



# Five Star Bank **POLICY**

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**Title** **Corporate Governance Policy**

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**Entity** Financial Institutions, Inc.  
Five Star Bank  
Five Star Investment Services, Inc.

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**Purpose** This policy outlines the Company's governance structure for the Board of Directors in fulfilling its oversight fiduciary responsibilities, complying with applicable banking and public company laws and regulations, and providing the necessary framework from which the Company will operate in achieving its' strategic objectives and desired financial performance.

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**Scope** This policy is applicable to all current and future Directors of Financial Institutions, Inc. (FII) and all subsidiaries, collectively referred to as the Company.

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**Policy** **I. Criteria for Director Independence**  
To be considered independent, Directors should have no material relationship with the Company. There are several criteria that have been discussed in determining director independence. FII shall include the following as NOT being independent:

- a. Any person who has a "Family Member" who is an Executive Officer of FII or any subsidiary. The term "Family Member" shall have the meaning set forth in NASDAQ Rule 4200 (a) (14) as amended from time to time.
- b. Any person who is employed by FII or any subsidiary.
- c. A person who accepts, or has a family member who accepts,

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## Corporate Governance Policy

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payments from FII or any subsidiary in excess of \$60,000 during the current or any of the past three fiscal years of FII. (The \$60,000 does not include compensation for board service; payments arising solely from investments in FII's securities; compensation paid to a family member as a non-executive employee of FII or a subsidiary; benefits under a tax qualified retirement plan; and non-discretionary compensation.)

d. Credit Relationships, as defined in Regulation O shall mean direct or indirect credit extensions to a director or his/her affiliates, that do not meet the following criteria:

- Substantially Similar Terms - Credit Relationships that are made on substantially similar terms to those that would be available to comparable borrowers in similar circumstances. (This is essentially what is contained in Regulation O of the Federal Reserve regulations.)
- Credit Declination/Termination - The Director or his interest would not be materially impacted if the Credit Relationship was not made or was terminated. This would be the case if the Director or his interests could obtain comparable financing from another lender.

e. Vendor Relationships

- Any director who is a partner or controlling shareholder, or executive officer of any organization to which the Company made, or from which the Company received, payments that exceed 5% of the recipients consolidated gross revenues or \$200,000, whichever is more, for the current or any of the past three fiscal years.

### II. Policy for Directors with Credit Relationships

This policy applies to any Director having a Credit Relationship meeting the Criteria for Director Independence set forth above, except that the Credit Relationship, or any part thereof has been Risk Rated 5 or worse.

a. Upon the assignment of a Risk Rating of 5 or worse to the Credit Relationship (a "Criticized/Classified Credit"), and

## Corporate Governance Policy

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effective as of the date the CEO of the Director's corporation is advised of such occurrence, the subject Director shall automatically be deemed non-independent. As such the subject Director shall resign from any committee or special assignment where independence is required, but the Director may continue to serve as a director of the Company, subject to the provisions of the following paragraphs.

b. At such time as the Criticized/Classified Credit is cured, either by being upgraded to a 4 Risk Rating or better, or being financed outside the Company without loss to the Company, the FII Executive, Nominating and Governance Committee may determine that the subject Director is again independent, and he/she shall then be eligible for assignment to committees or special assignments where independence is required.

c. In the event the Criticized/Classified Credit is not cured within a reasonable period of time, not to exceed 15 months, after being first criticized/classified, the subject Director shall resign from each FII or subsidiary board on which he or she serves, provided that each such board, with the approval of the FII Board, may waive or extend the cure period, exercising reasonable discretion.

d. In the event that the Company elects to sell the Criticized/Classified Credit outside the FII system, or the Criticized/Classified Credit is refinanced, repaid or collected, in either case at a loss to the Company, the subject Director shall resign from each FII or subsidiary board on which he or she serves.

e. This policy is subject to all provisions of FII's Code of Business Conduct and Ethics Policy.

### **III. Policy For Directors' Accounts**

All Directors having any personal demand or NOW account relationships with Five Star Bank must have an Overdraft Protection Credit Line for that account (subject to the \$5000 credit limit provided under Regulation O).

### IV. FII Financial Expert

The FII Audit Committee should have at least one member who is considered a financial expert under the Sarbanes Oxley Act definition.

### V. FII Board Leadership, Composition, and Structure

#### a. Leadership

- There are a number of alternative leadership models that FII could pursue. FII has determined that the positions of President, CEO and Chair of the Board should be separated so that one person does not hold more than two of these titles, e.g., one person is President and CEO and another is Chair of the Board.

#### b. Board Composition

- The FII Board should be composed of 10-13 members reflecting diverse experience, gender, race, and geographic representation, meeting the Director qualifications set forth in FII's Director Position Description, and consisting of one inside Director. At some future time an additional inside Director may be added to the Board if proposed by FII Management.

#### c. Policy on FII Director Nominations

- This Policy implements Section 12 "Nominations and Qualifications of Directors" of the FII By-Laws, and Section V (b) "Board Composition" of the FII Corporate Governance Policy, and any future amendments to any of said documents.
- The Executive, Nominating and Governance Committee (the "Committee") shall receive and consider all nominations received by it in a timely fashion (i) Pursuant to Section 12 of the By-Laws in the case of nominations to be considered for election at a shareholders' meeting, or (ii) not less than 60 days or more than 90 days before the Board acts to fill a vacancy on the Board by

## Corporate Governance Policy

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appointment.

- Nominations may be made by shareholders or Directors, and each nomination shall include the information specified in Section 12 of the By-Laws, together with sufficient information to establish (i) whether the nominee would be “independent” as defined in Section I of these Guidelines, and (ii) that the nominee fits the Board’s then current needs for diversity, geographic distribution and professional expertise.
- All nominations shall be made in writing to the Director of Human Resources who shall determine if the nomination is complete in form and content. All complete nominations shall be forwarded to the Committee for consideration. The Committee shall evaluate all nominees on the same basis, provided that current directors who are eligible for reelection may be evaluated primarily on the basis of their record of performance as an FII director.
- The Committee shall conduct such investigation and interviews of each nominee as it deems necessary to make a fair evaluation. Nominees determined to be qualified by a majority vote of the Committee may be proposed to the Board for election, appointment to fill a vacancy, or be held in reserve in a prospective director pool.
- The Director of Human Resources shall advise each person making a nomination of the Committee’s determination.

### d. Committee Structure

- The FII Audit, Risk Oversight, Management Development & Compensation (MD&C), and Executive, Nominating and Governance Committees should be comprised only of independent directors. The FII Board shall be composed of sufficient independent directors to provide enough committee members so that any director does not serve on more than three committees.
- The FII Audit Committee should include one or more financial experts, as provided under Section IV

## Corporate Governance Policy

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above, and its members shall meet the special rules for independence of Audit Committee members set forth in Section 301 of the Sarbanes Oxley Act and SEC Rule 10A-3.

- Committees shall operate under written charters outlining its respective functions and responsibilities.

### **VI. Subsidiary Bank Board, Composition, Structure and Committees**

#### **a. Composition and Structure**

- The Board of Five Star Bank (FSB) shall be the same as the FII Board, comprised solely of FII Directors.
- The Chair of the FSB Board shall be the Chairman of the Board (COB) of the FII Board.
- The Vice Chair will function as Chair in the absence of the COB.
- The meetings of the FSB Board will be coordinated with meetings of the FII Board, but will be separate, with a separate agenda and minutes.

#### **b. Committee Structure**

- The personnel, nominating, compensation and audit functions of FSB shall be delegated to the FII Audit, Risk Oversight, Executive, Nominating and Governance, and MD&C Committees to perform.
- FSB shall have an Executive Committee, comprised of the members of the FII Executive, Nominating and Governance Committee.

### **VII. Essential Functions of the Boards of FII and FSB**

**a.** Participates in the formulation of, and approves, the strategic plan for FII and FSB. Ensures decisions relating to major corporate actions, including mergers, acquisitions and reorganizations are consistent with FII's strategic plan.

**b.** Assesses risks and opportunities and adopts policies and procedures that are calculated to allow FII and FSB to achieve their objectives in a safe, sound, legal, and ethical manner.

## Corporate Governance Policy

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- c. Selects the FII and FSB CEO; evaluates the performance of the FII and FSB CEO and of the Directors, Committees, and the Board itself; sets the compensation of the executive management of FII and FSB and the Board; and oversees succession planning.
  - d. Assures processes are in place for maintaining integrity and ethical conducts at all levels of the entities and with respect to all constituencies.
  - e. Reviews and approves all policies and programs at least annually, or as needed when created, revised or modified, to ensure that they remain consistent with FII's and FSB's goals.
  - f. Monitors operations and financial performance through management reports and/or discussions with members of senior management. Ascertain that lines of authority within FII and FSB are clear and that management understands and carries out board policies and directives.
  - g. Takes all reasonable steps to ensure that FII and FSB management has adopted measures to maintain compliance with all accounting, regulatory and legal guidelines, including those established by various banking, holding company, securities and other applicable governing bodies. Assess the impact of new laws, regulations and accounting principles, on banking and holding company operations, disclosure requirements and procedures.
  - h. Monitors training and development programs for executive management to ensure that an orderly management succession plan is developed and implemented.
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## Corporate Governance Policy

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**Owner** CEO

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**Approvals** Executive, Nominating and Governance Committee and the Board of Directors

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**Date** May 6, 2010

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