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# 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 September 30, 2024**

**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 15,474,314 shares of Common Stock, $0.01 par value, outstanding as of October 31, 2024.

**FINANCIAL INSTITUTIONS, INC.**
**Form 10-Q**
**For the Quarterly Period Ended September 30, 2024**

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# 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)* | September 30, 2024 | December 31, 2023 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 249,569 | $ 124,442 |
| Securities available for sale, at fair value (amortized cost of $1,011,849 and $1,037,990, respectively) | 886,816 | 887,730 |
| Securities held to maturity, at amortized cost (net of allowance for credit losses of $3 and $4, respectively) (fair value of $112,613 and $137,030, respectively) | 121,279 | 148,156 |
| Loans held for sale | 2,495 | 1,370 |
| Loans (net of allowance for credit losses of $44,678 and $51,082, respectively) | 4,358,311 | 4,411,057 |
| Company owned life insurance | 165,424 | 161,363 |
| Premises and equipment, net | 40,788 | 39,902 |
| Goodwill and other intangible assets, net | 60,867 | 72,504 |
| Other assets | 270,768 | 314,357 |
| Total assets | $ 6,156,317 | $ 6,160,881 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Deposits: | | |
| Noninterest-bearing demand | $ 978,660 | $ 1,010,614 |
| Interest-bearing demand | 793,996 | 713,158 |
| Savings and money market | 2,027,181 | 2,084,444 |
| Time deposits | 1,506,764 | 1,404,696 |
| Total deposits | 5,306,601 | 5,212,912 |
| Short-term borrowings | 55,000 | 185,000 |
| Long-term borrowings, net of issuance costs of $235 and $468, respectively | 124,765 | 124,532 |
| Other liabilities | 169,609 | 183,641 |
| Total liabilities | 5,655,975 | 5,706,085 |
| 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; 171,486 shares issued | 17,149 | 17,149 |
| Total preferred equity | 17,292 | 17,292 |
| Common stock, $0.01 par value; 50,000,000 shares authorized; 16,099,556 shares issued | 161 | 161 |
| Additional paid-in capital | 125,112 | 125,841 |
| Retained earnings | 477,861 | 451,687 |
| Accumulated other comprehensive loss | (102,029) | (119,941) |
| Treasury stock, at cost – 625,242 and 692,150 shares, respectively | (18,055) | (20,244) |
| Total shareholders' equity | 500,342 | 454,796 |
| Total liabilities and shareholders' equity | $ 6,156,317 | $ 6,160,881 |

See accompanying notes to the consolidated financial statements.

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

| *(In thousands, except per share amounts)* | Three months ended September 30, 2024 | Three months ended September 30, 2023 | Nine months ended September 30, 2024 | Nine months ended September 30, 2023 |
|---|---|---|---|---|
| Interest income: | | | | |
| Interest and fees on loans | $ 71,218 | $ 68,273 | $ 212,227 | $ 189,423 |
| Interest and dividends on investment securities | 6,086 | 5,703 | 18,582 | 17,637 |
| Other interest income | 607 | 724 | 4,303 | 2,526 |
| Total interest income | 77,911 | 74,700 | 235,112 | 209,586 |
| Interest expense: | | | | |
| Deposits | 34,803 | 29,217 | 105,114 | 72,565 |
| Short-term borrowings | 858 | 2,235 | 3,345 | 6,596 |
| Long-term borrowings | 1,569 | 1,571 | 4,697 | 4,596 |
| Total interest expense | 37,230 | 33,023 | 113,156 | 83,757 |
| Net interest income | 40,681 | 41,677 | 121,956 | 125,829 |
| Provision (benefit) for credit losses | 3,104 | 966 | (311) | 8,410 |
| Net interest income after provision (benefit) for credit losses | 37,577 | 40,711 | 122,267 | 117,419 |
| Noninterest income: | | | | |
| Service charges on deposits | 1,103 | 1,207 | 3,159 | 3,457 |
| Insurance income | 3 | 1,678 | 2,141 | 5,093 |
| Card interchange income | 1,900 | 2,094 | 5,810 | 6,140 |
| Investment advisory | 2,797 | 2,544 | 8,158 | 8,286 |
| Company owned life insurance | 1,404 | 1,027 | 4,062 | 2,974 |
| Investments in limited partnerships | 400 | 391 | 1,545 | 1,111 |
| Loan servicing | 88 | 135 | 421 | 395 |
| Income from derivative instruments, net | 212 | 219 | 763 | 1,418 |
| Net gain on sale of loans held for sale | 220 | 115 | 432 | 349 |
| Net gain (loss) on other assets | 138 | (1) | 13,633 | 31 |
| Net loss on tax credit investments | (170) | (333) | (139) | (45) |
| Other | 1,345 | 1,410 | 4,370 | 3,667 |
| Total noninterest income | 9,440 | 10,486 | 44,355 | 32,876 |
| Noninterest expense: | | | | |
| Salaries and employee benefits | 15,879 | 18,160 | 48,967 | 54,047 |
| Occupancy and equipment | 3,370 | 3,791 | 10,570 | 11,059 |
| Professional services | 1,965 | 1,076 | 6,131 | 3,844 |
| Computer and data processing | 5,353 | 5,107 | 16,081 | 14,548 |
| Supplies and postage | 519 | 455 | 1,431 | 1,418 |
| FDIC assessments | 1,092 | 1,232 | 3,733 | 3,586 |
| Advertising and promotions | 371 | 744 | 1,108 | 1,556 |
| Amortization of intangibles | 112 | 225 | 443 | 689 |
| Restructuring recoveries | — | (55) | — | (74) |
| Deposit-related charged-off items | 410 | 188 | 19,987 | 978 |
| Other | 3,398 | 3,812 | 11,051 | 10,527 |
| Total noninterest expense | 32,469 | 34,735 | 119,502 | 102,178 |
| Income before income taxes | 14,548 | 16,462 | 47,120 | 48,117 |
| Income tax expense | 1,082 | 2,440 | 5,955 | 7,633 |
| Net income | $ 13,466 | $ 14,022 | $ 41,165 | $ 40,484 |
| Preferred stock dividends | 365 | 365 | 1,094 | 1,094 |
| Net income available to common shareholders | $ 13,101 | $ 13,657 | $ 40,071 | $ 39,390 |
| Earnings per common share (Note 2): | | | | |
| Basic | $ 0.85 | $ 0.89 | $ 2.60 | $ 2.56 |
| Diluted | $ 0.84 | $ 0.88 | $ 2.57 | $ 2.55 |
| Cash dividends declared per common share | $ 0.30 | $ 0.30 | $ 0.90 | $ 0.90 |

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 September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | **2024** | **2023** | **2024** | **2023** |
| Net income | $ 13,466 | $ 14,022 | $ 41,165 | $ 40,484 |
| Other comprehensive income (loss), net of tax: | | | | |
| Securities available for sale and transferred securities | 25,430 | (27,445) | 18,795 | (25,459) |
| Hedging derivative instruments | (1,851) | 385 | (1,381) | 1,126 |
| Pension and post-retirement obligations | 166 | 143 | 498 | 431 |
| Total other comprehensive income (loss), net of tax | 23,745 | (26,917) | 17,912 | (23,902) |
| Comprehensive income (loss) | $ 37,211 | $ (12,895) | $ 59,077 | $ 16,582 |

See accompanying notes to the consolidated financial statements.

**FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES**
**Consolidated Statements of Changes in Shareholders' Equity (Unaudited)**
Three and nine months ended September 30, 2024 and 2023

| *(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, 2023** | **$ 17,292** | **$ 161** | **$ 125,841** | **$ 451,687** | **$ (119,941)** | **$ (20,244)** | **$ 454,796** |
| Comprehensive (loss) income: | | | | | | | |
| Net income | — | — | — | 2,070 | — | — | 2,070 |
| Other comprehensive income, net of tax | — | — | — | — | (6,323) | — | (6,323) |
| Purchases of common stock for treasury | — | — | — | — | — | (393) | (393) |
| Share-based compensation plans: | | | | | | | |
| Share-based compensation | — | — | 569 | — | — | — | 569 |
| Restricted stock units released | — | — | (1,783) | — | — | 1,783 | — |
| 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–$0.30 per share | — | — | — | (4,620) | — | — | (4,620) |
| **Balance at March 31, 2024** | **$ 17,292** | **$ 161** | **$ 124,627** | **$ 448,772** | **$ (126,264)** | **$ (18,854)** | **$ 445,734** |
| Comprehensive income (loss): | | | | | | | |
| Net income | — | — | — | 25,629 | — | — | 25,629 |
| Other comprehensive loss, net of tax | — | — | — | — | 490 | — | 490 |
| Purchases of common stock for treasury | — | — | — | — | — | (3) | (3) |
| Share-based compensation plans: | | | | | | | |
| Share-based compensation | — | — | 746 | — | — | — | 746 |
| Restricted stock units released | — | — | (15) | — | — | 15 | — |
| Restricted stock awards issued | — | — | (607) | — | — | 607 | — |
| Stock awards | | | (47) | | | 120 | 73 |
| Cash dividends declared: | | | | | | | |
| Series A 3% Preferred–$0.75 per share | — | — | — | (1) | — | — | (1) |
| Series B-1 8.48% Preferred–$2.12 per share | — | — | — | (363) | — | — | (363) |
| Common–$0.30 per share | — | — | — | (4,638) | — | — | (4,638) |
| **Balance at June 30, 2024** | **$ 17,292** | **$ 161** | **$ 124,704** | **$ 469,399** | **$ (125,774)** | **$ (18,115)** | **$ 467,667** |
| Comprehensive income (loss): | | | | | | | |
| Net income | — | — | — | 13,466 | — | — | 13,466 |
| Other comprehensive loss, net of tax | — | — | — | — | 23,745 | — | 23,745 |
| Purchases of common stock for treasury | — | — | — | — | — | (26) | (26) |
| Share-based compensation plans: | | | | | | | |
| Share-based compensation | — | — | 494 | — | — | — | 494 |
| Restricted stock units released | — | — | (86) | — | — | 86 | — |
| 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-$0.30 per share | — | — | — | (4,639) | — | — | (4,639) |
| **Balance at September 30, 2024** | **$ 17,292** | **$ 161** | **$ 125,112** | **$ 477,861** | **$ (102,029)** | **$ (18,055)** | **$ 500,342** |

***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 nine months ended September 30, 2024 and 2023

| *(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, 2022** | **$ 17,292** | **$ 161** | **$ 126,636** | **$ 421,340** | **$ (137,487)** | **$ (22,337)** | **$ 405,605** |
| Comprehensive income (loss): | | | | | | | |
| Net income | — | — | — | 12,089 | — | — | 12,089 |
| Other comprehensive income (loss), net of tax | — | — | — | — | 10,115 | — | 10,115 |
| Purchases of common stock for treasury | — | — | — | — | — | (561) | (561) |
| Share-based compensation plans: | | | | | | | |
| Share-based compensation | — | — | 551 | — | — | — | 551 |
| Restricted stock units released | — | — | (1,711) | — | — | 1,711 | — |
| 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–$0.30 per share | — | — | — | (4,611) | — | — | (4,611) |
| **Balance at March 31, 2023** | **$ 17,292** | **$ 161** | **$ 125,476** | **$ 428,453** | **$ (127,372)** | **$ (21,187)** | **$ 422,823** |
| Comprehensive income (loss): | | | | | | | |
| Net income | — | — | — | 14,373 | — | — | 14,373 |
| Other comprehensive loss, net of tax | — | — | — | — | (7,100) | — | (7,100) |
| Purchases of common stock for treasury | — | — | — | — | — | (2) | (2) |
| Share-based compensation plans: | | | | | | | |
| Share-based compensation | — | — | 657 | — | — | — | 657 |
| Restricted stock awards released | — | — | (9) | — | — | 9 | — |
| Restricted stock awards issued | — | — | (590) | — | — | 590 | — |
| Stock awards | — | — | (77) | — | — | 174 | 97 |
| Cash dividends declared: | | | | | | | |
| Series A 3% Preferred–$0.75 per share | — | — | — | (1) | — | — | (1) |
| Series B-1 8.48% Preferred–$2.12 per share | — | — | — | (363) | — | — | (363) |
| Common–$0.30 per share | — | — | — | (4,611) | — | — | (4,611) |
| **Balance at June 30, 2023** | **$ 17,292** | **$ 161** | **$ 125,457** | **$ 437,851** | **$ (134,472)** | **$ (20,416)** | **$ 425,873** |
| Comprehensive income (loss): | | | | | | | |
| Net income | — | — | — | 14,022 | — | — | 14,022 |
| Other comprehensive loss, net of tax | — | — | — | — | (26,917) | — | (26,917) |
| Share-based compensation plans: | | | | | | | |
| Share-based compensation | — | — | 721 | — | — | — | 721 |
| 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–$0.30 per share | — | — | — | (4,618) | — | — | (4,618) |
| **Balance at September 30, 2023** | **$ 17,292** | **$ 161** | **$ 126,178** | **$ 446,890** | **$ (161,389)** | **$ (20,416)** | **$ 408,716** |

See accompanying notes to the consolidated financial statements.

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

| *(Dollars in thousands)* | Nine months ended September 30, 2024 | Nine months ended September 30, 2023 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 41,165 | $ 40,484 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,719 | 6,080 |
| Net amortization (accretion) of premiums (discounts) on securities | 2,014 | (2,681) |
| (Benefit) provision for credit losses | (311) | 8,410 |
| Share-based compensation | 1,809 | 1,929 |
| Deferred income tax expense (benefit) | 1,094 | (486) |
| Proceeds from sale of loans held for sale | 34,491 | 12,983 |
| Originations of loans held for sale | (35,184) | (13,957) |
| Income on company owned life insurance | (4,062) | (2,974) |
| Net gain on sale of loans held for sale | (432) | (349) |
| Net gain on sale of assets of subsidiary | (13,658) | — |
| Net loss (gain) on other assets | 25 | (31) |
| Non-cash restructuring recoveries against assets | — | (74) |
| Decrease (increase) in other assets | 31,113 | (26,976) |
| (Decrease) increase in other liabilities | (13,672) | 36,205 |
| Net cash provided by operating activities | 50,111 | 58,563 |
| Cash flows from investing activities: | | |
| Purchases of investment securities: | | |
| Available for sale | (131,401) | — |
| Held to maturity | (1,059) | (1,638) |
| Proceeds from principal payments, maturities and calls on investment securities: | | |
| Available for sale securities | 155,734 | 68,317 |
| Held to maturity | 27,772 | 36,702 |
| Net decrease (increase) in loans | 53,242 | (385,040) |
| Net proceeds from company owned life insurance | 1 | 255 |
| Proceeds from sale of assets of subsidiary | 27,000 | — |
| Purchases of premises and equipment | (4,571) | (1,739) |
| Net cash provided by (used in) investing activities | 126,718 | (283,143) |
| Cash flows from financing activities: | | |
| Net increase in deposits | 93,689 | 386,549 |
| Net decrease in short-term borrowings | (130,000) | (135,000) |
| Proceeds from long-term borrowings | — | 50,000 |
| Purchases of common stock for treasury | (422) | (563) |
| Cash dividends paid to common and preferred shareholders | (14,969) | (14,761) |
| Net cash (used in) provided by financing activities | (51,702) | 286,225 |
| Net increase in cash and cash equivalents | 125,127 | 61,645 |
| Cash and cash equivalents, beginning of period | 124,442 | 130,466 |
| Cash and cash equivalents, end of period | $ 249,569 | $ 192,111 |

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 (the "Bank") and Courier Capital, LLC ("Courier 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. The Bank also has commercial loan production offices in Ellicott City (Baltimore), Maryland and Syracuse, New York, and indirect lending network relationships with franchised automobile dealers in the Capital District of New York. Effective January 1, 2024, the Company exited the Pennsylvania automobile market to align our focus more fully around its core Upstate New York market. Courier Capital provides customized investment management, investment consulting and retirement plan services to individuals, businesses, institutions, foundations and retirement plans. The Company's Banking-as-a-Service ("BaaS") business has offered banking capabilities to non-bank financial service providers and other financial technology firms, or FinTechs, allowing them to provide banking services to their end users. On September 16, 2024, the Company issued a press release announcing its intent to begin an orderly wind down of its BaaS offerings, following a careful review by the Company's executive management and Board of Directors undertaken in conjunction with its annual strategic planning process.

On April 1, 2024, the Company announced and closed the sale of the assets of its former subsidiary SDN Insurance Agency, LLC ("SDN"), which provided a broad range of insurance services to personal and business clients, to NFP Property & Casualty Services, Inc., a subsidiary of NFP Corp. The sale generated $27 million in proceeds, or a pre-tax gain of $13.7 million, after selling costs, which was recorded to net gain (loss) on other assets on the Company's statement of income. The all-cash transaction value represented approximately four times our 2023 insurance revenue. Following the sale of the assets of SDN, the Company changed the name of the entity to Five Star Advisors LLC and expects to utilize it to serve as a conduit to refer insurance business to NFP.

### 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 disclosures to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2023. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year or any other period.

### Reclassifications

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

### 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 nine months ended September 30, 2024 and 2023 (in thousands):

| | 2024 | 2023 |
|---|---|---|
| Supplemental information: | | |
| Cash paid for interest | $ 121,197 | $ 95,913 |
| Cash paid for income taxes | 3,526 | 6,298 |
| Noncash investing and financing activities: | | |
| Real estate and other assets acquired in settlement of loans | 181 | 163 |
| Accrued and declared unpaid dividends | 5,004 | 4,983 |

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

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

**Fraudulent Activity**

In early March 2024, the Company experienced charge-offs associated with fraudulent activity pertaining to deposit transactions conducted over the course of several business days by an in-market business customer of the Bank, which resulted in an $18.2 million pre-tax loss for the nine months ended September 30, 2024. The fraud exposure arose from non-contractual, external fraud, and was treated as an operational loss, recorded in deposit-related charged-off items, in noninterest expense for the first quarter of 2024, with a small recovery of $143 thousand being recorded for the second quarter of 2024.

The Bank is working with the appropriate law enforcement authorities in connection with this matter and is aggressively pursuing all legal recourse available to recover additional funds and minimize the loss. However, there can be no assurance that the Company will be able to recover any further offset to the deposit loss. The ultimate financial impact could be lower and will depend, in part, on the Bank's success in its efforts to recover the funds.

**Recent Accounting Pronouncements**

In March 2023, the FASB issued ASU No. 2023-02, *Investments — Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method.* The ASU allows for entities to consistently account for tax credit equity investments utilizing the proportional amortization method across all types of tax credits when certain requirements are met. The election of proportional amortization method must be made on a programmatic basis rather than an individual investment basis. For previously held tax credit investments, the amendments will be applied either on a modified retrospective basis or a retrospective basis. The amendments are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Early adoption is permitted. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

***Standards Not Yet Effective***

In November 2023, the FASB issued ASU 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures.* The amendments expand the disclosure requirements of segment expenses, as well as adding disclosure of the title and position of the chief operation decision maker "CODM" and an explanation of how the CODM uses the reported measures of segment profit or loss in assessing segment performance and deciding how to allocate resources is also required. The amendments are effective for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024. Early adoption is permitted. The adoption of this guidance may require additional disclosure in the Company's financial statement related to segments.

In December 2023, the FASB issued ASU 2023-09, Income Tax *(Topic 740): Improvements to Income Tax Disclosures.* The amendments expand the disclosure requirements of income taxes, primarily related to the income tax rate reconciliation and income taxes paid. The guidance also eliminates certain existing disclosure requirements related to uncertain tax positions and unrecognized deferred income tax liabilities. The amendments are effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

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

**(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 September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2024 | 2023 | 2024 | 2023 |
| Net income available to common shareholders | $ 13,101 | $ 13,657 | $ 40,071 | $ 39,390 |
| Weighted average common shares outstanding: | | | | |
| Total shares issued | 16,100 | 16,100 | 16,100 | 16,100 |
| Unvested restricted stock awards | (10) | (11) | (10) | (8) |
| Treasury shares | (626) | (698) | (653) | (721) |
| Total basic weighted average common shares outstanding | 15,464 | 15,391 | 15,437 | 15,371 |
| Incremental shares from assumed: | | | | |
| Vesting of restricted stock awards | 172 | 71 | 145 | 72 |
| Total diluted weighted average common shares outstanding | 15,636 | 15,462 | 15,582 | 15,443 |
| Basic earnings per common share | $ 0.85 | $ 0.89 | $ 2.60 | $ 2.56 |
| Diluted earnings per common share | $ 0.84 | $ 0.88 | $ 2.57 | $ 2.55 |

For the three and nine months ended September 30, 2024 and 2023, no average shares were excluded from the computation of diluted EPS because the effect would be antidilutive.

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

## (3.) INVESTMENT SECURITIES

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

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **September 30, 2024** | | | | |
| **Securities available for sale:** | | | | |
| U.S. Government agency and government sponsored enterprises | $ 24,535 | $ — | $ 1,947 | $ 22,588 |
| Mortgage-backed securities: | | | | |
| Federal National Mortgage Association | 421,611 | 4 | 49,964 | 371,651 |
| Federal Home Loan Mortgage Corporation | 374,630 | 549 | 50,573 | 324,606 |
| Government National Mortgage Association | 120,796 | 221 | 19,415 | 101,602 |
| Collateralized mortgage obligations: | | | | |
| Federal National Mortgage Association | 10,131 | — | 1,927 | 8,204 |
| Federal Home Loan Mortgage Corporation | 37,123 | 562 | 3,607 | 34,078 |
| Government National Mortgage Association | 14,367 | 631 | — | 14,998 |
| Privately issued | — | 382 | — | 382 |
| Total mortgage-backed securities | 978,658 | 2,349 | 125,486 | 855,521 |
| Other debt securities | 8,656 | 51 | — | 8,707 |
| Total available for sale securities | $ 1,011,849 | $ 2,400 | $ 127,433 | $ 886,816 |
| **Securities held to maturity:** | | | | |
| U.S. Government agency and government sponsored enterprises | $ 16,626 | $ — | $ 213 | $ 16,413 |
| State and political subdivisions | 48,472 | 17 | 4,284 | 44,205 |
| Mortgage-backed securities: | | | | |
| Federal National Mortgage Association | 5,284 | — | 379 | 4,905 |
| Federal Home Loan Mortgage Corporation | 7,407 | — | 1,086 | 6,321 |
| Government National Mortgage Association | 18,810 | — | 1,440 | 17,370 |
| Collateralized mortgage obligations: | | | | |
| Federal National Mortgage Association | 9,556 | — | 538 | 9,018 |
| Federal Home Loan Mortgage Corporation | 11,971 | — | 561 | 11,410 |
| Government National Mortgage Association | 3,156 | — | 185 | 2,971 |
| Total mortgage-backed securities | 56,184 | — | 4,189 | 51,995 |
| Total held to maturity securities | 121,282 | $ 17 | $ 8,686 | $ 112,613 |
| Allowance for credit losses – securities | (3) | | | |
| Total held to maturity securities, net | $ 121,279 | | | |
| **December 31, 2023** | | | | |
| **Securities available for sale:** | | | | |
| U.S. Government agencies and government sponsored enterprises | $ 24,535 | $ — | $ 2,724 | $ 21,811 |
| Mortgage-backed securities: | | | | |
| Federal National Mortgage Association | 449,418 | — | 61,219 | 388,199 |
| Federal Home Loan Mortgage Corporation | 402,399 | 488 | 59,665 | 343,222 |
| Government National Mortgage Association | 126,417 | 252 | 21,409 | 105,260 |
| Collateralized mortgage obligations: | | | | |
| Federal National Mortgage Association | 10,954 | — | 2,343 | 8,611 |
| Federal Home Loan Mortgage Corporation | 19,766 | — | 4,186 | 15,580 |
| Government National Mortgage Association | 4,501 | 221 | — | 4,722 |
| Privately issued | — | 325 | — | 325 |
| Total mortgage-backed securities | 1,013,455 | 1,286 | 148,822 | 865,919 |
| Total available for sale securities | $ 1,037,990 | $ 1,286 | $ 151,546 | $ 887,730 |

**(3.) INVESTMENT SECURITIES (Continued)**

| December 31, 2023 (continued) | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **Securities held to maturity:** | | | | |
| U.S. Government agencies and government sponsored enterprises | $ 16,513 | $ — | $ 530 | $ 15,983 |
| State and political subdivisions | 68,854 | 34 | 5,106 | 63,782 |
| Mortgage-backed securities: | | | | |
| Federal National Mortgage Association | 5,729 | — | 467 | 5,262 |
| Federal Home Loan Mortgage Corporation | 7,648 | — | 1,269 | 6,379 |
| Government National Mortgage Association | 20,223 | — | 1,703 | 18,520 |
| Collateralized mortgage obligations: | | | | |
| Federal National Mortgage Association | 11,432 | — | 851 | 10,581 |
| Federal Home Loan Mortgage Corporation | 14,196 | — | 968 | 13,228 |
| Government National Mortgage Association | 3,565 | — | 270 | 3,295 |
| Total mortgage-backed securities | 62,793 | — | 5,528 | 57,265 |
| Total held to maturity securities | 148,160 | $ 34 | $ 11,164 | $ 137,030 |
| Allowance for credit losses – securities | (4) | | | |
| Total held to maturity securities, net | $ 148,156 | | | |

The Company elected to exclude accrued interest receivable (“AIR”) from the amortized cost basis of debt securities disclosed throughout this footnote. For available for sale (“AFS”) debt securities, AIR totaled $2.1 million as of both September 30, 2024 and December 31, 2023. For held to maturity (“HTM”) debt securities, AIR totaled $719 thousand and $571 thousand as of September 30, 2024 and December 31, 2023, respectively. AIR is included in other assets on the Company’s consolidated statements of financial condition.

For the three months ended September 30, 2024 and 2023, the provision for credit losses for HTM investment securities was less than $1 thousand in each period. The provision for credit losses for HTM investment securities was $1 thousand in the nine months ended September 30, 2024 and 2023.

Investment securities with a total fair value of $862.3 million and $845.2 million at September 30, 2024 and December 31, 2023, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

There were no sales of securities available for sale for the nine months ended September 30, 2024 and 2023.

The scheduled maturities of securities available for sale and securities held to maturity at September 30, 2024 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 | $ 16 | $ 16 |
| Due from one to five years | 91,628 | 85,664 |
| Due after five years through ten years | 87,217 | 80,109 |
| Due after ten years | 832,988 | 721,027 |
| Total available for sale securities | $ 1,011,849 | $ 886,816 |
| **Debt securities held to maturity:** | | |
| Due in one year or less | $ 18,896 | $ 18,771 |
| Due from one to five years | 21,975 | 21,257 |
| Due after five years through ten years | 22,940 | 21,487 |
| Due after ten years | 57,471 | 51,098 |
| Total held to maturity securities | $ 121,282 | $ 112,613 |

**(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 |
| **September 30, 2024** | | | | | | |
| **Securities available for sale:** | | | | | | |
| U.S. Government agencies and government sponsored enterprises | $ — | $ — | $ 22,588 | $ 1,947 | $ 22,588 | $ 1,947 |
| Mortgage-backed securities: | | | | | | |
| Federal National Mortgage Association | — | — | 371,447 | 49,964 | 371,447 | 49,964 |
| Federal Home Loan Mortgage Corporation | — | — | 301,234 | 50,573 | 301,234 | 50,573 |
| Government National Mortgage Association | 15 | — | 86,117 | 19,415 | 86,132 | 19,415 |
| Collateralized mortgage obligations: | | | | | | |
| Federal National Mortgage Association | — | — | 8,204 | 1,927 | 8,204 | 1,927 |
| Federal Home Loan Mortgage Corporation | — | — | 15,010 | 3,607 | 15,010 | 3,607 |
| Total mortgage-backed securities | 15 | — | 782,012 | 125,486 | 782,027 | 125,486 |
| Total available for sale securities | 15 | — | 804,600 | 127,433 | 804,615 | 127,433 |
| Other debt securities | — | — | — | — | — | — |
| Total AFS debt securities with unrealized losses | $ 15 | $ — | $ 804,600 | $ 127,433 | $ 804,615 | $ 127,433 |
| **December 31, 2023** | | | | | | |
| **Securities available for sale:** | | | | | | |
| U.S. Government agencies and government sponsored enterprises | $ — | $ — | $ 21,811 | $ 2,724 | $ 21,811 | $ 2,724 |
| Mortgage-backed securities: | | | | | | |
| Federal National Mortgage Association | 8 | — | 388,191 | 61,219 | 388,199 | 61,219 |
| Federal Home Loan Mortgage Corporation | — | — | 314,854 | 59,665 | 314,854 | 59,665 |
| Government National Mortgage Association | — | — | 86,475 | 21,409 | 86,475 | 21,409 |
| Collateralized mortgage obligations: | | | | | | |
| Federal National Mortgage Association | — | — | 8,611 | 2,343 | 8,611 | 2,343 |
| Federal Home Loan Mortgage Corporation | — | — | 15,580 | 4,186 | 15,580 | 4,186 |
| Total mortgage-backed securities | 8 | — | 813,711 | 148,822 | 813,719 | 148,822 |
| Total available for sale securities | 8 | — | 835,522 | 151,546 | 835,530 | 151,546 |
| Total AFS debt securities with unrealized losses | $ 8 | $ — | $ 835,522 | $ 151,546 | $ 835,530 | $ 151,546 |

**(3.) INVESTMENT SECURITIES (Continued)**

The total number of AFS securities' positions in the investment portfolio in an unrealized loss position was 185 at September 30, 2024 and 201 at December 31, 2023, respectively. At September 30, 2024, the Company had a position in 183 investment securities with a fair value of $804.6 million and a total unrealized loss of $127.4 million that had been in a continuous unrealized loss position for more than 12 months. At September 30, 2024, there were a total of two securities' positions in the Company's investment portfolio with a fair value of $15 thousand and a total unrealized loss of less than $1 thousand that had been in a continuous unrealized loss position for less than 12 months. At December 31, 2023, the Company had a position in 198 investment securities with a fair value of $835.5 million and a total unrealized loss of $151.5 million that had been in a continuous unrealized loss position for more than 12 months. At December 31, 2023, there were a total of three securities' positions in the Company's investment portfolio with a fair value of $8 thousand and a total unrealized loss of less than $1 thousand 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 the Company's portfolio fluctuates as market interest rates change.

**Securities Available for Sale**

As of September 30, 2024 and December 31, 2023, no allowance for credit losses had been recognized on AFS securities in an unrealized loss position as management does not believe any of the securities were 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, the Company expects to recover the amortized cost basis of its investments and more than likely will not need to sell before the recovery period for operating purposes, with no impairment identified. As the portfolio is managed from a liquidity, earnings, and risk standpoint, sales from the AFS portfolio may be warranted based upon prevailing market factors. 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 September 30, 2024, $45.3 million of our municipal bonds were rated as an equivalent to Standard & Poor's A/AA/AAA, with $3.2 million internally rated to be the equivalent of Standard & Poor's A/AA/AAA rating. Additionally, no municipal bonds were rated below investment grade. As of December 31, 2023, $64.6 million of our municipal bonds were rated as an equivalent to Standard & Poor's A/AA/AAA, with $4.2 million internally rated to be the equivalent of Standard & Poor's A/AA/AAA rating, and no municipal bonds were rated below investment grade.

As of September 30, 2024 and December 31, 2023, 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 |
|---|---|---|---|
| **September 30, 2024** | | | |
| Commercial business | $ 653,921 | $ 598 | $ 654,519 |
| Commercial mortgage - construction | 535,124 | (1,618) | 533,506 |
| Commercial mortgage - multifamily | 468,064 | (537) | 467,527 |
| Commercial mortgage - non-owner occupied | 815,369 | (977) | 814,392 |
| Commercial mortgage - owner occupied | 290,221 | (5) | 290,216 |
| Residential real estate loans | 636,870 | 11,371 | 648,241 |
| Residential real estate lines | 72,926 | 3,277 | 76,203 |
| Consumer indirect | 846,903 | 27,748 | 874,651 |
| Other consumer | 43,803 | (69) | 43,734 |
| Total | $ 4,363,201 | $ 39,788 | 4,402,989 |
| Allowance for credit losses – loans | | | (44,678) |
| Total loans, net | | | $ 4,358,311 |
| **December 31, 2023** | | | |
| Commercial business | $ 734,947 | $ 753 | $ 735,700 |
| Commercial mortgage - construction | 495,198 | (2,195) | 493,003 |
| Commercial mortgage - multifamily | 452,778 | (623) | 452,155 |
| Commercial mortgage - non-owner occupied | 789,631 | (1,116) | 788,515 |
| Commercial mortgage - owner occupied | 271,662 | (16) | 271,646 |
| Residential real estate loans | 637,173 | 12,649 | 649,822 |
| Residential real estate lines | 73,972 | 3,395 | 77,367 |
| Consumer indirect | 915,723 | 33,108 | 948,831 |
| Other consumer | 45,167 | (67) | 45,100 |
| Total | $ 4,416,251 | $ 45,888 | 4,462,139 |
| Allowance for credit losses – loans | | | (51,082) |
| Total loans, net | | | $ 4,411,057 |

Loans held for sale (not included above) were comprised entirely of residential real estate mortgages and totaled $2.5 million and $1.4 million as of September 30, 2024 and December 31, 2023, respectively.

The Company sells 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 $276.8 million and $269.4 million as of September 30, 2024 and December 31, 2023, respectively.

The Company elected to exclude AIR from the amortized cost basis of loans disclosed throughout this footnote. As of both September 30, 2024, and December 31, 2023, AIR for loans totaled $20.8 million 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 specific allowance |
|---|---|---|---|---|---|---|---|---|
| **September 30, 2024** | | | | | | | | |
| Commercial business | $ 7 | $ 6,500 | $ 8 | $ 6,515 | $ 5,752 | $ 641,654 | $ 653,921 | $ 332 |
| Commercial mortgage - construction | 52 | — | — | 52 | 20,280 | 514,792 | 535,124 | 20,280 |
| Commercial mortgage - multifamily | — | — | — | — | 71 | 467,993 | 468,064 | 71 |
| Commercial mortgage - non-owner occupied | 334 | — | — | 334 | 4,903 | 810,132 | 815,369 | 4,582 |
| Commercial mortgage - owner occupied | — | — | — | — | 366 | 289,855 | 290,221 | 366 |
| Residential real estate loans | 2,356 | — | — | 2,356 | 5,790 | 628,724 | 636,870 | 5,790 |
| Residential real estate lines | 81 | 49 | — | 130 | 232 | 72,564 | 72,926 | 232 |
| Consumer indirect | 7,284 | 1,998 | — | 9,282 | 3,291 | 834,330 | 846,903 | 3,291 |
| Other consumer | 236 | 11 | 35 | 282 | 14 | 43,507 | 43,803 | 14 |
| Total loans, gross | $ 10,350 | $ 8,558 | $ 43 | $ 18,951 | $ 40,699 | $ 4,303,551 | $ 4,363,201 | $ 34,958 |
| **December 31, 2023** | | | | | | | | |
| Commercial business | $ 341 | $ — | $ — | $ 341 | $ 5,664 | $ 728,942 | $ 734,947 | $ 341 |
| Commercial mortgage - construction | — | 727 | — | 727 | 5,320 | 489,151 | 495,198 | 5,320 |
| Commercial mortgage - multifamily | 4,036 | — | — | 4,036 | 189 | 448,553 | 452,778 | 189 |
| Commercial mortgage - non-owner occupied | 338 | — | — | 338 | 4,651 | 784,642 | 789,631 | 4,651 |
| Commercial mortgage - owner occupied | 1,526 | — | — | 1,526 | 403 | 269,733 | 271,662 | 403 |
| Residential real estate loans | 2,614 | 80 | — | 2,694 | 6,364 | 628,115 | 637,173 | 6,364 |
| Residential real estate lines | 163 | 20 | — | 183 | 221 | 73,568 | 73,972 | 221 |
| Consumer indirect | 16,128 | 3,204 | — | 19,332 | 3,814 | 892,577 | 915,723 | 3,814 |
| Other consumer | 122 | 27 | 21 | 170 | 13 | 44,984 | 45,167 | 13 |
| Total loans, gross | $ 25,268 | $ 4,058 | $ 21 | $ 29,347 | $ 26,639 | $ 4,360,265 | $ 4,416,251 | $ 21,316 |

There were $35 thousand and $21 thousand in consumer overdrafts which were past due greater than 90 days as of September 30, 2024 and December 31, 2023. Consumer overdrafts are overdrawn deposit accounts which have been reclassified as loans but by their terms do not accrue interest.

Interest income on nonaccrual loans, if recognized, is recorded using the cash basis method of accounting. There was no interest income recognized on nonaccrual loans during the nine months ended September 30, 2024 and 2023. Estimated interest income of $519 thousand and $437 thousand for the nine months ended September 30, 2024 and 2023, respectively, would have been recorded if all such loans had been accruing interest according to their original contractual terms.

**Loan Modifications for Borrowers Experiencing Financial Difficulty**

Loans may be modified when it is determined that a borrower is experiencing financial difficulty. Loan modifications may include principal forgiveness, interest rate reduction, an other-than-insignificant payment delay, and term extensions, or a combination of these concessions.

**(4.) LOANS (Continued)**

The following table presents the amortized cost basis of loans modified to borrowers experiencing financial difficulty, disaggregated by loan class and type of concession granted as of September 30, 2024 (in thousands):

| | Term Extension | |
|---|---|---|
| **Loan Type** | **Amortized Cost Basis** | **% of Total Loans** |
| Commercial business | $ — | 0.0 % |
| Commercial mortgage - construction | — | 0.0 % |
| Commercial mortgage - multifamily | — | 0.0 % |
| Commercial mortgage - non-owner occupied | — | 0.0 % |
| Commercial mortgage - owner occupied | — | 0.0 % |
| Residential real estate loans | 1,736 | 0.1 % |
| Residential real estate lines | — | 0.0 % |
| Consumer indirect | — | 0.0 % |
| Other consumer | — | 0.0 % |
| Total | $ 1,736 | 0.1 % |

The following table describes the financial effect of the modifications made to borrowers experiencing financial difficulty:

| Term Extension | |
|---|---|
| **Loan Type** | **Financial Effect** |
| Residential real estate loans | Added a weighted average 10.0 years to the life of the loan, which reduced the monthly payment amount for the borrower. |

The Company closely monitors the performance of loans that are modified to borrowers experiencing financial difficulty to understand the effectiveness of its modification efforts. The following table depicts the performance of loans that have been modified in the nine months ended September 30, 2024 (in thousands):

| | Payment Status (Amortized Cost Basis) | | |
|---|---|---|---|
| **Loan Type** | **Current** | **30-89 Days Past Due** | **90+ Days Past Due** |
| Commercial business | $ — | $ — | $ — |
| Commercial mortgage - construction | — | — | — |
| Commercial mortgage - multifamily | — | — | — |
| Commercial mortgage - non-owner occupied | — | — | — |
| Commercial mortgage - owner occupied | — | — | — |
| Residential real estate loans | 1,196 | 386 | 154 |
| Residential real estate lines | — | — | — |
| Consumer indirect | — | — | — |
| Other consumer | — | — | — |
| Total | $ 1,196 | $ 386 | $ 154 |

**(4.) LOANS (Continued)**

**Collateral Dependent Loans**

Management has determined that specific commercial loans on nonaccrual status, all loans that have had their terms restructured when a borrower is experiencing financial difficulty, and other loans deemed appropriate by management 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 September 30, 2024 and December 31, 2023 (in thousands):

| | Collateral type | | | |
|---|---|---|---|---|
| | Business assets | Real property | Total | Specific Reserve |
| **September 30, 2024** | | | | |
| Commercial business | $ 6,939 | $ 5,000 | $ 11,939 | $ 2,321 |
| Commercial mortgage - construction | — | 29,812 | 29,812 | — |
| Commercial mortgage - multifamily | — | 70 | 70 | — |
| Commercial mortgage - non-owner occupied | — | 17,788 | 17,788 | 24 |
| Commercial mortgage - owner occupied | — | 745 | 745 | — |
| Total | $ 6,939 | $ 53,415 | $ 60,354 | $ 2,345 |
| **December 31, 2023** | | | | |
| Commercial business | $ 8,698 | $ 5,000 | $ 13,698 | $ 2,198 |
| Commercial mortgage - construction | — | 14,939 | 14,939 | — |
| Commercial mortgage - multifamily | — | 6,164 | 6,164 | 559 |
| Commercial mortgage - non-owner occupied | — | 4,651 | 4,651 | — |
| Commercial mortgage - owner occupied | — | 821 | 821 | — |
| Total | $ 8,698 | $ 31,575 | $ 40,273 | $ 2,757 |

**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.

**(4.) LOANS (Continued)**

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

| September 30, 2024 | Term Loans Amortized Cost Basis by Origination Year 2024 | 2023 | 2022 | 2021 | 2020 | Prior | Revolving Loans Amortized Cost Basis | Revolving Loans Converted to Term | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Commercial Business:** | | | | | | | | | |
| Uncriticized | $ 79,428 | $ 85,801 | $ 76,264 | $ 46,767 | $ 33,608 | $ 20,535 | $ 277,164 | $ — | $ 619,567 |
| Special mention | 95 | 5,487 | 319 | 2,261 | 3 | 1,843 | 8,931 | — | 18,939 |
| Substandard | 15 | 1,077 | 21 | 72 | 22 | 200 | 9,093 | — | 10,500 |
| Doubtful | — | — | 5,039 | — | — | 265 | 209 | — | 5,513 |
| Total Commercial Business loans | $ 79,538 | $ 92,365 | $ 81,643 | $ 49,100 | $ 33,633 | $ 22,843 | $ 295,397 | $ — | $ 654,519 |
| Current period gross write-offs | $ — | $ 5 | $ — | $ 20 | $ — | $ 85 | $ — | $ — | $ 110 |
| **Commercial Mortgage - Construction** | | | | | | | | | |
| Uncriticized | $ 25,209 | $ 156,803 | $ 307,613 | $ 3,996 | $ 346 | $ 6,683 | $ — | $ — | $ 500,650 |
| Special mention | — | — | 723 | 2,269 | — | — | — | — | 2,992 |
| Substandard | — | — | — | — | — | 9,583 | — | — | 9,583 |
| Doubtful | — | 820 | — | 19,461 | — | — | — | — | 20,281 |
| Total Commercial Mortgage - Construction | $ 25,209 | $ 157,623 | $ 308,336 | $ 25,726 | $ 346 | $ 16,266 | $ — | $ — | $ 533,506 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Commercial Mortgage - Multifamily** | | | | | | | | | |
| Uncriticized | $ 16,393 | $ 106,024 | $ 46,205 | $ 145,511 | $ 65,848 | $ 70,012 | $ — | $ — | $ 449,993 |
| Special mention | — | — | 3,778 | — | 6,825 | 5,721 | — | — | 16,324 |
| Substandard | — | — | — | — | 472 | 667 | — | — | 1,139 |
| Doubtful | — | 71 | — | — | — | — | — | — | 71 |
| Total Commercial Mortgage - Multifamily | $ 16,393 | $ 106,095 | $ 49,983 | $ 145,511 | $ 73,145 | $ 76,400 | $ — | $ — | $ 467,527 |
| Current period gross write-offs | $ — | $ — | $ — | $ 13 | $ — | $ — | $ — | $ — | $ 13 |
| **Commercial Mortgage - Non-Owner Occupied** | | | | | | | | | |
| Uncriticized | $ 33,926 | $ 68,164 | $ 241,192 | $ 101,858 | $ 83,380 | $ 255,321 | $ — | $ — | $ 783,841 |
| Special mention | — | — | — | 4,726 | — | 7,824 | — | — | 12,550 |
| Substandard | — | 12,885 | — | 210 | — | 3 | — | — | 13,098 |
| Doubtful | — | — | 321 | — | — | 4,582 | — | — | 4,903 |
| Total Commercial Mortgage - Non-Owner Occupied | $ 33,926 | $ 81,049 | $ 241,513 | $ 106,794 | $ 83,380 | $ 267,730 | $ — | $ — | $ 814,392 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Commercial Mortgage - Owner Occupied** | | | | | | | | | |
| Uncriticized | $ 59,047 | $ 43,501 | $ 50,565 | $ 34,492 | $ 43,908 | $ 55,723 | $ — | $ — | $ 287,236 |
| Special mention | — | — | 454 | — | 318 | 1,228 | — | — | 2,000 |
| Substandard | — | — | 224 | — | 379 | 12 | — | — | 615 |
| Doubtful | — | — | — | — | — | 365 | — | — | 365 |
| Total Commercial Mortgage - Owner Occupied | $ 59,047 | $ 43,501 | $ 51,243 | $ 34,492 | $ 44,605 | $ 57,328 | $ — | $ — | $ 290,216 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |

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

## (4.) LOANS (Continued)

| | Term Loans Amortized Cost Basis by Origination Year | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **December 31, 2023** | **2023** | **2022** | **2021** | **2020** | **2019** | **Prior** | **Revolving Loans Amortized Cost Basis** | **Revolving Loans Converted to Term** | **Total** |
| **Commercial Business** | | | | | | | | | |
| Uncriticized | $ 111,035 | $ 124,572 | $ 77,079 | $ 49,531 | $ 21,971 | $ 64,648 | $ 257,585 | $ — | $ 706,421 |
| Special mention | 7,532 | — | 2,400 | — | 114 | — | 2,442 | — | 12,488 |
| Substandard | 1,609 | 11 | 81 | — | — | 888 | 8,532 | — | 11,121 |
| Doubtful | — | 5,097 | — | — | 14 | 397 | 162 | — | 5,670 |
| Total Commercial Business | $ 120,176 | $ 129,680 | $ 79,560 | $ 49,531 | $ 22,099 | $ 65,933 | $ 268,721 | $ — | $ 735,700 |
| Current period gross write-offs | $ — | $ 5 | $ 3 | $ 31 | $ 8 | $ 235 | $ — | $ — | $ 282 |
| **Commercial Mortgage - Construction** | | | | | | | | | |
| Uncriticized | $ 115,475 | $ 269,461 | $ 59,147 | $ 9,352 | $ 7,447 | $ 225 | $ — | $ — | $ 461,107 |
| Special mention | — | — | 16,895 | — | — | — | — | — | 16,895 |
| Substandard | — | — | — | — | — | 9,681 | — | — | 9,681 |
| Doubtful | 1,320 | — | 4,000 | — | — | — | — | — | 5,320 |
| Total Commercial Mortgage - Construction | $ 116,795 | $ 269,461 | $ 80,042 | $ 9,352 | $ 7,447 | $ 9,906 | $ — | $ — | $ 493,003 |
| Current period gross write-offs | $ 980 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 980 |
| **Commercial Mortgage - Multifamily** | | | | | | | | | |
| Uncriticized | $ 111,622 | $ 53,495 | $ 128,605 | $ 68,029 | $ 23,359 | $ 51,476 | $ — | $ — | $ 436,586 |
| Special mention | — | 494 | 241 | 6,825 | 119 | — | — | — | 7,679 |
| Substandard | — | — | — | 499 | — | 7,215 | — | — | 7,714 |
| Doubtful | 77 | — | 83 | 14 | — | 2 | — | — | 176 |
| Total Commercial Mortgage - Multifamily | $ 111,699 | $ 53,989 | $ 128,929 | $ 75,367 | $ 23,478 | $ 58,693 | $ — | $ — | $ 452,155 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| **Commercial Mortgage - Non-Owner Occupied** | | | | | | | | | |
| Uncriticized | $ 78,053 | $ 212,188 | $ 103,894 | $ 83,714 | $ 93,645 | $ 197,915 | $ — | $ — | $ 769,409 |
| Special mention | — | — | — | 2,157 | — | 11,355 | — | — | 13,512 |
| Substandard | — | 338 | 212 | — | — | 379 | — | — | 929 |
| Doubtful | — | — | 15 | — | 67 | 4,583 | — | — | 4,665 |
| Total Commercial Mortgage - Non-Owner Occupied | $ 78,053 | $ 212,526 | $ 104,121 | $ 85,871 | $ 93,712 | $ 214,232 | $ — | $ — | $ 788,515 |
| Current period gross write-offs | $ — | $ — | $ — | $ 14 | $ — | $ — | $ — | $ — | $ 14 |
| **Commercial Mortgage - Owner Occupied** | | | | | | | | | |
| Uncriticized | $ 45,220 | $ 68,542 | $ 37,270 | $ 48,118 | $ 26,571 | $ 45,087 | $ — | $ — | $ 270,808 |
| Special mention | — | — | — | — | — | — | — | — | — |
| Substandard | — | — | — | 419 | — | 16 | — | — | 435 |
| Doubtful | — | — | — | — | — | 403 | — | — | 403 |
| Total Commercial Mortgage - Owner Occupied | $ 45,220 | $ 68,542 | $ 37,270 | $ 48,537 | $ 26,571 | $ 45,506 | $ — | $ — | $ 271,646 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ — | $ 18 | $ — | $ — | $ 18 |

**(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 tables set 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 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| September 30, 2024 | 2024 | 2023 | 2022 | 2021 | 2020 | Prior | Revolving Loans Amortized Cost Basis | Revolving Loans Converted to Term | Total |
| **Residential Real Estate Loans** | | | | | | | | | |
| Performing | $ 36,246 | $ 113,089 | $ 76,412 | $ 76,403 | $ 102,516 | $ 237,785 | $ — | $ — | $ 642,451 |
| Non-performing | — | 396 | 529 | 806 | 1,264 | 2,795 | — | — | 5,790 |
| Total Residential Real Estate Loans | $ 36,246 | $ 113,485 | $ 76,941 | $ 77,209 | $ 103,780 | $ 240,580 | $ — | $ — | $ 648,241 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ — | $ 109 | $ — | $ — | $ 109 |
| | | | | | | | | | |
| **Residential Real Estate Lines** | | | | | | | | | |
| Performing | $ — | $ — | $ — | $ — | $ — | $ — | $ 71,630 | $ 4,341 | $ 75,971 |
| Non-performing | — | — | — | — | — | — | 51 | 181 | 232 |
| Total Residential Real Estate Lines | $ — | $ — | $ — | $ — | $ — | $ — | $ 71,681 | $ 4,522 | $ 76,203 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| | | | | | | | | | |
| **Consumer Indirect** | | | | | | | | | |
| Performing | $ 170,455 | $ 200,312 | $ 260,279 | $ 168,344 | $ 50,062 | $ 21,908 | $ — | $ — | $ 871,360 |
| Non-performing | 147 | 592 | 983 | 981 | 402 | 186 | — | — | 3,291 |
| Total Consumer Indirect Loans | $ 170,602 | $ 200,904 | $ 261,262 | $ 169,325 | $ 50,464 | $ 22,094 | $ — | $ — | $ 874,651 |
| Current period gross write-offs | $ 100 | $ 3,585 | $ 4,553 | $ 3,475 | $ 1,352 | $ 1,308 | $ — | $ — | $ 14,373 |
| | | | | | | | | | |
| **Other Consumer** | | | | | | | | | |
| Performing | $ 6,489 | $ 30,578 | $ 2,641 | $ 872 | $ 413 | $ 259 | $ 2,433 | $ — | $ 43,685 |
| Non-performing | 4 | 2 | — | — | — | 7 | 36 | — | 49 |
| Total Other Consumer Loans | $ 6,493 | $ 30,580 | $ 2,641 | $ 872 | $ 413 | $ 266 | $ 2,469 | $ — | $ 43,734 |
| Current period gross write-offs | $ 428 | $ 79 | $ 118 | $ 25 | $ 25 | $ 4 | $ 88 | $ — | $ 767 |

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

**(4.) LOANS (Continued)**

| | Term Loans Amortized Cost Basis by Origination Year | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| December 31, 2023 | 2023 | 2022 | 2021 | 2020 | 2019 | Prior | Revolving Loans Amortized Cost Basis | Revolving Loans Converted to Term | Total |
| **Residential Real Estate Loans** | | | | | | | | | |
| Performing | $ 112,704 | $ 80,117 | $ 80,323 | $ 109,601 | $ 70,325 | $ 190,388 | $ — | $ — | $ 643,458 |
| Non-performing | — | 384 | 1,190 | 1,354 | 1,137 | 2,299 | — | — | 6,364 |
| Total | $ 112,704 | $ 80,501 | $ 81,513 | $ 110,955 | $ 71,462 | $ 192,687 | $ — | $ — | $ 649,822 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ 32 | $ 95 | $ — | $ — | $ 127 |
| **Residential Real Estate Lines** | | | | | | | | | |
| Performing | $ — | $ — | $ — | $ — | $ — | $ — | $ 72,128 | $ 5,018 | $ 77,146 |
| Non-performing | — | — | — | — | — | — | 55 | 166 | 221 |
| Total | $ — | $ — | $ — | $ — | $ — | $ — | $ 72,183 | $ 5,184 | $ 77,367 |
| Current period gross write-offs | $ — | $ — | $ — | $ — | $ — | $ — | $ 28 | $ 13 | $ 41 |
| **Consumer Indirect** | | | | | | | | | |
| Performing | $ 247,194 | $ 336,369 | $ 232,891 | $ 78,652 | $ 31,091 | $ 18,820 | $ — | $ — | $ 945,017 |
| Non-performing | 724 | 1,083 | 1,273 | 380 | 224 | 130 | — | — | 3,814 |
| Total | $ 247,918 | $ 337,452 | $ 234,164 | $ 79,032 | $ 31,315 | $ 18,950 | $ — | $ — | $ 948,831 |
| Current period gross write-offs | $ 1,371 | $ 6,279 | $ 5,845 | $ 1,787 | $ 1,282 | $ 1,459 | $ — | $ — | $ 18,023 |
| **Other Consumer** | | | | | | | | | |
| Performing | $ 35,483 | $ 3,990 | $ 1,424 | $ 949 | $ 217 | $ 256 | $ 2,747 | $ — | $ 45,066 |
| Non-performing | 13 | — | — | — | — | — | 21 | — | 34 |
| Total | $ 35,496 | $ 3,990 | $ 1,424 | $ 949 | $ 217 | $ 256 | $ 2,768 | $ — | $ 45,100 |
| Current period gross write-offs | $ 902 | $ 127 | $ 105 | $ 52 | $ 31 | $ 20 | $ 47 | $ — | $ 1,284 |

**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 nine months ended September 30, 2024 and 2023 (in thousands):

| | | Commercial Mortgage | | | | Residential Real Estate | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Commercial Business | Construction | Multi-family | Non-Owner Occupied | Owner Occupied | Loans | Lines | Consumer Indirect | Other Consumer | Total |
| **Three months ended September 30, 2024** | | | | | | | | | | |
| Allowance for credit losses – loans: | | | | | | | | | | |
| Beginning balance | $ 12,246 | $ 3,746 | $ 3,449 | $ 6,052 | $ 2,118 | $ 4,211 | $ 769 | $ 10,842 | $ 519 | $ 43,952 |
| Charge-offs | (40) | — | (13) | — | — | (2) | — | (4,410) | (187) | (4,652) |
| Recoveries | 43 | — | 1 | 1 | 1 | 3 | — | 2,857 | 81 | 2,987 |
| (Benefit) provision | (3,774) | 1,656 | (828) | 1,425 | 2,081 | (417) | 64 | 2,057 | 127 | 2,391 |
| Ending balance | $ 8,475 | $ 5,402 | $ 2,609 | $ 7,478 | $ 4,200 | $ 3,795 | $ 833 | $ 11,346 | $ 540 | $ 44,678 |
| **Nine months ended September 30, 2024** | | | | | | | | | | |
| Beginning balance | $ 13,102 | $ 3,710 | $ 4,009 | $ 6,074 | $ 2,065 | $ 5,286 | $ 764 | $ 14,099 | $ 1,973 | $ 51,082 |
| Charge-offs | (110) | — | (13) | — | — | (109) | — | (14,373) | (767) | (15,372) |
| Recoveries | 143 | — | — | 3 | 4 | 10 | — | 9,003 | 301 | 9,464 |
| (Benefit) provision | (4,660) | 1,692 | (1,387) | 1,401 | 2,131 | (1,392) | 69 | 2,617 | (967) | (496) |
| Ending balance | $ 8,475 | $ 5,402 | $ 2,609 | $ 7,478 | $ 4,200 | $ 3,795 | $ 833 | $ 11,346 | $ 540 | $ 44,678 |

| | | Commercial Mortgage | | | | Residential Real Estate | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Commercial Business | Construction | Multi-family | Non-Owner Occupied | Owner Occupied | Loans | Lines | Consumer Indirect | Other Consumer | Total |
| **Three months ended September 30, 2023** | | | | | | | | | | |
| Allowance for credit losses – loans: | | | | | | | | | | |
| Beginning balance | $ 13,418 | $ 3,868 | $ 4,260 | $ 6,407 | $ 2,291 | $ 4,646 | $ 710 | $ 13,306 | $ 930 | $ 49,836 |
| Charge-offs | (146) | — | — | — | — | — | — | (4,848) | (344) | (5,338) |
| Recoveries | 114 | — | — | 886 | 86 | 4 | — | 2,565 | 85 | 3,740 |
| Provision | (600) | (255) | (43) | (1,081) | (142) | (791) | (173) | 3,583 | 894 | 1,392 |
| Ending balance | $ 12,786 | $ 3,613 | $ 4,217 | $ 6,212 | $ 2,235 | $ 3,859 | $ 537 | $ 14,606 | $ 1,565 | $ 49,630 |
| **Nine months ended September 30, 2023** | | | | | | | | | | |
| Beginning balance | 12,585 | 2,657 | 3,409 | 6,237 | 2,109 | 3,301 | 608 | 14,238 | 269 | 45,413 |
| Charge-offs | (263) | — | — | — | (18) | (102) | (41) | (12,477) | (1,064) | (13,965) |
| Recoveries | 322 | — | — | 887 | 89 | 35 | — | 8,056 | 253 | 9,642 |
| Provision (benefit) | 142 | 956 | 808 | (912) | 55 | 625 | (30) | 4,789 | 2,107 | 8,540 |
| Ending balance | $ 12,786 | $ 3,613 | $ 4,217 | $ 6,212 | $ 2,235 | $ 3,859 | $ 537 | $ 14,606 | $ 1,565 | $ 49,630 |

**(4.) LOANS (Continued)**

**Risk Characteristics**

Loans are pooled based on their homogeneous risk characteristics. The Company has divided its loan portfolio into segments, as the loans within each segment have similar characteristics related to loan purpose, tenor, amortization, repayment source, payment frequency, collateral and recourse.

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 typically associated with higher credit 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 inflation, 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 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 inflation, influencing 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. Beginning in the third quarter of 2024, the Company further disaggregated the commercial mortgage loans into the following categories: construction, multifamily, non-owner occupied, and owner occupied based on the risk characteristics of the loans and the Company's methodology for monitoring and assessing credit risk.

Residential real estate loans (comprised of conventional mortgages and home equity loans) and residential real estate lines of credit (comprised of home equity lines of credit) 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, 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 primarily unsecured or, in the case of some BaaS loans, secured by depreciable assets such as solar panels, and 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 inflation and adverse personal circumstances such as job loss, illness or personal bankruptcy, including the heightened risk that such circumstances may arise as a result of inflation. 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**

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 2061. Two building leases were subleased with terms that extended through December 31, 2024.

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 | September 30, 2024 | December 31, 2023 |
|---|---|---|---|
| **Operating Lease Right of Use Assets:** | | | |
| Gross carrying amount | Other assets | $ 39,342 | $ 38,684 |
| Accumulated amortization | Other assets | (8,511) | (7,160) |
| Net book value | | $ 30,831 | $ 31,524 |
| | | | |
| **Operating Lease Liabilities:** | | | |
| Right of use lease obligations | Other liabilities | $ 33,192 | $ 33,788 |

The weighted average remaining lease term for operating leases was 20.0 years at September 30, 2024 and the weighted-average discount rate used in the measurement of operating lease liabilities was 3.92%. The Company utilizes its incremental borrowing rate at lease inception, on a collateralized basis, over a similar term for the discount rate.

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

**(5.) LEASES (Continued)**

The following table represents lease costs and other lease information:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2024 | 2023 | 2024 | 2023 |
| **Lease costs:** | | | | |
| Operating lease costs | $ 775 | $ 773 | $ 2,327 | $ 2,308 |
| Variable lease costs [1] | 139 | 113 | 334 | 324 |
| Sublease income | (36) | (29) | (103) | (77) |
| Net lease costs | $ 878 | $ 857 | $ 2,558 | $ 2,555 |
| **Other information:** | | | | |
| Cash paid for amounts included in the measurement of lease liabilities: | | | | |
| Operating cash flows from operating leases | $ 775 | $ 769 | $ 2,327 | $ 2,212 |
| Right of use assets obtained in exchange for new operating lease liabilities | $ 139 | $ 932 | $ 334 | $ 2,167 |

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

Future minimum payments under non-cancellable operating leases with initial or remaining terms of one year or more, are as follows at September 30, 2024 (in thousands):

| | |
|---|---|
| Twelve months ended September 30, | |
| 2024 | $ 755 |
| 2025 | 2,927 |
| 2026 | 2,775 |
| 2027 | 2,748 |
| 2028 | 2,464 |
| Thereafter | 37,256 |
| Total future minimum operating lease payments | 48,925 |
| Amounts representing interest | (15,733) |
| Present value of net future minimum operating lease payments | $ 33,192 |

**(6.) GOODWILL AND OTHER INTANGIBLE ASSETS**

**Goodwill**

The carrying amount of goodwill totaled $58.1 million and $67.1 million as of September 30, 2024 and December 31, 2023, respectively. On April 1, 2024, the Company announced and closed on the sale of the assets of its wholly owned subsidiary, SDN. The sale resulted in a $9.0 million reduction in the carrying amount of goodwill.

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. The Company performs its annual goodwill impairment test as of October 1st. The Company did not identify an indication of goodwill impairment for any of its reporting units during the quarter ended September 30, 2024.

**(6.) GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)**

**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):

| | September 30, 2024 | December 31, 2023 |
|---|---|---|
| **Core deposit intangibles:** | | |
| Gross carrying amount | $ 2,042 | $ 2,042 |
| Accumulated amortization | (2,042) | (2,042) |
| Net book value | $ — | $ — |
| | | |
| **Other intangibles:** | | |
| Gross carrying amount | $ 7,243 | $ 14,545 |
| Accumulated amortization | (4,497) | (9,112) |
| Net book value | $ 2,746 | $ 5,433 |

Amortization expense for total other intangible assets was $112 thousand and $443 thousand for the three and nine months ended September 30, 2024 and $225 thousand and $689 thousand for the three and nine months ended September 30, 2023. The reduction of the net book value in other intangible assets as of September 30, 2024, of $2.6 million was primarily the result of the sale of the assets of SDN.

As of September 30, 2024, the estimated amortization expense of other intangible assets for the remainder of 2024 and each of the next five years is as follows (in thousands):

| | |
|---|---|
| 2024 (remainder of year) | $ 109 |
| 2025 | 415 |
| 2026 | 379 |
| 2027 | 343 |
| 2028 | 308 |
| 2029 | 272 |
| Thereafter | 920 |
| Total | $ 2,746 |

## (7.) OTHER ASSETS AND OTHER LIABILITIES

A summary of other assets and other liabilities as of the dates indicated are as follows (in thousands):

| | September 30, 2024 | December 31, 2023 |
|---|---|---|
| **Other Assets:** | | |
| Tax credit investments | $ 74,711 | $ 68,253 |
| Net deferred tax asset | 41,468 | 48,733 |
| Derivative instruments | 35,853 | 43,506 |
| Operating lease right of use assets | 30,831 | 31,524 |
| Federal Home Loan Bank (“FHLB”) and Federal Reserve Bank (“FRB”) stock | 16,186 | 17,406 |
| Accrued interest receivable | 23,702 | 24,481 |
| Other | 48,017 | 80,454 |
| Total other assets | $ 270,768 | $ 314,357 |

| | September 30, 2024 | December 31, 2023 |
|---|---|---|
| **Other Liabilities:** | | |
| Collateral on derivative instruments | $ 28,330 | $ 40,350 |
| Derivative instruments | 31,645 | 37,521 |
| Operating lease right of use obligations | 33,192 | 33,788 |
| Accrued interest expense | 27,453 | 19,412 |
| Other | 48,989 | 52,570 |
| Total other liabilities | $ 169,609 | $ 183,641 |

## (8.) 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. Such derivatives were used to hedge the variable cash flows associated with short-term borrowings or brokered CDs. 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 following table summarizes the terms of the Company's outstanding interest rate swap agreements entered into to manage its exposure to the variability in future cash flows at September 30, 2024 (dollars in thousands):

| Effective Date | Expiration Date | Notional Amount | | Pay Fixed Rate |
|---|---|---|---|---|
| 4/11/2022 | 4/11/2027 | $ | 50,000 | 0.787% |
| 1/24/2023 | 1/24/2026 | $ | 30,000 | 3.669% |
| 5/5/2023 | 5/5/2026 | $ | 25,000 | 3.4615% |

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. During the next twelve months, the Company estimates that $1.7 million in accumulated other comprehensive loss related to derivatives 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.

**(8.) DERIVATIVE INSTRUMENT AND HEDGING ACTIVITIES (Continued)**

**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.

**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 September 30, 2024 and December 31, 2023 (in thousands):

| | Gross notional amount | | Asset derivatives | | | Liability derivatives | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Fair value | | | Fair value | |
| | September 30, 2024 | December 31, 2023 | Balance sheet line item | September 30, 2024 | December 31, 2023 | Balance sheet line item | September 30, 2024 | December 31, 2023 |
| Derivatives designated as hedging instruments | | | | | | | | |
| Cash flow hedges | $ 105,000 | $ 105,000 | Other assets | $ 4,097 | $ 5,939 | Other liabilities | $ 31 | $ — |
| Total derivatives | $ 105,000 | $ 105,000 | | $ 4,097 | $ 5,939 | | $ 31 | $ — |
| Derivatives not designated as hedging instruments | | | | | | | | |
| Interest rate swaps [1] | $ 1,130,680 | $ 1,104,804 | Other assets | $ 31,597 | $ 37,517 | Other liabilities | $ 31,600 | $ 37,519 |
| Credit contracts | 81,878 | 81,211 | Other assets | — | — | Other liabilities | — | — |
| Mortgage banking | 16,376 | 5,292 | Other assets | 159 | 50 | Other liabilities | 14 | 2 |
| Total derivatives | $ 1,228,934 | $ 1,191,307 | | $ 31,756 | $ 37,567 | | $ 31,614 | $ 37,521 |

(1) The Company was holding collateral of $28.3 million and $40.4 million against its net obligations under these contracts at September 30, 2024 and December 31, 2023, 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 nine months ended September 30, 2024 and 2023 (in thousands):

| | | Gain (loss) recognized in income<br>Three months ended September 30, | | Gain (loss) recognized in income<br>Nine months ended September 30, | |
|---|---|---|---|---|---|
| **Undesignated derivatives** | **Line item of gain (loss) recognized in income** | **2024** | **2023** | **2024** | **2023** |
| Interest rate swaps | Income from derivative instruments, net | $ 212 | $ 93 | $ 661 | $ 1,219 |
| Credit contracts | Income from derivative instruments, net | — | 58 | 5 | 109 |
| Mortgage banking | Income from derivative instruments, net | — | 68 | 97 | 90 |
| Total undesignated | | $ 212 | $ 219 | $ 763 | $ 1,418 |

## (9.) SHAREHOLDERS' EQUITY

### Common Stock

The changes in shares of common stock were as follows for the three and nine months ended September 30, 2024 and 2023:

| | Outstanding | Treasury | Issued |
|---|---|---|---|
| **2024** | | | |
| Shares at December 31, 2023 | 15,407,406 | 692,150 | 16,099,556 |
| Restricted stock units released | 60,989 | (60,989) | — |
| Treasury stock purchases | (21,446) | 21,446 | — |
| Shares at March 31, 2024 | 15,446,949 | 652,607 | 16,099,556 |
| Restricted stock awards issued | 22,011 | (22,011) | — |
| Restricted stock forfeited | (1,000) | 1,000 | — |
| Stock awards | 4,141 | (4,141) | — |
| Restricted stock units released | 500 | (500) | — |
| Treasury stock purchases | (206) | 206 | — |
| Shares at June 30, 2024 | 15,472,395 | 627,161 | 16,099,556 |
| Restricted stock units released | 3,000 | (3,000) | — |
| Treasury stock purchases | (1,081) | 1,081 | — |
| Shares at September 30, 2024 | 15,474,314 | 625,242 | 16,099,556 |
| **2023** | | | |
| Shares at December 31, 2022 | 15,340,001 | 759,555 | 16,099,556 |
| Restricted stock units released | 58,188 | (58,188) | — |
| Treasury stock purchases | (22,710) | 22,710 | — |
| Shares at March 31, 2023 | 15,375,479 | 724,077 | 16,099,556 |
| Restricted stock awards issued | 20,185 | (20,185) | — |
| Stock awards | 5,945 | (5,945) | — |
| Restricted stock units released | 296 | (296) | — |
| Treasury stock purchases | (105) | 105 | — |
| Shares at June 30, 2023 | 15,401,800 | 697,756 | 16,099,556 |
| Restricted stock awards released | — | — | — |
| Treasury stock purchases | — | — | — |
| Shares at September 30, 2023 | 15,401,800 | 697,756 | 16,099,556 |

### Share Repurchase Programs

In June 2022, the Company's Board of Directors (the "Board") authorized a share repurchase program for up to 766,447 shares of common stock (the "2022 Share Repurchase Program"). Repurchased shares are recorded in treasury stock, at cost, which includes any applicable transaction costs. As of September 30, 2024, no shares have been repurchased under the 2022 Share Repurchase Program.

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

## (10.) ACCUMULATED OTHER COMPREHENSIVE LOSS

The following tables present the components of other comprehensive (loss) income for the three and nine months ended September 30, 2024 and 2023 (in thousands):

| | Pre-tax Amount | Tax Effect | Net-of-tax Amount |
|---|---|---|---|
| **Three months ended September 30, 2024** | | | |
| Securities available for sale and transferred securities: | | | |
| Change in unrealized loss during the period | $ 34,176 | $ 8,756 | $ 25,420 |
| Reclassification adjustment for net gains included in net income [(1)] | 13 | 3 | 10 |
| Total securities available for sale and transferred securities | 34,189 | 8,759 | 25,430 |
| Hedging derivative instruments: | | | |
| Change in unrealized gain during the period | (2,488) | (637) | (1,851) |
| Pension obligations: | | | |
| Amortization of prior service credit included in income | (134) | (34) | (100) |
| Amortization of net actuarial loss included in income | 358 | 92 | 266 |
| Total pension obligations | 224 | 58 | 166 |
| Other comprehensive income | $ 31,925 | $ 8,180 | $ 23,745 |
| **Nine months ended September 30, 2024** | | | |
| Securities available for sale and transferred securities: | | | |
| Change in unrealized loss during the period | $ 25,228 | $ 6,463 | $ 18,765 |
| Reclassification adjustment for net gains included in net income [(1)] | 40 | 10 | 30 |
| Total securities available for sale and transferred securities | 25,268 | 6,473 | 18,795 |
| Hedging derivative instruments: | | | |
| Change in unrealized gain during the period | (1,856) | (475) | (1,381) |
| Pension obligations: | | | |
| Amortization of prior service credit included in income | (402) | (103) | (299) |
| Amortization of net actuarial loss included in income | 1,073 | 276 | 797 |
| Total pension obligations | 671 | 173 | 498 |
| Other comprehensive loss | $ 24,083 | $ 6,171 | $ 17,912 |

(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.

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

**(10.) ACCUMULATED OTHER COMPREHENSIVE LOSS (Continued)**

| | Pre-tax Amount | Tax Effect | Net-of-tax Amount |
|---|---|---|---|
| **Three months ended September 30, 2023** | | | |
| Securities available for sale and transferred securities: | | | |
| Change in unrealized loss during the period | $ (36,914) | $ (9,457) | $ (27,457) |
| Reclassification adjustment for net gains included in net income [(1)] | 16 | 4 | 12 |
| Total securities available for sale and transferred securities | (36,898) | (9,453) | (27,445) |
| Hedging derivative instruments: | | | |
| Change in unrealized gain during the period | 518 | 133 | 385 |
| Pension obligations: | | | |
| Amortization of prior service credit included in income | (123) | (31) | (92) |
| Amortization of net actuarial loss included in income | 316 | 81 | 235 |
| Total pension obligations | 193 | 50 | 143 |
| Other comprehensive loss | $ (36,187) | $ (9,270) | $ (26,917) |
| **Nine months ended September 30, 2023** | | | |
| Securities available for sale and transferred securities: | | | |
| Change in unrealized loss during the period | $ (34,279) | $ (8,782) | $ (25,497) |
| Reclassification adjustment for net gains included in net income [(1)] | 51 | 13 | 38 |
| Total securities available for sale and transferred securities | (34,228) | (8,769) | (25,459) |
| Hedging derivative instruments: | | | |
| Change in unrealized gain during the period | 1,514 | 388 | 1,126 |
| Pension obligations: | | | |
| Amortization of prior service credit included in income | (368) | (94) | (274) |
| Amortization of net actuarial loss included in income | 948 | 243 | 705 |
| Total pension obligations | 580 | 149 | 431 |
| Other comprehensive income | $ (32,134) | $ (8,232) | $ (23,902) |

(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.

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

**(10.) ACCUMULATED OTHER COMPREHENSIVE LOSS (Continued)**

Activity in accumulated other comprehensive income (loss), net of tax, for the three and nine months ended September 30, 2024 and 2023 was as follows (in thousands):

| | Hedging Derivative Instruments | Securities Available for Sale and Transferred Securities | Pension and Post-retirement Obligations | Accumulated Other Comprehensive (Loss) Income |
|---|---|---|---|---|
| **Three months ended September 30, 2024** | | | | |
| Balance at beginning of period | $ 4,381 | $ (118,541) | $ (11,614) | $ (125,774) |
| Other comprehensive (loss) income before reclassifications | (1,851) | 25,420 | — | 23,569 |
| Amounts reclassified from accumulated other comprehensive income | — | 10 | 166 | 176 |
| Net current period other comprehensive (loss) income | (1,851) | 25,430 | 166 | 23,745 |
| Balance at end of period | $ 2,530 | $ (93,111) | $ (11,448) | $ (102,029) |
| **Nine months ended September 30, 2024** | | | | |
| Balance at beginning of period | $ 3,911 | $ (111,906) | $ (11,946) | $ (119,941) |
| Other comprehensive (loss) income before reclassifications | (1,381) | 18,765 | — | 17,384 |
| Amounts reclassified from accumulated other comprehensive income | — | 30 | 498 | 528 |
| Net current period other comprehensive (loss) income | (1,381) | 18,795 | 498 | 17,912 |
| Balance at end of period | $ 2,530 | $ (93,111) | $ (11,448) | $ (102,029) |
| **Three months ended September 30, 2023** | | | | |
| Balance at beginning of period | $ 5,476 | $ (126,648) | $ (13,300) | $ (134,472) |
| Other comprehensive income (loss) before reclassifications | 385 | (27,457) | — | (27,072) |
| Amounts reclassified from accumulated other comprehensive income | — | 12 | 143 | 155 |
| Net current period other comprehensive income (loss) | 385 | (27,445) | 143 | (26,917) |
| Balance at end of period | $ 5,861 | $ (154,093) | $ (13,157) | $ (161,389) |
| **Nine months ended September 30, 2023** | | | | |
| Balance at beginning of period | $ 4,735 | $ (128,634) | $ (13,588) | $ (137,487) |
| Other comprehensive income (loss) before reclassifications | 1,126 | (25,497) | — | (24,371) |
| Amounts reclassified from accumulated other comprehensive income | — | 38 | 431 | 469 |
| Net current period other comprehensive income (loss) | 1,126 | (25,459) | 431 | (23,902) |
| Balance at end of period | $ 5,861 | $ (154,093) | $ (13,157) | $ (161,389) |

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

**(10.) ACCUMULATED OTHER COMPREHENSIVE LOSS (Continued)**

The following table presents the amounts reclassified out of each component of accumulated other comprehensive (loss) income for the three and nine months ended September 30, 2024 and 2023 (in thousands):

| Details About Accumulated Other Comprehensive (Loss) Income Components | Amount Reclassified from Accumulated Other Comprehensive (Loss) Income | | Affected Line Item in the Consolidated Statement of Income |
|---|---|---|---|
| | Three months ended September 30, | | |
| | 2024 | 2023 | |
| Amortization of unrealized holding gain on investment securities transferred from available for sale to held to maturity | $ (13) | $ (16) | Interest income |
| | (13) | (16) | Total before tax |
| | 3 | 4 | Income tax expense |
| | (10) | (12) | Net of tax |
| Amortization of pension and post-retirement items: | | | |
| Prior service credit [1] | 134 | 123 | Salaries and employee benefits |
| Net actuarial losses [1] | (358) | (316) | Salaries and employee benefits |
| | (224) | (193) | Total before tax |
| | 58 | 50 | Income tax benefit |
| | (166) | (143) | Net of tax |
| Total reclassified for the period | $ (176) | $ (155) | |
| | Nine months ended September 30, | | |
| | 2024 | 2023 | |
| Amortization of unrealized holding gains on investment securities transferred from available for sale to held to maturity | $ (40) | $ (51) | Interest income |
| | (40) | (51) | Total before tax |
| | 10 | 13 | Income tax expense |
| | (30) | (38) | Net of tax |
| Amortization of pension and post-retirement items: | | | |
| Prior service credit [1] | 402 | 368 | Salaries and employee benefits |
| Net actuarial losses [1] | (1,073) | (948) | Salaries and employee benefits |
| | (671) | (580) | Total before tax |
| | 173 | 149 | Income tax benefit |
| | (498) | (431) | Net of tax |
| Total reclassified for the period | $ (528) | $ (469) | |

(1) These items are included in the computation of net periodic pension expense. See Note 12 – Employee Benefit Plans for additional information.

**(11.) SHARE-BASED COMPENSATION PLANS**

The Company maintains certain share-based compensation plans, approved by the Company's shareholders, which 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 granting 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.

**(11.) SHARE-BASED COMPENSATION PLANS (Continued)**

The Company granted restricted stock awards (“RSAs”), restricted stock unit award (“RSUs”), and performance-based restricted stock units (“PSUs”) during the nine months ended September 30, 2024 as follows:

| | Number of Underlying Shares | | Weighted Average Grant Date Fair Value |
|---|---|---|---|
| RSAs | 22,011 | $ | 17.49 |
| RSUs | 132,047 | $ | 15.56 |
| PSUs | 54,754 | $ | 15.59 |

The grant date for the RSAs granted during the nine months ended September 30, 2024 was equal to the closing market price of our common stock on the date of grant. The grant-date fair value for the RSUs and PSUs granted during the nine months ended September 30, 2024 was 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 RSAs granted during the nine months ended September 30, 2024 vested on the grant date. The remaining RSAs will vest the day before the Company’s next annual meeting. The RSUs and PSUs granted during the nine months ended September 30, 2024 will generally vest on the third anniversary of the grant date assuming the recipient’s continuous service to the Company.

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 September 30, | | | | Nine months ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2024 | | 2023 | | 2024 | | 2023 | |
| Salaries and employee benefits | $ | 450 | $ | 679 | $ | 1,485 | $ | 1,642 |
| Other noninterest expense | | 44 | | 42 | | 324 | | 287 |
| Total share-based compensation expense | $ | 494 | $ | 721 | $ | 1,809 | $ | 1,929 |
| Income tax benefit realized for compensation costs | $ | — | $ | — | $ | — | $ | 438 |

At September 30, 2024, there was $3.6 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 1.94 years.

## (12.) EMPLOYEE BENEFIT PLANS

The Company participates in a non-contributory defined benefit pension plan for certain employees who meet participation requirements. The components of the Company's net periodic benefit expense for its pension obligations were as follows (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2024 | 2023 | 2024 | 2023 |
| Service cost | $ 490 | $ 447 | $ 1,472 | $ 1,342 |
| Interest cost on projected benefit obligation | 861 | 855 | 2,583 | 2,565 |
| Expected return on plan assets | (1,004) | (878) | (3,013) | (2,634) |
| Amortization of unrecognized prior service credit | (134) | (123) | (402) | (368) |
| Amortization of unrecognized net actuarial loss | 358 | 316 | 1,073 | 948 |
| Net periodic benefit expense | $ 571 | $ 617 | $ 1,713 | $ 1,853 |

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 2024 fiscal year.

## (13.) COMMITMENTS AND CONTINGENCIES

### Financial Instruments with Off-Balance Sheet Risk

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

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

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

| | September 30, 2024 | December 31, 2023 |
|---|---|---|
| Commitments to extend credit | $ 1,238,685 | $ 1,200,617 |
| Standby letters of credit | 18,334 | 13,498 |

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.

### Unfunded Commitments

At September 30, 2024 and December 31, 2023, the allowance for credit losses for unfunded commitments totaled $3.8 million and $3.6 million, respectively, and was included in other liabilities on the Company's consolidated statements of financial condition. The credit loss (benefit) for unfunded commitments was as follows (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2024 | 2023 | 2024 | 2023 |
| Credit loss (benefit) for unfunded commitments | $ 713 | $ (426) | $ 186 | $ (129) |

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

**(13.) COMMITMENTS AND CONTINGENCIES (continued)**

**Contingent Liabilities and Litigation**

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, except for the matter described below, would not have a material adverse effect on the Company's consolidated financial statements.

As previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2023 as filed with the SEC on March 13, 2024 and as disclosed in Part II, Item 1 of this Quarterly Report on Form 10-Q, the Company is party to an action filed against it on May 16, 2017 by Matthew L. Chipego, Charlene Mowry, Constance C. Churchill and Joseph W. Ewing in the Court of Common Pleas in Philadelphia, Pennsylvania. Plaintiffs sought and were granted class certification to represent classes of consumers in New York and Pennsylvania seeking to recover statutory damages, interest and declaratory relief. The plaintiffs specifically claim that the notices the Bank sent to defaulting consumers after their vehicles were repossessed did not comply with the relevant portions of the Uniform Commercial Code in New York and Pennsylvania. The Company disputes and believes it has meritorious defenses against these claims and plans to vigorously defend itself.

On September 30, 2021, the Court granted plaintiffs' motion for class certification and certified four different classes (two classes of New York consumers and two classes of Pennsylvania consumers). There are approximately 5,200 members in the New York classes and 300 members in the Pennsylvania classes.

On September 26, 2022, the lower Court denied the plaintiffs' motion for partial summary judgment for most of the relief they seek and found that there were questions of fact as to whether the members of the class had purchased the subject vehicles for "consumer use" within the meaning of the relevant statutes. The Court also denied the Company's motion for partial summary judgment and seeking an offset in the form of recoupment reducing any liability that may be imposed against the Company by the amounts that the borrowers owe for failing to repay their motor vehicle loans, determining that the Court could not enter a judgment on recoupment – which is a set off from liability – without first determining whether there was liability.

During the July 11, 2024 pretrial conference, the Court instructed the parties to engage in further settlement of non-binding mediation discussions and set a September 11, 2024 deadline to file motions in limine and a bench trial to commence on May 5, 2025.

All depositions and document productions have been completed. Plaintiff did not file a Motion in Limine by September 11, 2024. Plaintiffs however filed a motion for partial judgment on October 8, 2024 asserting that the recoupment claims were barred because they were too distinct from the underlying claims. The Company intends to file an opposition against the motion for partial summary judgment with the Court by the November 7, 2024 deadline. The parties continue to discuss potential candidates to serve as a mediator in response to the Court's instruction that they explore further settlement or mediation discussions.

The Company has not accrued a contingent liability for this matter at this time because, given its defenses, it is unable to conclude whether a liability is probable to occur nor is it able to currently reasonably estimate the amount of potential loss.

If the Company settles these claims or the action is not resolved in its favor, the Company may suffer reputational damage and incur legal costs, settlements or judgments that exceed the amounts covered by its insurer. The Company can provide no assurances that its insurer will cover the full legal costs, settlements or judgments it incurs. If the Company is unsuccessful in defending itself from these claims or if its insurer does not cover the full amount of legal costs it incurs, the result may materially adversely affect the Company's business, results of operations and financial condition.

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

## (14.) 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. Accounting Standards Codification ("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. 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.

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

**(14.) FAIR VALUE MEASUREMENTS (Continued)**

**Loans held for sale:** The fair value of loans held for sale is determined using quoted secondary market prices and investor commitments. Loans held for sale are classified as Level 2 in the fair value hierarchy.

**Collateral dependent 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.

**Long-lived assets held for sale:** The fair value of the long-lived assets held for sale was based on estimated market prices from independently prepared current appraisals and are classified as Level 3 in the fair value hierarchy.

**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 management believes 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.

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

**(14.) 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 nonrecurring basis as of the dates indicated (in thousands).

| September 30, 2024 | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| **Measured on a recurring basis:** | | | | |
| Securities available for sale: | | | | |
| U.S. Government agency and government sponsored enterprises | $ — | $ 22,588 | $ — | $ 22,588 |
| Mortgage-backed securities | — | 855,521 | — | 855,521 |
| Other assets: | | | | |
| Other debt securities | — | 8,707 | — | — |
| Hedging derivative instruments | — | 4,097 | — | 4,097 |
| Other liabilities: | | | | |
| Hedging derivative instruments | — | 31 | — | 31 |
| **Fair value adjusted through comprehensive income** | $ — | $ 890,944 | $ — | $ 882,237 |
| Other assets: | | | | |
| Derivative instruments – interest rate swaps | — | 31,597 | — | 31,597 |
| Derivative instruments – mortgage banking | — | 159 | — | 159 |
| Other liabilities: | | | | |
| Derivative instruments – interest rate swaps | — | (31,600) | — | (31,600) |
| Derivative instruments – mortgage banking | — | (14) | — | (14) |
| **Fair value adjusted through net income** | $ — | $ 142 | $ — | $ 142 |
| **Measured on a nonrecurring basis:** | | | | |
| Loans: | | | | |
| Loans held for sale | $ — | $ 2,495 | $ — | $ 2,495 |
| Collateral dependent loans | — | — | 58,009 | 58,009 |
| Other assets: | | | | |
| Long-lived assets held for sale | — | — | 629 | 629 |
| Loan servicing rights | — | — | 1,430 | 1,430 |
| Other real estate owned | — | — | 109 | 109 |
| Total | $ — | $ 2,495 | $ 60,177 | $ 62,672 |

There were no transfers between Levels 1 and 2 during the nine months ended September 30, 2024. There were no liabilities measured at fair value on a nonrecurring basis during the nine months ended September 30, 2024.

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

**(14.) 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, 2023** | | | | |
| **Measured on a recurring basis:** | | | | |
| Securities available for sale: | | | | |
| U.S. Government agencies and government sponsored enterprises | $ — | $ 21,811 | $ — | $ 21,811 |
| Mortgage-backed securities | — | 865,919 | — | 865,919 |
| Other assets: | | | | |
| Hedging derivative instruments | — | 5,939 | — | 5,939 |
| **Fair value adjusted through comprehensive income** | $ — | $ 893,669 | $ — | $ 893,669 |
| Other assets: | | | | |
| Derivative instruments – interest rate products | $ — | $ 37,517 | $ — | $ 37,517 |
| Derivative instruments – mortgage banking | — | 50 | — | 50 |
| Other liabilities: | | | | |
| Derivative instruments – interest rate products | — | (37,519) | — | (37,519) |
| Derivative instruments – mortgage banking | — | (2) | — | (2) |
| **Fair value adjusted through net income** | $ — | $ 46 | $ — | $ 46 |
| **Measured on a nonrecurring basis:** | | | | |
| Loans: | | | | |
| Loans held for sale | $ — | $ 1,370 | $ — | $ 1,370 |
| Collateral dependent loans | — | — | 37,516 | 37,516 |
| Other assets: | | | | |
| Long-lived assets held for sale | — | — | 629 | 629 |
| Loan servicing rights | — | — | 1,382 | 1,382 |
| Other real estate owned | — | — | 142 | 142 |
| Total | $ — | $ 1,370 | $ 39,669 | $ 41,039 |

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 September 30, 2024 (dollars in thousands).

| Asset | Fair Value | Valuation Technique | Unobservable Input | Unobservable Input Value or Range |
|---|---|---|---|---|
| Collateral dependent loans | $ 58,009 | Appraisal of collateral (1) | Appraisal adjustments (2) | 30.9%(3) / 0 - 77.36% |
| Loan servicing rights | $ 1,430 | Discounted cash flow | Discount rate | 10.4% (3) |
| | | | Constant prepayment rate | 12.5% (3) |
| Long-lived assets held for sale | $ 629 | Appraisal of collateral (1) | Appraisal adjustments (2) | 27.9% |
| Other real estate owned | $ 109 | Appraisal of collateral (1) | Appraisal adjustments (2) | 39.0 - 47.7% |

(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.

**(14.) FAIR VALUE MEASUREMENTS (Continued)**

**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 nine months ended September 30, 2024 and 2023.

**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. Fair value estimates for other financial instruments not included elsewhere in this disclosure are discussed below.

**Securities held to maturity:** The fair value of the Company’s investment securities held to maturity is primarily measured using information from a third-party pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond’s terms and conditions, among other things.

**Loans:** The fair value of the Company’s loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made for the same remaining maturities. Loans were first segregated by type, such as commercial, residential mortgage, and consumer, and were then further segmented into fixed and variable rate and loan quality categories. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

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

**Long-term borrowings:** Long-term borrowings consist of $75 million of subordinated notes and $50 million of long-term borrowings from the FHLB. The subordinated notes are publicly traded and are valued based on market prices, which are characterized as Level 2 liabilities in the fair value hierarchy. The FHLB borrowings are valued using discounted cash flows based on current market rates for borrowings with similar remaining maturities and are characterized as Level 2 liabilities in the fair value hierarchy.

**(14.) FAIR VALUE MEASUREMENTS (Continued)**

The following table 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 | September 30, 2024 | | December 31, 2023 | |
|---|---|---|---|---|---|
| | | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| **Financial assets:** | | | | | |
| Cash and cash equivalents | Level 1 | $ 249,569 | $ 249,569 | $ 124,442 | $ 124,442 |
| Securities available for sale | Level 2 | 886,816 | 886,816 | 887,730 | 887,730 |
| Securities held to maturity, net | Level 2 | 121,279 | 112,613 | 148,156 | 137,030 |
| Loans held for sale | Level 2 | 2,495 | 2,495 | 1,370 | 1,370 |
| Loans | Level 2 | 4,300,302 | 4,153,946 | 4,373,541 | 4,143,918 |
| Loans [(1)] | Level 3 | 58,009 | 58,009 | 37,516 | 37,516 |
| Long-lived assets held for sale | Level 3 | 629 | 629 | 629 | 629 |
| Accrued interest receivable | Level 1 | 23,702 | 23,702 | 24,481 | 24,481 |
| Derivative instruments – cash flow hedges | Level 2 | 4,097 | 4,097 | 5,939 | 5,939 |
| Derivative instruments – interest rate products | Level 2 | 31,597 | 31,597 | 37,517 | 37,517 |
| Derivative instruments – mortgage banking | Level 2 | 159 | 159 | 50 | 50 |
| FHLB and FRB stock | Level 2 | 16,186 | 16,186 | 17,406 | 17,406 |
| **Financial liabilities:** | | | | | |
| Non-maturity deposits | Level 1 | 3,799,837 | 3,799,837 | 3,808,216 | 3,808,216 |
| Time deposits | Level 2 | 1,506,764 | 1,505,625 | 1,404,696 | 1,398,352 |
| Short-term borrowings | Level 1 | 55,000 | 55,000 | 185,000 | 185,000 |
| Long-term borrowings | Level 2 | 124,765 | 130,209 | 124,532 | 128,363 |
| Accrued interest payable | Level 1 | 27,453 | 27,453 | 19,412 | 19,412 |
| Derivative instruments – cash flow hedges | Level 2 | 31 | 31 | — | — |
| Derivative instruments – interest rate products | Level 2 | 31,600 | 31,600 | 37,519 | 37,519 |
| Derivative instruments – mortgage banking | Level 2 | 14 | 14 | 2 | 2 |

(1) Comprised of collateral dependent loans.

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

### (15.) SEGMENT REPORTING

The Company has one reportable segment, Banking, which includes all the Company's retail and commercial banking operations. This reportable segment has been identified and organized based on the nature of the underlying products and services applicable to the 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.

All other segments that do not meet the quantitative threshold for separate reporting have been grouped as "All Other," which include the activities of SDN and Courier Capital for the period ending December 31, 2023. On April 1, 2024, the Company announced and closed on the sale of the assets of its wholly owned subsidiary, SDN. See Note 1. Basis of Presentation and Summary of Significant Accounting Policies for further details on the sale of SDN. Courier Capital is our investment advisor and wealth management firm that offers customized investment management, financial planning and consulting services to individuals and families, businesses, institutions, non-profits and retirement plans. Also included in "All Other" are Holding Company amounts, which are the primary differences between segment amounts and consolidated totals, 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 | All Other | Consolidated Totals |
|---|---|---|---|
| **September 30, 2024** | | | |
| Goodwill | $ 48,536 | $ 9,585 | $ 58,121 |
| Other intangible assets, net | — | 2,746 | 2,746 |
| Total assets | 6,126,603 | 29,714 | 6,156,317 |
| **December 31, 2023** | | | |
| Goodwill | $ 48,536 | $ 18,535 | $ 67,071 |
| Other intangible assets, net | — | 5,433 | 5,433 |
| Total assets | 6,117,748 | 43,133 | 6,160,881 |

| | Banking | All Other | Consolidated Totals |
|---|---|---|---|
| **Three months ended September 30, 2024** | | | |
| Net interest income (expense) | $ 41,741 | $ (1,060) | $ 40,681 |
| Provision for credit losses | (3,104) | — | (3,104) |
| Noninterest income | 6,848 | 2,592 | 9,440 |
| Noninterest expense | (29,940) | (2,529) | (32,469) |
| Income before income taxes | 15,545 | (997) | 14,548 |
| Income tax expense (benefit) | (1,336) | 254 | (1,082) |
| Net income | $ 14,209 | $ (743) | $ 13,466 |
| **Nine months ended September 30, 2024** | | | |
| Net interest income (expense) | $ 125,137 | $ (3,181) | $ 121,956 |
| Benefit for credit losses | 311 | — | 311 |
| Noninterest income | 21,333 | 23,022 | 44,355 |
| Noninterest expense | (110,075) | (9,427) | (119,502) |
| Income before income taxes | 36,706 | 10,414 | 47,120 |
| Income tax expense | (3,080) | (2,875) | (5,955) |
| Net income | $ 33,626 | $ 7,539 | $ 41,165 |

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

**(15.) SEGMENT REPORTING (Continued)**

| | Banking | All Other | Consolidated Totals |
|---|---|---|---|
| **Three months ended September 30, 2023** | | | |
| Net interest income (expense) | $ 42,738 | $ (1,061) | $ 41,677 |
| Provision for credit losses | (966) | — | (966) |
| Noninterest income | 6,649 | 3,837 | 10,486 |
| Noninterest expense | (31,328) | (3,407) | (34,735) |
| Income (loss) before income taxes | $ 17,093 | $ (631) | $ 16,462 |
| Income tax (expense) benefit | (2,660) | 220 | (2,440) |
| Net income (loss) | $ 14,433 | $ (411) | $ 14,022 |
| **Nine months ended September 30, 2023** | | | |
| Net interest income (expense) | $ 129,010 | $ (3,181) | $ 125,829 |
| Provision for credit losses | (8,410) | — | (8,410) |
| Noninterest income | 20,522 | 12,354 | 32,876 |
| Noninterest expense | (91,072) | (11,106) | (102,178) |
| Income (loss) before income taxes | $ 50,050 | $ (1,933) | $ 48,117 |
| Income tax (expense) benefit | (8,169) | 536 | (7,633) |
| Net income | $ 41,881 | $ (1,397) | $ 40,484 |

## 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, 2023. 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" or "FII") 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," "continue," "anticipate," "estimate," "expect," "intend," "plan," "target," "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, 2023 (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:

- Fluctuations in market interest rates may affect our interest margins and income, demand for our products, defaults on loans, loan prepayments and the fair value of our financial instruments;
- Environmental, social and governance matters, and any related reporting obligations may impact our business;
- If we experience greater credit losses than anticipated, earnings may be adversely impacted;
- We are subject to risks and losses resulting from fraudulent activities that could adversely impact our financial performance and results of operations;
- Geographic concentration in our loan portfolio 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 are subject to environmental liability risk associated with our lending activities;
- We operate in a highly competitive industry and market area;
- Legal and regulatory proceedings and related matters, such as the action brought by a class of consumers against us as described in Part I, Item 3, "Legal Proceedings," could adversely affect us and the banking industry in general;
- 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;
- We are subject to the CRA and fair lending laws, and failure to comply with these laws could lead to material penalties;
- The policies of the Federal Reserve have a significant impact on our earnings;
- Our investment advisory and wealth management operations are subject to risk related to the regulation of the financial services industry and market volatility;
- We make certain assumptions and estimates in preparing our financial statements that may prove to be incorrect, which could significantly impact the results of our 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;
- The value of our goodwill and other intangible assets may decline in the future;
- We may be unable to successfully implement our growth strategies, including the integration and successful management of newly acquired businesses;
- The introduction of new products and services may subject us to increased regulation and regulatory scrutiny and may affect our reputation;
- Acquisitions may disrupt our business and dilute shareholder value;
- Our tax strategies and the value of our deferred tax assets and liabilities could adversely affect our operating results and regulatory capital ratios;

- Liquidity is essential to our businesses;
- We rely on dividends from our subsidiaries for most of our revenue;
- 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;
- The soundness of other financial institutions could adversely affect us;
- 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;
- The market price of our common stock may fluctuate significantly in response to a number of factors;
- We may not be able to attract and retain skilled people;
- We use financial models for business planning purposes that may not adequately predict future results;
- We depend on the accuracy and completeness of information about or from customers and counterparties;
- Our business may be adversely affected by conditions in the financial markets and economic conditions generally, including macroeconomic pressures such as inflation, supply chain issues, and geopolitical risks associated with international conflict; and
- Severe weather, natural disasters, public health emergencies and pandemics, acts of war or terrorism, and other external events could significantly impact our business.

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 Annual Report on Form 10-K for the year ended December 31, 2023. 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 operating subsidiaries, Five Star Bank (the “Bank”) and Courier Capital, LLC (“Courier 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. The Bank also has commercial loan production offices in Ellicott City (Baltimore), Maryland, and Syracuse, New York, serving the Mid-Atlantic and Central New York regions. Our indirect lending network includes relationships with franchised automobile dealers in Western and Central New York, and the Capital District of New York. Effective January 1, 2024, we exited the Pennsylvania automobile market to align our focus more fully around our core Upstate New York market. Courier Capital provides customized investment advice, wealth management, investment consulting and retirement plan services to individuals, businesses, institutions, foundations and retirement plans.

On April 1, 2024, the Company announced and closed the sale of the assets of its wholly owned subsidiary, SDN Insurance Agency, LLC (“SDN”), which provided a broad range of insurance services to personal and business clients, to NFP Property & Casualty Services, Inc. (“NFP”), a subsidiary of NFP Corp. The sale generated $27 million in proceeds, or a pre-tax gain of $13.7 million, after selling costs, of which $13.5 million was recognized in the second quarter of 2024. The all-cash transaction value represented approximately four times our 2023 insurance revenue. Following the sale of the assets of SDN, we changed the name of the entity to Five Star Advisors LLC and expect to utilize it to serve as a conduit to refer insurance business to NFP.

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 investment advisory and financial services provided to customers or ancillary services tied to loans and deposits, fees and other revenue from insurance, prior to the sale of the assets of SDN. 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 the results of our 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 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 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, and wealth management products typically found at larger banks, our highly experienced management team and our strategically located banking centers.

We prioritize customer acquisition through cost-effective, high-demand digital, virtual and physical channels, while maintaining a community bank distinctiveness relative to larger banks and digital-only neobanks. We leverage the retail branch network and customer contact center to build trust and credibility, provide personal financial education and advice, offer convenience, and bridge digital and physical channels. Our enhanced digital capabilities complement a continued focus on a consistent customer experience and engagement across physical and virtual channels, including using branches to create deeper engagement and relationships with customers, balancing customer engagement with efficiency opportunities (e.g., framing outreach to the customer contact center to teach customers how to use digital channels, in addition to addressing the reason for the call), and maintaining and expanding our customer reach digitally, physically or virtually. By employing digital channels across our current products and services, we deepen existing relationships and enter new geographies or market segments that would otherwise be prohibitively expensive targets using traditional approaches. Deepening our existing digital capabilities allows us to capitalize on a shift in customer preferences away from physical branches. On September 16, 2024, we announced our intent to begin an orderly wind down of our BaaS offerings, following a careful review by the Company's executive management and Board of Directors undertaken in conjunction with its annual strategic planning process.

We have evolved to meet changing customer needs by offering complementary physical, digital and virtual channels. We focus on technology to provide solutions that fit our customers' preferences for transacting business with us. Branches are staffed by certified personal bankers who are trained to meet a broad array of customer needs. Our digital banking capabilities, interactive teller machine ("ITM") functionality and Customer Contact Center provide additional self-serve and phone options through which customer needs are met effectively.

We will continue to explore market expansion opportunities that complement current market areas as opportunities arise. Our primary focus will be on increasing the Bank's market share within existing markets, while taking advantage of potential growth opportunities within our noninterest income lines of business by acquiring businesses that can be incorporated into existing operations. We believe our capital position remains strong enough to support an active merger and acquisition strategy and the expansion of our core financial service businesses. Consequently, we continue to explore acquisition opportunities in these activities. When evaluating acquisition opportunities, we will balance the potential for earnings accretion with maintaining adequate capital levels, which could result in our common stock being the predominant form of consideration and/or the need for us to raise capital.

Conversations with potential strategic partners occur on a regular basis. The evaluation of any potential opportunity will favor a transaction that complements our core competencies and strategic intent, with a lesser emphasis being placed on geographic location or size. Additionally, we remain committed to maintaining a diversified revenue stream. Our senior management team has experience in acquisitions and post-acquisition integration of operations and is prepared to act promptly should a potential opportunity arise but will remain disciplined with its approach. We believe this experience positions us to successfully acquire and integrate additional financial services and banking businesses.

**Cannabis Banking**

The Marijuana Regulation and Taxation Act was signed into law on March 31, 2021, legalizing the possession and sale of recreational marijuana in New York State for adults aged 21 or older and the state has issued adult-use cannabis cultivation, processing and retail dispensary licenses. We have implemented a program to provide financial products and services to legal cannabis-related businesses and partner with other financial institutions who provide such services.

Offering financial products and services to the cannabis industry presents a unique set of regulatory risks due to the conflict between state and federal laws, as marijuana remains illegal at the federal level. In January 2018, the U.S. Department of Justice (the "DOJ") rescinded the "Cole Memo" and related memoranda which characterized the enforcement of the Controlled Substances Act against persons and entities complying with state regulatory systems permitting the use, manufacture and sale of medical marijuana as an inefficient use of their prosecutorial resources and discretion. The impact of the DOJ's rescission of the Cole Memo and related memoranda is unclear, but in the future may result in increased enforcement actions against the regulated cannabis industry generally. More recently, the United States Attorney General has indicated that the DOJ, under his leadership, does not intend to pursue cases against parties who comply with the laws in states which have legalized and are effectively regulating marijuana. However, enforcement policies and practices may be highly variable between political administrations. In addition, federal prosecutors have significant discretion and there can be no assurance that the federal prosecutor for any district in which we operate will not choose to strictly enforce the federal laws governing cannabis. In the future, enforcement actions may be taken against cannabis-related businesses or financial services providers that are viewed as aiding and abetting such activities.

The Financial Crimes Enforcement Network ("FinCEN") published guidelines in 2014 for financial institutions servicing state-legal cannabis businesses. These guidelines were issued for the explicit purpose so "that financial institutions can provide services to marijuana-related businesses in a manner consistent with their obligations to know their customers and to report possible criminal activity." The Bank has and will continue to follow this and other FinCEN guidance in the areas of cannabis banking.

## EXECUTIVE OVERVIEW

### Recent Events

On September 16, 2024, we announced our intent to begin an orderly wind down of our BaaS offerings, following a careful review by the executive management and Board of Directors undertaken in conjunction with our annual strategic planning process. As of September 30, 2024, deposits and loans related to the Bank's BaaS offerings totaled $103 million and $29 million, respectively. We continue to preliminarily target completion of the wind down sometime in 2025.

### Summary of 2024 Third Quarter Results

Net income decreased $556 thousand to $13.5 million for the third quarter of 2024 compared to $14.0 million for the third quarter of 2023. Net income available to common shareholders for the third quarter of 2024 was $13.1 million, or $0.84 per diluted share, compared with $13.7 million, or $0.88 per diluted share, for the third quarter of 2023. Return on average common equity was 11.18% and return on average assets was 0.89% for the third quarter of 2024 compared to 13.15% and 0.92%, respectively, for the third quarter of 2023. Third quarter 2024 results included $384 thousand of professional services expenses attributed to the deposit-related fraud event disclosed in March 2024 that occurred in the first quarter of 2024. We continue to aggressively pursue our legal rights and seek any and all recovery avenues to minimize the fraud loss.

Net interest income totaled $40.7 million in the third quarter of 2024, a decrease of $1.0 million compared to $41.7 million in the third quarter of 2023. Average interest-earning assets for the third quarter of 2024 were $92.4 million lower than the third quarter of 2023 due to an $83.5 million decrease in average investment securities, and a $13.2 million decrease in the average balance of Federal Reserve interest-earning cash, partially offset by a $4.3 million increase in average loans. Average interest-bearing liabilities for the third quarter of 2024 were $27.2 million lower than the third quarter of 2023 due to a $93.4 million decrease in average borrowings, a $75.2 million decrease in average interest-bearing demand deposits and a $48.3 million decrease in average time deposits, partially offset by a $189.7 million increase in average savings and money market account deposits.

Net interest margin was 2.89% for the third quarter of 2024 compared to 2.91% in the third quarter of 2023, primarily due to higher funding costs amid the current high interest rate environment, offset by an increase in the average yield on interest-earning assets.

The provision for credit losses was $3.1 million in the third quarter of 2024 compared to a provision for credit losses of $1.0 million in the third quarter of 2023. The provision for credit losses for the third quarter of 2024 was primarily driven by a combination of factors, including a slight increase in the national unemployment forecast and higher qualitative factors overall, partially offset by a lower loan balance. Net charge-offs during the recent quarter were $1.7 million, representing 0.15% of average loans on an annualized basis, compared to $1.6 million, or an annualized 0.14% of average loans, in the third quarter of 2023. 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 provision for credit losses and net charge-offs.

Noninterest income totaled $9.4 million in the third quarter of 2024, compared to $10.5 million in the third quarter of 2023. The sale of the assets of our insurance subsidiary in April 2024 resulted in a decrease in insurance income of $1.7 million compared to the third quarter of 2023. Partially offsetting this decrease were increases of $377 thousand in company owned life insurance income, due to the higher crediting rate and associated impact to cash surrender value related to the surrender and redeploy strategy executed in the fourth quarter of 2023, and $253 thousand in investment advisory income largely due to market-driven increases in assets under management.

Noninterest expense totaled $32.5 million in the third quarter of 2024, compared to $34.7 million in the third quarter of 2023. The decrease in noninterest expense for the third quarter of 2024 was primarily attributable to a decrease in salaries and employee benefits expense of $2.3 million as a result of the sale of the assets of our insurance subsidiary, and the previously disclosed fourth quarter 2023 leadership and organizational changes, which reduced salaries and wages expense, $421 thousand in occupancy and equipment expense due in part to the timing of equipment purchases, and $414 thousand in other expenses. These decreases were partially offset by an $889 thousand increase in professional services expense, due primarily to legal expenses related to the previously disclosed deposit fraud-related event.

The regulatory Tier 1 Capital Ratio and Total Risk-Based Capital Ratio were 10.62%, and 12.95%, respectively, at September 30, 2024. 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.

## RESULTS OF OPERATIONS

### Net Interest Income and Net Interest Margin

Net interest income is our primary source of revenue, comprising approximately 81% and 73% of revenue during the three and nine months ended September 30, 2024, respectively. 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 interest-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 interest-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 September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2024 | 2023 | 2024 | 2023 |
| Interest income per consolidated statements of income | $ 77,911 | $ 74,700 | $ 235,112 | $ 209,586 |
| Adjustment to fully taxable equivalent basis | 65 | 93 | 232 | 327 |
| Interest income adjusted to a fully taxable equivalent basis | 77,976 | 74,793 | 235,344 | 209,913 |
| Interest expense per consolidated statements of income | 37,230 | 33,023 | 113,156 | 83,757 |
| Net interest income on a taxable equivalent basis | $ 40,746 | $ 41,770 | $ 122,188 | $ 126,156 |

***Analysis of Net Interest Income for the Three Months Ended September 30, 2024 and 2023***

Net interest income on a taxable equivalent basis for the three months ended September 30, 2024, was $40.7 million, a decrease of $1.0 million versus the comparable quarter last year of $41.8 million. The decrease in net interest income was primarily due to higher funding costs amid the current high interest rate environment.

Our net interest margin for the third quarter of 2024 was 2.89%, 2-basis points lower than 2.91% for the same period in 2023 due to higher funding costs as a result of the continued high interest rate environment, offset by an increase in the average yield on interest-earning assets.

For the third quarter of 2024, the average yield on average interest earning assets of 5.53% was 32-basis points higher than the third quarter of 2023 of 5.21% primarily due to an increase in market interest rates. Average loan yields increased 27-basis points during the third quarter of 2024 to 6.42% from 6.15% for the third quarter of 2023, and the average yield on investment securities increased 26-basis points during the third quarter of 2024 to 2.14% from 1.88% for the third quarter of 2023. Overall, the average interest rate changes increased interest income by $3.8 million and volume variance decreased interest income by $578 thousand during the third quarter of 2024, which collectively drove a favorable variance of $3.2 million.

Average interest-earning assets were $5.61 billion for the third quarter of 2024 compared to $5.70 billion for the third quarter of 2023, a decrease of $92.4 million, or 2%, from the comparable quarter last year, with a decrease in average securities of $83.5 million from $1.23 billion for the third quarter of 2023 to $1.15 billion for the third quarter of 2024, and a $13.2 million decrease in average Federal Reserve interest-earning cash, partially offset by an increase in average loans of $4.3 million from $4.41 billion for the third quarter of 2023 to $4.42 billion for the third quarter of 2024. Average loans comprised 79% of average interest-earning assets during the third quarter of 2024 compared to 77% during the third quarter of 2023. The increase in average loans was primarily due to organic growth in commercial mortgages and stability in residential loans. Loans generally have significantly higher yields compared to other interest-earning assets and, as such, have a more positive effect on the net interest margin. The average yield on average loans was 6.42% for the third quarter of 2024, an increase of 27-basis points compared to 6.15% for the comparable quarter in 2023 due to the impact of the higher market interest rates. Interest rate changes on average loans increased interest income by $2.9 million. Average investment securities represented 20% of average interest-earning assets during the third quarter of 2024 compared to 22% during the third quarter of 2023. The decrease in average investment securities was primarily due to maturities of investment securities, and the use of cash to fund loan originations and reduce short-term borrowings.

For the third quarter of 2024, the average cost of average interest-bearing liabilities of 3.37% was 41-basis points higher than the third quarter of 2023. The average cost of interest-bearing deposits of 3.34% was 50-basis points higher than the third quarter of 2023 due to the continued repricing of deposits at higher interest rates. The average cost of total borrowings decreased 55-basis points to 3.80% in the third quarter of 2024, compared to 4.35% in the third quarter of 2023. The reduction in the cost of total borrowings was driven by a wholesale mix shift, with a lower level of outstanding balances, and the benefit of the Bank's cash flow hedging program.

Average interest-bearing liabilities were $4.40 billion for the third quarter of 2024, compared to $4.43 billion for the third quarter of 2023, a decrease of $27.2 million, or 1%, driven by the $93.7 million decrease in the average balance of short-term borrowings, partially offset by a $66.2 million increase in average interest-bearing deposits. On average, interest-bearing deposits grew from $4.08 billion for the third quarter of 2023 to $4.15 billion for the current quarter while noninterest-bearing demand deposits (a principal component of net free funds) decreased $69.5 million to $953.0 million for the third quarter of 2024. The increase in average interest-bearing deposits was due to growth in average non-public and public deposits, partially offset by decreases in average brokered and reciprocal deposits. For further discussion of our reciprocal and brokered deposits, refer to the "Funding Activities – Deposits" section of this Management's Discussion and Analysis. The decrease in noninterest-bearing demand deposits was due to the interest rate environment driving customers to higher interest bearing accounts. Overall, interest-bearing deposit rate changes resulted in a $5.0 million increase in interest expense, and volume changes resulted in a $593 thousand increase in interest expense during the third quarter of 2024 as compared to the prior year quarter. A decrease in average short-term borrowings decreased interest expense by $760 thousand, and a decrease in interest rates on short-term borrowings decreased interest expense by $619 thousand during the third quarter of 2024.

***Analysis of Net Interest Income for the Nine Months Ended September 30, 2024 and 2023***

Net interest income on a taxable equivalent basis for the nine months ended September 30, 2024, was $122.2 million, a decrease of $4.0 million versus the comparable period in 2023 of $126.2 million. The decrease in net interest income was primarily due to higher funding costs amid the current high interest rate environment.

Our net interest margin for the nine months ended September 30, 2024 was 2.85%, 14-basis points lower than 2.99% for the same period in 2023 due to higher funding costs as a result of the continued high interest rate environment, partially offset by an increase in the average yield on interest-earning assets.

For the nine months ended September 30, 2024, the average yield on average interest earning assets of 5.49% was 51-basis points higher than the nine months ended September 30, 2023 of 4.98%. The average yield on loans increased 49-basis points during the nine months ended September 30, 2024, to 6.39% from 5.90% for the comparable period last year. The average yield on investment securities increased 25-basis points to 2.14% for the nine months ended September 30, 2024 compared to 1.89% for the nine months ended September 30, 2023. Overall, the impact of the interest rate increases in 2023 and 2024 has a positive impact on yields, increasing interest income by $18.0 million, while volume variances in average interest-earning assets and average interest-bearing liabilities increased net interest income by $7.4 million during the nine months ended September 30, 2024.

Average interest-earning assets were $5.73 billion for the nine months ended September 30, 2024 compared to $5.63 billion for the nine months ended September 30, 2023, an increase of $98.9 million, or 2%, with average loans up $150.2 million from $4.29 billion for the nine months ended September 30, 2023 to $4.44 billion for the nine months ended September 30, 2024, and a $40.7 million increase in average Federal Reserve interest-earning cash, partially offset by a decrease in average investment securities of $92.0 million from $1.27 billion for the nine months ended September 30, 2023 to $1.17 billion for the nine months ended September 30, 2024. Average investment securities represented 21% of average interest-earning assets during the nine months ended September 30, 2024 compared to 23% during the nine months ended September 30, 2023. The decrease in average investment securities was primarily due to maturities of investment securities, and the use of cash to fund loan originations and reduce short-term borrowings. Loans comprised 78% of average interest-earning assets during the nine months ended September 30, 2024 compared to 76% during the nine months ended September 30, 2023. The increase in average loans was primarily due to organic growth in commercial mortgages and residential real estate loans, partially offset by a decrease in consumer indirect loans. Loans generally have significantly higher yields compared to other interest-earning assets and, as such, have a more positive effect on the net interest margin. Higher interest rates on loans increased interest income by $15.4 million, and an increase in the volume of average loans resulted in a $7.4 million increase in interest income.

For the nine months ended September 30, 2024, the average cost of average interest-bearing liabilities of 3.34% was 77-basis points higher than the average cost of 2.57% for the nine months ended September 30, 2023, with the average cost of average interest-bearing deposits of 3.31% increasing 89-basis points from 2.42% for the nine months ended September 30, 2023 due to the higher interest rate environment that began in 2023 and continued into 2024.

Average interest-bearing liabilities of $4.52 billion in the nine months ended September 30, 2024 were $170.1 million, or 3.9%, higher than the nine months ended September 30, 2023. The increase was driven by an increase in average interest-bearing deposits, partially offset by a decrease in total average borrowings. On average, interest-bearing deposits increased $238.3 million from $4.01 billion for the nine months ended September 30, 2023 to $4.25 billion for the current period, while noninterest-bearing demand deposits (a principal component of net free funds) decreased $83.4 million to $955.4 million for the nine months ended September 30, 2024 as compared to the prior year period. Total average borrowings decreased to $274.2 million for the current period, down $68.2 million from the nine months ended September 30, 2023, as deposit growth enabled us to pay down short-term borrowings. The increase in average deposits was primarily due to growth in non-public, reciprocal, and public deposits, partially offset by a decrease in brokered deposits. 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 changes resulted in a $27.1 million increase in interest expense and volume changes contributed $5.5 million during the nine months ended September 30, 2024, primarily due to the higher interest rate environment.

The following tables set 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 (dollars in thousands). Average balances were derived from daily balances.

| | Three months ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2024 | | | 2023 | | |
| | Average Balance | Interest | Average Rate [3] | Average Balance | Interest | Average Rate [3] |
| **Interest-earning assets:** | | | | | | |
| Federal funds sold and interest-earning deposits | $ 49,476 | $ 606 | 4.88 % | $ 62,673 | $ 723 | 4.58 % |
| Investment securities [1]: | | | | | | |
| Taxable | 1,107,180 | 5,841 | 2.11 | 1,166,649 | 5,350 | 1.83 |
| Tax-exempt [2] | 39,872 | 310 | 3.11 | 63,941 | 447 | 2.79 |
| Total investment securities | 1,147,052 | 6,151 | 2.14 | 1,230,590 | 5,797 | 1.88 |
| Loans: | | | | | | |
| Commercial business | 673,830 | 13,066 | 7.71 | 712,224 | 13,356 | 7.44 |
| Commercial mortgage | 2,092,905 | 35,428 | 6.73 | 1,977,978 | 33,336 | 6.69 |
| Residential real estate loans | 647,844 | 6,619 | 4.09 | 621,074 | 5,864 | 3.78 |
| Residential real estate lines | 75,671 | 1,507 | 7.91 | 75,847 | 1,444 | 7.55 |
| Consumer indirect | 881,133 | 13,829 | 6.24 | 989,614 | 13,662 | 5.48 |
| Other consumer | 43,789 | 770 | 7.00 | 34,086 | 611 | 7.11 |
| Total loans [4] | 4,415,172 | 71,219 | 6.42 | 4,410,823 | 68,273 | 6.15 |
| Total interest-earning assets | 5,611,700 | 77,976 | 5.53 | 5,704,086 | 74,793 | 5.21 |
| Less: Allowance for credit losses | (45,066 ) | | | (50,868 ) | | |
| Other noninterest-earning assets | 451,756 | | | 420,435 | | |
| Total assets | $ 6,018,390 | | | $ 6,073,653 | | |
| **Interest-bearing liabilities:** | | | | | | |
| Deposits: | | | | | | |
| Interest-bearing demand | $ 691,412 | $ 1,833 | 1.05 % | $ 766,636 | $ 1,607 | 0.83 % |
| Savings and money market | 1,938,935 | 14,983 | 3.07 | 1,749,202 | 11,048 | 2.51 |
| Time deposits | 1,515,745 | 17,987 | 4.72 | 1,564,035 | 16,562 | 4.20 |
| Total interest-bearing deposits | 4,146,092 | 34,803 | 3.34 | 4,079,873 | 29,217 | 2.84 |
| Short-term borrowings | 129,130 | 857 | 2.64 | 222,871 | 2,235 | 3.98 |
| Long-term borrowings | 124,717 | 1,570 | 5.03 | 124,407 | 1,571 | 5.05 |
| Total borrowings | 253,847 | 2,427 | 3.80 | 347,278 | 3,806 | 4.35 |
| Total interest-bearing liabilities | 4,399,939 | 37,230 | 3.37 | 4,427,151 | 33,023 | 2.96 |
| Noninterest-bearing demand deposits | 952,970 | | | 1,022,423 | | |
| Other noninterest-bearing liabilities | 182,203 | | | 194,914 | | |
| Shareholders’ equity | 483,278 | | | 429,165 | | |
| Total liabilities and shareholders’ equity | $ 6,018,390 | | | $ 6,073,653 | | |
| Net interest income (tax-equivalent) | | $ 40,746 | | | $ 41,770 | |
| Interest rate spread | | | 2.16 % | | | 2.25 % |
| Net earning assets | $ 1,211,761 | | | $ 1,276,935 | | |
| Net interest margin (tax-equivalent) | | | 2.89 % | | | 2.91 % |
| Ratio of average interest-earning assets to average interest-bearing liabilities | | | 127.54 % | | | 128.84 % |

(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%.

(3) Annualized.

(4) Loans include net unearned income, net deferred loan fees and costs and non-accruing loans. Net deferred loan fees (costs) included in interest income were as follows (in thousands):

| | Three months ended September 30, 2024 | Three months ended September 30, 2023 |
|---|---|---|
| Commercial business | $ 135 | $ (29) |
| Commercial mortgage | 506 | 572 |
| Residential real estate loans | (408) | (414) |
| Residential real estate lines | (99) | (99) |
| Consumer indirect | (865) | (997) |
| Other consumer | 11 | 8 |
| Total | $ (720) | $ (959) |

| | Nine months ended September 30, 2024 Average Balance | 2024 Interest | 2024 Average Rate [3] | 2023 Average Balance | 2023 Interest | 2023 Average Rate [3] |
|---|---|---|---|---|---|---|
| **Interest-earning assets:** | | | | | | |
| Federal funds sold and interest-earning deposits | $ 113,656 | $ 4,303 | 5.06 % | $ 72,977 | $ 2,526 | 4.63 % |
| Investment securities [1]: | | | | | | |
| Taxable | 1,124,653 | 17,710 | 2.10 | 1,190,631 | 16,402 | 1.84 |
| Tax-exempt [2] | 50,197 | 1,104 | 2.93 | 76,201 | 1,563 | 2.73 |
| Total investment securities | 1,174,850 | 18,814 | 2.14 | 1,266,832 | 17,965 | 1.89 |
| Loans: | | | | | | |
| Commercial business | 700,178 | 39,934 | 7.62 | 697,728 | 37,289 | 7.15 |
| Commercial mortgage | 2,060,827 | 104,676 | 6.78 | 1,879,077 | 90,563 | 6.44 |
| Residential real estate loans | 648,286 | 19,671 | 4.05 | 603,268 | 16,557 | 3.66 |
| Residential real estate lines | 75,880 | 4,463 | 7.86 | 76,219 | 4,118 | 7.22 |
| Consumer indirect | 906,762 | 41,216 | 6.07 | 1,008,311 | 39,458 | 5.23 |
| Other consumer | 46,615 | 2,267 | 6.50 | 23,712 | 1,437 | 8.10 |
| Total loans [4] | 4,438,548 | 212,227 | 6.39 | 4,288,315 | 189,422 | 5.90 |
| Total interest-earning assets | 5,727,054 | 235,344 | 5.49 | 5,628,124 | 209,913 | 4.98 |
| Less: Allowance for credit losses | (47,072) | | | (48,922) | | |
| Other noninterest-earning assets | 452,128 | | | 411,873 | | |
| Total assets | $ 6,132,110 | | | $ 5,991,075 | | |
| **Interest-bearing liabilities:** | | | | | | |
| Deposits: | | | | | | |
| Interest-bearing demand | $ 727,179 | $ 6,087 | 1.12 % | $ 831,345 | $ 4,642 | 0.75 % |
| Savings and money market | 2,018,881 | 46,163 | 3.05 | 1,691,783 | 25,887 | 2.05 |
| Time deposits | 1,500,238 | 52,864 | 4.71 | 1,484,919 | 42,036 | 3.78 |
| Total interest-bearing deposits | 4,246,298 | 105,114 | 3.31 | 4,008,047 | 72,565 | 2.42 |
| Short-term borrowings | 149,588 | 3,345 | 2.99 | 221,392 | 6,596 | 3.98 |
| Long-term borrowings | 124,640 | 4,697 | 5.02 | 121,033 | 4,596 | 5.06 |
| Total borrowings | 274,228 | 8,042 | 3.92 | 342,425 | 11,192 | 4.37 |
| Total interest-bearing liabilities | 4,520,526 | 113,156 | 3.34 | 4,350,472 | 83,757 | 2.57 |
| Noninterest-bearing demand deposits | 955,428 | | | 1,038,798 | | |
| Other noninterest-bearing liabilities | 193,476 | | | 176,313 | | |
| Shareholders' equity | 462,680 | | | 425,492 | | |
| Total liabilities and shareholders' equity | $ 6,132,110 | | | $ 5,991,075 | | |
| Net interest income (tax-equivalent) | | $ 122,188 | | | $ 126,156 | |
| Interest rate spread | | | 2.15 % | | | 2.41 % |
| Net earning assets | $ 1,206,528 | | | $ 1,277,652 | | |
| Net interest margin (tax-equivalent) | | | 2.85 % | | | 2.99 % |
| Ratio of average interest-earning assets to average interest-bearing liabilities | | | 126.69 % | | | 129.37 % |

(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%.

(3) Annualized.

(4) Loans include net unearned income, net deferred loan fees and costs and non-accruing loans. Net deferred loan fees (costs) included in interest income were as follows (in thousands):

| | Nine months ended September 30, | |
|---|---|---|
| | 2024 | 2023 |
| Commercial business | $ 130 | $ (33) |
| Commercial mortgage | 1,654 | 1,718 |
| Residential real estate loans | (1,150) | (1,215) |
| Residential real estate lines | (291) | (275) |
| Consumer indirect | (2,687) | (3,158) |
| Other consumer | 32 | 12 |
| Total | $ (2,312) | $ (2,951) |

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). No out-of-period adjustments were included in the rate/volume analysis.

| | Three months ended September 30, 2024 vs. 2023 | | | Nine months ended September 30, 2024 vs. 2023 | | |
|---|---|---|---|---|---|---|
| **Increase (decrease) in:** | **Volume** | **Rate** | **Total** | **Volume** | **Rate** | **Total** |
| **Interest income:** | | | | | | |
| Federal funds sold and interest-earning deposits | $ (160) | $ 43 | $ (117) | $ 1,521 | $ 256 | $ 1,777 |
| Investment securities: | | | | | | |
| Taxable | (283) | 774 | 491 | (945) | 2,253 | 1,308 |
| Tax-exempt | (183) | 46 | (137) | (565) | 106 | (459) |
| Total investment securities | (466) | 820 | 354 | (1,510) | 2,359 | 849 |
| Loans: | | | | | | |
| Commercial business | (735) | 445 | (290) | 131 | 2,514 | 2,645 |
| Commercial mortgage | 1,944 | 148 | 2,092 | 9,063 | 5,050 | 14,113 |
| Residential real estate loans | 260 | 495 | 755 | 1,290 | 1,824 | 3,114 |
| Residential real estate lines | (3) | 66 | 63 | (18) | 363 | 345 |
| Consumer indirect | (1,589) | 1,756 | 167 | (4,221) | 5,979 | 1,758 |
| Other consumer | 171 | (12) | 159 | 1,161 | (331) | 830 |
| Total loans | 48 | 2,898 | 2,946 | 7,406 | 15,399 | 22,805 |
| **Total interest income** | (578) | 3,761 | 3,183 | 7,417 | 18,014 | 25,431 |
| **Interest expense:** | | | | | | |
| Deposits: | | | | | | |
| Interest-bearing demand | (169) | 395 | 226 | (640) | 2,085 | 1,445 |
| Savings and money market | 1,286 | 2,649 | 3,935 | 5,701 | 14,575 | 20,276 |
| Time deposits | (524) | 1,949 | 1,425 | 438 | 10,390 | 10,828 |
| Total interest-bearing deposits | 593 | 4,993 | 5,586 | 5,499 | 27,050 | 32,549 |
| Short-term borrowings | (764) | (614) | (1,378) | (1,838) | (1,413) | (3,251) |
| Long-term borrowings | 4 | (5) | (1) | 136 | (35) | 101 |
| Total borrowings | (760) | (619) | (1,379) | (1,702) | (1,448) | (3,150) |
| **Total interest expense** | (167) | 4,374 | 4,207 | 3,797 | 25,602 | 29,399 |
| **Net interest income** | $ (411) | $ (613) | $ (1,024) | $ 3,620 | $ (7,588) | $ (3,968) |

**Provision (Benefit) for Credit Losses**

The table below presents the composition of the provision (benefit) for credit losses for the periods indicated (dollars in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | **2024** | **2023** | **2024** | **2023** |
| Provision (benefit) for credit losses – loans | $ 2,391 | $ 1,392 | $ (496) | $ 8,540 |
| Credit loss provision (benefit) for unfunded commitments | 713 | (426) | 186 | (129) |
| Credit loss benefit for debt securities | - | - | (1) | (1) |
| Provision (benefit) for credit losses | $ 3,104 | $ 966 | $ (311) | $ 8,410 |

The provision for credit losses in the third quarter of 2024 was driven by a combination of factors, including a slight increase in the national unemployment forecast and higher qualitative factors overall, partially offset by lower loan balances. The benefit for credit losses for the nine months ended September 30, 2024 was reflective of the $4.9 million benefit for credit losses – loans for the first quarter of 2024, which was driven by improvement in forecasted losses, positive trends in qualitative factors, including a reduction in consumer indirect loan delinquencies during the period, and a reduction in total period-end loan balances.

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 September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2024 | 2023 | 2024 | 2023 |
| Service charges on deposits | $ 1,103 | $ 1,207 | $ 3,159 | $ 3,457 |
| Insurance income | 3 | 1,678 | 2,141 | 5,093 |
| Card interchange income | 1,900 | 2,094 | 5,810 | 6,140 |
| Investment advisory | 2,797 | 2,544 | 8,158 | 8,286 |
| Company owned life insurance | 1,404 | 1,027 | 4,062 | 2,974 |
| Investments in limited partnerships | 400 | 391 | 1,545 | 1,111 |
| Loan servicing | 88 | 135 | 421 | 395 |
| Income from derivative instruments, net | 212 | 219 | 763 | 1,418 |
| Net gain on sale of loans held for sale | 220 | 115 | 432 | 349 |
| Net gain (loss) on other assets | 138 | (1) | 13,633 | 31 |
| Net loss on tax credit investments | (170) | (333) | (139) | (45) |
| Other | 1,345 | 1,410 | 4,370 | 3,667 |
| Total noninterest income | $ 9,440 | $ 10,486 | $ 44,355 | $ 32,876 |

The April 1, 2024 sale of the assets of our insurance subsidiary generated a pre-tax gain of $13.7 million, after selling costs, which was included in net gain (loss) on other assets for the first nine months of 2024. The decrease in insurance income for the third quarter of 2024 and the first nine months of 2024 was reflective of the sale.

Investment advisory income increased $253 thousand, or 10%, to $2.8 million for the third quarter of 2024 compared to $2.5 million for the third quarter of 2023, primarily due to a market-driven increase in assets under management in addition to business development. For the first nine months of 2024, investment advisory income decreased $128 thousand, or 2%, to $8.2 million compared to $8.3 million for the first nine months of 2023.

Income from company owned life insurance increased $377 thousand, or 37%, to $1.4 million for the third quarter of 2024 compared to $1.0 million for the third quarter of 2023. For the first nine months of 2024, income from company owned life insurance increased $1.1 million, or 37%, to $4.1 million compared to $3.0 million for the first nine months of 2023. The increase in both periods was primarily due to the higher crediting rate and associated impact to cash surrender value recorded in the linked quarter related to the previously disclosed surrender and redeploy strategy executed in the fourth quarter of 2023.

Income from investments in limited partnerships of $400 thousand for the third quarter of 2024 was relatively flat compared to the third quarter of 2023. For the first nine months of 2024, income from investments in limited partnerships increased $434 thousand, or 39%, to $1.5 million compared to $1.1 million for the first nine months of 2023. We previously made several investments accounted for under the equity method. Income from these investments fluctuates based on the maturity and performance of the underlying investments.

Income from derivative instruments, net of $212 thousand for the third quarter of 2024 was relatively flat compared to the third quarter of 2023. For the first nine months of 2024, income from derivative income from derivative instruments, net decreased $655 thousand, or 46%, to $763 thousand compared to $1.4 million for the first nine months of 2023. Income from derivative instruments, net, is based on the number and value or interest rate swap transactions executed during the quarter combined with the impact of changes in the fair value of borrower-facing trades.

**Noninterest Expense**

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2024 | 2023 | 2024 | 2023 |
| Salaries and employee benefits | $ 15,879 | $ 18,160 | $ 48,967 | $ 54,047 |
| Occupancy and equipment | 3,370 | 3,791 | 10,570 | 11,059 |
| Professional services | 1,965 | 1,076 | 6,131 | 3,844 |
| Computer and data processing | 5,353 | 5,107 | 16,081 | 14,548 |
| Supplies and postage | 519 | 455 | 1,431 | 1,418 |
| FDIC assessments | 1,092 | 1,232 | 3,733 | 3,586 |
| Advertising and promotions | 371 | 744 | 1,108 | 1,556 |
| Amortization of intangibles | 112 | 225 | 443 | 689 |
| Restructuring recoveries | — | (55) | — | (74) |
| Deposit-related charged-off items | 410 | 188 | 19,987 | 978 |
| Other | 3,398 | 3,812 | 11,051 | 10,527 |
| Total noninterest expense | $ 32,469 | $ 34,735 | $ 119,502 | $ 102,178 |

Salaries and employee benefits expense decreased $2.3 million, or 13%, to $15.9 million for the third quarter of 2024 compared to $18.2 million for the third quarter of 2023. For the first nine months of 2024, salaries and employee benefits expense decreased $5.1 million, or 9%, to $49.0 million compared to $54.0 million for the first nine months of 2023. The decrease in both periods was driven in part by lower salaries and wages in the 2024 periods, as a result of the sale of the assets of SDN, as well as our previously disclosed leadership and organizational changes completed in the fourth quarter of 2023.

Professional services expense increased $889 thousand, or 83%, to $2.0 million for the third quarter of 2024 compared to $1.1 million for the third quarter of 2023. For the first nine months of 2024, professional services expense increased $2.3 million, or 59%, to $6.1 million compared to $3.8 million for the first nine months of 2023. The increases in both periods were primarily due to higher legal expenses in 2024 attributed to the deposit-related fraud event, including $384 thousand and $1.4 million for the third quarter of 2024 and first nine months of 2024, respectively.

Computer and data processing expense increased $246 thousand, or 5%, to $5.4 million for the third quarter of 2024 compared to $5.1 million for the third quarter of 2023. For the first nine months of 2024, computer and data processing expense increased $1.5 million, or 11%, to $16.1 million compared to $14.5 million for the first nine months of 2023. The increase during the 2024 periods was due in part to an increase in digital banking expense attributable to increased usage along with our strategic investments in data efficiency and marketing technology.

Advertising and promotions expense decreased $373 thousand, or 50%, to $371 thousand for the third quarter of 2024 compared to $744 thousand for the third quarter of 2023. For the first nine months of 2024, advertising and promotions expense decreased $448 thousand, or 29%, to $1.1 million, compared to $1.6 million for the first nine months of 2023. The decrease in both periods reflected higher advertising and promotions expense in the prior year periods related to the money market campaign.

Deposit-related charged-off items expense for the first nine months of 2024 included an $18.2 million loss associated with charge-offs associated with the deposit-related fraudulent activity we experienced in early March 2024, including the $18.4 million recorded in the first quarter of 2024, partially offset by $143 thousand of recoveries recorded in the second quarter of 2024.

Other expense decreased $414 thousand, or 11%, to $3.4 million for the third quarter of 2024 compared to $3.8 million for the third quarter of 2023. For the first nine months of 2024, other expense increased $524 thousand, or 5%, to $11.1 million compared to $10.5 million for the first nine months of 2023. The increase for the first nine months of 2024 was primarily driven by an increase in New York State capital base franchise tax accrual.

Our efficiency ratio for the third quarter of 2024 and the first nine months of 2024 was 64.70% and 71.75%, respectively, compared with 66.47% and 64.25% for the third quarter of 2023 and the first nine months of 2023, respectively. The higher efficiency ratio for the first nine months of 2024 was reflective of the $18.2 million pre-tax loss in deposit-related charged-off items and approximately $1.4 million of legal and consulting expenses, recorded in professional services expense, attributed to the deposit-related fraud event, partially offset by the $13.7 million gain on the sale of the assets of our insurance subsidiary. 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 three and nine months ended September 30, 2024, we recorded income tax expense of $1.1 million and $6.0 million, versus $2.4 million and $7.6 million for the same periods in the prior year. In the third quarter of 2024, we recognized federal and state tax benefits related to tax credit investments placed in service and/or amortized during the period resulting in a reduction in income tax expense of $1.3 million, versus $731 thousand for the same period in the prior year. The nine months ended September 30, 2024 and 2023 also included related tax credit investment benefits of $3.4 million and $2.1 million, respectively.

Our effective tax rate for the three and nine months ended September 30, 2024 was 7.4% and 12.6%, versus 14.8% and 15.9%, respectively, for the same periods in the prior year. 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, earnings on company owned life insurance and the impact of tax credit investments. In addition, our effective tax rates for 2024 and 2023 reflect 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 | | | |
|---|---|---|---|---|
| | September 30, 2024 | | December 31, 2023 | |
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| **Securities available for sale:** | | | | |
| U.S. Government agency and government-sponsored enterprise securities | $ 24,535 | $ 22,588 | $ 24,535 | $ 21,811 |
| Mortgage-backed securities: | | | | |
| Agency mortgage-backed securities | 978,658 | 855,139 | 1,013,455 | 865,594 |
| Non-Agency mortgage-backed securities | — | 382 | — | 325 |
| Other debt securities | 8,656 | 8,707 | — | — |
| Total available for sale securities | 1,011,849 | 886,816 | 1,037,990 | 887,730 |
| **Securities held to maturity:** | | | | |
| U.S. Government agency and government-sponsored enterprise securities | 16,626 | 16,413 | 16,513 | 15,983 |
| State and political subdivisions | 48,472 | 44,205 | 68,854 | 63,782 |
| Mortgage-backed securities | 56,184 | 51,995 | 62,793 | 57,265 |
| Total held to maturity securities | 121,282 | 112,613 | 148,160 | 137,030 |
| Allowance for credit losses – securities | (3) | | (4) | |
| Total held to maturity securities, net | 121,279 | | 148,156 | |
| Total investment securities | $ 1,133,128 | $ 999,429 | $ 1,186,146 | $ 1,024,760 |

Our available for sale ("AFS") investment securities portfolio decreased $26.1 million from December 31, 2023 to September 30, 2024. The AFS portfolio had a net unrealized loss of $125.0 million at September 30, 2024 and $150.3 million at December 31, 2023, respectively. The decrease in the AFS portfolio balance was primarily due to maturities of investment securities, and the use of cash to fund loan originations and reduce short-term borrowings in the first nine months of 2024.

### 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 September 30, 2024. In this table, Yield is defined as the book yield weighted against the ending book value. 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 | $ — | — | $ 15,000 | 1.70 % | $ 9,535 | 1.90 % | $ — | — | $ 24,535 | 1.78 % |
| Mortgage-backed securities | 16 | 3.01 % | 76,628 | 2.07 % | 69,026 | 1.87 % | 832,988 | 2.06 % | 978,658 | 2.05 % |
| Other debt securities | — | — | — | — | 8,656 | 7.25 % | — | — | 8,656 | 7.25 % |
| | 16 | 3.01 % | 91,628 | 2.01 % | 87,217 | 2.41 % | 832,988 | 2.06 % | 1,011,849 | 2.09 % |
| **Held to maturity debt securities:** | | | | | | | | | | |
| U.S. Government agencies and government-sponsored enterprises | $ — | — | $ 10,000 | 3.00 % | $ 6,626 | 3.48 % | $ — | — | $ 16,626 | 3.79 % |
| State and political subdivisions | 18,896 | 2.45 % | 8,084 | 2.13 % | — | — | 21,492 | 2.45 % | 48,472 | 2.34 % |
| Mortgage-backed securities | — | — | 3,891 | 2.60 % | 16,314 | 2.26 % | 35,979 | 2.80 % | 56,184 | 2.63 % |
| | 18,896 | 2.45 % | 21,975 | 2.95 % | 22,940 | 2.61 % | 57,471 | 2.67 % | 121,282 | 2.67 % |
| **Total investment securities** | $ 18,912 | 2.45 % | $ 113,603 | 2.19 % | $ 110,157 | 2.45 % | $ 890,459 | 2.10 % | $ 1,133,131 | 2.15 % |

### 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 three and nine months ended September 30, 2024 and 2023, no allowance for credit losses was 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

Total loans were $4.40 billion at September 30, 2024, a decrease of $59.2 million from $4.46 billion at December 31, 2023. The composition of our loan portfolio, excluding loans held for sale and including net unearned income and net deferred fees and costs, is summarized as follows (dollars in thousands):

| | Loan Portfolio Composition | | | |
|---|---|---|---|---|
| | September 30, 2024 | | December 31, 2023 | |
| | Amount | % of Total | Amount | % of Total |
| Commercial business | $ 654,519 | 14.9 % | $ 735,700 | 16.5 % |
| Commercial mortgage - construction | 533,506 | 12.1 | 493,003 | 11.0 |
| Commercial mortgage - multifamily | 467,527 | 10.6 | 452,155 | 10.1 |
| Commercial mortgage - non-owner occupied | 814,392 | 18.5 | 788,515 | 17.7 |
| Commercial mortgage - owner occupied | 290,216 | 6.6 | 271,646 | 6.1 |
| Total commercial mortgage | 2,105,641 | 47.8 | 2,005,319 | 44.9 |
| Total commercial | 2,760,160 | 62.7 | 2,741,019 | 61.4 |
| Residential real estate loans | 648,241 | 14.7 | 649,822 | 14.6 |
| Residential real estate lines | 76,203 | 1.7 | 77,367 | 1.7 |
| Consumer indirect | 874,651 | 19.9 | 948,831 | 21.3 |
| Other consumer | 43,734 | 1.0 | 45,100 | 1.0 |
| Total consumer | 1,642,829 | 37.3 | 1,721,120 | 38.6 |
| Total loans | 4,402,989 | 100.0 % | 4,462,139 | 100.0 % |
| Less: Allowance for credit losses – loans | 44,678 | | 51,082 | |
| Total loans, net | $ 4,358,311 | | $ 4,411,057 | |

Total commercial loans of $2.76 billion represented 63% of total loans as of September 30, 2024, compared to $2.74 billion, or 61% of total loans as of December 31, 2023. Commercial business loans of $654.5 million, or 15% of total loans, were down $81.2 million, or 11%, from December 31, 2023, and total commercial mortgage loans of $2.11 billion, or 48% of total loans, were up $100.3 million, or 5% from December 31, 2023. The increase in commercial mortgage loans was attributable to increases in construction, multifamily, owner and non-owner occupied loans. As of September 30, 2024, commercial real estate ("CRE") loans made up approximately 66% of total commercial loans, and 41% of total loans, commercial and industrial loans approximated 30% of total commercial loans, and 19% of total loans, and business banking unit loans were approximately 4% of total commercial loans and 3% of total loans. Our CRE committed credit exposure at September 30, 2024 related to approximately 42% multi-family, 18% office, 8% industrial property, 7% retail, 7% hospitality, and 6% home builder. Approximately 70% of our office exposure at September 30, 2024, or 12% of our total CRE exposure, related to Class B or medical office space. More than 70% of our office and 90% of our multifamily CRE loans have full or limited personal or corporate recourse.

Total consumer loans of $1.64 billion, or 37% of total loans at September 30, 2024, decreased $78.3 million from December 31, 2023. Consumer loans at September 30, 2024 were comprised of residential real estate loans and lines of credit of $724.4 million, or 16% of total loans, consumer indirect loans of $874.7 million, or 20% of total loans, and other consumer loans of $43.7 million, or 1% of total loans. During the nine months ended September 30, 2024, we originated $170.5 million in indirect automobile loans with a mix of approximately 25% new automobile and 75% used automobile loans. This compares with the $238.2 million originated of indirect automobile loans with a mix of approximately 27% new automobile and 73% used automobile loans for the nine months ended September 30, 2023. Origination volumes and the mix of new and used vehicles financed fluctuate depending on general market conditions. Effective January 1, 2024, we exited the Pennsylvania automobile market to align our focus more fully around our core Upstate New York market, which includes a strong network of approximately 375 new automobile dealers.

### Loans Held for Sale and Loans Serviced for Others

Loans held for sale (not included in the loan portfolio composition table) were entirely comprised of residential real estate loans and totaled $2.5 million and $1.4 million as of September 30, 2024 and December 31, 2023, 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 $276.8 million and $269.4 million as of September 30, 2024 and December 31, 2023, respectively.

**Allowance for Credit Losses – Loans**

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

| Credit Loss – Loans Analysis | Three months ended September 30, 2024 | Three months ended September 30, 2023 | Nine months ended September 30, 2024 | Nine months ended September 30, 2023 |
|---|---|---|---|---|
| Allowance for credit losses – loans, beginning of period | $ 43,952 | $ 49,836 | $ 51,082 | $ 45,413 |
| Net charge-offs (recoveries): | | | | |
| Commercial business | (3) | 32 | (33) | (59) |
| Commercial mortgage - construction | — | — | — | — |
| Commercial mortgage - multifamily | 12 | — | 13 | — |
| Commercial mortgage - non-owner occupied | (1) | (886) | (3) | (887) |
| Commercial mortgage - owner occupied | (1) | (86) | (4) | (71) |
| Residential real estate loans | (1) | (4) | 99 | 67 |
| Residential real estate lines | — | — | — | 41 |
| Consumer indirect | 1,553 | 2,283 | 5,370 | 4,421 |
| Other consumer | 106 | 259 | 466 | 811 |
| Total net charge-offs | 1,665 | 1,598 | 5,908 | 4,323 |
| Provision (benefit) for credit losses – loans | 2,391 | 1,392 | (496) | 8,540 |
| Allowance for credit losses – loans, end of period | $ 44,678 | $ 49,630 | $ 44,678 | $ 49,630 |
| | | | | |
| Net loan charge-offs (recoveries) to average loans: | | | | |
| Commercial business | 0.00 % | 0.02 % | -0.01 % | -0.01 % |
| Commercial mortgage - construction | 0.00 % | 0.00 % | 0.00 % | 0.00 % |
| Commercial mortgage - multifamily | 0.01 % | 0.00 % | 0.00 % | 0.00 % |
| Commercial mortgage - non-owner occupied | 0.00 % | -0.46 % | 0.00 % | -0.16 % |
| Commercial mortgage - owner occupied | 0.00 % | -0.13 % | 0.00 % | -0.04 % |
| Residential real estate loans | 0.00 % | 0.00 % | 0.02 % | 0.01 % |
| Residential real estate lines | 0.00 % | 0.00 % | 0.00 % | 0.07 % |
| Consumer indirect | 0.70 % | 0.92 % | 0.79 % | 0.59 % |
| Other consumer | 0.95 % | 3.00 % | 1.33 % | 4.57 % |
| Total loans | 0.15 % | 0.14 % | 0.18 % | 0.13 % |
| | | | | |
| Allowance for credit losses – loans to total loans | 1.01 % | 1.12 % | 1.01 % | 1.12 % |
| Allowance for credit losses – loans to nonaccrual loans | 110 % | 522 % | 192 % | 522 % |
| Allowance for credit losses – loans to non-performing loans | 110 % | 521 % | 192 % | 521 % |

Loans not analyzed for a specific reserve are segmented into “pools” of loans based on their homogeneous risk characteristics, including purpose, tenor, amortization, repayment source, payment frequency, collateral and recourse. Once loans have been segmented into pools, a loss rate is applied to the amortized cost basis. This is referred to as the “pooled loan” component of the allowance for credit losses estimate. Loans have historically been divided into six portfolio segments of loans including Commercial Loans/Lines, Commercial Mortgage, Indirect Loans, Direct Loans, Residential Lines of Credit, and Residential Loans. Beginning in the third quarter of 2024, we further disaggregated the Commercial Mortgage loans into the following categories: Construction, Multifamily, Non-Owner Occupied, and Owner Occupied based on the risk characteristics of the loans and our methodology for monitoring and assessing credit risk. 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 our Loan Review function. We establish 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, and other loans deemed appropriate by management, collectively referred to as collateral dependent loans. See Note 4., Loans, of the notes to the consolidated financial statements for further details on collateral dependent loans.

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 $1.7 million for the third quarter of 2024 represented 0.15% of average loans on an annualized basis compared to net charge-offs of $1.6 million, or 0.14% of average loans for the third quarter of 2023. The allowance for credit losses – loans was $44.7 million at September 30, 2024, compared with $49.6 million at September 30, 2023. The ratio of the allowance for credit losses – loans to total loans was 1.01% at September 30, 2024 and 1.12% at September 30, 2023. The ratio of allowance for credit losses – loans to non-performing loans was 110% at September 30, 2024, compared with 521% at September 30, 2023. The increase in non-performing loans at September 30, 2024, compared to September 30, 2023 was largely related to two separate and distinct commercial real estate loan relationships in our Upstate New York market, one of which was placed on nonaccrual during the third quarter of 2024, and the other in the fourth quarter of 2023.

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

| | Allowance for Credit Losses – Loans by Loan Category | | | |
|---|---|---|---|---|
| | September 30, 2024 | | December 31, 2023 | |
| | Credit Loss Allowance | Percentage of loans by category to total loans | Credit Loss Allowance | Percentage of loans by category to total loans |
| Commercial business | $ 8,475 | 14.9 % | $ 13,102 | 16.5 % |
| Commercial mortgage - construction | 5,402 | 12.1 | 3,710 | 11.0 |
| Commercial mortgage - multifamily | 2,609 | 10.6 | 4,009 | 10.1 |
| Commercial mortgage - non-owner occupied | 7,478 | 18.5 | 6,074 | 17.7 |
| Commercial mortgage - owner occupied | 4,200 | 6.6 | 2,065 | 6.1 |
| Residential real estate loans | 3,795 | 14.7 | 5,286 | 14.6 |
| Residential real estate lines | 833 | 1.7 | 764 | 1.7 |
| Consumer indirect | 11,346 | 19.9 | 14,099 | 21.3 |
| Other consumer | 540 | 1.0 | 1,973 | 1.0 |
| Total | $ 44,678 | 100.0 % | $ 51,082 | 100.0 % |

**Non-Performing Assets and Potential Problem Loans**

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

| | Non-Performing Assets | |
|---|---|---|
| | September 30, 2024 | December 31, 2023 |
| Nonaccrual loans: | | |
| Commercial business | $ 5,752 | $ 5,664 |
| Commercial mortgage - construction | 20,280 | 5,320 |
| Commercial mortgage - multifamily | 71 | 189 |
| Commercial mortgage - non-owner occupied | 4,903 | 4,651 |
| Commercial mortgage - owner occupied | 366 | 403 |
| Residential real estate loans | 5,790 | 6,364 |
| Residential real estate lines | 232 | 221 |
| Consumer indirect | 3,291 | 3,814 |
| Other consumer | 14 | 13 |
| Total nonaccrual loans | 40,699 | 26,639 |
| Accruing loans 90 days or more delinquent | 43 | 21 |
| Total non-performing loans | 40,742 | 26,660 |
| Foreclosed assets | 109 | 142 |
| Total non-performing assets | $ 40,851 | $ 26,802 |
| | | |
| Nonaccrual loans to total loans | 0.92 % | 0.60 % |
| Non-performing loans to total loans | 0.93 % | 0.60 % |
| Non-performing assets to total assets | 0.66 % | 0.44 % |

Non-performing assets include non-performing loans and foreclosed assets. Non-performing assets at September 30, 2024 were $40.9 million, an increase of $14.0 million from the $26.8 million balance at December 31, 2023. The primary component of non-performing assets is non-performing loans, which were $40.7 million or 0.93% of total loans at September 30, 2024 and $26.7 million or 0.60% of total loans at December 31, 2023. The increase in non-performing loans at September 30, 2024 as compared to December 31, 2023 was largely related to a commercial mortgage - construction relationship that was placed on nonaccrual during the third quarter of 2024.

Approximately $1.2 million, or 3%, of the $40.7 million in non-performing loans as of September 30, 2024 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.

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. We had $109 thousand and $142 thousand of properties representing foreclosed asset holdings at September 30, 2024 and December 31, 2023, respectively.

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 non-performing 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 $34.7 million and $29.9 million in loans that continued to accrue interest which were classified as substandard as of September 30, 2024 and December 31, 2023, respectively.

**Contractual Loan Maturity Schedule**

The following table summarizes the contractual maturities of our loan portfolio at September 30, 2024. Loans, net of deferred loan origination costs, include principal amortization and non-accruing loans. Demand loans having no stated schedule of repayment or maturity and overdrafts as reported as due in one year or less (in thousands).

| | Due in less than one year | Due from one to five years | Due from five to fifteen years | Due after fifteen years | Total |
|---|---|---|---|---|---|
| Commercial business | $ 137,627 | $ 228,247 | $ 18,743 | $ 269,902 | $ 654,519 |
| Commercial mortgage - construction | 222,600 | 272,866 | 37,894 | 146 | 533,506 |
| Commercial mortgage - multifamily | 173,738 | 252,778 | 40,910 | 101 | 467,527 |
| Commercial mortgage - non-owner occupied | 244,768 | 424,770 | 144,360 | 494 | 814,392 |
| Commercial mortgage - owner occupied | 157,124 | 114,961 | 18,106 | 25 | 290,216 |
| Residential real estate loans | 88,051 | 253,483 | 288,431 | 18,276 | 648,241 |
| Residential real estate lines | 1,496 | 6,731 | 26,629 | 41,347 | 76,203 |
| Consumer indirect (1) | 329,627 | 545,024 | — | — | 874,651 |
| Other consumer | 10,610 | 20,884 | 12,125 | 115 | 43,734 |
| Total loans | $ 1,365,641 | $ 2,119,744 | $ 587,198 | $ 330,406 | $ 4,402,989 |
| | | | | | |
| Loans maturing after one year: | | | | | |
| With a predetermined interest rate | | | | | |
| Commercial business | | $ 101,033 | $ 8,199 | $ 54 | $ 109,286 |
| Commercial mortgage - construction | | 43,240 | 8,484 | 9 | 51,733 |
| Commercial mortgage - multifamily | | 129,622 | 25,249 | 28 | 154,899 |
| Commercial mortgage - non-owner occupied | | 250,198 | 51,470 | 57 | 301,725 |
| Commercial mortgage - owner occupied | | 90,416 | 17,033 | 19 | 107,468 |
| Residential real estate loans | | 181,370 | 235,396 | 14,320 | 431,086 |
| Residential real estate lines | | — | — | — | — |
| Consumer indirect (1) | | 545,024 | — | — | 545,024 |
| Other consumer | | 20,884 | 12,125 | 115 | 33,124 |
| With a floating or adjustable rate | | | | | |
| Commercial business | | 127,214 | 10,544 | 269,848 | 407,606 |
| Commercial mortgage - construction | | 229,626 | 29,410 | 137 | 259,173 |
| Commercial mortgage - multifamily | | 123,156 | 15,661 | 73 | 138,890 |
| Commercial mortgage - non-owner occupied | | 174,572 | 92,890 | 437 | 267,899 |
| Commercial mortgage - owner occupied | | 24,545 | 1,073 | 6 | 25,624 |
| Residential real estate loans | | 72,113 | 53,035 | 3,956 | 129,104 |
| Residential real estate lines | | 6,731 | 26,629 | 41,347 | 74,707 |
| Consumer indirect (1) | | — | — | — | — |
| Other consumer | | — | — | — | — |
| Total loans maturing after one year | | $ 2,119,744 | $ 587,198 | $ 330,406 | $ 3,037,348 |

(1) Amounts include prepayment assumptions based on actual historical experience.

## FUNDING ACTIVITIES

### Deposits

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

| | Deposit Composition | | | |
|---|---|---|---|---|
| | September 30, 2024 | | December 31, 2023 | |
| | Amount | % of Total | Amount | % of Total |
| Noninterest-bearing demand | $ 978,660 | 18.4 % | $ 1,010,614 | 19.4 % |
| Interest-bearing demand | 793,996 | 15 | 713,158 | 13.7 |
| Savings and money market | 2,027,181 | 38 | 2,084,444 | 40.0 |
| Time deposits | 1,506,764 | 28 | 1,404,696 | 26.9 |
| Total deposits | $ 5,306,601 | 100.0 % | $ 5,212,912 | 100.0 % |

As of September 30, 2024 and December 31, 2023, the aggregate amount of estimated uninsured deposits (deposits in amounts greater than $250 thousand, which is the maximum amount for federal deposit insurance) was $2.09 billion, or 39% of total deposits, and $1.82 billion, or 35% of total deposits, respectively. The portion of our time deposits by account that were in excess of the FDIC insurance limit was $348.6 million and $302.6 million at September 30, 2024 and December 31, 2023, respectively. The maturities of our uninsured time deposits at September 30, 2024 were as follows: $162.7 million in three months or less; $32.5 million between three months and six months; $93.6 million between six months and one year; and $59.7 million over one year. Approximately $1.12 billion and $956.3 million of reciprocal and public deposits, characterized as preferred deposits for FDIC call report purposes, were collateralized by government-backed securities as of September 30, 2024 and December 31, 2023, respectively. As of September 30, 2024, estimated uninsured nonpublic deposits were approximately 18% of total deposits.

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 September 30, 2024, total deposits were $5.31 billion, representing an increase of $93.7 million, or 2%, from December 31, 2023. The increase was primarily due to increases in public, and non-public deposits, partially offset by decreases in brokered and reciprocal deposits. While seasonality in our public deposit portfolio was a contributor, public deposits accounts maintained higher balances during typical outflow cycles while growing deposits with new and existing municipalities. This was complemented by solid growth of non-public deposits during the nine month period. Time deposits were approximately 28% and 27% of total deposits at September 30, 2024 and December 31, 2023, respectively.

Non-public deposits, the largest component of our funding sources, totaled $3.23 billion and $3.12 billion at September 30, 2024 and December 31, 2023, respectively, and represented 61% and 60% of total deposits as of each date, respectively. We have managed this segment of funding through a strategy of competitive pricing that minimizes the number of customer relationships that have only a single service high-cost deposit account.

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 area. 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 liquidity to accommodate the seasonality associated with public deposits. Total public deposits were $1.18 billion and $1.02 billion at September 30, 2024 and December 31, 2023, respectively, and represented 22% of total deposits as of each date.

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. Reciprocal deposits totaled $816.1 million at September 30, 2024, compared to $817.6 million at December 31, 2023, as this product has been an attractive option for customers with more than $250 thousand on deposit desiring FDIC insurance. Reciprocal deposits represented 15% and 16% of total deposits as of each date, respectively.

Brokered deposits totaled $79.4 million and $256.8 million at September 30, 2024 and December 31, 2023, respectively, and represented 2% and 5% of total deposits as of each date. As of September 30, 2024 and December 31, 2023, $29.4 million and $206.8 million of interest-bearing demand deposits and $50.0 million of time deposits were brokered deposit accounts. The Bank reduced the outstanding balance of the brokered sweep deposit portfolio by $180.0 million in April 2024 through the utilization of more cost effective funding sources.

**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):

| | September 30, 2024 | December 31, 2023 |
|---|---|---|
| Short-term borrowings: | | |
| FHLB | $ 55,000 | $ 107,000 |
| FRB | — | 78,000 |
| Total short-term borrowings | 55,000 | 185,000 |
| Long-term borrowings: | | |
| FHLB | 50,000 | 50,000 |
| Subordinated notes, net | 74,765 | 74,532 |
| Total long-term borrowings | 124,765 | 124,532 |
| Total borrowings | $ 179,765 | $ 309,532 |

***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 September 30, 2024 and December 31, 2023 totaled $55.0 million and $107.0 million, respectively. The FHLB borrowings are collateralized by securities from the Company's investment portfolio and certain qualifying loans. In May 2023, we borrowed $15.0 million under the Federal Reserve Bank ("FRB") Bank Term funding program at a rate of 4.80%, which matured on May 8, 2024. In December 2023, we borrowed an additional $50 million under the program at an interest rate of 4.89%, which matures on December 13, 2024, and $13.0 million at an interest rate of 4.88%, which matures on December 20, 2024. Short-term borrowings and brokered deposits have historically been utilized to manage the seasonality of public deposits. We continue to be proactive in managing funding costs and reduced short-term borrowings in the third quarter.

As of September 30, 2024, $50.0 million of the short-term borrowings balance was designated as a cash-flow hedge, which became effective in April 2022, at a fixed rate of 0.787%, $30.0 million was designated as a cash-flow hedge, which became effective in January 2023, at a fixed rate of 3.669%, and $25.0 million was designated as a cash-flow hedge, which became effective in May 2023, at a fixed rate of 3.4615%.

We have credit capacity with the FHLB and can borrow through facilities that include amortizing and term advances or repurchase agreements. We had approximately $284.7 million of immediate credit capacity with the FHLB, and approximately $878.6 million in secured borrowing capacity at the FRB discount window as of September 30, 2024. The FHLB and FRB credit capacity are collateralized by securities from our investment portfolio and certain qualifying loans. We had $155.0 million of credit available under unsecured federal funds purchased lines with various banks as of September 30, 2024, with no amounts outstanding. Additionally, we had approximately $133.7 million of unencumbered liquid securities available for pledging at September 30, 2024.

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 September 30, 2024, no amounts have been drawn on the line of credit.

***Long-term Borrowings***

As of September 30, 2024 we had a long-term advance payable to FHLB of $50.0 million. The advance matures on January 20, 2026 and bears interest at a fixed rate of 4.05%. FHLB advances are collateralized by securities from our investment portfolio and certain qualifying loans.

On October 7, 2020, we completed a private placement of $35.0 million in aggregate principal amount of fixed-to-floating rate subordinated notes to qualified institutional buyers and accredited institutional investors that were subsequently exchanged for subordinated notes with substantially the same terms (the "2020 Notes") registered under the Securities Act of 1933, as amended. The 2020 Notes have a maturity date of October 15, 2030 and bear interest, payable semi-annually, at the rate of 4.375% per annum, until October 15, 2025. Commencing on that date, the interest rate will reset quarterly to an interest rate per annum equal to the then current three-month SOFR plus 4.265%, payable quarterly until maturity. The 2020 Notes are redeemable by us, in whole or in part, on any interest payment date on or after October 15, 2025, and we may redeem the Notes in whole at any time upon certain other specified events. We used the net proceeds for general corporate purposes, organic growth and to support regulatory capital ratios at Five Star Bank. Proceeds, net of debt issuance costs of $740 thousand, were $34.3 million. The 2020 Notes qualify as Tier 2 capital for regulatory purposes.

On April 15, 2015, we issued $40.0 million of subordinated notes (the "2015 Notes") in a registered public offering. The 2015 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 CME Term SOFR plus 4.20561%. The 2015 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 2015 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. Management is actively monitoring customer activity by way of commercial and consumer line of credit utilization, as well as deposit flows. As of September 30, 2024, 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, the FRB Discount Window, and brokered deposit relationships.

The primary source of our non-deposit short-term borrowings is FHLB advances, of which $55.0 million were outstanding at September 30, 2024. In addition to this amount, we have additional collateralized wholesale borrowing capacity of approximately $1.32 billion as of September 30, 2024 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 September 30, 2024. The line of credit has a one-year term and matures in May 2025. Funds drawn would be used for general corporate purposes and backup liquidity.

Cash and cash equivalents were $249.6 million as of September 30, 2024, up $125.1 million from $124.4 million as of December 31, 2023. During the nine months ended September 30, 2024, net cash provided by operating activities totaled $50.1 million and the principal source of operating activity cash flow was net income adjusted for noncash income and expense items. Net cash provided by investing activities totaled $126.7 million, which primarily included inflows from a decrease in net loans of $53.2 million, $51.0 million for net proceeds from investment securities, and $27.0 million for the proceeds from the sale of the assets of SDN, partially offset by outflows of $4.6 million for purchases of premises and equipment. Net cash used in financing activities of $51.7 million was primarily attributed to a $130.0 million net decrease in short-term borrowings, and $15.0 million in dividend payments, partially offset by a $93.7 million net increase in deposits.

### 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 $500.3 million at September 30, 2024, an increase of $45.5 million from $454.8 million at December 31, 2023, primarily due to net income in the first nine months of 2024, and a decrease in accumulated other comprehensive loss of $17.9 million during the nine months ended September 30, 2024 due primarily to a decrease in net unrealized losses 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 on a consolidated basis. As of September 30, 2024, the Company's capital levels remained characterized as "well-capitalized" under the Basel Committee on Banking Supervision's ("BCBS") capital guidelines for U.S. banks. See the "Basel III Capital Rules" section below for further discussion.

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

| | September 30, 2024 | December 31, 2023 |
|---|---|---|
| Common shareholders' equity | $ 485,184 | $ 441,773 |
| Less: Goodwill and other intangible assets | 58,292 | 69,594 |
| Net unrealized loss on investment securities [(1)] | (92,996) | (111,761) |
| Hedging derivative instruments | 2,530 | 3,911 |
| Net periodic pension and postretirement benefits plan adjustments | (11,448) | (11,946) |
| Other | (115) | (145) |
| Common Equity Tier 1 ("CET1") Capital | 528,921 | 492,120 |
| Plus: Preferred stock | 17,292 | 17,292 |
| Tier 1 Capital | 546,213 | 509,412 |
| Plus: Qualifying allowance for credit losses | 45,581 | 48,916 |
| Subordinated Notes | 74,765 | 74,532 |
| Total regulatory capital | $ 666,559 | $ 632,860 |
| Adjusted average total assets (for leverage capital purposes) | $ 6,082,367 | $ 6,224,339 |
| Total risk-weighted assets | $ 5,145,278 | $ 5,218,724 |
| | | |
| **Regulatory Capital Ratios** | | |
| Tier 1 Leverage (Tier 1 capital to adjusted average assets) | 8.98 % | 8.18 % |
| CET1 Capital (CET1 capital to total risk-weighted assets) | 10.28 % | 9.43 % |
| Tier 1 Capital (Tier 1 capital to total risk-weighted assets) | 10.62 % | 9.76 % |
| Total Risk-Based Capital (Total regulatory capital to total risk-weighted assets) | 12.95 % | 12.13 % |

(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 Current Expected Credit Losses ("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 has begun to phase into regulatory capital at 25% per year commencing January 1, 2022. For the ongoing impact of CECL, we were 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, also began to phase into regulatory capital at 25% per year commencing January 1, 2022.

**Basel III Capital Rules**

Under the Basel III Capital Rules, the current minimum capital ratios, including an additional capital conservation buffer applicable to the Company and the Bank, are:

- 7.0% CET1 to risk-weighted assets;
- 8.5% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets; and
- 10.5% Total capital (that is, Tier 1 capital plus Tier 2 capital) to 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 Basel III 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 Basel III Capital Rules. As of September 30, 2024, the Company and Bank's capital levels remained characterized as "well capitalized" under the Basel III rules, including the additional capital conversion buffer.

The following table presents actual and required capital ratios as of September 30, 2024 and December 31, 2023 for the Company and the Bank under the Basel III Capital Rules. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, under the Basel III Capital Rules (dollars in thousands):

| | Actual | | Minimum Capital Required – Basel III | | Required to be Considered Well Capitalized | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **September 30, 2024** | | | | | | |
| Tier 1 leverage: | | | | | | |
| Company | $ 546,213 | 8.98 % | $ 243,295 | 4.00 % | $ 304,118 | 5.00 % |
| Bank | 600,404 | 9.89 | 242,853 | 4.00 | 303,567 | 5.00 |
| CET1 capital: | | | | | | |
| Company | 528,921 | 10.28 | 360,169 | 7.00 | 334,443 | 6.50 |
| Bank | 600,404 | 11.70 | 359,208 | 7.00 | 333,551 | 6.50 |
| Tier 1 capital: | | | | | | |
| Company | 546,213 | 10.62 | 437,349 | 8.50 | 411,622 | 8.00 |
| Bank | 600,404 | 11.70 | 436,182 | 8.50 | 410,524 | 8.00 |
| Total capital: | | | | | | |
| Company | 666,559 | 12.95 | 540,254 | 10.50 | 514,528 | 10.00 |
| Bank | 645,986 | 12.59 | 538,813 | 10.50 | 513,155 | 10.00 |
| **December 31, 2023** | | | | | | |
| Tier 1 leverage: | | | | | | |
| Company | $ 509,412 | 8.18 % | $ 248,974 | 4.00 % | $ 311,217 | 5.00 % |
| Bank | 562,775 | 9.06 | 248,385 | 4.00 | 310,481 | 5.00 |
| CET1 capital: | | | | | | |
| Company | 492,120 | 9.43 | 365,311 | 7.00 | 339,217 | 6.50 |
| Bank | 562,775 | 10.82 | 364,191 | 7.00 | 338,177 | 6.50 |
| Tier 1 capital: | | | | | | |
| Company | 509,412 | 9.76 | 443,592 | 8.50 | 417,498 | 8.00 |
| Bank | 562,775 | 10.82 | 442,232 | 8.50 | 416,218 | 8.00 |
| Total capital: | | | | | | |
| Company | 632,860 | 12.13 | 547,966 | 10.50 | 521,872 | 10.00 |
| Bank | 611,691 | 11.76 | 546,286 | 10.50 | 520,272 | 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, 2023 in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2023, as filed with the Securities and Exchange Commission on March 13, 2024. 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, 2023 to September 30, 2024. 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 September 30, 2025, assuming instantaneous changes in interest rates for the given rate shock scenarios (dollars in thousands):

| | Changes in Interest Rate | | | |
|---|---|---|---|---|
| | -300 bp | -200 bp | -100 bp | +100 bp |
| Estimated change in net interest income | $ (17,201) | $ (11,660) | $ (5,722) | $ 3,649 |
| % Change | -9.52 % | -6.45 % | -3.17 % | 2.02 % |

In the rising rate scenarios, the static model results indicate that net interest income is modeled to increase compared to the flat rate scenario over a one-year time frame. This is a combination of an increase across the entire deposit portfolio, which has decreased wholesale borrowings and the higher cost associated with the borrowings. This simulation does not consider balance sheet growth or a change in the balance sheet mix. As intermediate and longer-term assets continue to mature and are replaced at higher yields, net interest income should improve over the longer-term time frame. Model results in the declining rate scenario show a decrease in net interest income due to a combination of increases in the yield curve, as well as increases in higher paying public and nonpublic deposits, which will reprice downward slower due to market deposit competition.

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. Furthermore, given the static balance sheet approach, retained earnings are considered to be reinvested in a noninterest earning asset.

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 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 September 30, 2024 and December 31, 2023 (dollars in thousands). The analysis additionally presents a measurement of the interest rate sensitivity at September 30, 2024 and December 31, 2023. 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):

| | September 30, 2024 | | | December 31, 2023 | | |
|---|---|---|---|---|---|---|
| **Rate Shock Scenario:** | **EVE** | **Change** | **Percentage Change** | **EVE** | **Change** | **Percentage Change** |
| Pre-Shock Scenario | $ 696,228 | | | $ 627,519 | | |
| - 300 Basis Points | 604,300 | $ (91,928) | -13.20% | 584,066 | $ (43,453) | -6.92% |
| - 200 Basis Points | 641,432 | (54,796) | -7.87 | 603,181 | (24,338) | -3.88 |
| - 100 Basis Points | 672,833 | (23,395) | -3.36 | 616,940 | (10,579) | -1.69 |
| + 100 Basis Points | 710,808 | 14,580 | 2.09 | 626,463 | (1,056) | -0.17 |

The increase in the Pre-Shock Scenario EVE at September 30, 2024 compared to December 31, 2023 is the result of the overall value increase of the loan portfolio, slightly offset by deposits. The sensitivity in the down Rate Shock Scenarios to EVE grow more negative at September 30, 2024 compared to December 31, 2023. This is a result from concentrated efforts to grow the deposit portfolio to decrease wholesale borrowings, and a subsequent mix shift from non-maturity deposits to time deposits. As a result, the shift from non-maturity to time deposits has made the deposit portfolio slightly less valuable in non-public deposits which was slightly offset by the seasonal inflow of non-maturity public deposits.

## ITEM 4. Controls and Procedures

### *Evaluation of Disclosure Controls and Procedures*

As of September 30, 2024, 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 September 30, 2024 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

From time to time, we are a party to or otherwise involved in legal proceedings arising out of the normal course of business. Regardless of the outcome, litigation can have an adverse impact on us because of prosecution, defense and settlement costs, unfavorable awards, diversion of management resources and other factors.

We are party to an action filed against us on May 16, 2017 by Matthew L. Chipego, Charlene Mowry, Constance C. Churchill and Joseph W. Ewing in the Court of Common Pleas in Philadelphia, Pennsylvania. Plaintiffs sought class certification to represent classes of consumers in New York and Pennsylvania along with statutory damages, interest and declaratory relief. The plaintiffs sought to represent a putative class of consumers who are alleged to have obtained direct or indirect financing from us for the purchase of vehicles that we later repossessed. The plaintiffs specifically claim that the notices the Bank sent to defaulting consumers after their vehicles were repossessed did not comply with the relevant portions of the Uniform Commercial Code in New York and Pennsylvania. We dispute and believe we have meritorious defenses against these claims and plan to vigorously defend ourselves.

On September 30, 2021, the Court granted plaintiffs' motion for class certification and certified four different classes (two classes of New York consumers and two classes of Pennsylvania consumers). There are approximately 5,200 members in the New York classes and 300 members in the Pennsylvania classes.

On September 26, 2022, the lower Court denied the plaintiffs' motion for partial summary judgment for most of the relief they seek and found that there were questions of fact as to whether the members of the class had purchased the subject vehicles for "consumer use" within the meaning of the relevant statutes. The Court also denied our motion for partial summary judgment seeking an offset in the form of recoupment reducing any liability that may be imposed against us by the amounts that the borrowers owe for failing to repay their motor vehicle loans, determining that the Court could not enter a judgment on recoupment – which is a set off from liability – without first determining whether there was liability.

During the July 11, 2024 pretrial conference, the Court instructed the parties to engage in further settlement of non-binding mediation discussions and set a September 11, 2024 deadline to file motions in limine and a bench trial to commence on May 5, 2025.

All depositions and document productions have been completed. Plaintiff did not file a Motion in Limine by September 11, 2024. Plaintiffs however filed a motion for partial judgment on October 8, 2024 asserting that the recoupment claims were barred because they were too distinct from the underlying claims. We intend to file an opposition against the motion for partial summary judgment with the Court by the November 7, 2024 deadline. The parties continue to discuss potential candidates to serve as a mediator in response to the Court's instruction that they explore further settlement or mediation discussions.

We have not accrued a contingent liability for this matter at this time because, given our defenses, we are unable to conclude whether a liability is probable to occur nor are we able to currently reasonably estimate the amount of potential loss.

If we settle these claims or the action is not resolved in our favor, we may suffer reputational damage and incur legal costs, settlements or judgments that exceed the amounts covered by our insurer. We can provide no assurances that our insurer will cover the full legal costs, settlements or judgments we incur. If we are unsuccessful in defending ourselves from these claims or if our insurer does not cover the full amount of legal costs we incur, the result may materially adversely affect our business, results of operations and financial condition.

### ITEM 1A. Risk Factors

During the quarter ended September 30, 2024, there have been no material changes to the risk factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2023 as filed with the SEC. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations.

**ITEM 2. Unregistered Sales of Equity Securities, Use of Proceeds, and Issuer Purchases of Equity Securities**

In June 2022, the Company's Board of Directors authorized a share repurchase program for up to 766,447 shares of common stock. The program will expire at the earlier of the completion of all share repurchases or a Board vote to retire the program.

The Company's repurchases of its common stock during the third quarter of 2024 were as follows:

**Issuer Purchases of Equity Securities**

| Period | Total Number of Shares Purchased (1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| July 1, 2024 – July 31, 2024 | — | $ — | — | 766,447 |
| August 1, 2024 – August 31, 2024 | 1,081 | 24.04 | — | 766,447 |
| September 1, 2024 – September 30, 2024 | — | — | — | 766,447 |
| Total | 1,081 | $ 24.04 | — | 766,447 |

(1) This column reflects shares of common stock deemed surrendered to satisfy tax withholding obligations in connection with the vesting of employee restricted stock units.

**ITEM 5. Other Information**

During the third quarter of 2024, none of our directors or officers adopted or terminated any contract, instruction or written plan for the purchase or sale of Company securities that was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) or any "non-Rule 10b5-1 trading arrangement," as that term is used in SEC regulations.

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**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 |
| --- | --- | --- |
| 3.1 | Amended and Restated Certificate of Incorporation of the Company | Incorporated by reference to Exhibits 3.1, 3.2 and 3.3 of the Form 10-K for the year ended December 31, 2008, dated March 12, 2009 |
| 3.2 | Amended and Restated Bylaws of Financial Institutions, Inc. | Incorporated by reference to Exhibit 3.1 of the Form 8-K, dated June 25, 2019 |
| 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 | |
| 101.SCH | Inline XBRL Taxonomy Extension Schema With Embedded Linkbases 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*** , November 4, 2024

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

***/s/ W. Jack Plants II*** , November 4, 2024

W. Jack Plants II
Executive Vice President and Chief Financial Officer and Treasurer
(Principal Financial Officer)

***/s/ Sandra L. Byers*** , November 4, 2024

Sandra L. Byers
Senior Vice President and Controller
(Principal Accounting Officer)

**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 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 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, which involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2024

***/s/ Martin K. Birmingham***

Martin K. Birmingham
President and Chief Executive Officer

**Exhibit 31.2**

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

I, W. Jack Plants II, 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 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 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, which involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2024

***/s/ W. Jack Plants II***

W. Jack Plants II

Chief Financial Officer

**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 W. Jack Plants II, 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 September 30, 2024 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: November 4, 2024 | ***/s/ Martin K. Birmingham*** |
| | Martin K. Birmingham |
| | President and Chief Executive Officer |
| | (Principal Executive Officer) |
| Date: November 4, 2024 | ***/s/ W. Jack Plants II*** |
| | W. Jack Plants |
| | 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.