DST SYSTEMS INC
Form 4
May 18, 2007

FORM 4

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

(Print or Type Responses)

1. Name and Address of Reporting Person *
STRANDJORD M JEANNINE

(Last) (First) (Middle)

333 WEST 11TH STREET

(Street)

KANSAS CITY, MO 64105

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
DST SYSTEMS INC [DST]

3. Date of Earliest Transaction (Month/Day/Year)
05/16/2007

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	05/16/2007		F		2,885	D	$ 78.74	33,156	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
STRANDJORD M JEANNINE 333 WEST 11TH STREET KANSAS CITY, MO 64105	X			

Signatures

Randall D. Young for M. Jeannine Strandjord by power of attorney.	05/18/2007
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. man" SIZE="2">Ratio of average interest-earning assets to average interest-bearing liabilities 124.97% 123.79%

(1) Investment securities are shown at amortized cost and include non-performing securities.
(2) The interest on tax-exempt securities is calculated on a tax equivalent basis assuming a Federal tax rate of 35%.

MANAGEMENT S DISCUSSION AND ANALYSIS

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

	Three months ended March 31, 2012 vs. 2011		
Increase (decrease) in:	**Volume**	**Rate**	**Total**
Interest income:			
Federal funds sold and interest-earning deposits	$	$	$
Investment securities:			
Taxable	(419)	(258)	(677)
Tax-exempt	92	(112)	(20)
Total investment securities	(327)	(370)	(697)
Loans:			
Commercial business	285	(31)	254
Commercial mortgage	569	(298)	271
Residential mortgage	(198)	(90)	(288)
Home equity	269	(97)	172
Consumer indirect	1,107	(982)	125
Other consumer	(44)	11	(33)
Total loans	1,988	(1,487)	501
Total interest income	1,661	(1,857)	(196)
Interest expense:			
Deposits:			
Interest-bearing demand	(1)	(15)	(16)
Savings and money market	42	(21)	21
Certificates of deposit	(106)	(698)	(804)
Total interest-bearing deposits	(65)	(734)	(799)
Short-term borrowings	55	(16)	39
Long-term borrowings	(266)	(266)	(532)
Total borrowings	(211)	(282)	(493)
Total interest expense	(276)	(1,016)	(1,292)
Net interest income	$ 1,937	$ (841)	$ 1,096

Provision for Loan Losses

The provision for loan losses is based upon credit loss experience, growth or contraction of specific segments of the loan portfolio, and the estimate of losses inherent in the current loan portfolio. The provision for loan losses for the first quarter of 2012 was $1.4 million, compared to $810 thousand for the same period in 2011. See Allowance for Loan Losses under the section titled Lending Activities included herein for additional information.

Explanation of Responses:

MANAGEMENT S DISCUSSION AND ANALYSIS

Noninterest Income

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

	Three months ended March 31,	
	2012	**2011**
Service charges on deposits	$ 1,835	$ 2,105
ATM and debit card	1,077	1,016
Broker-dealer fees and commissions	587	386
Company owned life insurance	426	266
Net gain on sale of loans held for sale	333	224
Net gain on disposal of investment securities	331	3
Loan servicing	94	349
Impairment charges on investment securities	(91)	
Net gain on sale and disposal of other assets	6	45
Other	853	754
Total noninterest income	$ 5,451	$ 5,148

The components of noninterest income fluctuated as discussed below.

Service charges on deposit accounts were down $270 thousand in the first quarter primarily due to changes in customer behavior and recent regulatory changes that include requirements for customers to opt in for overdraft coverage for certain types of electronic banking activities.

Broker-dealer fees and commissions were up $201 thousand or 52% for the first quarter of 2012 compared to 2011. Broker-dealer fees and commissions fluctuate mainly due to sales volume, which increased during 2012 as a result of improving market and economic conditions and our renewed focus on this line of business.

During the third quarter of 2011 we purchased an additional $18.0 million of company owned life insurance. The increased amount of insurance was largely responsible for the $160 thousand increase in company owned life insurance income.

Gains from the sale of loans held for sale were $109 thousand higher than in the first quarter of 2011 due to increased origination volume.

We recognized a $331 thousand pre-tax gain from the sale of a pooled trust-preferred security that had been written down in prior periods and included in non-performing assets. We continue to monitor the market for the trust-preferred securities and evaluate the potential for future dispositions. The amount and timing of our sale of investments securities is dependent on a number of factors, including our prudent efforts to realize gains while managing duration, premium and credit risk.

Loan servicing income represents fees earned for servicing mortgage and indirect auto loans sold to third parties, net of amortization expense and impairment losses, if any, associated with capitalized loan servicing assets. Loan servicing income was down $255 thousand for the three months ended March 31, 2012 compared to 2011. Loan servicing income decreased as a result of more rapid amortization of servicing rights due to loans paying off, lower fees collected due to a decrease in the sold and serviced portfolio and write-downs on capitalized mortgage servicing assets.

During the first quarter of 2012 we recognized an OTTI charge of $91 thousand related to a privately issued whole loan CMO that was determined to be impaired due to credit quality.

MANAGEMENT S DISCUSSION AND ANALYSIS

Noninterest Expense

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

	Three months ended March 31,	
	2012	**2011**
Salaries and employee benefits	$ 8,931	$ 8,401
Occupancy and equipment	2,770	2,843
Professional services	711	682
Computer and data processing	600	603
Supplies and postage	458	452
FDIC assessments	297	607
Advertising and promotions	101	165
Other	1,789	1,597
Total noninterest expense	$ 15,657	$ 15,350

The components of noninterest expense fluctuated as discussed below.

Salaries and employee benefits (which includes salary-related expenses and fringe benefit expenses) was $8.9 million for 2012, up $530 thousand or 6% from 2011. Average full-time equivalent employees (FTEs) were 574 for 2012, about the same as 576 for last year. Salary-related expenses increased $326 thousand or 5% for the three months ended March 31, 2012, compared to 2011, reflecting annual merit increases, as well as an increase in estimated incentive compensation, which was previously limited under the TARP Capital Purchase Program. Fringe benefit expenses increased $204 thousand or 10%, primarily attributable to higher pension expense.

Other noninterest expense was $1.8 million for the first quarter of 2012, an increase of $192 thousand or 12% from the first quarter of 2011. Other noninterest expense for the first quarter of 2012 included $125 thousand of severance expense associated with workforce realignment in a continued effort to reduce future costs.

FDIC assessments decreased $310 thousand for the three months ended March 31, 2012, compared to 2011, primarily a result of changes implemented by the FDIC in the method of calculating assessment rates which became effective in the second quarter of 2011.

The efficiency ratio for the first quarter of 2012 was 58.59% compared with 59.97% for the first quarter of 2011. See Use of Non-GAAP Financial Measures on page 40 for further discussion of the efficiency ratio.

Income Taxes

For the three months ended March 31, 2012, we recorded income tax expense of $3.2 million, versus $3.0 million a year ago. The change in income tax was primarily due to higher pre-tax income during the first quarter of 2012. The effective tax rates for the first quarter of 2012 and 2011 were 33.7% and 34.1%, respectively. Effective tax rates are impacted by items of income and expense that are not subject to federal or state taxation. Our effective tax rates reflect the impact of these items, which include, but are not limited to, interest income from tax-exempt and tax-preferred securities and earnings on company owned life insurance.

MANAGEMENT S DISCUSSION AND ANALYSIS

ANALYSIS OF FINANCIAL CONDITION

INVESTING ACTIVITIES

Investment Securities

The following table sets forth selected information regarding the composition our investment securities portfolio as of the dates indicated (in thousands):

	Investment Securities Portfolio Composition			
	March 31, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale:				
U.S. Government agency and government-sponsored enterprise securities	$ 104,599	$ 106,611	$ 94,947	$ 97,712
State and political subdivisions	141,184	145,289	119,099	124,424
Mortgage-backed securities:				
Agency mortgage-backed securities	432,904	444,709	390,375	401,596
Non-Agency mortgage-backed securities	147	1,322	327	2,089
Asset-backed securities [(1)]	267	1,566	297	1,697
Total available for sale securities	679,101	699,497	605,045	627,518
Securities held to maturity:				
State and political subdivisions	24,196	24,797	23,297	23,964
Total investment securities	$ 703,297	$ 724,294	$ 628,342	$ 651,482

(1) Includes non-performing investment securities. See Non-Performing Assets and Potential Problem Loans under the section titled Lending Activities included herein for additional information.

Investment securities available for sale increased $72.0 million or 11%, from $627.5 million at December 31, 2011 to $699.5 million at March 31, 2012, as we invested excess liquidity into this investment category.

Impairment Assessment

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

Securities Deemed to be Other-Than-Temporarily Impaired

Through the impairment assessment process, we determined that a privately issued whole loan CMO was other-than-temporarily impaired due to credit quality at March 31, 2012. We recognized an OTTI charge of $91 thousand related to that security for the three months ended March 31, 2012. No impairment was recorded in the three months ended March 31, 2011.

MANAGEMENT S DISCUSSION AND ANALYSIS

LENDING ACTIVITIES

The following table sets forth selected information regarding the composition of the Company s loan portfolio as of the dates indicated (in thousands).

	Loan Portfolio Composition			
	March 31, 2012		December 31, 2011	
	Amount	% of Total	Amount	% of Total
Commercial business	$ 233,764	15.4%	$ 233,836	15.7%
Commercial mortgage	406,521	26.7	393,244	26.5
Total commercial	640,285	42.1	627,080	42.2
Residential mortgage	112,148	7.4	113,911	7.7
Home equity	237,019	15.6	231,766	15.6
Consumer indirect	508,085	33.4	487,713	32.9
Other consumer	23,491	1.5	24,306	1.6
Total consumer	768,595	50.5	743,785	50.1
Total loans	1,521,028	100.0%	1,484,776	100.0%
Allowance for loan losses	23,763		23,260	
Total loans, net	$ 1,497,265		$ 1,461,516	

Total loans increased $36.3 million to $1.521 billion as of March 31, 2012 from $1.485 billion as of December 31, 2011.

Commercial loans increased $13.2 million and represented 42.1% of total loans as of March 31, 2012, a result of our continued commercial business development efforts.

Residential mortgage loans decreased $1.8 million to $112.1 million as of March 31, 2012 in comparison to $113.9 million as of December 31, 2011. This category of loans decreased as the majority of newly originated and refinanced residential mortgages were sold to the secondary market rather than being added to our portfolio.

Our home equity portfolio, which consists of home equity loans and lines, totaled $237.0 million as of March 31, 2012, up $5.3 million or 2% compared to December 31, 2011. As of March 31, 2012, approximately 70% of the loans in the home equity portfolio were first lien positions.

The consumer indirect portfolio increased $20.4 million to $508.1 million as of March 31, 2012, from $487.7 million as of December 31, 2011. During the first quarter of 2012, we originated $72.3 million in indirect auto loans with a mix of approximately 46% new auto and 54% used auto. This compares with $45.6 million in indirect loan auto originations with a mix of approximately 41% new auto and 59% used auto for the same period in 2011.

Loans Held for Sale and Mortgage Servicing Rights

Loans held for sale (not included in the loan portfolio composition table) totaled $2.1 million and $2.4 million as of March 31, 2012 and December 31, 2011, respectively, all of which were residential real estate loans.

We sell certain qualifying newly originated or refinanced residential real estate mortgages on the secondary market. Residential real estate mortgages serviced for others, which are not included in the consolidated statements of financial condition, amounted to $292.9 million as of March 31, 2012 and $297.8 million as of December 31, 2011.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Allowance for Loan Losses

The following table sets forth an analysis of the activity in the allowance for loan losses for the periods indicated (in thousands).

	Loan Loss Analysis Three months ended March 31,	
	2012	**2011**
Balance as of beginning of period	$ 23,260	$ 20,466
Charge-offs:		
Commercial business	55	90
Commercial mortgage	120	344
Residential mortgage	106	2
Home equity	4	107
Consumer indirect	1,395	1,290
Other consumer	314	211
Total charge-offs	1,994	2,044
Recoveries:		
Commercial business	77	154
Commercial mortgage	15	16
Residential mortgage	70	27
Home equity	9	10
Consumer indirect	727	552
Other consumer	214	128
Total recoveries	1,112	887
Net charge-offs	882	1,157
Provision for loan losses	1,385	810
Balance at end of period	$ 23,763	$ 20,119
Net loan charge-offs to average loans (annualized)	0.24%	0.35%
Allowance for loan losses to total loans	1.56%	1.49%
Allowance for loan losses to non-performing loans	289%	275%

The allowance for loan losses represents the estimated amount of probable credit losses inherent in our loan portfolio. We perform periodic, systematic reviews of the loan portfolio to estimate probable losses in the respective loan portfolios. In addition, we regularly evaluate prevailing economic and business conditions, industry concentrations, changes in the size and characteristics of the portfolio and other pertinent factors. The process we use to determine the overall allowance for loan losses is based on this analysis. Based on this analysis, we believe the allowance for loan losses is adequate as of March 31, 2012.

Assessing the adequacy of the allowance for loan losses 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. We do not engage in sub-prime or other high-risk residential mortgage lending as a line-of-business. We primarily originate fixed and variable rate one-to-four family residential mortgages collateralized by owner-occupied properties located within our central and western New York marketplace, which has been relatively stable in recent years. Residential mortgages collateralized by one-to-four family residential real estate generally have been originated in amounts of no more than 85% of appraised value or have mortgage insurance.

The adequacy of the allowance for loan losses is subject to ongoing management review. While management evaluates currently available information in establishing the allowance for loan losses, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution s allowance for loan losses. Such agencies may require the financial institution to recognize additions to

the allowance based on their judgments about information available to them at the time of their examination.

Net charge-offs of $882 thousand in the first quarter of 2012 represented 0.24% of average loans on an annualized basis compared to $1.2 million or 0.35% in the first quarter of 2011. The provision for loan losses totaled $1.4 million in the first quarter of 2012, exceeding charge-offs by $503 thousand, as we continue to maintain the allowance for loan losses consistent with the growth in our loan portfolio and trends in asset quality. The allowance equaled 289% of non-performing loans and 1.56% of total loans as of March 31, 2012.

MANAGEMENT S DISCUSSION AND ANALYSIS

Non-Performing Assets and Potential Problem Loans

The table below sets forth the amounts and categories of the Company s non-performing assets at the dates indicated (in thousands).

		Non-Performing Assets	
	March 31, 2012	December 31, 2011	March 31, 2011
Nonaccrual loans:			
Commercial business	$ 1,863	$ 1,259	$ 901
Commercial mortgage	3,040	2,928	2,736
Residential mortgage	1,929	1,644	2,192
Home equity	934	682	835
Consumer indirect	444	558	639
Other consumer	7		12
Total nonaccrual loans	8,217	7,071	7,315
Accruing loans 90 days or more delinquent	5	5	3
Total non-performing loans	8,222	7,076	7,318
Foreclosed assets	258	475	568
Non-performing investment securities	1,505	1,636	567
Total non-performing assets	$ 9,985	$ 9,187	$ 8,453
Non-performing loans to total loans	0.54%	0.48%	0.54%
Non-performing assets to total assets	0.41%	0.39%	0.37%

Information regarding the activity in nonaccrual loans for the three months ended March 31, 2012 is as follows (in thousands).

Nonaccrual loans, beginning of year	$ 7,071
Additions	4,454
Payments	(1,301)
Charge-offs	(1,794)
Returned to accruing status	(142)
Transferred to other real estate or repossessed assets	(71)
Nonaccrual loans, end of period	$ 8,217

Non-performing assets include non-performing loans, foreclosed assets and non-performing investment securities. Non-performing assets at March 31, 2012 were $10.0 million, an increase of $798 thousand from the $9.2 million balance at December 31, 2011. The primary component of non-performing assets is non-performing loans, which were $8.2 million at March 31, 2012, an increase of $1.1 million from the $7.1 million balance at December 31, 2011.

The ratio of non-performing loans to total loans was 0.54% at March 31, 2012, compared to 0.48% at December 31, 2011. The average of our peer group was 2.95% of total loans at December 31, 2011, the most recent period for which information is available (Source: Federal Financial Institutions Examination Council Bank Holding Company Performance Report as of December 31, 2011 Top-tier bank holding companies having consolidated assets between $1 billion and $3 billion).

Foreclosed assets consist of real property formerly pledged as collateral to loans, which we have acquired through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. Foreclosed asset holdings represented 5 properties totaling $258 thousand at March 31, 2012 and 8

properties totaling $475 thousand at December 31, 2011.

As of March 31, 2012, non-performing investment securities for which we have stopped accruing interest consists of 9 securities with a total fair value of $1.5 million, compared to 10 securities with a fair value of $1.6 million at December 31, 2011. The non-performing investment securities are pooled trust preferred securities included in non-performing assets at fair value. During the first quarter of 2012 we recognized a $331 thousand pre-tax gain from the sale of one security that had been written down in prior periods and classified as non-performing at December 31, 2011. The security had a fair value of $125 thousand at December 31, 2011.

Potential problem loans are loans that are currently performing, but information known about possible credit problems of the borrowers causes management to have concern as to the ability of such borrowers to comply with the present loan payment terms and may result in disclosure of such loans as nonperforming at some time in the future. These loans remain in a performing status due to a variety of factors, including payment history, the value of collateral supporting the credits, and/or personal or government guarantees. Management considers loans classified as substandard, which continue to accrue interest, to be potential problem loans. We identified $12.8 million and $8.6 million in loans that continued to accrue interest which were classified as substandard as of March 31, 2012 and December 31, 2011, respectively.

MANAGEMENT S DISCUSSION AND ANALYSIS

FUNDING ACTIVITIES

Deposits

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

	Deposit Composition			
	March 31, 2012		December 31, 2011	
	Amount	% of Total	Amount	% of Total
Noninterest-bearing demand	$ 404,186	19.5%	$ 393,421	20.3%
Interest-bearing demand	435,701	21.1	362,555	18.8
Savings and money market	530,754	25.7	474,947	24.6
Certificates of deposit < $100,000	469,862	22.8	486,496	25.2
Certificates of deposit of $100,000 or more	226,066	10.9	214,180	11.1
Total deposits	$ 2,066,569	100.0%	$ 1,931,599	100.0%

We offer a variety of deposit products designed to attract and retain customers, with the primary focus on building and expanding long-term relationships. As of March 31, 2012, total deposits were $2.067 billion, an increase of $135.0 million in comparison to $1.932 billion as of December 31, 2011. Certificates of deposit were approximately 34% and 36% of total deposits at March 31, 2012 and December 31, 2011, respectively. Depositors remain hesitant to invest in certificates of deposit for long periods due to the low rate environment and, as a result, reduced both the amount they placed in time deposits and the maturity terms.

Nonpublic deposits represent the largest component of our funding. Total nonpublic deposits were $1.533 billion and $1.541 billion as of March 31, 2012 and December 31, 2011, respectively. We continue to manage this segment of funding through a strategy of competitive pricing and relationship-based sales and marketing that minimizes the number of customer relationships that have only a single high-cost deposit account.

As an additional source of funding, we offer a variety of public deposit products to the many towns, villages, counties and school districts within our market. Public deposits generally range from 20 to 25% of our total deposits. As of March 31, 2012, total public deposits were $533.3 million in comparison to $390.2 million as of December 31, 2011. There is a high degree of seasonality in this component of funding, as the level of deposits varies with the seasonal cash flows for these public customers. We maintain the necessary levels of short-term liquid assets to accommodate the seasonality associated with public deposits.

Borrowings

The following table summarizes our borrowings as of the dates indicated (in thousands):

	March 31, 2012	December 31, 2011
Short-term borrowings:		
Federal funds purchased	$	$ 11,597
Repurchase agreements	40,547	36,301
Short-term FHLB borrowings	76,800	102,800
Total short-term borrowings	$ 117,347	$ 150,698

We classify borrowings as short-term or long-term in accordance with the original terms of the agreement. There were no long-term borrowings outstanding as of March 31, 2012 or December 31, 2011.

We have credit capacity with the FHLB and can borrow through facilities that include amortizing and term advances or repurchase agreements. We had approximately $38 million of immediate credit capacity with FHLB as of March 31, 2012. We had approximately $392 million in secured borrowing capacity at the Federal Reserve Bank (FRB) Discount Window, none of which was outstanding at March 31, 2012. The FHLB and FRB credit capacity are collateralized by securities from our investment portfolio and certain qualifying loans. We had approximately $114 million of credit available under unsecured federal funds purchased lines with various banks as of March 31, 2012.

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MANAGEMENT S DISCUSSION AND ANALYSIS

Funds are borrowed on an overnight basis through retail repurchase agreements with bank customers and federal funds purchased from other financial institutions. Retail repurchase agreement borrowings are collateralized by securities of U.S. Government agencies. Federal funds purchased are short-term borrowings that typically mature within one to ninety days. There were no Federal funds purchased at March 31, 2012. Federal funds purchased totaled $11.6 million at December 31, 2011. Repurchase agreements are secured overnight borrowings with customers. These short-term repurchase agreements amounted to $40.5 million and $36.3 million as of March 31, 2012 and December 31, 2011, respectively. Short-term FHLB borrowings have original maturities of less than one year and include overnight borrowings which we typically utilizes to address short term funding needs as they arise. Short-term FHLB borrowings of $76.8 million and $102.8 million at March 31, 2012 and December 31, 2011, respectively, consisted of short-term advances.

Shareholders Equity

Shareholders equity was $240.0 million at March 31, 2012, an increase of $2.8 million from $237.2 million at December 31, 2011. Net income for the quarter increased shareholders equity by $6.2 million, which was partially offset by common and preferred stock dividends of $2.1 million. Accumulated other comprehensive income included in shareholders equity decreased $1.1 million during the first quarter due primarily to lower net unrealized gains on securities available for sale.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

The objective of maintaining adequate liquidity is to assure the ability of the Company to meet its financial obligations. These obligations include the withdrawal of deposits on demand or at their contractual maturity, the servicing and repayment of debt and preferred equity obligations, the ability to fund new and existing loan commitments, to take advantage of new business opportunities and to satisfy other operating requirements. The Company achieves liquidity by maintaining a strong base of core customer funds, maturing short-term assets, its ability to sell securities, lines of credit, and access to the financial and capital markets.

Liquidity for the Bank is managed through the monitoring of anticipated changes in loans, the investment portfolio, core deposits and wholesale funds, as well as the results of its operations and capital expenditures. The strength of the Bank s liquidity position is a result of its base of core customer deposits. These core deposits are supplemented by wholesale funding sources that include credit lines with the other banking institutions, the FHLB and the FRB.

The primary sources of liquidity for the parent company are dividends from the Bank and access to financial and capital markets. Dividends from the Bank are limited by various regulatory requirements related to capital adequacy and earnings trends. The Bank relies on cash flows from operations, core deposits, borrowings and short-term liquid assets. Five Star Investment Services relies on cash flows from operations and funds from the parent company when necessary.

The Company s cash and cash equivalents were $77.0 million as of March 31, 2012, up $19.4 million from $57.6 million as of December 31, 2011. Net cash provided by operating activities totaled $12.3 million and the principal source of operating activity cash flow was net income adjusted for noncash income and expense items. Net cash used in investing activities totaled $91.9 million, which included cash outflows of $37.2 million for net loan originations and $54.4 million from investment securities transactions. Net cash provided by financing activities of $99.1 million was attributed to a $135.0 million increase in deposits, partly offset by a $33.4 million increase in short-term borrowings and $2.1 million in dividend payments.

Capital Resources

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 the Company s consolidated financial statements. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets (all as defined in the regulations). These

minimum amounts and ratios are included in the table below.

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MANAGEMENT S DISCUSSION AND ANALYSIS

The Company s and the Bank s Tier 1 capital consists of shareholders equity excluding unrealized gains and losses on securities available for sale (except for unrealized losses which have been determined to be other than temporary and recognized as expense in the consolidated statements of income), goodwill and other intangible assets and disallowed portions of deferred tax assets. Tier 1 capital for the Company includes, subject to limitation, $17.5 million of preferred stock. The Company and the Bank s total capital are comprised of Tier 1 capital for each entity plus a permissible portion of the allowance for loan losses.

The Tier 1 and total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, excluding goodwill and other intangible assets and disallowed portions of deferred tax assets, allocated by risk weight category and certain off-balance-sheet items (primarily loan commitments and securities more than one level below investment grade that are subject to the low level exposure rules). The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets and disallowed portions of deferred tax assets.

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

	March 31, 2012	December 31, 2011
Total shareholders equity	$ 239,962	$ 237,194
Less: Unrealized gain on securities available for sale, net of tax	12,316	13,570
Unrecognized net periodic pension & postretirement benefits (costs), net of tax	(12,423)	(12,625)
Disallowed goodwill and other intangible assets	37,369	37,369
Disallowed deferred tax assets		1,794
Tier 1 capital	$ 202,700	$ 197,086
Adjusted average total assets (for leverage capital purposes)	$ 2,304,029	$ 2,282,755
Tier 1 leverage ratio (Tier 1 capital to adjusted average total assets)	8.80%	8.63%
Total Tier 1 capital	$ 202,700	$ 197,086
Plus: Qualifying allowance for loan losses	20,774	20,239
Total risk-based capital	$ 223,474	$ 217,325
Net risk-weighted assets	$ 1,658,969	$ 1,616,119
Tier 1 capital ratio (Tier 1 capital to net risk-weighted assets)	12.22%	12.20%
Total risk-based capital ratio (Total risk-based capital to net risk-weighted assets)	13.47%	13.45%

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

		Actual		For Capital Adequacy Purposes		Well Capitalized	
		Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2012							
Tier 1 leverage:	Company	$ 202,700	8.80%	$ 92,161	4.00%	$ 115,201	5.00%
	Bank	191,030	8.31	91,961	4.00	114,951	5.00
Tier 1 capital:	Company	202,700	12.22	66,359	4.00	99,538	6.00
	Bank	191,030	11.54	66,221	4.00	99,331	6.00
Total risk-based capital:	Company	223,474	13.47	132,718	8.00	165,897	10.00

	Bank	211,762	12.79	132,442	8.00	165,552	10.00
December 31, 2011							
Tier 1 leverage:	Company	$ 197,086	8.63%	$ 91,310	4.00%	$ 114,138	5.00%
	Bank	184,639	8.10	91,192	4.00	113,990	5.00
Tier 1 capital:	Company	197,086	12.20	64,645	4.00	96,967	6.00
	Bank	184,639	11.46	64,445	4.00	96,667	6.00
Total risk-based capital:	Company	217,325	13.45	129,290	8.00	161,612	10.00
	Bank	204,817	12.71	128,890	8.00	161,112	10.00

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MANAGEMENT S DISCUSSION AND ANALYSIS

Dividend Restrictions

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

USE OF NON-GAAP FINANCIAL MEASURES

In addition to results presented in accordance with U.S. GAAP, this report includes the non-GAAP financial measure efficiency ratio . We believe this non-GAAP financial measure provides a meaningful base for period-to-period comparisons and will assist investors in analyzing our operating results and facilitating performance comparisons with others in the banking industry. Non-GAAP measures have inherent limitations, are not required to be uniformly applied and are not audited. Readers should be aware of these limitations and should be cautious in their use of such measures. To mitigate these limitations, we have procedures in place to ensure that these measures are calculated using the appropriate GAAP or regulatory components in their entirety and to ensure that its performance is properly reflected to facilitate consistent period-to-period comparisons. Although we believe the efficiency ratio enhance investors understanding of our business and performance, this non-GAAP measure should not be considered in isolation, or as a substitute for GAAP basis financial measures. Investors should consider our performance and financial condition as reported under GAAP and all other relevant information when assessing our performance or financial condition.

The efficiency ratio measures the amount of revenue (defined as the sum of tax-equivalent net interest income and noninterest income before net gains and impairment charges on investment securities) needed to cover noninterest expenses. In accordance with industry standards, we believe that presenting net interest margin on a taxable equivalent basis, using a 35% effective federal tax rate, allows comparability of net interest margin with industry peers by eliminating the effect of the differences in portfolios attributable to the proportion represented by both taxable and tax-exempt investments. A reconciliation of interest income to interest income on a fully taxable equivalent basis and net interest income on a taxable equivalent basis is presented in the table under Net Interest Income and Net Interest Margin.

The following table provides: (i) a reconciliation of noninterest expense (GAAP) to adjusted noninterest expense (non-GAAP); (ii) a reconciliation of noninterest income (GAAP) to adjusted noninterest income (non-GAAP); (iii) a computation of adjusted total revenue (non-GAAP); and (iv) a computation of the efficiency ratio (non-GAAP) (dollars in thousands).

		Three months ended March 31,	
		2012	**2011**
Noninterest expense		$ 15,657	$ 15,350
Significant items:			
Other real estate owned expense		(37)	(59)
Adjusted noninterest expense (non-GAAP)	**A**	$ 15,620	$ 15,291
Net interest income on a taxable equivalent basis		$ 21,448	$ 20,352
Noninterest income		5,451	5,148
Significant items:			
Net gain on disposal of investment securities		(331)	(3)
Impairment charges on investment securities		91	
Adjusted noninterest expense (non-GAAP)	**B**	$ 26,659	$ 25,497
Efficiency ratio (non-GAAP)	**A/B**	58.59%	59.97%

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Our primary market risk is interest rate risk, which is defined as the potential variability of our earnings that arises from changes in market interest rates and the magnitude of the change at varying points along the yield curve. Changes in market interest rates, whether they are increases or decreases, can trigger repricings and changes in the pace of payments for both assets and liabilities, which individually or in combination may affect our net income, net interest income and net interest margin, either positively or negatively.

The principal objective of the Company s interest rate risk management is to evaluate the interest rate risk inherent in certain assets and liabilities, determine the appropriate level of risk to the Company given its business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with the guidelines approved by the Company s Board of Directors. The Company s management is responsible for reviewing with the Board its activities and strategies, the effect of those strategies on the net interest margin, the fair value of the portfolio and the effect that changes in interest rates will have on the portfolio and exposure limits. Management develops an Asset-Liability Policy that meets strategic objectives and regularly reviews the activities of the Bank.

The primary tool the Company uses to manage interest rate risk is a rate shock simulation to measure the rate sensitivity of the balance sheet. Rate shock simulation is a modeling technique used to estimate the impact of changes in rates on net interest income and economic value of equity. The Company measures net interest income at risk by estimating the changes in net interest income resulting from instantaneous and sustained parallel shifts in interest rates of different magnitudes over a period of twelve and twenty four months. This simulation is based on management s assumption as to the effect of interest rate changes on assets and liabilities and assumes a parallel shift of the yield curve. It also includes certain assumptions about the future pricing of loans and deposits in response to changes in interest rates. Further, it assumes that delinquency rates would not change as a result of changes in interest rates, although there can be no assurance that this will be the case. While this simulation is a useful measure as to net interest income at risk due to a change in interest rates, it is not a forecast of the future results and is based on many assumptions that, if changed, could cause a different outcome.

In addition to the changes in interest rate scenarios listed above, the Company typically runs other scenarios to measure interest rate risk, which vary depending on the economic and interest rate environments.

The Company has experienced no significant changes in market risk due to changes in interest rates since the Company s Annual Report on Form 10-K for the year ended December 31, 2011, dated March 9, 2012, as filed with the Securities and Exchange Commission.

ITEM 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of March 31, 2012, 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 Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this 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 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 March 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

The Company has experienced no material developments in its legal proceedings from the disclosure included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, dated March 9, 2012, as filed with the Securities and Exchange Commission.

ITEM 1A. Risk Factors

The Company has experienced no material changes in its risk factors from the disclosure included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, dated March 9, 2012, as filed with the Securities and Exchange Commission.

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
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Principal Executive Officer	Filed Herewith
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Principal Financial Officer	Filed Herewith
32	Certification pursuant to18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
*101.INS	XBRL Instance Document	
*101.SCH	XBRL Taxonomy Extension Schema Document	
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document	
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	

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

SIGNATURES

Pursuant to the requirements of 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/ *Peter G. Humphrey* , May 8, 2012
Peter G. Humphrey
President and Chief Executive Officer
(Principal Executive Officer)

/s/ *Karl F. Krebs* , May 8, 2012
Karl F. Krebs
Executive Vice President and Chief Financial Officer
(Principal Financial and Principal Accounting Officer)