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PATHFINDER BANCORP INC
Form 10-K
April 02, 2007

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d.) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transaction period from _____ to _____

COMMISSION FILE NUMBER: 23601

PATHFINDER BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

FEDERAL

16-1540137

(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification Number)

214 West First Street, Oswego, NY 13126

(Address of Principal Executive Office) (Zip Code)

(315) 343-0057

(Registrant's Telephone Number including area code)

Securities Registered Pursuant to Section 12(b) of the Act: Common Stock, par value \$.01 per share

Name of Exchange on which Registered:
Nasdaq Capital Market

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 .

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 .

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 twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such requirements for the past 90 days. Yes No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the

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best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. [X]

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of March 15, 2007, there were 2,970,819 shares issued and 2,483,532 shares outstanding of the Registrant's Common Stock.

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, 2006, as reported by the Nasdaq Capital Market was approximately \$10,708,298. Revenues for the years 2005 and 2006 were less than \$25 million. The Company will file its annual and quarterly reports in 2007 as a Small Business Issuer.

DOCUMENTS INCORPORATED BY REFERENCE:

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DECEMBER 31, 2006
PATHFINDER BANCORP, INC.

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PART I

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") and Pathfinder Statutory Trust I. The Company is majority owned by Pathfinder Bancorp, M.H.C., a federally-chartered mutual holding company (the "Mutual Holding Company"). At December 31, 2006, the Mutual Holding Company held 1,583,239 shares of Common Stock and the public held 883,093 shares of Common Stock (the "Minority Shareholders"). At December 31, 2006, Pathfinder Bancorp, Inc. had total assets of \$301.4 million, total deposits of \$245.6 million and shareholders' equity of \$20.9 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.

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 six full-service offices located in its market area consisting of Oswego County and the contiguous counties. 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, the county in which it operates.

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, 2006, \$158.2 million, or 78% of the Bank's total loan portfolio consisted of loans secured by real estate, of which \$117.7 million, or 74%, were loans secured by one- to four-family residences and \$40.5 million, or 26%, were secured by commercial real estate. Additionally, \$18.0 million, or 11%, of total real estate loans, were secured by second liens on residential properties that are classified as

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consumer loans. The Bank also originates commercial and consumer loans that totaled \$23.0 and \$3.2 million, respectively, or 13%, of the Bank's total loan portfolio. The Bank invests a portion of its assets in securities issued by the United States Government 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 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.

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

Pathfinder Bank formed a limited purpose commercial bank subsidiary, Pathfinder Commercial Bank, in October of 2002. Pathfinder Commercial Bank was established to serve the depository needs of public entities in its market area.

In April 1999, the Bank established Pathfinder REIT, Inc. as the Bank's wholly-owned real estate investment trust subsidiary. At December 31, 2006, Pathfinder REIT, Inc. held \$26.5 million in mortgages and mortgage related assets. Recent legislation proposed by the New York State legislature may significantly impact the tax treatment accorded REITs. Enactment of this legislation would increase the state tax rate for the Company. All disclosures in the Form 10-K relating to the Bank's loans and investments include loans and investments that are held by Pathfinder REIT, Inc.

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The Bank also has 100% ownership in Whispering Oaks Development Corp., which was originally formed to develop the Whispering Oaks real estate subdivision in Baldwinsville, New York. The Bank gained title to the Whispering Oaks real estate subdivision through foreclosure. The Whispering Oaks real estate subdivision has been fully developed. The subsidiary is retained, however, in case the need to operate or develop other foreclosed real estate emerges.

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 second largest financial institution headquartered in Oswego County. However, the Bank encounters competition from a variety of sources. The Bank's business and operating results are significantly affected by the general economic conditions prevalent in its market areas.

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 and 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 expects continued strong competition in the foreseeable future, including increased competition from "super-regional" banks entering the market by purchasing large commercial banks and savings banks. Many such institutions have greater financial and marketing resources available to them than does the Bank. The Bank competes for savings deposits by offering depositors a high level of personal service and a wide range of competitively priced financial

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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.

On April 23, 2006, Alliance Bank N.A. announced it had reached a definitive agreement to merge with the parent company of Oswego County National Bank (OCNB). OCNB, formerly, Oswego County Savings Bank has been domiciled in the city of Oswego since its founding in 1870 and has been the primary local competitor for Pathfinder Bank. In management's view, the absorption of OCNB into Alliance Bank, a \$900 million bank headquartered in Syracuse, NY, will provide both challenges and opportunities for Pathfinder Bank. The challenge will be the ability of a larger competitor to more actively and aggressively market within the primary business area of Pathfinder Bank. Opportunities exist, as management believes that it's unique competencies and differentiators are more closely matched by a locally domiciled bank, than one headquartered outside our primary market area. Opportunities may exist to garner additional business opportunities with the traditional customer base of OCNB which is more apt to conduct its business with a local bank.

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 DIF is a merger of the Bank Insurance Fund ("BIF") and the Savings Association Insurance Fund ("SAIF"). This merger was made effective March 31, 2006. 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. On July 19, 2001 the Company and the Mutual Holding Company completed their conversion to federal charters. Consequently, they are subject

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to regulations of the Office of Thrift Supervision ("OTS") as savings and loan holding companies. Any change in such regulations, whether by the Department, the FDIC, or the OTS could have a material adverse impact on the Bank, the Company or the Mutual Holding Company.

Regulatory requirements applicable to the Bank, the Company and the Mutual Holding Company are referred to below or elsewhere herein.

NEW YORK BANK REGULATION

The exercise by an FDIC-insured savings bank of the lending and investment powers under the New York State Banking Law is limited by FDIC regulations and other federal law and 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.

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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. 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 implementing regulations, the Bank's investment and service corporation activities are limited to activities permissible for a national bank unless the FDIC otherwise permits it.

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 law or unsafe or unsound banking practices.

INSURANCE OF ACCOUNTS AND REGULATION BY THE FDIC

The Bank is a member of the DIF, which is administered by the FDIC. Deposits are insured up to applicable limits by the FDIC and such insurance is backed by the full faith and credit of the U.S. Government.

The Federal Deposit Insurance Reform Act of 2005 was signed into law on February 8, 2006, and gives the FDIC increased flexibility in assessing premiums on banks and savings associations, including the Bank, to pay for deposit insurance and in managing its deposit insurance reserves. The reform legislation provides a credit to all insured institutions, based on the amount of their insured deposits at year-end 1996, to offset the premiums that they may be assessed: combines the BIF and SAIF to form a single Deposit Insurance Fund; increase deposit insurance to \$250,000 for Individual Retirement Accounts; and authorizes inflation-based increases in deposit insurance on other accounts every 5 years, beginning in 2001. In connection with the reform act of 2005, the Company has received communication from the FDIC disclosing how insurance premiums will be calculated for 2007 and forward, as well as the preliminary statement of one-time assessment credit. Management estimates that this one time credit will offset premiums assessed, beginning in July 2007, for a period of approximately 18-21 months.

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

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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.

These guidelines divide a savings bank's capital into two tiers. The first tier

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("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%, of which at least 4% must be Tier I capital.

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 which would reduce its capital below (i) the amount required to be maintained by state law and regulation, or (ii) the amount of the Bank's liquidation account established in connection with the reorganization undertaken in 1997.

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

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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).

Based on the foregoing, the Bank currently meets the criteria to be classified as a "well capitalized" savings institution.

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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 which 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. The loan amount (which includes all other outstanding loans to such person) as to which such prior board of director approval is required, is the greater of \$25,000 or 5% of capital and surplus or any loans over \$500,000. 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.

FEDERAL HOLDING COMPANY REGULATION

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GENERAL. The Company and the Mutual Holding Company are nondiversified mutual 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.

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;

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(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 Office of Thrift Supervision is prohibited from approving any acquisition

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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. Office of Thrift Supervision regulations require the Mutual Holding Company to notify the OTS of any proposed waiver of its receipt of dividends from the Company.

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 an exchange ratio 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. Under OTS regulations, Minority Stockholders would not be diluted because of any dividends waived by the Mutual Holding Company (and waived dividends would not be considered in determining an appropriate exchange ratio), in the event the Mutual Holding Company converts to stock form. 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.

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NEW YORK STATE BANK HOLDING COMPANY REGULATION

In addition to the federal regulation, a holding company controlling a state chartered savings bank organized or doing business in New York State also may be subject to regulation under the New York State Banking Law. The term "bank holding company," for the purposes of the New York State Banking Law, is defined generally to include any person, company or trust that directly or indirectly either controls the election of a majority of the directors or owns, controls or holds with power to vote more than 10% of the voting stock of a bank holding company or, if the Company is a banking institution, another banking institution, or 10% or more of the voting stock of each of two or more banking institutions. In general, a bank holding company controlling, directly or indirectly, only one banking institution will not be deemed to be a bank holding company for the purposes of the New York State Banking Law. As such, neither the Company nor the Mutual Holding Company is subject to supervision by the Department.

FEDERAL SECURITIES LAW

The common stock of the Company is registered with the SEC under the Exchange Act. The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the SEC under the Exchange Act.

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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, 2006, 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."

NEW YORK STATE COMMUNITY REINVESTMENT REGULATION

The Bank is also 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

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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 was signed into law on October 26, 2001. The USA 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 USA PATRIOT Act also requires the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering

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activities in determining whether to approve a merger or other acquisition application of a member 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 was signed into law on July 30, 2002. The Sarbanes-Oxley Act of 2002 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 Act of 2002, the Company 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. We will be subject to further reporting requirements with the year ending December 31, 2007 under the provisions of Section 404 of the Sarbanes-Oxley Act. Recently revised dates for compliance with Section 404 have given non-accelerated filers some relief by extending the date for compliance with auditor attestation requirements to the year ending December 31, 2008. We have existing policies, procedures and systems designed to comply with these regulations, and are further enhancing and documenting such policies, procedures and systems to ensure continued compliance with these regulations.

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. The Company has also made available on its website its Audit Committee Charter, Compensation Committee Charter, Governance Guidelines and Code of Ethics. 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's Annual Report on Form 10-K may be accessed on the Company's website at www.pathfinderbank.com.

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 1996 Act, the Bank was permitted to establish a reserve for bad debts and to make annual additions to the reserve. These

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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 beginning with its 1996 Federal tax return.

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.

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. This provision applies to losses incurred in taxable years beginning after August 5, 1997.

The Internal Revenue Service has examined the federal income tax return for the fiscal year ended 1992. New York State has examined fiscal year-end tax returns through 2000. See Note 13 to the Financial Statements.

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) 8.0% 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.

ITEM 1A: RISK FACTORS

The material risks and uncertainties that management believes affect the Company are described below. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that management is not aware of or that management currently deems immaterial may also impair the Company's business operations. This report is qualified in its entirety by these risk factors. If any of the following risks actually occur, the Company's financial condition and results of operations could be materially and adversely affected.

CHANGES IN INTEREST RATES CAN HAVE AN ADVERSE EFFECT ON PROFITABILITY

The Company's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest earning assets such as loans and investment securities and interest expense paid on interest bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are

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beyond the Company's control, including general economic conditions, competition, and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and investment securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of the Company's assets and liabilities. If the interest

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rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations. See Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" located elsewhere in this report for further discussion related to the Company's management of interest rate risk.

ALLOWANCE FOR LOAN LOSSES MAY BE INSUFFICIENT

The Company's loan customers may not repay their loans according to their terms and the collateral securing the payment of these loans may be insufficient to assure repayment. The Company may experience significant loan losses, which would have a material adverse effect on earnings. Management makes various assumptions and judgments about the collectibility of the loan portfolio, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans.

The Company maintains an allowance for loan losses in an attempt to cover any loan losses inherent in the portfolio. In determining the size of the allowance, management relies on an analysis of the loan portfolio based on historical loss experience, volume and types of loans, trends in classification, volume and trends in delinquencies and non-accruals, national and local economic conditions and other pertinent information. If those assumptions are incorrect, the allowance may not be sufficient to cover future loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. In addition, regulatory agencies review the Company's allowance for loan losses and may require additions to the allowance based on their judgment about information available to them at the time of their examination. An increase in the Company's allowance for loan losses would reduce its earnings.

EXTENSIVE REGULATION AND SUPERVISION

The Company, primarily through its principal subsidiaries, Pathfinder Bank and Pathfinder Commercial Bank, and certain non-bank subsidiaries, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect the Company's lending practices, capital structure, investment practices,

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dividend policy and growth, among other things. The Company is also subject to a number of federal laws, which, among other things, require it to lend to various sectors of the economy and population, and establish and maintain comprehensive programs relating to anti-money laundering and customer identification. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. The Company's compliance with certain of these laws will be considered by banking regulators when reviewing bank merger and bank holding company acquisitions. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. See the "Regulation and Supervision" section in Item 1, "Business" and Note 17 to consolidated financial statements included in Item 8, "Financial Statements and Supplementary Data", which are located elsewhere in this report.

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LOCAL MARKET ECONOMIES

The Company's business is concentrated in Oswego and parts of Onondaga counties of New York State. The economy in the Company's market area is manufacturing-oriented and dependent on the State University of New York College at Oswego. As a result, its financial condition, results of operations and cash flows are subject to changes if there are changes in the economic conditions in these areas. A prolonged period of economic recession or other adverse economic conditions in one or both of these areas could have a negative impact on the Company. The Company can provide no assurance that conditions in its market area economies will not deteriorate in the future and that such deterioration would not have a material adverse effect on the Company.

COMPETITION IN THE FINANCIAL SERVICES INDUSTRY

The Company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. The Company competes with other providers of financial services such as other bank holding companies, commercial and savings banks, savings and loan associations, credit unions, money market and mutual funds, mortgage companies, title agencies, asset managers, insurance companies and a growing list of other local, regional and national institutions which offer financial services. If the Company is unable to compete effectively, it will lose market share and income generated from loans, deposits, and other financial products will decline.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None

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ITEM 2: PROPERTIES

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The Bank conducts its business through its main office located in Oswego, New York, and six full service branch offices located in Oswego County. The following table sets forth certain information concerning the main office and each branch office of the Bank at December 31, 2006. The aggregate net book value of the Bank's premises and equipment was \$7.6 million at December 31, 2006. For additional information regarding the Bank's properties, see Note 7 to Notes to Consolidated Financial Statements.

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

(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 \$27,000

ITEM 3: LEGAL PROCEEDINGS

There are various claims and lawsuits to which the Company is periodically involved incident 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: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of fiscal 2006 to a vote of the Company's shareholders.

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON STOCK, RELATED SECURITY HOLDER 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 499 shareholders of record as of March 9, 2007. 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, 2006	\$16.000	\$13.037	\$ 0.1025
September 30, 2006	14.370	11.700	0.1025
June 30, 2006	13.070	11.750	0.1025
March 31, 2006	14.130	11.000	0.1025
December 31, 2005	\$15.050	\$12.360	\$ 0.1025
September 30, 2005	15.250	13.050	0.1025
June 30, 2005	18.000	14.250	0.1025
March 31, 2005	17.950	16.250	0.1025

PERFORMANCE GRAPH

Set forth hereunder is a performance graph comparing (a) the total return on the Common Stock for the period beginning on December 31, 2001 through December 31, 2006, (b) the cumulative total return on stocks included in the Nasdaq Composite Index over such period, and (c) the yearly cumulative total return on stocks included in the SNL Thrift Index over such period. The cumulative total return on the Common Stock was computed assuming the reinvestment of cash dividends during the fiscal year.

There can be no assurance that the Common Stock's performance will continue in the future with the same or similar trend depicted in the graph. The Company will not make or endorse any predictions as to future stock performance.

[GRAPHIC OMITED]

Period Ending

Index	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
Pathfinder Bancorp, Inc	100.00	113.55	146.14	135.86	108.18	111.48

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NASDAQ Composite	100.00	68.76	103.67	113.16	115.57	127.58
SNL Thrift Index	100.00	119.29	168.88	188.16	194.80	227.07

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. 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 requires prior non-objection of the Office of Thrift Supervision. Pathfinder Bancorp, M.H.C. elected to waive its dividend for the quarters ended March 31, 2006 and September 30, 2006. During 2007, Pathfinder Bancorp, M.H.C. expects to waive two quarterly dividends.

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ITEM 6: SELECTED FINANCIAL DATA

Pathfinder Bancorp, Inc. ("the Company") is the parent company of Pathfinder Bank and Pathfinder Statutory Trust I. Pathfinder 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.

	2006	2005	2004	2003	2002

YEAR END (In thousands)					
Total assets	\$301,382	\$296,948	\$302,037	\$277,940	\$279,000
Loans receivable, net	201,713	187,889	185,125	187,002	179,000
Deposits	245,585	236,377	236,672	206,894	204,000
Equity	20,850	20,928	21,826	21,785	23,000
FOR THE YEAR (In thousands)					
Net interest income	\$ 8,326	\$ 8,742	\$ 8,905	\$ 9,337	\$ 8,000
Noninterest income	2,635	2,040	3,047	2,608	2,000
Core noninterest income (a)	2,416	2,333	1,996	1,740	1,000
Noninterest expense	9,668	10,060	9,307	9,094	7,000
Net income	1,028	462	1,405	1,652	1,000
PER SHARE					
Net income (basic)	\$ 0.42	\$ 0.19	\$ 0.58	\$ 0.68	\$ 0.40
Book value	8.45	8.50	8.91	8.96	8.00
Tangible book value (b)	6.82	6.77	7.04	7.03	7.00
Cash dividends declared	0.410	0.410	0.405	0.40	0.00

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RATIOS

Return on average assets	0.34%	0.15%	0.47%	0.59%	0
Return on average equity	4.86	2.16	6.45	7.61	5
Return on average tangible equity (b)	6.04	2.72	8.17	9.77	7
Average equity to average assets	7.03	6.95	7.29	7.77	8
Dividend payout ratio (c)	66.73	147.84	47.54	39.41	36
Allowance for loan losses to loans receivable	0.74	0.89	0.98	0.91	0
Net interest rate spread	2.92	3.07	3.22	3.53	3
Noninterest income to average assets	0.87	0.66	1.02	0.93	0
Core noninterest income to average assets (a)	0.80	0.76	0.67	0.62	0
Noninterest expense to average assets	3.21	3.28	3.12	3.26	3
Efficiency ratio (d)	88.19	93.30	77.87	76.13	73

(a) Core noninterest income excludes net (losses) gains on sales and impairment of investment securities and net (losses) gains on sales of loans and foreclosed real estate.

(b) Tangible equity excludes intangible assets.

(c) The dividend payout ratio is calculated using dividends declared and not waived by the Company's mutual holding company parent, Pathfinder Bancorp, M.H.C., divided by net income.

(d) The efficiency ratio is calculated as noninterest expense divided by the sum of net interest income and noninterest income.

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

INTRODUCTION

Throughout the 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 I are wholly owned subsidiaries of Pathfinder Bancorp, Inc., however, Pathfinder Statutory Trust I is deconsolidated for reporting purposes (see Note 10). Pathfinder Commercial Bank, Pathfinder REIT, Inc. and Whispering Oaks Development Corp. represent wholly owned subsidiaries of Pathfinder Bank. At December 31, 2006, Pathfinder Bancorp, M.H.C, the Company's mutual holding company parent, whose activities are not included in the MD&A, held 64.2% of the Company's outstanding common stock and the public held 35.8%.

On March 22, 2007, the Company entered into a trust preferred issuance for \$5.0 million, adjustable quarterly at a spread over LIBOR. The Company intends to use all the proceeds from the issuance to retire its existing trust preferred obligation on June 27th, 2007, at its first call date.

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, including, among other things, changes in economic conditions in the Company's market area, changes in policies by regulatory agencies, fluctuations in interest rates, demand for loans in the Company's market areas and competition, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. 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

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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.

The Company does not undertake, and specifically declines any obligation, to publicly release the results of any revisions, which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

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 other 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 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, which events are beyond the control of the Company. In particular, the general level of market rates tends to be highly cyclical.

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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

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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 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 determination of the allowance for loan losses to be the accounting area that requires the most subjective and complex judgments, and as such could be the most subject to revision as new information becomes available.

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 balance sheet. 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.

The Company carries all of its security investments at fair value with any unrealized gains or losses reported net of tax as an adjustment to shareholders' equity. Based on management's assessment, at December 31, 2006, the Company did not hold any security that had a fair value decline that is currently expected to be other than temporary. Consequently, any declines in a specific security's fair value below amortized cost have not been provided for in the consolidated income statement. The Company's ability to fully realize the value of its investment in various securities, including corporate debt securities, is dependent on the underlying creditworthiness of the issuing organization.

EXECUTIVE SUMMARY

The Company opened a full service branch in Central Square, New York in June of 2005. Total deposits for this branch were \$11.0 million at December 31, 2006, as compared to \$6.3 million at December 31, 2005. Total deposits for the Company increased 4%, to \$245.6 million at December 31, 2006, while the average balance of deposits decreased \$1.5 million to \$238.4 million at December 31, 2006. The Company will continue to focus on building its market share in Central Square and developing more core deposit relationships in its existing markets during 2007.

Total assets increased 2%, primarily in the loan portfolio and interest-earning deposits. The loan portfolio increased 7% as net growth in the commercial real estate, commercial and consumer loan portfolios was partially offset by a decrease in the residential real estate portfolio. Asset quality continued to

improve during 2006. The ratio of nonperforming assets to total assets was 0.58% at December 31, 2006 compared to 0.82% in the prior year. The improvement in asset quality is attributable to the enhancement of collection procedures. The Company expects to concentrate on continued commercial mortgage and

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commercial loan portfolio growth during 2007.

Net income for 2006 was \$1.0 million, or \$0.42 per share, as compared to \$462,000, or \$0.19 per share, in 2005. An improvement in asset quality, increased service charges on deposit accounts, a reduction in noninterest expenses and an increase in net gains on investment securities contributed to the increase in net income from 2005. Net interest margin compression negatively impacted earnings during 2006.

The Company experienced net interest margin compression to 3.10% in 2006 from 3.21% in 2005. Net interest income decreased 5% to \$8.3 million for the year ended December 31, 2006. Beginning in June 2004, the Federal Reserve has increased its target for federal funds rate numerous times. While these short-term market interest rates have increased, longer-term market interest rates have remained relatively unchanged. This "flattening" of the market yield curve has had a negative impact on the Company's interest rate spread and net interest margin to date. If short-term interest rates continue to rise, and if rates on deposits and borrowings continue to reprice upwards faster than the rates on longer-term loans and investments, the Bank will continue to experience compression of its net interest rate spread and net interest margin, which would result in a negative impact on the Company's profitability. The Company has implemented an asset/liability management strategy to address the current interest rate environment, including the growth of the more rate sensitive commercial real estate and commercial loan portfolio, and increasing core deposit relationships and strategies to mitigate the rising cost of deposits.

The Company's efforts to enhance other income during 2006 by increasing the customer deposit base and increasing overdraft, returned check and non-sufficient fund charges to be more reflective with local competition resulted in a 6% increase in service charges on deposit accounts during 2006. The Company continues to explore cost saving strategies to minimize the growth of operating expenses. The Company's efforts resulted in a reduction in noninterest expense of \$392,000, or 3.9%, when comparing current year operating expense levels to the prior year. The expense reductions were achieved while operating the new Central Square branch for a full year in 2006.

RESULTS OF OPERATIONS

Net income for 2006 was \$1.0 million, an increase of \$566,000, or 123%, compared to net income of \$462,000 for 2005. Basic earnings per share increased to \$0.42 per share for the year ended December 31, 2006 from \$0.19 per share for the year ended December 31, 2005. Return on average equity increased to 4.86% in 2006 from 2.16% in 2005.

Net interest income, on a tax equivalent basis, decreased \$467,000, or 5%, primarily resulting from interest rate spread compression as shorter term funding sources are repricing into higher rates faster than longer term assets. Provision for loan losses at December 31, 2006 decreased 93% reflecting improved asset quality during 2006 and fewer charge-offs. The Company experienced a 4% increase in noninterest income, exclusive of securities gains and losses, primarily attributable to increased deposit levels and the related service charges associated with checking accounts, combined with an increase in the value of bank owned life insurance and commercial loan fees. Noninterest expense decreased 4% due to a reduction in personnel expense, decreased professional and other services and other expenses.

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 other borrowed

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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, decreased \$467,000, or 5%, to \$8.5 million for the year ended December 31, 2006, as compared to the year ended December 31, 2005. The Company's net interest margin for 2006 decreased to

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3.10% from 3.21% in 2005. The decrease in net interest income is attributable to increased costs of interest-bearing liabilities and was partially offset by an increase in the yields on interest earning assets. The average balance of interest-earning assets decreased \$5.4 million, or 2%, during 2006 and the average balance of interest-bearing liabilities decreased by \$6.7 million, or 3%. The decrease in the average balance of interest-bearing liabilities primarily resulted from a \$3.8 million, or 9%, decrease in the average balance of borrowed funds and a \$2.9 million, or 1% decrease in the average balance of deposits. Interest income, on a tax-equivalent basis, increased \$720,000 during 2006, as the yield on interest earning assets increased to 5.86% in 2006 from 5.49% in 2005. Interest expense on deposits increased \$1.2 million, or 27%, as the cost of deposits rose to 2.52% in 2006 from 1.96% in 2005. In addition to the increase in the cost of deposits, interest expense on borrowings also increased by \$19,000, or 1%, from the prior year.

In comparison, net interest income decreased \$106,000, or 1%, on a tax-equivalent basis, from 2004 to 2005. The decrease in net interest income was comprised of an increase in interest expense of \$783,000, or 14%, partially offset by an increase in interest income of \$677,000, or 5%. The average balance of interest-earning assets grew \$8.2 million during 2005 and the average balance of interest-bearing liabilities increased by \$7.8 million. The increase in the average balance of interest-bearing liabilities primarily resulted from attracting new municipal deposit customers. The decrease in the average yield on interest-earning assets by 60 basis points resulted from the downward repricing of loans from refinancing and originations in the lower interest rate environment and the purchase of \$35.6 million in investment securities at lower yields than the existing portfolio.

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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,

2006

2005

Average

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(Dollars in thousands)	Average Balance	Interest	Yield / Cost	Average Balance	Interest
Interest-earning assets:					
Real estate loans residential	\$119,417	\$ 6,876	5.76%	\$121,875	\$ 7,092
Real estate loans commercial	35,076	2,705	7.71%	29,385	2,181
Commercial loans	19,961	1,574	7.88%	17,563	1,135
Consumer loans	20,153	1,641	8.14%	19,257	1,418
Taxable investment securities	66,788	2,656	3.97%	74,496	2,728
Tax-exempt investment securities	10,240	482	4.70%	13,202	681
Interest-earning deposits	1,779	92	5.12%	3,041	71
Total interest-earning assets	\$273,414	\$ 16,026	5.86%	\$278,819	\$ 15,306
Noninterest-earning assets:					
Other assets	31,600			31,455	
Allowance for loan losses	(1,661)			(1,835)	
Net unrealized losses on available for sale securities	(2,142)			(1,307)	
Total Assets	\$301,211			\$307,132	
Interest-bearing liabilities:					
NOW accounts	\$ 21,094	\$ 102	0.48%	\$ 19,877	\$ 107
Money management accounts	13,318	110	0.83%	16,096	138
MMDA accounts	20,608	786	3.81%	25,284	697
Savings and club accounts	58,997	266	0.45%	65,558	291
Time deposits	103,596	4,223	4.08%	93,732	3,086
Junior subordinated debentures	5,155	448	8.57%	5,155	351
Borrowings	33,589	1,608	4.79%	37,348	1,686
Total Interest-bearing liabilities	\$256,357	\$ 7,543	2.94%	\$263,050	\$ 6,356
Noninterest-bearing liabilities:					
Demand deposits	20,745			19,324	
Other liabilities	2,943			3,416	
Total liabilities	280,045			285,790	
Shareholders' equity	21,166			21,342	
Total liabilities & shareholders' equity	\$301,211			\$307,132	
Net interest income		\$ 8,483			\$ 8,950
Net interest rate spread			2.92%		
Net interest margin			3.10%		
Ratio of average interest-earning assets to average interest-bearing liabilities					106.65%

2004

(Dollars in thousands)	Average Balance	Interest	Average Yield/ Cost
Interest-earning assets:			
Real estate loans residential	\$124,734	\$ 7,491	6.01%

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Real estate loans commercial	30,958	2,254	7.28%
Commercial loans	16,060	901	5.61%
Consumer loans	17,427	1,194	6.85%
Taxable investment securities	65,480	2,220	3.39%
Tax-exempt investment securities	8,603	488	5.67%
Interest-earning deposits	7,338	81	1.10%

Total interest-earning assets	\$270,600	\$ 14,629	5.41%
Noninterest-earning assets:			
Other assets	30,236		
Allowance for loan losses	(1,792)		
Net unrealized gains on available for sale securities	(515)		

Total Assets	\$298,529		
=====			
Interest-bearing liabilities:			
NOW accounts	\$ 20,808	\$ 135	0.65%
Money management accounts	14,459	167	1.15%
MMDA accounts	26,316	400	1.52%
Savings and club accounts	68,046	453	0.67%
Time deposits	82,769	2,484	3.00%
Junior subordinated debentures	5,155	251	4.80%
Borrowings	37,674	1,683	4.47%

Total Interest-bearing liabilities	\$255,227	\$ 5,573	2.18%

Noninterest-bearing liabilities:			
Demand deposits	17,974		
Other liabilities	3,556		

Total liabilities	276,757		

Shareholders' equity	21,772		
Total liabilities & shareholders' equity	\$298,529		
=====			
Net interest income		\$ 9,056	
Net interest rate spread			3.22%
Net interest margin			3.35%

Ratio of average interest-earning assets to average interest-bearing liabilities			106.02%

INTEREST INCOME

Changes in interest income are derived as a result of the volume of loans and securities, as measured by changes in the respective average balance and by the related yields on those balances. Interest income on a tax-equivalent basis increased \$720,000, or 5%. Average loans increased 3% in 2006, with yields

increasing 29 basis points to 6.58%. The Company's average residential mortgage loan portfolio decreased \$2.5 million, or 2%, when comparing the year 2006 to 2005. The average yield on the residential mortgage loan portfolio decreased 6 basis points to 5.76% in 2006 from 5.82% in 2005. An increase in the average balance of consumer loans of \$896,000, or 5%, resulted from an increase in home equity loans. The average yield increased 78 basis points, to 8.14% from 7.36%

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in 2005, primarily resulting from the increase in home equity loans, which are based on the Bank's prime rate. Average commercial loans increased 14% while the tax-equivalent yield increased 143 basis points to 7.89% in 2006 compared to 6.46%, in 2005.

Average loans decreased \$1.1 million in 2005, with average yields increasing 3 basis points to 6.29%. The interest income on loans decreased \$14,000 in 2005 compared to 2004. For the comparable periods, average residential mortgage loans decreased \$2.9 million, or 2% and average commercial mortgage loans decreased by \$1.6 million, or 5%. These decreases were partially offset by increases in average consumer loans of \$1.8 million, or 11% and average commercial loans of \$1.5 million, or 9%.

Interest income on investment securities decreased 8% from 2005, resulting from a decrease in the average balance of investment securities (taxable and tax-exempt) by \$10.7 million, or 12%, to \$77.0 million in 2006 from \$87.7 million in 2005. The decrease in the average balance of investment securities is primarily the result of cash flows generated from security portfolio maturities, amortization and sales being utilized to fund loan portfolio growth. The tax-equivalent yield increased 19 basis points to 4.08% in 2006 from 3.89% in 2005.

Average investment securities (taxable and tax-exempt) in 2005 increased by \$13.6 million, with an increase in tax-equivalent interest income from investments of \$701,000, or 26%, compared to 2004. The average tax-equivalent yield of the portfolio rose 23 basis points, to 3.89% from 3.66%. The increase in the average balance of investment securities and the increase in the tax-equivalent yield resulted from security portfolio acquisitions required for municipal deposit collateralization occurring at yields in excess of the existing average portfolio yield.

INTEREST EXPENSE

Changes in interest expense are derived as a result of the volume of deposits and borrowings as measured by changes in the respective average balances and by the related interest costs on those balances. Interest expense increased \$1.2 million, or 19%, in 2006, when compared to 2005. The increase in the cost of funds resulted from an increase in the average cost of interest-bearing liabilities of 52 basis points, to 2.94% in 2006 from 2.42% at 2005, offset by a \$6.7 million decrease in the average balance of interest-bearing liabilities during 2006. The average cost of deposits increased 56 basis points to 2.52% during 2006 from 1.96% for 2005. The increase in the cost of average deposits resulted from rising short-term interest rates, combined with a shift from lower cost savings products to the higher cost time deposits. The average cost of MMDA accounts increased 105 basis points and the cost of time deposits increased 79 basis points. The average balance of deposits decreased \$2.9 million to \$217.6 million at 2006 from \$220.5 million at 2005. The decrease in the average balance of deposits primarily resulted from a \$5.9 million, or 20%, decrease in the average balance of municipal deposits, offset by an increase in the average balance of retail deposits resulting primarily from inflows into the new branch in Central Square. The cost of junior subordinated debentures increased 185 basis points, increasing interest expense by \$97,000.

Interest expense increased \$783,000, or 14%, in 2005 compared to 2004. The average cost of interest-bearing liabilities rose 24 basis points during the 12 months ended December 31, 2005.

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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 changing 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.

FOR THE YEARS ENDED DECEMBER 31,						
2006 VS. 2005			2005 VS. 2004			
INCREASE/(DECREASE) DUE TO			INCREASE/(DECREASE) DUE TO			
(In thousands)	VOLUME	RATE	TOTAL INCREASE (DECREASE)	VOLUME	RATE	TOTAL INCREASE (DECREASE)
INTEREST INCOME:						
Real estate loans residential	\$(143)	\$ (73)	\$ (216)	\$(168)	\$(231)	\$(399)
Real estate loans commercial	436	88	524	(116)	43	(73)
Commercial loans	167	272	439	89	145	234
Consumer loans	68	155	223	131	93	224
Taxable investment securities	(296)	224	(72)	322	186	508
Tax-exempt investment securities	(143)	(56)	(199)	240	(47)	193
Interest-earning deposits	(39)	60	21	(65)	55	(10)
Total interest income	50	670	720	433	244	677
INTEREST EXPENSE:						
NOW accounts	7	(12)	(5)	(6)	(22)	(28)
Money management accounts	(23)	(5)	(28)	(14)	(15)	(29)
MMDA accounts	(145)	234	89	39	258	297
Savings and club accounts	(31)	6	(25)	(16)	(146)	(162)
Time deposits	346	791	1,137	348	254	602
Junior subordinated debentures	-	97	97	-	100	100
Borrowings	(177)	99	(78)	(13)	16	3
Total interest expense	(23)	1,210	1,187	338	445	783
Net change in net interest income	\$ 73	\$ (540)	\$ (467)	\$ 95	\$(201)	\$(106)

NONINTEREST INCOME

The Company's noninterest income is primarily comprised of fees on deposit

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account balances and transactions, loan servicing, commissions, and net gains 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)	2006	2005	2004
Service charges on deposit accounts	\$1,391	\$1,318	\$ 967
Loan servicing fees	224	215	256
Increase in the value of bank owned life insurance	225	218	175
Debit card interchange fees	189	147	119
Other charges, commissions and fees	387	435	479
<hr/>			
Core noninterest income	\$2,416	\$2,333	\$1,996
Net gains (losses) on sales and impairment of investment securities	299	(205)	772
Net (losses) gains on sales of loans and foreclosed real estate	(80)	(88)	279
<hr/>			
Total noninterest income	\$2,635	\$2,040	\$3,047

Noninterest income in 2006 increased 29%, when compared to 2005, as a result of a 4% increase in core noninterest income and a 174% increase in the non-core items, net gains (losses) on sales and impairment of investment securities and net (losses) gains on sales of loans and foreclosed real estate. Service charges on deposit accounts increased 6% as deposit related charges were increased to be more in line with local competition and the number of deposit accounts increased, creating a higher volume of fee-generating transactions, including overdrafts, nonsufficient funds, debit cards and ATM transactions. The value of bank owned life insurance increased 3%. Loan servicing fees increased 4% due to a reduction in the amortization of mortgage servicing rights, offset by a decrease in late charges on mortgage and commercial loans and a reduction in internal mortgage legal fees collected as outside sources were used for loan closings. Investment security gains increased \$504,000, when compared to the 2005 period resulting primarily from the recording of a long-term capital gain in the fourth quarter of 2006 and an impairment reserve of \$193,000 being recognized on equity security holdings during 2005 that did not recur in 2006. Net losses on the sale of loans/ foreclosed real estate decreased \$8,000 when compared to the prior year.

Noninterest income in 2005 decreased 33%, when compared to 2004, as a result of a 17% increase in core noninterest income and a 128% decrease in the non-core items. Service charges on deposit accounts increased 36% as the number of deposit accounts increased, a full year's effect of a fee enhancement program, increased ATM usage fees and increased internet banking usage. The value of bank owned life insurance increased 25%. These increases were offset by a decrease in loan servicing fees of 16%, primarily due to a reduction in fees associated with mortgage and commercial loan late charges, and internal mortgage legal fees. Investment security losses increased \$977,000, when compared to the 2004 period resulting primarily from net gains recognized in prior years combined with a \$193,000 impairment loss recognized on an equity security and fourth quarter investment portfolio restructurings. Net losses on the sale of loans/foreclosed real estate increased \$367,000 when compared to the prior year, as a result of a \$215,000 reduction in the gain recognized on the sale of loans to the secondary market as the volume of loans sold decreased by 25%, combined with adjustments made to the Fannie Mae custodial accounts to cover additional

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interest due caused by early pay offs of sold and serviced loans.

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NONINTEREST EXPENSE

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

(In thousands)	FOR THE YEARS ENDED DECEMBER 31,		
	2006	2005	2004
Salaries and employee benefits	\$5,007	\$ 5,123	\$4,798
Building occupancy	1,203	1,178	1,169
Data processing expenses	1,278	1,262	981
Professional and other services	615	782	682
Amortization of intangible asset	223	223	223
Other expenses	1,342	1,492	1,454
Total noninterest expense	\$9,668	\$10,060	\$9,307

Noninterest expenses decreased \$392,000, or 4%, for the year ended December 31, 2006 when compared to 2005. Salaries and employee benefits decreased 2% in 2006 primarily due to personnel realignments made in the fourth quarter of 2005 and a reduction in stock based compensation. This reduction was offset by normal salary merit increases, incentive compensation and lower deferred payroll expense due to fewer mortgage loan originations in 2006. The 21% decrease in professional and other expenses was primarily due to outside consulting charges for performance management, a process improvement program, and strategic planning projects in 2005. This decrease was offset by 2006 expenses incurred for the on-going SOX 404 process review, the creation of a new general ledger cost center accounting program, economic impact studies and a direct mailing campaign to attract new deposit customers. The 10% decrease in other expenses primarily resulted from a reduction in audits and exams, dues and membership and FDIC assessments. Additionally, ORE expenses were lower in conjunction with a reduction in the number of properties held during 2006. Mortgage recording taxes were lower than 2005 in direct correlation to the decreased volume of residential mortgage originations. The 2% increase in building occupancy is primarily due to a full year's operation of the new Central Square branch and increased lease expense on properties. The 1% increase in data processing expenses during 2006 related to increases in annual maintenance expense on our core processing system, depreciation expenses and third party processing charges. This increase was offset by a reduction in ATM processing charges as the number of offsite ATM machines decreased.

Noninterest expenses increased \$753,000, or 8%, for the year ended December 31, 2005 when compared to 2004. Salaries and employee benefits increased 7% in 2005 primarily resulting from incremental salary raises, the staffing of a new Central Square branch and fourth quarter personnel realignment costs. The 25% increase in data processing expenses during 2005 related to increased depreciation expense, an increase in internet banking expense due to increased volume of users, increased check processing charges due to an increase in the number of deposit accounts, and the increased annual maintenance expense on our core processing system. Professional and other services increased 20% due to

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outside consulting charges for performance management, a process improvement program, and strategic planning projects, along with increased advertising fees for the new Central Square branch. The 3% increase in other operating expenses during 2005 resulted primarily from the charge off of losses on ATM transactions and bad checks, additional ORE expenses associated with taxes and maintenance of properties, the write off of property and equipment at our former Fulton Branch, as well as an increase in audits and exams. These expenses were offset by decreases in postage expense, office supply expense and lower mortgage recording taxes due to decreased loan volume.

INCOME TAX EXPENSE

In 2006, the Company reported income tax expense of \$242,000 compared to an income tax provision of \$51,000 in 2005. The income tax expense in 2006 resulted from an increase in pretax income of \$859,000, while income earned on tax-exempt investment securities decreased. The effective tax rate increased to

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19% in 2006 compared to a tax benefit of (12)% in 2005. The increase in the effective tax rate resulted primarily from an increase in the level of pre-tax income, combined with a reduction in tax-exempt investment security income. The Company has reduced its tax rate from the statutory rate primarily through the ownership of tax-exempt investment securities, bank owned life insurance and other tax saving strategies. Enactment of proposed state tax legislation regarding Real Estate Investment Trusts would increase the state tax rate for the Company.

Income tax expense decreased \$553,000 to a \$(51,000) tax benefit for the year ended December 31, 2005 when compared to the prior year. The decrease in income tax expense reflected lower pre-tax income during the year. The Company's effective tax rate at 2005 was (12%) compared to 26% in 2004.

CHANGES IN FINANCIAL CONDITION

INVESTMENT SECURITIES

The investment portfolio represents 23% of the Company's earning assets and is designed to generate a favorable rate of return consistent with safety of principal while assisting the Company in meeting the liquidity needs and interest rate risk strategies of the Company. All of the Company's investments are classified as available for sale. The Company invests in securities consisting primarily of mortgage-backed securities, securities issued by United States Government agencies and sponsored enterprises, 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 alternative loan products.

Investment securities decreased \$11.8 million, to \$64.2 million at December 31, 2006 from \$76.0 million at December 31, 2005. The decrease in investment securities was primarily attributable to the sale of lower yielding investment securities in the fourth quarter of 2005, and first and fourth quarters of 2006. In comparison, investment securities decreased \$793,000, or 1%, from 2004 to 2005. The decrease in investment securities was primarily attributable to the sale of lower yielding investment securities in the fourth quarter of 2005.

The following table sets forth the carrying value of the Company's investment portfolio at the dates indicated.

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(In thousands)	AT DECEMBER 31,		
	2006	2005	2004
INVESTMENT SECURITIES:			
US Treasury and agencies	\$19,966	\$20,713	\$21,609
State and political subdivisions	5,870	11,177	8,881
Corporate	5,575	5,936	5,919
Mortgage-backed	25,481	31,565	32,213
Equity securities and FHLB stock	2,406	2,626	2,800
Mutual funds	6,336	6,177	5,935
	65,634	78,194	77,357
Unrealized loss on available for sale portfolio	(1,415)	(2,150)	(520)
Total investments in securities	\$64,219	\$76,044	\$76,837

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The following table sets forth the scheduled maturities, amortized cost, fair values and average yields for the Company's investment securities at December 31, 2006. Yield is calculated on the amortized cost to maturity and adjusted to a fully tax-equivalent basis.

(Dollars in thousands)	ONE YEAR OR LESS		ONE TO FIVE YEARS		FIVE
	AMORTIZED COST	ANNUALIZED WEIGHTED AVG YIELD	AMORTIZED COST	ANNUALIZED WEIGHTED AVG YIELD	AMORT
DEBT INVESTMENT SECURITIES:					
US Treasury and agencies	\$ 4,107	4.14%	\$ 11,794	4.30%	\$ 4
State and political subdivisions	505	2.94%	3,248	3.46%	2
Corporate	200	7.00%	2,246	4.72%	
Total	\$ 4,812	4.13%	17,288	4.20%	\$ 7
EQUITY AND MORTGAGE-BACKED SECURITIES:					
Mutual funds	\$ 6,336	2.50%	\$ -	-	\$ 4
Mortgage-backed	-	-	6,559	4.11%	4
Equity securities and FHLB stock	2,406	5.63%	-	-	
Total	\$ 8,742	3.36%	\$ 6,559	3.87%	\$ 4
Total investment securities	\$ 13,554	3.64%	\$ 23,847	4.17%	\$11

MORE THAN TEN YEARS TOTAL INVESTMENT SECURITIES

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(Dollars in thousands)	AMORTIZED COST	ANNUALIZED WEIGHTED AVG YIELD	AMORTIZED COST	FAIR VALUE	ANNUALIZED WEIGHTED AVG YIELD
DEBT INVESTMENT SECURITIES:					
US Treasury and agencies	\$ -	-	\$ 19,966	\$19,409	4.34%
State and political subdivisions	-	-	5,870	5,791	3.57%
Corporate	2,140	5.31%	5,575	5,514	5.03%
Total	\$ 2,140	5.31%	\$ 31,411	\$30,714	4.32%
EQUITY AND MORTGAGE-BACKED SECURITIES:					
Mutual funds	\$ -	-	\$ 6,336	\$ 6,112	2.50%
Mortgage-backed	14,678	4.64%	25,481	24,896	4.56%
Equity securities and FHLB stock	-	-	2,406	2,497	5.63%
Total	\$ 14,678	4.52%	34,223	33,505	4.26%
Total investment securities	\$ 16,818	4.73%	\$ 65,634	\$64,219	4.29%

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

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LOANS RECEIVABLE

Loans receivable represent 74% of the Company's 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 loans comprise 11% of the total loan portfolio. At December 31, 2006, 78% of the Company's total loan portfolio consisted of loans secured by real estate, of which 20% consisted of commercial real estate loans.

(In thousands)	DECEMBER 31,				
	2006	2005	2004	2003	2002
Residential real estate (1)	\$118,494	\$119,707	\$123,898	\$128,989	\$123,178
Commercial real estate	40,501	31,845	29,874	31,278	32,657
Commercial loans	23,001	18,334	16,834	15,090	13,196
Consumer loans	21,213	19,682	18,505	16,880	15,068
Total loans receivable	\$203,209	\$189,568	\$189,111	\$192,237	\$184,099

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(1) Includes loans held for sale.

The following table shows the amount of loans outstanding as of December 31, 2006 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
<hr/>				
REAL ESTATE:				
Commercial real estate	\$ 9,962	\$22,721	\$ 7,818	\$ 40,501
Construction	33	153	1,974	2,160
Residential real estate	46,263	65,941	4,130	116,334
	<hr/>	<hr/>	<hr/>	<hr/>
	56,258	88,815	13,922	158,995
	<hr/>			
Commercial	16,763	4,531	1,707	23,001
Consumer	9,504	5,188	6,521	21,213
	<hr/>			
Total loans	\$85,525	\$98,534	\$22,150	\$203,209
<hr/>				
INTEREST RATES:				
Fixed	14,129	62,119	12,260	88,508
Variable	68,396	36,415	9,890	114,701
	<hr/>			
Total Loans	\$85,525	\$98,534	\$22,150	\$203,209
<hr/>				

Total loans receivable increased 7% when compared to the prior year. The commercial real estate, commercial loan and consumer loan portfolios increased \$8.7 million, \$4.7 million and \$1.5 million, respectively. The increases in these portfolios were partially offset by a decrease in the residential real estate loans of \$1.2 million. By comparison, loans receivable increased \$457,000, in 2005 from 2004.

Residential real estate loans decreased \$1.3 million, or 1%, during 2006. The residential real estate portfolio consists of 57% in fixed-rate mortgages and 43% in adjustable-rate mortgages. The decrease in the residential real estate portfolio is principally due to a net decrease in 15-year fixed rate mortgages

of \$6.0 million and a \$3.0 million decrease in 30-year fixed rate loans held for sale, offset by an increase in the adjustable rate mortgage portfolio. The increase in the adjustable rate mortgage portfolio primarily resulted from an increase in customer demand for the Company's hybrid adjustable rate mortgages ("ARM"s). Hybrid ARMs have rates that are fixed for an initial period (principally 3, 5, 7 or 10 years) and then convert to one-year adjustable rate mortgages.

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Commercial real estate loans increased \$8.7 million, or 27%, from the prior year as new loan products and relationships were added to the portfolio. Commercial real estate loans increased \$2.0 million, or 7%, during 2005.

Commercial loans, including loans to municipalities, increased 25% over the prior year to \$23.0 million at December 31, 2006. The increase in commercial loans resulted primarily from a \$4.4 million net increase from new lending relationships and new loan products. In comparison, commercial loans, including municipal loans, increased 9% during 2005.

Consumer loans, which include second mortgage loans, home equity lines of credit, direct installment and revolving credit loans, increased 8% to \$21.2 million at December 31, 2006. The increase resulted from an increase in home equity lines of credit and second mortgage loans. The Company has promoted its home equity products by offering the customer loans with no closing costs at competitive market rates. Management feels these loans are an attractive use of funds and will continue to promote home equity products in 2007. During 2005, consumer loans increased \$1.2 million, or 6%, resulting primarily from an increase in home equity products.

NONPERFORMING LOANS AND ASSETS

The following table represents information concerning the aggregate amount of nonperforming assets:

	DECEMBER 31,				
(Dollars in thousands)	2006	2005	2004	2003	2002
	>				
NONACCRUAL LOANS:					
Commercial real estate and commercial	\$ 481	\$ 757	\$ 776	\$1,677	\$ 603
Consumer	125	89	122	172	166
Real estate - construction	-	-	-	270	-
mortgage	566	834	953	873	942
Total nonaccrual loans	\$1,172	\$1,680	\$1,851	\$2,992	\$1,711
Total non-performing loans	\$1,172	\$1,680	\$1,851	\$2,992	\$1,711
Foreclosed real estate	471	743	798	202	1,396
Total non-performing assets	\$1,643	\$2,423	\$2,649	\$3,194	\$3,107
Non-performing loans to total loans	0.57%	0.89%	0.98%	1.59%	0.95%
Non-performing assets to total assets	0.54%	0.82%	0.88%	1.15%	1.11%
Interest income that would have been recorded under the original terms of the loans	\$ 53	\$ 34	\$ 64	\$ 75	\$ 141

The asset quality of the Company's loan portfolio has improved during 2006. Residential delinquencies declined by 32% during 2006 and 14% during 2005, resulting from the institution of a more stringent collection policy. Total nonperforming assets (nonperforming loans and foreclosed real estate) at

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December 31, 2006 were 0.54% of total assets as compared to 0.82% of total assets at December 31, 2005. Total nonperforming loans (past due 90 days or more) decreased \$508,000, or 30%, during 2006 and decreased 11% during 2005. Total delinquent loans (those 30 days or more delinquent) as a percentage of total loans were 2.05% at December 31, 2006 compared to 2.03% at December 31, 2005. Approximately 44% of the Company's nonperforming loans at December 31, 2006 are secured by residential real estate with loss potential expected to be manageable within the allocated reserves.

The Company generally places a loan on nonaccrual status and ceases accruing interest when loan payment performance is deemed unsatisfactory and the loan is past due 90 days or more. 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 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, 2006 and 2005, the Company had \$98,000 and \$2.5 million in loans which were deemed to be impaired, having valuation allowances of \$24,000 and \$90,000, respectively. Of the prior year impaired loan balance, \$2.3 million represented one commercial credit relationship which was paid in full during 2006.

Management has identified additional potential problem loans totaling \$2.3 million as of December 31, 2006. These loans have been internally classified as substandard or lower, yet are not currently considered past due or in nonaccrual status. Management has identified potential credit problems which may result in the borrower not being able to comply with the current loan repayment terms and which may result in it being included in subsequent past due reporting. Management believes that the current allowance for loan losses is adequate to cover probable credit losses in the current loan portfolio.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a reserve established through charges to expense in the form of a provision for loan losses and reduced by loan charge-offs net of recoveries. 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 the 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 reviews individually, commercial real estate and commercial loans greater than \$150,000, that are not accruing interest and risk rated under the Company's risk rating system, as special mention, substandard, doubtful or loss to determine if the loans are impaired. If loans are determined to be impaired, the Company establishes a specific reserve 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 a reserve 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, 2006.

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The allowance for loan losses was \$1.5 million at December 31, 2006, an 11% decrease from December 31, 2005. The allowance for loan losses as a percentage of total loans decreased to 0.74% at December 31, 2006 from 0.89% in the prior year. Net loan charge-offs were \$206,000 during 2006 compared to \$459,000 in

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2005. The majority of the current year charge-off activity is the result of the write down of portions of two commercial lending relationships. The continued improvement in the overall loan portfolio asset quality resulted in reduced current year provisioning and lower allowance coverage ratios.

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)	2006		2005		2004		AMOUNT
	AMOUNT	% GROSS LOANS	AMOUNT	% GROSS LOANS	AMOUNT	% GROSS LOANS	
Commercial real estate and loans	\$ 985	31.3%	\$ 1,282	26.5%	\$ 1,483	24.7%	\$ 1,282
Consumer loans	339	10.4%	289	10.4%	270	9.8%	1,282
Residential real estate	172	58.3%	108	63.1%	74	65.5%	3,246
Total	\$ 1,496	100.0%	\$ 1,679	100.0%	\$ 1,827	100.0%	\$ 1,790

The following table sets forth the analysis of the allowance for loan losses at or for the periods indicated.

(Dollars in thousands)	2006	2005	2004	2003	2002
BALANCE AT BEGINNING OF YEAR	\$1,679	\$1,827	\$1,715	\$1,481	\$ 1,679
Allowance acquired in branch purchase	-	-	-	-	57
Provisions charged to operating expenses	23	311	738	598	1,375
RECOVERIES OF LOANS PREVIOUSLY CHARGED-OFF:					
Commercial real estate and loans	-	25	41	3	26
Consumer	18	14	20	17	6
Residential real estate	4	10	-	17	-
Total recoveries	22	49	61	37	32
LOANS CHARGED OFF:					
Commercial real estate and loans	(114)	(284)	(439)	(128)	(1,285)
Consumer	(89)	(137)	(126)	(189)	(291)
Residential real estate	(25)	(87)	(122)	(84)	(86)
Total charged-off	(228)	(508)	(687)	(401)	(1,662)

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Net charge-offs	(206)	(459)	(626)	(364)	(1,630)
Balance at end of year	\$1,496	\$1,679	\$1,827	\$1,715	\$ 1,481
Net charge-offs to average loans outstanding	0.11%	0.24%	0.33%	0.19%	0.92%
Allowance for loan losses to year-end loans	0.74%	0.89%	0.98%	0.91%	0.82%

DEPOSITS

The Company's deposit base is drawn from seven full-service offices in its market area. The deposit base consists of demand deposits, money management and money market deposit accounts, savings and time deposits. During 2006, 57% of the Company's average deposit base of \$238.4 million consisted of core deposits. Core deposits are considered to be more stable and provide the Company with a lower cost source of funds. The Company will continue to emphasize retail deposits by maintaining its network of full service offices and providing depositors with a full range of deposit product offerings. Pathfinder Commercial Bank will seek business growth by focusing on its local identification and service excellence. The Commercial Bank had an average balance of \$26.5 million in municipal deposits in 2006, primarily concentrated in money market deposit accounts.

Average deposits decreased \$1.5 million, or 1%, when compared to 2005. The decrease in average deposits primarily related to a \$3.1 million decrease in the average balance of municipal deposits, offset by an increase in retail deposits of \$1.6 million. The new branch in Central Square added \$6.8 million to the

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average balance of retail deposits since its opening in June of 2005. In comparison, average deposits increased \$9.5 million, or 4%, from 2004 to 2005. Deposit growth in 2005 resulted from the growth both in retail and in municipal deposits.

The Company's average deposit mix in 2006, as compared to 2005, reflected a shift from savings and club deposits to time deposits. The Company's average demand deposits, interest and noninterest bearing, represented 18% of total average deposits, compared to 16% at 2005. The Company's MMDA accounts represented 9% of total deposits, down 2 percentage points for the same period in 2005. The Company's time deposit accounts represented 43% of total deposits, up 4 percentage points from the same period in 2005. The Company promotes its MMDA and time deposit accounts by offering competitive rates to retain existing and attract new customers.

The average amount of deposits, average rate paid and percentage of deposits are summarized below for the years indicated.

	FOR THE YEARS ENDED DECEMBER 31,							
	2006			2005			2004	
(Dollars in thousands)	AVG BALANCE	AVG RATE PAID	PERCENT OF DEPOSITS	AVG BALANCE	AVG RATE PAID	PERCENT OF DEPOSITS	AVG BALANCE	AVG RATE PAID

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Noninterest bearing									
demand accounts	\$ 20,745	-	8.7%	\$ 19,324	-	8.1%	\$ 17,974		
NOW accounts	21,094	0.48%	8.9%	19,877	0.54%	8.3%	20,808		0.
Money management accounts	13,318	0.83%	5.5%	16,096	0.86%	6.7%	14,459		1.
MMDA accounts	20,608	3.81%	8.7%	25,284	2.76%	10.5%	26,316		1.
Savings and club accounts	58,997	0.45%	24.8%	65,558	0.44%	27.3%	68,046		0.
Time deposits	103,596	4.08%	43.4%	93,732	3.29%	39.1%	82,769		3.
Total average deposits	\$238,358	2.52%	100.00%	\$239,871	1.96%	100.00%	\$230,372		1.

At December 31, 2006, time deposits in excess of \$100,000 totaled \$32.8 million, or 32%, of time deposits and 14% of total deposits. At December 31, 2005, these deposits totaled \$24.0 million, or 26% of time deposits and 10% of total deposits.

The following table indicates the amount of the Bank's certificates of deposit of \$100,000 or more sorted by time remaining until maturity as of December 31, 2006:

(In thousands)

REMAINING MATURITY:

Three months or less	\$ 9,336
Three through six months	5,943
Six through twelve months	10,177
Over twelve months	7,320

Total \$32,776

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BORROWINGS

Short-term borrowings are comprised primarily of advances and overnight borrowing at the FHLB NY. There were no short-term borrowings outstanding at December 31, 2006, as compared to \$2.0 million at December 31, 2005.

Information regarding short-term borrowings during 2006, 2005 and 2004 is as follows:

(Dollars in thousands)	2006	2005	2004
Maximum outstanding at any month end	\$15,000	\$15,000	\$3,100
Average amount outstanding during the year	5,321	5,692	1,400
Average interest rate during the year	4.99%	3.57%	1.31%

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Long-term borrowed funds consist of advances and repurchase agreements from the FHLBNY and junior subordinated debentures. Long-term borrowed funds totaled \$31.5 million at December 31, 2006 as compared to \$34.5 million at December 31, 2005.

CAPITAL

Shareholders' equity decreased \$78,000 to \$20.9 million at December 31, 2006. The Company added \$1.0 million to retained earnings through net income, which was offset by cash dividends returned to its shareholders of \$686,000. Accumulated other comprehensive loss increased \$485,000 to \$1.8 million at December 31, 2006, resulting from the adoption of SFAS No. 158 on December 31, 2006, which resulted in \$921,000 of accumulated other comprehensive loss, offset by unrealized gains on securities available for sale, net of tax, of \$436,000. Additional paid in capital increased \$65,000 due to the exercise of stock options during 2006.

The Company's mutual holding company parent, Pathfinder Bancorp, M.H.C., waived its right to receive the dividend for the quarters ended June 30, 2006 and December 31, 2006.

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, 2006, 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%. See Note 17 in the accompanying financial statements for the Company's and the Bank's ratios.

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.

The Company's liquidity has been enhanced by its membership in the FHLBNY, 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

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of securities or loans.

The Asset Liability Management Committee (ALCO) of the Company is responsible for implementing the policies and guidelines for the maintenance of prudent levels of liquidity. As of December 31, 2006, the Company is in compliance with its policy guidelines with regard to liquidity.

AGGREGATE CONTRACTUAL OBLIGATIONS

The following table represents the Company's ON and off-balance sheet aggregate contractual obligations to make future payments as of December 31, 2006:

(In thousands)	1 YEAR OR LESS	OVER 1 TO 3 YEARS	OVER 3 TO 5 YEARS	OVER 5 YEARS	TOTAL
Time deposits	\$ 85,445	\$ 22,809	\$ 7,519	\$ 3,699	\$119,472
Junior subordinated debentures	-	-	-	5,155	5,155
Borrowings	11,350	10,010	5,000	-	26,360
Operating leases	63	130	117	63	373
Payments under benefit plans	330	743	779	10,155	12,007
Total	\$ 97,188	\$ 33,692	\$ 13,415	\$19,072	\$163,367

Despite the fact that the junior subordinated note is not contractually due until 2032, we expect to call the note in 2007 and replace it with a newly originated junior subordinated note with a lower carrying cost. In addition, the Company, in the conduct of ordinary business operations, routinely enters into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for the early termination of the contract. Management is not aware of any additional commitments or contingent liabilities, which may have a material adverse impact on the liquidity or capital resources of the Company.

OFF-BALANCE SHEET ARRANGEMENTS

The Company is also 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, 2006, the Company had \$26.9 million in outstanding commitments to extend credit and standby letters of credit. See Note 15 in the accompanying financial statements.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's risk of loss arising from adverse changes in the fair value of financial instruments, or market risk, is composed primarily of interest rate risk. The management of interest rate sensitivity seeks to avoid fluctuating net interest margins and to provide consistent net interest income through periods of changing interest rates. The Company has an Asset-Liability Management Committee (ALCO) which is responsible for establishing policies to limit exposure to interest rate risk, and to ensure procedures are established to monitor compliance with those policies. Those procedures include reviewing

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the Company's asset and liability policies, setting prices and terms on rate-sensitive products, and monitoring and measuring the impact of interest rate changes on the Company's earnings and capital. The Company's Board of Directors reviews the guidelines established by the ALCO.

Since December of 2004, the Federal Reserve has increased short-term target rates 11 times, 25 basis points each time to 5.25% from 2.50%. During this time frame longer-term interest rates have remained relatively unchanged resulting in a flattening and inversion of the yield curve. The short-term interest rate increases have caused continued net interest margin compression as short-term deposits and borrowings on the Company's liability sensitive balance sheet repriced into the current rate environment while security purchases and loan originations and refinances were being done at the stable longer-term rates. During the past 36-month period of rising short-term interest rates, the Company has continued to practice conservative balance sheet management strategies by attempting to extend the maturities of its rate sensitive liabilities and shorten the maturity or repricing term of its rate sensitive assets. This conservative balance sheet management strategy has resulted in additional margin pressure and reduction in net interest income during the prior years. Management believes this balance sheet strategy best positions the Company and lessens its risk against future interest rate fluctuations.

The primary objective of the Company's asset/liability management process is to maximize earnings and return on capital within acceptable levels of risk. The Company does not believe it is possible to reliably predict future interest rate movements, and it seeks to maintain an appropriate process and set of measurement tools that enable it to identify and quantify sources of interest rate risk ("IRR") in varying rate environments. The primary tools used by the Company in managing rate risk are income simulation and net portfolio value modeling techniques.

Interest rate risk can result from timing differences in the maturity/repricing of an institution's assets, liabilities and off balance sheet contracts; the effect of embedded options, such as loan prepayments, interest rate caps/floors, and deposit withdrawals; and the difference in the behavior of the various lending and funding rates, sometimes referred to as basis risk.

Given the potential types and differing related characteristics of IRR, it is important that the Company maintain an appropriate process and set of measurement tools that enable it to identify and quantify its primary sources of IRR. The Company also recognizes that effective management of IRR includes an understanding of when potential adverse changes in interest rates will flow through its income statements. Accordingly, the Company not only looks at a 12 month horizon when managing its exposure to IRR, it also considers a longer-term strategic horizon.

It is the Company's objective to manage its exposure to IRR, understanding that it is in the business of taking on rate risk and the elimination of such risk is not possible. It is also understood that as exposure to IRR is reduced, it may also result in net interest margin being reduced.

Management believes the modeling and analysis of net interest income (Earnings at Risk) and net portfolio value (Value at Risk) in different interest rate environments provides the most meaningful measure of IRR. Net interest income simulation analysis captures both the potential of all assets and liabilities to mature or reprice and the probability that they will do so. Net interest income simulation also attends to the relative interest rate sensitivities of these items, and projects their behavior over an extended period of time. Finally,

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net interest income simulation permits management to assess the probable effects on the balance sheet not only of changes in interest rates, but also of proposed strategies for responding to them. Net portfolio value represents the fair value of net assets (determined as the market value of assets minus the market value of liabilities using a discounted cash flow technique).

The following table measures the Company's IRR exposure in terms of the percentage change in its net interest income and net portfolio value as a result of hypothetical changes in 100 basis point increments in market interest rates. The table quantifies the changes in net interest income and net portfolio value to parallel shifts in the yield curve. The column "Percentage Change in Net Interest Income" measures the change to the next twelve month's projected net interest income, due to parallel shifts in the yield curve. The column "Percentage Change in Net Portfolio Value" measures changes in the current fair value of assets and liabilities to parallel shifts in the yield curve. The column "NPV Capital Ratio" measures the ratio of the fair value of net assets to the fair value of total assets at the base case and in 100 basis point incremental interest rate shocks. The Company uses these percentage changes as a means to measure IRR exposure and quantifies those changes against guidelines set by the Board of Directors as part of the Company's IRR policy. The Company's current IRR exposure is within those guidelines set forth.

CHANGE IN INTEREST RATES	NPV CAPITAL RATIO	PERCENTAGE CHANGE IN NET INTEREST INCOME	PERCENTAGE CHANGE IN NET PORTFOLIO VALUE
300	7.14%	-15.85%	-33.55%
200	8.13%	-10.42%	-22.59%
100	9.10%	-5.14%	-11.30%
0	10.03%	- -	----
-100	10.53%	2.52%	7.31%
-200	10.49%	2.12%	8.73%
-300	10.14%	0.15%	6.79%

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An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. Historically, the most common method of estimating IRR was to measure the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at a specific point in time ("GAP"), typically one year. Under this method, a company is considered liability sensitive when the amount of its interest-bearing liabilities exceeds the amount of its interest-earning assets within the one-year horizon. However, assets and liabilities with similar repricing characteristics may not reprice at the same time or to the same degree. As a result, the Company's GAP does not necessarily predict the impact of changes in general levels of interest rates on net interest income.

The following table shows the GAP position for the Company as of December 31, 2006:

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(Dollars in thousands)	WITHIN 3 MONTHS	3 TO 12 MONTHS	1 TO 3 YEARS	3 TO 5 YEARS
INTEREST-EARNING ASSETS:				
Interest earning deposits	\$ 6,655	\$ -	\$ -	\$ -
Investment securities and FHLB stock	19,177	16,044	14,714	8,342
Loans receivable	46,230	36,295	67,419	31,115
Total interest-earning assets	\$ 72,062	\$ 52,339	\$82,133	\$39,457
INTEREST-BEARING LIABILITIES:				
Transaction deposit accounts (1)	\$ 8,269	\$ 24,809	\$17,041	\$ -
Savings deposits (1)	1,068	7,655	11,900	9,143
Certificates of deposit	27,761	57,684	22,809	7,519
Borrowings	4,350	7,000	10,010	5,000
Junior subordinated debentures	-	-	-	-
Total interest-bearing liabilities	\$ 41,448	\$ 97,148	\$61,760	\$21,662
Interest-earning assets less interest-bearing liabilities ("interest rate sensitivity gap")	\$ 30,614	\$(44,809)	\$20,373	\$17,795
Cumulative excess (deficiency) of interest-sensitive assets over interest-sensitive liabilities	\$ 30,614	\$(14,198)	\$ 6,178	\$23,973
Interest sensitivity gap to total assets	10.16%	-14.87%	6.76%	5.90%
Cumulative interest sensitivity gap to total assets	10.16%	-4.71%	2.05%	7.95%
Ratio of interest-earning assets to interest-bearing liabilities	173.86%	53.88%	132.99%	182.15%
Cumulative ratio of interest-earning assets to interest-bearing liabilities	173.86%	89.76%	103.08%	110.80%

(1) The following assumptions have been used when analyzing non-maturity deposits for GAP Table purposes: 14% of savings deposits are assumed to reprice or mature within one year, 22% within 1 to 3 years, 16% within 3 to 5 years, and 24% within each of the remaining time periods. Transaction deposits - 66% of the NOW account balances are assumed to reprice or mature within one year, and the remaining 34% is assumed to reprice or mature within the 1 to 3 year time frame. 100% of the money management accounts are assumed to reprice within the first three months

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ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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PATHFINDER BANCORP, INC

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

[GRAPHIC OMITED]

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 as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. 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 financial position of Pathfinder Bancorp, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11 to the consolidated financial statements, the Company changed its method of accounting for its defined benefit pension and postretirement benefit plans in 2006.

/s/ BEARD MILLER COMPANY LLP

Beard Miller Company LLP
Harrisburg, Pennsylvania
March 27, 2007

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CONSOLIDATED STATEMENTS OF CONDITION

	DECEMBER 31	
(In thousands, except share data)	2006	2005
ASSETS:		
Cash and due from banks	\$ 7,068	\$ 7,068
Interest earning deposits	6,655	6,655
<hr style="border-top: 1px dashed black;"/>		
Total cash and cash equivalents	13,723	13,723
Investment securities, at fair value	62,640	74,000
Federal Home Loan Bank stock, at cost	1,579	1,579
Loans	203,209	189,000
Less: Allowance for loan losses	1,496	1,496
<hr style="border-top: 1px dashed black;"/>		
Loans receivable, net	201,713	187,504
Premises and equipment, net	7,597	8,000
Accrued interest receivable	1,694	1,694
Foreclosed real estate	471	471
Goodwill	3,840	3,840
Intangible asset, net	181	181
Bank owned life insurance	6,212	5,000
Other assets	1,732	4,000
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Total assets	\$301,382	\$296,000
<hr style="border-top: 3px double black;"/>		
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Deposits:		
Interest-bearing	\$225,003	\$216,000
Noninterest-bearing	20,582	20,000
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Total deposits	245,585	236,000
Short-term borrowings	-	2,000
Long-term borrowings	26,360	29,000
Junior subordinated debentures	5,155	5,000
Other liabilities	3,432	3,000
<hr style="border-top: 1px dashed black;"/>		
Total liabilities	280,532	276,000
Shareholders' equity:		
Preferred stock, authorized shares 1,000,000; no shares issued or outstanding		
Common stock, par value \$.01; authorized 10,000,000 shares; 2,953,619 and 2,950,419 shares issued; and 2,466,332 and 2,463,132 shares outstanding, respectively	29	29
Additional paid-in-capital	7,786	7,000
Retained earnings	21,307	20,000
Accumulated other comprehensive loss	(1,770)	(1,000)
Treasury Stock, at cost; 487,287 shares	(6,502)	(6,000)
<hr style="border-top: 1px dashed black;"/>		
Total shareholders' equity	20,850	20,000
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Total liabilities and shareholders' equity	\$301,382	\$296,000
<hr style="border-top: 3px double black;"/>		

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

CONSOLIDATED STATEMENTS OF INCOME

	YEARS ENDED
	2006
(In thousands, except per share data)	
INTEREST AND DIVIDEND INCOME:	
Loans, including fees	\$ 12,764
Debt securities:	
Taxable	2,364
Tax-exempt	357
Dividends	292
Other	92
Total interest income	15,869
INTEREST EXPENSE:	
Interest on deposits	5,487
Interest on short-term borrowings	265
Interest on long-term borrowings	1,791
Total interest expense	7,543
Net interest income	8,326
PROVISION FOR LOAN LOSSES	23
Net interest income after provision for loan losses	8,303
NONINTEREST INCOME:	
Service charges on deposit accounts	1,391
Increase in value of bank owned life insurance	225
Loan servicing fees	224
Net gains (losses) on sales and impairment of investment securities	299
Net (losses) gains on sales of loans and foreclosed real estate	(80)
Debit card interchange fees	189
Other charges, commissions and fees	387
Total noninterest income	2,635
NONINTEREST EXPENSE:	
Salaries and employee benefits	5,007
Building occupancy	1,203
Data processing expenses	1,278
Professional and other services	615
Amortization of intangible asset	223
Other expenses	1,342
Total noninterest expenses	9,668
Income before income taxes	1,270
Provision (Benefit) for income taxes	242
Net income	\$ 1,028
Net income per share - basic	\$ 0.42

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Net income per share - diluted	\$ 0.41
Dividends per share	\$ 0.41

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)	COMMON STOCK ISSUED		ADDITIONAL PAID-IN	RETAINED	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)
	SHARES	AMOUNT	CAPITAL	EARNINGS	INCOME (LOSS)
BALANCE, JANUARY 1, 2004	2,919,386	\$ 29	\$ 7,225	\$ 20,449	\$ 66
Comprehensive income:					
Net income				1,405	
Other comprehensive loss, net of tax					
Unrealized net losses on securities					(96)
TOTAL COMPREHENSIVE INCOME					
ESOP shares earned			88		
Stock options exercised	18,033	-	140		
Dividends declared (\$.405 per share)				(668)	
BALANCE, DECEMBER 31, 2004	2,937,419	\$ 29	\$ 7,453	\$ 21,186	\$ (30)
Comprehensive loss:					
Net income				462	
Other comprehensive loss, net of tax					
Unrealized net losses on securities					(97)
TOTAL COMPREHENSIVE LOSS					
ESOP shares earned			55		
Stock options exercised	13,000	-	213		
Dividends declared (\$.41 per share)				(683)	
BALANCE, DECEMBER 31, 2005	2,950,419	\$ 29	\$ 7,721	\$ 20,965	\$ (1,28)
Comprehensive income:					
Net income				1,028	
Other comprehensive income, net of tax					
Unrealized net gains on securities					43
TOTAL COMPREHENSIVE INCOME					

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Adjustment to initially apply FASB Statement No. 158, net of tax					(92)
Stock options exercised, including \$42 tax benefit	3,200	-		65	
Dividends declared (\$.41 per share)				(686)	

BALANCE, DECEMBER 31, 2006	2,953,619	\$ 29	\$ 7,786	\$ 21,307	\$ (1,77
=====					

(In thousands, except share data)	TREASURY STOCK	TOTAL

BALANCE, JANUARY 1, 2004	\$(6,502)	\$21,785
Comprehensive income:		
Net income		1,405
Other comprehensive loss, net of tax		
Unrealized net losses on securities		(969)

TOTAL COMPREHENSIVE INCOME		436
ESOP shares earned		133
Stock options exercised		140
Dividends declared (\$.405 per share)		(668)

BALANCE, DECEMBER 31, 2004	\$(6,502)	\$21,826
=====		
Comprehensive loss:		
Net income		462
Other comprehensive loss, net of tax		
Unrealized net losses on securities		(978)

TOTAL COMPREHENSIVE LOSS		(516)
ESOP shares earned		88
Stock options exercised		213
Dividends declared (\$.41 per share)		(683)

BALANCE, DECEMBER 31, 2005	\$(6,502)	\$20,928
=====		
Comprehensive income:		
Net income		1,028
Other comprehensive income, net of tax		
Unrealized net gains on securities		436

TOTAL COMPREHENSIVE INCOME		1,464
Adjustment to initially apply FASB Statement No. 158, net of tax		(921)
Stock options exercised, including \$42 tax benefit		65
Dividends declared (\$.41 per share)		(686)

BALANCE, DECEMBER 31, 2006	\$(6,502)	\$20,850
=====		

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

 CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

OPERATING ACTIVITIES:

Net Income

Adjustments to reconcile net income to net cash provided by operating activities:

- Provision for loan losses
- ESOP shares earned
- Deferred income tax expense
- Proceeds from sale of loans
- Originations of loans held-for-sale
- Realized losses (gains) on sales of:
 - Foreclosed real estate
 - Loans
 - Premises and equipment
 - Available-for-sale investment securities
- Depreciation
- Amortization of intangible asset
- Amortization of deferred financing costs
- Amortization of mortgage servicing rights
- Increase in value of bank owned life insurance
- Net amortization of premiums and discounts on investment securities
- Increase in interest receivable
- Net change in other assets and liabilities

 Net cash provided by operating activities

 INVESTING ACTIVITIES:

Purchase of investment securities available-for-sale

Net redemption (purchase) of Federal Home Loan Bank stock

Proceeds from maturities and principal reductions of investment securities available-for-sale

Proceeds from sale:

- Available-for-sale investment securities
- Real estate acquired through foreclosure
- Premises and equipment

Purchase of bank owned life insurance

Net (increase) decrease in loans

Purchase of premises and equipment

 Net cash used in investing activities

 FINANCING ACTIVITIES:

Net (decrease) increase in demand deposits, NOW accounts, saving accounts, money market deposit accounts, MMDA accounts, escrow deposits

Net increase in time deposits

Net (repayments on) proceeds from short-term borrowings

Payments on long-term borrowings

Proceeds from long-term borrowings

Proceeds from exercise of stock options

Tax benefit upon exercise of stock options

Cash dividends

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Net cash provided by (used in) financing activities	

Increase (decrease) in cash and cash equivalents	

Cash and cash equivalents at beginning of period	

Cash and cash equivalents at end of period	\$

CASH PAID DURING THE PERIOD FOR:	
Interest	\$
Income taxes paid	
NON-CASH INVESTING ACTIVITY:	
Conversion of Holding Company advance to loan receivable	
Transfer of loans to foreclosed real estate	
Transfer of loans to loans held-for-sale	

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

The accompanying consolidated financial statements include the accounts of Pathfinder Bancorp, Inc. (the "Company") and its wholly owned subsidiary, Pathfinder Bank (the "Bank"). The Bank has three wholly owned operating subsidiaries, Pathfinder Commercial Bank, Whispering Oaks Development Corp. and Pathfinder REIT, Inc. All inter-company accounts and activity have been eliminated in consolidation. The Company has seven full service offices located in Oswego County. The Company is primarily engaged in the business of attracting deposits from the general public in the Company's market area, and investing such deposits, together with other sources of funds, in loans secured by one-to-four family residential real estate, commercial real estate, business assets and investment securities.

Pathfinder Bancorp, M.H.C., (the "Holding Company") a mutual holding company whose activity is not included in the accompanying financial statements, owns approximately 64.2% of the outstanding common stock of the Company. Salaries, employee benefits and rent approximating \$127,000, \$135,000 and \$130,000, were allocated from the Company to Pathfinder Bancorp, M.H.C. during 2006, 2005 and 2004, respectively. As of December 31, 2006, the Bank had a loan receivable from the Holding Company of \$1,096,000.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has identified the allowance for loan losses and the evaluation of securities for other than temporary impairment 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 Company is subject to the regulations of various governmental agencies. The Company also undergoes periodic examinations by the regulatory agencies which may subject it to further changes with respect to asset valuations, amounts of required loss allowances, and operating restrictions resulting from the regulators' judgments based on information available to them at the time of their examinations.

SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Most of the Company's activities are with customers located primarily in Oswego and parts of Onondaga counties of New York State. Note 3 discusses the types of securities that the Company invests in. Note 4 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations to any one industry or customer.

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ADVERTISING

The Company follows the policy of charging the costs of advertising to expense as incurred. Advertising costs included in other operating expenses were \$300,000, \$249,000 and \$224,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, amounts due from banks and interest-bearing deposits (with original maturity of three months or less).

INVESTMENT SECURITIES

The Company classifies investment securities as available-for-sale. Available-for-sale securities are reported at fair value, with net unrealized gains and losses reflected as a separate component of shareholders' equity, net of the applicable income tax effect. None of the Company's investment securities have been classified as trading or held-to-maturity securities.

Gains or losses on investment security transactions are based on the amortized cost of the specific securities sold. Premiums and discounts on securities are amortized and accreted into income using the interest method over the period to first call or maturity.

The Company monitors investment securities for impairment on a quarterly basis. Declines in the fair value of investment securities below cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

FEDERAL HOME LOAN BANK STOCK

Federal law requires a member institution of the Federal Home Loan Bank ("FHLB") system to hold stock of its district FHLB according to a predetermined formula. The stock is carried at cost.

MORTGAGE LOANS HELD-FOR-SALE

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Mortgage loans held-for-sale are carried at the lower of cost or fair value. Fair value is determined in the aggregate. There were no forward commitments outstanding as of December 31, 2006 and 2005.

TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets, including sales of loans and loan participations, are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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LOANS

The Company grants mortgage, commercial and consumer loans to customers. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off, generally are stated at unpaid principal balances, less the allowance for loan losses and net deferred loan origination fees and costs. The ability of the Company's debtors to honor their contracts is dependent upon the real estate and general economic conditions in the market area. Interest income is generally recognized when income is earned using the interest method. Nonrefundable loan fees received and related direct origination costs incurred are deferred and amortized over the life of the loan using the interest method, resulting in a constant effective yield over the loan term. Deferred fees are recognized into income and deferred costs are charged to income immediately upon prepayment of the related loan.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The Company periodically evaluates the adequacy of the allowance for loan losses in order to maintain the allowance at a level that is sufficient to absorb probable credit losses. Management's evaluation of the adequacy of the allowance is based on a review of the Company's historical loss experience, known and inherent risks in the loan portfolio and an analysis of the levels and trends of delinquencies and charge-offs. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general and unallocated components. The specific component relates to loans that are classified as impaired. For impaired loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired, based on current information and events, if it is

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probable the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is generally based upon the present value of future cash flows discounted at the historical effective rate, except that all collateral-dependent loans are measured for impairment based on fair values of collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

INCOME RECOGNITION ON IMPAIRED AND NON-ACCRUAL LOANS

Loans, including impaired loans, are generally classified as non-accrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days. When a loan is classified as non-accrual and the future collectibility of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding.

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When future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a non-accrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

OFF-BALANCE SHEET CREDIT RELATED FINANCIAL INSTRUMENTS

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under standby letters of credit. Such financial instruments are recorded when they are funded.

PREMISES AND EQUIPMENT

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the related assets, ranging up to 40 years for premises and 10 years for equipment. Maintenance and repairs are charged to operating expenses as incurred. The asset cost and accumulated depreciation are removed from the accounts for assets sold or retired and any resulting gain or loss is included in the determination of income.

FORECLOSED REAL ESTATE

Properties acquired through foreclosure, or by deed in lieu of foreclosure, are carried at the lower of the Bank's recorded investment or at their fair value less estimated disposal costs. Fair value is determined based on a current appraisal and inspection. Costs incurred in connection with preparing the foreclosed real estate for disposition are capitalized to the extent that they enhance the overall fair value of the property. Write downs of, and expenses related to, foreclosed real estate holdings included in noninterest expense were \$111,000, \$155,000 and \$85,000 in 2006, 2005 and 2004, respectively.

INTANGIBLE ASSETS

Intangible assets represent core deposit intangibles and goodwill arising from

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acquisitions. Core deposit intangibles represent the premium the Company has paid for deposits acquired in excess of the cost incurred had the funds been purchased in the capital markets. Core deposit intangibles are amortized on a straight-line basis over a period of five years. Goodwill represents the excess cost of an acquisition over the fair value of the net assets acquired. Goodwill is not amortized but is evaluated annually for impairment.

MORTGAGE SERVICING RIGHTS

Originated mortgage servicing rights are recorded at their fair value at the time of transfer and are amortized in proportion to and over the period of estimated net servicing income or loss. The carrying value of the originated mortgage servicing rights is periodically evaluated for impairment.

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STOCK-BASED COMPENSATION

Prior to 2006, the Company accounted for stock-based compensation issued to directors and employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). This method required that compensation expense be recognized to the extent that the fair value of the stock exceeds the exercise price of the stock award at the grant date. The Company generally did not recognize compensation expense related to stock option awards because the stock options generally had fixed terms and exercise prices that were equal to or greater than the fair value of the Company's common stock at the grant date. Effective January 1, 2006, the Company adopted Financial Accounting Standards Board (FASB) Statement No. 123(R), Share-Based Payment, ("SFAS 123(R)"). SFAS 123(R) requires compensation costs related to share-based payment transactions to be recognized in the income statement (with limited exceptions). The Company is using the modified prospective method based on the grant-date fair value of the stock-based compensation issued. Compensation costs are recognized over the period that an employee provides service in exchange for the award. As of the date of adoption of SFAS 123(R), the Company's options were fully granted and vested, and accordingly, there was no impact to the Company's consolidated financial position or results of operations. No options were granted during 2006, 2005 and 2004.

RETIREMENT BENEFITS

The Company has established tax qualified retirement plans covering substantially all full-time employees and certain part-time employees. Pension expense under these plans is charged to current operations and consists of several components of net pension cost based on various actuarial assumptions regarding future experience under the plans.

In 2006, the Company adopted SFAS 158, which required the recognition of the under funded status of pension and other postretirement benefit plans on the consolidated statements of condition. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost.

In addition, the Company has unfunded deferred compensation and supplemental executive retirement plans for selected current and former employees and officers that provide benefits that cannot be paid from a qualified retirement plan due to Internal Revenue Code restrictions. These plans are nonqualified under the Internal Revenue Code, and assets used to fund benefit payments are

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not segregated from other assets of the Company, therefore, in general, a participant's or beneficiary's claim to benefits under these plans is as a general creditor.

INCOME TAXES

Provisions for income taxes are based on taxes currently payable or refundable and deferred income taxes on temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are reported in the consolidated financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled.

EARNINGS PER SHARE

Basic earnings per share are computed by dividing net income by the weighted average number of common shares outstanding throughout each year. Diluted earnings per share gives effect to weighted average shares that would be outstanding assuming the exercise of issued stock options using the treasury stock method.

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OTHER COMPREHENSIVE (LOSS) INCOME

Accounting principles generally accepted in the United States of America, require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the shareholders' equity section of the consolidated statements of condition, such items, along with net income, are components of comprehensive income. The adoption of SFAS 158 created a new component of other comprehensive income in 2006. The under funded status of pension and other postretirement benefits is now presented in the statement of condition through this account.

The components of other comprehensive (loss) income and related tax effects are as follows:

	FOR THE YEARS ENDED DECEMBER 31,		
(In thousands)	2006	2005	2004
Gross change in unrealized gains (losses) on securities available for sale	\$ 1,034	\$ (1,835)	\$ (843)
Reclassification adjustment for (gains) losses included in net income	(299)	205	(772)
Tax effect	735 (299)	(1,630) 652	(1,615) 646
Net of tax amount	\$ 436	\$ (978)	\$ (969)

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The components of accumulated other comprehensive loss, net of related tax effects, at December 31, are as follows:

(In thousands)	2006	2005
Unrealized losses on available for sale securities	\$ (849)	\$ (1,285)
Unrecognized pension and other postretirement benefit losses	(921)	-
	<u>\$ (1,770)</u>	<u>\$ (1,285)</u>

RECLASSIFICATIONS

Certain amounts in the 2005 and 2004 consolidated financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on net income as previously reported.

NOTE 2: NEW ACCOUNTING PRONOUNCEMENTS

In February 2006, the Financial Accounting Standards Board ("FASB"), issued Statement of Financial Accounting Standards (SFAS), No. 155, Accounting for Certain Hybrid Financial Instruments ("SFAS 155"). SFAS 155 amends FASB Statement No. 133 and FASB Statement No. 140, and improves the financial reporting of certain hybrid financial instruments by requiring more consistent accounting that eliminates exemptions and provides a means to simplify the accounting for these instruments. Specifically, SFAS 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. The Company is required to adopt the provisions of SFAS 155, as applicable, beginning in 2007. Management does not believe the adoption of SFAS 155 will have a material impact on the Company's consolidated financial position and results of operations.

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In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets -An Amendment of FASB Statement No. 140 ("SFAS 156"). SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. SFAS 156 is effective for the Company beginning in 2007. The Company does not believe that the adoption of SFAS 156 will have a significant effect on its consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that companies recognize in their financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. Management does not believe that the adoption of FIN 48 will have a significant effect on its consolidated

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financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, ("SFAS 157") which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. We are currently evaluating the potential impact, if any, of the adoption of SFAS 157 on our consolidated financial position, results of operations and cash flows.

On September 13, 2006, the Securities and Exchange Commission "SEC" issued Staff Accounting Bulletin No. 108 ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, companies might evaluate the materiality of financial statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company's balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. The Company has analyzed SAB 108 and determined that, upon adoption in the fourth quarter of 2006, it had no impact on the reported results of operations or financial condition.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115, ("SFAS 159"). This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions in SFAS 159 are elective; however, the amendment to SFAS 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. The FASB's stated objective in issuing this standard is as follows: "to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions." The fair value option established by SFAS 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. SFAS 159 is effective for the Company as of January 1, 2008, unless early adoption is elected. The Company is currently analyzing the effects of this interpretation but does not expect its implementation will have a significant impact on the Company's financial condition or results of operations.

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NOTE 3: INVESTMENT SECURITIES - AVAILABLE-FOR-SALE

The amortized cost and estimated fair value of investment securities are summarized as follows:

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DECEMBER 31, 2006

(In thousands)	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Bond investment securities:				
US Treasury and agencies	\$ 19,966	\$ -	\$ (557)	\$ 19,409
State and political subdivisions	5,870	-	(79)	5,791
Corporate	5,575	18	(79)	5,514
Mortgage-backed	25,481	53	(638)	24,896
Total	56,892	71	(1,353)	55,610
Equity investments	7,163	91	(224)	7,030
Total investment securities	\$ 64,055	\$ 162	\$ (1,577)	\$ 62,640

DECEMBER 31, 2005

(In thousands)	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Bond investment securities:				
US Treasury and agencies	\$ 20,713	\$ -	\$ (746)	\$ 19,967
State and political subdivisions	11,177	2	(199)	10,980
Corporate	5,936	24	(106)	5,854
Mortgage-backed	31,565	67	(914)	30,718
Total	69,391	93	(1,965)	67,519
Equity investments	6,998	14	(292)	6,720
Total investment securities	\$ 76,389	\$ 107	\$ (2,257)	\$ 74,239

Gross gains of \$325,000, \$190,000 and \$828,000 for 2006, 2005 and 2004, respectively and gross losses of \$26,000, \$395,000 and \$56,000 for 2006, 2005 and 2004, respectively were realized on sales and calls of securities. The tax expense related to net gains on investment securities was \$117,000 for 2006. The tax benefit related to net losses on investment securities in 2005 was \$80,000. Tax expense related to net gains on investment securities was \$301,000 for 2004.

Investment securities with a carrying value of approximately \$35,441,000 at December 31, 2006 were pledged to collateralize certain deposit and borrowing arrangements.

The amortized cost and estimated fair value of debt investments at December 31, 2006 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

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(In thousands)	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 4,812	\$ 4,774
Due after one year through five years	17,288	16,841
Due after five years through ten years	7,171	6,971
Due after ten years	2,140	2,128
Mortgage-backed securities	25,481	24,896
Totals	\$ 56,892	\$ 55,610

The Company's investment securities' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, is as follows:

(In thousands)	DECEMBER 31, 2006				
	LESS THAN TWELVE MONTHS		TWELVE MONTHS OR MORE		UNRE
	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	
US Treasury and agency securities	\$ (1)	\$1,996	\$ (556)	\$17,413	\$
State and political subdivision securities	(1)	439	(78)	5,218	
Corporate securities	-	-	(79)	3,887	
Mortgage-backed securities	(1)	198	(637)	22,525	
Equity investment securities	(136)	2,747	(88)	3,366	
	\$ (139)	\$5,380	\$ (1,438)	\$52,409	\$ (

(In thousands)	DECEMBER 31, 2005				
	LESS THAN TWELVE MONTHS		TWELVE MONTHS OR MORE		UNRE
	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	
US Treasury and agency securities	\$ (106)	\$ 4,130	\$ (640)	\$15,837	\$
State and political subdivision securities	(152)	8,872	(47)	1,491	
Corporate securities	(35)	1,965	(71)	1,896	
Mortgage-backed securities	(322)	13,814	(592)	15,073	
Equity investment securities	-	-	(292)	6,135	
	\$ (615)	\$28,781	\$ (1,642)	\$40,432	\$ (

The Company reviews its securities portfolio for potential impairment issues at least quarterly. No impairment losses were recorded during 2006. The Company

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recognized an impairment charge of \$196,000 during 2005 in connection with one marketable equity security holding. No impairment losses were recognized in 2004.

At December 31, 2006 53 mortgage-backed and 31 US Treasury and agency securities have unrealized losses. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of specific securities. None of the securities in this category had an unrealized loss that exceeded 6% of their carrying amount and a majority had unrealized losses totaling less than 3% of their carrying amount. The Company has the intent and ability to hold the individual securities to maturity or market price recovery.

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At December 31, 2006, 19 state and political subdivision securities and 4 corporate securities have unrealized losses. In analyzing the issuer's financial condition, management considers the industry analyst's reports, financial performance and projected target prices of investment analysts within a one-year time frame. None of the securities in this category had an unrealized loss that exceeded 4% of carrying value and a majority had unrealized losses totaling less than 2% of carrying value. The Company has the intent and ability to hold the individual securities to maturity or market price recovery.

At December 31, 2006, 2 equity securities had unrealized losses. One of these securities is a mutual fund backed by short-term adjustable rate mortgage-backed securities and has an unrealized loss of 3% of carrying value. The unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the mutual fund. A second equity security is a mutual fund consisting primarily of investment grade dividend-paying common stocks of large capitalization companies, i.e., companies with market capitalization in excess of \$5 billion. A review of the underlying securities indicates no individually impaired holdings and there is no indication that the profitability of these corporations is impaired beyond the economic cycle. As such, the decline in investment is not considered to be other-than-temporarily impaired.

NOTE 4: LOANS

Major classifications of loans at December 31, are as follows:

(In thousands)	2006	2005

REAL ESTATE MORTGAGES:		
Conventional	\$115,588	\$116,423
Construction	2,160	2,607
Commercial	40,501	31,845
	-----	-----
	158,249	150,875

OTHER LOANS:		
Consumer	3,248	3,363
Home Equity/Second Mortgage	17,965	16,319
Lease financing	623	334
Commercial	19,890	14,741
Municipal loans	2,488	3,259
	-----	-----
	44,214	38,016

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Total loans	202,463	188,891
Net deferred loan costs	746	677
Less allowance for loan losses	(1,496)	(1,679)
Loans receivable, net	\$201,713	\$187,889

The Company grants mortgage and consumer loans to customers throughout Oswego and parts of Onondaga counties. Although the Company has a diversified loan portfolio, a substantial portion of its debtor's ability to honor their contracts is dependent upon the counties' employment and economic conditions.

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The following represents the activity associated with loans to officers and directors and their affiliated entities during the fiscal year ending December 31, 2006:

(In thousands)

Balance at beginning of year	\$ 5,581
Originations	398
Principal payments	(1,278)
Balance at end of year	\$ 4,701

NOTE 5: ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the year ended December 31, are summarized as follows:

(In thousands)	2006	2005	2004
Balance at beginning of year	\$1,679	\$1,827	\$1,715
Recoveries credited	22	49	61
Provision for loan losses	23	311	738
Loans charged-off	(228)	(508)	(687)
Balance at end of year	\$1,496	\$1,679	\$1,827

The following is a summary of information pertaining to impaired loans for the years ending December 31:

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(In thousands)	2006	2005	2004
Impaired loans without a valuation allowance	\$ -	\$ -	\$ -
Impaired loans with a valuation allowance	98	2,452	3,110
Total impaired loans	\$ 98	\$2,452	\$3,110
Valuation allowance related to impaired loans	\$ 24	\$ 90	\$ 760
Average investment in impaired loans	\$ 91	\$2,856	\$3,611
Interest income recognized on impaired loans	\$ 1	\$ 175	\$ 153
Interest income recognized on a cash basis on impaired loans	\$ -	\$ -	\$ -

The amount of loans on which the Company has ceased accruing interest aggregated approximately \$1,172,000 and \$1,680,000 at December 31, 2006 and 2005, respectively. There were no loans past due ninety days or more and still accruing interest at December 31, 2006 or 2005.

NOTE 6: SERVICING

Loans serviced for others are not included in the accompanying consolidated statements of condition. The unpaid principal balances of mortgage and other loans serviced for others were \$53,100,000, \$56,300,000 and \$53,000,000 at December 31, 2006, 2005 and 2004, respectively.

The balance of capitalized servicing rights included in other assets at December 31, 2006 and 2005, was \$65,000 and \$146,000, respectively.

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The following summarizes mortgage-servicing rights capitalized and amortized:

(In thousands)	2006	2005	2004
Mortgage servicing rights capitalized	\$ 14	\$ 70	\$ 99
Mortgage servicing rights amortized	\$ 95	\$ 123	\$ 158

NOTE 7: PREMISES AND EQUIPMENT

A summary of premises and equipment at December 31, is as follows:

(In thousands)	2006	2005
Land	\$ 1,226	\$ 1,150

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Buildings	6,458	6,590
Furniture, fixture and equipment	6,401	6,120
Construction in progress	130	119
	-----	-----
	\$14,215	\$13,979
Less: Accumulated depreciation	6,618	5,959
	-----	-----
	\$ 7,597	\$ 8,020
	=====	=====

The Company has entered into certain contractual arrangements associated with renovations being made to one of its branches drive thru facilities. Total estimated project costs are \$427,000, with an anticipated completion date of June 2007.

NOTE 8: GOODWILL AND INTANGIBLE ASSETS

A summary of intangible assets is as follows:

(In thousands)	2006		2005	
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Core deposit intangible	\$ 1,111	\$ (930)	\$ 1,111	\$ (707)

Amortization expense related to core deposit intangibles is estimated to total \$181,000 for the year ending December 31, 2007. Amortization of goodwill and the core deposit intangible is deductible for tax purposes.

NOTE 9: DEPOSITS

A summary of deposits at December 31, is as follows:

(In thousands)	2006	2005
Savings accounts	\$ 52,506	\$ 60,176
Time accounts	86,696	72,121
Time accounts over \$100,000	32,776	24,034
Money management accounts	12,630	14,685
MMDA accounts	17,615	24,324
Demand deposit interest-bearing	19,875	18,259
Demand deposit noninterest-bearing	20,582	20,241
Mortgage escrow funds	2,905	2,537
	-----	-----
	\$245,585	\$236,377
	=====	=====

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At December 31, 2006 the scheduled maturities of time deposits are as follows:

(In thousands)

YEAR OF MATURITY:	
2007	\$ 85,445
2008	15,011
2009	7,798
2010	3,491
2011	4,028
Thereafter	3,699

	\$119,472
=====	

NOTE 10: BORROWED FUNDS

The composition of borrowings at December 31 is as follows:

(In thousands)	2006	2005

SHORT-TERM FHLB ADVANCES:		
FHLB Advances	\$ -	\$ 2,000

Total short-term borrowings	\$ -	\$ 2,000
=====		
LONG-TERM:		
FHLB Repurchase agreements	\$ 2,400	\$ 3,400
FHLB advances	23,960	25,960

Total long-term borrowings	\$26,360	\$29,360
=====		

The principal balance, interest rate and maturity of the above borrowings at December 31, 2006 is as follows:

TERM	PRINCIPAL	RATES

(Dollars in thousands)		
Long-term:		
Repurchase agreements (due in 2009)	2,400	5.56% -5.76%

Advances with FHLB		
due within 1 year	11,350	3.00%-5.04%
due within 2 years	6,610	2.67%-5.98%
due within 3 years	1,000	6.00%
due within 4 years	5,000	4.39%

Total advances with FHLB	\$23,960	

Total long-term borrowings	\$26,360	

=====

The repurchase agreements with the Federal Home Loan Bank ("FHLB") are collateralized by certain investment securities having a carrying value of \$2,661,000 at December 31, 2006. The collateral is under the Company's control. The line of credit agreement with the FHLB is used for liquidity purposes. Interest on this line is determined at the time of borrowing. The average rate paid on the overnight line during 2006 approximated 5.21%. At December 31, 2006, \$30,393,000 was available under the line of credit. In addition to the overnight line of credit program, the Company also has access to the FHLB's Term Advance Program under which it can borrow at various terms and interest rates. Residential mortgage loans with a carrying value of \$69,547,000 and FHLB stock with a carrying value of \$1,579,000 have been pledged by the Company under a blanket collateral agreement to secure the Company's line of credit and term borrowings. The Company also maintains a \$5,000,000 line of credit with a correspondent bank. Interest on the line is determined at the time of borrowing. The Company did not draw on the line during 2006. Investment securities with a carrying value of \$6,104,000 at December 31, 2006 collateralize the line of credit.

The Company has a non-consolidated subsidiary trust, Pathfinder Statutory Trust I, of which 100% of the common equity is owned by the Company. The Trust issued \$5,000,000 of 30 year floating rate Company-obligated pooled capital securities of Pathfinder Statutory Trust I. The Company borrowed the proceeds of the capital securities from its subsidiary by issuing floating rate junior subordinated deferrable interest debentures having substantially similar terms. The capital securities mature in 2032 and are treated as Tier 1 capital by the Federal Deposit Insurance Corporation and the Office of Thrift Supervision. The capital securities of the trust are a pooled trust preferred fund of Preferred Term Securities VI, Ltd. and are tied to the 3-month LIBOR plus 3.45% (8.82% at December 31, 2006 and 7.97% at December 31, 2005) with a five-year call provision. The Company guarantees all of these securities.

The Company's equity interest in the trust subsidiary of \$155,000 is reported in "Other assets". For regulatory reporting purposes, the Federal Reserve Board has indicated that the preferred securities will continue to qualify as Tier 1 Capital subject to previously specified limitations, until further notice. If regulators make a determination that Trust Preferred Securities can no longer be considered in regulatory capital, the securities become callable and the Company may redeem them.

On March 22, 2007, the Company entered into a trust preferred issuance of \$5,000,000, adjustable quarterly at a 1.65% spread over the 3-month LIBOR rate. The Company intends to use the proceeds from the issuance to retire its existing trust preferred obligation which is callable in June of 2007.

NOTE 11: EMPLOYEE BENEFITS AND DEFERRED COMPENSATION AND SUPPLEMENTAL RETIREMENT PLANS

The Company has a noncontributory defined benefit pension plan covering substantially all employees. The plan provides defined benefits based on years of service and final average salary. In addition, the Company provides certain health and life insurance benefits for eligible retired employees. The healthcare plan is contributory with participants' contributions adjusted annually; the life insurance plan is noncontributory. Employees with less than 14 years of service as of January 1, 1995, are not eligible for the health and life insurance retirement benefits.

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The Company uses an October 1 measurement date for the defined benefit plan and postretirement benefit plan.

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The following tables set forth the changes in the plans' benefit obligations, fair value of plan assets and prepaid (accrued) benefit (cost) as of December 31:

(In thousands)	PENSION BENEFITS		POSTRETIREMENT BENEFITS	
	2006	2005	2006	2005
CHANGE IN BENEFIT OBLIGATIONS:				
Benefit obligation at beginning of year	\$4,361	\$3,745	\$ 354	\$ 309
Service cost	193	151	2	2
Interest cost	252	229	20	18
Actuarial (loss) gain	(203)	378	(10)	46
Plan participants' contributions	-	-	-	6
Benefits paid	(164)	(142)	(20)	(27)
Benefit obligations at end of year	\$4,439	\$4,361	\$ 346	\$ 354
CHANGE IN PLAN ASSETS:				
Fair value of plan assets at beginning of year	\$4,070	\$3,154	\$ -	\$ -
Actual return on plan assets	297	388	-	-
Plan participants' contributions	-	-	-	6
Benefits paid	(164)	(142)	(20)	(27)
Employer contributions	135	670	20	21
Fair value of plan assets at end of year	\$4,338	\$4,070	\$ -	\$ -
COMPONENTS OF PREPAID/(ACCRUED) BENEFIT (COST):				
Unfunded status	\$ (101)	\$ (291)	\$ (346)	\$ (354)
Unrecognized transition obligation	-	-	-	115
Unrecognized actuarial net loss	-	1,656	-	34
Prepaid/(accrued) benefit/(cost)	\$ (101)	\$1,365	\$ (346)	\$ (205)

The accumulated benefit obligation for the defined benefit plan was \$3,710,000 and \$3,602,000 at December 31, 2006 and 2005, respectively.

The significant assumptions used in determining the benefit obligations as of December 31, 2006, 2005 and 2004 are as follows:

	PENSION BENEFITS			POSTRETIREMENT BENEFITS		
	2006	2005	2004	2006	2005	2004
Weighted average discount rate	6.25%	5.88%	6.25%	6.25%	5.88%	6.25%

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Expected long term rate of return on plan assets	9.00%	9.00%	9.00%	-	-
Rate of increase in future compensation levels	3.00%	3.00%	3.50%	-	-

Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement health care plans. The annual rates of increase in the per capita cost of covered medical and prescription drug benefits for year-end calculations were assumed to be 9.0% and 9.5%, respectively. The rates were assumed to decrease gradually to 3.75% in 2012 and remain at that level thereafter. A one-percentage point change in the health care cost trend rates would have the following effects:

(In thousands)	1 PERCENTAGE POINT INCREASE	1 PERCENTAGE POINT DECREASE
Effect on total of service and interest cost components	\$ 23	\$ (22)
Effect on post retirement benefit obligation	9	(8)

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The composition of the net periodic benefit plan cost for the years ended December 31, 2006, 2005 and 2004 is as follows:

(In thousands)	PENSION BENEFITS			POSTRETIREMENT BENEFITS		
	2006	2005	2004	2006	2005	2004
Service cost	\$ 193	\$ 151	\$ 155	\$ 2	\$ 2	\$ 2
Interest cost	252	229	207	20	18	19
Amortization of transition obligation	-	-	-	18	19	18
Amortization of gains and losses	110	96	94	-	-	-
Expected return on plan assets	(368)	(285)	(254)	-	-	-
Net periodic benefit plan cost	\$ 187	\$ 191	\$ 202	\$40	\$39	\$39

The significant assumptions used in determining the net periodic benefit plan cost for years ended December 31 were as follows:

	PENSION BENEFITS			POSTRETIREMENT BENEFITS		
	2006	2005	2004	2006	2005	2004
Weighted average discount rate	6.25%	5.88%	6.25%	6.25%	5.88%	6.25%
Expected long term rate of return on plan assets	9.00%	9.00%	9.00%	-	-	-

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The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid.

YEARS ENDING DECEMBER 31:

(In thousands)	
2007	\$ 146
2008	145
2009	149
2010	154
2011	161
Years 2012 - 2016	1,075

On September 29, 2006, the Financial Accounting Standards Board "FASB" issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans ("SFAS 158"), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date - the date at which the benefit obligation and plan assets are measured - is required to be the company's fiscal year end. SFAS 158 is effective for publicly-held companies for fiscal years ending after December 15, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The Company has adopted SFAS 158 on December 31, 2006. The effect of the implementation was to increase accumulated other comprehensive loss by \$921,000 (net of related deferred tax effect of \$614,000), decrease prepaid pension cost by \$1,414,000 and increase accrued post retirement benefit by \$121,000.

In 2007, it is estimated that \$87,000 will be amortized from accumulated comprehensive loss into the net periodic cost for the defined benefit pension plan.

The Company also offers a 401(k) plan to its employees. Contributions to this plan by the Company were \$148,000, \$145,000 and \$92,000 for 2006, 2005 and 2004, respectively.

The Company maintains optional deferred compensation plans for its directors, and certain executive officers, whereby fees and income normally received are deferred and paid by the Company based upon a payment schedule commencing at age 65 and continue monthly for 10 years. Directors must serve on the board for a minimum of 5 years to be eligible for the Plan. At December 31, 2006 and 2005, other liabilities include approximately \$1,556,000 and \$1,412,000, respectively, relating to deferred compensation. Deferred compensation expense for the years ended December 31, 2006, 2005 and 2004 amounted to approximately \$240,000, \$211,000 and \$185,000, respectively.

The Company has a supplemental executive retirement plan for the benefit of certain executive officers. At December 31, 2006 and 2005, other liabilities include approximately \$396,000 and \$424,000 accrued under these plans. Compensation expense includes approximately \$51,000, \$56,000 and \$53,000

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relating to the supplemental executive retirement plan for 2006, 2005 and 2004, respectively.

To fund the benefits under these plans, the Company is the owner of single premium life insurance policies on participants in the non-qualified retirement plans. At December 31, 2006 and 2005, the cash value of these policies was \$6,212,000 and \$5,987,000, respectively.

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NOTE 12: STOCK BASED COMPENSATION PLANS

In February 1997, the Board of Directors approved an option plan and granted options thereunder with an exercise price equal to the market value of the Company's shares at the date of grant. Under the Stock Option Plan, up to 132,249 options have been authorized for grant of incentive stock options and nonqualified stock options.

In July 2001, the Board approved the issuance of 38,499 stock options remaining in the 1997 Stock Option Plan. The exercise price is equal to the market value of the Company's shares at the date of grant (\$8.34). The options granted under the issuance have a 10-year term with one-third vesting upon grant date and the remaining vesting and becoming exercisable ratably over a 2-year period.

Activity in the Stock Option Plan is as follows:

(Shares in thousands)	OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS EXERCISABLE
Outstanding at December 31, 2003	88	\$ 7.25	88
Exercised	(18)	7.75	
Outstanding at December 31, 2004	70	\$ 7.12	70
Exercised	(13)	6.58	
Expired	(16)	6.58	
Outstanding at December 31, 2005	41	\$ 7.41	41
Exercised	(4)	7.35	
Expired	-	-	
Outstanding at December 31, 2006	37	\$ 7.53	37

The aggregate intrinsic value of a stock option represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2006. This amount changes based on changes in the market value of the Company's stock. At December 31, 2006, the aggregate intrinsic value of all outstanding and exercisable stock options approximated \$206,000.

The total intrinsic value of stock options exercised during 2006 approximated \$22,600.

Information pertaining to options outstanding at December 31, 2006 is as

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follows:

OPTIONS OUTSTANDING AND EXERCISABLE			
EXERCISE PRICE	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE
\$ 6.58	17,200	.07 years	\$6.58
\$ 8.34	20,150	4.5 years	\$8.34
Outstanding at end of year	37,350	2.5 years	\$7.53

No new options have been granted since July 2001. All outstanding options were fully vested as of July 2003.

The Bank sponsors an Employee Stock Ownership Plan (ESOP) for employees who have attained the age of 21 and who have completed a 12 month period of employment with the Bank during which they worked at least 1,000 hours. The Bank purchased 92,574 shares of common stock on behalf of the ESOP. The purchase of the shares was funded by a loan from the Company and the unearned shares are pledged as

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collateral for the borrowing. As the loan was repaid, earned shares were released from collateral and allocated to the participants. As shares were earned, the Bank recorded compensation expense at the average market price of the shares during the period. Cash dividends received on unearned shares were allocated among the participants and were reported as compensation expense. All shares were earned at December 31, 2005, therefore, no compensation expense related to the ESOP was recorded in 2006. ESOP compensation expense, including cash dividends received on unearned shares, approximated \$88,000 and \$133,000 for the years ended December 31, 2005 and 2004, respectively. Total earned shares at December 31, 2006 and 2005 were 92,574. Unearned ESOP shares were not considered outstanding for purposes of computing earnings per share.

NOTE 13: Income Taxes

The provision for income tax expense (benefit) for the years ended December 31, is as follows:

(In thousands)	2006	2005	2004
Current	\$ 309	\$(160)	\$ -
Deferred	(67)	109	502
	\$ 242	\$ (51)	\$ 502

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The provision for income taxes includes the following:

(In thousands)	2006	2005	2004
Federal Income Tax	\$ 267	\$ (29)	\$ 520
New York State Franchise Tax	(25)	(22)	(18)
	\$ 242	\$ (51)	\$ 502

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The components of net deferred tax asset, included in other assets as of December 31, are as follows:

(In thousands)	2006	2005
ASSETS:		
Deferred compensation	\$ 760	\$ 715
Allowance for loan losses	583	654
Postretirement benefits	88	82
Prepaid pension	85	-
Mortgage recording tax credit carryforward	364	361
Investment securities	566	865
Other	142	121
	\$ 2,588	\$ 2,798
LIABILITIES:		
Prepaid pension	-	(532)
Depreciation	(573)	(647)
Accretion	(38)	(37)
Loan origination fees	(289)	(250)
Intangible assets	(536)	(432)
Prepaid expenses	(83)	(79)
	\$ (1,519)	\$ (1,977)
Net deferred tax asset	\$ 1,069	\$ 821

Realization of deferred tax assets is dependent upon the generation of future taxable income or the existence of sufficient taxable income within the carry back period. A valuation allowance is provided when its more likely than not that some portion, or all of the deferred tax assets, will not be realized. In assessing the need for a valuation allowance, management considers the scheduled reversal of the deferred tax liabilities, the level of historical taxable income and the projected future level of taxable income over the periods in which the temporary differences comprising the deferred tax assets will be deductible. Based on its assessment, management determined that no valuation allowance is necessary.

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A reconciliation of the federal statutory income tax rate to the effective income tax rate for the years ended December 31, is as follows:

	2006	2005	2004
Federal statutory income tax rate	34.0%	34.0%	34.0%
State tax	(1.3)	(3.0)	(0.9)
Tax-exempt interest income, net of TEFRA	(11.1)	(44.8)	(6.0)
Increase in value of life insurance	(5.3)	(18.1)	(3.1)
Other	2.8	19.5	2.3
Effective income tax rate	19.1%	(12.4)%	26.3%

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NOTE 14: EARNINGS PER SHARE

The following is a reconciliation of basic to diluted earnings per share for the years ended December 31:

	EARNINGS	SHARES	EPS
(In thousands, except per share data)			
2006 Net Income	\$ 1,028		
Basic EPS	1,028	2,464	\$0.42
Effect of dilutive securities			
Stock options	-	19	
Diluted EPS	\$ 1,028	2,483	\$0.41
2005 Net Income	\$ 462		
Basic EPS	462	2,456	\$0.19
Effect of dilutive securities			
Stock options	-	25	
Diluted EPS	\$ 462	2,481	\$0.19
2004 Net Income	\$ 1,405		
Basic EPS	1,405	2,435	\$0.58
Effect of dilutive securities			
Stock options	-	44	
Diluted EPS	\$ 1,405	2,479	\$0.57

NOTE 15: COMMITMENTS AND CONTINGENCIES

The Company is 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. Such commitments involve, to varying degrees, elements of

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credit risk in excess of the amount recognized in the consolidated statement of condition. The contractual amount of those commitments to extend credit reflects the extent of involvement the commitment has in this particular class of financial instrument. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of the instrument.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments.

At December 31, 2006 and 2005, the following financial instruments were outstanding whose contract amounts represent credit risk:

(In thousands)	CONTRACT AMOUNT	
	2006	2005
Commitments to grant loans	\$ 9,388	\$ 6,371
Unfunded commitments under lines of credit	17,260	12,361
Standby letters of credit	271	798

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitment amounts are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include residential real estate and income-producing commercial properties. Loan commitments outstanding at December 31, 2006 with fixed interest rates amounted to approximately \$6.2 million. Loan commitments, including unused lines of credit, outstanding at December 31, 2006 with variable interest rates amounted to approximately \$20.4 million. These outstanding loan commitments carry current market rates.

Unfunded commitments under standby letters of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Outstanding letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral supporting these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The amount of the liability as of December

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31, 2006 and 2005 for guarantees under standby letters of credit issued is not material.

The Company leases land and leasehold improvements under agreements that expire in various years with renewal options over the next 30 years. Rental expense, included in operating expenses, amounted to \$62,000, \$42,000 and \$41,000 in 2006, 2005 and 2004, respectively. In October 2002, the Company entered into a land lease with one of its directors on an arms-length basis. In January 2006, the Company entered into a lease with Pathfinder Bancorp, MHC, for the use of a training facility. This lease was also executed on an arms-length basis. The rent expense paid to the related parties during 2006, 2005 and 2004 was \$42,000, \$23,000 and \$21,000, respectively. Approximate minimum rental commitments for the noncancelable operating leases are as follows:

YEARS ENDING DECEMBER 31:

(In thousands)

2007	\$ 63
2008	65
2009	65
2010	65
2011	52
Thereafter	63
Total minimum lease payments	\$373

NOTE 16: DIVIDENDS AND RESTRICTIONS

The Board of Directors of Pathfinder Bancorp, M.H.C., determines whether the Holding Company will waive or receive dividends declared by the Company each time the Company declares a dividend, which is expected to be on a quarterly basis. The Holding Company may elect to receive dividends and utilize such funds to pay expenses or for other allowable purposes. The Office of Thrift Supervision ("OTS") has indicated that (i) the Holding Company shall provide the OTS annually with written notice of its intent to waive its dividends prior to the proposed date of the dividend, and the OTS shall have the authority to approve or deny any dividend waiver request; (ii) if a waiver is granted, dividends waived by the Holding Company will be excluded from the Company's capital accounts for purposes of calculating dividend payments to minority shareholders. During 2006, the Company paid cash dividends totaling \$325,000 to the Holding Company. For the second and fourth quarters ending June 30, 2006 and December 31, 2006, respectively, the Holding Company waived the right to receive its portion of the cash dividends declared on June 28, 2006 and December 28, 2006, respectively, which totaled \$325,000. During 2005 and 2004, the Holding Company waived dividends totaling \$325,000 and \$320,000, respectively.

The Company's ability to pay dividends to its shareholders is largely dependent on the Bank's ability to pay dividends to the Company. In addition to state law requirements and the capital requirements discussed in Note 17 the circumstances under which the Bank may pay dividends are limited by federal statutes, regulations and policies. The amount of retained earnings legally available

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under these regulations approximated \$2,823,000 as of December 31, 2006. Dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

NOTE 17: REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2006, that the Bank meets all capital adequacy requirements to which it is subject.

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As of December 31, 2006, the Bank's most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as "well-capitalized", under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized", the Bank must maintain total risk based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the tables below. There are no conditions or events since that notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31, 2006 and 2005 are also presented in the following table.

	ACTUAL		FOR CAPITAL ADEQUACY PURPOSES		TO BE "WE CAPITALIZE UNDER PROM CORRECTIVE PRO
	AMOUNT	RATIO	AMOUNT	RATIO	AMOUNT RA
(Dollars in thousands)					
AS OF DECEMBER 31, 2006:					
BANK					
Total Core Capital (to Risk-Weighted Assets)	\$24,676	12.9%	\$15,297	8.0%	\$19,121 1
Tier 1 Capital (to Risk-Weighted Assets)	\$23,180	12.1%	\$ 7,648	4.0%	\$11,472
Tier 1 Capital (to Average Assets)	\$23,180	7.7%	\$11,987	4.0%	\$14,984
=====					
AS OF DECEMBER 31, 2005:					
BANK					
Total Core Capital (to Risk-Weighted Assets)	\$22,957	12.6%	\$14,615	8.0%	\$18,269 1
Tier 1 Capital (to Risk-Weighted Assets)	\$21,278	11.7%	\$ 7,307	4.0%	\$10,961
Tier 1 Capital (to Average Assets)	\$21,278	7.1%	\$11,927	4.0%	\$14,909
=====					

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The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2006 and 2005, these reserve balances amounted to \$1,856,000 and \$1,608,000, respectively.

NOTE 18: FAIR VALUES OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosure About Fair Value of Financial Instruments," requires disclosure of fair value information of financial instruments, whether or not recognized in the consolidated statement of condition, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends, and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The Company, in estimating its fair value disclosures for financial instruments, used the following methods and assumptions:

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CASH AND CASH EQUIVALENTS - the carrying amounts approximate fair value.

INVESTMENT SECURITIES - fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

LOANS AND MORTGAGE LOANS HELD-FOR-SALE - for variable rate loans that reprice frequently and with no significant credit risk, fair values approximate carrying values. Fair values for fixed rate loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

FEDERAL HOME LOAN BANK STOCK - the carrying amounts reported approximate fair value.

MORTGAGE SERVICING RIGHTS - the carrying amount approximates fair value.

ACCRUED INTEREST RECEIVABLE AND PAYABLE - the carrying amounts of accrued

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interest receivable and payable approximate their fair values.

DEPOSIT LIABILITIES - The fair values disclosed for demand deposits (e.g., interest-bearing and noninterest-bearing checking, passbook savings and certain types of money management accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates of deposits to a schedule of aggregated expected monthly maturities on time deposits.

BORROWINGS - the fair values for short-term borrowings and junior subordinated debentures approximate the carrying amounts. The fair values for long-term borrowings were estimated using discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

OFF-BALANCE SHEET INSTRUMENTS - Fair values for the Company's off-balance sheet instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

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The carrying amounts and fair values of the Company's financial instruments as of December 31 are presented in the following table:

(Dollars in thousands)	2006		2005	
	CARRYING AMOUNTS	ESTIMATED FAIR VALUES	CARRYING AMOUNTS	ESTIMATED FAIR VALUES
FINANCIAL ASSETS:				
Cash and cash equivalents	\$ 13,723	\$ 13,723	\$ 7,895	\$ 7,895
Investment securities	62,640	62,640	74,239	74,239
Net Loans	201,713	200,555	187,889	189,598
Federal Home Loan Bank Stock	1,579	1,579	1,805	1,805
Accrued interest receivable	1,694	1,694	1,678	1,678
Mortgage servicing rights	65	65	146	146
FINANCIAL LIABILITIES:				
Deposits	\$245,585	\$ 246,236	\$236,377	\$ 236,552
Borrowed funds	26,360	26,173	31,360	33,883
Junior subordinated debentures	5,155	5,155	5,155	5,155
Accrued interest payable	161	161	161	161
OFF-BALANCE SHEET INSTRUMENTS:				
Standby letter of credit	\$ -	\$ -	\$ -	\$ -
Commitments to extend credit	-	-	-	-

NOTE 19: PARENT COMPANY - FINANCIAL INFORMATION

The following represents the condensed financial information of Pathfinder Bancorp, Inc. as of and for the years ended December 31:

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STATEMENTS OF CONDITION

	2006	2005
(In thousands)		
ASSETS		
Cash	\$ 100	\$ 245
Investments	24	19
Investment in subsidiary	25,529	24,530
Investment in non-bank subsidiary	155	155
Due from subsidiaries	-	1,042
Other assets	317	207
Total assets	\$26,125	\$26,198
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accrued liabilities	120	115
Junior subordinated debentures	5,155	5,155
Shareholders' equity	20,850	20,928
Total liabilities and shareholders' equity	\$26,125	\$26,198

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STATEMENTS OF INCOME

	2006	2005	2004
(In thousands)			
Interest income	\$ 20	\$ 14	\$ 9
Interest expense	450	352	259
Net interest expense	(430)	(338)	(250)
Operating expense	(96)	(92)	(130)
Realized gain on sale of investment securities	6	-	330
Amortization of deferred financing costs	(30)	(30)	(30)
Loss before tax benefit and equity in undistributed net income of subsidiaries	(550)	(460)	(80)
Tax benefit	94	128	20
Loss before equity in undistributed net income of subsidiaries	(456)	(332)	(60)
Equity in undistributed net income of subsidiaries	1,484	794	1,465
Net income	\$ 1,028	\$ 462	\$ 1,405

STATEMENTS OF CASH FLOWS

	2006	2005	2004
(In thousands)			
OPERATING ACTIVITIES			
Net Income	\$ 1,028	\$ 462	\$ 1,405
Equity in undistributed earnings of subsidiaries	(1,484)	(794)	(1,465)

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Realized gain on sale of investment securities	(6)	-	(330)
ESOP shares earned	-	88	133
Amortization of deferred financing costs	30	30	30
Other operating activities	908	(987)	(304)

Net cash provided by (used in) operating activities	505	(1,201)	(531)

INVESTING ACTIVITIES			
Proceeds from loan to subsidiary	-	41	56
Dividends receivable	-	911	8
Purchase of investments	(24)	(18)	-
Proceeds from sale of investments	24	-	430

Net cash provided by investing activities	-	934	494

FINANCING ACTIVITIES			
Proceeds from exercise of stock options	23	213	140
Tax benefit upon exercise of stock options	42	-	-
Cash dividends	(686)	(683)	(664)

Net used in financing activities	(621)	(470)	(524)

Decrease in cash and cash equivalents	(145)	(737)	(561)
Cash and cash equivalents at beginning of year	245	982	1,543

Cash and cash equivalents at end of year	\$ 100	\$ 245	\$ 982
=====			

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ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A: CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this annual report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B: OTHER INFORMATION

None

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PART III

ITEM 10: DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

- (a) Information concerning the directors of the Company is incorporated by reference hereunder in the Company's Proxy Materials for the Annual Meeting of Stockholders.
- (b) Set forth below is information concerning the Executive Officers of the Company at December 31, 2006

NAME	AGE	POSITIONS HELD WITH THE COMPANY
Thomas W. Schneider	45	President and Chief Executive Officer
James A. Dowd, CPA	39	Senior Vice President, Chief Financial Officer
Edward A. Mervine	50	Senior Vice President, General Counsel
Melissa A. Miller	49	Senior Vice President, Chief Operating Officer
Ronald Tascarella	48	Senior Vice President, Chief Credit Officer

ITEM 11: EXECUTIVE COMPENSATION

Information with respect to management compensation and transactions required under this item is incorporated by reference hereunder in the Company's Proxy Materials for the Annual Meeting of Stockholders under the caption "Compensation".

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information contained under the sections captioned "Stock Ownership of Management" is incorporated by reference to the Company's Proxy Materials for its Annual Meeting of Stockholders.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is set forth under the caption "Transactions with Certain Related Persons" in the Definitive Proxy Materials for the Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 14: PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is set forth under the caption "Audit and Related Fees" in the Definitive Proxy Materials for the Annual Meeting of Stockholders and is incorporated herein by reference.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

- (a)1) Financial Statements - The Company's consolidated financial statements, for the years ended December 31, 2005, 2004 and 2003, together with the Report of Independent Registered Public Accounting Firm are filed as part

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of this Form 10-K report. See "Item 8: Financial Statements and Supplementary Data." The supplemental financial information listed and appearing hereafter should be read in conjunction with the financial statements included in this report.

- (a)2) Financial Statement Schedules - All financial statement schedules have been omitted as the required information is inapplicable or has been included in "Item 7: Management Discussion and Analysis."
- (b) Exhibits
 - 3.1 Certificate of Incorporation of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Current Report on Form 8-K dated June 25, 2001)
 - 3.2 Bylaws of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Current Report on Form 8-K dated June 25, 2001)
 - 4 Form of Stock Certificate of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Current Report on Form 8-K dated June 25, 2001)
 - 10.1 Form of Pathfinder Bank 1997 Stock Option Plan (Incorporated herein by reference to the Company's S-8 file no. 333-53027)
 - 10.2 Form of Pathfinder Bank 1997 Recognition and Retention Plan (Incorporated by reference to the Company's S-8 file no. 333-53027)
 - 10.3 2003 Executive Deferred Compensation Plan (Incorporated by herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 file no. 000-23601)
 - 10.4 2003 Trustee Deferred Fee Plan (Incorporated by herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 file no. 000-23601)
 - 10.5 Employment Agreement between the Bank and Thomas W. Schneider, President and Chief Executive Officer (Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 file no. 000-23601)
 - 10.6 Employment Agreement between the Bank and Edward A. Mervine, Corporate Counsel (Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 file no. 000-23601)
 - 10.7 Change of Control Agreement between the Bank and Ronald Tascarella
 - 10.8 Change of Control Agreement between the Bank and James A. Dowd
 - 10.9 Change of Control Agreement between the Bank and Melissa A. Miller
 - 14 Code of Ethics (Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)
 - 21 Subsidiaries of Company
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- 23 Consent of Beard Miller Company LLP
- 31.1 Rule 13a-14(a) / 15d-14(a) Certification of the Chief Executive Officer

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31.2 Rule 13a-14(a) / 15d-14(a) Certification of the Chief Financial Officer

32.1 Section 1350 Certification of the Chief Executive and Chief Financial Officer

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EXHIBIT 10.7

PATHFINDER BANCORP, INC.
PATHFINDER BANK
CHANGE IN CONTROL AGREEMENT

This Agreement is made effective as of the 19th day of December, 2006, by and between Pathfinder Bank (the "Bank"), a New York chartered stock savings bank, with its principal administrative office at 214 West First Street, Oswego, New York 13126-2547, jointly with Pathfinder Bancorp, Inc, the sole stockholder of the Bank, and Ronald Tascarella (the "Executive"). Any reference to "Company" herein shall mean Pathfinder Bancorp, Inc. or any successor thereto. Any reference to "Employer" herein shall mean both the Bank and the Company or any successors thereto

WHEREAS, the Executive is employed by the Employer; and

WHEREAS, the Employer desires to provide Executive with certain benefits in the event of a Change in Control of the Employer, as hereinafter defined:

NOW, THEREFORE, in consideration of the mutual covenants herein contained, and upon the other terms and conditions hereinafter provided, the parties hereby agree as follows:

1. CHANGE IN CONTROL DEFINED

For purposes of this Agreement, a "Change in Control" of the Bank or Company shall mean a Change in Control of a nature that (i) would be required to be reported in response to Item 5.01 of the current report on Form 8-K, as in effect on the date hereof, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"); or (ii) results in a Change in Control of the Bank or the Company within the meaning of the Home Owners Loan Act, as amended, and applicable rules and regulations promulgated there under, as in effect at the time of the Change in Control (collectively, the "HOLA"); or (iii) without limitation such a Change in Control shall be deemed to have occurred at such time as (a) any "person" (as the term is used in Sections 13(d) and 14(d) of the Exchange Act) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 25% or more of the combined voting power of Company's outstanding securities except for any securities purchased by the Employer's employee stock ownership plan or trust; or (b) individuals who constitute the Company's Board of Directors on the date hereof (the "Incumbent Board") cease for any reason to constitute at least a majority thereof, provided that any person becoming a director subsequent to the date hereof whose election was approved by a vote of at least three-quarters of the directors comprising the Incumbent Board, or whose nomination for election by the Company's stockholders was approved by the same Nominating Committee serving under an Incumbent Board, shall be, for purposes of this clause (b), considered as though he were a member of the Incumbent Board; or (c) a plan of reorganization, merger, consolidation, sale of all or substantially all the assets of the Bank or the Company or

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similar transaction in which the Bank or Company is not the surviving institution occurs; or (d) a proxy statement soliciting proxies from stockholders of the Company, by someone other than the current management of the Company, seeking stockholder approval of a plan of reorganization, merger or consolidation of the Company or similar transaction with one or more corporations or financial institutions, and as a result such proxy solicitation a plan of reorganization, merger consolidation or similar transaction involving the Company is approved by the requisite vote of the Company's stockholders; or (e) a tender offer is made for 25% or more of the voting securities of the Company and the shareholders owning beneficially or of record 25% or more of the outstanding securities of the Company have tendered or offered to sell their shares pursuant to such tender offer and such tendered shares have been accepted by the tender offeror. Notwithstanding anything to the contrary herein, a "Change in Control" of the Bank or the Company shall not be deemed to have occurred in the event of a conversion of Pathfinder Bancorp, MHC to stock holding company form.

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2. BENEFITS DUE EXECUTIVE IN THE EVENT OF CHANGE IN CONTROL

If any of the events described in Section 1 hereof constituting a Change in Control have occurred, Executive shall be entitled to the benefits provided in paragraphs (a), (b), (c), (d) and (e) of this Section 2 upon his dismissal from employment within twelve (12) months of the Change in Control ("Dismissal"). (Notwithstanding any other provision of this Agreement, a voluntary termination by the Executive shall not be deemed a "Dismissal")

(a) Upon the occurrence of a Change in Control followed by the Executive's Dismissal, the Employer shall pay Executive, or in the event of his subsequent death, his beneficiary or beneficiaries, or his estate, as the case may be, as severance pay or liquidated damages, or both, a sum equal to his most recent annual base salary, including bonuses and any other cash compensation paid to the Executive within the most recent twelve (12) month period. Such Payment shall be made by the Employer on the Date of Dismissal.

(b) Upon the occurrence of a Change in Control followed by the Executive's Dismissal of employment, the Employer will cause to be continued life, medical, dental and disability coverage substantially identical to the coverage maintained by the Employer for Executive prior to his Dismissal. Such coverage and payments shall cease upon the expiration of twelve (12) months.

(c) Upon the occurrence of a Change in Control, Executive shall become fully vested in and entitled to all benefits granted to him pursuant to any Stock Option Plan of the Bank or Company.

(d) Upon the occurrence of a Change in Control, Executive shall become fully vested in and entitled to all benefits granted to him pursuant to Supplemental Executive Retirement Plan of the Bank or Company, applicable to him, if any.

(e) Upon the occurrence of a Change in Control, the Executive shall become fully vested in and entitled to all benefits awarded to him under the Bank's or the Company's Recognition and Retention Plan or any restricted stock plan in effect.

(f) Notwithstanding the preceding paragraphs of this Section 2, in the event that:

(i) the aggregate payments or benefits to be made or afforded to

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Executive under said paragraphs (the "Termination Benefits") would be deemed to include an "excess parachute payment" under Section 280G of the Internal Revenue Code or any successor thereto, and

(ii) if such Termination Benefits were reduced to an amount (the "Non-Triggering Amount"), the value of which is one dollar (\$1.00) less than an amount equal to the total amount of payments permissible under Section 280G of the Internal Revenue Code or any successor thereto, then the Termination Benefits to be paid to Executive shall be so reduced so as to be a Non-Triggering Amount.

(g) Notwithstanding the foregoing, there will be no reduction in the Payment otherwise payable to Executive during any period during which Executive is incapable of performing his duties hereunder by reason of disability.

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3. TERMINATION FOR CAUSE

The term "Termination for Cause" shall mean termination because of the Executive's personal dishonesty, incompetence, willful misconduct, any breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of this Agreement. In determining incompetence, the acts or omissions shall be measured against standards generally prevailing in the financial services industry. For purposes of this paragraph, no act or failure to act on the part of Executive shall be considered "willful" unless done, or omitted to be done, by the Executive not in good faith and without reasonable belief that the Executive's action or omission was in the best interest of the Employer. Notwithstanding the foregoing, Executive shall not be deemed to have been Terminated for Cause unless and until there shall have been delivered to him a copy of a resolution duly adopted by the affirmative vote of not less than three-fourths of the members of the Boards of Directors of the Company and the Bank at a meeting of said Boards called and held for that purpose (after reasonable notice to Executive and an opportunity for him, together with counsel, to be heard before the Boards), finding that in the good faith opinion of the Boards, Executive was guilty of conduct justifying Termination for Cause and specifying the particulars thereof in detail. Notwithstanding any provision in paragraph 2, the Executive shall not have the right to receive Termination Benefits for any period after Termination for Cause.

4. NO ATTACHMENT

(a) Except as required by law, no right to receive payments under this Agreement shall be subject to anticipation, commutation, alienation, sale, assignment, encumbrance, charge, pledge, or hypothecation, or to execution, attachment, levy, or similar process or assignment by operation of law, and any attempt, voluntary or involuntary, to affect any such action shall be null, void, and of no effect.

(b) This Agreement shall be binding upon, and inure to the benefit of, Executive and the Employer and their respective successors and assigns.

5. MODIFICATION AND WAIVER

(a) This Agreement may not be modified or amended except by an instrument in writing signed by the parties hereto.

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(b) No term or condition of this Agreement shall be deemed to have been waived, nor shall there be any estoppel against the enforcement of any provision of this Agreement, except by written instrument of the party charged with such waiver or estoppel. No such written waiver shall be deemed a continuing waiver unless specifically stated therein, and each such waiver shall operate only as to the specific term or condition waived and shall not constitute a waiver of such term or condition for the future as to any act other than that specifically waived.

6. SEVERABILITY

If, for any reason, any provision of this Agreement, or any part of any provision, is held invalid, such invalidity shall not affect any other provision of this Agreement or any part of such provision not held so invalid, and each such other provision and part thereof shall to the full extent consistent with law continue in full force and effect.

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7. EMPLOYMENT AT WILL

Except for the limited benefits granted herein, nothing in this Agreement shall be construed to create an employment contract and the parties acknowledge that the Executive's employment remains "at will".

8. AGREEMENT TERM

The initial "Agreement Term" shall begin on the date this agreement is executed and shall continue through December 31, 2007. As of December 31, 2007, and as of each December 31st thereafter, the agreement term shall extend automatically for one year unless the Bank gives notice to the executive prior to the date of such extension that the agreement term will not be extended. Notwithstanding the foregoing, if a change in control occurs during the agreement term, the agreement term shall continue through and terminate on the first anniversary of the date on which the change in control occurs.

9. PROPRIETARY INFORMATION

The parties agree to the protection of the Bank's proprietary information as follows:

(a) Nondisclosure of Confidential Information

(i) Access. The Executive acknowledges that employment with the Bank necessarily involves exposure to, familiarity with, and opportunity to learn highly sensitive, confidential and proprietary information of the Bank and its subsidiaries, which may include information about products and services, markets, customers and prospective customers, vendors and suppliers, miscellaneous business relationships, investment products, pricing, billing and collection procedures, proprietary software and other intellectual property, financial and accounting data, personnel and compensation, data processing and communications, technical data, marketing strategies, research and development of new or improved products and services, and know-how regarding the business of the Bank and its products and services (collectively referred to herein as "Confidential Information")

(ii) Valuable Asset. The Executive further acknowledges that the Confidential Information is a valuable, special, and unique asset of the Bank, such that the unauthorized disclosure or use by persons or entities outside the Bank would cause irreparable damage to the business of the Bank. Accordingly,

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the Executive agrees that during and after the Executive's employment with the Bank, until the Confidential Information becomes publicly known, the Executive shall not directly or indirectly disclose to any person or entity, use for any purpose or permit the exploitation, copying or summarizing of, any Confidential Information of the Bank, except as specifically required in the proper performance of his duties for the Bank.

(iii) Duties. The Executive agrees to take all appropriate action, whether by instruction, agreement or otherwise, to endure the protection, confidentiality and security of the Confidential Information and to satisfy his obligations under this Agreement. Prior to lecturing or publishing articles which reference to Bank and its business, the Executive will provide to an officer of the Bank a copy of the material to be presented for the Bank to review and approve in order to ensure that no Confidential Information is disclosed.

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(iv) Confidential Relationship. The Bank considers its Confidential Information to constitute "trade secrets" which are protected from unauthorized disclosure under applicable law. However, whether or not the Confidential Information constitutes trade secrets, the Executive acknowledges and agrees that the Confidential Information is protected from unauthorized disclosure or use due to his covenants under this Section 9 and his fiduciary duties as an executive of the Bank.

(v) Return of Documents. The Executive acknowledges and agrees that the Confidential Information is and at all times shall remain the sole and exclusive property of the Bank. Upon the termination of his employment with the Bank or upon request by the Bank, the Executive will promptly return to the Bank in good condition all documents, data and records of any kind, whether in hardcopy or electronic form, which contain any Confidential Information, including any and all copies thereof, as well as all materials furnished to or acquired by the Executive during the course of the Executive's employment with the Bank.

(b) Enforcement. For purposes of this Section 9, the term "Bank" shall include the Bank and the Company and all of their subsidiaries. Each such entity shall be an intended third party beneficiary of this Agreement and shall have the right to enforce the provisions of this Agreement against the Executive individually or collectively with any one or more of the other subsidiaries.

(c) Equitable Relief. The Executive acknowledges and agreed that, by reason of the sensitive nature of the Confidential Information of the Bank referred to in this Agreement, in addition to recovery of damages and any other legal relief to which the Bank may be entitled in the event of the Executive's violation of this Agreement, the Bank shall also be entitled to equitable relief, including such injunctive relief as may be necessary to protect the interests of the Bank in such Confidential Information and as may be necessary to specifically enforce the Executive's obligations under this Agreement.

10. HEADINGS FOR REFERENCE ONLY

The headings of sections and paragraphs herein are included solely for convenience of reference and shall not control the meaning or interpretation of any of the provisions of this Agreement.

11. GOVERNING LAW

This Agreement shall be governed by the laws of the State of New York, but

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only to the extent not superseded by federal law.

12. ARBITRATION

Any dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration in accordance with the rules of the American Arbitration Association then in effect. Judgment may be entered on the arbitrator's award in any court having jurisdiction.

13. SUCCESSOR TO THE EMPLOYER

The Employer shall require any successor or assignee, whether direct or indirect, by purchase, merger, consolidation or otherwise, to all or substantially all the business or assets of the Bank or the Company, expressly and unconditionally to assume and agree to perform the Employer's obligations under this Agreement, in the same manner and to the same extent that the Employer would be required to perform if no such succession or assignment had taken place.

SIGNATURES

IN WITNESS WHEREOF, the Employer has caused this Agreement to be executed and its seal to be affixed hereunto by its duly authorized officer, and Executive has signed this Agreement, on the day and date first above written.

ATTEST: PATHFINDER BANK

Secretary

By: _____
Thomas W. Schneider
President and Chief Executive Officer

ATTEST: PATHFINDER BANCORP, INC.

Secretary

By: _____
Thomas W. Schneider
President and Chief Executive Officer

WITNESS: EXECUTIVE

By: _____

EXHIBIT 10.8

PATHFINDER BANCORP, INC.
PATHFINDER BANK
CHANGE IN CONTROL AGREEMENT

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This Agreement is made effective as of the 19th day of December, 2006, by and between Pathfinder Bank (the "Bank"), a New York chartered stock savings bank, with its principal administrative office at 214 West First Street, Oswego, New York 13126-2547, jointly with Pathfinder Bancorp, Inc, the sole stockholder of the Bank, and James A. Dowd (the "Executive"). Any reference to "Company" herein shall mean Pathfinder Bancorp, Inc. or any successor thereto. Any reference to "Employer" herein shall mean both the Bank and the Company or any successors thereto

WHEREAS, the Executive is employed by the Employer; and

WHEREAS, the Employer desires to provide Executive with certain benefits in the event of a Change in Control of the Employer, as hereinafter defined:

NOW, THEREFORE, in consideration of the mutual covenants herein contained, and upon the other terms and conditions hereinafter provided, the parties hereby agree as follows:

1. CHANGE IN CONTROL DEFINED

For purposes of this Agreement, a "Change in Control" of the Bank or Company shall mean a Change in Control of a nature that (i) would be required to be reported in response to Item 5.01 of the current report on Form 8-K, as in effect on the date hereof, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"); or (ii) results in a Change in Control of the Bank or the Company within the meaning of the Home Owners Loan Act, as amended, and applicable rules and regulations promulgated there under, as in effect at the time of the Change in Control (collectively, the "HOLA"); or (iii) without limitation such a Change in Control shall be deemed to have occurred at such time as (a) any "person" (as the term is used in Sections 13(d) and 14(d) of the Exchange Act) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 25% or more of the combined voting power of Company's outstanding securities except for any securities purchased by the Employer's employee stock ownership plan or trust; or (b) individuals who constitute the Company's Board of Directors on the date hereof (the "Incumbent Board") cease for any reason to constitute at least a majority thereof, provided that any person becoming a director subsequent to the date hereof whose election was approved by a vote of at least three-quarters of the directors comprising the Incumbent Board, or whose nomination for election by the Company's stockholders was approved by the same Nominating Committee serving under an Incumbent Board, shall be, for purposes of this clause (b), considered as though he were a member of the Incumbent Board; or (c) a plan of reorganization, merger, consolidation, sale of all or substantially all the assets of the Bank or the Company or similar transaction in which the Bank or Company is not the surviving institution occurs; or (d) a proxy statement soliciting proxies from stockholders of the Company, by someone other than the current management of the Company, seeking stockholder approval of a plan of reorganization, merger or consolidation of the Company or similar transaction with one or more corporations or financial institutions, and as a result such proxy solicitation a plan of reorganization, merger consolidation or similar transaction involving the Company is approved by the requisite vote of the Company's stockholders; or (e) a tender offer is made for 25% or more of the voting securities of the Company and the shareholders owning beneficially or of record 25% or more of the outstanding securities of the Company have tendered or offered to sell their shares pursuant to such tender offer and such tendered shares have been accepted by the tender offeror. Notwithstanding anything to the contrary herein, a "Change in Control" of the Bank or the Company shall not be deemed to have occurred in the event of a conversion of Pathfinder Bancorp, MHC to stock holding company form.

2. BENEFITS DUE EXECUTIVE IN THE EVENT OF CHANGE IN CONTROL

If any of the events described in Section 1 hereof constituting a Change in Control have occurred, Executive shall be entitled to the benefits provided in paragraphs (a), (b), (c), (d) and (e) of this Section 2 upon his dismissal from employment within twelve (12) months of the Change in Control ("Dismissal"). (Notwithstanding any other provision of this Agreement, a voluntary termination by the Executive shall not be deemed a "Dismissal")

(a) Upon the occurrence of a Change in Control followed by the Executive's Dismissal, the Employer shall pay Executive, or in the event of his subsequent death, his beneficiary or beneficiaries, or his estate, as the case may be, as severance pay or liquidated damages, or both, a sum equal to his most recent annual base salary, including bonuses and any other cash compensation paid to the Executive within the most recent twelve (12) month period. Such Payment shall be made by the Employer on the Date of Dismissal.

(b) Upon the occurrence of a Change in Control followed by the Executive's Dismissal of employment, the Employer will cause to be continued life, medical, dental and disability coverage substantially identical to the coverage maintained by the Employer for Executive prior to his Dismissal. Such coverage and payments shall cease upon the expiration of twelve (12) months.

(c) Upon the occurrence of a Change in Control, Executive shall become fully vested in and entitled to all benefits granted to him pursuant to any Stock Option Plan of the Bank or Company.

(d) Upon the occurrence of a Change in Control, Executive shall become fully vested in and entitled to all benefits granted to him pursuant to Supplemental Executive Retirement Plan of the Bank or Company, applicable to him, if any.

(e) Upon the occurrence of a Change in Control, the Executive shall become fully vested in and entitled to all benefits awarded to him under the Bank's or the Company's Recognition and Retention Plan or any restricted stock plan in effect.

(f) Notwithstanding the preceding paragraphs of this Section 2, in the event that:

(i) the aggregate payments or benefits to be made or afforded to Executive under said paragraphs (the "Termination Benefits") would be deemed to include an "excess parachute payment" under Section 280G of the Internal Revenue Code or any successor thereto, and

(ii) if such Termination Benefits were reduced to an amount (the "Non-Triggering Amount"), the value of which is one dollar (\$1.00) less than an amount equal to the total amount of payments permissible under Section 280G of the Internal Revenue Code or any successor thereto, then the Termination Benefits to be paid to Executive shall be so reduced so as to be a Non-Triggering Amount.

(g) Notwithstanding the foregoing, there will be no reduction in the Payment otherwise payable to Executive during any period during which Executive is incapable of performing his duties hereunder by reason of disability.

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3. TERMINATION FOR CAUSE

The term "Termination for Cause" shall mean termination because of the Executive's personal dishonesty, incompetence, willful misconduct, any breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of this Agreement. In determining incompetence, the acts or omissions shall be measured against standards generally prevailing in the financial services industry. For purposes of this paragraph, no act or failure to act on the part of Executive shall be considered "willful" unless done, or omitted to be done, by the Executive not in good faith and without reasonable belief that the Executive's action or omission was in the best interest of the Employer. Notwithstanding the foregoing, Executive shall not be deemed to have been Terminated for Cause unless and until there shall have been delivered to him a copy of a resolution duly adopted by the affirmative vote of not less than three-fourths of the members of the Boards of Directors of the Company and the Bank at a meeting of said Boards called and held for that purpose (after reasonable notice to Executive and an opportunity for him, together with counsel, to be heard before the Boards), finding that in the good faith opinion of the Boards, Executive was guilty of conduct justifying Termination for Cause and specifying the particulars thereof in detail. Notwithstanding any provision in paragraph 2, the Executive shall not have the right to receive Termination Benefits for any period after Termination for Cause.

4. NO ATTACHMENT

(a) Except as required by law, no right to receive payments under this Agreement shall be subject to anticipation, commutation, alienation, sale, assignment, encumbrance, charge, pledge, or hypothecation, or to execution, attachment, levy, or similar process or assignment by operation of law, and any attempt, voluntary or involuntary, to affect any such action shall be null, void, and of no effect.

(b) This Agreement shall be binding upon, and inure to the benefit of, Executive and the Employer and their respective successors and assigns.

5. MODIFICATION AND WAIVER

(a) This Agreement may not be modified or amended except by an instrument in writing signed by the parties hereto.

(b) No term or condition of this Agreement shall be deemed to have been waived, nor shall there be any estoppel against the enforcement of any provision of this Agreement, except by written instrument of the party charged with such waiver or estoppel. No such written waiver shall be deemed a continuing waiver unless specifically stated therein, and each such waiver shall operate only as to the specific term or condition waived and shall not constitute a waiver of such term or condition for the future as to any act other than that specifically waived.

6. SEVERABILITY

If, for any reason, any provision of this Agreement, or any part of any provision, is held invalid, such invalidity shall not affect any other provision of this Agreement or any part of such provision not held so invalid, and each such other provision and part thereof shall to the full extent consistent with law continue in full force and effect.

7. EMPLOYMENT AT WILL

Except for the limited benefits granted herein, nothing in this Agreement shall be construed to create an employment contract and the parties acknowledge that the Executive's employment remains "at will".

8. AGREEMENT TERM

The initial "Agreement Term" shall begin on the date this agreement is executed and shall continue through December 31, 2007. As of December 31, 2007, and as of each December 31st thereafter, the agreement term shall extend automatically for one year unless the Bank gives notice to the executive prior to the date of such extension that the agreement term will not be extended. Notwithstanding the foregoing, if a change in control occurs during the agreement term, the agreement term shall continue through and terminate on the first anniversary of the date on which the change in control occurs.

9. PROPRIETARY INFORMATION

The parties agree to the protection of the Bank's proprietary information as follows:

(a) Nondisclosure of Confidential Information

(i) Access. The Executive acknowledges that employment with the Bank necessarily involves exposure to, familiarity with, and opportunity to learn highly sensitive, confidential and proprietary information of the Bank and its subsidiaries, which may include information about products and services, markets, customers and prospective customers, vendors and suppliers, miscellaneous business relationships, investment products, pricing, billing and collection procedures, proprietary software and other intellectual property, financial and accounting data, personnel and compensation, data processing and communications, technical data, marketing strategies, research and development of new or improved products and services, and know-how regarding the business of the Bank and its products and services (collectively referred to herein as "Confidential Information")

(ii) Valuable Asset. The Executive further acknowledges that the Confidential Information is a valuable, special, and unique asset of the Bank, such that the unauthorized disclosure or use by persons or entities outside the Bank would cause irreparable damage to the business of the Bank. Accordingly, the Executive agrees that during and after the Executive's employment with the Bank, until the Confidential Information becomes publicly known, the Executive shall not directly or indirectly disclose to any person or entity, use for any purpose or permit the exploitation, copying or summarizing of, any Confidential Information of the Bank, except as specifically required in the proper performance of his duties for the Bank.

(iii) Duties. The Executive agrees to take all appropriate action, whether by instruction, agreement or otherwise, to endure the protection, confidentiality and security of the Confidential Information and to satisfy his obligations under this Agreement. Prior to lecturing or publishing articles which reference to Bank and its business, the Executive will provide to an officer of the Bank a copy of the material to be presented for the Bank to review and approve in order to ensure that no Confidential Information is disclosed.

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(iv) Confidential Relationship. The Bank considers its Confidential Information to constitute "trade secrets" which are protected from unauthorized disclosure under applicable law. However, whether or not the Confidential Information constitutes trade secrets, the Executive acknowledges and agrees that the Confidential Information is protected from unauthorized disclosure or use due to his covenants under this Section 9 and his fiduciary duties as an executive of the Bank.

(v) Return of Documents. The Executive acknowledges and agrees that the Confidential Information is and at all times shall remain the sole and exclusive property of the Bank. Upon the termination of his employment with the Bank or upon request by the Bank, the Executive will promptly return to the Bank in good condition all documents, data and records of any kind, whether in hardcopy or electronic form, which contain any Confidential Information, including any and all copies thereof, as well as all materials furnished to or acquired by the Executive during the course of the Executive's employment with the Bank.

(b) Enforcement. For purposes of this Section 9, the term "Bank" shall include the Bank and the Company and all of their subsidiaries. Each such entity shall be an intended third party beneficiary of this Agreement and shall have the right to enforce the provisions of this Agreement against the Executive individually or collectively with any one or more of the other subsidiaries.

(c) Equitable Relief. The Executive acknowledges and agreed that, by reason of the sensitive nature of the Confidential Information of the Bank referred to in this Agreement, in addition to recovery of damages and any other legal relief to which the Bank may be entitled in the event of the Executive's violation of this Agreement, the Bank shall also be entitled to equitable relief, including such injunctive relief as may be necessary to protect the interests of the Bank in such Confidential Information and as may be necessary to specifically enforce the Executive's obligations under this Agreement.

10. HEADINGS FOR REFERENCE ONLY

The headings of sections and paragraphs herein are included solely for convenience of reference and shall not control the meaning or interpretation of any of the provisions of this Agreement.

11. GOVERNING LAW

This Agreement shall be governed by the laws of the State of New York, but only to the extent not superseded by federal law.

12. ARBITRATION

Any dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration in accordance with the rules of the American Arbitration Association then in effect. Judgment may be entered on the arbitrator's award in any court having jurisdiction.

13. SUCCESSOR TO THE EMPLOYER

The Employer shall require any successor or assignee, whether direct or indirect, by purchase, merger, consolidation or otherwise, to all or substantially all the business or assets of the Bank or the Company, expressly

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and unconditionally to assume and agree to perform the Employer's obligations under this Agreement, in the same manner and to the same extent that the Employer would be required to perform if no such succession or assignment had taken place.

SIGNATURES

IN WITNESS WHEREOF, the Employer has caused this Agreement to be executed and its seal to be affixed hereunto by its duly authorized officer, and Executive has signed this Agreement, on the day and date first above written.

ATTEST: PATHFINDER BANK

Secretary By: Thomas W. Schneider President and Chief Executive Officer

ATTEST: PATHFINDER BANCORP, INC.

Secretary By: Thomas W. Schneider President and Chief Executive Officer

WITNESS: EXECUTIVE

By:

EXHIBIT 10.9

PATHFINDER BANCORP, INC.
PATHFINDER BANK
CHANGE IN CONTROL AGREEMENT

This Agreement is made effective as of the 19th day of December, 2006, by and between Pathfinder Bank (the "Bank"), a New York chartered stock savings bank, with its principal administrative office at 214 West First Street, Oswego, New York 13126-2547, jointly with Pathfinder Bancorp, Inc, the sole stockholder of the Bank, and Melissa A. Miller (the "Executive"). Any reference to "Company" herein shall mean Pathfinder Bancorp, Inc. or any successor thereto. Any reference to "Employer" herein shall mean both the Bank and the Company or any successors thereto

WHEREAS, the Executive is employed by the Employer; and

WHEREAS, the Employer desires to provide Executive with certain benefits in the event of a Change in Control of the Employer, as hereinafter defined:

NOW, THEREFORE, in consideration of the mutual covenants herein contained, and upon the other terms and conditions hereinafter provided, the parties hereby agree as follows:

- 1. CHANGE IN CONTROL DEFINED

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For purposes of this Agreement, a "Change in Control" of the Bank or Company shall mean a Change in Control of a nature that (i) would be required to be reported in response to Item 5.01 of the current report on Form 8-K, as in effect on the date hereof, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"); or (ii) results in a Change in Control of the Bank or the Company within the meaning of the Home Owners Loan Act, as amended, and applicable rules and regulations promulgated thereunder, as in effect at the time of the Change in Control (collectively, the "HOLA"); or (iii) without limitation such a Change in Control shall be deemed to have occurred at such time as (a) any "person" (as the term is used in Sections 13(d) and 14(d) of the Exchange Act) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 25% or more of the combined voting power of Company's outstanding securities except for any securities purchased by the Employer's employee stock ownership plan or trust; or (b) individuals who constitute the Company's Board of Directors on the date hereof (the "Incumbent Board") cease for any reason to constitute at least a majority thereof, provided that any person becoming a director subsequent to the date hereof whose election was approved by a vote of at least three-quarters of the directors comprising the Incumbent Board, or whose nomination for election by the Company's stockholders was approved by the same Nominating Committee serving under an Incumbent Board, shall be, for purposes of this clause (b), considered as though he were a member of the Incumbent Board; or (c) a plan of reorganization, merger, consolidation, sale of all or substantially all the assets of the Bank or the Company or similar transaction in which the Bank or Company is not the surviving institution occurs; or (d) a proxy statement soliciting proxies from stockholders of the Company, by someone other than the current management of the Company, seeking stockholder approval of a plan of reorganization, merger or consolidation of the Company or similar transaction with one or more corporations or financial institutions, and as a result such proxy solicitation a plan of reorganization, merger consolidation or similar transaction involving the Company is approved by the requisite vote of the Company's stockholders; or (e) a tender offer is made for 25% or more of the voting securities of the Company and the shareholders owning beneficially or of record 25% or more of the outstanding securities of the Company have tendered or offered to sell their shares pursuant to such tender offer and such tendered shares have been accepted by the tender offeror. Notwithstanding anything to the contrary herein, a "Change in Control" of the Bank or the Company shall not be deemed to have occurred in the event of a conversion of Pathfinder Bancorp, MHC to stock holding company form.

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2. BENEFITS DUE EXECUTIVE IN THE EVENT OF CHANGE IN CONTROL

If any of the events described in Section 1 hereof constituting a Change in Control have occurred, Executive shall be entitled to the benefits provided in paragraphs (a), (b), (c), (d) and (e) of this Section 2 upon his dismissal from employment within twelve (12) months of the Change in Control ("Dismissal"). (Notwithstanding any other provision of this Agreement, a voluntary termination by the Executive shall not be deemed a "Dismissal")

(a) Upon the occurrence of a Change in Control followed by the Executive's Dismissal, the Employer shall pay Executive, or in the event of his subsequent death, his beneficiary or beneficiaries, or his estate, as the case may be, as severance pay or liquidated damages, or both, a sum equal to his most recent annual base salary, including bonuses and any other cash compensation paid to the Executive within the most recent twelve (12) month period. Such Payment shall be made by the Employer on the Date of Dismissal.

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(b) Upon the occurrence of a Change in Control followed by the Executive's Dismissal of employment, the Employer will cause to be continued life, medical, dental and disability coverage substantially identical to the coverage maintained by the Employer for Executive prior to his Dismissal. Such coverage and payments shall cease upon the expiration of twelve (12) months.

(c) Upon the occurrence of a Change in Control, Executive shall become fully vested in and entitled to all benefits granted to him pursuant to any Stock Option Plan of the Bank or Company.

(d) Upon the occurrence of a Change in Control, Executive shall become fully vested in and entitled to all benefits granted to him pursuant to Supplemental Executive Retirement Plan of the Bank or Company, applicable to him, if any.

(e) Upon the occurrence of a Change in Control, the Executive shall become fully vested in and entitled to all benefits awarded to him under the Bank's or the Company's Recognition and Retention Plan or any restricted stock plan in effect.

(f) Notwithstanding the preceding paragraphs of this Section 2, in the event that:

(i) the aggregate payments or benefits to be made or afforded to Executive under said paragraphs (the "Termination Benefits") would be deemed to include an "excess parachute payment" under Section 280G of the Internal Revenue Code or any successor thereto, and

(ii) if such Termination Benefits were reduced to an amount (the "Non-Triggering Amount"), the value of which is one dollar (\$1.00) less than an amount equal to the total amount of payments permissible under Section 280G of the Internal Revenue Code or any successor thereto, then the Termination Benefits to be paid to Executive shall be so reduced so as to be a Non-Triggering Amount.

(g) Notwithstanding the foregoing, there will be no reduction in the Payment otherwise payable to Executive during any period during which Executive is incapable of performing his duties hereunder by reason of disability.

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3. TERMINATION FOR CAUSE

The term "Termination for Cause" shall mean termination because of the Executive's personal dishonesty, incompetence, willful misconduct, any breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of this Agreement. In determining incompetence, the acts or omissions shall be measured against standards generally prevailing in the financial services industry. For purposes of this paragraph, no act or failure to act on the part of Executive shall be considered "willful" unless done, or omitted to be done, by the Executive not in good faith and without reasonable belief that the Executive's action or omission was in the best interest of the Employer. Notwithstanding the foregoing, Executive shall not be deemed to have been Terminated for Cause unless and until there shall have been delivered to him a copy of a resolution duly adopted by the affirmative vote of not less than three-fourths of the members of the Boards of Directors of the Company and the Bank at a meeting of said Boards called and held for that

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purpose (after reasonable notice to Executive and an opportunity for him, together with counsel, to be heard before the Boards), finding that in the good faith opinion of the Boards, Executive was guilty of conduct justifying Termination for Cause and specifying the particulars thereof in detail. Notwithstanding any provision in paragraph 2, the Executive shall not have the right to receive Termination Benefits for any period after Termination for Cause.

4. NO ATTACHMENT

(a) Except as required by law, no right to receive payments under this Agreement shall be subject to anticipation, commutation, alienation, sale, assignment, encumbrance, charge, pledge, or hypothecation, or to execution, attachment, levy, or similar process or assignment by operation of law, and any attempt, voluntary or involuntary, to affect any such action shall be null, void, and of no effect.

(b) This Agreement shall be binding upon, and inure to the benefit of, Executive and the Employer and their respective successors and assigns.

5. MODIFICATION AND WAIVER

(a) This Agreement may not be modified or amended except by an instrument in writing signed by the parties hereto.

(b) No term or condition of this Agreement shall be deemed to have been waived, nor shall there be any estoppel against the enforcement of any provision of this Agreement, except by written instrument of the party charged with such waiver or estoppel. No such written waiver shall be deemed a continuing waiver unless specifically stated therein, and each such waiver shall operate only as to the specific term or condition waived and shall not constitute a waiver of such term or condition for the future as to any act other than that specifically waived.

6. SEVERABILITY

If, for any reason, any provision of this Agreement, or any part of any provision, is held invalid, such invalidity shall not affect any other provision of this Agreement or any part of such provision not held so invalid, and each such other provision and part thereof shall to the full extent consistent with law continue in full force and effect.

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7. EMPLOYMENT AT WILL

Except for the limited benefits granted herein, nothing in this Agreement shall be construed to create an employment contract and the parties acknowledge that the Executive's employment remains "at will".

8. AGREEMENT TERM

The initial "Agreement Term" shall begin on the date this agreement is executed and shall continue through December 31, 2007. As of December 31, 2007, and as of each December 31st thereafter, the agreement term shall extend automatically for one year unless the Bank gives notice to the executive prior to the date of such extension that the agreement term will not be extended. Notwithstanding the foregoing, if a change in control occurs during the agreement term, the agreement term shall continue through and terminate on the first anniversary of the date on which the change in control occurs.

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9. PROPRIETARY INFORMATION

The parties agree to the protection of the Bank's proprietary information as follows:

(a) Nondisclosure of Confidential Information

(i) Access. The Executive acknowledges that employment with the Bank necessarily involves exposure to, familiarity with, and opportunity to learn highly sensitive, confidential and proprietary information of the Bank and its subsidiaries, which may include information about products and services, markets, customers and prospective customers, vendors and suppliers, miscellaneous business relationships, investment products, pricing, billing and collection procedures, proprietary software and other intellectual property, financial and accounting data, personnel and compensation, data processing and communications, technical data, marketing strategies, research and development of new or improved products and services, and know-how regarding the business of the Bank and its products and services (collectively referred to herein as "Confidential Information")

(ii) Valuable Asset. The Executive further acknowledges that the Confidential Information is a valuable, special, and unique asset of the Bank, such that the unauthorized disclosure or use by persons or entities outside the Bank would cause irreparable damage to the business of the Bank. Accordingly, the Executive agrees that during and after the Executive's employment with the Bank, until the Confidential Information becomes publicly known, the Executive shall not directly or indirectly disclose to any person or entity, use for any purpose or permit the exploitation, copying or summarizing of, any Confidential Information of the Bank, except as specifically required in the proper performance of his duties for the Bank.

(iii) Duties. The Executive agrees to take all appropriate action, whether by instruction, agreement or otherwise, to endure the protection, confidentiality and security of the Confidential Information and to satisfy his obligations under this Agreement. Prior to lecturing or publishing articles which reference to Bank and its business, the Executive will provide to an officer of the Bank a copy of the material to be presented for the Bank to review and approve in order to ensure that no Confidential Information is disclosed.

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(iv) Confidential Relationship. The Bank considers its Confidential Information to constitute "trade secrets" which are protected from unauthorized disclosure under applicable law. However, whether or not the Confidential Information constitutes trade secrets, the Executive acknowledges and agrees that the Confidential Information is protected from unauthorized disclosure or use due to his covenants under this Section 9 and his fiduciary duties as an executive of the Bank.

(v) Return of Documents. The Executive acknowledges and agrees that the Confidential Information is and at all times shall remain the sole and exclusive property of the Bank. Upon the termination of his employment with the Bank or upon request by the Bank, the Executive will promptly return to the Bank in good condition all documents, data and records of any kind, whether in hardcopy or electronic form, which contain any Confidential Information, including any and all copies thereof, as well as all materials furnished to or acquired by the Executive during the course of the Executive's employment with the Bank.

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(b) Enforcement. For purposes of this Section 9, the term "Bank" shall include the Bank and the Company and all of their subsidiaries. Each such entity shall be an intended third party beneficiary of this Agreement and shall have the right to enforce the provisions of this Agreement against the Executive individually or collectively with any one or more of the other subsidiaries.

(c) Equitable Relief. The Executive acknowledges and agreed that, by reason of the sensitive nature of the Confidential Information of the Bank referred to in this Agreement, in addition to recovery of damages and any other legal relief to which the Bank may be entitled in the event of the Executive's violation of this Agreement, the Bank shall also be entitled to equitable relief, including such injunctive relief as may be necessary to protect the interests of the Bank in such Confidential Information and as may be necessary to specifically enforce the Executive's obligations under this Agreement.

10. HEADINGS FOR REFERENCE ONLY

The headings of sections and paragraphs herein are included solely for convenience of reference and shall not control the meaning or interpretation of any of the provisions of this Agreement.

11. GOVERNING LAW

This Agreement shall be governed by the laws of the State of New York, but only to the extent not superseded by federal law.

12. ARBITRATION

Any dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration in accordance with the rules of the American Arbitration Association then in effect. Judgment may be entered on the arbitrator's award in any court having jurisdiction.

13. SUCCESSOR TO THE EMPLOYER

The Employer shall require any successor or assignee, whether direct or indirect, by purchase, merger, consolidation or otherwise, to all or substantially all the business or assets of the Bank or the Company, expressly and unconditionally to assume and agree to perform the Employer's obligations under this Agreement, in the same manner and to the same extent that the Employer would be required to perform if no such succession or assignment had taken place.

SIGNATURES

IN WITNESS WHEREOF, the Employer has caused this Agreement to be executed and its seal to be affixed hereunto by its duly authorized officer, and Executive has signed this Agreement, on the day and date first above written.

ATTEST: PATHFINDER BANK

By: _____

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Secretary Thomas W. Schneider
President and Chief Executive Officer

ATTEST: PATHFINDER BANCORP, INC.

Secretary By: _____
Thomas W. Schneider
President and Chief Executive Officer

WITNESS: EXECUTIVE

By: _____

EXHIBIT 21: SUBSIDIARIES OF THE COMPANY

Company	Percent Owned
Pathfinder Bank (1)	100%
Pathfinder Statutory Trust	100%

(1) Pathfinder Commercial Bank, Pathfinder REIT, Inc. and Whispering Oaks Development Corp. 100% owned by Pathfinder Bank

EXHIBIT 23: CONSENT OF BEARD MILLER COMPANY LLP

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Pathfinder Bancorp, Inc.
Oswego, New York

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-53027) of Pathfinder Bancorp, Inc. of our report dated March 27, 2007, relating to the consolidated financial statements which appears in this Annual Report on Form 10-K.

/s/ BEARD MILLER COMPANY LLP

Beard Miller Company LLP
Harrisburg, Pennsylvania
March 27, 2007

EXHIBIT 31.1: RULE 13A-14(A) / 15D-14(A) CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER

Certification of Chief Executive Officer

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Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Thomas W. Schneider, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Pathfinder Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 30, 2007

/s/ Thomas W. Schneider
Thomas W. Schneider
President and Chief Executive Officer

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EXHIBIT 31.2: RULE 13A-14(A) / 15D-14(A) CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

Certification of Chief Financial Officer

Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, James A. Dowd, Senior Vice President and Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Pathfinder Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 30, 2007

/s/ James A. Dowd
James A. Dowd

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Pursuant to the requirements of the Securities Exchange of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Janette Resnick,
Janette Resnick,
Chairman of the Board
Date: March 30, 2007

By: /s/ Thomas W. Schneider
Thomas W. Schneider, President
and Chief Executive Officer
Date: March 30, 2007

By: /s/ Chris R. Burritt
Chris R. Burritt, Director
Date: March 30, 2007

By: /s/ James A. Dowd
James A. Dowd, Vice President,
Chief Financial Officer and Trust Officer
Date: March 30, 2007

By: /s/ George P. Joyce
George P. Joyce, Director
Date: March 30, 2007

By: /s/ Bruce E. Manwaring
Bruce E. Manwaring, Director
Date: March 30, 2007

By: /s/ Corte J. Spencer
Corte J. Spencer, Director
Date: March 30, 2007

By: /s/ L. William Nelson, Jr.
L. William Nelson, Jr. Director
Date: March 30, 2007

By: /s/ Lloyd Stemple
Lloyd Stemple, Director
Date: March 30, 2007

By: /s/ Steven W. Thomas
Steven W. Thomas, Director
Date: March 30, 2007