632	2,490
Pension and post-retirement obligations:			
Net actuarial gain (loss), net of amortization	(253)	(99)	(154)
Prior service cost, net of amortization	(47)	(19)	(28)
Total pension and post-retirement obligations	(300)	(118)	(182)
Other comprehensive income	$ 3,822	$ 1,514	$ 2,308
2011			

Securities available for sale:			
Change in 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
Total securities available for sale	19,365	7,672	11,693
Pension and post-retirement obligations:			
Net actuarial gain (loss), net of amortization	(9,930)	(3,934)	(5,996)
Prior service cost, net of amortization	(49)	(19)	(30)
Total pension and post-retirement obligations	(9,979)	(3,953)	(6,026)
Other comprehensive income	$ 9,386	$ 3,719	$ 5,667

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(13.) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) (Continued)

Activity in accumulated other comprehensive income (loss), net of tax, was as follows (in thousands):

	Securities Available for Sale and Transferred Securities	Pension and Post-retirement Obligations	Accumulated Other Comprehensive Income (Loss)
Balance at January 1, 2013	$ 16,060	$ (12,807)	$ 3,253
Other comprehensive (loss) income before reclassifications	(20,656)	7,173	(13,483)
Amounts reclassified from accumulated other comprehensive income	(741)	784	43
Net current period other comprehensive (loss) income	(21,397)	7,957	(13,440)
Balance at December 31, 2013	$ (5,337)	$ (4,850)	$ (10,187)
Balance at January 1, 2012	$ 13,570	$ (12,625)	$ 945
Other comprehensive income (loss) before reclassifications	4,036	(981)	3,055
Amounts reclassified from accumulated other comprehensive income	(1,546)	799	(747)
Net current period other comprehensive income (loss)	2,490	(182)	2,308
Balance at December 31, 2012	$ 16,060	$ (12,807)	$ 3,253
Balance at January 1, 2011	$ 1,877	$ (6,599)	$ (4,722)
Other comprehensive income (loss) before reclassifications	13,495	(6,363)	7,132
Amounts reclassified from accumulated other comprehensive loss	(1,802)	337	(1,465)
Net current period other comprehensive income (loss)	11,693	(6,026)	5,667

Balance at December 31, 2011	$ 13,570	$ (12,625)	$ 945

(14.) 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 (the 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), and collectively with the Management Plan, the Plans . An aggregate of 690,000 shares of the Company s common stock have 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 of which are defined in the plan. An aggregate of 250,000 shares of the Company s common stock have 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 of 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, 2013, there were approximately 185,000 and 425,000 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 Plans, the Board, in the case of the Director s Plan, or the Compensation Committee, in the case of the Management Plan, 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 an option recipient exercises their options, the Company issues shares from treasury stock and records the proceeds as additions to capital. Shares of restricted stock granted to employees generally vest over 2 to 3 years from the grant date. Fifty percent of the shares of restricted stock granted to non-employee directors generally vests on the date of grant and the remaining fifty percent generally vests one year 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.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(14.) SHARE-BASED COMPENSATION (Continued)

The share-based compensation plans were established to allow for the granting of compensation awards to attract, motivate and retain employees, executive officers and non-employee directors who contribute to the success and profitability of the Company and to give such persons a proprietary interest in the Company, thereby enhancing their personal interest in the Company s success.

The Company awarded grants of 33,035 shares of restricted common stock to certain members of management during the year ended December 31, 2013. Fifty percent of the shares subject to each grant will be earned based upon achievement of an EPS performance requirement for the Company s fiscal year ended December 31, 2013. The remaining fifty percent of the shares will be earned based on the Company s achievement of a relative total shareholder return (TSR) performance requirement, on a percentile basis, compared to a defined group of peer companies over a three-year performance period ended December 31, 2015. The shares earned based on the achievement of the EPS and TSR performance requirements, if any, will vest based on the recipient s continuous service to the Company on December 31, 2015.

The grant-date fair value of the TSR portion of the award granted during the year ended December 31, 2013 was determined using the Monte Carlo simulation model on the date of grant, assuming the following (i) expected term of 2.88 years, (ii) risk free interest rate of 0.42%, (iii) expected dividend yield of 3.59% and (iv) expected stock price volatility over the expected term of the TSR award of 37.2%. The grant-date fair value of all other restricted stock awards is equal to the closing market price of our common stock on the date of grant.

In addition, the Company granted 1,000 shares of restricted common stock to management during the year ended December 31, 2013. The shares will vest after completion of a three-year service requirement. The market price of the restricted stock on the date of grant was $20.70.

During the year ended December 31, 2013, the Company granted 9,000 shares of restricted common stock to directors, of which 4,500 shares vested immediately and 4,500 shares will vest after completion of a one-year service requirement. The market price of the restricted stock on the date of grant was $19.81.

The restricted stock awards granted to management and directors in 2013 do not have rights to dividends or dividend equivalents.

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 2013, 2012 or 2011. There was no unrecognized compensation expense related to unvested stock options as of December 31, 2013. The following is a summary of stock option activity for the year ended December 31, 2013 (dollars in thousands, except per share amounts):

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	319,275	$ 20.22		
Granted				
Exercised	(23,265)	19.31		
Forfeited				
Expired	(103,076)	21.15		
Outstanding and exercisable at end of period	192,934	$ 19.83	2.6 years	$ 940

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, 2013, 2012 and 2011 was $106 thousand, $10 thousand, and $31 thousand, respectively. The total cash received as a result of option exercises under stock compensation plans for the years ended December 31, 2013, 2012 and 2011 was $448 thousand, $69 thousand, and $91 thousand, respectively. The tax benefits realized in connection with these stock option exercises were not significant.

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(14.) SHARE-BASED COMPENSATION (Continued)

The following is a summary of restricted stock award activity for the year ended December 31, 2013:

	Number of Shares	Weighted Average Market Price at Grant Date
Outstanding at beginning of year	79,580	$ 16.89
Granted	43,035	16.94
Vested	(38,598)	17.04
Forfeited	(18,977)	16.60
Outstanding at end of period	65,040	$ 16.92

As of December 31, 2013, there was $325 thousand of unrecognized compensation expense related to unvested restricted stock awards that is expected to be recognized over a weighted average period of 1.6 years.

The Company amortizes the expense related to restricted stock awards over the vesting period. Share-based compensation expense is recorded as a component of salaries and employee benefits in the consolidated statements of income for awards granted to management and as a component of other noninterest expense for awards granted to directors. The share-based compensation expense for the years ended December 31 was as follows (in thousands):

	2013	2012	2011
Salaries and employee benefits	$ 236	$ 394	$ 972
Other noninterest expense	171	132	133
Total share-based compensation expense	$ 407	$ 526	$ 1,105

(15.) INCOME TAXES

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

	2013	2012	2011
Current tax expense:			
Federal	$ 8,917	$ 4,021	$ 3,747
State	1,913	955	1,158
Total current tax expense	10,830	4,976	4,905
Deferred tax expense:			
Federal	1,251	5,262	5,584
State	296	1,081	926
Total deferred tax expense	1,547	6,343	6,510
Total income tax expense	$ 12,377	$ 11,319	$ 11,415

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

	2013	2012	2011
Statutory federal tax rate	35.0%	35.0%	35.0%
Increase (decrease) resulting from:			
Tax exempt interest income	(4.8)	(4.6)	(4.3)
Non-taxable earnings on company owned life insurance	(1.6)	(1.8)	(1.5)
State taxes, net of federal tax benefit	3.8	3.8	4.0
Nondeductible expenses	0.2	0.3	0.4
Other, net	0.1	(0.1)	(0.2)
Effective tax rate	32.7%	32.6%	33.4%

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(15.) INCOME TAXES (Continued)

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

	2013	2012	2011
Income tax expense	$ 12,377	$ 11,319	$ 11,415
Shareholder s equity	(8,817)	1,514	3,718

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):

	2013	2012
Deferred tax assets:		
Allowance for loan losses	$ 10,591	$ 9,791
Net unrealized loss on securities available for sale	3,501	
Other than temporary impairment of investment securities	2,728	5,283
Deferred compensation	873	868
Share-based compensation	753	1,111
SERP agreements	709	734
Interest on nonaccrual loans	662	732
Other	814	1,060
Gross deferred tax assets	20,631	19,579
Deferred tax liabilities:		
Prepaid pension costs	6,185	1,648
Depreciation and amortization	1,606	1,827
Loan servicing assets	620	681
Net unrealized gain on securities available for sale		10,536
Other	63	
Gross deferred tax liabilities	8,474	14,692
Net deferred tax asset	$ 12,157	$ 4,887

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, 2013 or 2012.

The Company and its subsidiaries are subject to federal and New York State (NYS) income taxes. The federal and NYS income tax years currently open for audits are 2010 through 2013.

At December 31, 2013, the Company had no federal or NYS net operating loss or tax credit carryforwards.

The Company s unrecognized tax benefits and changes in unrecognized tax benefits were not significant as of or for the years ended December 31, 2013 and 2012. There were no interest or penalties recorded in the income statement in income tax expense for the year ended December 31, 2013. As of December 31, 2013, there were no amounts accrued for interest or penalties related to uncertain tax positions.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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(16.) 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).

	2013	2012	2011
Net income available to common shareholders	$ 24,064	$ 21,975	$ 19,617
Less: Earnings allocated to participating securities		2	38
Net income available to common shareholders for EPS	$ 24,064	$ 21,973	$ 19,579
Weighted average common shares outstanding:			
Total shares issued	14,162	14,162	13,599
Unvested restricted stock awards	(69)	(107)	(166)
Treasury shares	(354)	(359)	(366)
Total basic weighted average common shares outstanding	13,739	13,696	13,067
Incremental shares from assumed:			
Exercise of stock options	13	4	3
Vesting of restricted stock awards	32	51	65
Exercise of warrant			22
Total diluted weighted average common shares outstanding	13,784	13,751	13,157
Basic earnings per common share	$ 1.75	$ 1.60	$ 1.50
Diluted earnings per common share	$ 1.75	$ 1.60	$ 1.49

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:

Stock options	122	303	339
Restricted stock awards	2	1	
	124	304	339

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(17.) 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 Company s 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):

	2013	2012
Change in projected benefit obligation:		
Projected benefit obligation at beginning of period	$ 53,625	$ 48,303
Service cost	2,063	2,037
Interest cost	2,017	2,017
Actuarial (gain) loss	(6,393)	3,291
Benefits paid and plan expenses	(2,321)	(2,023)
Projected benefit obligation at end of period	48,991	53,625
Change in plan assets:		
Fair value of plan assets at beginning of period	57,785	46,943
Actual return on plan assets	9,139	4,865
Employer contributions		8,000
Benefits paid and plan expenses	(2,321)	(2,023)
Fair value of plan assets at end of period	64,603	57,785
Funded status at end of period	$ 15,612	$ 4,160

The accumulated benefit obligation was $44.0 million and $48.0 million at December 31, 2013 and 2012, 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 has no minimum required contribution for the 2014 fiscal year.

Estimated benefit payments under the pension plan over the next ten years at December 31, 2013 are as follows (in thousands):

2014	$ 1,709
2015	1,868
2016	2,094
2017	2,277
2018	2,339
2019 - 2023	14,044

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

	2013	2012	2011
Service cost	$ 2,063	$ 2,037	$ 1,756
Interest cost on projected benefit obligation	2,017	2,017	2,027
Expected return on plan assets	(3,684)	(3,211)	(2,653)
Amortization of unrecognized loss	1,344	1,370	608
Amortization of unrecognized prior service cost	20	20	19
Net periodic pension cost	$ 1,760	$ 2,233	$ 1,757

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(17.) EMPLOYEE BENEFIT PLANS (Continued)

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

	2013	2012	2011
Weighted average discount rate	3.84%	4.27%	5.38%
Rate of compensation increase	3.00%	3.00%	3.00%
Expected long-term rate of return	6.50%	7.00%	7.00%

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

	2013	2012	2011
Weighted average discount rate	4.80%	3.84%	4.27%
Rate of compensation increase	3.00%	3.00%	3.00%

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 capita 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 government issues (maturing in less than three months) and short term investment funds. Equity securities primarily include investments in common stock, depository receipts, preferred stock and real estate investment trusts. Fixed income securities include corporate bonds, government issues, mortgage backed securities, municipals and other asset backed securities.

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(17.) EMPLOYEE BENEFIT PLANS (Continued)

Effective February 2012, 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. Effective June 2013, the issuer of any security purchased must be located in a country in the Morgan Stanley Capital International World Index. 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 13% of the investment manager s portfolio. Prior to February 2012, these investments could not exceed 10% of the manager s portfolio.

	Effective February 2012, an investment manager s portfolio of commercial MBS and ABS shall not exceed 10% of the portfolio at the time of purchase.
Other financial instruments	Unhedged currency exposure in countries not defined as high income economies by the World Bank

All other investments not prohibited by the Plan are permitted. At December 31, 2013 and 2012, the Plan held 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.

The target allocation range below is both historic and prospective in that it has not changed since prior to 2012. It is the asset allocation range that the investment managers have been advised to adhere to and within which they may make tactical asset allocation decisions.

	2014 Target Allocation	Percentage of Plan Assets at December 31, 2013	Percentage of Plan Assets at December 31, 2012	Weighted Average Expected Long-term Rate of Return
Asset category:				
Cash equivalents	0 20%	5.5%	12.8%	0.17%
Equity securities	40 60	50.6	45.5	4.26
Fixed income securities	40 60	43.9	41.7	2.06
Other financial instruments	0 5			

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 18 - Fair Value Measurements). There were no assets classified as Level 3 assets during the years ended December 31, 2013 and 2012.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. Investments valued using the NAV (Net Asset Value) are classified as level 2 if the Plan can redeem its investment with the investee at the NAV at the measurement date. If the Plan can never redeem the investment with the investee at the NAV, it is considered a level 3. If the Plan can redeem the investment at the NAV at a future date, the Plan s assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

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December 31, 2013, 2012 and 2011

(17.) EMPLOYEE BENEFIT PLANS (Continued)

The Plan uses the Thomson Reuters Pricing Service to determine the fair value of equities and the pricing service of IDC Corporate USA to determine the fair value of fixed income securities. The major categories of Plan assets measured at fair value on a recurring basis as of December 31 are presented in the following table (in thousands).

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
2013				
Cash equivalents:				
Foreign currencies	92			92
Government issues		937		937
Short term investment funds		2,498		2,498
Total cash equivalents	92	3,435		3,527
Equity securities:				
Common stock	32,072			32,072
Depository receipts	309	96		405
Preferred stock	151			151
Real estate investment fund	94			94
Total equity securities	32,626	96		32,722
Fixed income securities:				
Auto loan receivable		232		232
Collateralized mortgage obligations		7,079		7,079
Corporate Bonds		7,609		7,609
FHLMC		883		883
FNMA		3,044		3,044
GNMA I		215		215
GNMA II		96		96
Government Issues		8,984		8,984
Municipals		212		212
Total fixed income securities		28,354		28,354

Total Plan investments	$ 32,718	31,885	64,603

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(17.) EMPLOYEE BENEFIT PLANS (Continued)

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
2012				
Cash equivalents:				
Foreign currencies	60			60
Government issues		314		314
Short term investment funds		7,083		7,083
Total cash equivalents	60	7,397		7,457
Equity securities:				
Common stock	25,447			25,447
Depository receipts	569			569
Preferred stock	113			113
Real estate investment fund	113			113
Total equity securities	26,242			26,242
Fixed income securities:				
Auto loan receivable		313		313
Collateralized mortgage obligations		6,262		6,262
Corporate Bonds		5,456		5,456
FHLMC		717		717
FNMA		2,867		2,867
GNMA I		31		31
GNMA II		133		133
Government Issues		8,231		8,231
Municipals		63		63
Other Asset Backed		13		13
Total fixed income securities		24,086		24,086
Total Plan investments	$ 26,302	31,483		57,785

At December 31, 2013 the portfolio was managed by two investment firms, with control of the portfolio split approximately 58% and 41% under the control of the investment managers with the remaining 1% under the direct control of the Plan. A portfolio concentration in the State Street Bank & Trust Co. Short Term Investment Fund of 5% and 12% existed at December 31, 2013 and 2012, 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 employees who had already met the then-applicable age and service requirements 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. Retirees ages 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 $93 thousand and $118 thousand as of December 31, 2013 and 2012, 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, 2013, 2012 and 2011. The plan is not funded.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(17.) EMPLOYEE BENEFIT PLANS (Continued)

The components of accumulated other comprehensive loss related to the defined benefit plan and postretirement benefit plan as of December 31 are summarized below (in thousands):

	2013	2012
Defined benefit plan:		
Net actuarial loss	$ (8,237)	$ (21,428)
Prior service cost	(72)	(93)
	(8,309)	(21,521)
Postretirement benefit plan:		
Net actuarial loss	(163)	(195)
Prior service credit	440	508
	277	313
	(8,032)	(21,208)
Deferred tax benefit	3,182	8,401
Amounts included in accumulated other comprehensive loss	$ (4,850)	$ (12,807)

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

	2013	2012
Defined benefit plan:		
Net actuarial gain (loss)	$ 11,847	$ (1,638)
Amortization of net loss	1,344	1,370
Amortization of prior service cost	21	20
	13,212	(248)

Postretirement benefit plan:		
Net actuarial gain	32	15
Amortization of prior service credit	(68)	(67)
	(36)	(52)
Total recognized in other comprehensive loss	$ 13,176	$ (300)

For the year ending December 31, 2014, 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 $159 thousand and $20 thousand, respectively.

Defined Contribution Plan

Employees that meet specified eligibility conditions 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 at 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 2013, 2012 or 2011. The expense included in salaries and employee benefits in the consolidated statements of income for this plan amounted to $1.1 million in 2013 and $1.0 million in 2012 and 2011.

Supplemental Executive Retirement Plans

The Company has non-qualified Supplemental Executive Retirement Plans (SERPs) covering four former executives. The unfunded pension liability related to the SERPs was $2.1 million and $2.2 million at December 31, 2013 and 2012, respectively. SERP expense was $95 thousand, $1.3 million, and $67 thousand for 2013, 2012 and 2011, respectively.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(18.) 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.

Securities available for sale: 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: Fair value of impaired loans with specific allocations of the allowance for loan losses is measured based on the value of the collateral securing these loans and is classified as Level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable and collateral value is determined based on appraisals performed by qualified licensed appraisers hired by the Company. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised and reported values may be discounted based on management s historical knowledge, changes in market conditions from the time of valuation, and/or management s expertise and knowledge of the client and the client s business. Such discounts are typically significant and result in a Level 3 classification of the inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2013, 2012 and 2011

(18.) FAIR VALUE MEASUREMENTS (Continued)

Loan servicing rights: Loan servicing rights do not trade in an active market with readily observable market data. As a result, the Company estimates the fair value of loan 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. The significant unobservable inputs used in the fair value measurement of the Company s loan servicing rights are the constant prepayment rates and weighted average discount rate. Significant increases (decreases) in any of those inputs in isolation could result in a significantly lower (higher) fair value measurement. Although the constant prepayment rate and the discount rate are not directly interrelated, they will generally move in opposite directions. Loan servicing rights are classified as Level 3 measurements due to the use of significant unobservable inputs, as well as significant management judgment and estimation.

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. The appraisals are sometimes further discounted based on management s historical knowledge, changes in market conditions from the time of valuation, and/or management s expertise and knowledge of the client and client s business. Such discounts are typically significant and result in a Level 3 classification of the inputs for determining fair value. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Commitments to extend credit and letters of credit: Commitments to extend credit and fund letters of credit are principally at current interest rates, and, therefore, the carrying amount approximates fair value. The fair value of commitments to is not material.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(18.) FAIR VALUE MEASUREMENTS (Continued)

Assets Measured at Fair Value

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

	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
2013				
Measured on a recurring basis:				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$	$ 134,452	$	$ 134,452
Mortgage-backed securities		474,549		474,549
Asset-backed securities		399		399
	$	$ 609,400	$	$ 609,400
Measured on a nonrecurring basis:				
Loans:				
Loans held for sale	$	$ 3,381	$	$ 3,381
Collateral dependent impaired loans			9,227	9,227
Other assets:				
Loan servicing rights			1,565	1,565
Other real estate owned			333	333
	$	$ 3,381	$ 11,125	$ 14,506

2012				
Measured on a recurring basis:				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$	$ 131,695	$	$ 131,695
State and political subdivisions		195,210		195,210
Mortgage-backed securities		495,868		495,868
Asset-backed securities		1,023		1,023
	$	$ 823,796	$	$ 823,796
Measured on a nonrecurring basis:				
Loans:				
Loans held for sale	$	$ 1,518	$	$ 1,518
Collateral dependent impaired loans			2,364	2,364
Other assets:				
Loan servicing rights			1,719	1,719
Other real estate owned			184	184
	$	$ 1,518	$ 4,267	$ 5,785

There were no transfers between level 1 and 2 during the years ended December 31, 2013 and 2012. There were no liabilities measured at fair value on a recurring or nonrecurring basis during the years ended December 31, 2013 and 2012.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(18.) FAIR VALUE MEASUREMENTS (Continued)

The following table presents additional quantitative information about assets measured at fair value on a recurring and nonrecurring basis for which the Company has utilized Level 3 inputs to determine fair value (dollars in thousands).

Asset	Fair Value	Valuation Technique	Unobservable Input	Unobservable Input Value or Range
Collateral dependent impaired loans	$ 9,227	Appraisal of collateral [1]	Appraisal adjustments [2]	18% - 100% discount
		Discounted cash flow	Discount rate	4.6%[3]
			Risk premium rate	12.0%[3]
Loan servicing rights	$ 1,565	Discounted cash flow	Discount rate	5.2%[3]
			Constant prepayment rate	12.4%[3]
Other real estate owned	$ 333	Appraisal of collateral [1]	Appraisal adjustments [2]	28% - 44% discount

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.
(3) Weighted averages.

Changes in Level 3 Fair Value Measurements

There were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2013. The reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2012 is as follows (in thousands):

Securities available for sale, beginning of period	$ 1,636
Sales	(360)
Total gains (losses) realized/unrealized:	
Included in earnings	331
Included in other comprehensive income	(102)
Transfers from Level 3 to Level 2	(1,505)

Securities available for sale, end of period	$

The Company transferred all of the assets classified as Level 3 assets at December 31, 2011 to Level 2 during the three months ended March 31, 2012. The transfers of the $1.5 million of pooled trust preferred securities out of Level 3 was primarily the result of using observable pricing information or a third party pricing quote that appropriately reflects the fair value of those securities, without the need for adjustment based on our own assumptions regarding the characteristics of a specific security or the current liquidity in the market.

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(18.) FAIR VALUE MEASUREMENTS (Continued)

Disclosures about Fair Value of Financial Instruments

The assumptions used below are expected to approximate those that market participants would use in valuing these financial instruments.

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. 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.

The estimated fair value approximates carrying value for cash and cash equivalents, FHLB and FRB stock, accrued interest receivable, non-maturity deposits, short-term borrowings and accrued interest payable. Fair value estimates for other financial instruments not included elsewhere in this disclosure are discussed below.

Securities held to maturity: The fair value of the Company s investment securities held to maturity is primarily measured using information from a third-party 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: The fair value of the Company s loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made for the same remaining maturities. Loans were first segregated by type such as commercial, residential mortgage, and consumer, and were then further segmented into fixed and variable rate and loan quality categories. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

Time deposits: The fair value of time deposits was estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments. The fair values of the Company s time deposit liabilities do not take into consideration the value of the Company s long-term relationships with depositors, which may have significant value.

The following presents the carrying amount, estimated fair value, and placement in the fair value measurement hierarchy of the Company s financial instruments as of December 31 (in thousands):

	Level in Fair Value Measurement Hierarchy	2013		2012	
		Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:					
Cash and cash equivalents	Level 1	$ 59,692	$ 59,692	$ 60,436	$ 60,436
Securities available for sale	Level 2	609,400	609,400	823,796	823,796
Securities held to maturity	Level 2	249,785	250,657	17,905	18,478
Loans held for sale	Level 2	3,381	3,381	1,518	1,547
Loans	Level 2	1,797,656	1,802,407	1,678,648	1,701,419
Loans (1)	Level 3	9,227	9,227	2,364	2,364
Accrued interest receivable	Level 1	8,150	8,150	7,843	7,843
FHLB and FRB stock	Level 2	19,663	19,663	12,321	12,321
Financial liabilities:					
Non-maturity deposits	Level 1	1,724,133	1,724,133	1,606,856	1,606,856
Time deposits	Level 2	595,923	596,928	654,938	658,342
Short-term borrowings	Level 1	337,042	337,042	179,806	179,806
Accrued interest payable	Level 1	3,407	3,407	3,819	3,819

(1) Comprised of collateral dependent impaired loans.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(19.) PARENT COMPANY FINANCIAL INFORMATION

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

Condensed Statements of Condition	**December 31,**	
	2013	**2012**
Assets:		
Cash and due from subsidiary	$ 9,510	$ 6,602
Investment in and receivables due from subsidiary	245,071	246,535
Other assets	3,463	3,563
Total assets	$ 258,044	$ 256,700
Liabilities and shareholders equity:		
Other liabilities	$ 3,205	$ 2,803
Shareholders equity	254,839	253,897
Total liabilities and shareholders equity	$ 258,044	$ 256,700

Condensed Statements of Income	**Years ended December 31,**		
	2013	**2012**	**2011**
Dividends from subsidiary and associated companies	$ 15,000	$ 4,000	$ 9,233
Management and service fees from subsidiary	368	517	1,161
Other income	71	24	78
Total income	15,439	4,541	10,472
Operating expenses	2,906	2,732	3,787
Loss on extinguishment of debt			1,083
Total expenses	2,906	2,732	4,870
Income before income tax benefit and equity in undistributed earnings of subsidiary	12,533	1,809	5,602
Income tax benefit	1,020	991	1,539
	13,553	2,800	7,141

Income before equity in undistributed earnings of subsidiary			
Equity in undistributed earnings of subsidiary	11,977	20,649	15,658
Net income	$ 25,530	$ 23,449	$ 22,799

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(19.) PARENT COMPANY FINANCIAL INFORMATION (Continued)

Condensed Statements of Cash Flows	**Years ended December 31,**		
	2013	**2012**	**2011**
Cash flows from operating activities:			
Net income	$ 25,530	$ 23,449	$ 22,799
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiary	(11,977)	(20,649)	(15,658)
Depreciation and amortization	47	65	116
Share-based compensation	407	526	1,105
Decrease in other assets	166	805	771
(Decrease) increase in other liabilities	(17)	44	(534)
Net cash provided by operating activities	14,156	4,240	8,599
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
Purchase of preferred and common shares	(360)	(559)	(37,764)
Repurchase of warrant issued to U.S. Treasury			(2,080)
Proceeds from stock options exercised	448	69	91
Dividends paid	(11,218)	(8,866)	(7,564)
Other	(118)	97	20
Net cash used in financing activities	(11,248)	(9,259)	(20,872)
Net increase (decrease) in cash and cash equivalents	2,908	(5,019)	(12,273)
Cash and cash equivalents as of beginning of year	6,602	11,621	23,894
Cash and cash equivalents as of end of the year	$ 9,510	$ 6,602	$ 11,621

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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 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 (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has concluded that, as of December 31, 2013, 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, 2013 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

During February 2014, Five Star Bank (the Bank) formed a wholly-owned subsidiary, Five Star REIT, Inc. (the REIT), to acquire a portion of the Bank s assets, which will primarily be qualifying mortgage related loans. The Bank made an initial contribution of mortgage related loans to the REIT in return for common stock of the REIT. The REIT expects to purchase mortgage related loans from the Bank on a periodic basis going forward. The REIT entered into service agreements with the Bank for administrative and investment services. The Company expects the formation of the REIT to result in a lower effective tax rate for 2014 subject to New York State tax reform and future tax legislation.

The foregoing disclosure is being made on a voluntary basis and was not required to be disclosed on a Form 8-K.

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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 2014 Annual Meeting of Shareholders (the 2014 Proxy Statement) to be filed within 120 days following the end of the Company s fiscal year, under the headings Proposal 1 - 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 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 Overview in the 2014 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 of 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 2014 Proxy Statement under the headings Compensation Discussion and Analysis and Executive Compensation Tables 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 2014 Proxy Statement under the heading Security Ownership of Certain Beneficial Owners and Management is incorporated herein by reference.

Equity Compensation Plan Information

The following table sets forth, as of December 31, 2013, information about our equity compensation plans that have been approved by our shareholders, including the number of shares of our common stock exercisable under all outstanding options, warrants and rights, the weighted average exercise price of all outstanding options, warrants and rights and the number of shares available for future issuance under our equity compensation plans. We have no equity compensation plans that have not been approved by our shareholders.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by shareholders	192,934	$ 19.83	560,436
Equity compensation plans not approved by shareholders		$	

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

In response to this Item, the information set forth in the 2014 Proxy Statement under the headings Certain Relationships and Related Party Transactions and Corporate Governance Overview is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

In response to this Item, the information set forth in the 2014 Proxy Statement under the headings Audit Committee Report and Independent Registered Public Accounting Firm is incorporated herein by reference.

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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 Annual Report on 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
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 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated July 28, 2006
10.3	Form of Non-Qualified Stock Option Agreement Pursuant to the 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 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 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 2009 Directors Stock Incentive Plan	Incorporated by reference to Exhibit 10.10 of the Form 10-K for the year ended December 31, 2012, dated March 18, 2013
10.11	Form of Restricted Stock Award Agreement Pursuant to the 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
10.12	Form of Restricted Stock Award Agreement Pursuant to the 2009 Management Stock Incentive Plan (LTIP Award)	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated March 1, 2010

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Exhibit Number	Description	Location
10.13	Form of Service Based Restricted Stock Award Agreement Pursuant to the 2009 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.12 of the Form 10-K for the year ended December 31, 2011, dated March 9, 2012
10.14	Form of 2012 Performance Program Master Agreement	Incorporated by reference to Exhibit 10.13 of the Form 10-K for the year ended December 31, 2011, dated March 9, 2012
10.15	Form of 2012 Performance Program Award Certificate	Incorporated by reference to Exhibit 10.14 of the Form 10-K for the year ended December 31, 2011, dated March 9, 2012
10.16	Form of 2013 Performance Program Master Agreement	Incorporated by reference to Exhibit 10.16 of the Form 10-K for the year ended December 31, 2012, dated March 18, 2013
10.17	Form of 2013 Performance Program Award Certificate	Incorporated by reference to Exhibit 10.17 of the Form 10-K for the year ended December 31, 2012, dated March 18, 2013
10.18	Amended and Restated Executive Agreement between Financial Institutions, Inc. and Peter G. Humphrey	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated July 5, 2012
10.19	Amended and Restated Executive Agreement between Financial Institutions, Inc. and Martin K. Birmingham	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated May 23, 2013
10.20	Executive Agreement between Financial Institutions, Inc. and Kevin B. Klotzbach	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated May 23, 2013
10.21	Executive Agreement between Financial Institutions, Inc. and Richard J. Harrison	Incorporated by reference to Exhibit 10.3 of the Form 8-K, dated May 23, 2013
10.22	Executive Agreement between Financial Institutions, Inc. and Ronald Mitchell McLaughlin	Incorporated by reference to Exhibit 10.4 of the Form 8-K, dated July 5, 2012
10.23	Executive Agreement between Financial Institutions, Inc. and Kenneth V. Winn	Incorporated by reference to Exhibit 10.5 of the Form 8-K, dated July 5, 2012
10.24	Separation and release agreement between Five Star Bank and George D. Hagi	Incorporated by reference to Exhibit 10.6 of the Form 8-K, dated July 5, 2012
10.25	Voluntary Retirement Agreement with Ronald A. Miller	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated September 26, 2008
10.26	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
10.27	Separation and release agreement between Financial Institutions, Inc. and Peter G. Humphrey	Incorporated by reference to Exhibit 10.2 of the Form 10-Q for the quarterly period ended September 30, 2012, dated November 6, 2012

10.28	Supplemental Executive Retirement Agreement between Financial Institutions, Inc. and Peter G. Humphrey	Incorporated by reference to Exhibit 10.3 of the Form 10-Q for the quarterly period ended September 30, 2012, dated November 6, 2012
*10.29	Assignment, Purchase and Assumption Agreement dated January 19, 2012 between First Niagara Bank, National Association and Five Star Bank	Incorporated by reference to Exhibit 10.24 of the Form 10-K for the year ended December 31, 2011, dated March 9, 2012
*10.30	Amendment No. 1 to Assignment, Purchase and Assumption Agreement, effective as of August 16, 2012, by and between Five Star Bank and First Niagara Bank, National Association	Incorporated by reference to Exhibit 10.1 of the Form 10-Q for the quarterly period ended September 30, 2012, dated November 6, 2012

Exhibit Number	Description	Location
*10.31	Purchase and Assumption Agreement dated January 19, 2012 between First Niagara Bank, National Association and Five Star Bank	Incorporated by reference to Exhibit 10.25 of the Form 10-K for the year ended December 31, 2011, dated March 9, 2012
*10.32	Amendment No. 1 to Purchase and Assumption Agreement, effective as of June 21, 2012, by and between Five Star Bank and First Niagara Bank, National Association.	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated June 28, 2012
10.33	Executive Agreement between Financial Institutions, Inc. and Karl F. Krebs	Incorporated by reference to Exhibit 10.3 of the Form 8-K, dated July 5, 2012
10.34	Separation and release agreement between Financial Institutions, Inc. and Karl F. Krebs	Incorporated by reference to Exhibit 10.1 of the Form 10-Q for the quarterly period ended September 30, 2013, dated November 5, 2013
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 to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
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	

* Except for these agreements, all of our other material agreements consist of Management contracts, Compensatory plans or arrangements.

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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 12, 2014 By: ***/s/ Martin K. Birmingham***

Martin K. Birmingham
President and 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/ Martin K. Birmingham Martin K. Birmingham	Director, President and Chief Executive Officer (Principal Executive Officer)	March 12, 2014
/s/ Kevin B. Klotzbach Kevin B. Klotzbach	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	March 12, 2014
/s/ Michael D. Grover Michael D. Grover	Senior Vice President and Chief Accounting Officer (Principal Accounting Officer)	March 12, 2014
/s/ Karl V. Anderson, Jr. Karl V. Anderson, Jr.	Director	March 12, 2014
/s/ John E. Benjamin John E. Benjamin	Director, Chairman	March 12, 2014
/s/ Barton P. Dambra Barton P. Dambra	Director	March 12, 2014
/s/ Samuel M. Gullo Samuel M. Gullo	Director	March 12, 2014
/s/ Susan R. Holliday Susan R. Holliday	Director	March 12, 2014

/s/ Peter G. Humphrey Peter G. Humphrey	Director	March 12, 2014
/s/ Erland E. Kailbourne Erland E. Kailbourne	Director	March 12, 2014
/s/ Robert N. Latella Robert N. Latella	Director, Vice Chairman	March 12, 2014
/s/ James L. Robinson James L. Robinson	Director	March 12, 2014
/s/ James H. Wyckoff James H. Wyckoff	Director	March 12, 2014