Section 1: 10-Q (10-Q)

[Table of Contents]

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

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2020

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

(585) 786-1100

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, par value $0.01 per share	FISI	Nasdaq Global Select Market

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☑ No ☐

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

Large accelerated filer	☐	Accelerated filer	☑
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

The registrant had 16,037,585 shares of Common Stock, $0.01 par value, outstanding as of July 31, 2020.

FINANCIAL INSTITUTIONS, INC.
Form 10-Q
For the Quarterly Period Ended June 30, 2020

TABLE OF CONTENTS

		PAGE
PART I.	**FINANCIAL INFORMATION**	
ITEM 1.	Financial Statements	
	Consolidated Statements of Financial Condition (Unaudited) - at June 30, 2020 and December 31, 2019	3
	Consolidated Statements of Income (Unaudited) - Three and six months ended June 30, 2020 and 2019	4
	Consolidated Statements of Comprehensive Income (Unaudited) - Three and six months ended June 30, 2020 and 2019	5
	Consolidated Statements of Changes in Shareholders' Equity (Unaudited) - Three and six months ended June 30, 2020 and 2019	6
	Consolidated Statements of Cash Flows (Unaudited) - Six months ended June 30, 2020 and 2019	8
	Notes to Consolidated Financial Statements (Unaudited)	9
ITEM 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	43
ITEM 3.	Quantitative and Qualitative Disclosures About Market Risk	62
ITEM 4.	Controls and Procedures	63
PART II.	**OTHER INFORMATION**	
ITEM 1.	Legal Proceedings	64
ITEM 1A.	Risk Factors	64
ITEM 6.	Exhibits	66
	Signatures	67

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

(Dollars in thousands, except share and per share data)	June 30, 2020	December 31, 2019
ASSETS		
Cash and due from banks	$ 119,610	$ 112,947
Securities available for sale, at fair value	469,413	417,917
Securities held to maturity, at amortized cost (net of allowance for credit losses of $8 and $0, respectively) (fair value of $320,954 and $363,259, respectively)	309,872	359,000
Loans held for sale	6,654	4,224
Loans (net of allowance for credit losses of $46,316 and $30,482, respectively)	3,439,505	3,190,505
Company owned life insurance	69,876	68,942
Premises and equipment, net	41,403	41,424
Goodwill and other intangible assets, net	74,342	74,923
Other assets	150,255	114,296
Total assets	$ 4,680,930	$ 4,384,178
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand	$ 1,008,958	$ 707,752
Interest-bearing demand	727,676	627,842
Savings and money market	1,368,805	1,039,892
Time deposits	888,569	1,180,189
Total deposits	3,994,008	3,555,675
Short-term borrowings	105,300	275,500
Long-term borrowings, net of issuance costs of $692 and $727, respectively	39,308	39,273
Other liabilities	94,269	74,783
Total liabilities	4,232,885	3,945,231
Shareholders' equity:		
Series A 3% preferred stock, $100 par value; 1,533 shares authorized; 1,435 shares issued	143	143
Series B-1 8.48% preferred stock, $100 par value; 200,000 shares authorized; 171,847 shares issued	17,185	17,185
Total preferred equity	17,328	17,328
Common stock, $0.01 par value; 50,000,000 shares authorized; 16,099,556 shares issued	161	161
Additional paid-in capital	124,523	124,582
Retained earnings	307,845	313,364
Accumulated other comprehensive loss	(496)	(14,513)
Treasury stock, at cost – 61,971 and 96,657 shares, respectively	(1,316)	(1,975)
Total shareholders' equity	448,045	438,947
Total liabilities and shareholders' equity	$ 4,680,930	$ 4,384,178

See accompanying notes to the consolidated financial statements.

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

(In thousands, except per share amounts)	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
Interest income:				
Interest and fees on loans	$ 35,197	$ 37,807	$ 72,057	$ 74,273
Interest and dividends on investment securities	4,538	4,752	9,120	9,698
Other interest income	24	89	235	191
Total interest income	39,759	42,648	81,412	84,162
Interest expense:				
Deposits	4,677	7,378	11,696	14,177
Short-term borrowings	284	2,189	1,176	4,494
Long-term borrowings	617	617	1,235	1,235
Total interest expense	5,578	10,184	14,107	19,906
Net interest income	34,181	32,464	67,305	64,256
Provision for credit losses	3,746	2,354	17,661	3,547
Net interest income after provision for credit losses	30,435	30,110	49,644	60,709
Noninterest income:				
Service charges on deposits	480	1,756	2,067	3,436
Insurance income	819	872	2,168	2,250
ATM and debit card	1,776	1,739	3,378	3,182
Investment advisory	2,251	2,327	4,497	4,543
Company owned life insurance	462	424	927	834
Investments in limited partnerships	(244)	144	(31)	376
Loan servicing	50	104	57	214
Income from derivative instruments, net	1,940	(45)	2,686	123
Net gain on sale of loans held for sale	731	407	1,035	589
Net gain on investment securities	674	166	895	113
Net (loss) gain on other assets	(1)	9	63	58
Loss on tax credit investments	(40)	—	(80)	—
Other	934	1,330	2,132	2,635
Total noninterest income	9,832	9,233	19,794	18,353
Noninterest expense:				
Salaries and employee benefits	15,074	13,249	30,088	27,250
Occupancy and equipment	3,388	3,252	7,144	6,725
Professional services	1,580	932	3,732	2,090
Computer and data processing	2,699	2,424	5,372	4,760
Supplies and postage	517	498	1,070	1,032
FDIC assessments	539	486	911	998
Advertising and promotions	545	1,086	1,100	1,606
Amortization of intangibles	287	316	581	639
Other	2,065	2,760	4,418	5,074
Total noninterest expense	26,694	25,003	54,416	50,174
Income before income taxes	13,573	14,340	15,022	28,888
Income tax expense	2,441	2,939	2,763	5,966
Net income	$ 11,132	$ 11,401	$ 12,259	$ 22,922
Preferred stock dividends	366	366	731	731
Net income available to common shareholders	$ 10,766	$ 11,035	$ 11,528	$ 22,191
Earnings per common share (Note 2):				
Basic	$ 0.67	$ 0.69	$ 0.72	$ 1.39
Diluted	$ 0.67	$ 0.69	$ 0.72	$ 1.39
Cash dividends declared per common share	$ 0.26	$ 0.25	$ 0.52	$ 0.50

See accompanying notes to the consolidated financial statements.

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

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2020	**2019**	**2020**	**2019**
Net income	$ 11,132	$ 11,401	$ 12,259	$ 22,922
Other comprehensive income (loss), net of tax:				
Securities available for sale and transferred securities	1,741	5,239	13,847	10,742
Hedging derivative instruments	(388)	(106)	(297)	(360)
Pension and post-retirement obligations	233	261	467	522
Total other comprehensive income, net of tax	1,586	5,394	14,017	10,904
Comprehensive income	$ 12,718	$ 16,795	$ 26,276	$ 33,826

See accompanying notes to the consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
Three and six months ended June 30, 2020 and 2019

(Dollars in thousands, except per share data)	Preferred Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2019	**$ 17,328**	**$ 161**	**$ 124,582**	**$ 313,364**	**$ (14,513)**	**$ (1,975)**	**$ 438,947**
Cumulative-effect adjustment	—	—	—	(8,719)	—	—	(8,719)
Balance at January 1, 2020	**$ 17,328**	**$ 161**	**$ 124,582**	**$ 304,645**	**$ (14,513)**	**$ (1,975)**	**$ 430,228**
Comprehensive income:							
Net income	—	—	—	1,127	—	—	1,127
Other comprehensive income, net of tax	—	—	—	—	12,431	—	12,431
Purchases of common stock for treasury	—	—	—	—	—	(196)	(196)
Share-based compensation plans:							
Share-based compensation	—	—	332	—	—	—	332
Restricted stock units released	—	—	(469)	—	—	469	—
Cash dividends declared:							
Series A 3% Preferred-$0.75 per share	—	—	—	(1)	—	—	(1)
Series B-1 8.48% Preferred-$2.12 per share	—	—	—	(364)	—	—	(364)
Common-$0.26 per share	—	—	—	(4,164)	—	—	(4,164)
Balance at March 31, 2020	**$ 17,328**	**$ 161**	**$ 124,445**	**$ 301,243**	**$ (2,082)**	**$ (1,702)**	**$ 439,393**
Comprehensive income:							
Net income	—	—	—	11,132	—	—	11,132
Other comprehensive income, net of tax	—	—	—	—	1,586	—	1,586
Share-based compensation plans:							
Share-based compensation	—	—	369	—	—	—	369
Restricted stock awards issued	—	—	(272)	—	—	272	—
Stock awards	—	—	(19)	—	—	114	95
Cash dividends declared:							
Series A 3% Preferred-$0.75 per share	—	—	—	(1)	—	—	(1)
Series B-1 8.48% Preferred-$2.12 per share	—	—	—	(365)	—	—	(365)
Common-$0.26 per share	—	—	—	(4,164)	—	—	(4,164)
Balance at June 30, 2020	**$ 17,328**	**$ 161**	**$ 124,523**	**$ 307,845**	**$ (496)**	**$ (1,316)**	**$ 448,045**

Continued on next page

See accompanying notes to the consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Equity (Unaudited) (Continued)
Three and six months ended June 30, 2020 and 2019

(Dollars in thousands, except per share data)	Preferred Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2018	**$ 17,328**	**$ 161**	**$ 122,704**	**$ 279,867**	**$ (21,281)**	**$ (2,486)**	**$ 396,293**
Cumulative-effect adjustment	—	—	—	(710)	—	—	(710)
Balance at January 1, 2019	**$ 17,328**	**$ 161**	**$ 122,704**	**$ 279,157**	**$ (21,281)**	**$ (2,486)**	**$ 395,583**
Comprehensive income:							
Net income	—	—	—	11,521	—	—	11,521
Other comprehensive income, net of tax	—	—	—	—	5,510	—	5,510
Reclassification of income tax effects	—	—	—	2,783	(2,783)	—	—
Purchases of common stock for treasury	—	—	—	—	—	(193)	(193)
Share-based compensation plans:							
Share-based compensation	—	—	182	—	—	—	182
Restricted stock units released	—	—	(362)	—	—	362	—
Cash dividends declared:							
Series A 3% Preferred-$0.75 per share	—	—	—	(1)	—	—	(1)
Series B-1 8.48% Preferred-$2.12 per share	—	—	—	(364)	—	—	(364)
Common-$0.25 per share	—	—	—	(3,985)	—	—	(3,985)
Balance at March 31, 2019	**$ 17,328**	**$ 161**	**$ 122,524**	**$ 289,111**	**$ (18,554)**	**$ (2,317)**	**$ 408,253**
Comprehensive income:							
Net income	—	—	—	11,401	—	—	11,401
Other comprehensive income, net of tax	—	—	—	—	5,394	—	5,394
Common stock issued	—	—	1,151	—	—	—	1,151
Share-based compensation plans:							
Share-based compensation	—	—	453	—	—	—	453
Restricted stock awards issued	—	—	(165)	—	—	165	—
Stock awards	—	—	17	—	—	46	63
Cash dividends declared:							
Series A 3% Preferred-$0.75 per share	—	—	—	(1)	—	—	(1)
Series B-1 8.48% Preferred-$2.12 per share	—	—	—	(365)	—	—	(365)
Common-$0.25 per share	—	—	—	(3,995)	—	—	(3,995)
Balance at June 30, 2019	**$ 17,328**	**$ 161**	**$ 123,980**	**$ 296,151**	**$ (13,160)**	**$ (2,106)**	**$ 422,354**

See accompanying notes to the consolidated financial statements.

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

(Dollars in thousands)	Six months ended June 30, 2020	Six months ended June 30, 2019
Cash flows from operating activities:		
Net income	$ 12,259	$ 22,922
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,950	4,155
Net amortization of premiums on securities	1,378	1,052
Provision for credit losses	17,661	3,547
Share-based compensation	701	635
Deferred income tax expense (benefit)	(1,663)	680
Proceeds from sale of loans held for sale	31,504	15,432
Originations of loans held for sale	(32,899)	(14,163)
Income on company owned life insurance	(927)	(834)
Net gain on sale of loans held for sale	(1,035)	(589)
Net gain on investment securities	(895)	(113)
Net gain on other assets	(63)	(58)
Increase in other assets	(36,571)	(2,786)
Increase (decrease) in other liabilities	16,772	(747)
Net cash provided by operating activities	10,172	29,133
Cash flows from investing activities:		
Purchases of available for sale securities	(121,622)	(20,932)
Purchases of held to maturity securities	(4,761)	(7,494)
Proceeds from principal payments, maturities and calls on available for sale securities	38,706	40,119
Proceeds from principal payments, maturities and calls on held to maturity securities	53,282	54,735
Proceeds from sales of securities available for sale	50,153	44,615
Net loan originations	(276,409)	(88,993)
Loans sold to others	—	21,077
Purchases of company owned life insurance, net of proceeds received	(7)	(24)
Proceeds from sales of other assets	482	329
Purchases of premises and equipment	(2,375)	(1,684)
Net cash (used in) provided by investing activities	(262,551)	41,748
Cash flows from financing activities:		
Net increase in deposits	438,333	105,082
Net decrease in short-term borrowings	(170,200)	(161,000)
Purchases of common stock for treasury	(196)	(193)
Cash dividends paid to common and preferred shareholders	(8,895)	(8,537)
Net cash provided (used in) by financing activities	259,042	(64,648)
Net increase in cash and cash equivalents	6,663	6,233
Cash and cash equivalents, beginning of period	112,947	102,755
Cash and cash equivalents, end of period	$ 119,610	$ 108,988

See accompanying notes to the consolidated financial statements.

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

(1.) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Financial Institutions, Inc. (the "Company") is a financial holding company organized in 1931 under the laws of New York State ("New York"). The Company provides diversified financial services through its subsidiaries, Five Star Bank, SDN Insurance Agency, LLC ("SDN"), Courier Capital, LLC ("Courier Capital") and HNP Capital, LLC ("HNP Capital"). The Company offers a broad array of deposit, lending and other financial services to individuals, municipalities and businesses in Western and Central New York through its wholly-owned New York chartered banking subsidiary, Five Star Bank (the "Bank"). The Bank also has indirect lending network relationships with franchised automobile dealers in the Capital District of New York and Northern and Central Pennsylvania. SDN provides a broad range of insurance services to personal and business clients. Courier Capital and HNP Capital provide customized investment management, investment consulting and retirement plan services to individuals, businesses, institutions, foundations and retirement plans.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting policies conform to U.S. generally accepted accounting principles ("GAAP"). Certain information and footnote disclosures normally included in financial statements prepared in conformity with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying consolidated financial statements reflect all adjustments of a normal and recurring nature necessary for a fair presentation of the consolidated statements of financial condition, income, comprehensive income, changes in shareholders' equity and cash flows for the periods indicated and contain adequate disclosure to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the Company's 2019 Annual Report on Form 10-K for the year ended December 31, 2019. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year.

Allowance for Credit Losses

On January 1, 2020, the Company adopted Accounting Standards Update ("ASU") No. 2016-13, *Financial Instruments – Credit Losses (Topic 326) – Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 amends guidance on reporting credit losses for financial assets held at amortized cost basis and available for sale debt securities. Topic 326 eliminates the probable initial recognition threshold in current GAAP and instead, requires an entity to reflect its current estimate of all expected credit losses based on historical experience, current conditions and reasonable and supportable forecasts. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the reserve for credit losses. In addition, entities need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. The Company adopted ASU 2016-13 using the modified retrospective approach. Results for the periods beginning after January 1, 2020 are presented under Accounting Standards Codification ("ASC") 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP. The Company recorded a net reduction of retained earnings of $8.7 million upon adoption. The transition adjustment includes an increase in credit-related reserves of $9.6 million, $14 thousand, and $2.1 million for loans, held to maturity investment securities and unfunded commitments, respectively, net of the corresponding increase in deferred tax assets of $3.0 million.

The allowance for credit losses is evaluated on a regular basis and established through charges to earnings in the form of a provision for credit 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. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

a. Portfolio Segmentation ("Pooled Loans")

Portfolio segmentation is defined as the pooling of loans based upon similar risk characteristics such that quantitative methodologies and qualitative adjustment factors for estimating the allowance for credit losses is constructed for each segment. The Company has identified six portfolio segments of loans including Commercial Loans/Lines, Commercial Mortgage, Indirect Loans, Direct Loans, Residential Lines of Credit, and Residential Loans

The allowance for credit losses for Pooled Loans estimate is based upon periodic review of the collectability of the loans quantitatively correlating historical loan experience with reasonable and supportable forecasts using forward looking information. Adjustments to the quantitative evaluation may be made for differences in current or expected qualitative risk characteristics such as changes in: underwriting standards, delinquency level, regulatory environment, economic condition, Company management and the status of portfolio administration including the Company's Loan Review function.

(1.) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

b. Individually Evaluated Loans

The Company establishes a specific reserve for individually evaluated loans which do not share similar risk characteristics with the loans included in the forecasted allowance for credit losses. These individually evaluated loans are removed from the pooling approach discussed above for the forecasted allowance for credit losses, and include nonaccrual loans, troubled debt restructurings (“TDRs”), and other loans deemed appropriate by management.

c. Held to Maturity (“HTM”) Debt Securities

The Company’s HTM debt securities are also required to utilize the current expected credit losses approach to estimate expected credit losses. The Company’s HTM debt securities included securities that are issued by U.S. government or U.S. government-sponsored enterprises. These securities carry the explicit and/or implicit guarantee of the U.S. government, are widely recognized as “risk free,” and have a long history of zero credit loss. The Company also carries a portfolio of HTM municipal bonds. The Company measures its allowance for credit losses on HTM debt securities on a collective basis by major security type. The estimate is based on historical credit losses, if any, adjusted for current conditions and reasonable and supportable forecasts. The Company considers the nature of the collateral, potential future changes in collateral values and available loss information.

d. Available for Sale (“AFS”) Debt Securities

For AFS securities in an unrealized loss position, we first assess whether (i) we intend to sell, or (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. If either case is affirmative, any previously recognized allowances are charged-off and the security's amortized cost is written down to fair value through income. If neither case is affirmative, the security is evaluated to determine whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency and any adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income. Adjustments to the allowance are reported in our income statement as a component of credit loss expense. AFS securities are charged-off against the allowance or, in the absence of any allowance, written down through income when deemed uncollectible by management or when either of the aforementioned criteria regarding intent or requirement to sell is met.

e. Accrued Interest Receivable

Upon adoption of ASU 2016-13 and its related amendments on January 1, 2020, the Company made the following elections regarding accrued interest receivable:

- Presenting accrued interest receivable balances separately within another line item on the statement of financial condition.
- Excluding accrued interest receivable that is included in the amortized cost of financing receivables and debt securities from related disclosure requirements.
- Continuing our policy to write off accrued interest receivable by reversing interest income. For commercial loans, the write off typically occurs upon becoming 90 days past due. For consumer loans, the write off typically occurs upon becoming 120 days past due. Historically, the Company has not experienced uncollectible accrued interest receivable on its investment securities. However, the Company would generally write off accrued interest receivable by reversing interest income if the Company does not reasonably expect to receive payments. Due to the timely manner in which accrued interest receivables are written off, the amounts of such write offs are immaterial.
- Not measuring an allowance for credit losses for accrued interest receivable due to the Company’s policy of writing off uncollectible accrued interest receivable balances in a timely manner, as described above.

(1.) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

f. *Reserve for Unfunded Commitments*

The reserve for unfunded commitments (the "Unfunded Reserve") represents the expected credit losses on off-balance sheet commitments such as unfunded commitments to extend credit and standby letters of credit. However, a liability is not recognized for commitments unconditionally cancellable by the Company. The Unfunded Reserve is recognized as a liability (other liabilities in the consolidated statements of financial condition), with adjustments to the reserve recognized as a provision for credit loss expense in the consolidated statements of income. The Unfunded Reserve is determined by estimating expected future fundings, under each segment, and applying the expected loss rates. Expected future fundings are based on historical averages of funding rates (i.e., the likelihood of draws taken). To estimate future fundings on unfunded balances, current funding rates are compared to historical funding rates.

Operating, Accounting and Reporting Considerations related to COVID-19

The COVID-19 pandemic has negatively impacted the global economy, including our operating footprint of Western and Central New York. In response to this crisis, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act was passed by Congress and signed into law on March 27, 2020. The CARES Act provides an estimated $2.2 trillion to fight the COVID-19 pandemic and stimulate the economy by supporting individuals and businesses through loans, grants, tax changes, and other types of relief. Some of the provisions applicable to the Company include, but are not limited to:

- *Accounting for Loan Modifications* - The CARES Act provides that a financial institution may elect to suspend (1) the application of GAAP for certain loan modifications related to COVID-19 that would otherwise be categorized as a TDR and (2) any determination that such loan modifications would be considered a TDR, including the related impairment for accounting purposes.
- *Paycheck Protection Program* - The CARES Act established the Paycheck Protection Program ("PPP"), an expansion of the Small Business Administration's ("SBA") 7(a) loan program and the Economic Injury Disaster Loan Program ("EIDL"), administered directly by the SBA.
- *Mortgage Forbearance* - Under the CARES Act, through the earlier of December 31, 2020, or the termination date of the COVID-19 national emergency, a borrower with a federally backed mortgage loan that is experiencing financial hardship due to COVID-19 may request a forbearance.

Also, in response to the COVID-19 pandemic, the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration ("NCUA"), the Office of the Comptroller of the Currency ("OCC"), and the Consumer Financial Protection Bureau ("CFPB"), in consultation with the state financial regulators (collectively, the "agencies") issued a joint interagency statement (issued March 22, 2020; revised statement issued April 7, 2020). Some of the provisions applicable to the Company include, but are not limited to:

- *Accounting for Loan Modifications* - Loan modifications that do not meet the conditions of the CARES Act may still qualify as a modification that does not need to be accounted for as a TDR. The agencies confirmed with FASB staff that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or insignificant delays in payment.
- *Past Due Reporting* - With regard to loans not otherwise reportable as past due, financial institutions are not expected to designate loans with deferrals granted due to COVID-19 as past due because of the deferral. A loan's payment date is governed by the due date stipulated in the legal agreement. If a financial institution agrees to a payment deferral, these loans would not be considered past due during the period of the deferral.
- *Nonaccrual Status and Charge-offs* - During short-term COVID-19 modifications, these loans generally should not be reported as nonaccrual or as classified.

Effective March 23, 2020 through July 9, 2020, for consumer customers, the Bank waived early CD penalty fees for withdrawals up to $20,000 (limited to one penalty-free withdrawal per CD account); eliminated all insufficient funds (overdrafts) and returned item fees; eliminated all Pay by Phone fees; waived all late fees; offered the opportunity for monthly mortgage, home equity loan or home equity line payment relief; offered the opportunity to defer unsecured consumer loans or lines of credit and secured consumer loans and lines of credit payments; and offered unsecured personal loans up to $5,000, up to 60 months at 2.95% APR subject to credit approval (additional terms and conditions may apply).

(1.) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications

Certain reclassifications of previously reported amounts have been made to conform to the current year presentation. Such reclassifications did not impact net income or shareholders' equity as previously reported.

Subsequent Events

On July 17, 2020, the Bank announced management's decision to adapt to a full-service branch model to streamline retail branches to better align with shifting customer needs and preferences. The transformation will result in six branch closures and a reduction in staffing. The announcement was the result of a nine-month comprehensive assessment of all lines of business and functional areas, conducted in partnership with a leading process improvement organization. The data-driven analysis identified, among other things, overlapping service areas, automation opportunities and streamlining of processes and operations that would enhance customer experiences and facilitate the long-term sustainability of current and future branches. The announced consolidations represent about ten percent of the branch network and will impact approximately six percent of the total Company workforce. Where possible, those impacted were offered alternative roles or the opportunity to apply for open positions in other areas of the Company. Separated associates will receive a comprehensive severance package based on tenure. The Company expects to complete a substantial majority of these actions by December 31, 2020.

The Company expects to incur total pre-tax expense related to the branch closures of approximately $1.7 million, including approximately $0.2 million in employee severance, $0.6 million in lease termination costs and $0.9 million in valuation adjustments on branch facilities. The Company expects $0.8 million of total costs will result in future cash expenditures. The Company expects to recognize the majority of these expenses during the third quarter of 2020, with the remainder incurred by the end of 2020.

The Company anticipates annual expense savings of approximately $2.6 million as a result of these branch closures.

Use of Estimates

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

Cash Flow Reporting

Supplemental cash flow information is summarized as follows for the six months ended June 30 (in thousands):

	2020	2019
Supplemental information:		
Cash paid for interest	$ 18,545	$ 18,818
Cash paid for income taxes	959	5,220
Noncash investing and financing activities:		
Real estate and other assets acquired in settlement of loans	646	68
Accrued and declared unpaid dividends	4,529	4,361
Increase in net unsettled security purchases	—	10,481
Common stock issued for Courier Capital contingent earn-out	—	1,151

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

(1.) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In April 2019, the Financial Accounting Standards Board ("FASB") issued ASU No. 2019-04, Codification Improvements to Topic 326, Financial Instruments - Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments. With respect to Topic 815, Derivatives and Hedging, ASU 2019-04 clarifies that the reclassification of a debt security from Held to Maturity ("HTM") to Available for Sale ("AFS") under the transition guidance in ASU No. 2017-12, *Derivatives and Hedging (Topic 815) – Targeted Improvements to Accounting for Hedging Activities*, would not (1) call into question the classification of other HTM securities, (2) be required to actually designate any reclassified security in a last-of-layer hedge, or (3) be restricted from selling any reclassified security. As part of the transition of ASU 2019-04, entities may reclassify securities that would qualify for designation as the hedged item in a last-of-layer hedging relationship from HTM to AFS; however, entities that already made such a reclassification upon their adoption of ASU 2017-12 are precluded from reclassifying additional securities. The Company did not reclassify any securities from HTM to AFS upon adoption of ASU 2017-12. The Company elected to early adopt the amendments to Topic 815 in December 2019, resulting in the reclassification of $26.2 million of qualified investment securities from HTM to AFS. With respect to Topic 326, Financial Instruments - Credit Losses, ASU 2019-04 clarifies the scope of the credit losses standard and addresses issues related to accrued interest receivable balances, recoveries, variable interest rates and prepayments, among other things. With respect to Topic 825, Financial Instruments, on recognizing and measuring financial instruments, ASU 2019-04 addresses the scope of the guidance, the requirement for remeasurement under ASC 820 (Fair Value Measurement) when using the measurement alternative, certain disclosure requirements and which equity securities have to be remeasured at historical exchange rates. The amendments to Topic 326 and the amendments to Topic 825, under ASU 2019-04, were adopted as of January 1, 2020 and did not have a significant impact on the Company's financial statements.

(2.) EARNINGS PER COMMON SHARE ("EPS")

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

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Net income available to common shareholders	$ 10,766	$ 11,035	$ 11,528	$ 22,191
Weighted average common shares outstanding:				
Total shares issued	16,100	16,088	16,100	16,072
Unvested restricted stock awards	(5)	(4)	(4)	(4)
Treasury shares	(77)	(114)	(84)	(118)
Total basic weighted average common shares outstanding	16,018	15,970	16,012	15,950
Incremental shares from assumed:				
Exercise of stock options	—	—	—	—
Vesting of restricted stock awards	29	45	46	47
Total diluted weighted average common shares outstanding	16,047	16,015	16,058	15,997
Basic earnings per common share	$ 0.67	$ 0.69	$ 0.72	$ 1.39
Diluted earnings per common share	$ 0.67	$ 0.69	$ 0.72	$ 1.39

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	—	—	—	—
Restricted stock awards	74	7	38	8
Total	74	7	38	8

(3.) INVESTMENT SECURITIES

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2020				
Securities available for sale:				
U.S. Government agency and government sponsored enterprises	$ 6,229	$ 441	$ —	$ 6,670
Mortgage-backed securities:				
Federal National Mortgage Association	287,014	15,623	29	302,608
Federal Home Loan Mortgage Corporation	105,422	2,905	14	108,313
Government National Mortgage Association	23,972	840	—	24,812
Collateralized mortgage obligations:				
Federal National Mortgage Association	21,596	328	—	21,924
Federal Home Loan Mortgage Corporation	4,647	—	3	4,644
Privately issued	—	442	—	442
Total mortgage-backed securities	442,651	20,138	46	462,743
Total available for sale securities	$ 448,880	$ 20,579	$ 46	$ 469,413
Securities held to maturity:				
State and political subdivisions	$ 159,530	$ 5,075	$ —	$ 164,605
Mortgage-backed securities:				
Federal National Mortgage Association	11,829	708	—	12,537
Federal Home Loan Mortgage Corporation	6,510	360	—	6,870
Government National Mortgage Association	42,002	1,417	—	43,419
Collateralized mortgage obligations:				
Federal National Mortgage Association	36,547	1,252	—	37,799
Federal Home Loan Mortgage Corporation	43,715	1,927	—	45,642
Government National Mortgage Association	9,747	335	—	10,082
Total mortgage-backed securities	150,350	5,999	—	156,349
Total held to maturity securities	309,880	$ 11,074	$ —	$ 320,954
Allowance for credit losses - securities	(8)			
Total held to maturity securities, net	$ 309,872			
December 31, 2019				
Securities available for sale:				
U.S. Government agency and government sponsored enterprises	$ 26,440	$ 437	$ —	$ 26,877
Mortgage-backed securities:				
Federal National Mortgage Association	293,873	2,263	1,380	294,756
Federal Home Loan Mortgage Corporation	52,733	318	172	52,879
Government National Mortgage Association	14,065	60	4	14,121
Collateralized mortgage obligations:				
Federal National Mortgage Association	23,834	—	57	23,777
Federal Home Loan Mortgage Corporation	4,907	—	18	4,889
Privately issued	—	618	—	618
Total mortgage-backed securities	389,412	3,259	1,631	391,040
Total available for sale securities	$ 415,852	$ 3,696	$ 1,631	$ 417,917

(3.) INVESTMENT SECURITIES (Continued)

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2019 (continued)				
Securities held to maturity:				
State and political subdivisions	$ 192,215	$ 3,803	$ —	$ 196,018
Mortgage-backed securities:				
Federal National Mortgage Association	12,049	227	6	12,270
Federal Home Loan Mortgage Corporation	6,995	77	47	7,025
Government National Mortgage Association	45,758	306	128	45,936
Collateralized mortgage obligations:				
Federal National Mortgage Association	41,561	150	256	41,455
Federal Home Loan Mortgage Corporation	49,389	307	103	49,593
Government National Mortgage Association	11,033	12	83	10,962
Total mortgage-backed securities	166,785	1,079	623	167,241
Total held to maturity securities	$ 359,000	$ 4,882	$ 623	$ 363,259

The Company elected to exclude accrued interest receivable ("AIR") from the amortized cost basis of debt securities disclosed throughout this footnote. For AFS debt securities, AIR totaled $1.0 million as of June 30, 2020 and December 31, 2019. For HTM debt securities, AIR totaled $1.0 million and $1.2 million as of June 30, 2020 and December 31, 2019, respectively. AIR is included in other assets on the Company's consolidated statements of financial condition.

For the three months ended June 30, 2020 and 2019, credit loss expense (credit) for HTM investment securities was $(5) thousand and $0, respectively. For the six months ended June 30, 2020 and 2019, credit loss expense (credit) for HTM investment securities was $(6) thousand and $0, respectively.

Investment securities with a total fair value of $605.0 million and $676.9 million at June 30, 2020 and December 31, 2019, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

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

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Proceeds from sales	$ 29,896	$ 39,667	$ 50,153	$ 44,615
Gross realized gains	674	203	904	203
Gross realized losses	—	37	9	90

The scheduled maturities of securities available for sale and securities held to maturity at June 30, 2020 are shown below (in thousands). Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	Amortized Cost	Fair Value
Debt securities available for sale:		
Due in one year or less	$ —	$ —
Due from one to five years	41,123	43,060
Due after five years through ten years	156,094	167,736
Due after ten years	251,663	258,617
Total available for sale securities	$ 448,880	$ 469,413
Debt securities held to maturity:		
Due in one year or less	$ 50,075	$ 50,664
Due from one to five years	106,697	110,924
Due after five years through ten years	22,253	23,274
Due after ten years	130,855	136,092
Total held to maturity securities	$ 309,880	$ 320,954

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

(3.) INVESTMENT SECURITIES (Continued)

Unrealized losses on investment securities for which an allowance for credit losses has not been recorded 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, were 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
June 30, 2020						
Securities available for sale:						
U.S. Government agency and government sponsored enterprises	$ —	$ —	$ —	$ —	$ —	$ —
Mortgage-backed securities:						
Federal National Mortgage Association	9,246	29	—	—	9,246	29
Federal Home Loan Mortgage Corporation	5,080	14	—	—	5,080	14
Government National Mortgage Association	—	—	—	—	—	—
Collateralized mortgage obligations:						
Federal National Mortgage Association	3,677	—	8	—	3,685	—
Federal Home Loan Mortgage Corporation	4,644	3	—	—	4,644	3
Total mortgage-backed securities	22,647	46	8	—	22,655	46
Total available for sale securities	22,647	46	8	—	22,655	46
Total temporarily impaired securities	$ 22,647	$ 46	$ 8	$ —	$ 22,655	$ 46
December 31, 2019						
Securities available for sale:						
U.S. Government agencies and government sponsored enterprises	$ —	$ —	$ —	$ —	$ —	$ —
Mortgage-backed securities:						
Federal National Mortgage Association	104,634	1,277	7,196	103	111,830	1,380
Federal Home Loan Mortgage Corporation	10,347	11	9,409	161	19,756	172
Government National Mortgage Association	533	4	—	—	533	4
Collateralized mortgage obligations:						
Federal National Mortgage Association	8,803	57	8	—	8,811	57
Federal Home Loan Mortgage Corporation	4,889	18	—	—	4,889	18
Total mortgage-backed securities	129,206	1,367	16,613	264	145,819	1,631
Total available for sale securities	129,206	1,367	16,613	264	145,819	1,631
Securities held to maturity:						
State and political subdivisions	—	—	—	—	—	—
Mortgage-backed securities:						
Federal National Mortgage Association	2,388	6	—	—	2,388	6
Federal Home Loan Mortgage Corporation	2,967	19	2,598	28	5,565	47
Government National Mortgage Association	11,155	61	5,625	67	16,780	128
Collateralized mortgage obligations:						
Federal National Mortgage Association	9,120	40	13,486	216	22,606	256
Federal Home Loan Mortgage Corporation	15,127	30	7,988	73	23,115	103
Government National Mortgage Association	8,760	72	892	11	9,652	83
Total mortgage-backed securities	49,517	228	30,589	395	80,106	623
Total held to maturity securities	49,517	228	30,589	395	80,106	623
Total temporarily impaired securities	$ 178,723	$ 1,595	$ 47,202	$ 659	$ 225,925	$ 2,254

(3.) INVESTMENT SECURITIES (Continued)

The total number of security positions in the investment portfolio in an unrealized loss position at June 30, 2020 was seven compared to 91 at December 31, 2019. At June 30, 2020, the Company had a position in one investment security with a fair value of $8 thousand and a total unrealized loss of less than $1 thousand that has been in a continuous unrealized loss position for more than 12 months. At June 30, 2020, there were a total of six securities positions in the Company's investment portfolio with a fair value of $22.6 million and a total unrealized loss of $46 thousand that had been in a continuous unrealized loss position for less than 12 months. At December 31, 2019, the Company had positions in 34 investment securities with a fair value of $47.2 million and a total unrealized loss of $659 thousand that had been in a continuous unrealized loss position for more than 12 months. At December 31, 2019, there were a total of 57 securities positions in the Company's investment portfolio with a fair value of $178.7 million and a total unrealized loss of $1.6 million that had been in a continuous unrealized loss position for less than 12 months. The unrealized loss on 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.

Securities Available for Sale

As of June 30, 2020, no allowance for credit losses has been recognized on available for sale securities in an unrealized loss position as management does not believe any of the securities are impaired due to reasons of credit quality. This is based upon our analysis of the underlying risk characteristics, including credit ratings, and other qualitative factors related to our available for sale securities and in consideration of our historical credit loss experience and internal forecasts. The issuers of these securities continue to make timely principal and interest payments under the contractual terms of the securities. Furthermore, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that we will not have to sell any such securities before a recovery of cost. The unrealized losses are 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 securities approach their maturity date or repricing date or if market yields for such investments decline.

Securities Held to Maturity

The Company's HTM investment securities include debt securities that are issued by U.S. government agencies or U.S. government-sponsored enterprises. These securities carry the explicit and/or implicit guarantee of the U.S. government, are widely recognized as "risk free," and have a long history of zero credit loss. In addition, the Company's HTM investment securities include debt securities that are issued by state and local government agencies, or municipal bonds.

The Company monitors the credit quality of our municipal bonds through the use of a credit rating agency or by ratings that are derived by an internal scoring model. The scoring methodology for the internally derived ratings is based on a series of financial ratios for the municipality being reviewed as compared to typical industry figures. This information is used to determine the financial strengths and weaknesses of the municipality, which is indicated with a numeric rating. This number is then converted into a letter rating to better match the system used by the credit rating agencies. As of June 30, 2020, $159.3 million of our municipal bonds were rated as an equivalent to Standard & Poor's A/AA/AAA, with $8.7 million internally rated to be the equivalent of Standard & Poor's A/AA/AAA rating. Additionally, one municipal bond is rated below investment grade, with a BB+ Standard & Poor's equivalent rating. The below investment grade bond was recently upgraded from a Standard & Poor's equivalent rating of BB-, represents exposure of $279 thousand, or 0.17% of the municipal bond portfolio and is closely monitored for repayment.

As of June 30, 2020, the Company had no past due or nonaccrual held to maturity investment securities.

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

(4.) LOANS

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

	Principal Amount Outstanding	Net Deferred Loan (Fees) Costs	Loans, Net
June 30, 2020			
Commercial business	$ 824,818	$ (6,127)	$ 818,691
Commercial mortgage	1,142,359	(2,033)	1,140,326
Residential real estate loans	572,562	12,473	585,035
Residential real estate lines	94,285	3,142	97,427
Consumer indirect	801,434	26,671	828,105
Other consumer	16,071	166	16,237
Total	$ 3,451,529	$ 34,292	3,485,821
Allowance for credit losses - loans			(46,316)
Total loans, net			$ 3,439,505
December 31, 2019			
Commercial business	$ 571,222	$ 818	$ 572,040
Commercial mortgage	1,108,315	(2,032)	1,106,283
Residential real estate loans	560,717	11,633	572,350
Residential real estate lines	101,048	3,070	104,118
Consumer indirect	822,179	27,873	850,052
Other consumer	15,984	160	16,144
Total	$ 3,179,465	$ 41,522	3,220,987
Allowance for credit losses - loans			(30,482)
Total loans, net			$ 3,190,505

Loans held for sale (not included above) were comprised entirely of residential real estate mortgages and totaled $6.7 million and $4.2 million as of June 30, 2020 and December 31, 2019, respectively.

The CARES Act was passed by Congress and signed into law on March 27, 2020. The CARES Act established the PPP, an expansion of the SBA's 7(a) loan program and the EIDL, administered directly by the SBA. The Company had $268.5 million of PPP loans (included in Commercial business above) as of June 30, 2020. In addition, the CARES Act provides that a financial institution may elect to suspend (1) the application of GAAP for certain loan modifications related to COVID-19 that would otherwise be categorized as a TDR and (2) any determination that such loan modifications would be considered a TDR, including the related impairment for accounting purposes. Accordingly, the Company had $522.2 million of loans with modifications related to COVID-19 as of June 30, 2020.

The Company elected to exclude AIR from the amortized cost basis of loans disclosed throughout this footnote. As of June 30, 2020 and December 31, 2019, AIR for loans totaled $10.3 million and $9.1 million, respectively, and is included in other assets on the Company's consolidated statements of financial condition.

(4.) 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 the dates indicated (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Nonaccrual	Current	Total Loans	Nonaccrual with no allowance
June 30, 2020								
Commercial business	$ 398	$ 28	$ —	$ 426	$ 4,918	$ 819,474	$ 824,818	$ 3,647
Commercial mortgage	115	69	—	184	4,140	1,138,035	1,142,359	4,140
Residential real estate loans	786	27	—	813	2,992	568,757	572,562	2,992
Residential real estate lines	74	35	—	109	177	93,999	94,285	177
Consumer indirect	1,571	424	—	1,995	868	798,571	801,434	868
Other consumer	100	48	57	205	30	15,836	16,071	30
Total loans, gross	$ 3,044	$ 631	$ 57	$ 3,732	$ 13,125	$3,434,672	$3,451,529	$ 11,854
December 31, 2019								
Commercial business	$ 361	$ —	$ —	$ 361	$ 1,177	$ 569,684	$ 571,222	
Commercial mortgage	531	—	—	531	3,146	1,104,638	1,108,315	
Residential real estate loans	929	114	—	1,043	2,484	557,190	560,717	
Residential real estate lines	231	37	—	268	102	100,678	101,048	
Consumer indirect	3,729	1,019	—	4,748	1,725	815,706	822,179	
Other consumer	116	8	6	130	—	15,854	15,984	
Total loans, gross	$ 5,897	$ 1,178	$ 6	$ 7,081	$ 8,634	$3,163,750	$3,179,465	

There were no loans past due greater than 90 days and still accruing interest as of June 30, 2020 and December 31, 2019. There were $57 thousand and $6 thousand in consumer overdrafts which were past due greater than 90 days as of June 30, 2020 and December 31, 2019, respectively. Consumer overdrafts are overdrawn deposit accounts which have been reclassified as loans but by their terms do not accrue interest.

The Company recognized no interest income on nonaccrual loans during the six months ended June 30, 2020 and 2019.

(4.) LOANS (Continued)

Troubled Debt Restructurings

A modification of a loan constitutes a TDR when a borrower is experiencing financial difficulty and the modification constitutes a concession. 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, collateral concessions, forgiveness of principal, forbearance agreements, 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 three and six months ended June 30, 2020 and 2019:

	Quarter-to-Date			Year-to-Date		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
June 30, 2020						
Commercial business	—	$ —	$ —	1	$ 11,898	$ 11,898
Total	—	$ —	$ —	1	$ 11,898	$ 11,898
June 30, 2019						
Commercial business	—	$ —	$ —	—	$ —	$ —
Total	—	$ —	$ —	—	$ —	$ —

The loan restructured during the six months ended June 30, 2020 was on nonaccrual status at the end of the period, with the modifications primarily related to collateral concessions. 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 classifications did not have a material impact on the Company's determination of the allowance for credit losses – loans because the modified loans were evaluated for a specific reserve both before and after restructuring.

There were no loans modified as a TDR within the previous 12 months that defaulted during the six months ended June 30, 2020 and 2019. For purposes of this disclosure, a loan modified as a TDR is considered to have defaulted when the borrower becomes 90 days past due.

Collateral Dependent 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 where repayment is expected to be provided substantially through the operation or sale of the collateral to be collateral dependent loans. The following table presents the amortized cost basis of collateral dependent loans by collateral type as of June 30, 2020 (in thousands):

	Collateral type		
	Business assets	Real property	Total
June 30, 2020			
Commercial business	$ 3,533	$ 3,356	$ 6,889
Commercial mortgage	—	4,112	4,112
Total	$ 3,533	$ 7,468	$ 11,001

(4.) LOANS (Continued)

Credit Quality Indicators

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

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

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

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

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

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

	Term Loans Amortized Cost Basis by Origination Year								
	2020	2019	2018	2017	2016	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
June 30, 2020									
Commercial Business									
Uncriticized	$ 315,256	$ 113,442	$ 94,313	$ 54,704	$ 14,210	$ 23,713	$ 186,745	$ —	$ 802,383
Special mention	—	24	279	1,526	241	92	2,667	—	4,829
Substandard	29	629	1,150	819	202	3,467	5,183	—	11,479
Doubtful	—	—	—	—	—	—	—	—	—
Total	$ 315,285	$ 114,095	$ 95,742	$ 57,049	$ 14,653	$ 27,272	$ 194,595	$ —	$ 818,691
Commercial Mortgage									
Uncriticized	$ 138,718	$ 272,620	$ 212,339	$ 197,891	$ 97,668	$ 212,453	$ 485	$ —	$ 1,132,174
Special mention	—	—	132	146	57	356	—	—	691
Substandard	—	2,446	128	1,619	158	2,911	199	—	7,461
Doubtful	—	—	—	—	—	—	—	—	—
Total	$ 138,718	$ 275,066	$ 212,599	$ 199,656	$ 97,883	$ 215,720	$ 684	$ —	$ 1,140,326

Table of Contents

(4.) LOANS (Continued)

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

	Term Loans Amortized Cost Basis by Origination Year								
	2020	2019	2018	2017	2016	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
June 30, 2020									
Residential Real Estate Loans									
Performing	$ 65,156	$ 104,978	$ 99,825	$ 78,953	$ 74,386	$ 158,745	$ —	$ —	$ 582,043
Nonperforming	—	108	943	730	176	1,035	—	—	2,992
Total	$ 65,156	$ 105,086	$ 100,768	$ 79,683	$ 74,562	$ 159,780	$ —	$ —	$ 585,035
Residential Real Estate Lines									
Performing	$ —	$ —	$ —	$ —	$ —	$ —	$ 86,521	$ 10,729	$ 97,250
Nonperforming	—	—	—	—	—	—	46	131	177
Total	$ —	$ —	$ —	$ —	$ —	$ —	$ 86,567	$ 10,860	$ 97,427
Consumer Indirect									
Performing	$ 131,503	$ 240,429	$ 208,797	$ 148,267	$ 68,837	$ 29,404	$ —	$ —	$ 827,237
Nonperforming	48	123	309	179	178	31	—	—	868
Total	$ 131,551	$ 240,552	$ 209,106	$ 148,446	$ 69,015	$ 29,435	$ —	$ —	$ 828,105
Other Consumer									
Performing	$ 4,515	$ 4,230	$ 2,448	$ 1,308	$ 588	$ 563	$ 2,555	$ —	$ 16,207
Nonperforming	—	16	8	5	—	—	1	—	30
Total	$ 4,515	$ 4,246	$ 2,456	$ 1,313	$ 588	$ 563	$ 2,556	$ —	$ 16,237

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

(4.) LOANS (Continued)

Allowance for Credit Losses - Loans

The following table sets forth the changes in the allowance for credit losses - loans for the three- and six-month periods ended June 30, 2020 (in thousands):

	Commercial Business	Commercial Mortgage	Residential Real Estate Loans	Residential Real Estate Lines	Consumer Indirect	Other Consumer	Total
Three months ended June 30, 2020							
Beginning balance	$ 10,223	$ 15,154	$ 6,170	$ 899	$ 10,645	$ 265	$ 43,356
Charge-offs	(25)	(1,072)	(2)	—	(2,554)	(70)	(3,723)
Recoveries	1,483	—	8	—	1,379	67	2,937
Provision (credit)	718	1,584	(407)	40	1,752	59	3,746
Ending balance	$ 12,399	$ 15,666	$ 5,769	$ 939	$ 11,222	$ 321	$ 46,316
Six months ended June 30, 2020							
Beginning balance, prior to adoption of ASC 326	$ 11,358	$ 5,681	$ 1,059	$ 118	$ 11,852	$ 414	$ 30,482
Impact of adopting ASC 326	(246)	7,310	3,290	607	(1,234)	(133)	9,594
Beginning balance, after adoption of ASC 326	11,112	12,991	4,349	725	10,618	281	40,076
Charge-offs	(8,266)	(1,072)	(100)	—	(5,978)	(339)	(15,755)
Recoveries	1,541	—	18	3	3,047	217	4,826
Provision	8,012	3,747	1,502	211	3,535	162	17,169
Ending balance	$ 12,399	$ 15,666	$ 5,769	$ 939	$ 11,222	$ 321	$ 46,316

The following table sets forth the changes in the allowance for credit losses - loans for the three- and six-month periods ended June 30, 2019 (in thousands):

	Commercial Business	Commercial Mortgage	Residential Real Estate Loans	Residential Real Estate Lines	Consumer Indirect	Other Consumer	Total
Three months ended June 30, 2019							
Beginning balance	$ 12,167	$ 6,316	$ 1,265	$ 173	$ 13,025	$ 381	$ 33,327
Charge-offs	(138)	(3)	(87)	(2)	(2,700)	(243)	(3,173)
Recoveries	128	—	11	3	1,678	106	1,926
Provision (credit)	(440)	2,477	28	(29)	154	164	2,354
Ending balance	$ 11,717	$ 8,790	$ 1,217	$ 145	$ 12,157	$ 408	$ 34,434
Six months ended June 30, 2019							
Beginning balance	$ 14,312	$ 5,219	$ 1,112	$ 210	$ 12,572	$ 489	$ 33,914
Charge-offs	(268)	(3)	(118)	(2)	(5,682)	(552)	(6,625)
Recoveries	231	17	17	5	3,102	226	3,598
Provision (credit)	(2,558)	3,557	206	(68)	2,165	245	3,547
Ending balance	$ 11,717	$ 8,790	$ 1,217	$ 145	$ 12,157	$ 408	$ 34,434

(4.) LOANS (Continued)

Loans and the related allowance for credit losses - loans are presented below as of the dates indicated (in thousands):

	Commercial Business	Commercial Mortgage	Residential Real Estate Loans	Residential Real Estate Lines	Consumer Indirect	Other Consumer	Total
June 30, 2019							
Loans:							
Ending balance	$ 594,121	$ 1,011,925	$ 535,873	$ 104,937	$ 846,829	$ 16,379	$3,110,064
Evaluated for impairment:							
Individually	$ 768	$ 7,274	$ —	$ —	$ —	$ —	$ 8,042
Collectively	$ 593,353	$ 1,004,651	$ 535,873	$ 104,937	$ 846,829	$ 16,379	$3,102,022
Allowance for loan losses:							
Ending balance	$ 11,717	$ 8,790	$ 1,217	$ 145	$ 12,157	$ 408	$ 34,434
Evaluated for impairment:							
Individually	$ 110	$ 2,997	$ —	$ —	$ —	$ —	$ 3,107
Collectively	$ 11,607	$ 5,793	$ 1,217	$ 145	$ 12,157	$ 408	$ 31,327

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, including the impact of the COVID-19 pandemic on small to mid-sized business in our market area, 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, potentially resulting in 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, including the impact of the COVID-19 pandemic on the ability of the tenants to pay rent at these properties, 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 real estate loans (comprised of conventional mortgages and home equity loans) and residential real estate lines (comprised of home equity lines) are generally made based on 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, including the impact of the COVID-19 pandemic on the employment income of these borrowers, 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. 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, including the heightened risk that such circumstances may arise as a result of the COVID-19 pandemic. 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.

(5.) LEASES

ASC 842, Leases ("ASC 842"), establishes a right of use model that requires a lessee to record a right of use asset and a lease liability for all leases with terms longer than 12 months. The Company is obligated under a number of non-cancellable operating lease agreements for land, buildings and equipment with terms, including renewal options reasonably certain to be exercised, extending through 2047. One building lease is subleased for terms extending through 2021.

The following table represents the consolidated statements of financial condition classification of the Company's right of use assets and lease liabilities:

	Balance Sheet Location	June 30, 2020	December 31, 2019
Operating Lease Right of Use Assets:			
Gross carrying amount	Other assets	$ 23,626	$ 23,224
Accumulated amortization	Other assets	(2,795)	(1,861)
Net book value		$ 20,831	$ 21,363
Operating Lease Liabilities:			
Right of use lease obligations	Other liabilities	$ 22,327	$ 22,800

The weighted average remaining lease term for operating leases was 21.5 years at June 30, 2020 and the weighted-average discount rate used in the measurement of operating lease liabilities was 3.79%. The Company utilizes its incremental borrowing rate at lease inception, on a collateralized basis, over a similar term for the discount rate.

The following table represents lease costs and other lease information:

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Lease costs:				
Operating lease costs	$ 678	$ 697	$ 1,355	$ 1,390
Variable lease costs [1]	101	113	202	209
Sublease income	(12)	(11)	(23)	(23)
Net lease costs	$ 767	$ 799	$ 1,534	$ 1,576
Other information:				
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases			$ 1,296	$ 1,332
Initial recognition of operating lease right of use assets			$ —	$ 23,275
Initial recognition of operating lease liabilities			$ —	$ 23,985
Right of use assets obtained in exchange for new operating lease liabilities			$ 405	$ 346

(1) Variable lease costs primarily represent variable payments such as common area maintenance, insurance, taxes and utilities.

(5.) LEASES (Continued)

Future minimum payments under non-cancellable operating leases with initial or remaining terms of one year or more, are as follows at June 30, 2020 (in thousands):

Twelve months ended June 30,		
2021	$	2,609
2022		2,157
2023		1,873
2024		1,372
2025		1,227
Thereafter		25,378
Total future minimum operating lease payments		34,616
Amounts representing interest		(12,289)
Present value of net future minimum operating lease payments	$	22,327

(6.) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

The carrying amount of goodwill totaled $66.1 million as of both June 30, 2020 and December 31, 2019. The Company performs a goodwill impairment test on an annual basis as of October 1st or more frequently if events and circumstances warrant.

		Banking		Non-Banking		Total
Balance, December 31, 2019	$	48,536	$	17,526	$	66,062
No activity during the period		—		—		—
Balance, June 30, 2020	$	48,536	$	17,526	$	66,062

Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis, and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Based on the volatility in the capital markets in 2020 and overall economic conditions as a result of the COVID-19 pandemic accompanied by a decline in the Company's stock price, a goodwill impairment test was performed in the second quarter of 2020. Based on its qualitative assessment, the Company concluded that it was not more likely than not that goodwill was impaired as of June 30, 2020. Therefore, no quantitative assessment was deemed necessary as of June 30, 2020.

Other Intangible Assets

The Company has other intangible assets that are amortized, consisting of core deposit intangibles and other intangibles (primarily related to customer relationships). Gross carrying amount, accumulated amortization and net book value, were as follows (in thousands):

		June 30, 2020		December 31, 2019
Other intangibles assets:				
Gross carrying amount	$	15,925	$	15,925
Accumulated amortization		(7,645)		(7,064)
Net book value	$	8,280	$	8,861

Amortization expense for total other intangible assets was $287 thousand and $581 thousand for the three and six months ended June 30, 2020, respectively, and $316 thousand and $639 thousand for the three and six months ended June 30, 2019, respectively. As of June 30, 2020, the estimated amortization expense of other intangible assets for the remainder of 2020 and each of the next five years is as follows (in thousands):

2020 (remainder of year)	$	553
2021		1,014
2022		923
2023		852
2024		783
2025		714

(7.) DERIVATIVE INSTRUMENT AND HEDGING ACTIVITIES

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities, and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments.

Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company uses interest rate caps and interest rate swaps as part of its interest rate risk management strategy. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium. During the first six months of 2020 and in 2019, such derivatives were used to hedge the variable cash flows associated with short-term borrowings. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. The Company is hedging its exposure to the variability in future cash flows for forecasted transactions over a period of approximately 60 months. As of June 30, 2020, the Company had one outstanding forward starting interest rate derivative with a notional value of $50.0 million that was designated as a cash flow hedge of interest rate risk. The derivative becomes effective in April 2022.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in accumulated other comprehensive income (loss) and subsequently reclassified into interest expense in the same period(s) during which the hedged transaction affects earnings. Amounts reported in accumulated other comprehensive income (loss) related to derivatives will be reclassified to interest expense as interest payments are made on the Company's borrowings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. The Company's cash flow hedge derivatives did not have any hedge ineffectiveness recognized in earnings during the six months ended June 30, 2020 and 2019. During the next twelve months, the Company estimates that $438 thousand will be reclassified as an increase to interest expense.

Interest Rate Swaps

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings.

Credit-risk-related Contingent Features

The Company has agreements with certain of its derivative counterparties that contain one or more of the following provisions: (a) if the Company defaults on any of its indebtedness, including a default where repayment of the indebtedness has not been accelerated by the lender, the Company could also be declared in default on its derivative obligations, and (b) if the Company fails to maintain its status as a well-capitalized institution, the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreements.

Mortgage Banking Derivatives

The Company 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.

(7.) DERIVATIVE INSTRUMENT AND HEDGING ACTIVITIES (Continued)

Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the notional amounts, respective fair values of the Company's derivative financial instruments, as well as their classification on the balance sheet as of June 30, 2020 and December 31, 2019 (in thousands):

	Gross notional amount		Asset derivatives			Liability derivatives		
			Balance sheet line item	Fair value		Balance sheet line item	Fair value	
	June 30, 2020	Dec. 31, 2019		June 30, 2020	Dec. 31, 2019		June 30, 2020	Dec. 31, 2019
Derivatives designated as hedging instruments								
Cash flow hedges	$150,000	$100,000	Other assets	$ 1	$ —	Other liabilities	$ 659	$ —
Total derivatives	$150,000	$100,000		$ 1	$ —		$ 659	$ —
Derivatives not designated as hedging instruments								
Interest rate swaps [(1)]	$474,084	$272,962	Other assets	$ 23,335	$ 6,419	Other liabilities	$ 23,868	$ 6,720
Credit contracts	82,108	68,324	Other assets	32	13	Other liabilities	54	18
Mortgage banking	29,128	11,859	Other assets	408	119	Other liabilities	138	7
Total derivatives	$585,320	$353,145		$ 23,775	$ 6,551		$ 24,060	$ 6,745

(1) The Company secured its obligations under these contracts with $24.6 million and $6.7 million in cash at June 30, 2020 and December 31, 2019, respectively.

Effect of Derivative Instruments on the Income Statement

The table below presents the effect of the Company's derivative financial instruments on the income statement for the three and six months ended June 30, 2020 and 2019 (in thousands):

		Gain (loss) recognized in income Three months ended June 30,		Gain (loss) recognized in income Six months ended June 30,	
Undesignated derivatives	Line item of gain (loss) recognized in income	2020	2019	2020	2019
Interest rate swaps	Income from derivative instruments, net	$ 1,681	$ (117)	$ 2,405	$ (16)
Credit contracts	Income from derivative instruments, net	128	(8)	123	6
Mortgage banking	Income from derivative instruments, net	131	80	158	133
Total undesignated		$ 1,940	$ (45)	$ 2,686	$ 123

(8.) SHAREHOLDERS' EQUITY

Common Stock

The changes in shares of common stock were as follows for the three and six months ended June 30, 2020 and 2019:

	Outstanding	Treasury	Issued
2020			
Shares at December 31, 2019	16,002,899	96,657	16,099,556
Restricted stock units released	22,921	(22,921)	—
Treasury stock purchases	(6,436)	6,436	—
Shares at March 31, 2020	16,019,384	80,172	16,099,556
Restricted stock awards issued	12,798	(12,798)	—
Stock awards	5,403	(5,403)	—
Shares at June 30, 2020	16,037,585	61,971	16,099,556
2019			
Shares at December 31, 2018	15,928,598	127,580	16,056,178
Restricted stock units released	18,580	(18,580)	—
Treasury stock purchases	(6,368)	6,368	—
Shares at March 31, 2019	15,940,810	115,368	16,056,178
Common stock issued for Courier Capital contingent earn-out	43,378	—	43,378
Restricted stock awards issued	8,226	(8,226)	—
Stock awards	2,283	(2,283)	—
Shares at June 30, 2019	15,994,697	104,859	16,099,556

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

(9.) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables present the components of other comprehensive income (loss) for the three and six months ended June 30, 2020 and 2019 (in thousands):

	Pre-tax Amount	Tax Effect	Net-of-tax Amount
Three months ended June 30, 2020			
Securities available for sale and transferred securities:			
Change in unrealized gain/loss during the period	$ 2,912	$ 746	$ 2,166
Reclassification adjustment for net gains included in net income [1]	(571)	(146)	(425)
Total securities available for sale and transferred securities	2,341	600	1,741
Hedging derivative instruments:			
Change in unrealized gain/loss during the period	(522)	(134)	(388)
Pension and post-retirement obligations:			
Amortization of prior service credit included in income	(9)	(3)	(6)
Amortization of net actuarial loss included in income	323	84	239
Total pension and post-retirement obligations	314	81	233
Other comprehensive income	$ 2,133	$ 547	$ 1,586
Six months ended June 30, 2020			
Securities available for sale and transferred securities:			
Change in unrealized gain/loss during the period	$ 19,363	$ 4,961	$ 14,402
Reclassification adjustment for net gains included in net income [1]	(746)	(191)	(555)
Total securities available for sale and transferred securities	18,617	4,770	13,847
Hedging derivative instruments:			
Change in unrealized gain/loss during the period	(399)	(102)	(297)
Pension and post-retirement obligations:			
Amortization of prior service credit included in income	(18)	(5)	(13)
Amortization of net actuarial loss included in income	646	166	480
Total pension and post-retirement obligations	628	161	467
Other comprehensive loss	$ 18,846	$ 4,829	$ 14,017

(1) Includes amounts related to the amortization/accretion of unrealized net gains and losses related to the Company's reclassification of available for sale investment securities to the held to maturity category. The unrealized net gains/losses will be amortized/accreted over the remaining life of the investment securities as an adjustment of yield.

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

	Pre-tax Amount	Tax Effect	Net-of-tax Amount
Three months ended June 30, 2019			
Securities available for sale and transferred securities:			
Change in unrealized gain/loss during the period	$ 7,046	$ 1,776	$ 5,270
Reclassification adjustment for net gains included in net income [(1)]	(42)	(11)	(31)
Total securities available for sale and transferred securities	7,004	1,765	5,239
Hedging derivative instruments:			
Change in unrealized gain/loss during the period	(141)	(35)	(106)
Pension and post-retirement obligations:			
Amortization of prior service credit included in income	(17)	(4)	(13)
Amortization of net actuarial loss included in income	366	92	274
Total pension and post-retirement obligations	349	88	261
Other comprehensive income	$ 7,212	$ 1,818	$ 5,394
Six months ended June 30, 2019			
Securities available for sale and transferred securities:			
Change in unrealized gain/loss during the period	$ 14,230	$ 3,587	$ 10,643
Reclassification adjustment for net gains included in net income [(1)]	132	33	99
Total securities available for sale and transferred securities	14,362	3,620	10,742
Hedging derivative instruments:			
Change in unrealized gain/loss during the period	(481)	(121)	(360)
Pension and post-retirement obligations:			
Amortization of prior service credit included in income	(33)	(8)	(25)
Amortization of net actuarial loss included in income	732	185	547
Total pension and post-retirement obligations	699	177	522
Other comprehensive income	$ 14,580	$ 3,676	$ 10,904

(1) Includes amounts related to the amortization/accretion of unrealized net gains and losses related to the Company's reclassification of available for sale investment securities to the held to maturity category. The unrealized net gains/losses will be amortized/accreted over the remaining life of the investment securities as an adjustment of yield.

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

Activity in accumulated other comprehensive income (loss), net of tax, for the three and six months ended June 30, 2020 and 2019 was as follows (in thousands):

	Hedging Derivative Instruments	Securities Available for Sale and Transferred Securities	Pension and Post-retirement Obligations	Accumulated Other Comprehensive Income (Loss)
Three months ended June 30, 2020				
Balance at beginning of period	$ (427)	$ 12,979	$ (14,634)	$ (2,082)
Other comprehensive income before reclassifications	(388)	2,166	—	1,778
Amounts reclassified from accumulated other comprehensive income (loss)	—	(425)	233	(192)
Net current period other comprehensive income	(388)	1,741	233	1,586
Balance at end of period	$ (815)	$ 14,720	$ (14,401)	$ (496)
Six months ended June 30, 2020				
Balance at beginning of period	$ (518)	$ 873	$ (14,868)	$ (14,513)
Other comprehensive income (loss) before reclassifications	(297)	14,402	—	14,105
Amounts reclassified from accumulated other comprehensive income (loss)	—	(555)	467	(88)
Net current period other comprehensive income (loss)	(297)	13,847	467	14,017
Balance at end of period	$ (815)	$ 14,720	$ (14,401)	$ (496)
Three months ended June 30, 2019				
Balance at beginning of period	$ (530)	$ (2,947)	$ (15,077)	$ (18,554)
Other comprehensive income (loss) before reclassifications	(106)	5,270	—	5,164
Amounts reclassified from accumulated other comprehensive income	—	(31)	261	230
Net current period other comprehensive income (loss)	(106)	5,239	261	5,394
Balance at end of period	$ (636)	$ 2,292	$ (14,816)	$ (13,160)
Six months ended June 30, 2019				
Balance at beginning of period	$ (276)	$ (7,769)	$ (13,236)	(21,281)
Reclassification of income tax effects to retained earnings	—	(681)	(2,102)	(2,783)
Other comprehensive income (loss) before reclassifications	(360)	10,643	—	10,283
Amounts reclassified from accumulated other comprehensive income (loss)	—	99	522	621
Net current period other comprehensive income (loss)	(360)	10,742	522	10,904
Balance at end of period	$ (636)	$ 2,292	$ (14,816)	$ (13,160)

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

The following table presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three and six months ended June 30, 2020 and 2019 (in thousands):

Details About Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss)		Affected Line Item in the Consolidated Statement of Income
	Three months ended June 30,		
	2020	2019	
Realized gain on sale of investment securities	$ 674	$ 166	Net gain on investment securities
Amortization of unrealized holding losses on investment securities transferred from available for sale to held to maturity	(103)	(124)	Interest income
	571	42	Total before tax
	(146)	(11)	Income tax expense
	425	31	Net of tax
Amortization of pension and post-retirement items:			
Prior service credit (1)	9	17	Salaries and employee benefits
Net actuarial losses (1)	(323)	(366)	Salaries and employee benefits
	(314)	(349)	Total before tax
	81	88	Income tax benefit
	(233)	(261)	Net of tax
Total reclassified for the period	$ 192	$ (230)	
	Six months ended June 30,		
	2020	2019	
Realized gain on sale of investment securities	$ 895	$ 113	Net gain on investment securities
Amortization of unrealized holding losses on investment securities transferred from available for sale to held to maturity	(149)	(245)	Interest income
	746	(132)	Total before tax
	(191)	33	Income tax (expense) benefit
	555	(99)	Net of tax
Amortization of pension and post-retirement items:			
Prior service credit (1)	18	33	Salaries and employee benefits
Net actuarial losses (1)	(646)	(732)	Salaries and employee benefits
	(628)	(699)	Total before tax
	161	177	Income tax benefit
	(467)	(522)	Net of tax
Total reclassified for the period	$ 88	$ (621)	

(1) These items are included in the computation of net periodic pension expense. See Note 11 – Employee Benefit Plans for additional information.

(10.) SHARE-BASED COMPENSATION PLANS

The Company maintains certain share-based compensation plans, approved by the Company's shareholders, that are administered by the Management Development and Compensation Committee (the "MD&C Committee") of the Board. The share-based compensation plans were established to allow for the grant of compensation awards to attract, motivate and retain employees, executive officers and non-employee directors who contribute to the long-term growth 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 MD&C Committee approved the grant of restricted stock units ("RSUs") and performance share units ("PSUs") shown in the table below to certain members of management during the six months ended June 30, 2020.

	Number of Underlying Shares	Weighted Average Per Share Grant Date Fair Value
RSUs	57,306	$ 25.67
PSUs	23,302	25.63

The grant-date fair value for the RSUs granted during the six months ended June 30, 2020 is equal to the closing market price of our common stock on the date of grant reduced by the present value of the dividends expected to be paid on the underlying shares.

Fifty percent of the PSUs that ultimately vest is contingent on achieving specified return on average equity ("ROAE") targets relative to the SNL Small Cap Bank & Thrift Index, a market index the MD&C Committee has selected as a peer group for this purpose. These shares will be earned based on the Company's achievement of a relative ROAE performance requirement, on a percentile basis, compared to the SNL Small Cap Bank & Thrift Index over a three-year performance period ended December 31, 2022. The shares earned based on the achievement of the ROAE performance requirement, if any, will vest on the third anniversary of the grant date assuming the recipient's continuous service to the Company. The remaining fifty percent of the PSUs that ultimately vest is contingent upon achievement of an average return on average assets ("ROAA") performance requirement over a three-year performance period ended December 31, 2022. The shares earned based on the achievement of the ROAA performance requirement, if any, will vest on the third anniversary of the grant date assuming the recipient's continuous service to the Company.

The grant-date fair values for both the ROAE and the ROAA portions of PSUs granted during the six months ended June 30, 2020 are equal to the closing market price of our common stock on the date of grant reduced by the present value of the dividends expected to be paid on the underlying shares.

During the six months ended June 30, 2020, the Company issued a total of 5,403 shares of common stock in-lieu of cash for the annual retainer of four non-employee directors and granted a total of 12,798 restricted shares of common stock to non-employee directors, of which 6,399 shares vested immediately and 6,399 shares will vest after completion of a one-year service requirement. The market value of the stock and restricted stock at the close of the Nasdaq Global Select Market on the date of grant was $17.57.

The following is a summary of restricted stock awards and restricted stock units activity for the six months ended June 30, 2020:

	Number of Shares	Weighted Average Market Price at Grant Date
Outstanding at beginning of year	151,808	$ 27.80
Granted	93,406	24.55
Vested	(33,433)	28.88
Forfeited	(30,482)	28.43
Outstanding at end of period	181,299	$ 25.82

At June 30, 2020, there was $3.0 million of unrecognized compensation expense related to unvested restricted stock awards and restricted stock units that is expected to be recognized over a weighted average period of 2.2 years.

(10.) SHARE-BASED COMPENSATION PLANS (Continued)

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 the first six months of 2020 or 2019. There was no unrecognized compensation expense related to unvested stock options as of June 30, 2020. There was no stock option activity for the six months ended June 30, 2020.

The Company amortizes the expense related to share-based compensation 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 included in the consolidated statements of income, is as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Salaries and employee benefits	$ 228	$ 310	$ 532	$ 461
Other noninterest expense	141	143	169	174
Total share-based compensation expense	$ 369	$ 453	$ 701	$ 635

(11.) EMPLOYEE BENEFIT PLANS

The components of the Company's net periodic benefit expense for its pension and post-retirement obligations were as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Service cost	$ 923	$ 802	$ 1,846	$ 1,604
Interest cost on projected benefit obligation	635	695	1,270	1,390
Expected return on plan assets	(1,284)	(1,184)	(2,568)	(2,368)
Amortization of unrecognized prior service credit	(9)	(17)	(18)	(33)
Amortization of unrecognized net actuarial loss	323	366	646	732
Net periodic benefit expense	$ 588	$ 662	$ 1,176	$ 1,325

The net periodic benefit expense is recorded as a component of salaries and employee benefits in the consolidated statements of income. 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 the Internal Revenue Code. The Company has no minimum required contribution for the 2020 fiscal year.

(12.) COMMITMENTS AND CONTINGENCIES

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

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

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

	June 30, 2020	December 31, 2019
Commitments to extend credit	$ 926,730	$ 820,282
Standby letters of credit	22,929	21,911

(12.) COMMITMENTS AND CONTINGENCIES (Continued)

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 which 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.

At June 30, 2020 and December 31, 2019, the allowance for credit losses for unfunded commitments totaled $2.6 million and $0, respectively, and was included in other liabilities on the Company's consolidated statements of financial condition. For the three months ended June 30, 2020 and 2019, credit loss expense for unfunded commitments was $5 thousand and $0, respectively. For the six months ended June 30, 2020 and 2019, credit loss expense for unfunded commitments was $498 thousand and $0, respectively.

In the ordinary course of business, there are various threatened and pending legal proceedings against the Company. 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.

(13.) 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. There have been no changes in the valuation techniques used during the current period. 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.

Transfers between levels of the fair value hierarchy are recorded as of the end of the reporting period.

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.

Derivative instruments: The fair value of derivative instruments is determined using quoted secondary market prices for similar financial instruments and are classified as Level 2 in the fair value hierarchy.

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.

(13.) FAIR VALUE MEASUREMENTS (Continued)

Collateral dependent loans: Fair value of collateral dependent loans with specific allocations of the allowance for credit losses – loans 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. Collateral dependent loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

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 is not material.

(13.) FAIR VALUE MEASUREMENTS (Continued)

Assets Measured at Fair Value

The following tables present 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 the dates indicated (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
June 30, 2020				
Measured on a recurring basis:				
Securities available for sale:				
U.S. Government agency and government sponsored enterprises	$ —	$ 6,670	$ —	$ 6,670
Mortgage-backed securities	—	462,743	—	462,743
Other assets:				
Hedging derivative instruments	—	1	—	1
Other liabilities:				
Hedging derivative instruments	—	(659)	—	(659)
Fair value adjusted through comprehensive income	$ —	$ 468,755	$ —	$ 468,755
Other assets:				
Derivative instruments - interest rate products	$ —	$ 23,335	$ —	$ 23,335
Derivative instruments - credit contracts	—	32	—	32
Derivative instruments - mortgage banking	—	408	—	408
Other liabilities:				
Derivative instruments - interest rate products	—	(23,868)	—	(23,868)
Derivative instruments - credit contracts	—	(54)	—	(54)
Derivative instruments - mortgage banking	—	(138)	—	(138)
Fair value adjusted through net income	$ —	$ (285)	$ —	$ (285)
Measured on a nonrecurring basis:				
Loans:				
Loans held for sale	$ —	$ 6,654	$ —	$ 6,654
Collateral dependent loans	—	—	10,588	10,588
Other assets:				
Loan servicing rights	—	—	1,082	1,082
Other real estate owned	—	—	679	679
Total	$ —	$ 6,654	$ 12,349	$ 19,003

There were no transfers between Levels 1 and 2 during the six months ended June 30, 2020. There were no liabilities measured at fair value on a nonrecurring basis during the six months ended June 30, 2020.

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

(13.) FAIR VALUE MEASUREMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
December 31, 2019				
Measured on a recurring basis:				
Securities available for sale:				
U.S. Government agency and government sponsored enterprises	$ —	$ 26,877	$ —	$ 26,877
Mortgage-backed securities	—	391,040	—	391,040
Other assets:				
Hedging derivative instruments	—	—	—	—
Fair value adjusted through comprehensive income	$ —	$ 417,917	$ —	$ 417,917
Other assets:				
Derivative instruments - interest rate products	$ —	$ 6,419	$ —	$ 6,419
Derivative instruments - credit contracts	—	13	—	13
Derivative instruments - mortgage banking	—	119	—	119
Other liabilities:				
Derivative instruments - interest rate products	—	(6,720)	—	(6,720)
Derivative instruments - credit contracts	—	(18)	—	(18)
Derivative instruments - mortgage banking	—	(7)	—	(7)
Fair value adjusted through net income	$ —	$ (194)	$ —	$ (194)
Measured on a nonrecurring basis:				
Loans:				
Loans held for sale	$ —	$ 4,224	$ —	$ 4,224
Collateral dependent impaired loans	—	—	3,630	3,630
Other assets:				
Loan servicing rights	—	—	1,129	1,129
Other real estate owned	—	—	468	468
Total	$ —	$ 4,224	$ 5,227	$ 9,451

There were no transfers between Levels 1 and 2 during the six months ended June 30, 2019. There were no liabilities measured at fair value on a nonrecurring basis during the six months ended June 30, 2019.

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 as of June 30, 2020 (dollars in thousands).

Asset	Fair Value	Valuation Technique	Unobservable Input	Unobservable Input Value or Range
Collateral dependent loans	$ 10,588	Appraisal of collateral (1)	Appraisal adjustments (2)	8% (3)
Loan servicing rights	1,082	Discounted cash flow	Discount rate	10.2% (3)
			Constant prepayment rate	18.4% (3)
Other real estate owned	679	Appraisal of collateral (1)	Appraisal adjustments (2)	33% (3)

(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 or during the six months ended June 30, 2020 and 2019.

(13.) 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, Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB") stock, accrued interest receivable, non-maturity deposits, short-term borrowings and accrued interest payable.

The following presents (in thousands) the carrying amount, estimated fair value, and placement in the fair value measurement hierarchy of the Company's financial instruments as of the dates indicated.

	Level in Fair Value Measurement Hierarchy	June 30, 2020		December 31, 2019	
		Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:					
Cash and cash equivalents	Level 1	$ 119,610	$ 119,610	$ 112,947	$ 112,947
Securities available for sale	Level 2	469,413	469,413	417,917	417,917
Securities held to maturity, net	Level 2	309,872	320,954	359,000	363,259
Loans held for sale	Level 2	6,654	6,654	4,224	4,224
Loans	Level 2	3,428,917	3,461,937	3,186,875	3,201,814
Loans (1)	Level 3	10,588	10,588	3,630	3,630
Accrued interest receivable	Level 1	12,345	12,345	11,308	11,308
FHLB and FRB stock	Level 2	13,119	13,119	20,637	20,637
Derivative instruments – cash flow hedge	Level 2	1	1	—	—
Derivative instruments – interest rate products	Level 2	23,335	23,335	6,419	6,419
Derivative instruments – credit contracts	Level 2	32	32	13	13
Derivative instruments – mortgage banking	Level 2	408	408	119	119
Financial liabilities:					
Non-maturity deposits	Level 1	3,105,439	3,105,439	2,375,486	2,375,486
Time deposits	Level 2	888,569	891,390	1,180,189	1,179,991
Short-term borrowings	Level 1	105,300	105,300	275,500	275,500
Long-term borrowings	Level 2	39,308	44,947	39,273	41,083
Accrued interest payable	Level 1	6,504	6,504	10,942	10,942
Derivative instruments – cash flow hedge	Level 2	659	659	—	—
Derivative instruments – interest rate products	Level 2	23,868	23,868	6,720	6,720
Derivative instruments – credit contracts	Level 2	54	54	18	18
Derivative instruments – mortgage banking	Level 2	138	138	7	7

(1) Comprised of collateral dependent loans.

(14.) SEGMENT REPORTING

The Company has two reportable segments: Banking and Non-Banking. These reportable segments have been identified and organized based on the nature of the underlying products and services applicable to each segment, the type of customers to whom those products and services are offered and the distribution channel through which those products and services are made available.

The Banking segment includes all of the Company's retail and commercial banking operations. The Non-Banking segment includes the activities of SDN, a full-service insurance agency that provides a broad range of insurance services to both personal and business clients, and Courier Capital and HNP Capital, our investment advisor and wealth management firms that provide customized investment management, investment consulting and retirement plan services to individuals, businesses, institutions, foundations and retirement plans. Holding company amounts are the primary differences between segment amounts and consolidated totals and are reflected in the Holding Company and Other column below, along with amounts to eliminate balances and transactions between segments.

The following tables present information regarding our business segments as of and for the periods indicated (in thousands).

	Banking	Non-Banking	Holding Company and Other	Consolidated Totals
June 30, 2020				
Goodwill	$ 48,536	$ 17,526	$ —	$ 66,062
Other intangible assets, net	58	8,222	—	8,280
Total assets	4,645,277	35,745	(92)	4,680,930
December 31, 2019				
Goodwill	$ 48,536	$ 17,526	$ —	$ 66,062
Other intangible assets, net	98	8,763	—	8,861
Total assets	4,346,615	36,733	830	4,384,178

	Banking	Non-Banking	Holding Company and Other	Consolidated Totals
Three months ended June 30, 2020				
Net interest income (expense)	$ 34,798	$ —	$ (617)	$ 34,181
Provision for credit losses	(3,746)	—	—	(3,746)
Noninterest income	7,201	2,790	(159)	9,832
Noninterest expense	(23,726)	(2,592)	(376)	(26,694)
Income (loss) before income taxes	14,527	198	(1,152)	13,573
Income tax (expense) benefit	(2,860)	(50)	469	(2,441)
Net income (loss)	$ 11,667	$ 148	$ (683)	$ 11,132
Six months ended June 30, 2020				
Net interest income (expense)	$ 68,540	$ —	$ (1,235)	$ 67,305
Provision for credit losses	(17,661)	—	—	(17,661)
Noninterest income	14,068	6,054	(328)	19,794
Noninterest expense	(47,504)	(5,778)	(1,134)	(54,416)
Income (loss) before income taxes	17,443	276	(2,697)	15,022
Income tax (expense) benefit	(2,719)	(75)	31	(2,763)
Net income (loss)	$ 14,724	$ 201	$ (2,666)	$ 12,259

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

(14.) SEGMENT REPORTING (Continued)

	Banking	Non-Banking	Holding Company and Other	Consolidated Totals
Three months ended June 30, 2019				
Net interest income (expense)	$ 33,082	$ —	$ (618)	$ 32,464
Provision for loan losses	(2,354)	—	—	(2,354)
Noninterest income	6,788	2,634	(189)	9,233
Noninterest expense	(21,650)	(2,831)	(522)	(25,003)
Income (loss) before income taxes	15,866	(197)	(1,329)	14,340
Income tax (expense) benefit	(3,315)	43	333	(2,939)
Net income (loss)	$ 12,551	$ (154)	$ (996)	$ 11,401
Six months ended June 30, 2019				
Net interest income (expense)	$ 65,491	$ —	$ (1,235)	$ 64,256
Provision for loan losses	(3,547)	—	—	(3,547)
Noninterest income	13,054	5,660	(361)	18,353
Noninterest expense	(43,103)	(5,872)	(1,199)	(50,174)
Income (loss) before income taxes	31,895	(212)	(2,795)	28,888
Income tax (expense) benefit	(6,659)	43	650	(5,966)
Net income (loss)	$ 25,236	$ (169)	$ (2,145)	$ 22,922

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

This Quarterly Report on Form 10-Q should be read in conjunction with the more detailed and comprehensive disclosures included in our Annual Report on Form 10-K for the year ended December 31, 2019. In addition, please read this section in conjunction with our Consolidated Financial Statements and Notes to Consolidated Financial Statements contained herein.

FORWARD LOOKING INFORMATION

Statements and financial analysis contained in this Quarterly Report on Form 10-Q that are based on other than historical data are forward-looking statements 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") and its subsidiaries (collectively, the "Company," "we," "our" or "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 Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended December 31, 2019 (the "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 material differences include, but are not limited to:

- The ongoing novel coronavirus ("COVID-19") pandemic, and governmental and individual efforts to contain the pandemic, have had a significant negative impact on the U.S. and New York State economy which will adversely affect our customers and have an adverse effect on our business, financial condition and results of operations;
- If we experience greater credit losses than anticipated, earnings may be adversely impacted;
- Geographic concentration may unfavorably impact our operations;
- Our commercial business and mortgage loans increase our exposure to credit risks;
- Our indirect and consumer lending involves risk elements in addition to normal credit risk;
- Lack of seasoning in portions of our loan portfolio could increase risk of credit defaults in the future;
- We accept deposits that do not have a fixed term, and which may be withdrawn by the customer at any time for any reason;
- 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;
- We operate in a highly competitive industry and market area;
- Changes to and replacement of the LIBOR Benchmark Interest Rate may adversely affect our business, financial condition, and results of operations;
- Our insurance brokerage subsidiary is subject to risk related to the insurance industry;
- Our investment advisory and wealth management operations are subject to risk related to the regulation of the financial services industry and market volatility;
- Our tax strategies and the value of our deferred tax assets and liabilities could adversely affect our operating results and regulatory capital ratios;
- We make certain assumptions and estimates in preparing our financial statements that may prove to be incorrect, which could significantly impact our results of operations, cash flows and financial condition, and we are subject to new or changing accounting rules and interpretations, and the failure by us to correctly interpret or apply these evolving rules and interpretations could have a material adverse effect;
- We may be unable to successfully implement our growth strategies, including the integration and successful management of newly-acquired businesses;
- Acquisitions may disrupt our business and dilute shareholder value;
- The value of our goodwill and other intangible assets may decline in the future;
- We use financial models for business planning purposes that may not adequately predict future results;
- Liquidity is essential to our businesses;
- We rely on dividends from our subsidiaries for most of our revenue;
- We may not be able to attract and retain skilled people;
- Severe weather, natural disasters, acts of war or terrorism, and other external events could significantly impact our business;
- If our risk management framework does not effectively identify or mitigate our risks, we could suffer losses;

- We face competition in staying current with technological changes and banking alternatives to compete and meet customer demands;
- We rely on other companies to provide key components of our business infrastructure;
- A breach in security of our or third-party information systems, including the occurrence of a cyber incident or a deficiency in cybersecurity, or a failure by us to comply with New York State cybersecurity regulations, may subject us to liability, result in a loss of customer business or damage our brand image;
- Any future FDIC insurance premium increases may adversely affect our earnings;
- We are highly regulated, and any adverse regulatory action may result in additional costs, loss of business opportunities, and reputational damage;
- Legal and regulatory proceedings and related matters could adversely affect us and the banking industry in general;
- The policies of the Federal Reserve have a significant impact on our earnings;
- We are subject to interest rate risk, and a rising rate environment may reduce our income and result in higher defaults on our loans, whereas a falling rate environment may result in earlier loan prepayments than we expect, which may reduce our income;
- The soundness of other financial institutions could adversely affect us;
- Our business may be adversely affected by conditions in the financial markets and economic conditions generally;
- 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 not pay or may reduce the 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 dilute our current shareholders or negatively affect the value of our common stock;
- Our certificate of incorporation, our bylaws, and certain banking laws may have an anti-takeover effect; and
- The market price of our common stock may fluctuate significantly in response to a number of factors.

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 the Form 10-K and Item 1A, Risk Factors, below 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.

GENERAL

The Parent is a financial holding company headquartered in New York State, providing diversified financial services through its subsidiaries, Five Star Bank (the "Bank"), SDN Insurance Agency, LLC ("SDN"), Courier Capital, LLC ("Courier Capital") and HNP Capital, LLC ("HNP Capital"). The Company offers a broad array of deposit, lending and other financial services to individuals, municipalities and businesses in Western and Central New York through its wholly-owned New York-chartered banking subsidiary, the Bank. Our indirect lending network includes relationships with franchised automobile dealers in Western and Central New York, the Capital District of New York and Northern and Central Pennsylvania. SDN provides a broad range of insurance services to personal and business clients. Courier Capital and HNP Capital provide customized investment advice, wealth management, investment consulting and retirement plan services to individuals, businesses, institutions, foundations and retirement plans.

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 insurance, investment advisory and 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.

Our business strategy has been to maintain a community bank philosophy, which consists of focusing on and understanding the individualized banking and other financial needs of individuals, municipalities and businesses of the local communities surrounding our primary service area. 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 small- to medium-sized businesses, individuals and community organizations who prefer to build banking, insurance and wealth management relationships with a community bank that combines high quality, competitively-priced 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, loan, insurance and wealth management products typically found at larger banks, our highly experienced management team and our strategically located banking centers. We have evolved to meet changing customer needs by opening what we refer to as financial solution center branches. These financial solution center branches have a smaller footprint than our traditional branches, focus on technology to provide solutions that fit our customer preferences for transacting business with us, and are staffed by certified personal bankers who are trained to meet a broad array of customer needs. In recent years, we have opened four financial solution centers in the Rochester and Buffalo markets. We believe that the foregoing factors all help to grow our core deposits, which supports a central element of our business strategy - the growth of a diversified and high-quality loan portfolio.

EXECUTIVE OVERVIEW

Summary of 2020 Second Quarter Results

Net income decreased $269 thousand, or 2%, to $11.1 million for the second quarter of 2020 compared to $11.4 million for the second quarter of 2019. Net income available to common shareholders for the second quarter of 2020 was $10.8 million, or $0.67 per diluted share, compared with $11.0 million, or $0.69 per diluted share, for the second quarter of last year. Return on average common equity was 10.05% and return on average assets was 0.97% for the second quarter of 2020 compared to 11.12% and 1.06%, respectively, for the second quarter of 2019.

Second quarter results were negatively impacted by a higher provision for credit losses of $3.7 million, as compared to $2.4 million in the second quarter of 2019. The higher provision was driven by the adoption of the current expected credit loss ("CECL") standard and the impact of the COVID-19 pandemic on the economic environment.

Net interest income totaled $34.2 million in the second quarter of 2020, up from $32.5 million in the second quarter of 2019. This increase was primarily the result of a change in the interest-earning asset mix as loans became a larger percentage of the portfolio. Average loans were up $270.5 million in the second quarter of 2020 compared to the same quarter in 2019.

The provision for credit losses - loans was $3.7 million in the second quarter of 2020 compared to $2.4 million in the second quarter of 2019. Net charge-offs during the recent quarter were $786 thousand, down from $1.2 million in the second quarter of 2019. Net charge-offs expressed as an annualized percentage of average loans outstanding were 0.09% during the second quarter of 2020 compared with 0.16% in the second quarter of 2019. See the "Allowance for Credit Losses - Loans" and "Non-Performing Assets and Potential Problem Loans" sections of this Management's Discussion and Analysis for further discussion regarding the increase in the provision for credit losses - loans and the decrease in net charge-offs.

Noninterest income totaled $9.8 million in the second quarter of 2020, compared to $9.2 million in the second quarter of 2019. The increase was primarily attributed to increases in income from derivative instruments, net, and net gain on investment securities, partially offset by a decrease in service charges on deposits. Income from derivative instruments of $1.9 million was recognized in the second quarter of 2020 driven primarily by an increase in the number and value of interest rate swap transactions executed. The Company sold investment securities during the second quarter of 2020 generating a net gain of $674 thousand as compared to a net gain of $166 thousand in the second quarter of 2019. The Company recognized $480 thousand in service charges on deposits in the second quarter of 2020 as compared to $1.8 million in the second quarter of 2019 as a result of the Company's COVID-19 relief initiatives of waiving or eliminating fees, implemented on March 23, 2020.

Noninterest expense in the second quarter of 2020 totaled $26.7 million compared with $25.0 million in the second quarter of 2019. The increase in noninterest expense was primarily the result of increases in salaries and employee benefits and professional services. The increase in salaries and employee benefits was primarily a result of incentive compensation, the full quarter impact of annual merit increases, COVID-19-related incremental pay to front-line retail associates, expenses related to the departure of a senior officer and higher medical expenses during the second quarter of 2020. The increase in professional services was primarily related to the timing of fees for consulting and advisory projects.

The regulatory Common Equity Tier 1 Ratio and Total Risk-Based Capital Ratio were 10.27%, and 12.83%, respectively, at June 30, 2020. See the "Liquidity and Capital Management" section of this Management's Discussion and Analysis for further discussion regarding regulatory capital and the Basel III capital rules.

Operational, Accounting and Reporting Impacts Related to COVID-19

The COVID-19 pandemic has negatively impacted the global economy, including our operating footprint of Western and Central New York. In response to this crisis, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act was passed by Congress and signed into law on March 27, 2020. The CARES Act provides an estimated $2.2 trillion to fight the COVID-19 pandemic and stimulate the economy by supporting individuals and businesses through loans, grants, tax changes, and other types of relief. Some of the provisions applicable to the Company include, but are not limited to:

- *Accounting for Loan Modifications* - The CARES Act provides that a financial institution may elect to suspend (1) the application of GAAP for certain loan modifications related to COVID-19 that would otherwise be categorized as a troubled debt restructuring ("TDR") and (2) any determination that such loan modifications would be considered a TDR, including the related impairment for accounting purposes.
- *Paycheck Protection Program* - The CARES Act established the Paycheck Protection Program ("PPP"), an expansion of the Small Business Administration's ("SBA") 7(a) loan program and the Economic Injury Disaster Loan Program ("EIDL"), administered directly by the SBA.
- *Mortgage Forbearance* - Under the CARES Act, through the earlier of December 31, 2020, or the termination date of the COVID-19 national emergency, a borrower with a federally backed mortgage loan that is experiencing financial hardship due to COVID-19 may request a forbearance.

Also, in response to the COVID-19 pandemic, the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration ("NCUA"), the Office of the Comptroller of the Currency ("OCC"), and the Consumer Financial Protection Bureau ("CFPB"), in consultation with the state financial regulators (collectively, the "agencies") issued a joint interagency statement (issued March 22, 2020; revised statement issued April 7, 2020). Some of the provisions applicable to the Company include, but are not limited to:

- *Accounting for Loan Modifications* - Loan modifications that do not meet the conditions of the CARES Act may still qualify as a modification that does not need to be accounted for as a TDR. The agencies confirmed with FASB staff that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or insignificant delays in payment.
- *Past Due Reporting* - With regard to loans not otherwise reportable as past due, financial institutions are not expected to designate loans with deferrals granted due to COVID-19 as past due because of the deferral. A loan's payment date is governed by the due date stipulated in the legal agreement. If a financial institution agrees to a payment deferral, these loans would not be considered past due during the period of the deferral.
- *Nonaccrual Status and Charge-offs* - During short-term COVID-19 modifications, these loans generally should not be reported as nonaccrual or as classified**.**

Effective March 23, 2020 through July 9, 2020, for consumer customers, the Bank waived early CD penalty fees for withdrawals up to $20,000 (limited to one penalty-free withdrawal per CD account); eliminated all insufficient funds (overdrafts) and returned item fees; eliminated all Pay by Phone fees; waived all late fees; offered the opportunity for monthly mortgage, home equity loan or home equity line payment relief; offered the opportunity to defer unsecured consumer loans or lines of credit and secured consumer loans and lines of credit payments; and offered unsecured personal loans up to $5,000, up to 60 months at 2.95% APR subject to credit approval (additional terms and conditions may apply).

Business customers are being faced with challenging and unique circumstances. The Bank's relationship bankers are highly skilled in providing tailored financial solutions designed to meet the specific, individual needs of each business and they are actively reaching out to each business customer to understand how the Bank can help, given each unique business circumstance.

As of July 20, 2020, we have helped more than 1,700 customers obtain more than $270 million in loans through the PPP. Additionally, approximately 22% of our commercial loan and mortgage customers, 5% of our residential real estate loans and lines customers and 11% of our indirect loans customers have received payment deferrals.

RESULTS OF OPERATIONS

Net Interest Income and Net Interest Margin

Net interest income is our primary source of revenue, comprising 77% of revenue during the six months ended June 30, 2020. Net interest income is the difference between interest income on interest-earning assets, such as loans and investment securities, and 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.

We use interest rate spread and net interest margin 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 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Interest income per consolidated statements of income	$ 39,759	$ 42,648	$ 81,412	$ 84,162
Adjustment to fully taxable equivalent basis	233	289	479	591
Interest income adjusted to a fully taxable equivalent basis	39,992	42,937	81,891	84,753
Interest expense per consolidated statements of income	5,578	10,184	14,107	19,906
Net interest income on a taxable equivalent basis	$ 34,414	$ 32,753	$ 67,784	$ 64,847

Analysis of Net Interest Income for the Three Months Ended June 30, 2020 and 2019

Net interest income on a taxable equivalent basis for the three months ended June 30, 2020, was $34.4 million, an increase of $1.7 million versus the comparable quarter last year of $32.8 million. The increase in net interest income was due primarily to an increase in average loans of $270.5 million, or 9%, compared to the second quarter of 2019, partially offset by a decrease in investment securities of $79.0 million, or 9%, compared to the second quarter of 2019. The decrease in investment securities is primarily the result of the redeployment of assets from investment securities into loans, resulting in loans comprising a higher percentage of total interest-earning assets.

Our net interest margin for the second quarter of 2020 was 3.23%, five-basis points lower than 3.28% for the same period in 2019. This comparable period decrease was a function of a 12-basis point lower contribution from net free funds, partially offset by a seven-basis point increase in the interest rate spread. The higher interest rate spread was a result of a 53-basis point decrease in the yield on average interest-earning assets and a 60-basis point decrease in the cost of average interest-bearing liabilities.

For the second quarter of 2020, the yield on average interest earning assets of 3.76% was 53-basis points lower than the second quarter of 2019 of 4.29%. Loan yields decreased 68 basis points during the second quarter of 2020 to 4.14% from 4.82%. The yield on investment securities increased ten-basis points during the second quarter of 2020 to 2.48% from 2.38%. Overall, the earning asset rate changes decreased interest income by $5.6 million during the second quarter of 2020 and a favorable volume variance increased interest income by $2.6 million, which collectively drove a $2.9 million decrease in interest income.

Average interest-earning assets were $4.27 billion for the second quarter of 2020 compared to $4.01 billion for the second quarter of 2019, an increase of $265.5 million, or 7%, from the comparable quarter last year, with average loans up $270.5 million from $3.14 billion to $3.41 billion and average securities down $79.0 million from $845.6 million to $766.6 million. The growth in average loans reflected increases in the commercial loans and residential real estate loans categories. Commercial loans, in particular, were up $303.0 million from $1.59 billion to $1.89 billion, or 19%, from the second quarter of 2019. The increase in commercial loans was primarily driven by the PPP loans. Residential real estate loans were up $41.3 million, partially offset by a decrease of $8.3 million in residential real estate lines. Consumer indirect loans and other consumer loans decreased by $64.9 million and $566 thousand, respectively. Loans comprised 79.9% of average interest-earning assets during the second quarter of 2020 compared to 78.4% during the second quarter of 2019. Loans generally have significantly higher yields compared to securities and federal funds sold and interest-bearing deposits and, as such, have a more positive effect on the net interest margin. The yield on average loans was 4.14% for the second quarter of 2020, a decrease of 68-basis points compared to 4.82% for the comparable quarter in 2019. An unfavorable rate variance resulted in a $5.6 million decrease in interest income, partially offset by an increase of $3.0 million due to the increase in the volume of average loans. Securities represented 17.9% of average interest-earning assets during the second quarter of 2020 compared to 21.1% during the second quarter of 2019. The decrease in the volume of average securities resulted in a $482 thousand decrease in interest income, partially offset by a $212 thousand increase due to the favorable rate variance.

The cost of average interest-bearing liabilities of 0.71% in the second quarter of 2020 compared to 1.31% in the second quarter of 2019, was 60-basis points lower. The cost of average interest-bearing deposits decreased 45-basis points from 1.07% to 0.62% and the cost of short-term borrowings decreased 168-basis points from 2.71% to 1.03% in the second quarter of 2020 compared to the same quarter of 2019. The decrease in the cost of short-term borrowings was a result of decreases in the federal funds rate. The cost of long-term borrowings for the second quarter of 2020 decreased one-basis point from 6.30% to 6.29% compared to the same quarter of 2019. Overall, interest-bearing liability rate and volume decreases resulted in $4.6 million of lower interest expense.

Average interest-bearing liabilities of $3.18 billion in the second quarter of 2020 were $59.5 million, or 2%, higher than the second quarter of 2019. On average, interest-bearing deposits grew $272.6 million from $2.75 billion to $3.03 billion, and noninterest-bearing demand deposits (a principal component of net free funds) were up $198.0 million from $714.2 million to $912.2 million. The increase in average deposits was driven by PPP loan proceeds, successful business development efforts in retail banking, an increase in reciprocal deposit programs, and higher utilization of brokered deposits as a funding source. For further discussion of the reciprocal deposit programs, refer to the "Funding Activities - Deposits" section of this Management's Discussion and Analysis. Overall, interest-bearing deposit rate and volume changes resulted in a $2.7 million decrease in interest expense during the second quarter of 2020. Average borrowings decreased $213.1 million from $362.7 million to $149.6 million compared to the second quarter of 2019. Overall, short and long-term borrowing rate and volume changes resulted in $1.9 million of lower interest expense during the second quarter of 2020.

Analysis of Net Interest Income for the Six Months Ended June 30, 2020 and 2019

Net interest income on a taxable equivalent basis for the six months ended June 30, 2020, was $67.8 million, an increase of $2.9 million versus the comparable period last year of $64.8 million. The increase in net interest income was due primarily to an increase in average earning assets of $161.6 million or 4% compared to the first six months of 2019.

The net interest margin for the first six months of 2020 was 3.27%, one-basis point higher than 3.26% for the same period in 2019. This comparable period increase was a function of an eight-basis point increase in interest rate spread, partially offset by a seven-basis point lower contribution from net free funds. The higher interest rate spread was a result of a 39-basis point decrease in the cost of average interest-bearing liabilities and a 31-basis point decrease in the yield on average interest-earning assets.

For the first six months of 2020, the yield on average earning assets of 3.95% was 31-basis points lower than the first six months of 2019 of 4.26%. Loan yields decreased 43-basis points during the first six months of 2020 to 4.37% from 4.80%. The yield on investment securities increased ten-basis points during the first six months of 2020 to 2.48% from 2.38%. Overall, the earning asset rate changes decreased interest income by $6.6 million during the first six months of 2020 and a favorable volume variance increased interest income by $3.7 million, which collectively drove a $2.9 million decrease in interest income.

Average interest-earning assets were $4.16 billion for the first six months of 2020 compared to $4.00 billion for the first six months of 2019, an increase of $161.6 million, or 4%, from the comparable period last year, with average loans up $196.8 million from $3.12 billion to $3.31 billion and average securities down $92.9 million from $866.1 million to $773.3 million. The growth in average loans reflected increases in the commercial loans and residential real estate loans categories. Commercial loans, in particular, were up $224.6 million from $1.56 billion to $1.78 billion, or 9%, from the first six months of 2019. Loans represented 79.6% of average interest-earning assets during the first six months of 2020 compared to 77.9% during the first six months of 2019. Loans generally have significantly higher yields compared to securities and federal funds sold and interest-bearing deposits and, as such, have a more positive effect on the net interest margin. The yield on average loans was 4.37% for the first six months of 2020, a decrease of 43-basis points compared to 4.80% for first six months of 2019. An unfavorable rate variance resulted in a $6.8 million decrease in interest income, partially offset by an increase of $4.6 million due to the increase in the volume of average loans. Securities represented 18.6% of average interest-earning assets during first six months of 2020 compared to 21.6% during the first six months of 2019. The decrease in the volume of average securities resulted in a $1.1 million decrease in interest income, partially offset by a $443 thousand increase due to the favorable rate variance.

The cost of average interest-bearing liabilities of 0.90% in the first six months of 2020 compared to 1.29% in the first six months of 2019 was 39-basis points lower than the first six months of 2019. The cost of average interest-bearing deposits decreased 26-basis points from 1.05% to 0.79% and the cost of short-term borrowings decreased 102-basis points from 2.71% to 1.69% in the first six months of 2020 compared to the same period of 2019. The decrease in the cost of short-term borrowings was a result of decreases in the federal funds rate. The cost of long-term borrowings for the first six months of 2020 decreased one-basis point from 6.30% to 6.29% in the first six months of 2020 compared to the same period of 2019. Overall, interest-bearing liability rate and volume decreases resulted in $5.8 million of lower interest expense.

Average interest-bearing liabilities of $3.16 billion in the first six months of 2020 were $49.8 million, or 2%, higher than the first six months of 2019. On average, interest-bearing deposits grew $244.6 million from $2.73 billion to $2.98 billion, and noninterest-bearing demand deposits (a principal component of net free funds) were up $96.4 million from $720.7 million to $817.1 million. The increase in average deposits was driven by PPP loans, successful business development efforts in retail banking, an increase in reciprocal deposit programs, and higher utilization of brokered deposits as a funding source. For further discussion of the reciprocal deposit programs, refer to the "Funding Activities - Deposits" section of this Management's Discussion and Analysis. Overall, interest-bearing deposit rate and volume changes resulted in $2.5 million of lower interest expense during the first six months of 2020. Average borrowings decreased $194.8 million from $374.2 million to $179.3 million compared to the first six months of 2019. Overall, short and long-term borrowing rate and volume changes resulted in $3.3 million of lower interest expense during the first six months of 2020.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

	Three months ended June 30,					
	2020			2019		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Interest-earning assets:						
Federal funds sold and interest-earning deposits	$ 92,214	$ 24	0.10%	$ 18,145	$ 89	1.98%
Investment securities [1]:						
Taxable	585,970	3,662	2.50	621,936	3,664	2.36
Tax-exempt [2]	180,666	1,109	2.46	223,688	1,377	2.46
Total investment securities	766,636	4,771	2.49	845,624	5,041	2.38
Loans:						
Commercial business	757,588	6,537	3.47	577,884	7,764	5.39
Commercial mortgage	1,133,832	12,185	4.32	1,010,544	13,177	5.23
Residential real estate loans	581,651	5,333	3.67	540,390	5,194	3.85
Residential real estate lines	99,543	922	3.72	107,826	1,423	5.29
Consumer indirect	827,030	9,799	4.77	891,967	9,761	4.39
Other consumer	15,155	421	11.19	15,721	488	12.44
Total loans	3,414,799	35,197	4.14	3,144,332	37,807	4.82
Total interest-earning assets	4,273,649	39,992	3.76	4,008,101	42,937	4.29
Less: Allowance for credit losses	(44,585)			(34,365)		
Other noninterest-earning assets	395,296			326,518		
Total assets	$ 4,624,360			$ 4,300,254		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand	$ 712,300	$ 242	0.14%	$ 660,747	346	0.21%
Savings and money market	1,329,632	1,041	0.31	996,878	1,098	0.44
Time deposits	984,832	3,394	1.39	1,096,544	5,934	2.17
Total interest-bearing deposits	3,026,764	4,677	0.62	2,754,169	7,378	1.07
Short-term borrowings	110,272	284	1.03	323,461	2,189	2.71
Long-term borrowings	39,297	617	6.29	39,227	617	6.30
Total borrowings	149,569	901	2.41	362,688	2,806	3.10
Total interest-bearing liabilities	3,176,333	5,578	0.71	3,116,857	10,184	1.31
Noninterest-bearing demand deposits	912,238			714,205		
Other noninterest-bearing liabilities	90,350			53,781		
Shareholders' equity	445,439			415,411		
Total liabilities and shareholders' equity	$ 4,624,360			$ 4,300,254		
Net interest income (tax-equivalent)		$ 34,414			$ 32,753	
Interest rate spread			3.05%			2.98%
Net earning assets	$ 1,097,316			$ 891,244		
Net interest margin (tax-equivalent)			3.23%			3.28%
Ratio of average interest-earning assets to average interest-bearing liabilities			134.55%			128.59%

(1) Investment securities are shown at amortized cost.

(2) The interest on tax-exempt securities is calculated on a tax-equivalent basis assuming a Federal income tax rate of 21% for each of the three-month periods ended June 30, 2020 and 2019.

MANAGEMENT'S DISCUSSION AND ANALYSIS

	Six months ended June 30,					
	2020			2019		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Interest-earning assets:						
Federal funds sold and interest-earning deposits	$ 75,761	$ 235	0.62%	$ 18,050	$ 191	2.14%
Investment securities (1):						
Taxable	587,576	7,319	2.49	637,655	7,471	2.34
Tax-exempt (2)	185,689	2,280	2.46	228,483	2,818	2.47
Total investment securities	773,265	9,599	2.48	866,138	10,289	2.38
Loans:						
Commercial business	664,237	13,051	3.95	562,618	15,007	5.38
Commercial mortgage	1,117,247	25,499	4.59	994,271	25,750	5.22
Residential real estate loans	580,029	10,781	3.72	534,986	10,323	3.86
Residential real estate lines	101,111	2,105	4.19	108,673	2,850	5.29
Consumer indirect	836,915	19,718	4.74	901,556	19,361	4.33
Other consumer	15,310	903	11.87	15,972	982	12.40
Total loans	3,314,849	72,057	4.37	3,118,076	74,273	4.80
Total interest-earning assets	4,163,875	81,891	3.95	4,002,264	84,753	4.26
Less: Allowance for loan losses	(42,600)			(34,498)		
Other noninterest-earning assets	378,968			323,904		
Total assets	$ 4,500,243			$ 4,291,670		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand	$ 689,917	$ 586	0.17%	$ 664,577	$ 682	0.21%
Savings and money market	1,236,630	2,622	0.43	981,439	2,083	0.43
Time deposits	1,050,784	8,488	1.62	1,086,670	11,412	2.12
Total interest-bearing deposits	2,977,331	11,696	0.79	2,732,686	14,177	1.05
Short-term borrowings	140,049	1,176	1.69	334,939	4,494	2.71
Long-term borrowings	39,288	1,235	6.29	39,218	1,235	6.30
Total borrowings	179,337	2,411	2.70	374,157	5,729	3.08
Total interest-bearing liabilities	3,156,668	14,107	0.90	3,106,843	19,906	1.29
Noninterest-bearing demand deposits	817,106			720,727		
Other noninterest-bearing liabilities	83,141			55,876		
Shareholders' equity	443,328			408,224		
Total liabilities and shareholders' equity	$ 4,500,243			$ 4,291,670		
Net interest income (tax-equivalent)		$ 67,784			$ 64,847	
Interest rate spread			3.05%			2.97%
Net earning assets	$ 1,007,207			$ 895,421		
Net interest margin (tax-equivalent)			3.27%			3.26%
Ratio of average interest-earning assets to average interest-bearing liabilities			131.91%			128.82%

(1) Investment securities are shown at amortized cost.

(2) The interest on tax-exempt securities is calculated on a tax-equivalent basis assuming a Federal income tax rate of 21% for each of the six-month periods ended June 30, 2020 and 2019.

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 income not solely due to changes in volume or rate has been allocated in proportion to the absolute dollar amounts of the change in each (in thousands):

	Three months ended June 30, 2020 vs. 2019			Six months ended June 30, 2020 vs. 2019		
Increase (decrease) in:	**Volume**	**Rate**	**Total**	**Volume**	**Rate**	**Total**
Interest income:						
Federal funds sold and interest-earning deposits	$ 84	$ (149)	$ (65)	$ 257	$ (213)	$ 44
Investment securities:						
Taxable	(218)	216	(2)	(608)	456	(152)
Tax-exempt	(264)	(4)	(268)	(525)	(13)	(538)
Total investment securities	(482)	212	(270)	(1,133)	443	(690)
Loans:						
Commercial business	2,013	(3,240)	(1,227)	2,421	(4,377)	(1,956)
Commercial mortgage	1,492	(2,484)	(992)	2,992	(3,243)	(251)
Residential real estate loans	385	(246)	139	847	(389)	458
Residential real estate lines	(102)	(399)	(501)	(188)	(557)	(745)
Consumer indirect	(738)	776	38	(1,445)	1,802	357
Other consumer	(17)	(50)	(67)	(40)	(39)	(79)
Total loans	3,033	(5,643)	(2,610)	4,587	(6,803)	(2,216)
Total interest income	2,635	(5,580)	(2,945)	3,711	(6,573)	(2,862)
Interest expense:						
Deposits:						
Interest-bearing demand	25	(129)	(104)	25	(121)	(96)
Savings and money market	310	(367)	(57)	541	(2)	539
Time deposits	(557)	(1,983)	(2,540)	(366)	(2,558)	(2,924)
Total interest-bearing deposits	(222)	(2,479)	(2,701)	200	(2,681)	(2,481)
Short-term borrowings	(982)	(923)	(1,905)	(2,020)	(1,298)	(3,318)
Long-term borrowings	1	(1)	—	2	(2)	—
Total borrowings	(981)	(924)	(1,905)	(2,018)	(1,300)	(3,318)
Total interest expense	(1,203)	(3,403)	(4,606)	(1,818)	(3,981)	(5,799)
Net interest income	$ 3,838	$ (2,177)	$ 1,661	$ 5,529	$ (2,592)	$ 2,937

Provision for Credit Losses

The provision for credit losses for the three and six months ended June 30, 2020 was $3.7 million and $17.2 million, respectively, compared to $2.4 million and $3.5 million for the corresponding periods in 2019. The increase was driven by the adoption of the CECL standard, higher net charge-offs in the first quarter of 2020 and deterioration in the economic environment as a result of the COVID-19 pandemic, which adversely impacted our unemployment forecast, the designated loss driver for our CECL model. The increase in net charge-offs in the first six months of 2020 is primarily attributable to one commercial credit that was downgraded and partially charged-off during the first quarter of 2020. The borrower's business was related to the hospitality industry and the downgrade and charge-off were precipitated by the impact of the COVID-19 pandemic. The provision for credit losses - loans varies based primarily on forecasted unemployment rates, loan growth, net charge-offs, collateral values associated with collateral dependent loans and qualitative factors.

See the "Allowance for Credit Losses - Loans" and "Non-Performing Assets and Potential Problem Loans" sections of this Management's Discussion and Analysis for further discussion.

Noninterest Income

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

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Service charges on deposits	$ 480	$ 1,756	$ 2,067	$ 3,436
Insurance income	819	872	2,168	2,250
ATM and debit card	1,776	1,739	3,378	3,182
Investment advisory	2,251	2,327	4,497	4,543
Company owned life insurance	462	424	927	834
Investments in limited partnerships	(244)	144	(31)	376
Loan servicing	50	104	57	214
Income from derivative instruments, net	1,940	(45)	2,686	123
Net gain on sale of loans held for sale	731	407	1,035	589
Net gain (loss) on investment securities	674	166	895	113
Net gain on other assets	(1)	9	63	58
Net loss on tax credit investments	(40)	—	(80)	—
Other	934	1,330	2,132	2,635
Total noninterest income	$ 9,832	$ 9,233	$ 19,794	$ 18,353

Service charges on deposits decreased $1.3 million, or 73%, to $480 thousand for the second quarter of 2020 compared to $1.8 million for the second quarter of 2019. For the first six months of 2020, service charges on deposits decreased $1.4 million, or 40%, to $2.1 million compared to $3.4 million for the first six months of 2019. The decreases were primarily due to our COVID-19 relief initiatives implemented on March 23, 2020, including waiving or eliminating certain fees.

Income (loss) from investments in limited partnerships decreased $388 thousand, to a loss of $244 thousand for the second quarter of 2020 compared to income of $144 thousand for the second quarter of 2019. For the first six months of 2020, income (loss) from investments in limited partnerships decreased $407 thousand, to a loss of $31 thousand compared to income of $376 thousand for the first six months of 2019. We have investments in limited partnerships, primarily small business investment companies, and account for these investments under the equity method. The income from these equity method investments fluctuates based on the maturity and performance of the underlying investments.

Loan servicing income was $50 thousand for the second quarter of 2020 compared to a $104 thousand for the second quarter of 2019. For the first six months of 2020, loan servicing income was $57 thousand compared to $214 thousand for the first six months of 2019. The decrease was primarily due to the impact of lower interest rates on prepayment and refinancing activities in the mortgage service right ("MSR") portfolio. Additionally, in the first quarter of 2020, we recognized a valuation write-down of the MSR portfolio due to the impact of lower interest rates on prepayment assumptions.

Income from derivative instruments, net increased $2.0 million to $1.9 million for the second quarter of 2020 compared to a loss of $45 thousand for the second quarter of 2019. For the first six months of 2020, income from derivative instruments, net increased $2.6 million to $2.7 million compared to $123 thousand for the first six months of 2019. The increases were primarily the result of an increase in the number and value of interest rate swap transactions executed.

Net gain on investment securities was $674 thousand for the second quarter of 2020 compared to a $166 thousand for the second quarter of 2019. For the first six months of 2020, net gain on investment securities was $895 thousand compared to $113 thousand for the first six months of 2019. The net gain in the current quarter is attributable to the management of premium risk achieved through the sale of $25.4 million of fixed rate mortgage backed securities with higher expected prepayment speeds. Proceeds were reinvested in current coupon bonds, with lower anticipated prepayment behavior.

Other noninterest income was $934 thousand for the second quarter of 2020 compared to a $1.3 million for the second quarter of 2019. For the first six months of 2020, other noninterest income was $2.1 million compared to $2.6 million for the first six months of 2019. The decrease was due to lower pay-by-phone fees associated with our COVID-19 consumer relief initiatives, coupled with the impact of stay-at-home orders that reduced certain volume-based fees like merchant revenue and correspondent credit card fees. Our FHLB dividends have also declined year-over-year due to the lower level of FHLB borrowings in 2020 versus 2019.

Noninterest Expense

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

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Salaries and employee benefits	$ 15,074	$ 13,249	$ 30,088	$ 27,250
Occupancy and equipment	3,388	3,252	7,144	6,725
Professional services	1,580	932	3,732	2,090
Computer and data processing	2,699	2,424	5,372	4,760
Supplies and postage	517	498	1,070	1,032
FDIC assessments	539	486	911	998
Advertising and promotions	545	1,086	1,100	1,606
Amortization of intangibles	287	316	581	639
Other	2,065	2,760	4,418	5,074
Total noninterest expense	$ 26,694	$ 25,003	$ 54,416	$ 50,174

Salaries and employee benefits expense increased by $1.8 million, or 14%, to $15.1 million for the second quarter of 2020 compared to $13.2 million for the second quarter of 2019. For the first six months of 2020, salaries and employee benefits expense increased by $2.8 million, or 10%, to $30.1 compared to $27.3 million for the first six months of 2019. The increases were primarily the result of incentive compensation (including producer incentives and commissions), annual merit increases, COVID-19-related incremental pay to front-line retail associates, expense related to the departure of a senior officer on June 26, 2020 and higher medical expense.

Professional services expense increased $648 thousand, or 70%, to $1.6 million for the second quarter of 2020 compared to $932 thousand for the second quarter of 2019. For the first six months of 2020, professional services expense increased $1.6 million, or 79%, to $3.7 million compared to $2.1 million for the first six months of 2019. The increase was primarily due to the timing of audit fees and fees for consulting and advisory projects, including fees related to the Bank's derivative instruments program. Consulting fees related to our improvement initiatives totaled $353 thousand and $952 thousand for the three and six month periods ended June 30, 2020, respectively, and $130 thousand and $213 thousand for the three and six month periods ended June 30, 2019, respectively.

Advertising and promotions expense decreased $541 thousand, or 50%, to $545 thousand for the second quarter of 2020 compared to $1.1 million for the second quarter of 2019. For the first six months of 2020, advertising and promotions expense decreased $506 thousand, or 32%, to $1.1 million compared to $1.6 million for the first six months of 2019. Advertising and promotions expense was reduced in March 2020 when the COVID-19 pandemic impacted operations in Western New York.

Other expense decreased $695 thousand, or 25%, to $2.1 million for the second quarter of 2020 compared to $2.8 million for the second quarter of 2019. For the first six months of 2020, other expense decreased $656 thousand, or 13%, to $4.4 million compared to $5.1 million for the first six months of 2019. The decreases were primarily due to lower education, travel and business development expenses as a result of the stay-at home orders implemented in response to the COVID-19 pandemic, combined with lower expense incurred in connection with indirect consumer lending activity, which was significantly lower in the second quarter of 2020.

Our efficiency ratio for the first six months of 2020 was 62.78% compared with 60.39% for the first six months of 2019. The higher efficiency ratio is a result of the higher noninterest expenses associated with our improvement initiatives and COVID-related impacts on noninterest income and noninterest expenses. The efficiency ratio is calculated by dividing total noninterest expense by net revenue, defined as the sum of tax-equivalent net interest income and noninterest income before net gains on investment securities. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same volume of income, while a decrease indicates a more efficient allocation of resources. The efficiency ratio, a banking industry financial measure, is not required by GAAP. However, the efficiency ratio is used by management in its assessment of financial performance specifically as it relates to noninterest expense control. Management also believes such information is useful to investors in evaluating Company performance.

Income Taxes

For the six months ended June 30, 2020, we recorded income tax expense of $2.8 million, versus $6.0 million for the same period in the prior year. In the first six months of 2020, the Company recognized tax credit investments resulting in a $393 thousand reduction in income tax expense and an $80 thousand net loss recorded in noninterest income.

Our effective tax rates for the first six months of 2020 and 2019 were 18.4% and 20.7%, respectively. Effective tax rates are typically 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. In addition, our effective tax rate for 2020 and 2019 reflects the New York State tax benefit generated by our real estate investment trust.

ANALYSIS OF FINANCIAL CONDITION

INVESTING ACTIVITIES

Investment Securities

The following table summarizes the composition of our investment securities portfolio as of the dates indicated (in thousands):

	Investment Securities Portfolio Composition			
	June 30, 2020		December 31, 2019	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale:				
U.S. Government agency and government-sponsored enterprise securities	$ 6,229	$ 6,670	$ 26,440	$ 26,877
Mortgage-backed securities:				
Agency mortgage-backed securities	442,651	462,301	389,412	390,422
Non-Agency mortgage-backed securities	—	442	—	618
Total available for sale securities	448,880	469,413	415,852	417,917
Securities held to maturity:				
State and political subdivisions	159,530	164,605	192,215	196,018
Mortgage-backed securities	150,350	156,349	166,785	167,241
Total held to maturity securities	309,880	320,954	359,000	363,259
Allowance for credit losses - securities	(8)			
Total held to maturity securities, net	309,872			
Total investment securities	$ 758,752	$ 790,367	$ 774,852	$ 781,176

The available for sale ("AFS") investment securities portfolio increased $51.5 million from $417.9 million at December 31, 2019 to $469.4 million at June 30, 2020. The AFS portfolio had net unrealized gains of $20.5 million and $2.1 million at June 30, 2020 and December 31, 2019, respectively. The fair value of most of the investment securities in the AFS portfolio fluctuates as market interest rates change.

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 June 30, 2020. 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. No tax-equivalent adjustments were made to the weighted average yields (dollars 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	$ —	—%	$ 6,229	2.43%	$ —	—%	$ —	—%	$ 6,229	2.43%
Mortgage-backed securities	—	—	34,894	2.44	156,094	2.43	251,663	2.11	442,651	2.25
	—	—	41,123	2.44	156,094	2.43	251,663	2.11	448,880	2.25
Held to maturity debt securities:										
State and political subdivisions	50,075	2.27	104,311	1.95	5,144	1.93	—	—	159,530	2.05
Mortgage-backed securities	—	—	2,386	2.30	17,109	2.19	130,855	2.51	150,350	2.47
	50,075	2.27	106,697	1.96	22,253	2.13	130,855	2.51	309,880	2.26
Total investment securities	$50,075	2.27%	$147,820	2.09%	$178,347	2.39%	$ 382,518	2.25%	$758,760	2.25%

Impairment Assessment

For AFS securities in an unrealized loss position, we first assess whether (i) we intend to sell, or (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. If either case is affirmative, any previously recognized allowances are charged-off and the security's amortized cost is written down to fair value through income. If neither case is affirmative, the security is evaluated to determine whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency and any adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income. Adjustments to the allowance are reported in our income statement as a component of credit loss expense. AFS securities are charged-off against the allowance or, in the absence of any allowance, written down through income when deemed uncollectible by management or when either of the aforementioned criteria regarding intent or requirement to sell is met. For the six months ended June 30, 2020 and 2019 no allowance for credit losses has been recognized on AFS securities in an unrealized loss position as management does not believe any of the securities are impaired due to reasons of credit quality.

LENDING ACTIVITIES

The following table summarizes the composition of our loan portfolio, excluding loans held for sale and including net unearned income and net deferred fees and costs, as of the dates indicated (in thousands).

	Loan Portfolio Composition			
	June 30, 2020		December 31, 2019	
	Amount	% of Total	Amount	% of Total
Commercial business	$ 818,691	23.5%	$ 572,040	17.8%
Commercial mortgage	1,140,326	32.7	1,106,283	34.3
Total commercial	1,959,017	56.2	1,678,323	52.1
Residential real estate loans	585,035	16.8	572,350	17.8
Residential real estate lines	97,427	2.8	104,118	3.2
Consumer indirect	828,105	23.7	850,052	26.4
Other consumer	16,237	0.5	16,144	0.5
Total consumer	1,526,804	43.8	1,542,664	47.9
Total loans	3,485,821	100.0%	3,220,987	100.0%
Less: Allowance for credit losses	46,316		30,482	
Total loans, net	$ 3,439,505		$ 3,190,505	

Total loans increased $264.8 million to $3.49 billion at June 30, 2020 from $3.22 billion at December 31, 2019. The increase in loans was primarily due to the PPP loans in our commercial business portfolio.

Commercial loans increased $280.7 million during the six months ended June 30, 2020 and represented 56.2% of total loans as of June 30, 2020 as a result of the PPP loans.

The consumer indirect portfolio totaled $828.1 million and represented 23.7% of total loans as of June 30, 2020. During the first six months of 2020, we originated $135.6 million in indirect auto loans with a mix of approximately 30% new auto and 70% used auto. During the first six months of 2019, we originated $158.5 million in indirect auto loans with a mix of approximately 33% new auto and 67% used auto. Our origination volumes and mix of new and used vehicles financed fluctuate depending on general market conditions.

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 loans and totaled $6.7 million and $4.2 million as of June 30, 2020 and December 31, 2019, respectively.

We sell certain qualifying newly originated or refinanced residential real estate loans on the secondary market. Residential real estate loans serviced for others, which are not included in the consolidated statements of financial condition, amounted to $200.4 million and $189.8 million as of June 30, 2020 and December 31, 2019, respectively.

Allowance for Credit Losses - Loans

The following table summarizes the activity in the allowance for credit losses - loans for the periods indicated (in thousands).

	Loan Loss Analysis			
	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Allowance for credit losses - loans, beginning of period, prior to adoption of ASC 326			$ 30,482	$ 33,914
Impact of adopting ASC 326			9,594	—
Allowance for credit losses - loans, beginning of period, after adoption of ASC 326	43,356	33,327	40,076	33,914
Charge-offs:				
Commercial business	25	138	8,266	268
Commercial mortgage	1,072	3	1,072	3
Residential real estate loans	2	87	100	118
Residential real estate lines	—	2	-	2
Consumer indirect	2,554	2,700	5,978	5,682
Other consumer	70	243	339	552
Total charge-offs	3,723	3,173	15,755	6,625
Recoveries:				
Commercial business	1,483	128	1,541	231
Commercial mortgage	—	—	—	17
Residential real estate loans	8	11	18	17
Residential real estate lines	-	3	3	5
Consumer indirect	1,379	1,678	3,047	3,102
Other consumer	67	106	217	226
Total recoveries	2,937	1,926	4,826	3,598
Net charge-offs	786	1,247	10,929	3,027
Provision for credit losses - loans	3,746	2,354	17,169	3,547
Allowance for credit losses - loans, end of period	$ 46,316	$ 34,434	$ 46,316	$ 34,434
Net loan charge-offs to average loans (annualized)	0.09%	0.16%	0.66%	0.20%
Allowance for credit losses - loans to total loans	1.33%	1.09%	1.33%	1.09%
Allowance for credit losses - loans to non-performing loans	351%	300%	351%	300%

The Company adopted CECL effective January 1, 2020, which resulted in an increase to the allowance for credit losses - loans of $9.6 million and established a reserve for unfunded commitments of $2.1 million, for a total pre-tax cumulative effect adjustment of $11.7 million.

The allowance for credit losses for Pooled Loans estimate is based upon periodic review of the collectability of the loans quantitatively correlating historical loan experience with reasonable and supportable forecasts using forward looking information. Adjustments to the quantitative evaluation may be made for differences in current or expected qualitative risk characteristics such as changes in: underwriting standards, delinquency level, regulatory environment, economic condition, Company management and the status of portfolio administration including the Company's Loan Review function. The Company establishes a specific reserve for individually evaluated loans which do not share similar risk characteristics with the loans included in the forecasted allowance for credit losses. These individually evaluated loans are removed from the pooling approach discussed above for the forecasted allowance for credit losses, and include nonaccrual loans, troubled debt restructurings ("TDRs"), and other loans deemed appropriate by management.

Assessing the adequacy of the allowance for credit losses - loans involves substantial uncertainties and is based upon management's evaluation of the amounts required to meet estimated charge-offs in the loan portfolio after weighing a variety of factors, including the risk profile of our loan products and customers.

The adequacy of the allowance for credit losses - loans is subject to ongoing management review. While management evaluates currently available information in establishing the allowance for credit losses - loans, 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 credit losses - loans. Such agencies may require the financial institution to increase the allowance based on their judgments about information available to them at the time of their examination.

Net charge-offs of $786 thousand in the second quarter of 2020 represented 0.09% of average loans on an annualized basis compared to $1.2 million, or 0.16%, in the second quarter of 2019. For the six months ended June 30, 2020, net charge-offs of $10.9 million represented 0.66% of average loans, compared to $3.0 million or 0.20% of average loans for the same period in 2019. The increase in net charge-offs in the six months ended June 30, 2020 was primarily due to an $8.2 million partial charge-off of an $11.9 million commercial loan downgraded in the first quarter of 2020. The borrower's business was related to the hospitality industry and the downgrade and charge-off were precipitated by the impact of the COVID-19 pandemic. The allowance for credit losses - loans was $46.3 million at June 30, 2020, compared with $30.5 million at December 31, 2019. The ratio of the allowance for credit losses -loans to total loans was 1.33% and 0.95% at June 30, 2020 and December 31, 2019, respectively. The ratio of allowance for credit losses - loans to non-performing loans was 351% at June 30, 2020, compared with 353% at December 31, 2019.

Non-Performing Assets and Potential Problem Loans

The table below summarizes our non-performing assets at the dates indicated (in thousands).

	Non-Performing Assets	
	June 30, 2020	December 31, 2019
Nonaccrual loans:		
Commercial business	$ 4,918	$ 1,177
Commercial mortgage	4,140	3,146
Residential real estate loans	2,992	2,484
Residential real estate lines	177	102
Consumer indirect	868	1,725
Other consumer	30	—
Total nonaccrual loans	13,125	8,634
Accruing loans 90 days or more delinquent	57	6
Total non-performing loans	13,182	8,640
Foreclosed assets	679	468
Total non-performing assets	$ 13,861	$ 9,108
Non-performing loans to total loans	0.38%	0.27%
Non-performing assets to total assets	0.30%	0.21%

Non-performing assets include non-performing loans and foreclosed assets. Non-performing assets at June 30, 2020 were $13.9 million, an increase of $4.8 million from the $9.1 million balance at December 31, 2019. The primary component of non-performing assets is non-performing loans, which were $13.2 million or 0.38% of total loans at June 30, 2020, compared with $8.6 million or 0.27% of total loans at December 31, 2019. The increase in non-performing loans in the six months ended June 30, 2020 is primarily due to an $11.9 million commercial loan downgraded, with $8.2 million charged-off, in the first quarter of 2020. The borrower's business was related to the hospitality industry and the downgrade and charge-off were precipitated by the impact of the COVID-19 pandemic.

Approximately $1.5 million, or 12%, of the $13.1 million in non-performing loans as of June 30, 2020 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. Included in nonaccrual loans are TDRs of $3.4 million and $297 thousand at June 30, 2020 and December 31, 2019, respectively. There were no TDRs accruing interest as of June 30, 2020 and one TDR of $550 thousand was accruing interest as of December 31, 2019.

Foreclosed assets consist of real property formerly pledged as collateral for loans, which we have acquired through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. Foreclosed asset holdings represented two properties totaling $679 thousand at June 30, 2020 and three properties totaling $468 thousand at December 31, 2019.

Potential problem loans are loans that are currently performing, but information known about possible credit problems of the borrowers causes us 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. We consider loans classified as substandard, which continue to accrue interest, to be potential problem loans. We identified $9.9 million and $14.6 million in loans that continued to accrue interest which were classified as substandard as of June 30, 2020 and December 31, 2019, respectively.

FUNDING ACTIVITIES

Deposits

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

	Deposit Composition			
	June 30, 2020		December 31, 2019	
	Amount	% of Total	Amount	% of Total
Noninterest-bearing demand	$ 1,008,958	25.3%	$ 707,752	19.9%
Interest-bearing demand	727,676	18.2	627,842	17.7
Savings and money market	1,368,805	34.3	1,039,892	29.2
Time deposits < $250,000	706,781	17.6	893,177	25.1
Time deposits of $250,000 or more	181,788	4.6	287,012	8.1
Total deposits	$ 3,994,008	100.0%	$ 3,555,675	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 June 30, 2020, total deposits were $3.99 billion, representing an increase of $438.3 million from December 31, 2019. The increase was driven by growth in nonpublic deposits and the reciprocal deposit portfolio. Time deposits were approximately 22% and 33% of total deposits at June 30, 2020 and December 31, 2019, respectively.

Nonpublic deposits, the largest component of our funding sources, totaled $2.51 billion and $2.16 billion at June 30, 2020 and December 31, 2019, respectively, and represented 63% and 61% of total deposits as of the end of each period, respectively. The increase in nonpublic deposits was in part attributable to PPP loan proceeds received by customers. 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.

As an additional source of funding, we offer a variety of public (municipal) deposit products to the towns, villages, counties and school districts within our market. Public deposits generally range from 20% to 30% 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 $899.4 million and $860.7 million at June 30, 2020 and December 31, 2019, respectively, and represented 23% and 24% of total deposits as of the end of each period, respectively. The decrease in public deposits during 2020 was due largely to seasonality.

We also participate in reciprocal deposit 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. Prior to the Economic Growth, Regulatory Relief and Consumer Protection Act ("EGRRCPA") enacted on May 14, 2018, all reciprocal deposits were considered brokered deposits for regulatory reporting purposes. With the enactment of EGRRCPA, reciprocal deposits, subject to certain restrictions, are no longer required to be reported as brokered deposits. Reciprocal deposits totaled $220.6 million and $196.5 million, respectively, at June 30, 2020, compared to $157.9 million and $172.0 million, respectively, at December 31, 2019. Reciprocal deposits represented 10% and 9% of total deposits as of the end of each period, respectively.

Brokered deposits totaled $167.0 million and $208.8 million at June 30, 2020 and December 31, 2019, respectively, and represented 4% and 6% of total deposits as of the end of each period, respectively.

Borrowings

The Company classifies borrowings as short-term or long-term in accordance with the original terms of the applicable agreement. Outstanding borrowings consisted of the following as of the dates indicated (in thousands):

	June 30, 2020	December 31, 2019
Short-term borrowings - FHLB	$ 105,300	$ 275,500
Long-term borrowings - Subordinated notes, net	39,308	39,273
Total borrowings	$ 144,608	$ 314,773

Short-term Borrowings

Short-term Federal Home Loan Bank ("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 June 30, 2020 consisted of $105.3 million in short-term borrowings. The maximum amount of short-term FHLB borrowings outstanding at any month-end during the six months ended June 30, 2020 was $198.9 million. Short-term FHLB borrowings at December 31, 2019 consisted of $10.0 million in overnight borrowings and $265.5 million in short-term borrowings.

We have credit capacity with the FHLB and can borrow through facilities that include amortizing and term advances or repurchase agreements. We had approximately $142.8 million of immediate credit capacity with the FHLB as of June 30, 2020. We had approximately $614.0 million in secured borrowing capacity at the Federal Reserve Bank (“FRB”) discount window, none of which was outstanding at June 30, 2020. The FHLB and FRB credit capacity are collateralized by securities from our investment portfolio and certain qualifying loans. We had approximately $145.0 million of credit available under unsecured federal funds purchased lines with various banks as of June 30, 2020 and December 31, 2019. Additionally, we had approximately $176.3 million of unencumbered liquid securities available for pledging.

The Parent has a revolving line of credit with a commercial bank allowing borrowings up to $20.0 million in total as an additional source of working capital. At June 30, 2020, no amounts have been drawn on the line of credit.

Long-term Borrowings

On April 15, 2015, we issued $40.0 million of Subordinated Notes in a registered public offering. The Subordinated Notes bear interest at a fixed rate of 6.0% per year, payable semi-annually, for the first 10 years. From April 15, 2025 to the April 15, 2030 maturity date, the interest rate will reset quarterly to an annual interest rate equal to the then-current three-month London Interbank Offered Rate (LIBOR) plus 3.944%, payable quarterly. After the discontinuance of LIBOR, the interest rate will be determined by an alternate method as reasonably selected by the Company. The Subordinated Notes are redeemable by us at any quarterly interest payment date beginning on April 15, 2025 to maturity at par, plus accrued and unpaid interest. Proceeds, net of debt issuance costs of $1.1 million, were $38.9 million. The Subordinated Notes qualify as Tier 2 capital for regulatory purposes.

LIQUIDITY AND CAPITAL MANAGEMENT

Liquidity

We continue to actively monitor our liquidity profile and funding concentrations in accordance with our Board approved Liquidity Policy. While funding pressures have not occurred, management is actively monitoring customer activity by way of commercial and consumer line of credit utilization, as well as deposit flows. As of June 30, 2020, all structural liquidity ratios and early warning indicators remain in compliance, with what we believe are ample funding sources available in the event of a stress scenario.

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 both core customer funds and maturing short-term assets; we also rely on our ability to sell or pledge securities and lines-of-credit and our overall ability to access to the financial and capital markets.

Liquidity for the Bank is managed through the monitoring of anticipated changes in loans, the investment portfolio, 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 other banking institutions, the FHLB and the FRB. The primary source of our non-deposit borrowings is FHLB advances, of which we had $105.3 million outstanding at June 30, 2020. In addition to this amount, we have additional collateralized wholesale borrowing capacity of approximately $901.8 million from various funding sources which include the FHLB, the FRB, and commercial banks that we can use to fund lending activities, liquidity needs, and/or to adjust and manage our asset and liability position.

The Parent’s funding requirements consist primarily of dividends to shareholders, debt service, income taxes, operating expenses, funding of non-bank subsidiaries, repurchases of our stock, and acquisitions. The Parent obtains funding to meet obligations from dividends received from the Bank, net taxes collected from subsidiaries included in the federal consolidated tax return, and the issuance of debt and equity securities. In addition, the Parent maintains a revolving line of credit with a commercial bank for an aggregate amount of up to $20.0 million, all of which was available at June 30, 2020. The line of credit has a one-year term and matures in May 2021. Funds drawn would be used for general corporate purposes and backup liquidity.

Cash and cash equivalents were $119.6 million as of June 30, 2020, up $6.7 million from $112.9 million as of December 31, 2019. Net cash provided by operating activities totaled $10.2 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 $262.6 million, which included outflows of $276.4 million for net loan originations, and was partially offset by inflows of $15.8 million from net investment securities transactions. Net cash provided by financing activities of $259.0 million was attributed to a $438.3 million increase in deposits, partially offset by a $170.2 million decrease in short-term borrowings and by $8.9 million in dividend payments.

Capital Management

We actively manage capital, commensurate with our risk profile, to enhance shareholder value. We also seek to maintain capital levels for the Company and the Bank at amounts in excess of the regulatory “well-capitalized” thresholds. Periodically, we may respond to market conditions by implementing changes to our overall balance sheet positioning to manage our capital position.

Banks and financial holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material impact on our 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.

Shareholders' equity was $448.0 million at June 30, 2020, an increase of $9.1 million from $438.9 million at December 31, 2019. Net income for the six months ended June 30, 2020 increased shareholders' equity by $12.3 million, offset by an $8.7 million cumulative effect adjustment from the adoption of ASC 326 and common and preferred stock dividends declared of $9.1 million. Accumulated other comprehensive loss included in shareholders' equity decreased $14.0 million during the first six months of 2020 due primarily to higher net unrealized gains on securities available for sale.

The FRB and FDIC have adopted a system using risk-based capital guidelines to evaluate the capital adequacy of banks and bank holding companies. The final rules implementing the Basel Committee on Banking Supervision's ("BCBS") capital guidelines for U.S. banks became effective for the Company on January 1, 2015 and was fully phased-in on January 1, 2019. As of June 30, 2020, the Company's capital levels remained characterized as "well-capitalized" under the new rules.

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

	June 30, 2020	December 31, 2019
Common shareholders' equity	$ 430,717	$ 421,619
Add: CECL transitional amount	10,402	—
Less: Goodwill and other intangible assets	71,393	71,987
Net unrealized gain (loss) on investment securities [(1)]	14,720	873
Hedging derivative instruments	(815)	(518)
Net periodic pension and postretirement benefits plan adjustments	(14,401)	(14,868)
Other	—	—
Common Equity Tier 1 ("CET1") Capital	370,222	364,145
Plus: Preferred stock	17,328	17,328
Less: Other	—	—
Tier 1 Capital	387,550	381,473
Plus: Qualifying allowance for credit losses	35,531	30,482
Subordinated Notes	39,308	39,273
Total regulatory capital	$ 462,389	$ 451,228
Adjusted average total assets (for leverage capital purposes)	$ 4,563,558	$ 4,237,596
Total risk-weighted assets	$ 3,603,256	$ 3,533,281
Regulatory Capital Ratios		
Tier 1 Leverage (Tier 1 capital to adjusted average assets)	8.49%	9.00%
CET1 Capital (CET1 capital to total risk-weighted assets)	10.27	10.31
Tier 1 Capital (Tier 1 capital to total risk-weighted assets)	10.76	10.80
Total Risk-Based Capital (Total regulatory capital to total risk-weighted assets)	12.83	12.77

(1) Includes unrealized gains and losses related to the Company's reclassification of available for sale investment securities to the held to maturity category.

We have elected to apply the 2020 CECL transition provision related to the impact of the CECL accounting standard on regulatory capital, as provided by the US banking agencies' March 2020 interim final rule. Under the 2020 CECL transition provision, the regulatory capital impact of the Day 1 adjustment to the allowance for credit losses (after-tax) upon the January 1, 2020 CECL adoption date has been deferred, and will phase in to regulatory capital at 25% per year commencing January 1, 2022. For the ongoing impact of CECL, we are allowed to defer the regulatory capital impact of the allowance for credit losses in an amount equal to 25% of the change in the allowance for credit losses (pre-tax) recognized through earnings for each period between January 1, 2020, and December 31, 2021. The cumulative adjustment to the allowance for credit losses between January 1, 2020, and December 31, 2021, will also phase in to regulatory capital at 25% per year commencing January 1, 2022.

BCBS Capital Rules

The BCBS Capital Rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, increase the minimum Tier 1 capital to risk-weighted assets ratio from 4.0% to 6.0%, require a minimum total capital to risk-weighted assets ratio of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer is also established above the regulatory minimum capital requirements, effectively increasing the minimum required risk-weighted asset ratios. This capital conservation buffer was fully phased-in as of January 1, 2019 at 2.5% of risk-weighted assets. Banking institutions with a capital conservation buffer below the minimum level will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. The BCBS Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Company or the Bank. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revised the definition and calculation of Tier 1 capital, total capital, and risk-weighted assets.

The following table presents actual and required capital ratios as of June 30, 2020 and December 31, 2019 for the Company and the Bank under the BCBS Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of those dates based on the phase-in provisions of the BCBS Capital Rules and the minimum required capital levels as of January 1, 2019 when the BCBS Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the BCBS Capital Rules (in thousands):

	Actual		Minimum Capital Required – Basel III		Required to be Considered Well Capitalized	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
June 30, 2020						
Tier 1 leverage:						
Company	$ 387,550	8.49%	$ 182,542	4.00%	$ 228,178	5.00%
Bank	414,570	9.10	182,278	4.00	227,848	5.00
CET1 capital:						
Company	370,222	10.27	252,228	7.00	234,212	6.50
Bank	414,570	11.53	251,676	7.00	233,699	6.50
Tier 1 capital:						
Company	387,550	10.76	306,277	8.50	288,260	8.00
Bank	414,570	11.53	305,607	8.50	287,630	8.00
Total capital:						
Company	462,389	12.83	378,342	10.50	360,326	10.00
Bank	450,101	12.52	377,514	10.50	359,538	10.00
December 31, 2019						
Tier 1 leverage:						
Company	$ 381,473	9.00%	$ 169,504	4.00%	$ 211,880	5.00%
Bank	409,031	9.67	169,189	4.00	211,486	5.00
CET1 capital:						
Company	364,145	10.31	247,330	7.00	229,663	6.50
Bank	409,031	11.61	246,674	7.00	229,055	6.50
Tier 1 capital:						
Company	381,473	10.80	300,329	8.50	282,663	8.00
Bank	409,031	11.61	299,533	8.50	281,914	8.00
Total capital:						
Company	451,228	12.77	370,995	10.50	353,328	10.00
Bank	439,514	12.47	370,011	10.50	352,392	10.00

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.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk refers to the potential impact on earnings or capital arising from movements in interest rates. The Bank's market risk management framework has been developed to control both short-term and long-term exposure within Board approved policy limits and is monitored by the Asset-Liability Management Committee and Board of Directors. Quantitative and qualitative disclosures about market risk were presented at December 31, 2019 in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2019, as filed with the Securities and Exchange Commission on March 4, 2020. The following is an update of the discussion provided therein.

Portfolio Composition

There was no material change in the composition of assets, deposit liabilities or borrowings from December 31, 2019 to June 30, 2020. See the section titled "Analysis of Financial Condition" in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of asset, deposit and borrowing activity during the period.

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.

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 June 30, 2021 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
Estimated change in net interest income	$ 1,354	$ 764	$ 1,909	$ 3,719
% Change	0.95%	0.54%	1.34%	2.62%

In the rising rate environments, the model results indicate increases in net interest income compared to the flat rate scenario over a one-year timeframe. This is a result of assumed commercial loan products repricing at a higher frequency than underlying borrowing and deposit costs. As intermediate and longer-term assets continue to mature and are replaced at higher yields, net interest income improves over longer term timeframes. Model results in the declining rate environments also indicate increases in net interest income due to floating rate loans, tied to Prime, no longer repricing downwards due to Prime rate being floored, while interest rate sensitive liabilities still have slight sensitivity to downward movement in rates.

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 simulation referenced above is based on our 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 future results, does not measure the effect of changing interest rates on noninterest income 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 variance 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.

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 on 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 June 30, 2020 and December 31, 2019 (dollars in thousands). The analysis additionally presents a measurement of the interest rate sensitivity at June 30, 2020 and December 31, 2019. 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. The following table sets forth the estimated changes to EVE assuming instantaneous changes in interest rates for the given rate shock scenarios (dollars in thousands):

	June 30, 2020			December 31, 2019		
Rate Shock Scenario:	**EVE**	**Change**	**Percentage Change**	**EVE**	**Change**	**Percentage Change**
Pre-Shock Scenario	$ 537,401			$ 632,832		
- 100 Basis Points	520,362	$ (17,039)	-3.17%	676,362	$ 43,530	6.88%
+100 Basis Points	563,453	26,052	4.85	627,409	(5,423)	(0.86)
+ 200 Basis Points	586,674	49,273	9.17	614,927	(17,905)	(2.83)
+ 300 Basis Points	606,997	69,596	12.95	600,636	(32,196)	(5.09)

The decrease in the Pre-Shock Scenario EVE at June 30, 2020 compared to December 31, 2019 is a result of a 15% increase in non-public deposits largely due to funds received through the PPP. The decrease in the -100 basis point Rate Shock Scenario EVE is reflective of the assumption that deposit pricing is nearly floored and has the inability to reprice to a lower level. This is compounded by the assumption that the discount curve on the fixed rate portfolio is nearly floored, resulting in less premium on the portfolio in a falling rate environment. The overall level of change is in line with expectations due to the Federal Open Market Committee action to reduce the Federal Funds target rate by 150 basis points within the period and programs introduced to help small businesses with loans.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of June 30, 2020, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15(b), as adopted by the SEC under the Securities Exchange Act of 1934, as amended ("Exchange Act"). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

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

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2020 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

The Company has experienced no material developments in its legal proceedings from the disclosure included in the Company's Annual Report on Form 10-K for the year ended December 31, 2019, as filed with the SEC on March 4, 2020.

ITEM 1A. Risk Factors

Except as stated below, there have been no material changes from the risk factors previously disclosed in Part I – Item 1A of the Company's Form 10-K for the year ended December 31, 2019.

The ongoing novel coronavirus ("COVID-19") pandemic, and governmental and individual efforts to contain the pandemic, have had a significant negative impact on the U.S. and global economy which has and will continue to adversely affect our business, financial condition and results of operations.

During the first quarter of 2020, the Federal Reserve reduced the target federal funds rate to a range of 0.00% to 0.25% in response to the expected economic downturn caused by the COVID-19 pandemic. This change influences the rate of interest we earn on loans and pay on borrowings and interest-bearing deposits, and can affect the value of financial instruments we hold. In an environment with lower interest rates, we will not be able to earn as much on our interest-earning assets, which will likely reduce net interest margin. In addition, our ability to earn interest and receive dividend income from investment securities will be reduced. If interest rates remain low for an extended period of time, our results of operations could be materially adversely affected.

In response to executive orders from the Governor of the State of New York, during the week of March 16, 2020, we took necessary steps to protect the health and safety of our associates, customers and communities by maximizing social distancing and implementing a work-from-home policy for many associates. Bank branch locations were also limited to drive-thru windows wherever possible, while we continue to provide essential services for our communities and their banking and financial needs. In addition, we have waived certain transaction fees for our customers during this time, including overdraft and late fees, and are providing payment relief opportunities for mortgage and home equity borrowers. Temporarily eliminating these fees and providing payment relief to customers will have a negative impact on our results of operations in the short term. If these measures are not effective in mitigating the effects of the pandemic on our customers and borrowers, we may experience higher rates of default and increased credit losses in future periods.

The U.S. economy generally and our customers and employees in particular have been directly impacted by prevalent "stay at home" orders in place in the State of New York that reduced travel and in-person interactions during the first and second quarters of 2020, and we expect they will continue to be impacted by social distancing efforts for the duration of the COVID-19 pandemic. A majority of our employees are working remotely, which may slow response times to customers' inquiries or preclude providing the level of service our employees are typically able to offer in person. Our reputation and results of operations may be impacted if our competitors are better able to adjust to the restrictions on in-person interactions and remote work. Furthermore, as a majority of our employees continue to work from home, our operational risk, including data security risk, is higher than it would otherwise be, as cybercriminal activity has increased in an attempt to profit from the disruption to typical operations. The cybersecurity-related risks we face include more phishing, malware, and other cybersecurity attacks, vulnerability to disruptions of our information technology infrastructure and telecommunications systems for remote operations, and unauthorized dissemination, misuse or destruction of confidential or valuable information.

While we have experienced higher loan origination volume due to the Paycheck Protection Program ("PPP") under the CARES Act, there can be no assurance that the borrowers under the CARES Act programs will be able to pay the interest, and principal payments, if applicable, when they are due. If the borrower of a PPP loan fails to qualify for loan forgiveness under the program, we will have to hold the loan at an unfavorable interest rate as compared to a loan we may otherwise have extended to our customer. Even though those loans are guaranteed by the U.S. Small Business Association (the "SBA"), we may not be able to collect from the SBA as quickly as those payments come due, and our cash flow and earnings may be reduced accordingly. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which we originated, funded or serviced the PPP loan, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already made payment under the guaranty, seek recovery of any loss related to the deficiency from us. Originations for consumer indirect lending, which currently constitutes 23.7% of our total loans, have declined since the outbreak of the COVID-19 pandemic. If this trend continues, our financial condition and results of operations could be materially adversely affected.

Our loan customers will likely be impacted by the overall decline in the U.S. economy, which may cause them to make late or reduced payments on their loans or default on their loans with us. In particular, our commercial mortgage customers may be experiencing higher rates of tenants not paying rent due to the COVID-19 pandemic. 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. The collateral securing our indirect loan portfolio in particular may not be sufficient to cover the full value of an outstanding loan because the collateral, namely automobiles, are depreciating assets. Our credit risk has increased since the start of the COVID-19 pandemic and related decline in the U.S. economy. In the event of delinquencies, regulatory changes and policies designed to protect borrowers may slow or prevent us from taking certain remediation actions, including foreclosure. 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 COVID-19 pandemic and resulting changes to the U.S. economy. The actual amount of future provisions for credit losses may vary from the amount of past provisions. The longer the economic results of the COVID-19 pandemic negatively impact our customers, the more likely our credit quality is to decline and the more likely our customers will be to default on their loans with us. Continued economic disruption and fear of the spread of COVID-19 could result in business shutdowns, limitations on commercial activity and financial transactions, labor shortages, supply chain interruptions, increased unemployment and commercial property vacancy rates and reduced profitability and ability for property owners to make mortgage payments. If a significant proportion of our customers are unable to repay their loans and the collateral securing repayment is insufficient to cover our losses, we may have to increase our allowance for credit losses - loans, the quality of our loan portfolio will decline, our net income will decrease and our results of operations will be materially adversely impacted. In addition, our capital and leverage ratios may be adversely impacted.

At June 30, 2020, we held $159.5 million in debt securities that are issued by state and local government agencies, or municipal bonds, that are backed by the credit and taxing power of the issuing jurisdiction. As these state and local governments experience the impacts of the pandemic and stay at home orders, they are earning less sales tax revenue while incurring higher than expected costs as a result of the COVID-19 pandemic. The impact of the COVID-19 pandemic may cause the credit rating of the municipal bonds we hold to be downgraded, which could in turn cause us to incur credit losses. If these bond issuers are unable to repay us when the bonds mature, we could lose our investment and our results of operations and cash flows could be materially adversely impacted.

The market volatility related to the COVID-19 pandemic has driven market values of publicly traded securities downward. Because the majority of our investment advisory revenue is from fees based on a percentage of assets under management, our investment advisory revenues and profitability have fallen and will continue to fluctuate with the overall market conditions.

The spread of COVID-19 is expected to lead to an economic recession and other severe disruptions in the U.S. economy. Should the COVID-19 pandemic continue for an extended period of time, our business, financial condition, results of operations and cash flows may likewise be materially adversely impacted for an extended period of time.

The value of our goodwill and other intangible assets may decline in the future.

As of June 30, 2020, we had $66.1 million of goodwill and $8.3 million of other intangible assets. Although we did not record any impairment to our goodwill for the first six months of 2020, 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 and slower growth rates, any or all of which could be materially impacted by the ongoing COVID-19 pandemic, may necessitate our taking charges in the future related to the impairment of our goodwill. If the recent capital markets downturn resulting from the COVID-19 pandemic continues for an extended period of time, or the capital markets continue to experience increased volatility, we may record an impairment to our goodwill in subsequent fiscal periods. Future regulatory actions could also have a material impact on assessments of goodwill for impairment. If the fair value of our net assets improves at a faster rate than the market value of our reporting units, or if we were to experience increases in book values of a reporting unit in excess of the increase in fair value of equity, we may also have to take charges related to the impairment of our goodwill. If we were to conclude that a future write-down of our goodwill is necessary, we would record the appropriate charge, which could have a material adverse effect on our results of operations.

Identifiable intangible assets other than goodwill consist of core deposit intangibles and other intangible assets (primarily customer relationships). Adverse events or circumstances could impact the recoverability of these intangible assets including loss of core deposits, significant losses of customer accounts and/or balances, increased competition or adverse changes in the economy, such as those related to the ongoing COVID-19 pandemic. To the extent these intangible assets are deemed unrecoverable, a non-cash impairment charge would be recorded which could have a material adverse effect on our results of operations.

For further discussion, see Note 6, Goodwill and Other Intangible Assets, to the Consolidated Financial Statements (Unaudited) included in Item 1 of this Quarterly Report on Form 10-Q.

Table of Contents

ITEM 6. Exhibits

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

Exhibit Number	Description	Location
10.1	Severance and Settlement Agreement and Release with William L. Kreienberg	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	Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.	
101.SCH	Inline XBRL Taxonomy Extension Schema Document	
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document	
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document	
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document	
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document	
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)	

SIGNATURES

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

FINANCIAL INSTITUTIONS, INC.

/s/ Martin K. Birmingham , August 5, 2020

Martin K. Birmingham
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Justin K. Bigham , August 5, 2020

Justin K. Bigham
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

/s/ Sonia M. Dumbleton , August 5, 2020

Sonia M. Dumbleton
Senior Vice President and Controller
(Principal Accounting Officer)

(Back To Top)

Section 2: EX-10.1 (EX-10.1)

EXHIBIT 10.1

SEPARATION AND SETTLEMENT AGREEMENT AND RELEASE

This **SEPARATION AND SETTLEMENT AGREEMENT AND RELEASE** (“**Agreement**”) is made and entered into between William L. Kreienberg (“**Employee**”), residing at 75 Ambassador Drive, Rochester, NY 14610 and Financial Institutions, Inc. and its subsidiaries and affiliated entities including Five Star Bank (“Bank”), Five Star REIT, Inc., SDN Insurance Agency, LLC, Courier Capital, LLC, and HNP Capital, LLC (collectively “**Employer**”), a company with its principal office at 220 Liberty Street, Warsaw, New York 14569 (collectively, “**Parties**” and each individually “**Party**”) as of the Effective Date (as defined below).

WHEREAS, Employee has been employed by Employer and has received and had access to Confidential and Proprietary Information of Employer (as defined below); and

WHEREAS, Employer has elected to terminate Employee’s employment with Employer effective on the Separation Date (defined below), and

WHEREAS, Employee and Employer have agreed, among other things, to fully and finally resolve any and all claims Employee has against Employer; ensure that Employer’s confidential, proprietary and business interests are protected under the terms and circumstances set forth herein; and ensure a smooth and orderly transition of the matters that Employee has been handling on behalf of Employer;

NOW, THEREFORE, the Parties, in consideration for the promises and mutual covenants set forth herein and other good and valuable consideration, the receipt and sufficiency of which the Parties acknowledge, and the Parties acting on their own free will hereby irrevocably agree as follows:

1. **Separation.** Employee’s resignation of his employment with Employer will be effective at the close of business on June 26, 2020 (“Separation Date”). As of the Separation Date, Employee has no authority to speak for, act for, represent, or in any way affect the affairs of Employer and is restricted from entering Employer’s property, except as specifically permitted by the Employer.

2. **Company Property**.

a. Except as specifically set forth in Section 3 below, to the extent Employee has not already done so, by no later than five (5) business days from the Separation Date, Employee shall return to Employer all documents (and all copies thereof) and other property belonging to Employer that Employee has in Employee's possession, custody or control. The documents and property to be returned by Employee include, but are not limited to all files, correspondence, e-mail, memoranda, notes, notebooks, drawings, records, plans, forecasts, reports, studies, analyses, compilations of data, proposals, agreements, financial information, research and development information, customer lists and customer information (including but not limited to telephone directories, phone books, and any documents containing the name, address, telephone number, email address, or other contact information of any customer or any agent, representative, or employee of a customer), marketing information, operational and personnel information (including but not limited to organizational charts, telephone directories, phone books any documents containing the name, address, telephone number, email address, or other contact information of any employee, agent, or representative of Employer), specifications, code, software, databases, computer-recorded information, electronic records, tangible property and equipment, credit cards, entry cards, identification badges and keys; and any materials of any kind which contain or embody any Confidential and Proprietary Information of Employer (and

all reproductions thereof in whole or in part). Employee agrees to make a diligent search to locate any such documents, property and information.

b. If Employee has used any computer, server, e-mail or phone device owned by Employee or a member of Employee's immediate family to receive, store, review, prepare or transmit any Confidential and Proprietary Information or, documents, property, materials or information of or pertaining to Employer, by no later than five (5) business days from the Separation Date, Employee shall provide Employer with a computer-useable copy of all such information and then permanently delete and expunge such Confidential and Proprietary Information from those systems or devices.

c. Employee further agrees that if Employee discovers any Employer documents or property in Employee's possession, custody or control or on Employee's computer, server, e-mail system, or other electronic device in the future, Employee will immediately return such documents or information to Employer and delete them from such computer, device, or e-mail system.

d. Employer will work with Employee to retrieve any Company Property as outlined in this Section via a courier. Employee will fully cooperate with Employer to return such property to the Employer within five (5) business days from the Separation Date.

3. **Consideration**. In consideration of Employee's acceptance of the terms of this Agreement, Employer will provide Employee with consideration, to which Employee would not otherwise be entitled, described in this Section 3.

a. Employer will pay Employee five hundred thousand dollars **($500,000.00)**, less any required deductions or withholdings, to be paid to Employee in four equal installments with the first payment to be made on Employer's first payroll period following the Effective Date, and the remaining three payments to be made no later than Employer's first payroll period in October 2020, January 2021, and April 2021. This amount is equivalent to twelve (12) months of Employee's current base salary ($380,839.68) plus an amount Employer determined to provide Employee as additional consideration for the covenants Employee makes in this Agreement and in order to provide Employee a form of incentive based compensation that Employee may have enjoyed given Employee's participation in Employer's Annual Incentive Plan ("AIP") and notwithstanding the impact the pandemic has had on achievement of performance metrics set forth in the 2020 AIP.

b. Provided that Employee timely elects continuation health insurance coverage under COBRA, Employer shall pay Employee's full monthly health and dental insurance premiums (i.e., employer and employee share) from the Separation Date until December 30, 2020 (the "Continuation Period"), subject to the following terms and conditions. Employee agrees and acknowledges that Employer is only obligated to make premium payments for continuation of the same types and levels of coverage and for the same dependents that Employee had as of Employee's Separation Date and Employee shall remain responsible for all other costs under the plan. If (i) Employee obtains health insurance coverage from a subsequent employer, (ii) Employee discontinues COBRA continuation coverage and/or (iii) that coverage is cancelled at any point during the Continuation Period, the Company shall have no further obligations under this subsection.

c. Employer will transfer to Employee title to the company car that Employer provided to Employee (2019 Lincoln Nautilus Reserve, AWD, 2LMPJ8LP6KBL56781 with an approximate value of $38,000)("Company Car"), provided however that Employer shall include the value of the Company Car in Employee's taxable wages and Employer shall have the right to deduct any tax and withholding applicable to the taxable value of the Company Car. Upon transfer of title, Employee is required to promptly take all necessary steps to transfer ownership responsibility (to include insurance) from Employer to Employee.

d. Employer makes no representations to Employee regarding the taxability and/or tax implications of this Agreement and any payments made under it. Employee is solely responsible for any tax consequences associated with the payments made pursuant to this Agreement, regardless of whether Employer should have contributed and withheld taxes from the amounts paid (including Social Security and Medicare). Employee agrees to defend, indemnify, reimburse and hold Employer harmless for any and all taxes, contributions, withholdings, fees, assessments, interest, costs, penalties and other charges that may be imposed on Employer by the Internal Revenue Service, the New York State Tax Department, or any other federal, state or local taxing authority by reason of the payments made pursuant to this Section 3, the absence of withholdings and deductions made from those payments and/or Employee's non-payment or late payment of taxes due with respect to such payments. Employee alone assumes all liability for all such amounts. The compensation and benefits under this Section 3 are intended to comply with or be exempt from Section 409A of the Internal Revenue Code of 1986, as amended, and the Treasury Regulations and other official guidance promulgated and issued thereunder, and this Agreement shall be administered and interpreted consistent with that intent.

e. Whether or not Employee signs this Agreement, Employer will continue to pay regular wages and employment related benefits through the Separation Date and payout of accrued but unused paid time off in accordance with Employer policy. Except as described below, all employment-related benefits shall cease on June 30, 2020.

f. Employee agrees that Employee is not entitled to any other compensation, commissions, bonus, stock award or benefits of any kind or description from Employer, its employees, agents, representatives, successors, assigns, affiliates, parents, or related companies, or from or under any employee benefit plan or fringe benefit plan sponsored by Employer, its successors, assigns, affiliates or related companies, other than as described in this Agreement, and except for vested benefits under the any qualified retirement plans in which Employee participated.

g. Employee acknowledges and agrees that by executing this Agreement, that upon receipt of payments described in this Section 3, Employee has received regular wages, employment related benefits, accrued and unused paid time off through the Separation Date, all of which were paid in accordance with Employer's regular payroll schedule and benefit policies and practices. The compensation Employee receives as part of this Agreement as outlined in this Section 3 includes all compensation, bonus, commissions, and other payments that would have been owed to the Employee pursuant to any incentive plan that Employee was a participant in. Pursuant to the terms of this Agreement, Employee is entitled to no other compensation, commission, bonus, stock award, benefit, or other form of compensation.

4. **Release of Claims**.

a. Employee, on his own behalf and on behalf of his agents, representatives, fiduciaries, successors and assigns, heirs, executors and administrators remises, releases and forever discharges Employer and Employer's past, present, and future assigns, predecessors, successors, officers, directors, attorneys, agents, representatives, employees, servants, shareholders, parents, subsidiaries, affiliates, and insurers from all, and all manner of action and actions, cause and causes of action, suits, claims, debts, dues, sums of money, accounts, reckonings, bonds, bills, specialties, covenants, contracts, controversies, agreements, promises, variances, trespasses, damages, economic damages, emotional distress, punitive damages, judgments, extents, executions, claims and demands whatsoever, in law or in equity, whether known or unknown, foreseen or unforeseen, which against Employer, its directors, officers, managers, agents, representatives, servants, shareholders, parents, subsidiaries, affiliates, insurers and employees that Employee ever had, now has, or which Employee's beneficiaries, agents, representatives, fiduciaries, successors and assigns, heirs, executors and administrators, hereafter can, shall or may have for, upon or by reason of any matter, cause or thing whatsoever from the beginning of the world to the date of this Agreement including but not limited to all claims relating to or arising from Employee's employment with the Employer; Employee's termination of employment; compensation, commissions, bonuses, or benefits; statutory claims, including but not limited to Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act of 1967 ("ADEA"), the Older Works Benefit Protection Act of 1990 ("OWBPA"), the Rehabilitation Act of 1973, the Civil Rights Acts of 1866 and 1991, the Americans with Disabilities Act of 1990 ("ADA"), the Genetic Information Nondiscrimination Act of 2008 ("GINA"), the Equal Pay Act of 1963, the Family and Medical Leave Act of 1993 ("FMLA"), the Employment Retirement Income Security Act of 1974 ("ERISA"), the New York State Human Rights Law and any similar federal, state or local statute, regulation, order or common law. Employee also agrees that the legal rights and claims Employee is giving up includes all common law rights and claims, such as a breach of express or implied contract, tort (whether negligent or intentional), wrongful discharge, constructive discharge, infliction of emotional distress, defamation, promissory estoppel, and any claim for fraud, omission or misrepresentation, breach of express or implied duties, or violation of public policy or policies, practices, or procedures of Employer and any claim relating to workplace discrimination or harassment, sex discrimination, sexual stereotyping, disability discrimination, retaliation, or emotional distress.

b. The claims Employee is giving up and releasing do not include Employee's vested rights, if any, under any qualified retirement plan in which Employee participates, and Employee's COBRA, unemployment insurance and workers' compensation rights, if any. Nothing in this Agreement shall be construed to constitute a waiver of: (i) any claims Employee may have against Employer that arise from events that occur after the date that Employee signs this Agreement; (ii) Employee's right to file an administrative charge or complaint with any government agencies, including the Equal Employment Opportunity Commission ("EEOC"), the National Labor Relations Board ("NLRB"), the Occupational Safety and Health Administration ("OSHA"), the Securities and Exchange Commission ("SEC") or any other federal, state or local governmental agency or commission; (iii) Employee's right to communicate with any government agency or Employee's right to participate in any regulatory or law enforcement investigation, including Employee's right to report any suspected violations

of law; or (iv) any other right that Employee cannot waive as a matter of law. Employee agrees, however, to waive and release any right to receive any individual remedy or to recover any individual monetary or non-monetary damages as a result of any administrative charge, complaint or lawsuit filed by Employee or anyone on Employee's behalf, except as explicitly prohibited by law. Moreover, this Agreement does not limit Employee's right to receive an award for information provided to the SEC. In addition, the release of all claims set forth in this Agreement does not affect Employee's rights as expressly created by this Agreement and does not limit Employee's ability to enforce this Agreement or to challenge the enforceability of this Agreement.

5. **Confidential and Proprietary Information**. Employee agrees and acknowledges as follows:

   a. In the course of employment with Employer, Employee has acquired access to and became acquainted with Confidential and Proprietary Information (as defined below) about the professional business and financial affairs of Employer.

   b. Employee will not at any time, whether before or after the termination of Employee's employment, use, copy, disclose or make available any Confidential and Proprietary Information (as defined in Section 5(c) below) to any individual, corporation, partnership, trust, governmental body or other entity; except that Employee may use, copy or disclose any Confidential and Proprietary Information (i) to the extent it becomes publicly available through no fault on Employee's part, and (ii) to the extent Employee is required to do so pursuant to applicable law or pursuant to a final order of a court or arbitrator having jurisdiction thereof; provided, however, that prior to such disclosure Employee shall promptly notify Employer in writing of any such order or request to disclose and shall cooperate fully with Employer in protecting against any such disclosure by narrowing the scope of such disclosure and/or obtaining a protective order with respect to the permitted use of the Confidential and Proprietary Information.

   c. For purposes of this Agreement, the term "Confidential and Proprietary Information" means all data, trade secrets, business, products, or client information and other information of any kind whatsoever that Employer discloses, in writing, orally, visually or in any other medium, to the Employee or to which the Employee obtained access during his employment with Employer, whether or not marked "Confidential" or "Proprietary," transmitted orally, or communicated to the Employee as being Confidential and Proprietary Information or which by its nature would be, if in written form, deemed Confidential and Proprietary Information. Confidential and Proprietary Information includes, but is not limited to, Employer's strategies, operations, financial information, business methods, systems, studies, client lists, client information, employee and personnel information, business and contractual relationships, business forecasts, sales, merchandising, marketing plans, and any written notes, analyses, reports, compilations or other material or documents based in whole or in part on such information.

   d. Employee shall have responsibility for and bear all risk of loss or damage to such Confidential and Proprietary Information and any and all actual out-of-pocket costs, losses, fines, penalties, forfeitures, judgments and expenses incurred by Employer, including court costs and fees and reasonable and necessary fees and disbursements of counsel, resulting from improper or

inaccurate use, processing or disclosure of such data or arising from the negligence or willful misconduct of the Employee.

e. Employee agrees to keep this Agreement, all documents relating to this Agreement, and the terms of this Agreement, including the consideration being paid under it, completely confidential. Employee shall not disclose any information concerning the existence or terms of this Agreement or provide a copy of this Agreement to anyone, except as follows: (i) to the extent necessary to report income to appropriate taxing authorities; (ii) to communicate with Employee's spouse, attorneys, Employee's investment or financial advisors, or Employee's accountants as necessary for obtaining legal and/or financial planning advice (in which case such person or entity shall be informed of the confidential nature of this Agreement and agree to maintain the confidentiality of this Agreement); or (iii) in response to a judicial order or subpoena issued by a state or federal court or governmental agency or any other order of a court of competent jurisdiction or a discovery request pursuant to established Rules of Civil Procedure in a civil action in state or federal court or in response to any other discovery request or deposition question made or posed.

f. Pursuant to the federal Defend Trade Secrets Act, Employer hereby notifies Employee that an individual shall not be held criminally or civilly liable under any Federal or State trade secret law for disclosure of a trade secret that (A) is made (i) in confidence to a Federal, State or local government official, either directly or indirectly, or to an attorney; and (ii) solely for the purpose of reporting or investigating a suspected violation of law; or (B) is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal. In addition, an individual who files a lawsuit for retaliation by an employer for reporting a suspected violation of law may disclose the trade secret to the attorney of the individual and use the trade secret information in the court proceeding, if the individual (A) files any document containing the trade secret under seal; and (B) does not disclose the trade secret, except pursuant to court order.

6. **Non-Competition and Non-Solicitation**. In consideration of the payments and benefits provided to Employee by Employer under this Agreement, Employee agrees that from the Separation Date through a period of six (6) months following the Separation Date:

a. Employee shall not engage anywhere within the following counties of New York State: (A) Erie, Chautauqua, Niagara, Cattaraugus, Allegany, Wyoming, Genesee, Orleans, Monroe, Livingston, Wayne and Ontario, and (B) any county from which, during the 2019 and 2020 fiscal years, Employer derived more than 10% of their aggregate revenue on a consolidated basis (the "Additional Counties") and (C) any county contiguous to an Additional County (the counties described in (A), (B), and (C) collectively the "Restricted Area"), whether directly or indirectly, or through any employee, agent, attorney or any other person or party acting on behalf of the Employee, as principal, owner, officer, director, agenda, employee, consultant or partner, in the management or administration of a bank holding company, commercial bank, savings bank, credit union, insurance company, wealth management company, financial investment company, or any other financial services provider that competes with any companies that fall within the definition of Employer or products, services, or programs offered by Employer ("Restricted Activities"), provided that the foregoing shall not restrict Employee from engaging in any Restricted Activities which Employer directs Employee to undertake or

which the Company expressly authorizes. The foregoing shall not restrict Employee from owning less than 5% of the outstanding capital stock of any company that engages in Restricted Activities, provided that Employee is not otherwise involved with such company as an officer, director, agent, employee or consultant.

b. "Restricted Activities" also include directly or indirectly, canvassing, soliciting, accepting, making, marketing, or selling any bank or financial solution products or services (including any deposit product or service, savings account, checking account, certificate of deposit, individual retirement account, credit card, residential or commercial mortgage, consumer or commercial loan, home equity, line of credit, letter of credit, cash management service, merchant service or treasury service, insurance, surety or bond, or investment product or service) in any manner, to any person or business (i) who or which is or was a client, customer, investor or supplier of Employer; (ii) with whom or which Employee acquired a relationship during Employee's employment with Employer; and/or (iii) any "Prospective Customer" of Employer defined as any person or entity that has communicated with Employer and has engaged in any one or more of the following activities within the twelve month period preceding the Separation Date: (i) received written product or services pricing information; (ii) met with Employee or other staff of the Employer; (iii) visited a Bank branch or other office of the Company; or (iv) negotiated terms.

c. In making the foregoing covenants, Employee acknowledges that Employer has a legitimate interest in preventing Employee from exploiting or appropriating Employer's goodwill and Confidential and Proprietary Information as it relates to Employer's clients, customers, investors and suppliers, which goodwill and Confidential and Proprietary Information has been created and maintained at Employer's expense.

d. Employee will not, directly or indirectly (i) induce any party who or which is a customer, supplier, investor or vendor of Employer to patronize any business directly or indirectly in competition with Employer, or (ii) request or advise any party who or which is a customer, supplier, investor, or carriers of Employer, or its or their successors, to withdraw, curtail, cancel or modify any such customer's or carrier's business with such entity.

e. Employee will not (i) employ, or knowingly permit any company or business that employs Employee or is directly or indirectly controlled by, owned by, or which Employee, in any way, has an ownership interest in to employ any person who was employed by Employer on the Separation Date and is currently employed by Employer, or (ii) in any manner seek to induce any person who was employed by Employer on the Separation Date and is currently employed by Employer to leave his or her employment with Employer.

f. Employee agrees that the scope of the territory covered, the actions restricted thereby, and the duration of such covenants set forth in this Section 6 are reasonable and necessary to protect the legitimate business interests of Employer.

g. Employer's customers, clients or Centers of Influence may possess Employee's personal cell phone or home number, or personal email address or social media account and may attempt to contact Employee in the future either by phone or other means for business related matters of Employer. Employee agrees to refer such individuals back to Employer and indicate that Employee is no longer employed by Employer.

7. **Remedies.** In the event that Employee breaches any of Employee's obligations under this Agreement, Employer may, at its option, obtain monetary damages, a court order requiring that Employee comply with this Agreement, or other legal and equitable remedies as appropriate. Employee specifically agrees that any breach or threatened breach of Sections 5 or 6 would cause irreparable injury to Employer, that money damages may not provide an adequate remedy to Employer and that Employer will accordingly have the right and remedy (a) to obtain an injunction prohibiting Employee from violating or threatening to violate such provisions, (b) to have such provisions specifically enforced by any court of competent jurisdiction, and (c) to require Employee to account for and pay over to Employer all compensation, profits, monies, accruals, increments or other benefits derived or received by Employee as the result of any transactions constituting a breach of such provisions. Nothing herein shall be construed as prohibiting Employer from pursuing any other remedies available to it for such breach or threatened breach, including the recovery of money damages. Employee and Employer believe that the restrictions and covenants in this Agreement are reasonable and enforceable under the circumstances. However, if any one or more of the provisions in this Agreement shall, for any, reason be held to be excessively broad as to time, duration, geographic scope, activity, or subject, it shall be construed by limiting and reducing it so as to be enforceable to the extent compatible with law and with Employee and Employer's intentions as stated herein.

8. **No Pending Action**. Employee represents that, as of the Effective Date, Employee has not filed any charge, complaint or action in any forum against the Employer.

9. **Duty to Cooperate**. Employee agrees to provide assistance to Employer to assure a smooth and orderly transition and transfer of work and responsibilities. Employee agrees to fully cooperate with Employer and its attorneys, auditors and consultants following the Separation Date; to provide prompt, truthful, and complete information in relation to any inquiry by Employer or its attorney and in connection with any matter, litigation or other proceeding arising out of or relating to matters of which Employee was involved prior to the termination of Employee's employment. Employee's cooperation shall include, without limitation, providing assistance to Employer's counsel, experts and consultants, and providing truthful testimony in pretrial and trial or hearing proceedings. Employer agrees to timely pay all reasonable expenses incurred by Employee, including, but not limited to, transportation costs, lodging costs, and lost wages.

10. **No Derogatory Statements; Future Inquiries**. Employee agrees that Employee will not directly or indirectly make, or cause to be made, any written or oral statement or other communication that is derogatory or disparaging to Employer or Employer's predecessors, successors, parents, subsidiaries, or related entities, or any of Employer's members, shareholders, officers, directors, agents, attorneys, employees, or assigns. Likewise, Employer agrees that it will not directly or indirectly make, or cause to be made, any written or oral statement or other communication that is derogatory or disparaging to Employee. In the event that Employer receives an inquiry from a future prospective employer, Employer will, consistent with its policies, disclose only the position held by Employee and the duration of Employee's employment.

11. **Competent, Knowing, Voluntary Acceptance; Advice of Counsel**.

    a. Employee represents, warrants, and acknowledges that Employee: (i) is legally competent; (ii) understands and accepts the nature, terms and scope of this Agreement with full knowledge of

all material facts related thereto; (iii) did not execute this Agreement under coercion or duress of any kind whatsoever.

b. Employee acknowledges that Employee has had a full and fair opportunity to review this Agreement. Employee understands that Employee had the right to study and obtain advice from others about the meaning of this Agreement for not less than twenty-one (21) days from the date Employee was first given this Agreement (June 26, 2020) before Employee was asked to sign it. Employee acknowledges that if Employee signs this Agreement before the expiration of the twenty-one (21) day period, Employee knowingly and willingly waives the balance of such period. Both Employee and Employer agree that any amendments to this Agreement made after the date that Employee first received it will not re-start the 21-day period of review.

c. Employee also affirms and acknowledges that Employee has had the opportunity to consult with an attorney of Employee's choosing before signing this Agreement. By signing this Agreement, Employee acknowledges Employee had an opportunity to do so and either consulted with an attorney or chose not to consult with any attorney.

12. **Right to Revoke**. Employee understands that Employee may revoke this Agreement for a period of seven (7) days after executing this Agreement. To be effective, the revocation must be in writing and delivered to Samuel J. Burruano, Jr., General Counsel and Corporate Secretary, Five Star Bank, 100 Chestnut Street, Rochester New York 14604 before the close of business on the seventh day after Employee's execution. If the Agreement is not revoked within this seven (7) day period, it shall be fully effective and enforceable without any further affirmative action by either party on the eighth business day after the date of Employee's signature (the "**Effective Date**").

13. **Binding Nature**. This Agreement shall bind, be transferable to, and/or be enforceable by or against, Employer's successors and assigns, now and in the future. This Agreement shall also bind, be transferable to and/or be enforceable by or against, all persons who might assert a legal right or claim on Employee's behalf, such as Employee's heirs, executors, personal representatives and assigns, now and in the future.

14. **Governing Law and Notices.** This Agreement shall be construed in accordance with and governed by the laws of the State of New York. Disputes arising under it shall be heard exclusively by the state or federal courts located in Monroe County, New York. Any notices or communications relating to this Agreement should be sent to the attention of Employer's General Counsel at 100 Chestnut Street, Rochester, New York 14604.

15. **Scope of Agreement**. Employee agrees that no promise, inducement or other agreement not expressly contained or referred to in this Agreement has been made conferring any benefit upon Employee. Employee also agrees that this Agreement contains the entire agreement between Employer and Employee regarding Employee's employment and termination from employment and supersedes and renders null and void any and all prior or contemporaneous oral or written understandings, statements, representations promises, or written agreements, except that the terms and provisions of the Indemnity Agreement dated December 28, 2016 between Employee and Financial Institutions, Inc. will remain in full force and effect to the extent that the provisions contained in said agreement do not contravene or conflict with the terms of this Agreement.

IN WITNESS WHEREOF, Employee and Employer by its duly authorized agent, have hereunder executed this Agreement and intend to be legally bound by its provisions.

FINANCIAL INSITUTIONS, INC.,
and its subsidiaries and affiliate entities

By: _/s/ Martin K. Birmingham_______ Date: ___June 30, 2020_______________
Martin K. Birmingham
President and Chief Executive Officer

WILLIAM L. KREIEINBERG

_/s/ William L. Kreienberg___________ Date: ____June 30, 2020______________
William L. Kreienberg

STATE OF NEW YORK)

COUNTY OF __Monroe__) ss:

On the _30th_ day of __June_______, 2020 before me, the undersigned, personally appeared William L. Kreienberg, personally known to me or proved to me on the basis of satisfactory evidence to be the individual whose name is subscribed to the within instrument and acknowledged to me that she executed the same in the capacity, and that by his signature on the instrument, the individual, or the person upon behalf of which the individual acted, executed the instrument.

__/s/ David Masler_____________
Notary Public

(Back To Top)

Section 3: EX-31.1 (EX-31.1)

Exhibit 31.1

Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Martin K. Birmingham, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Financial Institutions, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2020

/s/ Martin K. Birmingham

Martin K. Birmingham
President and Chief Executive Officer

(Back To Top)

Section 4: EX-31.2 (EX-31.2)

Exhibit 31.2

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Justin K. Bigham, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Financial Institutions, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2020

/s/ Justin K. Bigham

Justin K. Bigham
Chief Financial Officer

(Back To Top)

Section 5: EX-32 (EX-32)

Exhibit 32

Certification pursuant to
18 U.S.C. Section 1350,
as adopted pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

Martin K. Birmingham, President and Chief Executive Officer, and Justin K. Bigham, Chief Financial Officer of Financial Institutions, Inc. (the "Company"), each certify in his capacity as an officer of the Company that he has reviewed the Quarterly Report of the Company on Form 10-Q for the period ended June 30, 2020 and that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 5, 2020

/s/ Martin K. Birmingham

Martin K. Birmingham
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 5, 2020

/s/ Justin K. Bigham

Justin K. Bigham
Chief Financial Officer
(Principal Financial Officer)

The purpose of this statement is solely to comply with Title 18, Chapter 63, Section 1350 of the United States Code, as amended by Section 906 of the Sarbanes-Oxley Act of 2002. A signed original of this written statement required by Section 906 has been provided to Financial Institutions, Inc. and will be retained by Financial Institutions, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

(Back To Top)