



# Financial Institutions, Inc.

# 94

- NO CERTIFICATION  
- called 3/11

March 9, 2009

Neil M. Barofsky  
Special Inspector General  
Office of the Special Inspector General  
Troubled Asset Relief Program  
1500 Pennsylvania Ave., N.W., Suite 1064  
Washington, D.C. 20220

Dear Mr. Barofsky:

Please accept this letter as Financial Institutions, Inc. (FII) formal written response to your letter dated February 6, 2009, OMB Control No. 1505-0212, which requests information pertaining to FII's utilization of TARP funds. This letter highlights your request for information with our response following.

- (1) A narrative response specifically outlining (a) your anticipated use of TARP funds; (b) whether the TARP funds were segregated from other institutional funds; (c) your actual use of TARP funds to date; and (d) your expected use of unspent TARP funds. In your response, please take into consideration your anticipated use of TARP funds at the time that you applied for such funds, or any actions that have taken that you would not have been able to take absent the infusion of TARP funds.

Response: (a) Our intention for application for TARP funds was to bolster our capital position to ensure that we maintained our regulatory "well capitalized" status in light of significant Other Than Temporary Impairment (OTTI) write downs in the investment securities portfolio during 2008 (Auction Rate Securities backed by FNMA and PHLMC preferred stock, bank trust preferred securities, and CMO's) and to support future balance sheet growth; (b) TARP funds were not and have not been segregated from other institutional funds; (c) Our actual use of TARP funds to date includes the origination of \$31MM of new residential, consumer, automobile, commercial and small business loans during January 2009; and

[REDACTED]

b(4)

- (2) Your specific plans, and the status of implementation of those plans, for addressing executive compensation requirements associated with the funding. Information provided regarding executive compensation should also include any assessments made of loan risks and their relationship to executive compensation; how limitations on executive compensation will be implemented in line with Department of Treasury guidelines; and whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation.

Response: On January 14, 2009, the FII Board of Directors' Management Development and Compensation Committee assessed our current Management Incentive Compensation Programs and concluded that our programs do not lead to excessive risk taking. Copies of that certification and the minutes of the meeting are attached to this letter. Additionally, all of FII's senior executives have signed the required TARP Capital Purchase Program waivers (attached).

Please do not hesitate to contact the undersigned, at (b) (6) if you have any questions or need any clarification regarding this response.

Sincerely,



George D. Hagi,  
Chief Risk Officer  
Financial Institutions, Inc.

**Management, Development & Compensation Committee  
Financial Institutions, Inc.**

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January 14, 2009

In Attendance: Susan Holliday, Chairperson; Jack Benjamin; Sam Gullo; and Tom Connolly.  
Erland Kailbourne attend by teleconference.

Present by Invitation: Peter Humphrey, Bruce Nagle, and Dan Hagi

**I. Review and Approve Minutes**

Upon motion duly made by Jack Benjamin and seconded by Tom Connolly, the minutes of the December 10, 2008 meeting were unanimously approved.

**II. Review and Approve List of FII and FSB Officers**

Upon motion duly made by Tom Connolly and seconded by Jack Benjamin, the attached list of FII Officers and list of FSB Officers (**Exhibit A**) were unanimously approved.

**III. Certify Management Incentive Plan are TARP Compliant**

Mr. Dan Hagi, Chief Risk Officer, was in attendance for this item. Dan presented his analysis of our Management Incentive Plans from a risk perspective. The committee discussed all aspects of the plans and whether or not the plans encouraged management to take excessive risk. At the conclusion of the discussion the Committee concurred with Mr. Hagi's assessment, and upon motion duly made by Jack Benjamin and seconded by Sam Gullo, they unanimously approved the attached certification (**Exhibit B**).

**IV. Review and Approve Non EPS Related Management Incentive Awards**

Based on the solid performance of the core banking operations, Management recommended "Special" bonuses for 2008 (**Exhibit C**). The proposed bonuses were based on their individual performance scorecards, which would have been used to calculate the non-EPS portion of their incentive under the Annual Management Incentive Plan. The Committee conducted a thorough discussion on the appropriateness of the awards, the methodology used by management, and how it would be communicated if approved. Upon motion duly made by Jack Benjamin and seconded by Sam Gullo, the Committee unanimously approved the proposed awards pending full Board approval at the 1/28/09 Board meeting.

V. **Review and Approve Targets for Performance Based Equity Plan for 2009**

[REDACTED]

VI. **Review Participants and Grant Amounts for 2009 Performance Based Equity Plan**

Mr. Humphrey presented the proposed list of participants and grant amounts for the 2009 Performance Based Equity Plan. The Committee held a lengthy and thorough discussion focusing on eligibility criteria. After that discussion, the Committee proposed a few modifications to the proposed grants, and upon motion duly made by Tom Connelly, and seconded by Jack Benjamin, the Committee unanimously approved the list of participants and grants as attached (**Exhibit D**).

VII. **Review 'Next' Draft of Proxy Materials**

The Committee reviewed a draft of the Proxy materials and recommended several changes to be incorporated into the final draft to be presented and reviewed at the February 2009 meeting.

VIII. **Review 'Next' Draft of Management and Director Stock Plans**

The Committee spent considerable time on this item with particular emphasis on the Director's Plan. The discussion focused on three areas: (1) total shares available; (2) number of shares to award; and (3) vesting. It was determined that the Chairperson and Mr. Nagle would do further research and present a revised draft at the February 2009 meeting.

IX. **Update on CFO Search**

Mr. Nagle updated the Committee on the status of the search. It is highly possible that the Company will have a candidate or two in for first interviews prior to the end of February 2009.

X. **The Committee reviewed Mr. Humphrey's year-end performance reviews for his senior executives.**

**XI.** The Committee analyzed and discussed the composite annual MD&C Committee evaluation. The Committee scored higher than a '4' rating in all areas with the exception of training.

**XII. Review MD&C Work Plan**

The Committee reviewed the Work Plan and made the following additions:

January

- \* Tarp Certification
- \* Review Committee Evaluations

A rectangular area of text is completely redacted with black ink. A small asterisk is visible at the beginning of the redacted line.

With no further business the meeting was adjourned.

Respectfully Submitted,

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Susan R. Holliday  
Chairperson



# Five Star Bank

TO: FII MD&C Committee  
FROM: G.D. Hagi, Chief Risk Officer  
DATE: January 14, 2009  
SUBJECT: TARP Certification

Our participation in the TARP Program (TARP) requires us to certify that our Management Incentive Compensation Programs (MICP) do not lead to excessive risk taking. The purpose of this memorandum is to outline the fundamental aspects of our Programs and to highlight the risk management processes and risk mitigation practices that maintain our risk profile within acceptable limits.

## Management Incentive Compensation Programs

We currently have two distinct MICPs. An Annual Management Incentive Plan (AMIP) and a Performance Based Equity Incentive Plan (PBEIP). Both were approved at the January 16, 2008 MD&C Committee meeting. The AMIP is eligible for employees who hold a Bank Officer Title. The AMIP award is based on the company's Earnings Per Share (EPS) calculation, supplemented by a scorecard for personal performance. The PBEIP award is based on EPS, efficiency ratio, and net charge-offs which are also components of the regulatory CAMELS rating system. The awards for these three components of the PBEIP are weighted 60%, 20%, and 20%, respectively. The various components of both the AMIP and PEBIP are standard industry measurements and are widely utilized in incentive compensation programs within the financial services industry.

## Risk Management Processes

An annual budget is developed and approved by the Board of Directors. The annual budget is based on an annual Business Plan that is developed by senior management and ultimately approved by the Board of Directors. The company's actual performance is compared to budget on a monthly basis. Executive management also tracks the status of completion of all the elements in the annual business plan by line of business and department. The triggers noted above that form the basis of the awards for the AMIP and PBEIP are directly related to the annual business plans and budgets. Incentive compensation awards are directly related to attainment of budget targets. The attainment which is calculated based on the bank's actual performance is disclosed in regulatory filings of financial results on a quarterly and annual basis in 10Q and 10K forms.

Corporate Risk Management Department

29 North Main Street  
(585) 786-4547

Warsaw, NY 14569  
(585) 786-4386 facsimile

## Risk Mitigation Practices

Management and the Board of Directors have established several methods for ensuring that the bank does not undertake unwarranted risk positions. These methods take the form of Sarbanes Oxley 404 controls and testing, Internal Control over Financial Reporting, Policies and Procedures, and the Board and Management Committee structure and reporting mechanisms.

All publicly held financial institutions are subject to Sarbanes- Oxley (SOX), and its predecessor FDICIA. SOX requires the bank to establish a well defined and documented system of controls over financial reporting that ensures that regulatory filings are accurate. Our SOX and ICoFR processes have been fully vetted by our independent accountants and testing of these mechanisms have disclosed no significant deficiencies or material weaknesses during the 2008 time period.

Policies and procedures are well established and provide well defined risk tolerance limits and standard guidelines that management operates within. Overall compliance with established policies and procedures are tested periodically by various internal and external entities.

Various management committees have been established whose functions include oversight of performance and levels of risk. These include, but are not limited to, the Executive Management Committee, Risk Management Committee, Executive Loan Committee, Allowance for Loan and Lease Losses Governing Committee, Asset/Liability Committee, and Pricing Committee. The results of these various committees are reported to the Audit Committee and the Board of Directors in the form of Earnings per share, Net Interest Margin, efficiency ratio, asset quality indicators, and net charge offs, etc.

## Summary

Based on the structure of the company's AMIP and PBEIP, the triggers that drive the awards, the business planning and budgeting processes, the risk management processes that ensure accurate reporting of actual results, and the risk mitigants that ensure management operates within established risk tolerance guidelines, it is my opinion that our Management Incentive Plans do not lead to excessive risk taking pursuant to TARP guidelines and industry standards.

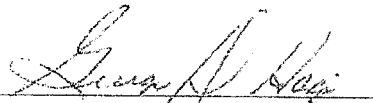
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## WAIVER

In consideration for the benefits I will receive as a result of my employer's participation in the United States Department of the Treasury's TARP Capital Purchase Program, I hereby voluntarily waive any claim against the United States or my employer for any changes to my compensation or benefits that are required to comply with the regulation issued by the Department of the Treasury as published in the Federal Register on October 20, 2008. I acknowledge that this regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements, policies and agreements (including so-called "golden parachute" agreements) that I have with my employer or in which I participate as they relate to the period the United States holds any equity or debt securities of my employer acquired through the TARP Capital Purchase Program.

This waiver includes all claims I may have under the laws of the United States or any state related to the requirements imposed by the aforementioned regulation, including without limitation a claim for any compensation or other payments I would otherwise receive, any challenge to the process by which this regulation was adopted and any tort or constitutional claim about the effect of these regulations on my employment relationship.



George D. Hagi  
Executive Vice President and Chief Risk  
Officer  
Financial Institutions, Inc.

December 23, 2008





# Financial Institutions, Inc.

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December 23, 2008

Mr. George D. Hagi  
Executive Vice President and  
Chief Risk Officer  
Financial Institutions, Inc.  
220 Liberty Street  
P.O. Box 227  
Warsaw, New York 14569

Dear Mr. Hagi,

Financial Institutions, Inc. (the "*Company*") anticipates entering into a Securities Purchase Agreement (the "*Participation Agreement*") with the United States Department of Treasury ("*Treasury*") that provides for the Company's participation in the Treasury's TARP Capital Purchase Program (the "*CPP*"). If the Company does not participate or ceases at any time to participate in the CPP, this letter shall be of no further force and effect.

For the Company to participate in the CPP and as a condition to the closing of the investment contemplated by the Participation Agreement, the Company is required to establish specified standards for incentive compensation to its senior executive officers and to make changes to its compensation arrangements. To comply with these requirements, and in consideration of the benefits that you will receive as a result of the Company's participation in the CPP, you agree as follows:

- 1) *No Golden Parachute Payments.* The Company is prohibiting any golden parachute payment to you during any "applicable tax year." An "*applicable tax year*" is any period during which (a) you are a senior executive officer, and (b) Treasury holds an equity or debt position in the Company under the CPP.
- 2) *Recovery of Bonus and Incentive Compensation.* Any bonus and incentive compensation paid to you during a CPP Covered Period is subject to recovery or "clawback" by the Company if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.
- 3) *Compensation Program Amendments.* Each of the Company's compensation, bonus, incentive and other benefit plans, arrangements and agreements (including golden parachute, severance and employment agreements) either currently or hereinafter in effect and including all amendments thereto (collectively, "*Benefit Plans*") with respect to you are hereby amended to the extent necessary to give effect to provisions (1) and (2).
- 4) *Definitions and Interpretation.* This letter shall be interpreted as follows:

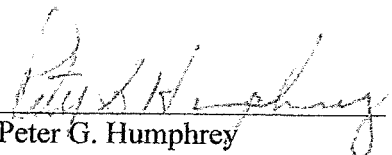
- The term “Company” includes any entities treated as a single employer with the Company under 31 C.F.R. § 30.1(b) (as in effect on the Closing Date). You are also delivering a waiver pursuant to the Participation Agreement, and, as between the Company and you, the term “employer” in that waiver will be deemed to mean the Company as used in this letter.
  - The term “applicable tax year” shall be limited by, and interpreted in a manner consistent with, 31 C.F.R. § 30.11, (as in effect on the Closing Date).
  - “EESA” means the Emergency Economic Stabilization Act of 2008 as implemented by guidance or regulation issued by the Department of the Treasury and as published in the Federal Register on October 20, 2008.
  - “Golden parachute payment” is used with same meaning as in Section 111(b)(2)(C) of EESA.
  - “Senior executive officer” means the Company’s “senior executive officers” as defined in subsection 111(b)(3) of EESA.
  - Provisions (1) and (2) of this letter are intended to, and will be interpreted, administered and construed to, comply with Section 111 of EESA and the guidance thereunder (and, to the maximum extent consistent with the preceding, to permit operation of the Benefit Plans in accordance with their terms before giving effect to this letter)
- 5) *Miscellaneous.* To the extent not subject to federal law, this letter will be governed by and construed in accordance with the laws of New York. This letter may be executed in two or more counterparts, each of which will be deemed to be an original. A signature transmitted by facsimile will be deemed an original signature.

In addition, the Company is required to review its Benefit Plans to ensure that they do not encourage senior executive officers to take unnecessary and excessive risks that threaten the value of the Company. To the extent any such review requires revisions to any Benefit Plan with respect to you, you and the Company agree to negotiate such changes promptly and in good faith. - -

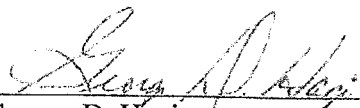
In addition to the foregoing and in consideration for the benefits you will receive as a result of Company’s participation in the CPP, you agree to voluntarily waive any claim against the United States or the Company for any changes to your compensation or benefits that are required to comply with EESA. This waiver includes all claims you may have under the laws of the United States or any state related to the requirements imposed by EESA, including without limitation a claim for any compensation or other payments you would otherwise receive, any challenge to the process by which this regulation was adopted and any tort or constitutional claim about the effect of these regulations on your employment relationship.

Please indicate your agreement by signing and returning this letter agreement.

Yours sincerely,

  
Peter G. Humphrey  
President and Chief Executive Officer  
Financial Institutions, Inc.

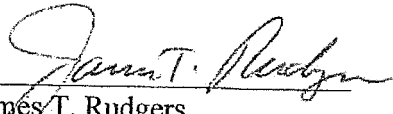
Intending to be legally bound, I agree with  
and accept the foregoing terms on the date set  
forth below.

  
George D. Hagi  
Date: December 23, 2008

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James T. Rudgers  
Executive Vice President and Chief of  
Community Banking  
Financial Institutions, Inc.

December 23, 2008



# Financial Institutions, Inc.

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December 23, 2008

Mr. James T. Rudgers  
Executive Vice President and  
Chief of Community Banking  
Financial Institutions, Inc.  
220 Liberty Street  
P.O. Box 227  
Warsaw, New York 14569

Dear Mr. Rudgers,

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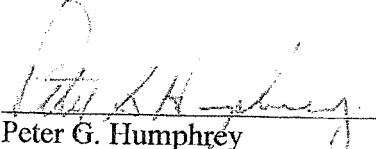
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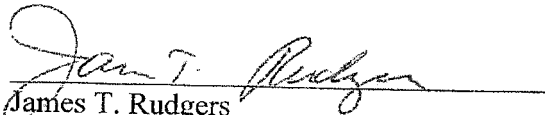
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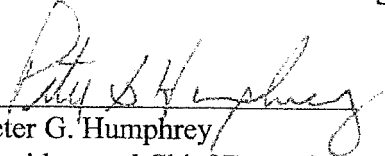
  
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Peter G. Humphrey  
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December 23, 2008





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Please indicate your agreement by signing and returning this letter agreement.

Yours sincerely,

*Ronald A. Miller*

\_\_\_\_\_  
Ronald A. Miller  
Executive Vice President and  
Chief Financial Officer,  
Financial Institutions, Inc.

Intending to be legally bound, I agree with  
and accept the foregoing terms on the date set  
forth below.

*Peter G. Humphrey*

\_\_\_\_\_  
Peter G. Humphrey

Date: December 23, 2008

## WAIVER

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Ronald A. Miller

Ronald A. Miller  
Executive Vice President and Chief Financial  
Officer  
Financial Institutions, Inc.

December 23, 2008



# Financial Institutions, Inc.

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December 23, 2008

Mr. Ronald A. Miller  
Executive Vice President and  
Chief Financial Officer  
Financial Institutions, Inc.  
220 Liberty Street  
P.O. Box 227  
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Dear Mr. Miller,

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For the Company to participate in the CPP and as a condition to the closing of the investment contemplated by the Participation Agreement, the Company is required to establish specified standards for incentive compensation to its senior executive officers and to make changes to its compensation arrangements. To comply with these requirements, and in consideration of the benefits that you will receive as a result of the Company's participation in the CPP, you agree as follows:

- 1) *No Golden Parachute Payments.* The Company is prohibiting any golden parachute payment to you during any "applicable tax year." An "*applicable tax year*" is any period during which (a) you are a senior executive officer, and (b) Treasury holds an equity or debt position in the Company under the CPP.
- 2) *Recovery of Bonus and Incentive Compensation.* Any bonus and incentive compensation paid to you during a CPP Covered Period is subject to recovery or "clawback" by the Company if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.
- 3) *Compensation Program Amendments.* Each of the Company's compensation, bonus, incentive and other benefit plans, arrangements and agreements (including golden parachute, severance and employment agreements) either currently or hereinafter in effect and including all amendments thereto (collectively, "*Benefit Plans*") with respect to you are hereby amended to the extent necessary to give effect to provisions (1) and (2).
- 4) *Definitions and Interpretation.* This letter shall be interpreted as follows:

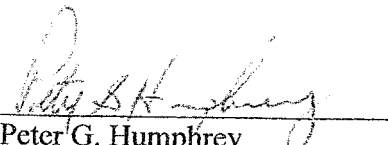
- The term “Company” includes any entities treated as a single employer with the Company under 31 C.F.R. § 30.1(b) (as in effect on the Closing Date). You are also delivering a waiver pursuant to the Participation Agreement, and, as between the Company and you, the term “employer” in that waiver will be deemed to mean the Company as used in this letter.
  - The term “applicable tax year” shall be limited by, and interpreted in a manner consistent with, 31 C.F.R. § 30.11, (as in effect on the Closing Date).
  - “EESA” means the Emergency Economic Stabilization Act of 2008 as implemented by guidance or regulation issued by the Department of the Treasury and as published in the Federal Register on October 20, 2008.
  - “Golden parachute payment” is used with same meaning as in Section 111(b)(2)(C) of EESA.
  - “Senior executive officer” means the Company’s “senior executive officers” as defined in subsection 111(b)(3) of EESA.
  - Provisions (1) and (2) of this letter are intended to, and will be interpreted, administered and construed to, comply with Section 111 of EESA and the guidance thereunder (and, to the maximum extent consistent with the preceding, to permit operation of the Benefit Plans in accordance with their terms before giving effect to this letter)
- 5) *Miscellaneous.* To the extent not subject to federal law, this letter will be governed by and construed in accordance with the laws of New York. This letter may be executed in two or more counterparts, each of which will be deemed to be an original. A signature transmitted by facsimile will be deemed an original signature.

In addition, the Company is required to review its Benefit Plans to ensure that they do not encourage senior executive officers to take unnecessary and excessive risks that threaten the value of the Company. To the extent any such review requires revisions to any Benefit Plan with respect to you, you and the Company agree to negotiate such changes promptly and in good faith. - -

In addition to the foregoing and in consideration for the benefits you will receive as a result of Company’s participation in the CPP, you agree to voluntarily waive any claim against the United States or the Company for any changes to your compensation or benefits that are required to comply with EESA. This waiver includes all claims you may have under the laws of the United States or any state related to the requirements imposed by EESA, including without limitation a claim for any compensation or other payments you would otherwise receive, any challenge to the process by which this regulation was adopted and any tort or constitutional claim about the effect of these regulations on your employment relationship.

Please indicate your agreement by signing and returning this letter agreement.

Yours sincerely,



Peter G. Humphrey  
President and Chief Executive Officer  
Financial Institutions, Inc.

Intending to be legally bound, I agree with  
and accept the foregoing terms on the date set  
forth below.



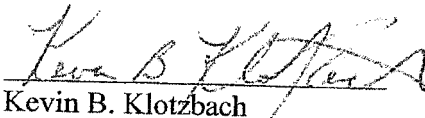
Ronald A. Miller

Date: December 23, 2008

## WAIVER

In consideration for the benefits I will receive as a result of my employer's participation in the United States Department of the Treasury's TARP Capital Purchase Program, I hereby voluntarily waive any claim against the United States or my employer for any changes to my compensation or benefits that are required to comply with the regulation issued by the Department of the Treasury as published in the Federal Register on October 20, 2008. I acknowledge that this regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements, policies and agreements (including so-called "golden parachute" agreements) that I have with my employer or in which I participate as they relate to the period the United States holds any equity or debt securities of my employer acquired through the TARP Capital Purchase Program.

This waiver includes all claims I may have under the laws of the United States or any state related to the requirements imposed by the aforementioned regulation, including without limitation a claim for any compensation or other payments I would otherwise receive, any challenge to the process by which this regulation was adopted and any tort or constitutional claim about the effect of these regulations on my employment relationship.

  
Kevin B. Klotzbach  
Senior Vice President and Treasurer  
Financial Institutions, Inc.

December 23, 2008





# Financial Institutions, Inc.

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December 23, 2008

Mr. Kevin B. Klotzbach  
Senior Vice President and Treasurer  
Financial Institutions, Inc.  
220 Liberty Street  
P.O. Box 227  
Warsaw, New York 14569

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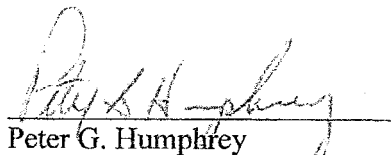
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- 5) *Miscellaneous.* To the extent not subject to federal law, this letter will be governed by and construed in accordance with the laws of New York. This letter may be executed in two or more counterparts, each of which will be deemed to be an original. A signature transmitted by facsimile will be deemed an original signature.

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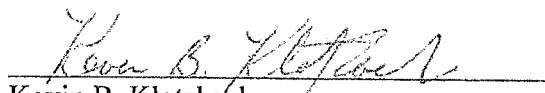
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Peter G. Humphrey  
President and Chief Executive Officer  
Financial Institutions, Inc.

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and accept the foregoing terms on the date set  
forth below.



Kevin B. Klotzbach

Date: December 23, 2008

2/17/09	6:00 pm	Bob Latella	Private Room for 6 people at GVC
2/18	8:00 am	Karl Anderson	Private Room for 6 people at GVC *Email Karl address and directions to GVC
<del>2/18/09</del>	10:00 am	Woodcliff Lodge	EEK, B Latella, J Benjamin, J Tyler, S Holliday & <del>_____</del>
	Noon	Lunch	Buffet Style at Woodcliff Lodge
	12:30 pm	Board Meeting	
	5:00 pm	<del>Adjourn</del> Brief VC Subcommittee Mtg	
	5:30p	adjourn	
	8:30-11:00a		
2/19/08	<del>11:00 am</del>	Selection Committee	Woodcliff Lodge EEK, PGH, Tyler, Gullo, Wyckoff ( <del>in person?</del> )
	11:00am-2:00p	ENG Comm	Order Lunch off Menu
	<del>12:30 am</del>	Adjourn	
<b>Hold this part</b>	12:30 am	Securities Issues (eng)	Benjamin, Latella, PGH, EEK (Thompson Hine) Susan & John Tyler wrap up meeting for Securities issues
	3:00 pm	Adjourn	