PATHFINDER BANCORP INC
Form 10-K/A
April 28, 2011

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

FORM 10-K/A

AMENDMENT NO. 1

T ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2010.
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: 000-23601

PATHFINDER BANCORP, INC.'
(Exact name of registrant as specified in its charter)

Federal
16-1540137
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

214 West First Street
Oswego, NY 13126
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (315) 343-0057

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

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES * NO T

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES * NO T

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 T NO *

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES * NO *

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.*

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

Large accelerated filer * Accelerated filer * Non-accelerated filer * Smaller reporting company T
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES * NO T

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on June 30, 2010, as reported by the NASDAQ Capital Market, was approximately $5.4 million.

As of March 18, 2011, there were 2,484,832 shares outstanding of the Registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE:

(1) Proxy Statement for the 2011 Annual Meeting of Stockholders of the Registrant (Part III).
(2) Annual Report to Stockholders (Part II and IV).

EXPLANATORY NOTE:

PART II

Item 8 - Financial Statements and Supplementary Data

Item 8 is being amended herein because the original filing of Form 10-K lacked the electronic signature of our independent auditor due to a filing error. The signed audit report is included with this amendment.

Except as described above, the Original filing has not been amended, updated or otherwise modified.

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FORM 10-K ANNUAL REPORT
FOR THE YEAR ENDED
DECEMBER 31, 2010
PATHFINDER BANCORP, INC.

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PART I

FORWARD-LOOKING STATEMENTS

When used in this Annual Report the words or phrases “will likely result”, “are expected to”, “will continue”, “is anticipated” “estimate”, ”project” or similar expression are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties.By identifying these forward-looking statements for you in this manner, the Company is alerting you to the possibility that its actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause the Company’s actual results and financial condition to differ from those indicated in the forward-looking statements include, among others:

§ credit quality and the effect of credit quality on the adequacy of our allowance for loan losses;

§ deterioration in financial markets that may result in impairment charges relating to our securities portfolio;

§ competition in our primary market areas;.

§ significant government regulations, legislation and potential changes thereto;

§ a reduction in our ability to generate or originate revenue-producing assets as a result of compliance with heightened capital standards;

§ increased cost of operations due to greater regulatory oversight, supervision and examination of banks and bank holding companies, and higher deposit insurance premiums;

§ the limitation on our ability to expand consumer product and service offerings due to anticipated stricter consumer protection laws and regulations: and

§ other risks described herein and in the other reports and statements we file with the SEC.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company’s financial performance and could cause the Company’s actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

ITEM 1: BUSINESS

GENERAL

Pathfinder Bancorp, Inc.

Pathfinder Bancorp, Inc. (the "Company") is a Federally chartered mid-tier holding company headquartered in Oswego, New York. The primary business of the Company is its investment in Pathfinder Bank (the "Bank"). The Company is majority owned by Pathfinder Bancorp, M.H.C., a federally-chartered mutual holding company (the "Mutual Holding Company"). At December 31, 2010, the Mutual Holding Company held 1,583,239 shares of the Company’s common stock (“Common Stock”) and the public held 901,593 shares of Common Stock (the "Minority Stockholders"). At December 31, 2010, Pathfinder Bancorp, Inc. and subsidiaries had total assets of $408.5 million, total deposits of $326.5 million and shareholders' equity of $30.6 million.

The Company's executive office is located at 214 West First Street, Oswego, New York and the telephone number at that address is (315) 343-0057.

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Pathfinder Bank

The Bank is a New York-chartered savings bank headquartered in Oswego, New York. The Bank operates from its main office as well as seven branch offices located in its market area consisting of Oswego County and the contiguous counties. The seventh branch was added in Cicero, New York and opened to the public on February 1, 2011. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank was chartered as a New York savings bank in 1859 as Oswego City Savings Bank. The Bank is a customer-oriented institution dedicated to providing mortgage loans and other traditional financial services to its customers. The Bank is committed to meeting the financial needs of its customers in Oswego County, New York, and the contiguous counties.

The Bank is primarily engaged in the business of attracting deposits from the general public in the Bank's market area, and investing such deposits, together with other sources of funds, in loans secured by one- to four-family residential real estate and commercial real estate. At December 31, 2010, $216.3 million, or 76% of the Bank's total loan portfolio consisted of loans secured by real estate, of which $147.2 million, or 68%, were loans secured by one- to four-family residences and $69.1 million, or 32%, were secured by commercial real estate. Additionally, $25.2 million, or 9%, of total loans, were secured by second liens on residential properties that are classified as consumer loans. The Bank also originates commercial and consumer loans that totaled $39.7 million and $3.4 million, respectively, or 15%, of the Bank's total loan portfolio at December 31, 2010. The Bank invests a portion of its assets in securities issued by the United States Government and its agencies and sponsored enterprises, state and municipal obligations, corporate debt securities, mutual funds, and equity securities. The Bank also invests in mortgage-backed securities primarily issued or guaranteed by United States Government sponsored enterprises. The Bank's principal sources of funds are deposits, principal and interest payments on loans and investments, as well as borrowings from correspondent financial institutions. The principal source of income is interest on loans and investment securities. The Bank's principal expenses are interest paid on deposits, and employee compensation and benefits.

Pathfinder Bank also operates through a limited purpose commercial bank subsidiary, Pathfinder Commercial Bank, which serves the depository needs of public entities in its market area.

The Bank has Pathfinder REIT, Inc., a New York corporation, as its wholly-owned real estate investment trust subsidiary. At December 31, 2010, Pathfinder REIT, Inc. held $14.7 million in mortgages and mortgage related assets. All disclosures in this Form 10-K relating to the Bank's loans and investments include loans and investments that are held by Pathfinder REIT, Inc.

The Bank also has 100% ownership in Whispering Oaks Development Corp., a New York corporation, which is retained in case the need to operate or develop foreclosed real estate emerges. This subsidiary is currently inactive.

Finally, the Company has a non-consolidated Delaware statutory trust subsidiary, Pathfinder Statutory Trust II, of which 100% of the common equity is owned by the Company. Pathfinder Statutory Trust II was formed in connection with the issuance of trust preferred securities.

Employees

As of December 31, 2010, the Bank had 95 full-time employees and 21 part-time employees. The employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

MARKET AREA AND COMPETITION

The economy in the Bank's market area is manufacturing-oriented and is also significantly dependent upon the State University of New York College at Oswego. The major manufacturing employers in the Bank's market area are

Entergy Nuclear Northeast, Novelis, Constellation, NRG and Huhtamaki. The Bank is the largest depository institution headquartered in Oswego County. The Bank's business and operating results are significantly affected by the general economic conditions prevalent in its market areas.

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The Bank encounters strong competition both in attracting deposits and in originating real estate and other loans. Its most direct competition for deposits has historically come from commercial banks, savings banks, savings associations and credit unions in its market area. Competition for loans comes from such financial institutions as well as mortgage banking companies. The Bank competes for deposits by offering depositors a high level of personal service and a wide range of competitively priced financial services. The Bank competes for real estate loans primarily through the interest rates and loan fees it charges and advertising, as well as by originating and holding in its portfolio mortgage loans which do not necessarily conform to secondary market underwriting standards. The turmoil in the residential mortgage sector of the United States economy has caused certain competitors to be less effective in the market place. While Central New York did not experience the level of speculative lending and borrowing in residential real estate that has adversely affected other regions on a national basis, certain mortgage brokers and finance companies in our area are either no longer operating, or have limited aggressive lending practices. Additionally, as certain money centers and large regional banks grapple with current economic conditions and the related credit crisis, their ability to compete as effectively has been muted. Management believes that these conditions have created a window of reduced competition for local community and regional banks in residential loans, and to a lesser extent, commercial real estate loans. Of course, there are others, including tax-exempt credit unions, that are aggressively taking advantage of that window.

REGULATION AND SUPERVISION

General

The Bank is a New York-chartered stock savings bank and its deposit accounts are insured up to applicable limits by the FDIC through the Deposit Insurance Fund (“DIF ”). The Bank is subject to extensive regulation by the New York State Banking Department (the “Department”), as its chartering agency, and by the FDIC, as its deposit insurer and primary federal regulator. The Bank is required to file reports with, and is periodically examined by, the FDIC and the Superintendent of the Department concerning its activities and financial condition and must obtain regulatory approvals prior to entering into certain transactions, including, but not limited to, mergers with or acquisitions of other banking institutions. The Bank is a member of the Federal Home Loan Bank of New York (“FHLBNY”) and is subject to certain regulations by the Federal Home Loan Bank System.

The Company and the Mutual Holding Company are federally chartered. Consequently, they are currently subject to regulations of the Office of Thrift Supervision ("OTS") as savings and loan holding companies.However, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which is discussed further below, the OTS’s functions relating to savings and loan holding companies will be transferred to the Federal Reserve Board by July 21, 2011, unless extended by up to six months by the Secretary of the Treasury.

Regulatory requirements applicable to the Bank, the Company and the Mutual Holding Company are referred to below or elsewhere herein. This description of statutory and regulatory provisions does not purport to be a complete description of all such statutes and regulations applicable to the Mutual Holding Company, the Company, or the Bank. Any change in these laws or regulations, whether by Congress or the applicable regulatory agencies, could have a material adverse impact on the Bank, the Company or the Mutual Holding Company.

Dodd-Frank Act

The Dodd-Frank Act will significantly change the current bank regulatory structure and affect the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act will eliminate the current primary federal regulator of the Company and the Mutual Holding Company, the OTS. Under the Dodd-Frank Act, the Federal Reserve Board will supervise and regulate all savings and loan holding companies, such as the Company and the Mutual Holding Company, in addition to bank holding companies, which the Federal Reserve Board currently regulates. As a result, the Federal Reserve Board’s current regulations applicable to bank holding companies, including holding company capital requirements, will apply to savings and loan holding companies like the Company, unless an exemption exists. The bank holding company capital requirements are substantially similar to the capital requirements currently applicable to the Bank, as described in "Regulatory Capital Requirements." The Dodd-Frank Act also requires the Federal Reserve Board to set minimum capital levels for bank holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Bank holding companies with assets of less than $500 million are exempt from these capital requirements. Under the Dodd-Frank Act, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than $15 billion of assets. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months. These new leverage and capital requirements must take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives. Moreover, the Mutual Holding Company will require the approval of the Federal Reserve Board before it may waive the receipt of any dividends from the Company, and there is no assurance that the Federal Reserve Board will approve future dividend waivers or what conditions it may impose on such waivers. See "Federal Holding Company Regulation—Waivers of Dividends by Mutual Holding Company" below.

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The Dodd-Frank Act also creates a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as Pathfinder Bank, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets will be examined by their applicable bank regulators. The new legislation also weakens the federal preemption available for national banks and federal savings associations, and gives state attorneys general the ability to enforce applicable federal consumer protection laws.

The Dodd-Frank Act also broadens the base for Federal Deposit Insurance Corporation insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. The legislation also permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2008, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2012. Lastly, the Dodd-Frank Act will increase stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments, and authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate and solicit votes for their own candidates using a company’s own proxy materials. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not.

New York State Banking Law and FDIC Regulation

The Bank derives its lending, investment and other authority primarily from the applicable provisions of New York State Banking Law and the regulations of the Department, as limited by FDIC regulations. In particular, the applicable provisions of New York State Banking Law and regulations governing the investment authority and activities of an FDIC insured state-chartered savings bank have been substantially limited by the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") and the FDIC regulations issued pursuant thereto. Under these laws and regulations, savings banks, including the Bank, may invest in real estate mortgages, consumer and commercial loans, certain types of debt securities, including certain corporate debt securities and obligations of federal, state and local governments and agencies, certain types of corporate equity securities and certain other assets. New York State chartered savings banks may also invest in subsidiaries under their service corporation investment authority. A savings bank may use this power to invest in corporations that engage in various activities authorized for savings banks, plus any additional activities, which may be authorized by the Banking Board. Under FDICIA and the FDIC’s implementation of regulations, the Bank’s investment and service corporation activities are limited to activities permissible for a national bank unless the FDIC otherwise permits it.

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The FDIC and the Superintendent have broad enforcement authority over the Bank. Under this authority, the FDIC and the Superintendent have the ability to issue formal or informal orders to correct violations of laws or unsafe or unsound banking practices.

FDIC Insurance on Deposits

The Federal Deposit Insurance Corporation, or FDIC, insures deposits at FDIC insured financial institutions such as the Bank. Deposit accounts in the Bank are insured by the FDIC generally up to a maximum of $250,000 per separately insured depositor and up to a maximum of $250,000 for self-directed retirement accounts. The FDIC charges the insured financial institutions premiums to maintain the Deposit Insurance Fund.

Under the FDIC's current risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other risk factors. The rates for nearly all of the financial institutions industry vary between five and seven cents for every $100 of domestic deposits.

As part of its plan to restore the Deposit Insurance Fund in the wake of the large number of bank failures following the financial crisis, the FDIC imposed a special assessment of 5 basis points for the second quarter of 2009. In addition, the FDIC has required all insured institutions to prepay their quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. As part of this prepayment, the FDIC assumed a 5% annual growth in the assessment base and applied a 3 basis point increase in assessment rates effective January 1, 2011. Prepaid assessments for 2010 totaled $477,000.

In February 2011, the FDIC published a final rule under the Dodd-Frank Act to reform the deposit insurance assessment system. The rule redefines the assessment base used for calculating deposit insurance assessments effective April 1, 2011. Under the new rule, assessments will be based on an institution's average consolidated total assets minus average tangible equity as opposed to total deposits. Since the new base will be much larger than the current base, the FDIC also lowered assessment rates so that the total amount of revenue collected from the industry will not be significantly altered. The new rule is expected to benefit smaller financial institutions, which typically rely more on deposits for funding, and shift more of the burden for supporting the insurance fund to larger institutions, which have greater access to non-deposit sources of funding.

The Dodd-Frank Act also extended the unlimited deposit insurance on non-interest bearing transaction accounts through December 31, 2012. Unlike the FDIC's Temporary Liquidity Guarantee Program, the insurance provided under the Dodd-Frank Act does not extend to low-interest NOW accounts, and there is no separate assessment on covered accounts.

In addition to the FDIC assessments, the Financing Corporation ("FICO") is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. During the year ended December 31, 2010, the Bank paid $35,000 in fees related to the FICO.

Insurance of deposits may be terminated by the FDIC upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. We do not currently know of any practice, condition or violation that may lead to termination of our deposit insurance.

Regulatory Capital Requirements

The FDIC has adopted risk-based capital guidelines to which the Bank is subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. The Bank is required to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. The ratio of such regulatory capital to regulatory risk-weighted assets is referred to as the Bank's "risk-based capital ratio." Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items to four risk-weighted categories ranging from 0% to 100%, with higher levels of capital being required for the categories perceived as representing greater risk.

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These guidelines divide a savings bank's capital into two tiers. The first tier ("Tier I") includes common equity, retained earnings, certain non-cumulative perpetual preferred stock (excluding auction rate issues) and minority interests in equity accounts of consolidated subsidiaries, less goodwill and other intangible assets (except mortgage servicing rights and purchased credit card relationships subject to certain limitations). Supplementary ("Tier II") capital includes, among other items, cumulative perpetual and long-term limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan and lease losses, subject to certain limitations, less required deductions. Savings banks are required to maintain a total risk-based capital ratio of at least 8%, and a Tier I risk based capital level of at least 4%.

In addition, the FDIC has established regulations prescribing a minimum Tier I leverage ratio (Tier I capital to adjusted total assets as specified in the regulations). These regulations provide for a minimum Tier I leverage ratio of 3% for banks that meet certain specified criteria, including that they have the highest examination rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier I leverage ratio of 3% plus an additional cushion of at least 100 to 200 basis points. The FDIC and the other federal banking regulators have proposed amendments to their minimum capital regulations to provide that the minimum leverage capital ratio for a depository institution that has been assigned the highest composite rating of 1 under the Uniform Financial Institutions Rating System will be 3% and that the minimum leverage capital ratio for any other depository institution will be 4% unless a higher leverage capital ratio is warranted by the particular circumstances or risk profile of the depository institution. The FDIC may, however, set higher leverage and risk-based capital requirements on individual institutions when particular circumstances warrant. Savings banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

Limitations on Dividends and Other Capital Distributions

The FDIC has the authority to use its enforcement powers to prohibit a savings bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis. New York law also restricts the Bank from declaring a dividend that would reduce its capital below the amount that is required to be maintained by state law and regulation. The Company is also subject to the OTS capital distribution rules by virtue of being an OTS regulated savings and loan holding company.

Since the Company has chosen to participate in the Treasury’s CPP program, its ability to increase dividends to its stockholders is limited without prior approval by the United States Treasury Department.

Prompt Corrective Action

The federal banking agencies have promulgated regulations to implement the system of prompt corrective action required by federal law. Under the regulations, a bank shall be deemed to be (i) "well capitalized" if it has total risk-based capital of 10% or more, has a Tier I risk-based capital ratio of 6% or more, has a Tier I leverage capital ratio of 5% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a total risk based capital ratio of 8% or more, a Tier I risk-based capital ratio of 4% or more and a Tier I leverage capital ratio of 4% or more (3% under certain circumstances) and does not meet the definition of "well capitalized"; (iii) "undercapitalized" if it has a total risk-based capital ratio that is less than 8%, a Tier I risk-based capital ratio that is less than 4% or a Tier I leverage capital ratio that is less than 4% (3% under certain circumstances); (iv) "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6%, a Tier I risk-based capital ratio that is less than 3% or a Tier I leverage capital ratio that is less than 3%; and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2%. Federal law and regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized).

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The Bank currently meets the criteria to be classified as a "well capitalized" savings institution.

Transactions With Affiliates and Insiders

Under current federal law, transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act and its implementing regulations. An affiliate of a savings bank is any company or entity that controls, is controlled by, or is under common control with the savings bank, other than a subsidiary of the savings bank. In a holding company context, at a minimum, the parent holding company of a savings bank, and any companies that are controlled by such parent holding company, are affiliates of the savings bank. Generally, Section 23A limits the extent to which the savings bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such savings bank's capital stock and surplus and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The term "covered transaction" includes the making of loans or other extensions of credit to an affiliate; the purchase of assets from an affiliate, the purchase of, or an investment in, the securities of an affiliate; the acceptance of securities of an affiliate as collateral for a loan or extension of credit to any person; or issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate. Section 23A also establishes specific collateral requirements for loans or extensions of credit to, or guarantees, acceptances on letters of credit issued on behalf of an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same, or no less favorable, to the savings bank or its subsidiary as similar transactions with nonaffiliates.

Further, Section 22(h) of the Federal Reserve Act and its implementing regulations restrict a savings bank with respect to loans to directors, executive officers, and principal stockholders. Under Section 22(h), loans to directors, executive officers and stockholders who control, directly or indirectly, 10% or more of voting securities of a savings bank and certain related interests of any of the foregoing, may not exceed, together with all other outstanding loans to such persons and affiliated entities, the savings bank's total unimpaired capital and unimpaired surplus. Section 22(h) also prohibits loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and stockholders who control 10% or more of voting securities of a stock savings bank, and their respective related interests, unless such loan is approved in advance by a majority of the board of directors of the savings bank. Any "interested" director may not participate in the voting. Further, pursuant to Section 22(h), loans to directors, executive officers and principal stockholders must generally be made on terms substantially the same as offered in comparable transactions to other persons. Section 22(g) of the Federal Reserve Act places additional limitations on loans to executive officers.

Supervisory Agreement

During May 2009, the Company entered into a Supervisory Agreement with the OTS. The agreement was issued in connection with the identification of certain violations of applicable statutory and regulatory restrictions on capital distributions and transactions with affiliates. As a result of the identified violations, the Company recorded $41,000 of income relating to certain transactions with its unconsolidated parent company Pathfinder Bancorp, MHC. In addition the Company is prohibited from accepting or directing Pathfinder Bank to declare or pay a dividend or other capital distributions without the prior written approval of the Office of Thrift Supervision. All violations have been corrected and the Company believes it is in compliance with the Agreement.

Federal Holding Company Regulation

General. The Company and the Mutual Holding Company are nondiversified savings and loan holding companies within the meaning of the Home Owners' Loan Act. The Company and the Mutual Holding Company are registered with the OTS and are subject to OTS regulations, examinations, supervision and reporting requirements. As such, the OTS has enforcement authority over the Company and the Mutual Holding Company, and their non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution. Upon the sunset of the OTS, the Company, and the Mutual Holding Company, will be regulated by the Board of Governors of the Federal Reserve. See "The Dodd-Frank Act" above.

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Permitted Activities. Under OTS regulation and policy, a mutual holding company and a federally chartered mid-tier holding company, such as the Company, may engage in the following activities: (i) investing in the stock of a savings association; (ii) acquiring a mutual association through the merger of such association into a savings association subsidiary of such holding company or an interim savings association subsidiary of such holding company; (iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings association; (iv) investing in a corporation, the capital stock of which is available for purchase by a savings association under federal law or under the law of any state where the subsidiary savings association or associations share their home offices; (v) furnishing or performing management services for a savings association subsidiary of such company; (vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company; (vii) holding or managing properties used or occupied by a savings association subsidiary of such company; (viii) acting as trustee under deeds of trust; (ix) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956, unless the Director of the OTS, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987; (x) any activity permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act, including securities and insurance underwriting; and (xi) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the Director. If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed in (i) through (xi) above, and has a period of two years to cease any nonconforming activities and divest of any nonconforming investments.

The Home Owners' Loan Act prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring another savings association or holding company thereof, without prior written approval of the OTS. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a nonsubsidiary savings association, a nonsubsidiary holding company, or a nonsubsidiary company engaged in activities other than those permitted by the Home Owners' Loan Act; or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings associations, the OTS must consider the financial and managerial resources, future prospects of the company and association involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

The OTS is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings associations in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Waivers of Dividends by Mutual Holding Company.The Mutual Holding Company currently waives its right to receive its dividends on its shares of the Company, which means that the Company has more cash resources to pay dividends to our public stockholders than if the Mutual Holding Company accepted such dividends. OTS regulations allow federally chartered mutual holding companies to waive dividends without taking into account the amount of waived dividends in determining an appropriate exchange ratio in the event of a conversion of a mutual holding company to stock form. The Mutual Holding Company is required to obtain OTS approval before it may waive its receipt of dividends. However, under the Dodd-Frank Act, the powers and duties of the OTS relating to mutual holding companies will be transferred to the Federal Reserve Board, and the Mutual Holding Company will be required to give the Federal Reserve Board notice before waiving the receipt of dividends. The Dodd-Frank Act also sets forth the standards for granting a waiver, including a requirement that waived dividends be considered in determining an appropriate exchange ratio in the event of a conversion of the mutual holding company to stock form. The Dodd-Frank Act, however, further provides that the Federal Reserve Board may not consider waived dividends in determining an appropriate exchange ratio in a conversion to stock form by any federal mutual holding company, such as the Mutual Holding Company, that has waived dividends prior to December 1, 2009. The Federal Reserve Board historically has generally not allowed mutual holding companies to waive the receipt of dividends, and there can be no assurance as to the conditions, if any, the Federal Reserve Board will place on future dividend waiver requests by grandfathered mutual holding companies such as the Mutual Holding Company. The Mutual Holding Company has not requested a current dividend waiver and is not planning to waive future dividends at this time.

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Conversion of the Mutual Holding Company to Stock Form. OTS regulations permit the Mutual Holding Company to convert from the mutual form of organization to the capital stock form of organization (a "Conversion Transaction"). There can be no assurance when, if ever, a Conversion Transaction will occur, and the Board of Directors has no current intention or plan to undertake a Conversion Transaction. In a Conversion Transaction a new holding company would be formed as the successor to the Company (the "New Holding Company"), the Mutual Holding Company's corporate existence would end, and certain depositors of the Bank would receive the right to subscribe for additional shares of the New Holding Company. In a Conversion Transaction, each share of common stock held by stockholders other than the Mutual Holding Company ("Minority Stockholders") would be automatically converted into a number of shares of common stock of the New Holding Company determined pursuant to an exchange ratio (determined by an independent valuation) that ensures that Minority Stockholders own the same percentage of common stock in the New Holding Company as they owned in the Company immediately prior to the Conversion Transaction. The total number of shares held by Minority Stockholders after a Conversion Transaction also would be increased by any purchases by Minority Stockholders in the stock offering conducted as part of the Conversion Transaction.

Federal Securities Law

The common stock of the Company is registered with the SEC under the Securities Exchange Act of 1934, as amended ("Exchange Act"). The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the SEC under the Exchange Act.

The Company Common Stock held by persons who are affiliates (generally officers, directors and principal stockholders) of the Company may not be resold without registration or unless sold in accordance with certain resale restrictions. If the Company meets specified current public information requirements, each affiliate of the Company is able to sell in the public market, without registration, a limited number of shares in any three-month period.

Federal Reserve System

The Federal Reserve Board requires all depository institutions to maintain noninterest-bearing reserves at specified levels against their transaction accounts (primarily checking, money management and NOW checking accounts). At December 31, 2010, the Bank was in compliance with these reserve requirements.

Federal Community Reinvestment Regulation

Under the Community Reinvestment Act, as amended (the "CRA"), as implemented by FDIC regulations, a savings bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the FDIC, in connection with its examination of a savings institution, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution. The CRA requires the FDIC to provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. The Bank's latest CRA rating was "satisfactory."

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New York State Community Reinvestment Regulation

The Bank is subject to provisions of the New York State Banking Law which impose continuing and affirmative obligations upon banking institutions organized in New York State to serve the credit needs of its local community ("NYCRA") which are substantially similar to those imposed by the CRA. Pursuant to the NYCRA, a bank must file an annual NYCRA report and copies of all federal CRA reports with the Department. The NYCRA requires the Department to make a biennial written assessment of a bank's compliance with the NYCRA, utilizing a four-tiered rating system and make such assessment available to the public. The NYCRA also requires the Superintendent to consider a bank's NYCRA rating when reviewing a bank's application to engage in certain transactions, including mergers, asset purchases and the establishment of branch offices or automated teller machines, and provides that such assessment may serve as a basis for the denial of any such application.

The Bank's NYCRA rating as of its latest examination was "satisfactory."

The USA PATRIOT Act

The USA PATRIOT Act (“the PATRIOT Act”) was signed into law on October 26, 2001. The PATRIOT Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The PATRIOT Act also requires the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering activities in determining whether to approve a merger or other acquisition application of a financial institution. Accordingly, if the Company were to engage in a merger or other acquisitions, its controls designed to combat money laundering would be considered as part of the application process. The Company and the Bank have established policies, procedures and systems designed to comply with these regulations.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (“Sarbanes Oxley”) was signed into law on July 30, 2002. Sarbanes-Oxley is a law that addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by Section 302(a) of Sarbanes-Oxley, the Company’s Chief Executive Officer and Chief Financial Officer are each required to certify that the Company’s quarterly and annual reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal controls; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal controls; and they have included information in our quarterly and annual reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation. As part of the Dodd-Frank Act, the outside auditor attestation requirement on internal controls of companies with less than $75 million in market capitalization, like the Company, was rescinded. Disclosure of management attestations on internal control over financial reporting will continue to be required for smaller reporting companies, including the Company. We have existing policies, procedures and systems designed to comply with these regulations, and continue to further enhance and document our policies, procedures and systems to ensure continued compliance with these regulations.

Emergency Economic Stabilization Act of 2008

The Emergency Economic Stabilization Act of 2008 ("EESA") was enacted on October 3, 2008. EESA enables the federal government, under terms and conditions to be developed by the Secretary of the Treasury, to insure troubled assets, including mortgage-backed securities, and collect premiums from participating financial institutions. EESA includes, among other provisions: (a) the $700 billion Troubled Assets Relief Program ("TARP"), under which the Secretary of the Treasury is authorized to purchase, insure, hold, and sell a wide variety of financial instruments, particularly those that are based on or related to residential or commercial mortgages originated or issued on or before March 14, 2008; and (b) an increase in the amount of deposit insurance provided by the FDIC.

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Under the TARP, the United States Department of Treasury authorized a voluntary Capital Purchase Program to purchase up to $250 billion of senior preferred shares of qualifying financial institutions that elected to participate by November 14, 2008. The program was developed to attract broad participation by strong financial institutions, to stabilize the financial system and increase lending to benefit the national economy and citizens of the United States.The board of directors and management analyzed the potential merits of participating in the Capital Purchase Program ("CPP") of the Treasury Department's TARP. It was the general view of the board and management that in the present national economic risk environment, enhancing the Company's capital ratios is both prudent, given the current climate, and potentially opportunistic as we move into the next business cycle. Additionally, any increase to capital will continue to support the Company's lending activities to individuals, families, and businesses in our community. Companies participating in the CPP are required to adopt certain standards relating to executive compensation. The terms of the CPP also limit certain uses of capital by the issuer, including with respect to repurchases of securities and increases in dividends.

On September 11, 2009, the Company entered into a Purchase Agreement with the Treasury Department pursuant to which the Company has issued and sold to Treasury: (i) 6,771 shares of the Company's Series A Preferred Stock, having a liquidation amount per share equal to $1,000, for a total price of $6,771,000; and (ii) a Warrant to purchase 154,354 shares of the Company's common stock, par value $0.01 per share, at an exercise price per share of $6.58.

The Chief Executive Officer and the Chief Financial Officer are required to certify compliance with the compensation provisions of the CPP program. Our certifications are appended to this 10-K in Exhibit 99.1 and 99.2.

Securities and Exchange Commission Reporting

The Company maintains an Internet website located at www.pathfinderbank.com on which, among other things, the Company makes available, free of charge, various reports that it files with or furnishes to the Securities and Exchange Commission, including its Annual Report on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K. These reports are made available as soon as reasonably practicable after these reports are filed with or furnished to the Securities and Exchange Commission. The Company has also made available on its website its Audit Committee Charter, Compensation Committee Charter, Governance Guidelines (which serve as the Nominating / Governance Committee's charter) and Code of Ethics.

The Company's Annual Report on Form 10-K may be accessed on the Company's website at www.pathfinderbank.com/annualmeeting.

FEDERAL AND STATE TAXATION

Federal Taxation

The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to the Company or the Bank.

Bad Debt Reserves. Prior to the Tax Reform Act of 1996 ("the 1996 Act"), the Bank was permitted to establish a reserve for bad debts and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at the Bank's taxable income. As a result of the 1996 Act, the Bank must use the small bank experience method in computing its bad debt deduction.

Taxable Distributions and Recapture. Prior to the 1996 Act, bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income should the Bank fail to meet certain thrift asset and definitional tests. New federal legislation eliminated these thrift related recapture rules. However, under current law, pre-1988 reserves remain subject to recapture should the Bank cease to retain a bank or thrift charter or make certain non-dividend distributions.

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Minimum Tax. The Internal Revenue Code imposes an alternative minimum tax ("AMT") at a rate of 20% on a base of regular taxable income plus certain tax preferences ("alternative minimum taxable income" or "AMTI"). The AMT is payable to the extent such AMTI is in excess of an exemption amount. Net operating losses can offset no more than 90% of AMTI. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years.

State Taxation

New York Taxation. The Bank is subject to the New York State Franchise Tax on Banking Corporations in an annual amount equal to the greater of (i) 7.1% of the Bank's "entire net income" allocable to New York State during the taxable year, or (ii) the applicable alternative minimum tax. The alternative minimum tax is generally the greater of (a) 0.01% of the value of the Bank's assets allocable to New York State with certain modifications, (b) 3% of the Bank's "alternative entire net income" allocable to New York State, or (c) $250. Entire net income is similar to federal taxable income, subject to certain modifications and alternative entire net income is equal to entire net income without certain modifications. Net operating losses arising in the current period can be carried forward to the succeeding 20 taxable years.

Neither the Internal Revenue Service or New York State have examined our federal or state tax returns within the past 5 years.

ITEM 1A: RISK FACTORS

Not required of a smaller reporting company.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None.

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ITEM 2: PROPERTIES

The Bank conducts its business through its main office located in Oswego, New York, six branch offices located in Oswego County, and a new branch, opened February 1, 2011, in Onondaga County. Management believes that the Bank's facilities are adequate for the business conducted. The following table sets forth certain information concerning the main office and each branch office of the Bank at December 31, 2010. The aggregate net book value of the Bank's premises and equipment was $9.4 million at December 31, 2010. For additional information regarding the Bank's properties, see Notes 7 and 15 to the Consolidated Financial Statements.

LOCATION	OPENING DATE	OWNED/LEASED
Main Office	1874	Owned
214 West First Street		
Oswego, New York 13126		
Plaza Branch	1989	Owned (1)
Route 104, Ames Plaza		
Oswego, New York 13126		
Mexico Branch	1978	Owned
Norman & Main Streets		
Mexico, New York 13114		
Oswego East Branch	1994	Owned
34 East Bridge Street		
Oswego, New York 13126		
Lacona Branch	2002	Owned
1897 Harwood Drive		
Lacona, New York 13083		
Fulton Branch	2003	Owned (2)
5 West First Street South		
Fulton, New York 13069		
Central Square Branch	2005	Owned
3025 East Ave		
Central Square, New York 13036		
Cicero Branch	2011	Owned
6194 State Route 31		
Cicero, New York 13039		

(1) The building is owned; the underlying land is leased with an annual rent of $21,000
(2) The building is owned; the underlying land is leased with an annual rent of $30,000

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ITEM 3: LEGAL PROCEEDINGS

There are various claims and lawsuits to which the Company is periodically involved that are incidental to the Company's business. In the opinion of management, such claims and lawsuits in the aggregate are not expected to have a material adverse impact on the Company's consolidated financial condition and results of operations.

ITEM 4: (REMOVED AND RESERVED)

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Pathfinder Bancorp, Inc.'s common stock currently trades on the NASDAQ Capital Market under the symbol "PBHC". There were 476 shareholders of record as of March 18, 2011. The following table sets forth the high and low closing bid prices and dividends paid per share of common stock for the periods indicated:

Quarter Ended:	High	Low	Dividend Paid
December 31, 2010	$ 8.500	$ 7.750	$ 0.0300
September 30, 2010	8.000	6.030	0.0300
June 30, 2010	6.690	6.000	0.0300
March 31, 2010	8.000	5.600	0.0300
December 31, 2009	$ 7.000	$ 5.550	$ 0.0300
September 30, 2009	7.980	5.430	0.0300
June 30, 2009	8.000	4.950	0.0600
March 31, 2009	8.200	4.750	-

Dividends and Dividend History

The Company has historically paid regular quarterly cash dividends on its common stock, and the Board of Directors presently intends to continue the payment of regular quarterly cash dividends, subject to the need for those funds for debt service and other purposes. Payment of dividends on the common stock is subject to determination and declaration by the Board of Directors and will depend upon a number of factors, including capital requirements, regulatory limitations on the payment of dividends, Pathfinder Bank and its subsidiaries results of operations and financial condition, tax considerations, and general economic conditions. Given deteriorating economic conditions, and the Company's focus on the retention and growth of capital, it is unlikely that future, near-term dividends will replicate the historical dividend payouts of 2008 and prior years. The Company's mutual holding company, Pathfinder Bancorp, M.H.C., may elect to waive or receive dividends each time the Company declares a dividend. The election to waive the dividend receipt has required prior non-objection of the OTS in the past. Following the sunset of the

OTS, dividend waivers must receive the non-objection of the Federal Reserve. Historically, the Federal Reserve has not provided its non-objection to the waiver of dividends by mutual holding companies. The Mutual Holding Company did not waive the right to receive its portion of the cash dividends declared during 2010 or 2009.

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ITEM 6: SELECTED FINANCIAL DATA

The Company is the parent company of the Bank and Pathfinder Statutory Trust I. The Bank has three operating subsidiaries – Pathfinder Commercial Bank, Pathfinder REIT, Inc., and Whispering Oaks Development Corp.

The following selected consolidated financial data sets forth certain financial highlights of the Company and should be read in conjunction with the consolidated financial statements and related notes, and the "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this annual report on Form 10-K.

	2010	2009	2008	2007	2006
Year End (In thousands)					
Total assets	$ 408,545	$ 371,692	$ 352,760	$ 320,691	$ 301,382
Loans receivable, net	281,648	259,387	247,400	221,046	201,713
Deposits	326,502	296,839	269,438	251,085	245,585
Equity	30,592	29,238	19,495	21,704	20,850
For the Year (In thousands)					
Net interest income	$ 13,331	$ 11,777	$ 10,675	$ 8,667	$ 8,346
Core noninterest income (a)	2,854	2,724	2,786	2,622	2,396
Net gains/(losses) on sales, redemptions and impairment of investment securities	211	112	(2,191)	378	299
Net (losses) gains on sales of loans and foreclosed real estate	(45)	54	(44)	42	(80)
Noninterest expense (b)	11,274	10,381	9,882	9,799	9,646
Regulatory assessments	515	745	53	39	22
Net income	2,505	1,615	368	1,122	1,028
Per Share					
Net income (basic)	$ 0.82	$ 0.61	$ 0.15	$ 0.45	$ 0.42
Book value per common share	9.81	9.31	8.04	8.74	8.45
	8.26	7.77	6.50	7.19	6.82

Tangible book value per common share (c)										
Cash dividends declared	0.12		0.12		0.41		0.41		0.41	
Ratios										
Return on average assets	0.64	%	0.45	%	0.11	%	0.36	%	0.34	%
Return on average equity	8.07		7.04		1.70		5.27		4.86	
Return on average tangible equity (c)	9.20		8.45		2.07		6.47		6.04	
Average equity to average assets	7.89		6.40		6.32		6.82		7.03	
Dividend payout ratio (d)	11.90		18.45		232.61		62.03		66.73	
Allowance for loan losses to loans receivable	1.28		1.17		0.99		0.76		0.74	
Net interest rate spread	3.58		3.40		3.22		2.81		2.92	
Noninterest income to average assets	0.77		0.81		0.16		0.98		0.87	
Noninterest expense to average assets	3.00		3.10		2.91		3.15		3.21	
Efficiency ratio (e)	71.95		76.36		73.02		85.89		88.71	

(a) Exclusive of net gains (losses) on sales and impairment of investment securities and net gains (losses) on sales of loans and foreclosed real estate.

(b) Exclusive of regulatory assessments.

(c) Tangible equity excludes intangible assets.

(d) The dividend payout ratio is calculated using dividends declared and not waived by the Mutual Holding Company, divided by net income.

(e) The efficiency ratio is calculated as noninterest expense, including regulatory assessments, divided by the sum of taxable-equivalent net interest income and noninterest income excluding net gains (losses) on sales, redemptions and impairment of investment securities and net gains (losses) on sales of loans and foreclosed real estate.

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ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

Throughout Management's Discussion and Analysis ("MD&A") the term, "the Company", refers to the consolidated entity of Pathfinder Bancorp, Inc. Pathfinder Bank and Pathfinder Statutory Trust II are wholly owned subsidiaries of Pathfinder Bancorp, Inc., however, Pathfinder Statutory Trust II is not consolidated for reporting purposes (see Note 10 of the consolidated financial statements). Pathfinder Commercial Bank, Pathfinder REIT, Inc. and Whispering Oaks Development Corp. are wholly owned subsidiaries of Pathfinder Bank. At December 31, 2010, Pathfinder Bancorp, M.H.C, the Company's mutual holding company parent, whose activities are not included in the consolidated financial statements or the MD&A, held 63.7% of the Company's outstanding common stock and the public held 36.3% of the outstanding common stock.

The Company's business strategy is to operate as a well-capitalized, profitable and independent community bank dedicated to providing value-added products and services to our customers. Generally, the Company has sought to implement this strategy by emphasizing retail deposits as its primary source of funds and maintaining a substantial part of its assets in locally-originated residential first mortgage loans, loans to business enterprises operating in its markets, and in investment securities. Specifically, the Company's business strategy incorporates the following elements: (i) operating as an independent community-oriented financial institution; (ii) maintaining capital in excess of regulatory requirements; (iii) emphasizing investment in one-to-four family residential mortgage loans, loans to small businesses and investment securities; and (iv) maintaining a strong retail deposit base.

The Company's net income is primarily dependent on its net interest income, which is the difference between interest income earned on its investments in mortgage and other loans, investment securities and other assets, and its cost of funds consisting of interest paid on deposits and borrowings. The Company's net income also is affected by its provision for loan losses, as well as by the amount of noninterest income, including income from fees, service charges and servicing rights, net gains and losses on sales and redemptions of securities, loans and foreclosed real estate, and noninterest expense such as employee compensation and benefits, occupancy and equipment costs, data processing costs and income taxes. Earnings of the Company also are affected significantly by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities, of which these events are beyond the control of the Company. In particular, the general level of market rates tends to be highly cyclical.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow practices within the banking industry. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices or are provided by other third-party sources, when available. When third party information is not available, valuation adjustments are estimated in good faith by management.

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the allowance for loan losses, deferred income taxes, pension obligations, the evaluation of goodwill for impairment, the evaluation of investment securities for other than temporary impairment and the estimation of fair values for accounting and disclosure purposes to be the accounting areas that require the most subjective and complex judgments, and as such, could be the most subject to revision as new information becomes available.

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The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated statements of condition. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses, and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in this report.

Deferred income tax assets and liabilities are determined using the liability method. Under this method, the net deferred tax asset or liability is recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as net operating and capital loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. To the extent that current available evidence about the future raises doubt about the likelihood of a deferred tax asset being realized, a valuation allowance is established. The judgment about the level of future taxable income, including that which is considered capital, is inherently subjective and is reviewed on a continual basis as regulatory and business factors change. A valuation allowance of $458,000 was maintained at December 31, 2010, as management believes it may not generate sufficient capital gains to offset its capital loss carry forward. The Company’s effective tax rate differs from the statutory rate due to non-taxable income from investment securities and bank owned life insurance offset, in 2009, by the valuation allowance established on a portion of the capital loss carry forwards.

Pension and post-retirement benefit plan liabilities and expenses are based upon actuarial assumptions of future events, including fair value of plan assets, interest rates, rate of future compensation increases and the length of time the Company will have to provide those benefits. The assumptions used by management are discussed in Note 11 to the consolidated annual financial statements.

Management performs an annual valuation of the Company’s goodwill for possible impairment. Based on the results of this testing, management has determined that the carrying value of goodwill is not impaired as of December 31, 2010. The valuation approach is described in Note 8 of the consolidated financial statements.

The Company carries all of its investments at fair value with any unrealized gains or losses reported net of tax as an adjustment to shareholders' equity, except for the credit-related portion of debt security impairment losses and other-than-temporary impairment of equity securities, which are charged to earnings. The Company's ability to fully realize the value of its investments in various securities, including corporate debt securities, is dependent on the underlying creditworthiness of the issuing organization. In evaluating the debt security portfolio for other-than-temporary impairment losses, management considers (1) if we intend to sell the security; (2) if it is “more likely than not” we will be required to sell the security before recovery of its amortized cost basis; or (3) if the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. In determining whether OTTI has occurred for equity securities, the Company considers the applicable factors described above and the length of time the equity security’s fair value has been below the carrying amount. Management continually analyzes the portfolio to determine if further impairment has occurred that may be deemed as other-than-temporary. Further charges are possible depending on future economic conditions.

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The estimation of fair value is significant to several of our assets, including investment securities available for sale, the interest rate derivative, intangible assets and foreclosed real estate, as well as the value of loan collateral when valuing loans. These are all recorded at either fair value or the lower of cost or fair value. Fair values are determined based on third party sources, when available. Furthermore, accounting principles generally accepted in the United States require disclosure of the fair value of financial instruments as a part of the notes to the consolidated financial statements. Fair values may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of yield curves.

Fair values for securities available for sale are obtained from an independent third party pricing service. Where available, fair values are based on quoted prices on a nationally recognized securities exchange. If quoted prices are not available, fair values are measured using quoted market prices for similar benchmark securities. Management made no adjustments to the fair value quotes that were provided by the pricing source. The fair values of foreclosed real estate and the underlying collateral value of impaired loans are typically determined based on appraisals by third parties, less estimated costs to sell. If necessary, appraisals are updated to reflect changes in market conditions.

EXECUTIVE SUMMARY

Total deposits increased 10.0%, to $326.5 million at December 31, 2010, while the average balance of deposits increased $29.4 million to $317.9 million for the year ended December 31, 2010. Overall, in Oswego County, Pathfinder Bank has the majority of the current deposit market share. The Company will continue to focus on building market share in the Central Square and Fulton markets, while emphasizing the development of a new share of the market in the Cicero area of Onondaga County. The Bank continues to develop core deposit relationships in all markets by developing demand deposit relationships. Efforts will also be focused on the expansion of commercial deposit relationships with the Bank’s existing commercial lending customers.

Total assets increased 9.9% from December 31, 2009 to December 31, 2010, primarily in the loan portfolio. The loan portfolio increased 8.6% with net growth primarily in the commercial loan and residential mortgage loan categories. The Company expects to concentrate on continued commercial mortgage and commercial loan portfolio growth during 2011. Increasing the commercial loan portfolio will increase inherent risk in the loan portfolio, but the Company continues to diversify its loan portfolio and addresses the higher risk by monitoring the level of the allowance for loan losses and making provisions as necessary.

The ratio of non-performing assets to total assets was 1.54% at December 31, 2010, compared to 0.67% at the prior year end. Non-performing loans increased $3.6 million and foreclosed real estate increased $194,000 since December 31, 2009. The increase in non-performing loans was primarily the result of the delinquency of a small number of relatively large commercial loan relationships. The increase in foreclosed real estate is a reflection of a lower than normal level of foreclosed real estate in the prior year.

Net income for 2010 was $2.5 million, as compared to $1.6 million in 2009. Net income available to common shareholders, after preferred stock dividends and discount accretion, was $2.0 million, or $0.82 per share, compared to $0.61 per share for the previous year. The improvement in income was primarily the result of a $1.6 million increase in net interest income during 2010.The income improvement was partially offset by increased noninterest operating expenses of $663,000, or 6%.

RESULTS OF OPERATIONS

Net income for 2010 was $2.5 million, an increase of $890,000, or 55.1%, compared to net income of $1.6 million for 2009. Basic and diluted earnings per share increased to $0.82 per share for the year ended December 31, 2010 from $0.61 per share, for the year ended December 31, 2009. Return on average equity increased to 8.07% in 2010 from 7.04% in 2009.

Net interest income, on a tax equivalent basis, increased $1.7 million, or 14.2%, resulting from the combination of volume increases in all loan categories and rate decreases applied to all interest-bearing liabilities, with the exception of the junior subordinated debentures. The provision for loan losses for the year ended December 31, 2010 increased $174,000, or 19.9%. The elevated level of provisioning by the Company during the prior two years reflects management's assessment of the increased inherent risk associated with increasing commercial lending activities, the overall growth in the total loan portfolio and deteriorated economic conditions. The Company experienced a 4.5% increase in noninterest income, which was primarily due to an increase in income from bank owned life insurance. Noninterest expenses increased 6% primarily due to increases in personnel costs.

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Net Interest Income

Net interest income is the Company's primary source of operating income for payment of operating expenses and providing for possible loan losses. It is the amount by which interest earned on interest-earning deposits, loans and investment securities, exceeds the interest paid on deposits and borrowed money. Changes in net interest income and the net interest margin ratio result from the interaction between the volume and composition of earning assets and interest-bearing liabilities, and their respective yields and funding costs.

Net interest income, on a tax-equivalent basis, increased $1.7 million, or 14.2%, to $13.5 million for the year ended December 31, 2010, as compared to $11.8 million for the year ended December 31, 2009. The Company's net interest margin for 2010 increased to 3.73% from 3.56% in 2009. The increase in net interest income is attributable to a decrease in the cost of interest-bearing liabilities, partially offset by an increase in the average balance of interest-bearing deposits. Although the average balance of interest-earning assets increased 9.3%, the decline in the yield on those assets partially offset the overall volume increase, resulting in only a 2.6% increase in interest income earned, on a tax-equivalent basis.

The average balance of interest-earning assets increased $30.7 million, or 9.3%, during 2010 and the average balance of interest-bearing liabilities increased by $22.8 million, or 7.5%. The increase in the average balance of interest earning assets primarily resulted from an $18.8 million increase in the average balance of the loan portfolio and an $11.3 million increase in the average balance of the security investment portfolio, combined with a $629,000 increase in the average balance of interest earning deposits. The increase in the average balance of interest-bearing liabilities primarily resulted from a $26.0 million, or 9.9%, increase in the average balance of deposits, offset by a $3.2 million, or 7.6%, decrease in the average balance of borrowed funds. Interest income, on a tax-equivalent basis, increased $465,000, or 2.6%, during 2010. The decrease in yield on interest earning assets to 5.05% in 2010 from 5.38% in 2009 was offset by the 9.3% increase in volume. Interest expense on deposits decreased $1.0 million, or 23.1%, as the cost of deposits dropped 51 basis points to 1.18% in 2010 from 1.69% in 2009. Interest expense on borrowings decreased $196,000, or 12.3%, during 2010 as the 7.6% decrease in the average balance of borrowed funds was combined with a decrease in the cost of borrowed funds to 3.56% in 2010 from 3.75% in 2009.

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Average Balances and Rates

The following table sets forth information concerning average interest-earning assets and interest-bearing liabilities and the yields and rates thereon. Interest income and resultant yield information in the table is on a fully tax-equivalent basis using marginal federal income tax rates of 34%. Averages are computed on the daily average balance for each month in the period divided by the number of days in the period. Yields and amounts earned include loan fees. Non-accrual loans have been included in interest-earning assets for purposes of these calculations.

	For the Years Ended December 31,								
	2010			2009			2008		
(Dollars in thousands)	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest	Average Yield / Cost
Interest-earning assets:									
Real estate loans residential	$138,497	$7,672	5.54 %	$133,442	$7,463	5.59 %	$130,702	$7,527	5.76 %
Real estate loans commercial	65,120	4,044	6.21 %	58,424	4,024	6.89 %	49,040	3,620	7.38 %
Commercial loans	37,700	1,894	5.02 %	31,665	1,607	5.08 %	27,033	1,751	6.48 %
Consumer loans	29,506	1,774	6.01 %	28,487	1,767	6.20 %	26,291	1,915	7.28 %
Taxable investment securities	75,660	2,549	3.37 %	71,455	2,942	4.12 %	74,105	3,365	4.54 %
Tax-exempt investment securities	8,587	399	4.65 %	1,464	65	4.44 %	5,252	255	4.86 %
Interest-earning deposits	8,140	7	0.09 %	7,511	6	0.08 %	2,851	61	2.14 %
Total interest-earning assets	363,210	18,339	5.05 %	332,448	17,874	5.38 %	315,274	18,494	5.87 %
Noninterest-earning assets:									
Other assets	32,087			29,704			30,274		
Allowance for loan losses	(3,420)			(2,731)			(2,006)		
Net unrealized gains (losses) on available for sale securities	1,513			(620)			(1,690)		
Total assets	$393,390			$358,801			$341,852		
Interest-bearing liabilities:									
NOW accounts	$29,816	79	0.26 %	$26,055	72	0.28 %	$23,762	95	0.40 %
Money management accounts	12,101	39	0.32 %	11,037	35	0.32 %	10,574	52	0.49 %
MMDA accounts	50,722	336	0.66 %	35,571	246	0.69 %	29,181	570	1.95 %

Savings and club accounts	57,810	84	0.15%	53,726	87	0.16%	52,482	168	0.32%
Time deposits	137,975	2,871	2.08%	135,965	3,994	2.94%	124,267	4,777	3.84%
Junior subordinated debentures	5,155	164	3.18%	5,155	149	2.89%	5,155	257	4.99%
Borrowings	34,102	1,235	3.62%	37,340	1,446	3.87%	45,239	1,756	3.88%
Total interest-bearing liabilities	327,681	4,808	1.47%	304,849	6,029	1.98%	290,660	7,675	2.64%
Noninterest-bearing liabilities:									
Demand deposits	29,479			26,114			25,493		
Other liabilities	5,173			4,888			4,088		
Total liabilities	362,333			335,851			320,241		
Shareholders' equity	31,057			22,950			21,611		
Total liabilities & shareholders' equity	$393,390			$358,801			$341,852		
Net interest income		$13,531			$11,845			$10,819	
Net interest rate spread			3.58%			3.40%			3.23%
Net interest margin			3.73%			3.56%			3.43%
Ratio of average interest-earning assets									
to average interest-bearing liabilities			110.84%			109.05%			108.47%

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Interest Income

Changes in interest income result from changes in the average balances of loans, securities and interest-earning deposits and the related yields on those balances. Interest income on a tax-equivalent basis increased $465,000, or 2.6%. Average loans increased 7.5% in 2010, with yields decreasing 22 basis points to 5.68%. The Company's average residential mortgage loan portfolio increased $5.1 million, or 3.8%, when comparing 2010 to 2009. The average yield on the residential mortgage loan portfolio decreased 5 basis points to 5.54% in 2010. The average balance of commercial real estate loans increased $6.7 million, or 11.5%, while the yield decreased 68 basis points to 6.21% in 2010 from 6.89% in 2009. Average commercial loans increased $6.0 million, or 19.1% and the tax-equivalent yield decreased to 5.02% in 2010 compared to 5.08% in 2009. The average balance of consumer loans increased $1.0 million, or 3.6% when compared to 2009. The average yield decreased to 6.01% from 6.20% in 2009.

Interest income on investment securities decreased 2.0% from 2009. The average yield decreased 63 basis points to 3.50% in 2010 from 4.13% in 2009, offset by an increase in the average balance of investment securities (taxable and tax-exempt) of $11.3 million, or 15.5%, to $84.2 million in 2010 from $72.9 million in 2009.

Interest Expense

Changes in interest expense result from changes in the average balances of deposits and borrowings and the related interest costs on those balances. Interest expense decreased $1.2 million, or 20.3%, in 2010, when compared to 2009. The decrease in the cost of funds resulted from a decrease in the average cost of interest-bearing liabilities of 51 basis points, to 1.47% in 2010 from 1.98% in 2009, partially offset by a $22.8 million increase in the average balance of interest-bearing liabilities during 2010. The average cost of deposits decreased 51 basis points to 1.18% during 2010 from 1.69% for 2009. The average balance of interest-bearing deposits increased $26.0 million to $288.4 million in 2010 from $262.4 million in 2009. The increase in the average balance of deposits resulted from increases in all deposit categories. The largest increases in average deposits came from a 42.6% increase in MMDA accounts, a 14.4% increase in interest-bearing demand deposit accounts, a 9.6% increase in money management accounts, and a 7.6% increase in savings accounts. The cost of junior subordinated debentures underlying our trust preferred securities increased 29 basis points, and represented the only increase in rates affecting liabilities. It resulted in an increase in interest expense of $15,000, due to the interest rate swap entered into on a portion of the subordinated debentures. The swap converted $2.0 million of the debentures from an adjustable rate being tied to LIBOR to a fixed rate of 4.96%. The fixed rate paid during 2010 was significantly higher than the floating rate paid in 2009, prior to entering into the swap. The average balance of borrowed funds decreased $3.2 million to $34.1 million in 2010 from $37.3 million in 2009. The average cost of borrowed funds decreased 25 basis points, to 3.62% in 2010 from 3.87% in 2009.

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Rate/Volume Analysis

Net interest income can also be analyzed in terms of the impact of changing interest rates on interest-earning assets and interest-bearing liabilities and changes in the volume or amount of these assets and liabilities. The following table represents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (change in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) total increase or decrease. Changes attributable to both rate and volume have been allocated ratably.

	Years Ended December 31,					
	2010 vs. 2009 Increase/(Decrease) Due to			2009 vs. 2008 Increase/(Decrease) Due to		
(In thousands)	Volume	Rate	Total Increase (Decrease)	Volume	Rate	Total Increase (Decrease)
Interest Income:						
Real estate loans residential	$ 277	$ (68)	$ 209	$ 158	$ (222)	$ (64)
Real estate loans commercial	438	(418)	20	657	(253)	404
Commercial loans	306	(19)	287	281	(425)	(144)
Consumer loans	62	(55)	7	151	(299)	(148)
Taxable investment securities	165	(558)	(393)	(117)	(304)	(421)
Tax-exempt investment securities	331	3	334	(170)	(20)	(190)
Interest-earning deposits	1	2	3	40	(97)	(57)
Total interest income	1,580	(1,113)	467	1,000	(1,620)	(620)
Interest Expense:						
NOW accounts	12	(5)	7	8	(31)	(23)
Money management accounts	4	-	4	2	(19)	(17)
MMDA accounts	101	(11)	90	104	(428)	(324)
Savings and club accounts	4	(7)	(3)	4	(85)	(81)

Time deposits	58	(1,181)	(1,123)	417	(1,200)	(783)
Junior subordinated debentures	-	15	15	-	(108)	(108)
Borrowings	(121)	(90)	(211)	(305)	(5)	(310)
Total interest expense	58	(1,279)	(1,221)	230	(1,876)	(1,646)
Net change in net interest income	$ 1,522	$ 166	$ 1,688	$ 770	$ 256	$ 1,026

Provision for Loan Losses

The provision for loan losses increased $174,000 to $1.1 million for the year ended December 31, 2010, as compared to the prior year. This increase reflects additional provisions recorded throughout the year to address an increase in delinquency of commercial loans and a growing loan portfolio that is more heavily weighted to commercial term and commercial real estate loans. These loans generally have higher inherent risk characteristics than a traditional residential real estate portfolio. It has been the Company’s intention to continue to provide for future loan losses at a consistently higher level in light of the general weakening in economic conditions and overall asset quality. All of the increase in the provision has been allocated to commercial lending. The Company's ratio of allowance for loan losses to period-end loans increased to 1.28% at December 31, 2010 as compared to 1.17% at December 31, 2009. Non-performing loans to period end loans increased to 2.08% at December 31, 2010 from 0.88% at December 31, 2009. The increase in non-performing loans is primarily the result of an increase in delinquency of a small number of relatively large commercial real estate loan relationships. Management believes that the existing allowances provided on these loans are sufficient to cover anticipated losses.

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Noninterest Income

The Company's noninterest income is primarily comprised of fees on deposit account balances and transactions, loan servicing, commissions, and net gains or losses on securities, loans and foreclosed real estate.

The following table sets forth certain information on noninterest income for the years indicated.

	For the Years Ended December 31,	
(In thousands)	2010	2009
Service charges on deposit accounts	$ 1,375	$ 1,496
Earnings and gains on bank owned life insurance	434	225
Loan servicing fees	206	233
Debit card interchange fees	316	280
Other charges, commissions and fees	523	490
Noninterest income before gains (losses)	2,854	2,724
Net gains on sales, redemptions and impairment of investment securities	211	112
Net (losses) gains on sales of loans and foreclosed real estate	(45)	54
Total noninterest income	$ 3,020	$ 2,890

For the year ended December 31, 2010, noninterest income before gains (losses) increased $130,000, or 4.8%, when compared with the year ended December 31, 2009. The increase was comprised of increases in earnings and gains on bank owned life insurance, debit card interchange fees, and other charges and commissions and fees, which were offset by decreases in service charges on deposit accounts and loan servicing fees. Earnings and gains on bank owned life insurance increased $209,000, or 92.9%, which is primarily due to insurance proceeds received relating to the death benefit associated with life insurance coverage on a former director. The increase in debit card interchange fees is due to increased customer activity, which is driven by the debit card rewards program that was established late in the third quarter of 2009. As a result of the Dodd-Frank Act mandated limits on interchange fees of larger institutions, and market pressure on the Company that may follow, debit card interchange fee income may decrease in the future. The $33,000 increase in other charges, commissions and fees was attributable to an increase in investment services revenue and automated teller machine fees due to increased activity. The increases were partially offset by a $121,000 decrease in service charges on deposit accounts associated with a decrease in customer use of the Company’s extended overdraft program. The customer’s usage of the program was negatively impacted by the Federal Reserve Board’s issuance, during November 2009, of a final rule revising the provisions of Regulation E. As part of these revisions, financial institutions were prohibited from charging consumers fees for paying overdrafts on automated teller machine (ATM) and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. The final rule became effective on July 1, 2010.

Net gains and losses from the sale, redemption or impairment of securities increased to a net gain of $211,000 for the year ended December 31, 2010 as compared to a net gain of $112,000 for the same period of 2009. The increase is due to gains recognized on the sale of securities and from cash redemptions from the SHAY Assets large cap equity fund and ultra short mortgage fund, as compared to the recording of other-than-temporary impairment charges during 2009. Net losses from the sales of loans and foreclosed real estate totaled $45,000 for the year ended December 31, 2010, as compared to a net gain of $54,000 when compared to the same period in 2009. The decrease is due to losses recognized on the sale of foreclosed properties in 2010 compared to the gains that were recognized on loan sales to the secondary market of 30-year fixed rate residential mortgages during 2009.

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Noninterest Expense

The following table sets forth certain information on noninterest expense for the years indicated.

	For the Years Ended December 31,	
(In thousands)	2010	2009
Salaries and employee benefits	$ 6,126	$ 5,577
Building occupancy	1,281	1,246
Data processing	1,372	1,307
Professional and other services	831	844
FDIC assessments	515	745
Other expenses	1,664	1,407
Total noninterest expense	$ 11,789	$ 11,126

Noninterest expenses increased $663,000, or 6.0% for the year ended December 31, 2010. The increase in noninterest expense is due to an increase of $549,000 in salaries and employee benefits, a $257,000 increase in other expenses, a $65,000 increase in data processing and a $35,000 increase in building occupancy. These increases were partially offset by a $230,000 decrease in FDIC assessments. The increase in salaries and employee benefits was due to the addition of 6 full-time equivalent positions, annual merit based wage adjustments and other incentive based compensation costs. The increase in other expenses is partially due to expenses related to the Company's debit card rewards program, which was not in place for the most of 2009. FDIC assessments decreased when compared to 2009 due to a special assessment of $165,000 levied during 2009, as well as adjustments made to reflect a change in the structure and amount of the regular regulatory assessment. As a result of the Dodd-Frank Act and other Federal and State government regulatory initiatives, additional compliance costs are anticipated in the future.

Income Tax Expense

In 2010, the Company reported income tax expense of $1.0 million compared with $1.1 million in 2009. The effective tax rate decreased to 28.7% in 2010 compared to a tax rate of 39.4% in 2009. The consistency in income tax expense, despite the higher pretax income earned in 2010, was the result of the lower effective tax rate. The Company's tax rate has decreased primarily as a result of deferred tax asset valuation allowance adjustments recorded in the prior year, combined with an increase in tax-exempt income from the investment portfolio and the receipt of tax-exempt life insurance proceeds relating to the death benefit associated with coverage on a former director. See Note 13 to the consolidated financial statements for the reconciliation of the statutory tax rate to the effective tax rate.

CHANGES IN FINANCIAL CONDITION

Investment Securities

The investment portfolio represents 21% of the Company's average earning assets and is designed to generate a favorable rate of return consistent with safety of principal while assisting the Company in meeting its liquidity needs and interest rate risk strategies. All of the Company's investments are classified as available for sale. The Company invests primarily in securities issued by United States Government agencies and sponsored enterprises, mortgage-backed securities, state and municipal obligations, mutual funds, equity securities, investment grade corporate debt instruments, and common stock issued by the Federal Home Loan Bank of New York (FHLBNY). By investing in these types of assets, the Company reduces the credit risk of its asset base, but must accept lower yields than would typically be available on loan products. Our mortgage backed securities portfolio is comprised predominantly of pass-through securities guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae and does not, to our knowledge, include any securities backed by sub-prime or other high-risk mortgages.

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At December 31, 2010, investment securities increased 17.2% to $87.5 million from $74.7 million at December 31, 2009. There were no securities that exceeded 10% of consolidated shareholders' equity. See Note 3 to the consolidated financial statements for further discussion on securities.

The following table sets forth the carrying value of the Company's investment portfolio at December 31:

(In Thousands)	2010	2009
Investment Securities:		
US treasury, agencies and GSEs	$ 20,023	$ 14,532
State and political subdivisions	18,979	8,928
Corporate	5,600	4,965
Residential mortgage-backed	37,246	36,940
Mutual funds	3,024	4,814
Equity securities	455	372
Other	-	2,203
Total investments in securities	$ 85,327	$ 72,754

Certain individual securities have been reclassified in the prior year table above to conform to the current year presentation. The reclassifications had no effect on the total investment portfolios previously reported.

The following table sets forth the scheduled maturities, amortized cost, fair values and average yields for the Company's investment securities at December 31, 2010. Yield is calculated on the amortized cost to maturity and adjusted to a fully tax-equivalent basis.

	One Year or Less		One to Five Years		Five to Ten Years	
(Dollars in thousands)	Amortized Cost	Annualized Weighted Avg Yield	Amortized Cost	Annualized Weighted Avg Yield	Amortized Cost	Annualized Weighted Avg Yield
Debt investment securities:						
US Treasury, agencies and GSEs	$ -	-	$ 17,107	1.55 %	$ 2,030	2.08 %
State and political subdivisions	96	1.50 %	2,195	2.33 %	8,374	4.04 %
Corporate	502	5.17 %	3,126	5.13 %	-	-
Total	598	4.58 %	22,428	2.12 %	10,404	3.65 %
Mortgage-backed securities:						
Residential mortgage-backed	264	4.10 %	629	4.41 %	5,639	3.53 %
Total	264	4.10 %	629	4.41 %	5,639	3.53 %
Other non-maturity investments:						

Mutual funds	2,844	3.43 %	-	-	-	-
Equity securities	450	2.03 %	-	-	-	-
Total	3,294	2.96 %	-	-	-	-
Total investment securities	$ 4,156	3.49 %	$ 23,057	2.19 %	$ 16,043	3.61 %

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(Dollars in thousands)	More Than Ten Years Amortized Cost	More Than Ten Years Annualized Weighted Avg Yield	Total Investment Securities Amortized Cost	Total Investment Securities Fair Value	Total Investment Securities Annualized Weighted Avg Yield
Debt investment securities:					
US Treasury, agencies and GSEs	$ 1,000	5.20 %	$ 20,137	$ 20,023	1.78 %
State and political subdivisions	8,562	4.56 %	19,227	18,979	4.06 %
Corporate	2,237	0.90 %	5,865	5,600	3.52 %
Total	11,799	3.92 %	45,229	44,602	2.97 %
Mortgage-backed securities:					
Residential mortgage-backed	29,998	3.86 %	36,530	37,246	3.82 %
Total	29,998	3.86 %	36,530	37,246	3.82 %
Other non-maturity investments:					
Mutual funds	-	-	2,844	3,024	3.43 %
Equity securities	-	-	450	455	2.03 %
Total	-	-	3,294	3,479	3.24 %
Total investment securities	$ 41,797	3.88 %	$ 85,053	$ 85,327	3.35 %

The above noted yield information does not give effect to changes in fair value that are reflected in accumulated other comprehensive loss in consolidated shareholders' equity.

Loans Receivable

Loans receivable represent 69% of the Company's average earning assets and account for the greatest portion of total interest income. The Company emphasizes residential real estate financing and anticipates a continued commitment to financing the purchase or improvement of residential real estate in its market area. The Company also extends credit to businesses within its marketplace secured by commercial real estate, equipment, inventories, and accounts receivable. It is anticipated that small business lending in the form of mortgages, term loans, leases, and lines of credit will provide the most opportunity for balance sheet and revenue growth over the near term. Commercial and municipal loans comprise 14% of the total loan portfolio. At December 31, 2010, 76% of the Company's total loan portfolio consisted of loans secured by real estate, and 24% of the total loan portfolio consisted of commercial real estate loans.

	December 31,				
(In thousands)	2010	2009	2008	2007	2006
Residential real estate (1)	$ 147,722	$ 135,102	$ 136,218	$ 126,666	$ 118,494

Commercial real estate	69,060	62,250	55,061	45,490	40,501
Commercial and municipal	39,833	35,447	30,685	25,288	23,001
Home equity and junior liens	25,271	26,086	24,392	21,379	18,054
Consumer	3,410	3,580	3,516	3,926	3,159
Total loans receivable	$ 285,296	$ 262,465	$ 249,872	$ 222,749	$ 203,209

(1) Includes loans held for sale. (None at December 31, 2010, 2009, 2008 and 2007.)

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The following table shows the amount of loans outstanding as of December 31, 2010 which, based on remaining scheduled repayments of principal, are due in the periods indicated. Demand loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as one year or less. Adjustable and floating rate loans are included in the period on which interest rates are next scheduled to adjust rather than the period in which they contractually mature, and fixed rate loans are included in the period in which the final contractual repayment is due.

(In thousands)	Due Under One Year	Due 1-5 Years	Due Over Five Years	Total
Real estate:				
Commercial real estate	$ 22,103	$ 42,322	$ 4,635	$ 69,060
Residential real estate	12,195	24,912	110,615	147,722
	34,298	67,234	115,250	216,782
Other Commercial	31,890	7,312	631	39,833
Home Equity and junior liens	14,552	960	9,759	25,271
Consumer	643	2,342	425	3,410
Total loans	$ 81,383	$ 77,848	$ 126,065	$ 285,296
Interest rates:				
Fixed	$ 6,439	$ 10,688	$ 121,083	$ 138,210
Variable	74,944	67,161	4,981	147,086
Total loans	$ 81,383	$ 77,849	$ 126,064	$ 285,296

Total loans receivable increased 8.7% when compared to the prior year. Residential real estate loans increased $12.6 million, or 9.3%, during 2010. The residential real estate portfolio consists of 74% fixed-rate mortgages and 26% adjustable-rate mortgages. There was a 6% shift to fixed rate mortgages from adjustable rate mortgages when compared to the portfolio composition as of December 31, 2009. The increase in the fixed rate mortgage portfolio resulted from increased demand for fixed rate products due to the historically low interest rate environment that was prevalent during 2010. The Company does not originate sub-prime, Alt-A, negative amortizing or other higher risk structured residential mortgages.

Commercial real estate loans increased $6.8 million, or 10.9%, from the prior year as new loan products and relationships were added to the portfolio.

Commercial loans, including loans to municipalities, increased 12.4% over the prior year to $39.8 million at December 31, 2010. The increase in commercial loans was primarily the result of new lending relationships with an expanding commercial customer base. The Company has continued its efforts to transform its more traditional thrift balance sheet, which emphasized residential real estate lending, to a more diversified balance sheet, which includes a greater proportion of commercial lending products.

Consumer loans, which include second mortgage loans, home equity lines of credit, direct installment and revolving credit loans, decreased 3.3% to $28.6 million at December 31, 2010. The decrease resulted from an decrease in home equity lines of credit as a result of the current market and economic conditions.

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Non-performing Loans and Assets

The following table represents information concerning the aggregate amount of non-performing assets:

	December 31,				
(In thousands)	2010	2009	2008	2007	2006
Non-accrual loans:					
Commercial real estate and commercial	$ 4,224	$ 1,021	$ 1,455	$ 521	$ 481
Consumer	365	111	254	150	125
Residential real estate	1,335	1,181	614	920	566
Total non-accrual loans	5,924	2,313	2,323	1,591	1,172
Total non-performing loans	5,924	2,313	2,323	1,591	1,172
Foreclosed real estate	375	181	335	865	471
Total non-performing assets	$ 6,299	$ 2,494	$ 2,658	$ 2,456	$ 1,643
Non-performing loans to total loans	2.08 %	0.88 %	0.93 %	0.71 %	0.57 %
Non-performing assets to total assets	1.54 %	0.67 %	0.75 %	0.77 %	0.54 %
Interest income that would have been recorded					
under the original terms of the loans	$ 260	$ 113	$ 131	$ 71	$ 53

Total non-performing loans increased approximately $3.6 million at December 31, 2010, when compared to December 31, 2009. The increase in non-performing loans was primarily the result of the delinquency of a small number of relatively large commercial loan relationships. These large commercial relationships are monitored closely by management and met with on a regular basis to work out repayment plans and alternative strategies for collection. It is management's intention to work closely and patiently with the small business owners as they adapt to the new market dynamics. Management continues to monitor and react to national and local economic trends as well as general portfolio conditions, which may impact the quality of the portfolio. In response to recent trends and risk management the Bank has increased the provision for loan losses, maintaining the Company's strict loan underwriting standards and carefully monitoring the performance of the loan portfolio.

The current level of non-performing assets would not have fallen outside of the Bank's historic level trends were it not for the inclusion of three large commercial relationships. The increase in non-performing loans since December 31, 2009 is comprised of primarily these three large relationships totaling $3.2 million. The largest of these relationships totals $2.2 million in non-performing loans at December 31, 2010. Of the balance outstanding, approximately $2.0 million is secured by commercial real estate and equipment. A current evaluation of the commercial real estate and equipment was obtained from a third party in June 2010. Management believes that the appraised fair value of the underlying collateral, discounted for selling costs, along with the associated guarantees of business principals and the existing allowance provided against these loans of $313,600, are adequate to cover the carrying amounts of the loans. During the third quarter of 2010, two other relatively large commercial relationships, with a combined loan balance of approximately $1.0 million, became non-performing. Both lending relationships are secured by commercial real estate and equipment, as well as personal and SBA guarantees. Management believes that the collateral securing these loans, along with the guarantees of either business principals or government entities, and the existing allowance specifically allocated for the loans of $42,400, are adequate to cover the carrying amounts of the loans.

Appraisals are obtained at the time a real estate secured loan is originated. Collateral is reevaluated should the loan become 45 days delinquent to best determine the bank's level of exposure. For commercial real estate held as collateral, the property is inspected every two years. When evaluating our ability to collect from secondary sources, appraised values are adjusted to reflect the age of appraisal, the condition of the property, the current local real estate market, and cost to sell. Properties are re-appraised when our evaluation of the current property condition and the local real estate market suggests values may not be accurate.

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The Company generally places a loan on non-accrual status and ceases accruing interest when loan payment performance is deemed unsatisfactory and the loan is past due 90 days or more. There are no loans that are past due 90 or more and are still accruing interest. The Company considers a loan impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan.

The measurement of impaired loans is generally based upon the present value of future cash flows discounted at the historical effective interest rate, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral. The Company used the fair value of collateral to measure impairment on commercial and commercial real estate loans. At December 31, 2010 and 2009, the Company had $7.0 million and $3.2 million in loans, which were deemed to be impaired, having valuation allowances of $1.1 million and $79,000, respectively.

Management has identified additional potential problem loans totaling $3.5 million as of December 31, 2010, compared to $5.0 million in potential problem loans as of December 31, 2009. These loans have been internally classified as special mention or substandard, yet are not currently considered past due, impaired or in non-accrual status. Management has identified potential credit problems which may result in the borrowers not being able to comply with the current loan repayment terms and which may result in it being included in future past due reporting. Management believes that the current allowance for loan losses is adequate to cover probable credit losses in the current loan portfolio.

In the normal course of business, Pathfinder Bank has sold residential mortgage loans and participation interests in commercial loans. As is typical in the industry, the bank makes certain representations and warranties to the buyer. Pathfinder maintains a quality control program for closed loans and has never been asked to repurchase a sold loan. Therefore, management considers the risks and uncertainties associated with potential repurchase requirements to be minimal. There are no known or alleged defects in the securitization process or in the mortgage documentation. Any future risk of exposure would be immaterial.

Allowance for Loan Losses

The allowance for loan losses is established through charges to expense in the form of a provision for loan losses and reduced by loan charge-offs net of recoveries. The allowance for loan losses represents the amount available for probable credit losses in the Company’s loan portfolio as estimated by management. The Company maintains an allowance for loan losses based upon a monthly evaluation of known and inherent risks in the loan portfolio, which includes a review of the balances and composition of the loan portfolio as well as analyzing the level of delinquencies in each segment of the loan portfolio. The Company uses a general allocation method for the residential real estate and consumer loan pools, based upon a methodology that uses loss factors applied to loan balances and reflects actual loss experience, delinquency trends and current economic conditions. The Company individually reviews commercial real estate and commercial loans greater than $150,000 that are not accruing interest and that are risk rated under the Company’s risk rating system as special mention, substandard, doubtful or loss to determine if the loans require an allowance for impairment. Large residential real estate loans may also be included in this individual loan review. If impairment is noted, the Company establishes a specific allocation. The specific allocation is determined based on the most recent valuation of the loan’s collateral and the customer’s ability to pay. For all other commercial real estate and commercial loans, the Company uses the general allocation method that establishes an allowance for each risk-rating category. The general allocation method for commercial real estate and commercial loans considers the same factors that are considered when evaluating residential real estate and consumer loan pools. The allowance for loan losses reflects management’s best estimate of probable loan losses at December 31, 2010.

The allowance for loan losses at December 31, 2010 and 2009 was $3.6 million and $3.1 million, or 1.28% and 1.17% of total period end loans, respectively.Net loan charge-offs were $480,000 during 2010, as compared to $270,000 in 2009. The majority of the increase in current year charge-off activity is the result of the write off of a $200,000 loan that was part of the largest non-performing commercial relationship previously discussed.

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The following table sets forth the allocation of allowance for loan losses by loan category for the periods indicated. The allocation of the allowance by category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

(Dollars in thousands)	2010 Allocation of the Allowance	2010 Percent of Loans to Total Loans	2009 Allocation of the Allowance	2009 Percent of Loans to Total Loans	2008 Allocation of the Allowance	2008 Percent of Loans to Total Loans	2007 Allocation of the Allowance	2007 Percent of Loans to Total Loans	2006 Allocation of the Allowance	2006 Percent of Loans to Total Loans
Residential real estate	$750	51.8 %	$763	51.5 %	$679	54.5 %	$464	56.9 %	$172	58.3 %
Commercial real estate	1,204	24.2 %	1,009	23.7 %	907	22.0 %	614	20.4 %	628	19.9 %
Commercial and municipal	1,083	13.9 %	864	13.5 %	505	12.3 %	342	11.3 %	357	11.3 %
Home equity and junior liens	424	8.9 %	390	9.9 %	333	9.8 %	239	9.6 %	289	8.9 %
Consumer loans	89	1.2 %	76	1.4 %	48	1.4 %	44	1.8 %	50	1.6 %
Unallocated	98		(24)		-		-		-	
Total	$3,648	100.0%	$3,078	100.0%	$2,472	100.0%	$1,703	100.0%	$1,496	100.0%

The following table sets forth the allowance for loan losses for the periods indicated, and related ratios.

(In thousands)	2010	2009	2008	2007	2006
Balance at beginning of year	$ 3,078	$ 2,472	$ 1,703	$ 1,496	$ 1,679
Provisions charged to operating expenses	1,050	876	820	365	23
Recoveries of loans previously charged-off:					
Commercial real estate and commercial	55	-	17	-	-
Consumer	36	20	30	27	18
Residential real estate	19	3	-	23	4
Total recoveries	110	23	47	50	22
Loans charged off:					
Commercial real estate and commercial	(385)	(74)	(46)	(85)	(114)

Consumer	(157)	(134)	(52)	(77)	(89)
Residential real estate	(48)	(85)	-	(46)	(25)
Total charged-off	(590)	(293)	(98)	(208)	(228)
Net charge-offs	(480)	(270)	(51)	(158)	(206)
Balance at end of year	$ 3,648	$ 3,078	$ 2,472	$ 1,703	$ 1,496
Net charge-offs to average loans outstanding	0.18 %	0.11 %	0.02 %	0.08 %	0.11 %
Allowance for loan losses to year-end loans	1.28 %	1.17 %	0.99 %	0.76 %	0.74 %

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Deposits

The Company’s deposit base is drawn from seven full-service offices in its market area and will expand to include an eighth office opened in Cicero, New York on February 1, 2011. The deposit base consists of demand deposits, money management and money market deposit accounts, savings and time deposits. During 2010, 57% of the Company's average deposit base of $317.9 million consisted of core deposits. Core deposits, which exclude time deposits, are considered to be more stable and provide the Company with a lower cost source of funds than time deposits. The Company will continue to emphasize retail core deposits by maintaining its network of full service offices and providing depositors with a full range of deposit product offerings. In addition, Pathfinder Commercial Bank, our commercial bank subsidiary, will seek business growth by focusing on its local identification and service excellence. Pathfinder Commercial Bank had an average balance of $47.4 million in municipal deposits in 2010, primarily concentrated in money market deposit accounts.

Average deposits increased $29.4 million, or 10.2%, when compared to 2009. The increase in average deposits primarily related to a $7.1 million increase in the average balance of municipal deposits and a $22.3 million increase in retail deposits.

The Company's average deposit mix in 2010, as compared to 2009, reflected a similar product line composition. The Company's average demand deposits, both interest and noninterest bearing accounts, represented 18% of total average deposits for 2010 and 2009. The Company's average MMDA accounts, which grew 43% in 2010, represented 16% of total deposits for 2010 and 12% for 2009. Savings accounts and money management accounts remained consistent at 19% and 4% of average deposits, respectively, for both 2010 and 2009. The Company’s time deposit accounts represented 43% of total deposits for 2010 and 47% for 2009. The Company promotes its MMDA accounts by offering competitive rates to retain existing and attract new customers.

At December 31, 2010, time deposits in excess of $100,000 totaled $57.4 million, or 40%, of time deposits and 18% of total deposits. At December 31, 2009, these deposits totaled $53.4 million, or 38% of time deposits and 18% of total deposits.

The following table indicates the amount of the Company’s certificates of deposit of $100,000 or more by time remaining until maturity as of December 31, 2010:

(In thousands)	
Remaining Maturity:	
Three months or less	$ 18,839
Three through six months	8,039
Six through twelve months	10,771
Over twelve months	19,746
Total	$ 57,395

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Borrowings

Short-term borrowings are comprised primarily of advances and overnight borrowing at the FHLBNY. At December 31, 2010, there were $13.0 million in short-term borrowings outstanding. There were no short-term borrowings outstanding at December 31, 2009.

The following table represents information regarding short-term borrowings during 2010, 2009 and 2008:

(Dollars in thousands)	2010	2009	2008
Maximum outstanding at any month end	$ 13,000	$ 1,400	$ 23,795
Average amount outstanding during the year	745	1,724	14,151
Average interest rate during the year	0.47 %	1.84 %	2.85 %

Long-term borrowed funds consist of advances and repurchase agreements from the FHLBNY and Citi Group and junior subordinated debentures. Long-term borrowed funds and junior subordinated debentures totaled $33.2 million at December 31, 2010 as compared to $41.2 million at December 31, 2009.

Capital

Shareholders' equity at December 31, 2010, was $30.6 million as compared to $29.2 million at December 31, 2009. The Company added $2.5 million to retained earnings through net income. The increase in retained earnings was offset by an increase of $514,000 in accumulated other comprehensive loss, which increased to $1.9 million from $1.4 million at December 31, 2009. Unrealized holding losses on securities, net of tax, resulted in an increase in accumulated other comprehensive loss of $85,000. In addition, unrealized losses on the interest rate derivative, net of tax expense, added $66,000 and retirement plan losses and transition obligation amortization, net of tax expense, added $363,000 to accumulated other comprehensive loss. Common stock dividends declared reduced capital by $298,000. Preferred stock dividends paid to the United States Treasury, under the terms of the agreement entered into in 2009 as part of the Company’s $6.8 million participation in the Capital Purchase Plan, reduced capital by $339,000.

Risk-based capital provides the basis for which all banks are evaluated in terms of capital adequacy. Capital adequacy is evaluated primarily by the use of ratios which measure capital against total assets, as well as against total assets that are weighted based on defined risk characteristics. The Company’s goal is to maintain a strong capital position, consistent with the risk profile of its subsidiary banks that supports growth and expansion activities while at the same time exceeding regulatory standards. At December 31, 2010, Pathfinder Bank exceeded all regulatory required minimum capital ratios and met the regulatory definition of a “well-capitalized” institution, i.e. a leverage capital ratio exceeding 5%, a Tier 1 risk-based capital ratio exceeding 6% and a total risk-based capital ratio exceeding 10%. As a result of the Dodd-Frank Act, the Company’s ability to raise new capital through the use of trust preferred securities may be limited because these securities will no longer be included in Tier 1 capital. In addition, our ability to generate or originate additional revenue producing assets may be constrained in the future in order to comply with anticipated heightened capital standards required by state and federal regulation. See note 17 to the consolidated financial statements for further discussion on regulatory capital requirements.

LIQUIDITY

Liquidity management involves the Company's ability to generate cash or otherwise obtain funds at reasonable rates to support asset growth, meet deposit withdrawals, maintain reserve requirements, and otherwise operate the Company on an ongoing basis. The Company's primary sources of funds are deposits, borrowed funds, amortization and prepayment of loans and maturities of investment securities and other short-term investments, and earnings and funds provided from operations. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. The Company manages the pricing of deposits to maintain a desired deposit balance. In addition, the Company invests excess funds in short-term interest-earning and other assets, which provide liquidity to meet lending requirements.

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The Company's liquidity has been enhanced by its membership in the Federal Home Loan Bank of New York, whose competitive advance programs and lines of credit provide the Company with a safe, reliable and convenient source of funds. A significant decrease in deposits in the future could result in the Company having to seek other sources of funds for liquidity purposes. Such sources could include, but are not limited to, additional borrowings, trust preferred security offerings, brokered deposits, negotiated time deposits, the sale of "available-for-sale" investment securities, the sale of securitized loans, or the sale of whole loans. Such actions could result in higher interest expense costs and/or losses on the sale of securities or loans.

The Company has a number of existing credit facilities. Total credit available under the existing lines is approximately $93 million. At December 31, 2010, the Company had $41 million outstanding under existing credit facilities with $52 million available.

The Asset Liability Management Committee of the Company is responsible for implementing the policies and guidelines for the maintenance of prudent levels of liquidity. As of December 31, 2010, management reported to the Board of Directors that the Company is in compliance with its liquidity policy guidelines.

OFF-BALANCE SHEET ARRANGEMENTS

The Company is also a party to financial instruments with off-balance sheet risk 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. At December 31, 2010, the Company had $30.1 million in outstanding commitments to extend credit and standby letters of credit. See Note 15 in the accompanying consolidated financial statements.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required of a smaller reporting company.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements
Pathfinder Bancorp, Inc.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate. The Company's internal control over financial reporting is a process designed under the supervision of the Company's principal executive officer and principal financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with United States generally accepted accounting principles.

Under the supervision and with the participation of management, including the Company's principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its evaluation under that framework, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2010. In addition, based on our assessment, management has determined that there were no material weaknesses in the Company's internal controls over financial reporting.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting pursuant to the rules of the Dodd-Frank Act that exempts the Company from such attestation and requires only management's report.

/s/ Thomas W. Schneider	/s/ James A. Dowd
Thomas W. Schneider President & Chief Executive Officer	James A. Dowd Senior Vice President and Chief Financial Officer

Oswego, New York
March 24, 2011

ParenteBeard

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders

Pathfinder Bancorp, Inc.

Oswego, New York

We have audited the accompanying consolidated statements of condition of Pathfinder Bancorp, Inc. and subsidiaries (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 2010. Pathfinder Bancorp, Inc.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Pathfinder Bancorp, Inc. and subsidiaries as of December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America.

/s/ ParenteBeard LLC

ParenteBeard LLC

Syracuse, New York
March 24, 2011

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CONSOLIDATED STATEMENTS OF CONDITION

December 31, (In thousands, except share data)	2010	2009
ASSETS:		
Cash and due from banks	$ 6,366	$ 8,678
Interest earning deposits	7,397	5,953
Total cash and cash equivalents	13,763	14,631
Investment securities, at fair value	85,327	72,754
Federal Home Loan Bank stock, at cost	2,134	1,899
Loans	285,296	262,465
Less: Allowance for loan losses	3,648	3,078
Loans receivable, net	281,648	259,387
Premises and equipment, net	9,432	7,173
Accrued interest receivable	1,709	1,482
Foreclosed real estate	375	181
Goodwill	3,840	3,840
Bank owned life insurance	6,915	6,956
Other assets	3,402	3,389
Total assets	$ 408,545	$ 371,692
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Deposits:		
Interest-bearing	$ 295,786	$ 269,539
Noninterest-bearing	30,716	27,300
Total deposits	326,502	296,839
Short-term borrowings	13,000	0
Long-term borrowings	28,000	36,000
Junior subordinated debentures	5,155	5,155
Other liabilities	5,296	4,460
Total liabilities	377,953	342,454
Shareholders' equity:		
Preferred stock, par value $0.01 per share; $1,000 liquidation preference; 1,000,000 shares authorized; 6,771 shares issued and outstanding	6,225	6,101
Common stock, par value $0.01; authorized 10,000,000 shares; 2,972,119 and 2,484,832 shares issued and outstanding, respectively	30	30
Additional paid in capital	8,615	8,615
Retained earnings	24,163	22,419
Accumulated other comprehensive loss	(1,939)	(1,425)
Treasury stock, at cost; 487,287 shares	(6,502)	(6,502)
Total shareholders' equity	30,592	29,238
Total liabilities and shareholders' equity	$ 408,545	$ 371,692

The accompanying notes are an integral part
of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31,

(In thousands, except per share data)	2010	2009
Interest and dividend income:		
Loans, including fees	$ 15,319	$ 14,815
Debt securities:		
Taxable	2,329	2,603
Tax-exempt	264	43
Dividends	220	339
Federal funds sold and interest earning deposits	7	6
Total interest income	18,139	17,806
Interest expense:		
Interest on deposits	3,409	4,434
Interest on short-term borrowings	4	32
Interest on long-term borrowings	1,395	1,563
Total interest expense	4,808	6,029
Net interest income	13,331	11,777
Provision for loan losses	1,050	876
Net interest income after provision for loan losses	12,281	10,901
Noninterest income:		
Service charges on deposit accounts	1,375	1,496
Earnings and gains on bank owned life insurance	434	225
Loan servicing fees	206	233
Losses on impairment of investment securities	-	(693)
Net gains on sales and redemptions of investment securities	211	805
Net (losses) gains on sales of loans and foreclosed real estate	(45)	54
Debit card interchange fees	316	280
Other charges, commissions & fees	523	490
Total noninterest income	3,020	2,890
Noninterest expense:		
	6,126	5,577

Salaries and employee benefits				
Building occupancy		1,281		1,246
Data processing		1,372		1,307
Professional and other services		831		844
FDIC assessments		515		745
Other expenses		1,664		1,407
Total noninterest expenses		11,789		11,126
Income before income taxes		3,512		2,665
Provision for income taxes		1,007		1,050
Net income		2,505		1,615
Preferred stock dividends and discount accretion		462		96
Net income available to common shareholders	$	2,043	$	1,519
Earnings per common share - basic	$	0.82	$	0.61
Earnings per common share - diluted	$	0.82	$	0.61
Dividends per common share	$	0.12	$	0.12

The accompanying notes are an integral part of the consolidated financial statements.

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CONSOLIDATED
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands, except share data)	Preferred Stock	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Com-prehensive Loss	Treasury Stock	Total
Balance, January 1, 2010	$6,101	$30	$8,615	$22,419	$(1,425)	$(6,502)	$29,238
Comprehensive income:							
Net income				2,505			2,505
Other comprehensive income (loss), net of tax:							
Unrealized holding losses on securities available for sale (net of $56 tax benefit)					(85)		(85)
Unrealized holding loss on financial derivative (net of $44 tax benefit)					(66)		(66)
Retirement plan net losses and transition obligation recognized in plan expenses (net of $242 tax benefit)					(363)		(363)
Total comprehensive income							1,991
Preferred stock discount accretion	124			(124)			-
Preferred stock dividends				(339)			(339)
				(298)			(298)

Common stock dividends declared ($0.12 per share)							
Balance, December 31, 2010	$6,225	$30	$8,615	$24,163	$(1,939)	$(6,502)	$30,592
Balance, January 1, 2009	$-	$30	$7,909	$21,198	$(3,140)	$(6,502)	$19,495
Comprehensive income:							
Net income				1,615			1,615
Other comprehensive income, net of tax:							
Unrealized holding gains on securities available for sale (net of $371 tax expense)					1,302		1,302
Retirement plan net gains and transition obligation recognized in plan expenses (net of $275 tax expense)					413		413
Total comprehensive income							3,330
Preferred stock and common stock warrants issued	6,065		706				6,771
Preferred stock discount accretion	36			(36)			-
Preferred stock dividends				(60)			(60)
Common stock dividends declared ($0.12 per share)				(298)			(298)
Balance, December 31,	$6,101	$30	$8,615	$22,419	$(1,425)	$(6,502)	$29,238

2009

The accompanying notes are an integral part of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
(In thousands)	2010	2009
OPERATING ACTIVITIES		
Net income	$ 2,505	$ 1,615
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,050	876
Deferred income tax expense	263	704
Proceeds from sales of loans	264	9,659
Originations of loans held-for-sale	(256)	(9,540)
Realized losses (gains) on sales of:		
Real estate acquired through foreclosure	53	65
Loans	(8)	2
Premises and equipment	1	(119)
Available-for-sale investment securities	(211)	(805)
Impairment write-down on available-for-sale securities	-	693
Depreciation	644	657
Amortization of mortgage servicing rights	28	32
Amortization of deferred loan costs	230	240
Earnings on bank owned life insurance	(279)	(225)
Realized gain on proceeds from bank owned life insurance	(155)	-
Net amortization of premiums and discounts on investment securities	319	254
(Increase) decrease in accrued interest receivable	(227)	196