

# RCKB 10-Q 9/30/2013

## Section 1: 10-Q (FORM 10-Q)

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

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**FORM 10-Q**

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- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2013.

Commission File Number: 001-35028

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**ROCKVILLE FINANCIAL, INC.**

(Exact name of registrant as specified in its charter)

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**Connecticut**  
(State or other jurisdiction of  
incorporation or organization)

**27-3577029**  
(I.R.S. Employer  
Identification No.)

**25 Park Street,  
Rockville, Connecticut**  
(Address of principal executive offices)

**06066**  
(Zip Code)

**(860) 291-3600**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

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

As of October 31, 2013, there were 25,966,978 shares of Registrant's no par value common stock outstanding.



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Part 1—FINANCIAL INFORMATION  
Item 1—Interim Financial Statements

### Rockville Financial, Inc. and Subsidiaries Consolidated Statements of Condition

<u>(In thousands, except share data) (Unaudited)</u>	<u>September 30,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 22,729	\$ 19,966
Short-term investments	31,742	15,349
Total cash and cash equivalents	54,471	35,315
Available for sale securities—At fair value (note 5)	370,127	241,389
Held to maturity securities—At amortized cost (note 5)	14,141	6,084
Loans held for sale	2,904	5,292
Loans receivable (Net of allowance for loan losses of \$18,703 at September 30, 2013 and \$18,477 at December 31, 2012) (note 7)	1,637,325	1,586,985
Federal Home Loan Bank of Boston stock	15,053	15,867
Accrued interest receivable	5,879	4,862
Deferred tax asset, net	14,056	10,720
Premises and equipment, net	22,848	20,078
Goodwill	1,070	1,070
Cash surrender value of bank-owned life insurance	63,949	58,370
Other real estate owned	2,129	2,846
Prepaid FDIC assessments	—	2,089
Federal income tax receivable	306	—
Other assets	14,822	7,832
	<u>\$ 2,219,080</u>	<u>\$ 1,998,799</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Deposits:		
Non-interest-bearing	\$ 259,773	\$ 238,924
Interest-bearing	1,432,299	1,265,756
Total deposits	1,692,072	1,504,680
Mortgagors' and investors' escrow accounts	3,635	6,776
Federal Home Loan Bank advances and other borrowings (note 8)	196,246	143,106
Accrued expenses and other liabilities	31,954	23,626
Total liabilities	1,923,907	1,678,188
Commitments and contingencies (note 15)		
Stockholders' equity:		
Preferred stock (no par value; 2,000,000 authorized; no shares issued)	—	—
Common stock (no par value; authorized 60,000,000 shares; 29,457,104 and 29,487,363 shares issued and 26,057,978 and 28,156,897 outstanding at September 30, 2013 and December 31, 2012, respectively)	243,776	243,776
Additional paid-in capital	14,717	13,418
Unearned compensation—ESOP	(7,442)	(8,306)
Retained earnings	96,573	91,811
Accumulated other comprehensive loss, net of tax (note 12)	(9,250)	(4,047)
Treasury stock, at cost (3,399,126 and 1,330,466 shares at September 30, 2013 and December 31, 2012, respectively)	(43,201)	(16,041)
Total stockholders' equity	295,173	320,611
	<u>\$ 2,219,080</u>	<u>\$ 1,998,799</u>

See accompanying notes to unaudited consolidated financial statements.

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**Rockville Financial, Inc. and Subsidiaries**  
**Consolidated Statements of Net Income**

(In thousands, except share data) (Unaudited)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
<b>Interest and dividend income:</b>				
Loans	\$ 16,898	\$ 17,883	\$ 50,854	\$ 53,377
Securities—taxable interest	1,828	1,082	4,692	3,415
Securities—non-taxable interest	685	651	1,985	1,327
Securities—dividends	71	42	178	127
Interest-bearing deposits	18	13	60	50
Total interest and dividend income	19,500	19,671	57,769	58,296
<b>Interest expense:</b>				
Deposits	2,000	2,149	5,862	6,646
Borrowed funds	627	558	1,826	1,669
Total interest expense	2,627	2,707	7,688	8,315
Net-interest income	16,873	16,964	50,081	49,981
<b>Provision for loan losses</b>				
	532	793	1,326	2,678
Net interest income after provision for loan losses	16,341	16,171	48,755	47,303
<b>Non-interest income:</b>				
Service charges and fees	2,571	1,578	6,125	4,798
Net gain from sales of securities	29	214	585	335
Net gain from sales of loans	1,736	2,514	4,797	3,083
Bank-owned life insurance	544	527	1,578	1,357
Other income (loss)	220	(219)	1,007	(30)
Total non-interest income	5,100	4,614	14,092	9,543
<b>Non-interest expense:</b>				
Salaries and employee benefits (notes 9 and 10)	8,962	8,314	26,748	23,905
Service bureau fees	888	946	2,624	3,234
Occupancy and equipment	1,514	1,254	5,160	3,355
Professional fees	608	1,049	1,948	2,595
Marketing and promotions	266	70	434	287
FDIC insurance assessments	247	268	871	774
Other real estate owned	173	110	633	444
Other	2,105	2,499	6,873	6,074
Total non-interest expense	14,763	14,510	45,291	40,668
Income before income taxes	6,678	6,275	17,556	16,178
Provision for income taxes (note 11)	2,058	1,607	5,086	4,706
Net income	\$ 4,620	\$ 4,668	\$ 12,470	\$ 11,472
<b>Net income per share (note 14):</b>				
Basic	\$ 0.18	\$ 0.17	\$ 0.47	\$ 0.41
Diluted	\$ 0.18	\$ 0.17	\$ 0.47	\$ 0.41
<b>Weighted-average shares outstanding:</b>				
Basic	25,491,638	27,659,996	26,339,942	27,892,886
Diluted	25,832,623	27,847,021	26,680,762	28,067,129

*See accompanying notes to unaudited consolidated financial statements.*

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**Rockville Financial, Inc. and Subsidiaries**  
**Consolidated Statements of Comprehensive Income**

(In thousands) (Unaudited)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
<b>Net income</b>	\$ 4,620	\$ 4,668	\$ 12,470	\$ 11,472
<b>Other comprehensive income (loss):</b>				
Unrealized (losses) gains on securities:				
Unrealized holding (losses) gains on available for sale securities	(1,525)	2,800	(13,924)	3,294
Reclassification adjustment for gains realized in net income <sup>(1)</sup>	(29)	(214)	(585)	(335)
Net unrealized (losses) gains	(1,554)	2,586	(14,509)	2,959
Tax effect—benefit (expense)	544	(906)	5,077	(1,035)
Net-of-tax amount—(losses) gains on securities	(1,010)	1,680	(9,432)	1,924
Unrealized (losses) gains on interest rate swaps designated as cash flow hedges accruing during period	(102)	(350)	5,740	(383)
Tax effect—benefit (expense)	36	134	(2,009)	134
Net-of-tax amount—interest rate swaps	(66)	(216)	3,731	(249)
Defined benefit pension plans:				
Reclassification adjustment for losses recognized in net periodic benefit cost <sup>(2)</sup>	196	309	588	927
Prior service cost recognized during the period	—	(12)	—	(36)
Change in gains or losses and prior service costs or credits	196	297	588	891
Tax effect—expense	(68)	(104)	(206)	(312)
Net-of-tax amount—pension plans	128	193	382	579
Post-retirement plans:				
Reclassification adjustment for prior service costs recognized in net periodic benefit cost <sup>(3)</sup>	5	7	18	21
Reclassification adjustment for losses recognized in net periodic benefit cost <sup>(4)</sup>	17	20	54	61
Prior service cost arising during the period	—	—	106	—
Change in gains or losses and prior service costs or credits	22	27	178	82
Tax effect—expense	(8)	(9)	(62)	(29)
Net-of-tax amount—post-retirement plans	14	18	116	53
Net-of-tax amount—pension and post-retirement plans	142	211	498	632
Total other comprehensive (loss) income	(934)	1,675	(5,203)	2,307
<b>Comprehensive income</b>	<b>\$ 3,686</b>	<b>\$ 6,343</b>	<b>\$ 7,267</b>	<b>\$ 13,779</b>

- (1) Amounts are included in net gains on sales of securities in the unaudited Consolidated Statements of Net Income in total non-interest income. Income tax benefit associated with the reclassification adjustment for the three months ended September 30, 2013 and 2012 was \$10 and \$204, and \$75 and \$117 for the nine months ended September 30, 2013 and 2012, respectively.
- (2) Amounts are included in salaries and employee benefits in the unaudited Consolidated Statements of Net Income in total non-interest expense. Income tax expense associated with the reclassification adjustment for the three months ended September 30, 2013 and 2012 was \$68 and \$104, and \$206 and \$312 for the nine months ended September 30, 2013 and 2012, respectively.
- (3) Amounts are included in salaries and employee benefits in the unaudited Consolidated Statements of Net Income in total non-interest expense. Income tax expense associated with the reclassification adjustment for the three and nine months ended September 30, 2013 was \$2 and \$6, respectively. Income tax expense associated with the reclassification adjustment for the three and nine months ended September 30, 2012 was \$2 and \$7, respectively.
- (4) Amounts are included in salaries and employee benefits in the unaudited Consolidated Statements of Net Income in total non-interest expense. Income tax expense associated with the reclassification adjustment for the three and nine months ended September 30, 2013 was negligible and \$2, respectively. Income tax expense associated with the reclassification adjustment for the three and nine months ended September 30, 2012 was negligible and \$1, respectively.

See accompanying notes to unaudited consolidated financial statements.



income	—	—	—	—	11,472	2,307	—	—	13,779
Share-based compensation expense	—	—	2,232	—	—	—	—	—	2,232
ESOP shares released or committed to be released	—	—	250	861	—	—	—	—	1,111
Cancellation of shares for tax withholding	(6,097)	—	(484)	—	(15)	—	(20,036)	235	(264)
Reissuance of treasury shares in connection with restricted stock grants	—	—	(4,434)	—	(300)	—	(403,496)	4,734	—
Reissuance of treasury shares in connection with stock options exercised	—	—	(134)	—	—	—	(30,036)	352	218
Treasury stock purchased	—	—	—	—	—	—	1,356,379	(15,751)	(15,751)
Dividends paid (\$0.26 per common share)	—	—	—	—	(7,507)	—	—	—	(7,507)
<b>Balance at September 30, 2012</b>	<u>29,508,371</u>	<u>\$ 243,776</u>	<u>\$ 12,619</u>	<u>\$ (8,592)</u>	<u>\$ 94,357</u>	<u>\$ (4,441)</u>	<u>902,811</u>	<u>\$(10,430)</u>	<u>\$ 327,289</u>

See accompanying notes to unaudited consolidated financial statements.



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**Consolidated Statements of Cash Flows**

(In thousands) (Unaudited)	For the Nine Months Ended September 30,	
	2013	2012
<b>Cash flows from operating activities:</b>		
Net income	\$ 12,470	\$ 11,472
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Amortization of premiums and discounts on investments, net	395	329
Share-based compensation expense	2,129	2,232
ESOP expense	1,262	1,111
Tax benefit from stock-based awards	60	—
Provision for loan losses	1,326	2,678
Net gain from sales of securities	(585)	(335)
Loans originated for sale	(169,307)	(81,551)
Proceeds from sales of loans held for sale	138,407	78,848
Net gain from sales of loans	(4,797)	(3,083)
Loss on sales of other real estate owned	81	64
Loss on disposal of equipment	55	2
Write-downs of other real estate owned	171	183
Depreciation and amortization	1,871	986
Deferred income tax benefit	(535)	(718)
Increase in cash surrender value of bank-owned life insurance	(1,578)	(1,357)
Net change in:		
Deferred loan fees and premiums	(1,546)	91
Accrued interest receivable	(1,017)	(1,432)
Prepaid FDIC assessment	2,089	700
Federal income tax receivable	(306)	1,532
Other assets	(6,444)	(3,821)
Accrued expenses and other liabilities	12,229	5,228
Net cash (used in) provided by operating activities	(13,570)	13,159
<b>Cash flows from investing activities:</b>		
Proceeds from sales of available for sale securities	44,880	21,207
Proceeds from calls and maturities of available for sale securities	—	7,400
Principal payments on available for sale mortgage-backed securities	21,183	24,454
Principal payments on held to maturity securities	2,062	2,605
Purchases of available for sale securities	(209,191)	(144,844)
Purchases of held to maturity securities	(10,093)	—
Redemption of FHLBB stock	814	1,140
Proceeds from sale of other real estate owned	3,290	1,637
Proceeds from portfolio loan sales	63,743	—
Purchases of loans	(9,788)	(1,108)
Net loan originations	(66,413)	(76,374)
Purchase of bank-owned life insurance	(4,000)	(25,000)
Purchases of premises and equipment	(4,696)	(4,454)
Proceeds from sale of other assets	—	3
Net cash used in investing activities	(168,209)	(193,334)
<b>Cash flows from financing activities:</b>		
Net increase in non-interest-bearing deposits	20,849	17,109
Net increase in interest-bearing deposits	166,543	133,255
Net decrease in mortgagors' and investors' escrow accounts	(3,141)	(2,488)
Net increase in short-term FHLBB advances	304,000	60,000
Repayments of long-term FHLBB advances	(274,052)	(7,017)
Net increase in repurchase agreements	23,192	—
Proceeds from exercise of stock options and stock purchase plan	721	218
Common stock repurchased	(28,563)	(15,751)
Cancellation of shares for tax withholding	(410)	(264)
Cancellation of treasury shares	(9)	—
Deposits forfeited on other real estate owned property	6	—
Cash dividend paid on common stock	(8,201)	(7,507)
Net cash provided by financing activities	200,935	177,555
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>19,156</b>	<b>(2,620)</b>

Cash and cash equivalents, beginning of period	<u>35,315</u>	<u>40,985</u>
Cash and cash equivalents, end of period	<u>\$ 54,471</u>	<u>\$ 38,365</u>

*See accompanying notes to unaudited consolidated financial statements.*

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**Rockville Financial, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows—Concluded**

(In thousands) (Unaudited)	For the Nine Months Ended September 30,	
	2013	2012
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the year for:		
Interest	\$ 7,595	\$ 8,183
Income taxes, net	6,717	4,131
Transfer of loans to other real estate owned	2,831	1,494
Due on common stock repurchases	196	—

*See accompanying notes to unaudited consolidated financial statements.*

**Rockville Financial, Inc. and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**

**Note 1. Summary of Significant Accounting Policies**

**Nature of Operations.** Rockville Financial, Inc. (the “Company”) is a bank holding company under the Bank Holding Company Act of 1956, as amended, headquartered in Rockville, Connecticut and incorporated under the laws of Connecticut in 2004. At September 30, 2013, the Company’s principal asset was all of the outstanding capital stock of Rockville Bank (the “Bank”), a wholly-owned subsidiary of the Company.

The Company, through Rockville Bank and various subsidiaries, delivers financial services to individuals, families and businesses primarily throughout Connecticut and the region through 22 banking offices, two loan production offices, 38 ATMs, telephone banking, mobile banking and its internet website (www.rockvillebank.com).

**Basis of Presentation.** The consolidated interim financial statements and the accompanying notes presented in this report include the accounts of Rockville Financial, Inc. and its wholly-owned subsidiary Rockville Bank, and the Bank’s wholly-owned subsidiaries, SBR Mortgage Company, SBR Investment Corp., Inc., Rockville Bank Commercial Properties, Inc., Rockville Bank Residential Properties, Inc., Rockville Financial Services, Inc. and Rockville Bank Investment Sub, Inc.

The consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to SEC Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included in the interim unaudited consolidated financial statements. The results of operations for the three months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013 or any future period. These interim unaudited consolidated financial statements should be read in conjunction with the Company’s 2012 consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

**Reclassifications.** Certain reclassifications have been made in prior periods’ consolidated financial statements to conform to the 2013 presentation. These reclassifications had no impact on the Company’s consolidated financial position, results of operations or net change in cash equivalents. All significant intercompany transactions have been eliminated.

**Use of Estimates.** The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of income and expenses during the reporting periods. Actual results in the future could vary from the amounts derived from management’s estimates and assumptions. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, pension and other post-retirement benefits, share-based compensation expense, valuation of deferred tax assets, the evaluation of securities for other-than-temporary impairment and derivatives.

**Note 2. Mutual Holding Company Reorganization and Minority Stock Issuance**

On March 3, 2011, the Company completed the “second-step” conversion of the Bank from a mutual holding company structure to a stock holding company structure (the “Conversion”) pursuant to a Plan of Conversion and Reorganization (the “Plan”). As part of the Conversion, New Rockville Financial, Inc. succeeded Rockville Financial, Inc. as the stock holding company of Rockville Bank, and Rockville Financial MHC, Inc. was dissolved. Upon completion of the Conversion, the Company became the holding company for the Bank and acquired ownership of all the issued and outstanding shares of the Bank’s common stock. In connection with the Conversion, 17,109,886 shares of common stock of the Company (the “Common Stock”) were sold in a subscription offering to certain depositors of the Bank and its employee stock ownership plan for \$10.00 per share, or \$171,099,000 in the aggregate (the “Offering”) net of offering costs of \$3,055,000. In accordance with the Plan, 1.5167 shares of Common Stock (without taking into consideration cash issued in lieu of fractional shares) were issued in exchange for each outstanding share of common stock of the Company’s predecessor, also named Rockville Financial, Inc. (“Old RFI”), the former state-chartered mid-tier holding company for the Bank, held by persons other than Rockville Financial MHC, Inc., the mutual holding company that owned the majority of Old RFI’s common stock. New Rockville Financial, Inc. changed its name to Rockville Financial, Inc. effective March 3, 2011.

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In connection with the 2011 Plan, the Company contributed additional funds to Rockville Bank Foundation, Inc., a non-profit charitable organization dedicated to helping the communities that the Bank serves. The Foundation received \$5.0 million, or 3.0%, of the net proceeds of the stock conversion offering.

The conversion was accounted for as a reorganization with no change to the historical basis of Rockville Financial, Inc.'s assets, liabilities, and equity. All number of shares outstanding and per share amounts are restated to give retroactive recognition to the exchange ratio (1.5167) applied in the conversion, where necessary.

### **Note 3. Recent Accounting Pronouncements**

**Derivatives and Hedging.** In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-10, *Inclusion of Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes* which provides guidance on the risks that are permitted to be hedged in a fair value or cash flow hedge. The Update permits the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR. The Update also removes the restriction on using different benchmark rates for similar hedges. The Update was effective prospectively for qualifying new or redesigned hedging relationships entered into on or after July 17, 2013. Adoption did not have a material impact on the Company's consolidated financial statements.

**Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.** In February 2013, FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. The amendments are effective prospectively for reporting periods beginning after December 15, 2012. Adoption did not have a material impact on the Company's consolidated financial statements.

**Technical Corrections and Improvements.** On October 1, 2012, the FASB released ASU No. 2012-04, *Technical Corrections and Improvements*, which clarifies the Codification or corrects unintended application of guidance and includes amendments identifying when the use of fair value should be linked to the definition of fair value in Topic 820, *Fair Value Measurement*. Amendments to the Codification without transition guidance are effective upon issuance; amendments subject to transitions guidance will be effective for the fiscal periods beginning after December 15, 2012. Adoption did not have a material impact on the Company's consolidated financial statements.

### **Note 4. Fair Value Measurements**

Fair value estimates are made as of a specific point in time based on the characteristics of the assets and liabilities and relevant market information. In accordance with FASB ASC 820, the fair value estimates are measured within the fair value hierarchy. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

- Level 1: Quoted prices are available in active markets for identical assets and liabilities as of the reporting date. The quoted price is not adjusted because of the size of the position relative to trading volume.
- Level 2: Pricing inputs are observable for assets and liabilities, either directly or indirectly but are not the same as those used in Level 1. Fair value is determined through the use of models or other valuation methodologies.
- Level 3: Pricing inputs are unobservable for assets and liabilities and include situations where there is little, if any, market activity and the determination of fair value requires significant judgment or estimation.

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The inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such instances, the determination of which category within the fair value hierarchy is appropriate for any given asset and liability is based on the lowest level of input that is significant to the fair value of the asset and liability.

When available, quoted market prices are used. In other cases, fair values are based on estimates using present value or other valuation techniques. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates and could be material. Derived fair value estimates may not be substantiated by comparison to independent markets and, in certain cases, could not be realized in an immediate sale of the instrument.

Fair value estimates for financial instrument fair value disclosures are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not financial instruments. Accordingly, the aggregate fair value amounts presented do not purport to represent the underlying market value of the Company.

**Assets and Liabilities Measured at Fair Value on a Recurring Basis:** The following tables detail the assets and liabilities carried at fair value on a recurring basis as of September 30, 2013 and December 31, 2012 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value. There were no transfers in and out of Level 1, Level 2 and Level 3 measurements during the three and nine months ended September 30, 2013 and 2012.

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(In thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>September 30, 2013</b>				
<b>Available for Sale Securities:</b>				
U.S. Government and government-sponsored enterprise obligations	\$ 6,142	\$ —	\$ 6,142	\$ —
Government-sponsored residential mortgage- backed securities	90,475	—	90,475	—
Government-sponsored residential collateralized debt obligations	55,647	—	55,647	—
Government-sponsored commercial mortgage- backed securities	13,043	—	13,043	—
Government-sponsored commercial collateralized debt obligations	4,743	—	4,743	—
Asset-backed securities	91,246	—	35,317	55,929
Corporate debt securities	39,622	—	38,280	1,342
Obligations of states and political subdivisions	62,902	—	62,902	—
Marketable equity securities	6,307	3,258	2,997	52
Total available for sale securities	<u>\$ 370,127</u>	<u>\$ 3,258</u>	<u>\$ 309,546</u>	<u>\$ 57,323</u>
Mortgage loan derivative assets	\$ 207	\$ —	\$ 207	\$ —
Mortgage loan derivative liabilities	112	—	112	—
Mortgage servicing rights	3,709	—	—	3,709
Interest rate swap assets	6,381	—	6,381	—
Interest rate swap liabilities	854	—	854	—
<b>December 31, 2012</b>				
<b>Available for Sale Securities:</b>				
U.S. Government and government-sponsored enterprise obligations	\$ 12,717	\$ —	\$ 12,717	\$ —
Government-sponsored residential mortgage- backed securities	91,144	—	91,144	—
Government-sponsored residential collateralized- debt obligations	20,947	—	20,947	—
Government-sponsored commercial mortgage- backed securities	9,302	—	9,302	—
Government-sponsored commercial collateralized- debt obligations	5,135	—	5,135	—
Asset-backed securities	11,200	—	4,174	7,026
Corporate debt securities	18,818	—	17,610	1,208
Obligations of states and political subdivisions	68,804	—	68,804	—
Marketable equity securities	3,322	3,244	—	78
Total available for sale securities	<u>\$ 241,389</u>	<u>\$ 3,244</u>	<u>\$ 229,833</u>	<u>\$ 8,312</u>
Mortgage loan derivative assets	\$ 464	\$ —	\$ 464	\$ —
Mortgage loan derivative liabilities	101	—	101	—
Interest rate swap liabilities	148	—	148	—

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The following table presents additional information about assets measured at fair value on a recurring basis for which the Company utilized Level 3 inputs to determine fair value.

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
<b>Available for Sale Securities:</b>				
Balance at beginning of period	\$ 54,819	\$ 1,600	\$ 8,312	\$1,290
Purchases	2,785	8,000	49,729	8,000
Principal payments	(550)	—	(550)	—
Total unrealized gains (losses) included in other comprehensive loss	269	247	(168)	557
Balance at end of period	<u>\$ 57,323</u>	<u>\$ 9,847</u>	<u>\$57,323</u>	<u>\$9,847</u>
<b>Mortgage Servicing Rights:</b>				
Balance at beginning of period	\$ 3,336		\$ —	
Transfers to Level 3	—		1,554	
Issuances	460		1,032	
Amortization	—		—	
Settlements	(36)		(123)	
Change in fair value recognized in net income	(51)		1,246	
Balance at end of period	<u>\$ 3,709</u>		<u>\$ 3,709</u>	

The following valuation methodologies are used for assets that are recorded at fair value on a recurring basis.

**Available for Sale Securities:** Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using an independent pricing service. Level 1 securities are those traded on active markets for identical securities including U.S. treasury debt securities, equity securities and mutual funds. Level 2 securities include U.S. Government agency obligations, U.S. Government-sponsored enterprises, mortgage-backed securities, obligations of states and political subdivisions, corporate and other debt securities. Level 3 securities include asset-backed securities, a pooled trust preferred security and thinly traded equity securities. All fair value measurements are obtained from a third party pricing service and are not adjusted by management.

Matrix pricing is used for pricing most obligations of states and political subdivisions, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on securities relationships to other benchmark quoted securities. The grouping of securities is completed according to insurer, credit support, state of issuance and rating to incorporate additional spreads and municipal bond yield curves.

The valuation of the Company's asset-backed securities is obtained from a third party pricing provider and is determined utilizing an approach that combines advanced analytics with structural and fundamental cash flow analysis based upon observed market based yields. The third party provider's model analyzes each instrument's underlying collateral given observable collateral characteristics and credit statistics to extrapolate future performance and project cash flows, by incorporating expectations of default probabilities, recovery rates, prepayment speeds, loss severities and a derived discount rate. The Company has determined that due to the liquidity and significance of unobservable inputs, that asset-backed securities are classified in Level 3 of the valuation hierarchy.

The Company holds one pooled trust preferred security. The security's fair value is based on unobservable issuer-provided financial information and discounted cash flow models derived from the underlying structured pool and therefore is classified as Level 3.

**Mortgage Servicing Rights:** A mortgage servicing right asset represents the amount by which the present value of the estimated future net cash flows to be received from servicing loans are expected to more than adequately compensate the Company for performing the servicing. The fair value of servicing rights is provided by a third party and is estimated using a present value cash flow model. The most important assumptions used in the valuation model are the anticipated rate of the loan prepayments and discount rates. Adjustments are recorded monthly, effective January 1, 2013, (See Note 7, "Loans Receivable and Allowance for Loan Losses" in the Notes to Unaudited Consolidated Financial Statements contained elsewhere in this report) as the cash flows derived from the valuation model change the fair value of the asset. Although some assumptions in determining fair value are based on standards used by market participants, some are based on unobservable inputs and therefore are classified in Level 3 of the valuation hierarchy.



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**Derivatives:** Derivative instruments related to commitments for loans to be sold are carried at fair value. Fair value is determined through quotes obtained from actively traded mortgage markets. Any change in fair value for rate lock commitments to the borrower is based upon the change in market interest rates between making the rate lock commitment and the measurement date and, for forward loan sale commitments to the investor, is based upon the change in market interest rates from entering into the forward loan sales contract and the measurement date. Both the rate lock commitments to the borrowers and the forward loan sale commitments to investors are derivatives pursuant to the requirements of FASB ASC 815-10; however, the Company has not designated them as hedging instruments. Accordingly, they are marked to fair value through earnings.

The Company's intention is to sell the majority of its fixed rate mortgage loans with original terms of 30 years on a servicing retained basis as well as certain 10, 15 and 20 year loans. The servicing value has been included in the pricing of the rate lock commitments. The Company estimates a fallout rate of approximately 14% based upon historical averages in determining the fair value of rate lock commitments. Although the use of historical averages is based upon unobservable data, the Company believes that this input is insignificant to the valuation and, therefore, has concluded that the fair value measurements meet the Level 2 criteria. The Company continually reassesses the significance of the fallout rate on the fair value measurement and updates the fallout rate accordingly.

Hedging derivatives include interest rate swaps as part of management's strategy to manage interest rate risk. The valuation of the Company's interest rate swaps is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves. The Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy.

**Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis:** The Company may also be required, from time to time, to measure certain other assets at fair value on a non-recurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from application of lower of amortized cost or fair value accounting or write-downs of individual assets. The following tables detail the assets carried at fair value on a non-recurring basis at September 30, 2013 and December 31, 2012 and indicate the fair value hierarchy of the valuation technique utilized by the Company to determine fair value. There were no liabilities measured at fair value on a non-recurring basis at September 30, 2013 and December 31, 2012.

(In thousands)	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>September 30, 2013</b>				
Impaired loans	\$ 2,186	\$ —	\$ —	\$ 2,186
Other real estate owned	2,129	—	—	2,129
Total	<u>\$ 4,315</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,315</u>
<b>December 31, 2012</b>				
Impaired loans	\$ 1,211	\$ —	\$ —	\$ 1,211
Other real estate owned	2,846	—	—	2,846
Total	<u>\$ 4,057</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,057</u>

The following is a description of the valuation methodologies used for certain assets that are recorded at fair value on a non-recurring basis.

**Impaired Loans:** Accounting standards require that a creditor recognize the impairment of a loan if the present value of expected future cash flows discounted at the loan's effective interest rate (or, alternatively, the observable market price of the loan or the fair value of the collateral) is less than the recorded investment in the impaired loan. Non-recurring fair value adjustments to collateral dependent loans are recorded, when necessary, to reflect partial write-downs and the specific reserve allocations based upon observable market price or current appraised value of the collateral less selling costs and discounts based on management's judgment of current conditions. Based on the significance of management's judgment, the Company records collateral dependent impaired loans as non-recurring Level 3 fair value measurements.

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**Other Real Estate Owned:** The Company classifies property acquired through foreclosure or acceptance of deed-in-lieu of foreclosure, as other real estate owned (“OREO”) in its financial statements. Upon foreclosure, the property securing the loan is recorded at fair value as determined by real estate appraisals less the estimated selling expense. Appraisals are based upon observable market data such as comparable sales within the real estate market. Assumptions are also made based on management’s judgment of the appraisals and current real estate market conditions and therefore these assets are classified as non-recurring Level 3 assets in the fair value hierarchy.

Losses on assets recorded at fair value on a non-recurring basis are as follows:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Impaired loans	\$ (209)	\$ (127)	\$ (821)	\$ (337)
Other real estate owned	(12)	—	(81)	(183)
Total	<u>\$ (221)</u>	<u>\$ (127)</u>	<u>\$ (902)</u>	<u>\$ (520)</u>

### **Disclosures about Fair Value of Financial Instruments:**

The following methods and assumptions were used by management to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

*Cash and Cash Equivalents:* Carrying value is assumed to represent fair value for cash and due from banks and short-term investments, which have original maturities of 90 days or less.

*Securities:* Refer to the above discussion on securities.

*Loans Held for Sale:* The fair value of residential mortgage loans held for sale is estimated using quoted market prices provided by government-sponsored entities as described above.

*Loans Receivable – net:* The fair value of the net loan portfolio is determined by discounting the estimated future cash flows using the prevailing interest rates and appropriate credit and prepayment risk adjustments as of period-end at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The fair value of nonperforming loans is estimated using the Bank’s prior credit experience.

*Federal Home Loan Bank of Boston (“FHLBB”) stock:* FHLBB stock is a non-marketable equity security which is assumed to have a fair value equal to its carrying value due to the fact that it can only be redeemed back to the FHLB of Boston at par value.

*Accrued Interest Receivable:* Carrying value is assumed to represent fair value.

*Derivative Assets:* Refer to the above discussion on derivatives.

*Deposits and Mortgagors’ and Investors’ Escrow Accounts:* The fair value of demand, non-interest-bearing checking, savings and certain money market deposits is determined as the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the estimated future cash flows using rates offered for deposits of similar remaining maturities as of period-end.

*Federal Home Loan Bank Advances and Other Borrowings:* The fair value of borrowed funds is estimated by discounting the future cash flows using market rates for similar borrowings.

*Derivative Liabilities:* Refer to the above discussion on derivatives.

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As of September 30, 2013 and December 31, 2012, the carrying value and estimated fair values of the Company's financial instruments are as described below.

(In thousands)	Carrying Value	Fair Value			Total
		Level 1	Level 2	Level 3	
<b>September 30, 2013</b>					
Financial assets:					
Cash and cash equivalents	\$ 54,471	\$54,471	\$ —	\$ —	\$ 54,471
Available for sale securities	370,127	3,258	309,546	57,323	370,127
Held to maturity securities	14,141	—	14,564	—	14,564
Loans held for sale	2,904	—	2,904	—	2,904
Loans receivable-net	1,637,325	—	—	1,639,076	1,639,076
FHLBB stock	15,053	—	—	15,053	15,053
Accrued interest receivable	5,879	—	—	5,879	5,879
Mortgage loan derivative assets	207	—	207	—	207
Mortgage servicing rights	3,709	—	—	3,709	3,709
Interest rate swaps	6,381	—	6,381	—	6,381
Financial liabilities:					
Deposits	1,692,072	—	—	1,599,792	1,599,792
Mortgagors' and investors' escrow accounts	3,635	—	—	3,635	3,635
FHLBB advances and other borrowings	196,246	—	—	198,825	198,825
Mortgage loan derivative liabilities	112	—	112	—	112
Interest rate swaps	854	—	854	—	854
<b>December 31, 2012</b>					
Financial assets:					
Cash and cash equivalents	35,315	35,315	—	—	35,315
Available for sale securities	241,389	3,244	229,833	8,312	241,389
Held to maturity securities	6,084	—	6,681	—	6,681
Loans held for sale	5,292	—	5,292	—	5,292
Loans receivable-net	1,586,985	—	—	1,624,001	1,624,001
FHLBB stock	15,867	—	—	15,867	15,867
Accrued interest receivable	4,862	—	—	4,862	4,862
Mortgage loan derivative assets	464	—	464	—	464
Financial liabilities:					
Deposits	1,504,680	—	—	1,513,188	1,513,188
Mortgagors' and investors' escrow accounts	6,776	—	—	6,776	6,776
Advances from FHLBB	143,106	—	—	148,201	148,201
Mortgage loan derivative liabilities	101	—	101	—	101
Interest rate swaps	148	—	148	—	148

Certain financial instruments and all nonfinancial investments are exempt from disclosure requirements. Accordingly, the aggregate fair value of amounts presented above may not necessarily represent the underlying fair value of the Company

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### Note 5. Securities

The amortized cost, gross unrealized gains, gross unrealized losses and fair values of available for sale and held to maturity securities at September 30, 2013 and December 31, 2012 are as follows:

(In thousands)	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>September 30, 2013</b>				
Available for sale:				
Debt securities:				
U.S. Government and government-sponsored enterprise obligations	\$ 6,804	\$ 45	\$ 707	\$ 6,142
Government-sponsored residential mortgage-backed securities	90,469	1,803	1,797	90,475
Government-sponsored residential collateralized debt obligations	56,559	193	1,105	55,647
Government-sponsored commercial mortgage-backed securities	13,908	—	865	13,043
Government-sponsored commercial collateralized debt obligations	5,045	—	302	4,743
Asset-backed securities	92,967	15	1,736	91,246
Corporate debt securities	40,868	790	2,036	39,622
Obligations of states and political subdivisions	67,222	—	4,320	62,902
Total debt securities	<u>373,842</u>	<u>2,846</u>	<u>12,868</u>	<u>363,820</u>
Marketable equity securities, by sector:				
Banks	3,068	—	19	3,049
Industrial	109	85	—	194
Mutual funds	2,783	79	5	2,857
Oil and gas	131	76	—	207
Total marketable equity securities	<u>6,091</u>	<u>240</u>	<u>24</u>	<u>6,307</u>
Total available for sale securities	<u>\$ 379,933</u>	<u>\$ 3,086</u>	<u>\$ 12,892</u>	<u>\$370,127</u>
Held to maturity:				
Debt securities:				
Obligations of states and political subdivisions	\$ 10,092	\$ 129	\$ 94	\$ 10,127
Government-sponsored residential mortgage-backed securities	4,049	388	—	4,437
Total held to maturity securities	<u>\$ 14,141</u>	<u>\$ 517</u>	<u>\$ 94</u>	<u>\$ 14,564</u>
<b>December 31, 2012</b>				
Available for sale:				
Debt securities:				
U.S. Government and government-sponsored enterprise obligations	\$ 12,413	\$ 304	\$ —	\$ 12,717
Government-sponsored residential mortgage-backed securities	87,769	3,445	70	91,144
Government-sponsored residential collateralized debt obligations	20,798	150	1	20,947
Government-sponsored commercial mortgage-backed securities	9,179	123	—	9,302
Government-sponsored commercial collateralized debt obligations	5,048	87	—	5,135
Asset-backed securities	11,193	26	19	11,200
Corporate debt securities	19,760	695	1,637	18,818
Obligations of states and political subdivisions	67,458	1,473	127	68,804
Total debt securities	<u>233,618</u>	<u>6,303</u>	<u>1,854</u>	<u>238,067</u>
Marketable equity securities, by sector:				
Banks	68	10	—	78
Industrial	109	50	—	159
Mutual funds	2,756	131	—	2,887
Mutual funds	135	63	—	198
Oil and gas	3,068	254	—	3,322
Total marketable equity securities	<u>\$ 236,686</u>	<u>\$ 6,557</u>	<u>\$ 1,854</u>	<u>\$241,389</u>
Total available for sale securities				

Held to maturity:

Debt securities:

Government-sponsored residential mortgage-backed securities

\$	<u>6,084</u>	\$	<u>597</u>	\$	<u>—</u>	\$	<u>6,681</u>
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At September 30, 2013, the net unrealized loss on securities available for sale of \$9.8 million, net of an income tax benefit of \$3.4 million, or \$6.4 million, is included in accumulated other comprehensive loss.

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The amortized cost and fair value of debt securities at September 30, 2013 by contractual maturities are presented below. Actual maturities may differ from contractual maturities because the securities may be called or repaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

(In thousands)	<u>Available for Sale</u>		<u>Held to Maturity</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
<b>Maturity:</b>				
Within 1 year	\$ 604	\$ 608	\$ —	\$ —
After 1 year through 5 years	21,469	21,972	—	—
After 5 years through 10 years	22,712	22,028	—	—
After 10 years	70,109	64,058	10,092	10,127
	114,894	108,666	10,092	10,127
<b>Mortgage-backed securities</b>	90,469	90,475	4,049	4,437
Government-sponsored residential collateralized debt obligations	56,559	55,647	—	—
Government-sponsored commercial mortgage-backed securities	13,908	13,043	—	—
Government-sponsored commercial collateralized debt obligations	5,045	4,743	—	—
<b>Asset-backed securities</b>	92,967	91,246	—	—
Total debt securities	<u>\$ 373,842</u>	<u>\$363,820</u>	<u>\$ 14,141</u>	<u>\$14,564</u>

At September 30, 2013, the Company had nine encumbered securities, with a fair value of \$25.9 million pledged as collateral for reverse repurchase borrowings.

For the three months ended September 30, 2013 and 2012, gross gains of \$184,000 and \$214,000, respectively, were realized on the sales of available for sale securities. There were gross losses of \$155,000 and \$0, respectively, realized on the sale of available for sale securities for the three months ended September 30, 2013 and 2012. For the nine months ended September 30, 2013 and 2012, gross gains of \$805,000 and \$363,000, respectively, were realized on the sales of available for sale securities. Gross losses realized on the sale of available for sale securities were \$220,000 and \$28,000 for the nine months ended September 30, 2013 and 2012, respectively.

As of September 30, 2013, the Company did not own any investment or mortgage-backed securities of a single private label issuer, other than securities guaranteed by the U.S. Government or government-sponsored enterprises, which had an aggregate book value in excess of 10% of the Company's stockholders' equity.

The Company's investment committee reviews state exposure in the obligations of states and political subdivisions portfolio on an ongoing basis. As of September 30, 2013, the estimated fair value of this portfolio was \$73.0 million, with no significant geographic exposure concentrations. Of the total revenue and general obligations of \$73.0 million, \$25.2 million were representative of general obligation bonds for which \$17.4 million are obligations of political subdivisions of the respective state. For all municipal debt purchases, the Management Investment Committee under the direction of the ALCO committee approved various conditions prior to purchase and quarterly thereafter, including the requirement that underlying ratings be A/A2 or higher. Generally, the Company does not utilize enhanced National Recognized Statistical Rating Organizations ratings, which include credit support provided by a state credit enhancement program. The Company analyzes the issuers' credit trends and other factors that may impact the ability to service its debt and will proactively sell a position that shows potential weaknesses. At September 30, 2013, one security, with an estimated fair value of \$1.0 million and an underlying rating of A2, was enhanced by the Texas Permanent School Fund, a AAA rated entity.

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The following table summarizes gross unrealized losses and fair value, aggregated by category and length of time the securities have been in a continuous unrealized loss position, as of September 30, 2013 and December 31, 2012:

(In thousands)	<u>Less than 12 months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
<b>September 30, 2013</b>						
Available for sale:						
Debt Securities:						
U.S. Government and government sponsored enterprise obligations	\$ 4,286	\$ 707	\$ —	\$ —	\$ 4,286	\$ 707
Government-sponsored residential mortgage-backed securities	45,924	1,797	—	—	45,924	1,797
Government-sponsored residential collateralized debt obligations	36,376	1,105	—	—	36,376	1,105
Government-sponsored commercial mortgage-backed securities	13,043	865	—	—	13,043	865
Government-sponsored commercial collateralized debt obligations	4,743	302	—	—	4,743	302
Asset-backed securities	87,197	1,736	—	—	87,197	1,736
Corporate debt securities	16,100	531	1,342	1,505	17,442	2,036
Obligations of states and political subdivisions	62,902	4,320	—	—	62,902	4,320
Total debt securities	270,571	11,363	1,342	1,505	271,913	12,868
Marketable equity securities	3,247	24	—	—	3,247	24
	<u>\$273,818</u>	<u>\$ 11,387</u>	<u>\$1,342</u>	<u>\$ 1,505</u>	<u>\$275,160</u>	<u>\$ 12,892</u>

## December 31, 2012

Available for sale:

Debt Securities:						
Government-sponsored residential mortgage-backed securities	\$ 10,360	\$ 70	\$ —	\$ —	\$ 10,360	\$ 70
Government-sponsored residential collateralized debt obligations	4,151	1	—	—	4,151	1
Asset-backed securities	4,173	19	—	—	4,173	19
Corporate debt securities	—	—	1,208	1,637	1,208	1,637
Obligations of states and political subdivisions	6,632	127	—	—	6,632	127
Total debt securities	<u>\$ 25,316</u>	<u>\$ 217</u>	<u>\$1,208</u>	<u>\$ 1,637</u>	<u>\$ 26,524</u>	<u>\$ 1,854</u>

Of the securities summarized above as of September 30, 2013, 166 issues had unrealized losses equaling 4.0% of the cost basis for less than twelve months and one issue had an unrealized loss of 52.9% of the amortized cost basis for twelve months or more. As of December 31, 2012, nineteen issues had unrealized losses equaling 0.85% of the cost basis for less than twelve months and one issue had losses equaling 57.54% of the cost basis for twelve months or more.

As of September 30, 2012, two held to maturity securities had unrealized losses equaling 2.2% of the cost basis for less than twelve months. There were no held to maturity securities with unrealized losses at December 31, 2012.

Management believes that no individual unrealized loss as of September 30, 2013 represents an other-than-temporary impairment, based on its detailed quarterly review of the securities portfolio. Among other things, the other-than-temporary impairment review of the investment securities portfolio focuses on the combined factors of percentage and length of time by which an issue is below book value as well as consideration of issuer specific (present value of cash flows expected to be collected, issuer rating changes and trends, credit worthiness and review of underlying collateral), broad market details and the Company's intent to sell the security or if it is more likely than not that the Company will be required to sell the debt security before recovering its cost. The Company also considers whether the depreciation is due to interest rates or credit risk.

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The following paragraphs outline the Company's position related to unrealized losses in its investment securities portfolio at September 30, 2013.

***U.S. Government and government-sponsored enterprises and mortgage-backed securities.*** The unrealized losses on the Company's U.S. Government and government-sponsored securities were caused by increases in the rate spread to comparable government securities. The Company does not expect these securities to settle at a price less than the par value of the securities. Because the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before the recovery of their amortized cost basis, which may be at maturity, the Company does not consider these securities to be other-than-temporarily impaired at September 30, 2013.

***U.S. Government and government-sponsored collateralized debt obligations and commercial mortgage-backed securities.*** The unrealized losses on the Company's U.S. Government and government-sponsored collateralized debt obligations and commercial mortgage backed securities were caused by increases in the rate spread to comparable government securities. The Company does not expect these securities to settle at a price less than the par value of the securities. Because the Company does not intend to sell the securities before the recovery of their amortized cost basis, which may be at maturity, the Company does not consider these securities to be other-than-temporarily impaired at September 30, 2013.

***Obligations of states and political subdivisions.*** The unrealized loss on obligations of states and political subdivisions relates to twenty securities, with no geographic concentration. The unrealized loss was due to a shift in the municipal bond curve that resulted in a negative impact to the respective bonds' pricing, relative to the time of purchase.

***Corporate debt securities.*** The unrealized losses on corporate debt securities are related to one pooled trust preferred security, Preferred Term Security XXVIII, Ltd ("PRETSL XXVIII"). The unrealized loss on this security is caused by the low interest rate environment because it reprices quarterly to the three month LIBOR and market spreads on similar securities have increased. No loss of principal or break in yield is projected. Based on the existing credit profile, management does not believe that this security will suffer from any credit related losses. In addition, because the Company does not intend to sell the security and it is not probable that the Company will be required to sell the securities before recovery of its amortized cost basis, which may be at maturity, therefore the Company does not consider this security to be other-than-temporarily impaired at September 30, 2013.

***Asset-Backed Securities.*** The unrealized losses on the Company's asset-backed securities were largely driven by increases in the spreads of the respective sectors' asset classes over comparable securities. The majority of these securities have resetting coupons that adjust on quarterly basis and the market spreads on similar securities have increased. Based on the credit profiles and asset qualities of the individual securities, management does not believe that the securities will suffer from any credit related losses. The Company does not expect these securities to settle at a price less than the par value of the securities. Because the Company does not intend to sell the securities before the recovery of their amortized cost basis, which may be at maturity, the Company does not consider these securities to be other-than-temporarily impaired at September 30, 2013.

The Company will continue to review its entire portfolio for other-than-temporarily impaired securities with additional attention being given to high risk securities such as the one pooled trust preferred security that the Company owns.

## **Note 6. Derivatives and Hedging Activities**

### **Risk Management Objective of Using Derivatives**

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposure to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its debt funding and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to the Company's investments and borrowings. The Company also has interest rate derivatives that result from a service provided to certain qualifying customers. The Company manages a matched book with respect to its derivative instruments in order to minimize its net risk exposure resulting from such transactions.



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Information about interest rate swap agreements and non-hedging derivative assets and liabilities as of September 30, 2013 and December 31, 2012 is as follows:

	<u>Notional Amount</u> (In thousands)	<u>Weighted- Average Remaining Maturity</u> (In years)	<u>Weighted-Average Rate</u>		<u>Estimated Fair Value Asset (Liability)</u> (In thousands)
			<u>Received</u>	<u>Paid</u>	
<b>September 30, 2013</b>					
<b>Cash flow hedge:</b>					
Forward starting interest rate swaps on future borrowings	\$ 100,000	7.00	TBD <sup>(1)</sup>	2.40%	\$ 5,592
<b>Fair value hedge:</b>					
Interest rate swap	20,000	4.27	1.10%	0.23% <sup>(2)</sup>	(104)
<b>Non-hedging derivatives:</b>					
Forward loan sale commitments	11,365	—			(112)
Derivative loan commitments	9,309	—			207
Loan level swaps—dealer <sup>(3)</sup>	25,340	8.77	2.06%	4.56%	(746)
Loan level swaps—borrowers <sup>(3)</sup>	25,340	8.77	4.56%	2.06%	785
<b>Total</b>	<u>\$ 191,354</u>				<u>\$ 5,622</u>
<b>December 31, 2012</b>					
<b>Cash flow hedge:</b>					
Forward starting interest rate swaps on future borrowings	<u>\$ 75,000</u>	7.00	TBD <sup>(1)</sup>	2.30%	<u>\$ (148)</u>

(1) The receiver leg of the cash flow hedges is floating rate and indexed to the 3-month USD-LIBOR-BBA, as determined two London banking days prior to the first day of each calendar quarter, commencing with the earliest effective trade. The earliest effective trade date for the cash flow hedges is July 1, 2015.

(2) The paying leg is one month LIBOR plus a fixed spread; above rate in effect as of September 30, 2013

(3) The Company offers a loan level hedging product to qualifying commercial borrowers that seek to mitigate risk to rising interest rates. As such, the Company enters into equal and offsetting trades with dealer counterparties.

### Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three and nine months ended September 30, 2013, the Company did not record any hedge ineffectiveness.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. The Company does not expect to reclassify any amounts from accumulated other comprehensive loss to interest expense during the next 12 months as the Company's earliest effective date is July 2015.

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The Company is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of 36 months (excluding forecasted transactions related to the payment of variable interest on existing financial instruments).

As of September 30, 2013, the Company had three outstanding interest rate derivatives with a notional value of \$100.0 million that were designated as cash flow hedges of interest rate risk.

### **Fair Value Hedges of Interest Rate Risk**

The Company is exposed to changes in the fair value of certain of its fixed rate obligations due to changes in benchmark interest rates. The Company uses interest rate swaps to manage its exposure to changes in fair value on these instruments attributable to changes in the benchmark interest rate. Interest rate swaps designated as fair value hedges involve the receipt of fixed-rate amounts from a counterparty in exchange for the Company making variable rate payments over the life of the agreements without the exchange of the underlying notional amount.

For derivatives designated and that qualify as fair value hedges, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in earnings. The Company includes the gain or loss on the hedged items in the same line item as the offsetting loss or gain on the related derivatives. During each of the three and nine months ended September 30, 2013, the Company recognized net losses of \$2,000 in interest expense related to hedge ineffectiveness. The Company also recognized a net reduction to interest expense of approximately \$37,000 and \$40,000, respectively, for the three and nine months ended September 30, 2013 related to net settlements on the derivatives.

As of September 30, 2013, the Company had outstanding interest rate derivatives with a notional of \$20.0 million that was designated as a fair value hedge of interest rate risk.

### **Non-Designated Hedges**

Qualifying derivatives not designated as hedges are not speculative and result from a service the Company provides to certain customers, which the Company implemented during the second quarter of 2013. The Company executes interest rate derivatives with commercial banking customers to facilitate their respective risk management strategies. Those interest rate derivatives are simultaneously hedged by offsetting derivatives that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate derivatives associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer derivatives and the offsetting derivatives are recognized directly in earnings.

As of September 30, 2013, the Company had four borrower-facing rate derivatives with an aggregate notional amount of \$25.3 million and four broker derivatives also with an aggregate notional value amount of \$25.3 million related to this program.

### *Derivative Loan Commitments*

Additionally, the Company enters into mortgage loan commitments that are also referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Company enters into commitments to fund residential mortgage loans at specified rates and times in the future, with the intention that these loans will subsequently be sold in the secondary market.

Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases.

### *Forward Loan Sale Commitments*

To protect against the price risk inherent in derivative loan commitments, the Company utilizes both “mandatory delivery” and “best efforts” forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments.

With a “mandatory delivery” contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay a “pair-off” fee, based on then-current market prices, to the investor to compensate the investor for the shortfall.

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With a “best efforts” contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g., on the same day the lender commits to lend funds to a potential borrower). The Company expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments.

### Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Company’s derivative financial instruments as well as their classification on the Consolidated Statements of Condition as of September 30, 2013.

### Fair Values of Derivative Instruments

(In thousands)	Balance Sheet Location	Fair Value	
		September 30, 2013	December 31, 2012
Derivatives designated as hedging instruments:			
Interest rate swap—cash flow hedge	Other Assets	\$ 5,592	\$ —
Interest rate swap—cash flow hedge	Other Liabilities	—	(148)
Interest rate swap—fair value hedge	Other Assets	4	—
Interest rate swap—fair value hedge	Other Liabilities	(108)	—
Total derivatives designated as hedging instruments		<u>\$ 5,488</u>	<u>\$ (148)</u>
Derivatives not designated as hedging instruments:			
Forward loan sale commitment	Other (Liabilities) / Assets	\$ (112)	\$ 464
Derivative loan commitment	Other Assets / (Liabilities)	207	(101)
Interest rate swap—non designated hedge	Other Assets	785	—
Interest rate swap—non designated hedge	Other Liabilities	(746)	—
Total derivatives not designated as hedging instruments		<u>\$ 134</u>	<u>\$ 363</u>

### Cash Flow Hedges

Derivatives in Cash Flow Hedging Relationships (In thousands)	Amount of (Loss) Gain Recognized in OCI on Derivatives (Effective Portion)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Interest Rate Swaps	\$ (102)	\$ (350)	\$ 5,740	\$ (383)
Total	<u>\$ (102)</u>	<u>\$ (350)</u>	<u>\$ 5,740</u>	<u>\$ (383)</u>

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### Effect of Derivative Instruments on the Income Statement

The tables below present information pertaining to the Company's derivatives on the Consolidated Statements of Net Income designated as hedging instruments for the three and nine months ended September 30, 2013 and 2012.

#### Fair Value Hedges

Derivatives in Fair Value Hedging Relationships (In thousands)	Location on Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income on Derivatives			
		Three Months Ended September 30,		Nine Months Ended September 30,	
		2013	2012	2013	2012
Interest Rate Swaps	Interest expense	\$ 111	\$ —	\$ (109)	\$ —

		Amount of (Loss) Gain Recognized in Income on Hedged Items			
		Three Months Ended September 30,		Nine Months Ended September 30,	
		2013	2012	2013	2012
Interest Rate Swaps	Interest expense	\$ (113)	\$ —	\$ 107	\$ —

The table below presents information pertaining to the Company's derivatives not designated as hedging instruments on the Consolidated Statements of Net Income as of September 30, 2013.

(In thousands)		Amount of (Loss) Gain Recognized for the			
		Three Months Ended September 30,		Nine Months Ended September 30,	
		2013	2012	2013	2012
Derivatives not designated as hedging instruments:					
	Derivative loan commitment	\$ 219	\$ —	\$ (118)	\$ —
	Forward loan sale commitments	(493)	(195)	(150)	(211)
	Interest rate swaps	37	—	40	—
		\$ (237)	\$ (195)	\$ (228)	\$ (211)

#### Credit-risk-related Contingent Features

The Company has agreements with each of its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness or fails to maintain a well-capitalized rating, then the Company could also be declared in default on its derivative obligations and could be required to terminate its derivative positions with the counterparty. As of September 30, 2013, the counterparties related to these agreements posted \$5.9 million of collateral to the Company.

The Company has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well-capitalized institution, then the Company could be required to terminate its derivative positions with the counterparty.

As of September 30, 2013, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$865,000. As of September 30, 2013, the Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of \$585,000 against its obligations under these agreements. A degree of netting occurs on occasions where the Company has exposure to a counterparty and the counterparty has exposure to the Company. If the Company had breached any of these provisions at September 30, 2013, it could have been required to settle its obligations under the agreements at the termination value and would have been required to pay any additional amounts due in excess of amounts previously posted as collateral with the respective counterparty.

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### Note 7. Loans Receivable and Allowance for Loan Losses

A summary of the Company's loan portfolio is as follows:

(In thousands)	September 30, 2013	December 31, 2012
<b>Real estate loans:</b>		
Residential	\$ 612,946	\$ 683,195
Commercial	753,589	697,133
Construction—residential	5,155	3,338
Construction—commercial	56,961	46,642
Total real estate loans	1,428,651	1,430,308
Commercial business loans	222,784	171,632
Installment loans	891	1,184
Collateral loans	1,386	1,567
Total loans	1,653,712	1,604,691
Net deferred loan costs and premiums	2,316	771
Allowance for loan losses	(18,703)	(18,477)
<b>Loans—net</b>	<b>\$ 1,637,325</b>	<b>\$ 1,586,985</b>

**Allowance for Loan Losses:** Management has established a methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. The allowance for loan losses is established as embedded losses are estimated to have occurred through the provisions for losses charged against operations and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Management's judgment in determining the adequacy of the allowance is inherently subjective and is based on past loan loss experience, known and inherent losses and size of the loan portfolios, an assessment of current economic and real estate market conditions, estimates of the current value of underlying collateral, review of regulatory authority examination reports and other relevant factors. An allowance is maintained for impaired loans to reflect the difference, if any, between the carrying value of the loan and the present value of the projected cash flows, observable fair value or collateral value. Loans are charged-off against the allowance for loan losses when management believes that the uncollectibility of principal is confirmed. Any subsequent recoveries are credited to the allowance for loan losses when received. In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties, when considered necessary.

The allowance for loan losses and the reserve for unfunded credit commitments are maintained at a level estimated by management to provide for probable losses inherent within the loan portfolio. Probable losses are estimated based upon a quarterly review of the loan portfolio, which includes historic default and loss experience, specific problem loans, risk rating profile, economic conditions and other pertinent factors which, in management's judgment, warrant current recognition in the loss estimation process.

The adequacy of the allowance for loan losses is subject to considerable assumptions and judgment used in its determination. Therefore, actual losses could differ materially from management's estimate if actual conditions differ significantly from the assumptions utilized. These conditions include economic factors in the Company's market and nationally, industry trends and concentrations, real estate values and trends, and the financial condition and performance of individual borrowers.

The Company's general practice is to identify problem credits early and recognize full or partial charge-offs as promptly as practicable when it is determined that the collection of loan principal is unlikely. The Company recognized full or partial charge-offs on collateral dependent impaired loans when the collateral is deemed to be insufficient to support the carrying value of the loan. The Company does not recognize a recovery when an updated appraisal indicates a subsequent increase in value.

At September 30, 2013, the Company has a loan loss allowance of \$18.7 million, or 1.13% of total loans as compared to a loan loss allowance of \$18.5 million, or 1.15% of total loans at December 31, 2012. Management believes that the allowance for loan losses is adequate and consistent with asset quality indicators and that it represents the best estimate of probable losses inherent in the loan portfolio. There are three components for the allowance for loan loss calculation:

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### **General component**

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate, commercial real estate, construction, commercial and consumer. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels and trends in delinquencies; level and trend of charge-offs and recoveries; trends in volume and types of loans; effects of changes in risk selection and underwriting standards, changes in risk selection and underwriting standards; experience and depth of lending weighted-average risk rating; and national and local economic trends and conditions. The qualitative factors are determined based on the various risk characteristics of each loan segment.

### **Allocated component**

The allocated component relates to loans that are classified as impaired. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due.

Impairment is measured on a loan-by-loan basis for commercial, commercial real estate and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan. Residential and consumer loans are evaluated for impairment if payments are 90 days or more delinquent. Updated property evaluations are obtained at time of impairment and serve as the basis for the loss allocation if foreclosure is probable or the loan is collateral dependent.

Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

### **Unallocated component**

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 allocated and general reserves in the portfolio.

## **Credit Quality Information**

The Company utilizes a nine grade internal loan rating system for residential and commercial real estate, construction, commercial and installment and collateral loans as follows:

Loans rated 1 – 5: Loans in these categories are considered “pass” rated loans with low to average risk.

Loans rated 6: Loans in this category are considered “special mention.” These loans reflect signs of potential weakness and are being closely monitored by management.

Loans rated 7: Loans in this category are considered “substandard.” Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

Loans rated 8: Loans in this category are considered “doubtful.” Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

Loans rated 9: Loans in this category are considered uncollectible (“loss”) and of such little value that their continuance as loans is not warranted.

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At the time of loan origination, a risk rating based on this nine point grading system is assigned to each loan based on the loan officer's assessment of risk. More complex loans, such as commercial business loans and commercial real estate loans require that our internal independent credit area further evaluate the risk rating of the individual loan, with the credit area and Chief Risk Officer having final determination of the appropriate risk rating. These more complex loans and relationships receive an in-depth analysis and periodic review to assess the appropriate risk rating on a post-closing basis with changes made to the risk rating as the borrower's and economic conditions warrant. The credit quality of the Company's loan portfolio is reviewed by a third-party risk assessment firm on a quarterly basis and by the Company's internal credit management function. The internal and external analysis of the loan portfolio is utilized to identify and quantify loans with higher than normal risk. Loans having a higher risk profile are assigned a risk rating corresponding to the level of weakness identified in the loan. All loans risk rated Special Mention, Substandard or Doubtful are reviewed by management not less than on a quarterly basis to assess the level of risk and to ensure that appropriate actions are being taken to minimize potential loss exposure. Loans identified as being a loss are normally fully charged off.

The following table presents the Company's loans by risk rating at September 30, 2013 and December 31, 2012.

(In thousands)	<u>Residential Real Estate</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Commercial Business</u>	<u>Installment and Collateral</u>
<b><u>September 30, 2013</u></b>					
Loans rated 1-5	\$ 600,468	\$ 728,345	\$ 58,649	\$ 208,405	\$ 2,233
Loans rated 6	2,383	10,778	444	8,182	—
Loans rated 7	10,095	14,466	3,023	6,197	44
Loans rated 8	—	—	—	—	—
Loans rated 9	—	—	—	—	—
	<u>\$ 612,946</u>	<u>\$ 753,589</u>	<u>\$ 62,116</u>	<u>\$ 222,784</u>	<u>\$ 2,277</u>
<b><u>December 31, 2012</u></b>					
Loans rated 1-5	\$ 669,905	\$ 673,844	\$ 43,488	\$ 158,576	\$ 2,699
Loans rated 6	2,182	14,121	4,310	5,366	—
Loans rated 7	11,108	9,168	2,182	7,690	52
Loans rated 8	—	—	—	—	—
Loans rated 9	—	—	—	—	—
	<u>\$ 683,195</u>	<u>\$ 697,133</u>	<u>\$ 49,980</u>	<u>\$ 171,632</u>	<u>\$ 2,751</u>

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Changes in the allowance for loan losses for the periods ended September 30, 2013 and 2012 are as follows:

(In thousands)	<b>Residential Real Estate</b>	<b>Commercial Real Estate</b>	<b>Construction</b>	<b>Commercial Business</b>	<b>Installment and Collateral</b>	<b>Unallocated</b>	<b>Total</b>
<b>Three Months Ended</b>							
<b>September 30, 2013</b>							
Balance, beginning of period	\$ 5,974	\$ 8,275	\$ 740	\$ 3,068	\$ 28	\$ 260	\$18,345
Provision (credit) for loan losses	58	28	308	342	36	(240)	532
Loans charged off	(145)	—	(1)	(65)	(40)	—	(251)
Recoveries of loans previously charged off	61	—	—	9	7	—	77
Balance, end of period	<u>\$ 5,948</u>	<u>\$ 8,303</u>	<u>\$ 1,047</u>	<u>\$ 3,354</u>	<u>\$ 31</u>	<u>\$ 20</u>	<u>\$18,703</u>
<b>Three Months Ended September 30, 2012</b>							
Balance, beginning of period	\$ 5,818	\$ 7,173	\$ 1,088	\$ 2,991	\$ 44	\$ 189	\$17,303
Provision (credit) for loan losses	(146)	232	98	388	(4)	225	793
Loans charged off	(145)	—	—	—	(9)	—	(154)
Recoveries of loans previously charged off	134	—	—	—	3	—	137
Balance, end of period	<u>\$ 5,661</u>	<u>\$ 7,405</u>	<u>\$ 1,186</u>	<u>\$ 3,379</u>	<u>\$ 34</u>	<u>\$ 414</u>	<u>\$18,079</u>
<b>Nine Months Ended September 30, 2013</b>							
Balance, beginning of period	\$ 6,194	\$ 8,051	\$ 807	\$ 2,916	\$ 29	\$ 480	\$18,477
Provision (credit) for loan losses	285	397	490	571	43	(460)	1,326
Loans charged off	(613)	(145)	(250)	(151)	(63)	—	(1,222)
Recoveries of loans previously charged off	82	—	—	18	22	—	122
Balance, end of period	<u>\$ 5,948</u>	<u>\$ 8,303</u>	<u>\$ 1,047</u>	<u>\$ 3,354</u>	<u>\$ 31</u>	<u>\$ 20</u>	<u>\$18,703</u>
<b>Nine Months Ended</b>							
<b>September 30, 2012</b>							
Balance, beginning of period	\$ 5,071	\$ 6,694	\$ 1,286	\$ 2,515	\$ 49	\$ 410	\$16,025
Provision (credit) for loan losses	1,138	819	(100)	817	—	4	2,678
Loans charged off	(692)	(108)	—	(2)	(28)	—	(830)
Recoveries of loans previously charged off	144	—	—	49	13	—	206
Balance, end of period	<u>\$ 5,661</u>	<u>\$ 7,405</u>	<u>\$ 1,186</u>	<u>\$ 3,379</u>	<u>\$ 34</u>	<u>\$ 414</u>	<u>\$18,079</u>



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Further information pertaining to the allowance for loan losses and impaired loans at September 30, 2013 and December 31, 2012 follows:

(In thousands)	<b>Residential Real Estate</b>	<b>Commercial Real Estate</b>	<b>Construction</b>	<b>Commercial Business</b>	<b>Installment and Collateral</b>	<b>Unallocated</b>	<b>Total</b>
<b>September 30, 2013</b>							
Allowance related to loans deemed impaired	\$ 145	\$ —	\$ —	\$ 13	\$ —	\$ —	\$ 158
Allowance related to loans not deemed impaired	5,803	8,303	1,047	3,341	31	20	18,545
Total allowance for loan losses	<u>\$ 5,948</u>	<u>\$ 8,303</u>	<u>\$ 1,047</u>	<u>\$ 3,354</u>	<u>\$ 31</u>	<u>\$ 20</u>	<u>\$ 18,703</u>
Loans deemed impaired	\$ 9,455	\$ 4,040	\$ 2,572	\$ 1,398	\$ 31	\$ —	\$ 17,496
Loans not deemed impaired	603,491	749,549	59,544	221,386	2,246	—	1,636,216
Total loans	<u>\$ 612,946</u>	<u>\$ 753,589</u>	<u>\$ 62,116</u>	<u>\$ 222,784</u>	<u>\$ 2,277</u>	<u>\$ —</u>	<u>\$1,653,712</u>
<b>December 31, 2012</b>							
Allowance related to loans deemed impaired	\$ 97	\$ —	\$ 1	\$ 220	\$ —	\$ —	\$ 318
Allowance related to loans not deemed impaired	6,097	8,051	806	2,696	29	480	18,159
Total allowance for loan losses	<u>\$ 6,194</u>	<u>\$ 8,051</u>	<u>\$ 807</u>	<u>\$ 2,916</u>	<u>\$ 29</u>	<u>\$ 480</u>	<u>\$ 18,477</u>
Loans deemed impaired	\$ 9,867	\$ 1,108	\$ 3,034	\$ 2,627	\$ 45	\$ —	\$ 16,681
Loans not deemed impaired	673,328	696,025	46,946	169,005	2,706	—	1,588,010
Total loans	<u>\$ 683,195</u>	<u>\$ 697,133</u>	<u>\$ 49,980</u>	<u>\$ 171,632</u>	<u>\$ 2,751</u>	<u>\$ —</u>	<u>\$1,604,691</u>

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The following is a summary of past due and non-accrual loans at September 30, 2013 and December 31, 2012:

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More	Total Past Due	Past Due 90 Days or More and Still Accruing	Loans on Non- accrual
<b>September 30, 2013</b>						
Real estate loans:						
Residential	\$ 552	\$ 1,298	\$ 3,348	\$ 5,198	\$ —	\$ 9,040
Commercial	—	811	1,086	1,897	—	1,086
Construction	—	—	1,221	1,221	—	1,442
Commercial business loans	—	23	319	342	—	915
Installment and collateral	1	4	3	8	—	31
Total	<u>\$ 553</u>	<u>\$ 2,136</u>	<u>\$ 5,977</u>	<u>\$ 8,666</u>	<u>\$ —</u>	<u>\$ 12,514</u>
<b>December 31, 2012</b>						
Real estate loans:						
Residential	\$ 5,818	\$ 3,087	\$ 4,794	\$ 13,699	\$ —	\$ 9,867
Commercial	8,235	466	1,230	9,931	—	1,108
Construction	1,046	121	1,497	2,664	—	2,409
Commercial business loans	301	3	62	366	—	2,626
Installment and collateral	16	5	46	67	—	46
Total	<u>\$ 15,416</u>	<u>\$ 3,682</u>	<u>\$ 7,629</u>	<u>\$ 26,727</u>	<u>\$ —</u>	<u>\$ 16,056</u>

The following is a summary of impaired loans with and without a valuation allowance as of September 30, 2013 and December 31, 2012.

(In thousands)	September 30, 2013			December 31, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
Impaired loans without a valuation allowance:						
Real estate loans:						
Residential	\$ 7,145	\$ 7,145	—	\$ 9,170	\$ 9,170	—
Commercial	4,040	4,040	—	1,108	1,108	—
Construction	2,572	2,572	—	2,538	2,538	—
Commercial business loans	1,365	1,365	—	2,291	2,291	—
Installment and collateral loans	31	31	—	45	45	—
Total	<u>15,153</u>	<u>15,153</u>	<u>—</u>	<u>15,152</u>	<u>15,152</u>	<u>—</u>
Impaired loans with a valuation allowance:						
Real estate loans:						
Residential	2,310	2,310	\$ 145	697	697	\$ 97
Construction	—	—	—	496	496	1
Commercial business loans	33	33	13	336	336	220
Total	<u>2,343</u>	<u>2,343</u>	<u>158</u>	<u>1,529</u>	<u>1,529</u>	<u>318</u>
Total	<u>\$ 17,496</u>	<u>\$ 17,496</u>	<u>\$ 158</u>	<u>\$ 16,681</u>	<u>\$ 16,681</u>	<u>\$ 318</u>

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The following is a summary of average recorded investment in impaired loans with and without a valuation allowance and interest income recognized on those loans for the three and nine months ended September 30, 2013 and 2012.

	For the Three Months Ended September 30, 2013			For the Three Months Ended September 30, 2012		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
<b>(In thousands)</b>						
<b>Impaired loans without a valuation allowance:</b>						
Real estate loans:						
Residential	\$ 7,938	\$ 82	\$ 82	\$ 8,339	\$ 87	\$ 87
Commercial	4,270	—	—	1,991	11	11
Construction	2,437	11	11	1,228	5	5
Commercial business loans	1,213	6	6	1,050	10	10
Installment and collateral loans	31	—	—	33	—	—
Total	15,889	99	99	12,641	113	113
<b>Impaired loans with a valuation allowance:</b>						
Real estate loans:						
Residential	1,737	8	8	1,639	2	2
Commercial business loans	17	—	—	357	5	5
Total	1,754	8	8	1,996	7	7
	<u>\$ 17,643</u>	<u>\$ 107</u>	<u>\$ 107</u>	<u>\$ 14,637</u>	<u>\$ 120</u>	<u>\$ 120</u>
<b>(In thousands)</b>						
<b>Impaired loans without a valuation allowance:</b>						
Real estate loans:						
Residential	\$ 8,342	\$ 281	\$ 281	\$ 8,217	\$ 277	\$ 277
Commercial	2,917	45	45	1,588	57	57
Construction	2,174	28	28	1,140	33	33
Commercial business loans	1,474	37	37	1,372	51	51
Installment and collateral loans	35	1	1	32	2	2
Total	14,942	392	392	12,349	420	420
<b>Impaired loans with a valuation allowance:</b>						
Real estate loans:						
Residential	1,508	38	38	1,358	39	39
Construction	321	—	—	—	—	—
Commercial business loans	175	4	4	178	6	6
Installment and collateral loans	3	—	—	—	—	—
Total	2,007	42	42	1,536	45	45
	<u>\$ 16,949</u>	<u>\$ 434</u>	<u>\$ 434</u>	<u>\$ 13,885</u>	<u>\$ 465</u>	<u>\$ 465</u>

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Management has established the allowance for loan loss in accordance with GAAP at September 30, 2013 based on the current risk assessment and level of loss that is believed to exist within the portfolio. This level of reserve is deemed an appropriate estimate of probable loan losses inherent in the loan portfolio as of September 30, 2013 based upon the analysis conducted and given the portfolio composition, delinquencies, charge offs and risk rating changes experienced during the first nine months of 2013 and the three-year evaluation period utilized in the analysis. Based on the qualitative assessment of the portfolio and in thorough consideration of non-performing loans, management believes that the allowance for loan losses properly supports the level of associated loss and risk.

**Troubled Debt Restructurings:** The restructuring of a loan is considered a “troubled debt restructuring” if both (i) the restructuring constitutes a concession by the creditor and (ii) the debtor is experiencing financial difficulties. A troubled debt restructuring may include (i) a transfer from the debtor to the creditor of receivables from third parties, real estate, or other assets to satisfy fully or partially a debt, (ii) issuance or other granting of an equity interest to the creditor by the debtor to satisfy fully or partially a debt unless the equity interest is granted pursuant to existing terms for converting debt into an equity interest, and (iii) modifications of terms of a debt.

Troubled debt restructurings during the three and nine months ended September 30, 2013 and 2012 are set forth in the following table:

	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
(Dollars in thousands)						
Residential real estate	4	\$ 508	\$ 508	6	\$ 1,001	\$ 1,001
Commercial real estate	—	—	—	2	3,159	3,159
Construction	3	521	521	3	521	521
Commercial business	1	50	50	1	50	50
Installment and collateral	—	—	—	2	30	30
	<u>8</u>	<u>\$ 1,079</u>	<u>\$ 1,079</u>	<u>14</u>	<u>\$ 4,761</u>	<u>\$ 4,761</u>

Troubled debt restructurings that defaulted within twelve months of restructuring during the three and nine months ended September 30, 2013 follows:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
(Dollars in thousands)				
Residential real estate	2	\$ 344	3	\$ 408
	<u>2</u>	<u>\$ 344</u>	<u>3</u>	<u>\$ 408</u>

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	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
(Dollars in thousands)						
Residential real estate	—	\$ —	\$ —	1	\$ 27	\$ —
Construction	—	—	—	5	1,546	1,552
Total troubled debt restructuring	—	\$ —	\$ —	6	\$ 1,573	\$ 1,552

Troubled debt restructurings that defaulted within twelve months of restructuring during the three and nine months ended September 30, 2012 follows:

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
(Dollars in thousands)				
Residential real estate	—	\$ —	3	\$ 490
Total troubled debt restructuring	—	\$ —	3	\$ 490

The majority of restructured loans were on non-accrual status as of September 30, 2013 and December 31, 2012. The financial impact of the trouble debt restructured loans has been minimal to date. Typically, residential loans are restructured with a modification and extension of the loan amortization and maturity at substantially the same interest rate as contained in the original credit extension. As part of the troubled debt restructuring process, the current value of the property is compared to the general ledger loan balance and if not fully supported, a write down is processed through the allowance for loan losses. Commercial real estate loans and commercial business loans also contain payment modification agreements and a like assessment of the underlying collateral value if the borrower's cash flow may be inadequate to service the entire obligation.

### **Loan Servicing**

The Company services certain loans for third parties. The aggregate of loans serviced for others was \$395.6 million and \$238.1 million as of September 30, 2013 and December 31, 2012, respectively. The balances of these loans are not included in the accompanying Consolidated Statements of Condition.

The risks inherent in mortgage servicing rights relate primarily to changes in prepayments that result from shifts in mortgage interest rates. The fair value of mortgage servicing rights at September 30, 2013 and 2012 was determined using pretax internal rates of return ranging from 8.0% to 10.0% and the Public Securities Association ("PSA") Standard Prepayment model to estimate prepayments on the portfolio with an average prepayment speed of 199 and 595, respectively. The fair value of mortgage servicing rights is obtained from a third party provider.

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Mortgage servicing rights are included in other assets in the Consolidated Statements of Condition. The following table summarizes mortgage servicing rights activity for the three and nine months ended September 30, 2013 and 2012:

(In thousands)	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
<b>Mortgage servicing rights:</b>				
Balance at beginning of period	\$ 3,336	\$ 836	\$ 1,052	\$ 944
Cumulative effect of change in accounting principle	—	—	502	—
Change in fair value recognized in net income	(51)	—	1,246	—
Issuances	460	258	1,032	341
Settlements	(36)	—	(123)	—
Amortization	—	(100)	—	(291)
Balance at end of period	<u>3,709</u>	<u>994</u>	<u>3,709</u>	<u>994</u>
<b>Valuation allowances:</b>				
Balance at beginning of period	—	(85)	—	(166)
Recoveries	—	—	—	108
Provisions	—	(39)	—	(66)
Balance at end of period	<u>—</u>	<u>(124)</u>	<u>—</u>	<u>(124)</u>
Mortgage servicing rights, net	<u>\$ 3,709</u>	<u>\$ 870</u>	<u>\$ 3,709</u>	<u>\$ 870</u>
Fair value of mortgage servicing rights at end of period	<u>\$ 3,709</u>	<u>\$ 1,013</u>	<u>\$ 3,709</u>	<u>\$ 1,013</u>

## Note 8. Federal Home Loan Bank Advances and Stock and Other Borrowings

### FHLB Advances and Stock

The Bank is a member of the FHLBB. Contractual maturities and weighted-average rates of outstanding advances from the FHLBB as of September 30, 2013 and December 31, 2012 are summarized below:

(Dollars in thousands)	September 30, 2013		December 31, 2012	
	Amount	Weighted-Average Rate	Amount	Weighted-Average Rate
2013	\$ 76,000	0.25%	\$ 61,000	0.33%
2014	23,112	1.45	8,112	3.70
2015	35,000	2.28	35,000	2.28
2016	3,000	2.70	3,000	2.70
2017	33,000	2.56	33,000	2.56
Thereafter	2,942	2.54	2,994	2.54
	<u>\$173,054</u>	1.34%	<u>\$143,106</u>	1.61%

At September 30, 2013, FHLBB advances totaling \$23.0 million with interest rates ranging from 3.19% to 4.39% which are scheduled to mature between 2014 and 2017 are callable. Advances are collateralized by first mortgage loans with an estimated eligible collateral value of \$294.1 million and \$350.6 million at September 30, 2013 and December 31, 2012, respectively.

In addition to the outstanding advances the Bank has access to an unsecured line of credit with the FHLBB amounting to \$10.0 million at September 30, 2013 and December 31, 2012. At September 30, 2013 and December 31, 2012 there were no advances outstanding under the line of credit.

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In accordance with an agreement with the FHLBB, the qualified collateral must be free and clear of liens, pledges and encumbrances. At September 30, 2013, the Bank could borrow immediately an additional \$98.5 million from the FHLBB inclusive of the line of credit.

The Bank is required to acquire and hold shares of capital stock in the FHLBB in an amount at least equal to the sum of 0.35% of the aggregate principal amount of its unpaid residential mortgage loans and similar obligations at the beginning of each year, and up to 4.5% of its advances (borrowings) from the FHLBB. The carrying value of FHLBB stock approximates fair value based on the most recent redemption provisions of the stock. The FHLBB repurchased \$814,000 of excess capital stock during the first quarter of 2013 as part of an announced program to repurchase \$250.0 million of members' excess stock, the second repurchase since it established a moratorium in 2008.

### *Other Borrowings*

As of September 30, 2013, advances outstanding under reverse repurchase agreements totaled \$23.2 million. The outstanding advances consisted of three individual borrowings with the remaining terms of five months or less and a weighted average cost of 0.45%.

In addition to the FHLBB advances, reverse repurchase borrowing agreements and committed fed funds lines of credit, the Bank has a relationship with a brokered sweep deposit provider by which funds are provided up to a maximum of 5% of the Bank's assets. As of September 30, 2013, amounts under this agreement totaled \$20.0 million at a cost of 0.50%. As of September 30, 2013, the Bank could borrow an additional \$90.9 million through this relationship.

## **Note 9. Pension and Other Post-Retirement Benefit Plans**

### **Defined Benefit, Supplemental and Other Post-Retirement Plans**

The Company offered a defined benefit noncontributory pension plan through December 31, 2012 for eligible employees who met certain minimum service and age requirements hired before January 1, 2005. Pension plan benefits were based upon employee earnings during the period of credited service. The pension plan was hard-frozen effective December 31, 2012. Employees hired on or after January 1, 2005 receive no benefits under the plan. All other employees will accrue no additional retirement benefits on or after January 1, 2013, and the amount of their qualified retirement income will not exceed the amount of benefits determined as of December 31, 2012.

The Company also has supplemental retirement plans (the "Supplemental Plans") that provide benefits for certain key executive officers. Benefits under the Supplemental Plans are based on a predetermined formula and are reduced by other benefits. The liability arising from these plans is being accrued over the participants' remaining periods of service so that at the expected retirement dates, the present value of the annual payments will have been expensed.

The Company also provides an unfunded post-retirement medical, health and life insurance benefit plan for retirees and employees hired prior to March 31, 1993.

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The following table presents the amount of net periodic pension cost for the three and nine months ended September 30, 2013 and 2012.

(In thousands)	Qualified Pension		Supplemental Executive Retirement Plans		Other Post-Retirement Benefits	
	For the Quarter		For the Quarter		For the Quarter	
	Ended September 30,		Ended September 30,		Ended September 30,	
	2013	2012	2013	2012	2013	2012
Service cost	\$ 13	\$ 265	\$ 8	\$ 10	\$ 9	\$ 8
Interest cost	262	291	12	11	23	25
Expected return on plan assets	(434)	(423)	—	—	—	—
Amortization:						
Loss	196	309	1	1	16	19
Prior service (credit) cost	—	(12)	5	7	—	—
Net periodic benefit cost	<u>\$ 37</u>	<u>\$ 430</u>	<u>\$ 26</u>	<u>\$ 29</u>	<u>\$ 48</u>	<u>\$ 52</u>

(In thousands)	Qualified Pension		Supplemental Executive Retirement Plans		Other Post-Retirement Benefits	
	For the Nine Months		For the Nine Months		For the Nine Months	
	Ended September 30,		Ended September 30,		Ended September 30,	
	2013	2012	2013	2012	2013	2012
Service cost	\$ 38	\$ 794	\$ 29	\$ 29	\$ 27	\$ 23
Interest cost	786	873	35	33	68	76
Expected return on plan assets	(1,301)	(1,268)	—	—	—	—
Amortization:						
Loss	588	927	5	3	49	58
Prior service (credit) cost	—	(36)	18	21	—	—
Additional amount recognized due to settlement or curtailment	—	—	199	—	—	—
Net periodic benefit cost	<u>\$ 111</u>	<u>\$ 1,290</u>	<u>\$ 286</u>	<u>\$ 86</u>	<u>\$ 144</u>	<u>\$ 157</u>

In addition to the above, the Company entered into a non-qualified, Supplemental Executive Retirement Plan with the Company's president in December 2012. Plan expenses for the three and nine months ended September 30, 2013 were \$18,000 and \$54,000, respectively. The accrued liability was \$114,000 as of September 30, 2013.

### Note 10. Share-Based Compensation Plans

The Company maintains and operates the Rockville Financial, Inc. 2006 Stock Incentive Award Plan (the "Plan") as approved by the Company's Board of Directors and stockholders. The Plan allows the Company to use stock options, stock awards, stock appreciation rights and performance awards to attract, retain and reward performance of qualified employees and others who contribute to the success of the Company. Prior to the Company's second-step stock offering effective March 3, 2011, the Plan allowed for the issuance of a maximum of 349,830 restricted stock shares and 874,575 stock options. After adjusting for the 1.5167 exchange ratio established as a result of the stock offering, the Plan allows for maximum issuances of 530,587 restricted stock shares and 1,326,467 stock options. As of December 31, 2012, 14,603 restricted stock shares and 161,841 stock options remained available for future grants. During the nine months ended September 30, 2013, there were no restricted stock shares and 94,419 stock options granted. Additionally, 1,717 restricted stock shares and 11,720 stock options were forfeited and re-entered the pool of available shares for future grants. As of September 30, 2013, 16,319 restricted stock shares and 79,142 stock options remain available for future grants under the Plan.



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The Company maintains and operates the Rockville Financial, Inc. 2012 Stock Incentive Plan (the “2012 Plan”) as approved by the Company’s Board of Directors and stockholders. The 2012 Plan allows the Company to use stock options, stock awards, stock appreciation rights and performance awards to attract, retain and reward performance of qualified employees and others who contribute to the success of the Company. The 2012 Plan allows for the issuance of a maximum of 684,395 restricted stock shares and 1,710,989 stock options. As of December 31, 2012, 258,390 restricted stock shares and 810,537 stock options remained available for future grants. During the nine months ended September 30, 2013, there were 53,834 restricted stock shares and 342,817 stock options granted. Of the 53,834 restricted shares granted in 2013, 15,391 shares are performance-related. Additionally, 4,424 restricted stock shares and 14,328 stock options were forfeited and re-entered the pool of available shares for future grants. There was also an adjustment for performance-related restricted stock shares of 19,498 shares, which were removed from the pool of remaining shares in anticipation of a coming performance-related vestings. As of September 30, 2013, 189,482 restricted stock shares and 482,048 stock options remain available for future grants under the 2012 Plan.

Total employee and Director share-based compensation expense recognized for stock options and restricted stock was \$475,000 with a related tax benefit recorded of \$166,000 for the three months ended September 30, 2013, of which Director share-based compensation expense recognized (in the Consolidated Statements of Net Income as other non-interest expense) was \$59,000 and officer share-based compensation expense recognized (in the Consolidated Statements of Net Income as salaries and employee benefit expense) was \$416,000. The total charge of \$475,000 for the three months ended September 30, 2013 includes \$293,000 of cost related to 22,080 vested restricted shares used for income tax withholding on behalf of certain executives in the three months ended September 30, 2013.

Total employee and Director share-based compensation expense recognized for stock options and restricted stock was \$2.1 million with a related tax benefit recorded of \$743,000 for the nine months ended September 30, 2013, of which Director share-based compensation expense recognized (in the Consolidated Statements of Net Income as other non-interest expense) was \$664,000 and officer share-based compensation expense recognized (in the Consolidated Statements of Net Income as salaries and employee benefit expense) was \$1.5 million. The total charge of \$2.1 million for the nine months ended September 30, 2013 includes \$319,000 related to 24,118 vested restricted shares used for income tax withholding on behalf of certain executives which occurred in the first nine months of 2013.

**Stock Options:** The following table presents the activity related to stock options under the Plans for the nine months ended September 30, 2013:

	<b>Number of Stock Options</b>	<b>Weighted- Average Exercise Price</b>	<b>Weighted-Average Remaining Contractual Term (in years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Outstanding at December 31, 2012	1,996,843	\$ 10.12		
Granted	437,236	13.20		
Exercised	(82,171)	8.77		
Forfeited or expired	(26,048)	10.76		
Outstanding at September 30, 2013	<u>2,325,860</u>	<u>\$ 10.74</u>	<u>7.5</u>	<u>\$ 5,358</u>
Stock options vested and exercisable at September 30, 2013	<u>1,318,420</u>	<u>\$ 10.04</u>	<u>6.3</u>	<u>\$ —</u>

The aggregate fair value of options that vested was \$764,000 and \$541,000 during the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013, the unrecognized cost related to the stock options awarded of \$1.4 million will be recognized over a weighted-average period of 2.3 years.

For share-based compensation recognized for the nine months ended September 30, 2013, the Company used the Black-Scholes option pricing model for estimating the fair value of stock options granted. There were 437,236 stock options granted in the first nine months of 2013. The weighted-average estimated fair values of stock option grants and the assumptions that were used in calculating such fair values were based on estimates at September 30, 2013 as follows:

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	<u>September 30, 2013</u>	<u>September 30, 2012</u>
Weighted per share average fair value of options granted	\$ 1.80	\$ 1.47
Assumptions:		
Risk-free interest rate	1.61%	0.91%
Expected volatility	20.33%	22.27%
Expected dividend yield	3.03%	3.28%
Expected life of options granted	6.0 years	6.0 years

There were no options granted in the three months ended September 30, 2013 and 2012.

**Restricted Stock:** Restricted stock provides grantees with rights to shares of common stock upon completion of a service period. During the restriction period, all shares are considered outstanding and dividends are paid on the restricted stock. The following table presents the activity for restricted stock for the nine months ended September 30, 2013:

	<u>Number of Shares</u>	<u>Weighted-Average Grant-Date Fair Value</u>
Unvested as of December 31, 2012	378,604	\$ 10.89
Granted	53,834	13.20
Vested	(178,725)	10.97
Forfeited	(6,141)	10.27
Unvested as of September 30, 2013	<u>247,572</u>	<u>\$ 11.35</u>

The fair value of restricted shares that vested during the nine months ended September 30, 2013 and 2012 was \$2.0 million and \$806,000, respectively. As of September 30, 2013, there was \$2.1 million of total unrecognized compensation cost related to unvested restricted stock which was expected to be recognized over a weighted-average period of 1.8 years.

During the nine months ended September 30, 2013, the Company granted 53,834 shares of restricted stock out of Treasury stock. In conjunction with the grant, 5,780 shares of restricted stock vested immediately.

Of the remaining unvested restricted stock, 2,362 shares will vest in 2013, 90,763 in 2014, 133,269 in 2015 and 21,178 in 2016. All unvested restricted stock shares are expected to vest.

**Employee Stock Ownership Plan:** In connection with its reorganization and stock offering completed in 2005, the Company established an Employee Stock Ownership Plan (“ESOP”) to provide substantially all employees of the Company the opportunity to also become shareholders. The ESOP borrowed \$7.8 million from the Company to purchase 699,659 shares of common stock in the subscription offering and in the open market. The outstanding loan balance of \$1.9 million at September 30, 2013 will be repaid principally from the Bank’s discretionary contributions to the ESOP over a remaining period of two years. The 699,659 ESOP shares purchased in the initial reorganization in 2005 were exchanged for shares in the second-step conversion using an exchange ratio of 1.5167.

As part of the second-step conversion and stock offering completed in 2011, the ESOP borrowed an additional \$7.1 million from the Company to purchase 684,395 shares of common stock during the initial public offering and in the open market. The outstanding loan balance of \$6.8 million at September 30, 2013 will be repaid principally from the Bank’s discretionary contributions to the ESOP over a remaining period of 28 years.

The Company accounts for its ESOP in accordance with FASB ASC 718-40, *Compensation – Stock Compensation*. Under this guidance, unearned ESOP shares are not considered outstanding and are shown as a reduction of stockholders’ equity as unearned compensation. The Company will recognize compensation cost equal to the fair value of the ESOP shares during the periods in which they are committed to be released. To the extent that the fair value of the Company’s ESOP shares differs from the cost of such shares, this difference will be credited or debited to equity. As the loan is internally leveraged, the loan receivable from the ESOP to the Company is not reported as an asset nor is the debt of the ESOP shown as a liability in the Company’s financial statements. Dividends on unallocated shares are used to pay the ESOP debt.

At September 30, 2013, the two loans had an outstanding balance of \$8.7 million and the interest rate is the prime rate plus one percent. The unallocated ESOP shares are pledged as collateral on the loans. As the loans are repaid to the Company, shares will be released from collateral and will be allocated to the accounts of the participants. The ESOP compensation expense for the nine months ended September 30, 2013 and 2012 was \$1.3 million and \$1.1 million, respectively.

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The ESOP shares as of September 30, 2013 were as follows:

Shares released for allocation	991,262
Unreleased shares	<u>754,306</u>
Total ESOP shares	<u>1,745,568</u>
Market value of unreleased shares at September 30, 2013 (in thousands)	\$ 9,806

In September 2013, the Company announced that it will be merging its ESOP with its Defined Contribution Plan, or 401(k) Plan, effective January 1, 2014.

### **Note 11. Income Taxes**

As of September 30, 2013 and December 31, 2012, there were no material uncertain tax positions related to federal and state income tax matters. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service and state taxing authorities for the years ended after December 31, 2009.

As of September 30, 2013 and December 31, 2012, the Company has not recorded any interest and penalties related to uncertain tax positions.

### **Note 12. Accumulated Other Comprehensive Loss**

Components of accumulated other comprehensive loss, net of taxes, consist of the following:

(In thousands)	Net Unrealized (Loss) Gain on Benefit Plans	Net Unrealized Gain (Loss) on Available For Sale Securities	Net Unrealized (Loss) Gain on Interest Rate Swaps	Accumulated Other Comprehensive Loss
December 31, 2012	\$ (7,006)	\$ 3,055	\$ (96)	\$ (4,047)
Change	498	(9,432)	3,731	(5,203)
September 30, 2013	<u>\$ (6,508)</u>	<u>\$ (6,377)</u>	<u>\$ 3,635</u>	<u>\$ (9,250)</u>

### **Note 13. Regulatory Matters**

The Company and the Bank are subject to various regulatory capital requirements administered by Federal and State 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. The regulations require the Company and the Bank to meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance sheet items, as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. At September 30, 2013, the Bank exceeded all regulatory capital requirements and is considered "well-capitalized" under regulatory guidelines.

The following is a summary of the Company's and the Bank's regulatory capital amounts and ratios as of September 30, 2013 and December 31, 2012 compared to the Federal Deposit Insurance Corporation's requirements for classification as a well-capitalized institution and for minimum capital adequacy:

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	<u>Actual</u>		<u>Minimum For Capital Adequacy Purposes</u>		<u>Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
(Dollars in thousands)						
<b>Rockville Bank:</b>						
<b>September 30, 2013</b>						
Total capital to risk weighted assets	\$286,696	16.4 %	\$139,937	8.0 %	\$174,921	10.0 %
Tier 1 capital to risk weighted assets	267,249	15.3	70,006	4.0	105,009	6.0
Tier 1 capital to total average assets	267,249	12.3	86,910	4.0	108,638	5.0
<b>December 31, 2012</b>						
Total capital to risk weighted assets	\$272,111	17.4 %	\$124,893	8.0 %	\$156,116	10.0 %
Tier 1 capital to risk weighted assets	253,089	16.2	62,453	4.0	93,679	6.0
Tier 1 capital to total average assets	253,089	12.9	78,721	4.0	98,402	5.0
<b>Rockville Financial, Inc.:</b>						
<b>September 30, 2013</b>						
Total capital to risk weighted assets	\$322,429	18.4 %	\$140,569	8.0 %	N/A	N/A
Tier 1 capital to risk weighted assets	302,982	17.3	70,257	4.0	N/A	N/A
Tier 1 capital to total average assets	302,982	13.9	87,064	4.0	N/A	N/A
<b>December 31, 2012</b>						
Total capital to risk weighted assets	\$342,505	21.9 %	\$125,345	8.0 %	N/A	N/A
Tier 1 capital to risk weighted assets	323,483	20.6	62,691	4.0	N/A	N/A
Tier 1 capital to total average assets	323,483	16.5	78,373	4.0	N/A	N/A

Connecticut law restricts the amount of dividends that the Bank can pay based on retained earnings for the current year and the preceding two years. As of September 30, 2013, \$42.4 million is available for payment of dividends.

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### Note 14. Net Income Per Share

The following table sets forth the calculation of basic and diluted net income per share for the three and nine months ended September 30, 2013 and 2012:

(In thousands, except share data)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income available to common stockholders	\$ 4,620	\$ 4,668	\$ 12,470	\$ 11,472
Adjusted weighted-average common shares outstanding	29,459,424	29,464,831	29,476,348	29,479,091
Less: average number of treasury shares	(3,192,225)	(900,344)	(2,328,930)	(649,679)
Less: average number of unvested ESOP award shares	(775,561)	(904,491)	(807,476)	(936,526)
Weighted-average basic shares outstanding	25,491,638	27,659,996	26,339,942	27,892,886
Dilutive effect of stock options	340,985	187,025	340,820	174,243
Weighted-average diluted shares	25,832,623	27,847,021	26,680,762	28,067,129
Net income per share:				
Basic	\$ 0.18	\$ 0.17	\$ 0.47	\$ 0.41
Diluted	\$ 0.18	\$ 0.17	\$ 0.47	\$ 0.41

### Note 15. Commitments and Contingencies

#### Financial Instruments With Off-Balance Sheet Risk

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit through issuing standby letters of credit and undisbursed portions of construction loans and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the statements of financial condition. The contractual amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The contractual amounts of commitments to extend credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults and the value of any existing collateral obligations is deemed worthless. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments. Off-balance sheet financial instruments whose contract amounts represent credit risk are as follows at September 30, 2013 and December 31, 2012:

(In thousands)	September 30, 2013	December 31, 2012
Commitments to extend credit:		
Commitment to grant loans	\$ 76,925	\$ 63,086
Undisbursed construction loans	101,026	71,459
Undisbursed home equity lines of credit	140,700	139,238
Undisbursed commercial lines of credit	26,989	76,673
Standby letters of credit	8,608	8,691
Unused checking overdraft lines of credit	39	51
	<u>\$ 354,287</u>	<u>\$ 359,198</u>

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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. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Since these commitments could 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 counterparty. Collateral held varies but may include residential and commercial property, accounts receivable, inventory, property, plant and equipment, deposits, and securities.

**Legal Matters:** The Company is not involved in any legal proceedings deemed to be material as of September 30, 2013 which have arisen in the normal course of business.

### **Forward-Looking Statements**

This Form 10-Q contains forward-looking statements that are within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are based upon the current beliefs and expectations of our management and are subject to significant risks and uncertainties. These risks and uncertainties could cause our results to differ materially from those set forth in such forward-looking statements.

Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. Words such as "believes," "anticipates," "expects," "intends," "plans," "estimates," "targeted" and similar expressions, and future or conditional verbs, such as "will," "would," "should," "could" or "may" are intended to identify forward-looking statements but are not the only means to identify these statements.

Factors that have a material adverse effect on operations include, but are not limited to, the following:

- Local, regional, national and international business or economic conditions may differ from those expected.
- The effects of and changes in trade, monetary and fiscal policies and laws, including the U.S. Federal Reserve Board's interest rate policies, may adversely affect our business.
- The ability to increase market share and control expenses may be more difficult than anticipated.
- Changes in government regulations (including those concerning taxes, banking, securities and insurance) may adversely affect us or our businesses, including those under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the Basel III update to the Basel Accords.
- Changes in accounting policies and practices, as may be adopted by regulatory agencies, the Public Company Accounting Oversight Board or the Financial Accounting Standards Board, may affect expected financial reporting.
- Future changes in interest rates may reduce our profits which could have a negative impact on the value of our stock.
- Technological changes and cyber-security matters.
- Changes in demand for loan products, financial products and deposit flow could impact our financial performance.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by customers.
- Adverse conditions in the securities markets that lead to impairment in the value of securities in our investment portfolio.
- Strong competition within our market area may limit our growth and profitability.
- We may plan to open new branches which may not become profitable as soon as anticipated, if at all.
- If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease.
- Our stock value may be negatively affected by banking regulations and our Certificate of Incorporation restricting takeovers.

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- Changes in the level of non-performing assets and charge-offs.
- Because we intend to continue to increase our commercial real estate and commercial business loan originations, our lending risk may increase, and downturns in the real estate market or local economy could adversely affect our earnings.
- The trading volume in our stock is less than in larger publicly traded companies which can cause price volatility, hinder your ability to sell our common stock and may lower the market price of the stock.
- We may not manage the risks involved in the foregoing as well as anticipated.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. Except as required by applicable law or regulation, management undertakes no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date on which such statements were made.

## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is intended to help the reader understand Rockville Financial, Inc., our operations and our present business environment. We believe accuracy, transparency and clarity are the primary goals of successful financial reporting. We remain committed to transparency in our financial reporting, providing our stockholders with informative financial disclosures and presenting an accurate view of our financial disclosures, financial position and operating results.

MD&A is provided as a supplement to—and should be read in conjunction with—our Unaudited Consolidated Financial Statements and the accompanying notes thereto contained in Part I, Item 1, of this report as well as our Annual Report on Form 10-K for the year ended December 31, 2012. The following sections are included in MD&A:

- *Our Business* – a general description of our business, our objectives and regulatory considerations
- *Critical Accounting Estimates* – a discussion of accounting estimates that require critical judgments and estimates.
- *Operating Results* – an analysis of our Company’s consolidated results of operations for the periods presented in our Unaudited Consolidated Financial Statements.
- *Comparison of Financial Liquidity and Capital Resources* – an overview of financial condition and market interest rate risk.

### **Our Business**

#### **General**

By assets, Rockville Financial, Inc. is the third largest publicly traded banking institution headquartered in Connecticut with consolidated assets of \$2.22 billion and stockholders’ equity of \$295.2 million at September 30, 2013. The Company delivers financial services to individuals, families and businesses throughout Connecticut and the region through its 22 banking offices, its commercial loan production office, its mortgage loan production office, 38 ATMs and internet website ([www.rockvillebank.com](http://www.rockvillebank.com)). The Company’s common stock is traded on the NASDAQ Global Select Stock Exchange under the symbol “RCKB.”

The Company strives to remain a leader in meeting the financial service needs of the community and to provide superior customer service to the individuals and businesses in the market areas that it has served since 1858. Rockville Bank is a community-oriented provider of traditional banking products and services to business organizations and individuals, offering products such as residential and commercial real estate loans, commercial business loans, consumer loans and a variety of deposit products. Our business philosophy is to remain a community-oriented franchise and continue to focus on providing superior customer service to meet the financial needs of the communities in which we operate. Current strategies include expanding our banking network by pursuing new branch locations and branch acquisition opportunities in our market area, continuing our residential mortgage lending activities which comprise a majority of our loan portfolio and continuing to expand our commercial real estate and commercial business lending activities and growing our deposit base.

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The Company's results of operations depend primarily on net interest income, which is the difference between the income earned on its loan and securities portfolios and its cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by the Company's provision for loan losses, income and expenses pertaining to other real estate owned, gains and losses from sales of loans and securities and non-interest income and expenses. Non-interest income primarily consists of fee income from depositors, mortgage servicing income, mortgage origination and loan sale income and increases in cash surrender value of bank-owned life insurance ("BOLI"). Non-interest expenses consist principally of salaries and employee benefits, occupancy, service bureau fees, marketing, professional fees, FDIC insurance assessments, other real estate owned and other operating expenses.

Results of operations are also significantly affected by general economic and competitive conditions and changes in interest rates as well as government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may materially affect the Company. Uncertainty and challenges surrounding future economic growth, consumer confidence, credit availability, competition and corporate earnings remains. Management believes that overall credit quality continues to be somewhat affected by weaknesses in national and regional economic conditions, including high unemployment levels, particularly in Connecticut.

### *Our Objectives*

The Company seeks to continually deliver superior value to its customers, stockholders, employees and communities through achievement of its core operating objectives which are to:

- Grow and retain primary households to increase core deposit relationships with a focus on checking, savings and money market accounts for personal, business and municipal depositors;
- Build high quality, profitable loan portfolios using primarily organic growth and also purchase strategies, while also continuing to build efficiencies in its robust secondary mortgage banking business;
- Build and diversify revenue streams through development of banking-related fee income, in particular, through the expansion of its financial advisory services and introduction of private banking professionals;
- Maintain expense discipline and improve operating efficiencies;
- Invest in technology to enhance superior customer service and products; and
- Maintain a rigorous risk identification and management process.

Significant factors management reviews to evaluate achievement of the Company's operating objectives and its operating results and financial condition include, but are not limited to: net income and earnings per share, return on equity and assets, net interest margin, non-interest income, operating expenses related to total assets and efficiency ratio, asset quality, loan and deposit growth, capital management, liquidity and interest rate sensitivity levels, customer service standards, market share and peer comparisons.

### *Regulatory Considerations*

Rockville Financial and its subsidiaries are subject to numerous examinations by federal and state banking regulators, as well as the Securities and Exchange Commission. Please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2012 for additional disclosures with respect to laws and regulations affecting the Company's businesses.

It is difficult to predict at this time what specific impact certain provisions the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on the Company, including any regulations promulgated by the Consumer Financial Protection Bureau. The financial reform legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and our ability to conduct business. Management will have to apply additional resources to ensure compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings.

In June 2012, the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation approved three proposals that would amend the existing capital adequacy requirements of banks and bank holding companies. The three proposals would, among other things, implement the Basel III capital standards, as well as the standardized approach for almost all banking organizations in the United States. The proposal would increase the minimum levels of required capital, narrow the definition of capital, and place greater emphasis on common equity. The Basel III standardized proposal would modify the risk weights for various asset classes.



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In July 2013, the three Federal bank regulatory agencies (the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation) approved the final Basel III rules that amended the existing capital adequacy requirements of banks and bank holding companies for smaller banks as defined. The new rules will become effective for smaller banks and bank holding companies on January 15, 2015. The Company believes it will continue to exceed all expected well-capitalized regulatory requirements upon the implementation of Basel III.

### Critical Accounting Estimates

The accounting policies followed by the Company and its subsidiaries conform with accounting principles generally accepted in the United States of America and with general practices within the banking industry. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that management believes to be relevant at the time our Consolidated Financial Statements are prepared. On a regular basis, management reviews the accounting policies, assumptions, estimates and judgments to ensure that our financial statements are presented fairly and in accordance with GAAP.

We believe that our most critical accounting policies, which involve the most complex subjective decisions or assessments, relate to allowance for loan losses, other-than-temporary impairment of investment securities, derivatives, income taxes, pension and other post-retirement benefits and share-based compensation. None of the Company's critical accounting estimates have changed during the quarter. Additional accounting policies are more fully described in Note 1 in the "Notes to Consolidated Financial Statements" presented in our 2012 Annual Report on Form 10-K. A brief description of our current policies involving significant judgment follows:

**Allowance for Loan Losses:** The allowance for loan losses is established as embedded losses are estimated to have occurred through the provisions for losses charged against operations and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Management's judgment in determining the adequacy of the allowance is inherently subjective and is based on past loan loss experience, known and inherent losses and size of the loan portfolios, an assessment of current economic and real estate market conditions, estimates of the current value of underlying collateral, review of regulatory authority examination reports and other relevant factors.

Although management believes it uses appropriate available information to establish the allowance for loan losses, future additions to the allowance may be necessary if certain future events occur that cause actual results to differ from the assumptions used in making the evaluation.

**Other-than-Temporary Impairment of Securities:** The Company maintains a securities portfolio that is classified into two major categories: available for sale and held to maturity. Securities available for sale are recorded at estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Held to maturity securities are recorded at amortized cost. Management determines the classifications of a security at the time of its purchase.

Quarterly, securities with unrealized losses are reviewed as deemed appropriate to assess whether the decline in fair value is temporary or other-than-temporary. The assessment is to determine whether the decline in value is from company-specific events, industry developments, general economic conditions, credit losses on debt or other reasons. Declines in the fair value of available for sale securities below their cost or amortized cost that are deemed to be other-than-temporary are reflected in earnings for equity securities and for debt securities that have an identified credit loss. Unrealized losses on debt securities with no identified credit loss component are reflected in other comprehensive income. In the first nine months of 2013, the Company did not experience any losses which were deemed to be other-than-temporarily impaired.

**Derivative Instruments and Hedging Activities:** The Company uses derivatives to manage a variety of risks, including risks related to interest rates. Accounting for derivatives as hedges requires that, at inception and over the term of the arrangement, the hedged item and related derivative meet the requirements for hedge accounting. The rules and interpretations related to derivatives accounting are complex. Failure to apply this complex guidance correctly will result in the changes in the fair value of the derivative being reported in earnings.

The Company uses interest rate swaps to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. The fair values of interest rate swaps are determined using the standard methodology of netting the discounted future fixed cash receipts (or payment) and the expected variable cash payments (or receipts.) The variable cash payment (or receipts) are based on an expectation of future interest rates (forward curves) derived from observable market interest rates curves.

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At September 30, 2013, derivative assets and liabilities were \$6.6 million and \$966,000, respectively. Further information about our use of derivatives is provided in Note 6, “Derivatives and Hedging Activities” in Notes to Unaudited Consolidated Financial Statements contained elsewhere in this report.

**Income Taxes:** The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. Some judgments are subjective and involve estimates and assumptions about matters that are inherently uncertain. In determining the valuation allowance, we use forecasted future operating results, based upon approved business plans, including a review of the eligible carryforward periods, tax planning opportunities and other relevant considerations. Management believes that the accounting estimate related to the valuation allowance is a critical accounting estimate because the underlying assumptions can change from period to period. For example, tax law changes or variances in future projected operating performance could result in a change in the valuation allowance.

The reserve for tax contingencies contains uncertainties because management is required to make assumptions and to apply judgment to estimate the exposures associated with our various tax positions. The effective income tax rate is also affected by changes in tax law, entry into new tax jurisdictions, the level of earnings and the results of tax audits.

**Pension and Other Post-retirement Benefits:** Management uses key assumptions that include discount rates, expected return on plan assets, benefits earned, interest costs, mortality rates, increases in compensation, and other factors. The two most critical assumptions—estimated return on plan assets and the discount rate—are important elements of plan expense and asset/liability measurements. These critical assumptions are evaluated at least annually on a plan basis.

**Share-based Compensation:** The Company accounts for stock options and restricted stock based on the grant date fair value of the award. These costs are recognized over the period during which an employee is required to provide services in exchange for the award, the requisite service period (usually the vesting period). The Company expenses the grant date fair value of the Company’s stock options and restricted stock with a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria.

The Company uses the Black-Scholes option valuation model to value stock options. Determining the appropriate fair-value model and calculating the estimated fair value of share-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life, expected dividend rate, risk-free interest rate and expected forfeiture rate. The Company develops estimates based on historical data and market information which can change significantly over time.

## Operating Results

### *Executive Overview*

Earnings for the third quarter of 2013 were \$4.6 million, or \$0.18 per diluted share, compared to \$4.7 million, or \$0.17 per diluted share, for the third quarter in 2012. For the nine months ended September 30, 2013 and 2012 the Company recorded earnings of \$12.5 million, or \$0.47 per diluted share, and \$11.5 million, or \$0.41 per diluted share, respectively.

The Company’s results can be attributed to its continued business momentum characterized by solid revenues, balance sheet growth, continued success in the financial advisory business and a strong loan level hedging strategy, in tandem with solid asset quality and disciplined expense control.

The Company’s tax-equivalent net interest margin for the three months ended September 30, 2013 was 3.32%, a decrease of 43 basis points over the prior year quarter of 3.75%. The tax-equivalent net interest margin for the nine months ended September 30, 2013 was 3.43% compared to 3.80% for the same period in 2012. The general year over year trends impacting the margin from the first and second quarters continued in the third quarter, which includes decreased yields on loans and investments due to the low interest rate environment. Additionally, downward pressure was felt in the net-interest margin as a result of a loan level hedging program that the Company implemented in the second quarter. The loan level hedging program serves as a strong fee

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generator for the Company, but converts fixed rate assets to floating rate, which typically have a lower yield at inception. Furthermore, the secondary market strategy of opportunistically selling long duration fixed rate residential originations without adding to the legacy higher-yielding residential portfolio has had a significant impact on the residential portfolio's contribution to net interest margin. To offset these decreases the Company grew the average balances of interest-earning assets and managed its cost of funds downward, particularly in borrowings. However, for both the current quarter and year-to-date periods, the average yield on interest-earning assets has declined more than double that of the decline in the average cost of deposits and borrowings. The sustained period of low interest rates has impacted the net interest margin as interest-earning assets continue to originate or reprice downward while the cost of interest-bearing deposits has for all practical purposes reached a floor. The net-interest margin could continue to be adversely impacted if the low interest rate environment persists.

The Company's strategy with interest rate risk management is to shorten asset durations while maintaining a relatively short duration of wholesale funding and incentivizing retail customers to originate longer duration instruments; affording the Company flexibility to increase duration of wholesale funding to respond to changes in the interest rate environment. The Company will continually reassess this strategy in light of new economic data releases and market expectations for changes to interest rates.

Execution of the strategy has reduced the Company's sensitivity to rising interest rates by nearly half from the exposure reported in the quarter ended June 30, 2013 in year one of the Company's interest rate risk model. However, in year two the model reports an increase of net interest income due to the origination of variable rate assets during the third quarter as well as a \$50 million notional forward starting hedge that becomes effective in the second year of the model, which has the effect of adding a longer duration liability improving sensitivity to rising interest rates.

The asset quality of our loan portfolio has remained strong even as the leading economic indicators have provided mixed results as evidenced in part by the continued high unemployment and foreclosure rates throughout Connecticut and the region. The allowance for loan losses to total loans ratio was 1.13% and 1.15%, the allowance for loan losses to non-performing loans ratio was 149.45% and 115.08%, and the ratio of non-performing loans to total loans was 0.76% and 1.00% at September 30, 2013 and December 31, 2012, respectively. A provision for loan losses of \$532,000 was recorded for the current quarter compared to \$793,000 for the quarter ended September 30, 2012. For the nine months ended September 30, 2013 and 2012, the provision for loan loss expense was \$1.3 million and \$2.7 million, respectively.

The Company continues to demonstrate discipline with expense control. Non-interest expense as a percentage of average assets was 2.71% and 2.88% for the three and nine months ended September 30, 2013, respectively. Included in the nine month period were non-recurring expenses of approximately \$1.4 million. Excluding these items the non-interest expense as a percentage of average assets would have been 2.80%.

The Company will be aggressive in pursuing its strategic goals while practicing prudent risk management to achieve continued positive business momentum and success.

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### Selected Financial Data

	At or For the Three Months Ended September 30,		At or For the Nine Months Ended September 30,	
	2013	2012	2013	2012
(Dollars in thousands, except share data)				
<b>Share Data:</b>				
Basic net income per share common	\$ 0.18	\$ 0.17	\$ 0.47	\$ 0.41
Diluted net income per share common	0.18	0.17	0.47	0.41
Dividends declared per share	0.10	0.09	0.30	0.26
<b>Operating Data:</b>				
Total operating revenue	\$21,973	\$21,578	\$64,173	\$59,524
Total operating expense	14,763	14,510	45,291	40,668
<b>Key Ratios:</b>				
Return on average assets	0.85%	0.97%	0.79%	0.82%
Return on average equity	6.28%	5.73%	5.40%	4.66%
Tax-equivalent net interest margin	3.32%	3.75%	3.43%	3.80%
Non-interest expense to average assets	2.71%	3.00%	2.88%	2.90%
Cost of interest-bearing deposits	0.57%	0.68%	0.59%	0.74%
<b>Non-performing Assets:</b>				
Total non-accrual loans, excluding troubled debt restructures	\$10,436	\$11,058	\$10,436	\$11,058
Troubled debt restructures—non-accruing	2,078	2,965	2,078	2,965
Total non-performing loans	12,514	14,023	12,514	14,023
Other real estate owned	2,129	2,618	2,129	2,618
Total non-performing assets	\$14,643	\$16,641	\$14,643	\$16,641
Non-performing loans to total loans	0.76%	0.91%	0.76%	0.91%
Non-performing assets to total assets	0.66%	0.85%	0.66%	0.85%
Allowance for loan losses to non-performing loans	149.45%	128.93%	149.45%	128.93%
Allowance for loan losses to total loans	1.13%	1.17%	1.13%	1.17%
<b>Non GAAP Ratio:</b>				
Efficiency ratio	67.18%	67.24%	70.58%	68.32%

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### Average Balances, Interest, Average Yields\Cost and Rate\Volume Analysis

The table below sets forth average balance sheets, average yields and costs, and certain other information for the periods indicated. A tax-equivalent yield adjustment was made for the three and nine months ended September 30, 2013 and 2012. All average balances are daily average balances. Loans held for sale and non-accrual loans are included in the computation of interest-earning average balances, with non-accrual loans carrying a zero yield. The yields set forth above include the effect of deferred costs, discounts and premiums that are amortized or accreted to interest income or expense.

### Average Balance Sheets for the Three Months Ended September 30, 2013 and 2012

	Three Months Ended September 30,					
	2013			2012		
	Average Balance	Interest and Dividends	Annualized Yield/Cost	Average Balance	Interest and Dividends	Annualized Yield/Cost
(Dollars in thousands)						
<b>Interest-earning assets:</b>						
Residential real estate loans	\$ 651,996	\$ 6,112	3.75%	\$ 698,319	\$ 7,108	4.07%
Commercial real estate loans	741,345	8,293	4.44	637,107	8,385	5.24
Construction loans	47,779	435	3.61	50,009	472	3.75
Commercial loans	207,656	2,027	3.87	169,314	1,877	4.41
Installment and collateral loans	2,534	31	4.91	3,199	41	5.17
Securities	365,364	2,832	3.10	233,104	1,991	3.42
Federal Home Loan Bank stock	15,053	14	0.37	15,867	20	0.50
Other earning assets	22,645	18	0.32	23,385	13	0.22
Total interest-earning assets	2,054,372	19,762	3.83	1,830,304	19,907	4.34
Allowance for loan losses	(18,544)			(17,668)		
Non-interest-earning assets	141,767			122,068		
Total assets	<u>\$2,177,595</u>			<u>\$1,934,704</u>		
<b>Interest-bearing liabilities:</b>						
NOW and money market accounts	\$ 620,540	481	0.31	\$ 518,176	381	0.29
Saving deposits <sup>(1)</sup>	224,831	35	0.06	209,197	47	0.09
Time deposits	541,042	1,484	1.09	525,799	1,721	1.30
Total interest-bearing deposits	1,386,413	2,000	0.57	1,253,172	2,149	0.68
Advances from the Federal Home Loan Bank	205,391	603	1.16	119,802	558	1.85
Other borrowings	21,067	24	0.45	—	—	—
Total interest-bearing liabilities	1,612,871	2,627	0.65%	1,372,974	2,707	0.78%
Non-interest-bearing liabilities	270,379			236,068		
Total liabilities	1,883,250			1,609,042		
Stockholders' equity	294,345			325,662		
Total liabilities and stockholders' equity	<u>\$2,177,595</u>			<u>\$1,934,704</u>		
Net interest-earning assets <sup>(3)</sup>	<u>\$ 441,501</u>			<u>\$ 457,330</u>		
Tax-equivalent net interest income		17,135			17,200	
Tax-equivalent net interest rate spread <sup>(2)</sup>			3.18%			3.56%
Tax-equivalent net interest margin <sup>(4)</sup>			3.32%			3.75%
Average interest-earning assets to average interest-bearing liabilities			127.37%			133.31%
Less tax-equivalent adjustment		262			236	
		<u>\$ 16,873</u>			<u>\$ 16,964</u>	

(1) Includes mortgagors' and investors' escrow accounts.

(2) Net interest rate spread represents the difference between yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(3) Tax-equivalent net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(4) Tax-equivalent net interest rate margin represents tax-equivalent net interest income divided by average interest-earning assets.

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### Average Balance Sheets for the Nine Months Ended September 30, 2013 and 2012

	Nine Months Ended September 30,					
	2013			2012		
	Average Balance	Interest and Dividends	Annualized Yield/ Cost	Average Balance	Interest and Dividends	Annualized Yield/ Cost
(Dollars in thousands)						
<b>Interest-earning assets:</b>						
Residential real estate loans	\$ 659,631	\$ 18,945	3.83%	\$ 689,276	\$ 21,613	4.180%
Commercial real estate loans	711,324	24,882	4.68	616,654	24,763	5.36
Construction loans	47,207	1,276	3.61	49,828	1,391	3.73
Commercial loans	185,369	5,653	4.08	162,566	5,463	4.49
Installment and collateral loans	2,671	98	4.90	3,648	147	5.37
Securities	331,641	7,546	3.03	209,359	5,308	3.38
Federal Home Loan Bank stock	15,279	44	0.39	16,150	63	0.52
Other earning assets	29,370	60	0.27	26,047	50	0.26
Total interest-earning assets	1,982,492	58,504	3.93	1,773,528	58,798	4.43
Allowance for loan losses	(18,574)			(16,986)		
Non-interest-earning assets	131,057			111,740		
Total assets	<u>\$2,094,975</u>			<u>\$1,868,282</u>		
<b>Interest-bearing liabilities:</b>						
NOW and money market accounts	\$ 575,248	1,225	0.28	\$ 475,036	1,015	0.29
Saving deposits <sup>(1)</sup>	225,810	105	0.06	204,575	199	0.13
Time deposits	534,812	4,532	1.13	523,627	5,432	1.39
Total interest-bearing deposits	1,335,870	5,862	0.59	1,203,238	6,646	0.74
Advances from the Federal Home Loan Bank	179,137	1,777	1.33	105,852	1,669	2.11
Other borrowings	13,622	49	0.48	—	—	—
Total interest-bearing liabilities	1,528,629	7,688	0.67%	1,309,090	8,315	0.85%
Non-interest-bearing liabilities	258,199			230,963		
Total liabilities	1,786,828			1,540,053		
Stockholders' equity	308,147			328,229		
Total liabilities and stockholders' equity	<u>\$2,094,975</u>			<u>\$1,868,282</u>		
Net interest-earning assets <sup>(3)</sup>	<u>\$ 453,863</u>			<u>\$ 464,438</u>		
Tax-equivalent net interest income		50,816			50,483	
Tax-equivalent net interest rate spread <sup>(2)</sup>			3.26%			3.58%
Tax-equivalent net interest margin <sup>(4)</sup>			3.43%			3.80%
Average interest-earning assets to average interest-bearing liabilities			129.69%			135.48%
Less tax-equivalent adjustment		735			502	
		<u>\$ 50,081</u>			<u>\$ 49,981</u>	

(1) Includes mortgagors' and investors' escrow accounts.

(2) Net interest rate spread represents the difference between yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(3) Tax-equivalent net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(4) Tax-equivalent net interest rate margin represents tax-equivalent net interest income divided by average interest-earning assets.

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### Rate\Volume Analysis

The following table presents the effects of changing rates and volumes on our net interest income for the periods indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

### Rate\Volume Analysis

(In thousands)	Three Months Ended September 30, 2013 Compared to September 30, 2012			Nine Months Ended September 30, 2013 Compared to September 30, 2012		
	Increase (Decrease)			Increase (Decrease)		
	Due to			Due to		
	Volume	Rate	Net	Volume	Rate	Net
<b>Interest and dividend income:</b>						
Loans receivable	\$ 1,036	\$ (2,021)	\$ (985)	\$ 2,838	\$ (5,361)	\$ (2,523)
Securities	1,040	(199)	841	2,830	(592)	2,238
Other earning assets <sup>(1)</sup>	(1)	—	(1)	6	(15)	(9)
<b>Total earning assets</b>	<b>2,075</b>	<b>(2,220)</b>	<b>(145)</b>	<b>5,674</b>	<b>(5,968)</b>	<b>(294)</b>
<b>Interest expense:</b>						
NOW and money market accounts	78	22	100	213	(3)	210
Savings accounts	3	(15)	(12)	19	(113)	(94)
Time deposits	49	(286)	(237)	114	(1,014)	(900)
<b>Total interest-bearing deposits</b>	<b>130</b>	<b>(279)</b>	<b>(149)</b>	<b>346</b>	<b>(1,130)</b>	<b>(784)</b>
FHLBB advances	92	(47)	45	235	(127)	108
Other borrowings	24	—	24	49	—	49
<b>Total interest-bearing liabilities</b>	<b>246</b>	<b>(326)</b>	<b>(80)</b>	<b>630</b>	<b>(1,257)</b>	<b>(627)</b>
<b>Change in tax-equivalent net interest income</b>	<b>\$ 1,829</b>	<b>\$ (1,894)</b>	<b>\$ (65)</b>	<b>\$ 5,044</b>	<b>\$ (4,711)</b>	<b>\$ 333</b>

(1) Includes FHLBB stock

### Comparison of Operating Results for the Three and Nine Months Ended September 30, 2013 and 2012

The following discussion provides a summary and comparison of the Company's operating results for the three and nine months ended September 30, 2013 and 2012.

#### Net Interest Income Analysis

Net interest income is the amount that interest and fees on earning assets (loans and investments) exceeds the cost of funds, interest paid to the Company's depositors and interest on external borrowings. Net interest margin is the difference between the income on earning assets and the cost of interest-bearing funds as a percentage of average earning assets.

As shown in the tables, tax-equivalent net interest income decreased \$65,000 for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The yield on average earning assets declined 51 basis points for the three months ended September 30, 2013 and the cost of interest-bearing liabilities declined 13 basis points compared to the same period in the prior year. Partially offsetting the negative impact of the decline in the tax-equivalent interest rate spread was an increase of \$224.1 million of average earning assets for the three months ended September 30, 2013 compared to September 30, 2012. However, as a result of the greater decline in the yield of interest-earning assets than the decline in the cost on interest-earning liabilities, the tax-equivalent net interest margin decreased by 43 basis points to 3.32% for the three months ended September 30, 2013, from 3.75% for the three months ended September 30, 2012.

For the nine months ended September 30, 2013 tax-equivalent net interest income was \$50.8 million, an increase of \$333,000 compared to the same period in 2012. The increase for the nine months ended September 30, 2013 was primarily due to: a) an increased volume of securities offset by a rate reduction due to the

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addition of adjustable rate securities to the portfolio with lower initial yields; b) the increased average balance of loans, the impact of which was partially offset by a lower yield of 45 basis points; c) an increase of \$233,000 in the tax-free income adjustment primarily from the addition of investments in municipal bonds; d) the higher cost of borrowings driven by a \$86.9 million increase in borrowed funds which was partially offset by an 84 basis point reduction in borrowing costs; and e) the shift in the mix of funding sources from higher cost time deposits to core interest and non-interest-bearing deposits which was a factor in reducing the cost of funds.

Since net interest income is affected by changes in interest rates, loan and deposit pricing strategies, competitive conditions, the volume and mix of interest-earning assets and interest-bearing liabilities as well as the level of non-performing assets, Rockville Financial manages the risk of changes in interest rates on its net interest income through an Asset/Liability Management Committee and through related interest rate risk monitoring and management policies.

**Provision for Loan Losses:** The provision for loan losses is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company. The level of the allowance is a critical accounting estimate, which is subject to uncertainty.

Management evaluates the adequacy of the allowance for loan losses on a quarterly basis. The adequacy of the loan loss allowance is based on such interrelated factors as the composition of the loan portfolio and its inherent risk characteristics, the level of non-performing loans and charge-offs, both current and historic, local economic and credit conditions, the direction of real estate values, and regulatory guidelines. The provision is charged against earnings in order to maintain an allowance for loan losses that reflects management's best estimate of probable losses inherent in the loan portfolio at the balance sheet date.

Management recorded a provision of \$532,000 and \$1.3 million for the three and nine months ended September 30, 2013, respectively, compared to \$793,000 and \$2.7 million for the same periods of 2012. The primary factors that influenced management's decision to record these provision expenses were due to the ongoing assessment of estimated exposure on impaired loans, the increase in net loans outstanding of \$50.3 million and loan volume realized during the period. Impaired loans totaled \$17.5 million at September 30, 2013 compared to \$16.7 million at December 31, 2012, an increase of \$814,000, or 4.9%. At September 30, 2013, the allowance for loan losses totaled \$18.7 million, which represented 1.13% of total loans and 149.45% of non-performing loans compared to an allowance for loan losses of \$18.5 million, which represented 1.15% of total loans and 115.08% of non-performing loans as of December 31, 2012. The repayment of these impaired loans is largely dependent upon the sale and value of collateral that may be impacted by current real estate conditions.

### **Non-interest Income:**

Total non-interest income was \$5.1 million and \$14.1 million for the three and nine months ended September 30, 2013. For the three and nine months ended September 30, 2013, non-interest income represented 23.2% and 22.0% of total net revenues, respectively. The following is a summary of non-interest income by major category for the three and nine months ended September 30, 2013 and 2012:

### **Non-Interest Income**

(Dollars in thousands)	<u>For the Three Months Ended September 30,</u>				<u>For the Nine Months Ended September 30,</u>			
	<u>2013</u>	<u>2012</u>	<u>\$ Change</u>	<u>% Change</u>	<u>2013</u>	<u>2012</u>	<u>\$ Change</u>	<u>% Change</u>
Service charges and fees	\$ 2,571	\$ 1,578	\$ 993	62.9%	\$ 6,125	\$4,798	\$ 1,327	27.7%
Net gain from sales of securities	29	214	(185)	(86.4)	585	335	250	74.6
Net gain from sales of loans	1,736	2,514	(778)	(30.9)	4,797	3,083	1,714	55.6
BOLI income	544	527	17	3.2	1,578	1,357	221	16.3
Other income (loss)	220	(219)	439	200.5	1,007	(30)	1,037	3,456.7
Total non-interest income	<u>\$ 5,100</u>	<u>\$ 4,614</u>	<u>\$ 486</u>	10.5%	<u>\$14,092</u>	<u>\$9,543</u>	<u>\$ 4,549</u>	47.7%

**Service Charges and Fees:** Service charges and fees were \$2.6 million and \$6.1 million for the three and nine months ended September 30, 2013, respectively, an increase of \$993,000 and \$1.3 million from the comparable 2012 periods. The increases were due primarily (a) to increases in loan servicing income resulting from increases in loan sales to the secondary market over the past year with servicing retained, (b) increases in fee income produced by the Company's investment subsidiary, Rockville Financial Services Inc. and (c) fees



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derived from the Company's loan level hedge program that was implemented in the second quarter of 2013 that is offered to certain commercial banking customers to facilitate their respective risk management strategies. These increases were partially offset by reductions in loan origination fee income, previously provided by Rockville Bank Mortgage, Inc.

**Net Gain From Sales of Securities:** For the three months ended September 30, 2013, the Company recorded \$29,000 in net gains on security sales compared to \$214,000 in the same period in the prior year period. Periodically, the Company evaluates the portfolio for prepayment risk and will act to reduce this exposure. To date, sales in 2013 reflect execution of this strategy. Sales of fast paying, lower market yielding securities in 2013 accounted for the majority of the gains on security sales for the quarter and nine months ended September 30, 2013. For the nine months ended September 30, 2013 and 2012, the Company recorded \$585,000 and \$335,000, respectively, in net gains on security sales.

**Net Gain From Sales of Loans:** Net gain from sales of loans was \$1.7 million and \$4.8 million for the three and nine months ended September 30, 2013, respectively, a decrease of \$778,000 for the three months and an increase of \$1.7 million for the nine months ended September 30, 2013 from the comparable periods of 2012. During the third quarter of 2013, the rising interest rate environment resulted in a lower spread on sales in the secondary market and slowed secondary sale activity after a prolonged period of historically low interest rates. However, overall, increased consumer activity in the secondary market for the nine months ended September 30, 2013 resulted in greater gains on sales than was experienced for the nine months ended September 30, 2012. Over the course of the year, the Company has deployed more resources to its mortgage banking business with the hiring of additional mortgage loan officers, which is the prime driver for the increase in volume.

**BOLI Income:** For the three and nine months ended September 30, 2013 the Company recorded BOLI income of \$544,000 and \$1.6 million, respectively, an increase of \$17,000 and \$221,000 from the comparable 2012 periods. The increases were primarily due to the additional purchase of \$25.0 million of BOLI policies towards the end of the first quarter of 2012 combined with the \$4.0 million purchase in May 2013. These increases were partially offset by a decline in the average yield earned on the BOLI policies as a result of current market interest rates.

**Other Income (Loss):** The Company recorded an increase in other income of \$439,000 and \$1.0 million for the three and nine months ended September 30, 2013 as compared to the prior year periods. The increase for the three months ended is due to the change in value of the rate lock commitments, partially offset by losses on forward loan sale contracts on loans held for sale, the impact of changing to the fair value method of valuing mortgage servicing rights from the amortization method and to a loss on the disposal of fixed assets. The increase for the nine month period is primarily due to the impact of changing to the fair value method of valuing mortgage servicing rights from the amortization method, partially offset by a decrease in the change in the value of rate lock commitments and to a business interruption insurance claim recorded in the first quarter of 2012.

**Non-interest Expense:** The following table summarizes non-interest expense for the three and nine months ended September 30, 2013 and 2012:

### **Non-Interest Expense**

(Dollars in thousands)	<u>For the Three Months Ended September 30,</u>				<u>For the Nine Months Ended September 30,</u>			
	<u>2013</u>	<u>2012</u>	<u>\$ Change</u>	<u>% Change</u>	<u>2013</u>	<u>2012</u>	<u>\$ Change</u>	<u>% Change</u>
Salaries and employee benefits	\$ 8,962	\$ 8,314	\$ 648	7.8%	\$26,748	\$23,905	\$ 2,843	11.9%
Service bureau fees	888	946	(58)	(6.1)	2,624	3,234	(610)	(18.9)
Occupancy and equipment	1,514	1,254	260	20.7	5,160	3,355	1,805	53.8
Professional fees	608	1,049	(441)	(42.0)	1,948	2,595	(647)	(24.9)
Marketing and promotions	266	70	196	280.0	434	287	147	51.2
FDIC insurance assessments	247	268	(21)	(7.8)	871	774	97	12.5
Other real estate owned	173	110	63	57.3	633	444	189	42.6
Other	2,105	2,499	(394)	(15.8)	6,873	6,074	799	13.2
<b>Total non-interest expense</b>	<b>\$ 14,763</b>	<b>\$ 14,510</b>	<b>\$ 253</b>	<b>1.7%</b>	<b>\$45,291</b>	<b>\$40,668</b>	<b>\$ 4,623</b>	<b>11.4%</b>

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**Non-interest Expense:** Non-interest expense totaled \$14.8 million for the third quarter of 2013, an increase of \$253,000, or 1.7%, from the third quarter of 2012. For the nine months ended September 30, 2013, non-interest expense increased \$4.6 million to \$45.3 million from \$40.7 million for the nine months ended September 30, 2012.

**Salaries and Employee Benefits:** Salaries and employee benefits was \$9.0 million and \$26.7 million for the three and nine months ended September 30, 2013, respectively, an increase of \$648,000 and \$2.8 million from the comparable 2012 periods.

These increases were primarily due to the higher level of full-time equivalent employees in the current period supporting the Company's growth plan reflecting salaries and related benefits for new hires and increased commissions expense related to mortgage loan originations and product sales. These increases were partially offset by a) decreased pension costs as the Company froze its noncontributory defined benefit and pension plan as of December 31, 2012, whereby participants in the plan stopped earning additional benefits under the plan, b) decreased employee restricted stock and option expense and c) an increase in deferred compensation expense related to an increase in volume of loan originations. Additionally, the increase for the nine months ended September 30, 2013 was impacted by costs incurred with position eliminations in the second quarter.

**Service Bureau Fees:** Service bureau fees decreased \$58,000 and \$610,000, respectively, for the three and nine months ended September 30, 2013 compared to the 2012 periods. The decrease is primarily attributable to the renegotiation of our service contract with our data processing vendor in June 2012 and to classifying certain telephone expenses in other expenses in 2013.

**Occupancy and Equipment:** Occupancy and equipment was \$1.5 million and \$5.2 million for the three and nine months ended September 30, 2013, respectively, an increase of \$260,000 and \$1.8 million from the comparable 2012 periods. The increases were due primarily to additional rent and maintenance contracts related to newly leased properties in the second half of 2012. Additionally, the increase for the nine months ended September 30, 2013 was affected by the Company's decision in the second quarter of 2013 to close a retail branch facility in Enfield, CT in November 2013 representing the write down of unamortized leasehold improvements and a negotiated payment for the lease buyout.

**Professional Fees:** Professional fees were \$608,000 and \$1.9 million for the three and nine months ended September 30, 2013, respectively, a decrease of \$441,000 and \$647,000 from the comparable 2012 periods. The decrease in professional fees was primarily in legal and consulting expenses as the Company's projects that focused on potential growth opportunities and evaluation of the infrastructure and risk management needs necessary for the Company's future growth were scaled back.

**Marketing and Promotions:** Marketing and promotion expense increased \$196,000 and \$147,000 for the three and nine months ended September 30, 2013, respectively, compared to the 2012 periods. The increase is attributable to engaging a marketing firm for the development of a Company-wide marketing campaign including brand redevelopment and web design.

**Other Expenses:** Other expense was \$2.1 million and \$6.9 million for the three and nine months ended September 30, 2013, respectively, a decrease of \$394,000 and an increase of \$799,000 from the comparable 2012 periods.

The decrease for the three months ended September 30, 2013 is primarily due to decreases in expenses for director equity awards, human resources expenses, debit card transaction and other public company expenses. These decreases were partially offset by increases in software maintenance related to investments made in the loan origination area, statement and mailing expenses for certain promotional events, expenses related to the new loan level hedging program and increases for mortgage appraisals and credit reports.

The above explanations are consistent with the change for the nine months ended September 30, 2013 compared to the prior year period, except that director equity awards increased approximately \$290,000 in the nine month period ended September 30, 2013 compared to the same period in the prior year.

**Income Tax Provision:** The provision for income taxes was \$2.1 million and \$1.6 million the three months ended September 30, 2013 and 2012, respectively. The Company's effective tax rate for the three months ended September 30, 2013 was 30.8%, as compared to 25.6% for the same period in 2012. The increase in the effective tax rate was due largely to the reduced benefits of tax-exempt income from the purchase of various tax-free municipal bonds and additional purchases of bank-owned life insurance as well as the recognition of additional state income tax expense. For the nine months ended September 30, 2013 and September 30, 2012, the provision for income taxes was \$5.1 million and \$4.7 million with effective income tax rates of 29.0% and 29.1%, respectively.

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### **Financial Condition, Liquidity and Capital Resources**

#### **Summary:**

The Company had total assets of \$2.22 billion at September 30, 2013 and \$2.00 billion at December 31, 2012, an increase of \$220.3 million, or 11.0%, primarily due to the increase in short-term investments, available for sale securities, principally asset-backed and corporate debt securities and loans. The Company utilized deposit growth and additional advances from the Federal Home Loan Bank of Boston to fund the growth in securities and loans.

Total loans, net of \$1.64 billion, with allowance for loan and lease losses of \$18.7 million at September 30, 2013, increased \$50.3 million when compared to total loans, net of \$1.59 billion, with allowance for loan of \$18.5 million at December 31, 2012. Total deposits of \$1.69 billion at September 30, 2013 increased \$187.4 million when compared to total deposits of \$1.50 billion at December 31, 2012. Non-interest-bearing deposits increased \$20.8 million, or 8.7%, resulting from an increase in commercial demand deposit balances totaling \$31.5 million. Interest-bearing deposits increased \$166.5 million, or 13.2%, during the period due to the Company's opening of the new West Hartford, CT banking center. The Bank's net loan-to-deposit ratio was 96.8% at September 30, 2013, compared to 105.5% at December 31, 2012.

At September 30, 2013, total equity of \$295.2 million decreased \$25.4 million when compared to total equity of \$320.6 million at December 31, 2012 due primarily to common stock repurchases in the first nine months of 2013 totaling \$28.8 million and \$8.2 million of dividends, partially offset by comprehensive income of \$7.3 million. At September 30, 2013, the tangible common equity ratio was 13.1% compared to 16.0% at December 31, 2012. See Note 13, "Regulatory Matters" in Notes to Unaudited Consolidated Financial Statements contained elsewhere in this report for information on the Bank and the Company's regulatory capital levels and ratios.

#### **Securities:**

The Company maintains a securities portfolio that is primarily structured to generate interest income, manage interest-rate sensitivity and provide a source of liquidity for operating needs. The securities portfolio is managed in accordance with regulatory guidelines and established internal corporate investment policies.

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The following table sets forth information regarding the amortized cost and fair value of the Company's investment portfolio at the dates indicated:

### Securities

(In thousands)	September 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<b>Available for sale:</b>				
Debt securities:				
U.S. Government and government-sponsored enterprise obligations	\$ 6,804	\$ 6,142	\$ 12,413	\$ 12,717
Government-sponsored residential mortgage-backed securities	90,469	90,475	87,769	91,144
Government-sponsored residential collateralized debt obligations	56,559	55,647	20,798	20,947
Government-sponsored commercial mortgage-backed securities	13,908	13,043	9,179	9,302
Government-sponsored commercial collateralized debt obligations	5,045	4,743	5,048	5,135
Asset-backed securities	92,967	91,246	11,193	11,200
Corporate debt securities	40,868	39,622	19,760	18,818
Obligations of states and political subdivisions	67,222	62,902	67,458	68,804
Total debt securities	<u>373,842</u>	<u>363,820</u>	<u>233,618</u>	<u>238,067</u>
Marketable equity securities, by sector:				
Banks	3,068	3,049	68	78
Industrial	109	194	109	159
Mutual funds	2,783	2,857	2,756	2,887
Oil and gas	131	207	135	198
Total marketable equity securities	<u>6,091</u>	<u>6,307</u>	<u>3,068</u>	<u>3,322</u>
Total available for sale securities	<u>\$ 379,933</u>	<u>\$370,127</u>	<u>\$ 236,686</u>	<u>\$241,389</u>
<b>Held to maturity:</b>				
Debt securities:				
Obligations of states and political subdivisions	\$ 10,092	\$ 10,127	\$ —	\$ —
Government-sponsored residential mortgage-backed securities	4,049	4,437	6,084	6,681
	<u>\$ 14,141</u>	<u>\$ 14,564</u>	<u>\$ 6,084</u>	<u>\$ 6,681</u>

The available for sale securities portfolio increased by \$128.7 million to \$370.1 million, while the held to maturity portfolio increased by \$8.1 million to \$14.1 million at September 30, 2013.

The Company's underlying investment strategy has been to incrementally shorten the duration of the investment portfolio by purchasing investments that show favorable price movement to changes in rising interest rates. The Company's strategy included the addition of shorter duration floating rate asset-backed securities and floating rate corporate bonds, of which purchases totaled \$10.6 million and \$103.4 million for the three and nine months ended September 30, 2013, respectively. The Company's investment focus for asset-backed securities is to make purchases of collateralized loan obligations ("CLO") in senior tranches of structures that exhibit high levels of over collateralization and interest coverage ratios. Investments made in CLOs are limited to industry leading, experienced collateral managers and a portion of positions allow for the collateral manager to reinvest proceeds from principal paydowns. The Company limits purchases in non-government sponsored asset-backed securities and corporate bonds to investment grade or better rating prior to purchase. Furthermore, the Company limits its exposure to position parameters and will review the impact on the portfolio from periodic issuer disclosures as well as developing market trends. The effective duration and weighted average life of the CLO portfolio is 0.2 years and 3.5 years, respectively.

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During the three months ended September 30, 2013, the Company recorded no write-downs for other-than-temporary impairments of its available for sale securities. The Company held \$275.2 million in securities that are in an unrealized loss position at September 30, 2013. Approximately \$273.8 million of this total had been in an unrealized loss position for less than twelve months while the remainder, \$1.3 million had been in an unrealized loss position for twelve months or longer. These securities were evaluated by management and were determined not to be other-than-temporarily impaired. The Company does not have the intent to sell these securities, and it is more-likely-than-not that it will not have to sell the securities before the recovery of their cost basis. To the extent that changes in interest rates, credit movements and other factors that influence the fair value of securities continue, the Company may be required to record additional impairment charges for other-than-temporary impairment in future periods. For additional information on the securities portfolio, see Note 5- "Securities" in the Notes to Unaudited Consolidated Financial Statements contained elsewhere in this report.

The Company has the ability to use the investment portfolio, as well as interest-rate financial instruments within internal policy guidelines, to hedge and manage interest-rate risk as part of its asset/liability strategy. See Note 6, "Derivatives and Hedging Activities", in the Notes to Unaudited Consolidated Financial Statements contained elsewhere in this report for additional information concerning derivative financial instruments.

### **Lending Activities:**

The Company makes residential real estate loans secured by one-to-four family residences, commercial real estate loans, residential and commercial construction loans, commercial business loans, multi-family loans, home equity loans and lines of credit and other consumer loans. The table below displays the balances of the Company's loan portfolio as of September 30, 2013 and December 31, 2012.

### **Loan Portfolio Analysis**

(Dollars in thousands)	<u>September 30, 2013</u>		<u>December 31, 2012</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Real estate loans:				
Residential	\$ 612,946	37.1%	\$ 683,195	42.6%
Commercial	753,589	45.6	697,133	43.4
Construction—residential	5,155	0.3	3,338	0.2
Construction—commercial	56,961	3.4	46,642	2.9
Total real estate loans	1,428,651	86.4	1,430,308	89.1
Commercial business loans	222,784	13.5	171,632	10.7
Installment and collateral loans	2,277	0.1	2,751	0.2
Total loans	1,653,712	100.0%	1,604,691	100.0%
Net deferred loan costs and premiums	2,316		771	
Allowance for loan losses	(18,703)		(18,477)	
Loans—net	<u>\$1,637,325</u>		<u>\$1,586,985</u>	

As shown above, gross loans were \$1.65 billion, up \$49.0 million, or 3.1%, at September 30, 2013 from year-end 2012. The Company primarily experienced increases in commercial real estate, construction-residential, construction-commercial and commercial business loans and decreases in residential real estate, and installment and collateral loans.

Residential real estate loans continue to represent a major segment of the Company's loan portfolio as of September 30, 2013, comprising 37.1% of total loans. The decrease of \$70.2 million from December 31, 2012 was primarily due to the sale of newly originated and existing residential mortgage loans and the net impact of prepayments. The Company had significant originations of both adjustable and fixed rate mortgages of \$69.9 million during the third quarter of the year, with approximately \$48.0 million originated for portfolio and \$19.0 million sold in the secondary market. The Company opportunistically sells a majority of originated fixed rate residential real estate loans with terms of 10 to 30 years. The strong mortgage origination activity resulted from competitive pricing and increased emphasis by the Company on the expansion of the residential mortgage business program.

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Commercial real estate loans represent the largest segment of our loan portfolio at 45.6% of total loans and increased \$56.5 million from December 31, 2012. The Bank has experienced increased demand in commercial real estate loans given the current rate environment. Mid-sized businesses continue to look to community banks for relationship banking and personalized lending services.

Construction real estate loans totaled \$62.1 million at September 30, 2013, an increase of \$12.1 million from December 31, 2012. Construction real estate loans consist of residential construction and commercial construction. Residential real estate construction segment loans are made to individuals for home construction whereby the borrower owns the parcel of land and the funds are advanced in stages until completion. Residential real estate construction loans totaled \$5.2 million at September 30, 2013 compared to \$3.3 million at December 31, 2012.

Commercial real estate construction loans are made for developing commercial real estate properties such as office complexes, apartment buildings and residential subdivisions. Total commercial real estate construction loans totaled \$57.0 million at September 30, 2013, \$20.2 million of which is residential use and \$36.8 million commercial use, compared to total commercial real estate construction loans of \$46.6 million at December 31, 2012.

Commercial business loans increased \$51.2 million, or 29.8%, and included production from the Shared National Credit program. A newly formed business line within Commercial Banking "Corporate Loan Strategies" engages in the participation and purchase of credits with other "supervised" unaffiliated banks or financial institutions specifically loan syndications and participations. These loans generate earning assets to increase profitability of the Bank; diversify commercial loan portfolios by providing opportunities to participate in loans to borrowers in other regions or industries the Bank might otherwise have no access.

The Bank has employed specific parameters taking into account: geographical considerations; exposure hold levels; qualifying financial partners; and most importantly sound credit quality with strong metrics. A thorough independent analysis of the credit quality of each borrower is made for every transaction whether it is an assignment or participation.

The Company originates loans with interest reserves on certain commercial construction credits depending on various factors including, but not limited to, quality of credit, interest rate and project type. At September 30, 2013, the Company had one performing commercial construction loan for \$127,000 for which it funded the outstanding interest reserves of approximately \$11,000.

It is the Company's policy to recognize income for this interest component as long as the project is progressing as agreed and if there has been no material deterioration in the financial standing of the borrower or the underlying project. If there is monetary or non-monetary loan default, the Company will cease any interest accrual. At September 30, 2013 there were no situations where additional interest reserves were advanced to keep a loan from becoming non-performing.

### **Asset Quality**

Rockville's lending strategy focuses on direct relationship lending within its primary market area as the quality of assets underwritten is an important factor in the successful operation of a financial institution. Non-performing assets, loan delinquency and credit loss levels are considered to be key measures of asset quality. Management strives to maintain asset quality through its underwriting standards, servicing of loans and management of non-performing assets since asset quality is a key factor in the determination of the level of the allowance for loan losses ("ALL"). See Note 7 "Loans Receivable and Allowance for Loan Losses" contained elsewhere in this report for further information concerning the Allowance for Loan Losses.

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The following table details asset quality ratios for the following periods:

### Asset Quality Ratios

	<u>At September 30, 2013</u>	<u>At December 31, 2012</u>
Non-performing loans as a percentage of total loans	0.76%	1.00%
Non-performing assets as a percentage of total assets	0.66%	0.95%
Net charge-offs as a percentage of average loans <sup>(1)</sup>	0.09%	0.07%
Allowance for loan losses as a percentage of total loans	1.13%	1.15%
Allowance for loan losses to non-performing loans	149.45%	115.08%

(1) Calculated based on year to date net charge-offs annualized

### Non-performing Assets

Generally loans are placed on non-accrual if collection of principal or interest in full is in doubt, if the loan has been restructured, or if any payment of principal or interest is past due 90 days or more. A loan may be returned to accrual status if it has demonstrated sustained contractual performance for six continuous months or if all principal and interest amounts contractually due are reasonably assured of repayment within a reasonable period. There are, on occasion, circumstances that cause commercial loans to be placed in the 90 days and accruing category, for example, loans that are considered to be well secured and in the process of collection or renewal. As of September 30, 2013 and December 31, 2012, no loans greater than 90 days past due were accruing.

The following table details non-performing assets for the periods presented:

### Non-performing Assets

(Dollars in thousands)	<u>At September 30, 2013</u>		<u>At December 31, 2012</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Non-accrual loans:				
Real estate loans:				
Residential	\$ 7,106	48.53%	\$ 7,837	41.46%
Commercial	1,086	7.42	1,502	7.95
Construction	1,442	9.85	1,824	9.65
Commercial business loans	799	5.46	1,713	9.06
Installment and collateral loans	3	—	45	0.24
Total non-accrual loans, excluding troubled debt restructured loans	10,436	71.26	12,921	68.36
Troubled debt restructurings—non-accruing	2,078	14.20	3,135	16.59
Total non-performing loans	12,514	85.46	16,056	84.95
Other real estate owned	2,129	14.54	2,846	15.05
Total non-performing assets	<u>\$ 14,643</u>	<u>100.00%</u>	<u>\$ 18,902</u>	<u>100.00%</u>

As displayed in the table above, non-performing assets at September 30, 2013 decreased to \$14.6 million compared to \$18.9 million at December 31, 2012. The decrease is primarily due to across the board decreases in non-accrual loans, non-accruing troubled debt restructurings and other real estate owned.

The decrease in non-accruing residential loans of \$731,000 was due to an increase of \$531,000 in net charge offs and the transfer of ten loans to other real estate owned. Current economic conditions, including factors such as continued high unemployment rates and softness in the real estate market, are impacting customers' ability to make loan payments. There are 81 loans in the residential real estate non-performing category, including troubled debt restructured loans ("TDR"), totaling \$9.0 million, representing 1.5% of the total

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residential real estate portfolio. The Company continues to originate loans with superior credit characteristics and routinely updates non-performing loans in terms of FICO scores and LTV ratios. Through continued heightened account monitoring, collections and workout efforts, the Bank is committed to mortgage solution programs designed to assist homeowners to remain in their homes. As has been its practice historically, the Company does not originate subprime loans.

The \$416,000 decrease in non-accruing commercial real estate loans is primarily due to the transfer of two loans to other real estate owned and principal payment reductions on non-accrual commercial real estate loans. The \$382,000 decrease in non-accruing construction loans is due to the transfer of four loans to other real estate owned status and principal payment reductions on non-accrual construction loans. The \$914,000 decrease in non-accruing commercial business loans is due to principal reductions of \$165,000 in loans and the transfer of three loans to other real estate owned status.

The \$717,000 net decrease in other real estate owned is due to the addition of sixteen properties which was offset by the sale of twelve properties resulting in a net reduction in the fair value of the remaining properties.

### **Troubled Debt Restructuring**

Loans are considered restructured in a troubled debt restructuring when the Company has granted concessions to a borrower due to the borrower's financial condition that it otherwise would not have considered. These concessions include modifications of the terms of the debt such as reduction of the stated interest rate other than normal market rate adjustments, extension of maturity dates, or reduction of principal balance or accrued interest. The decision to restructure a loan, versus aggressively enforcing the collection of the loan, may benefit the Company by increasing the ultimate probability of collection.

Restructured loans are classified as accruing or non-accruing based on management's assessment of the collectability of the loan. Loans which are already on non-accrual status at the time of the restructuring generally remain on non-accrual status for a minimum of six months before management considers such loans for return to accruing TDR status. Accruing restructured loans are placed into non-accrual status if and when the borrower fails to comply with the restructured terms and management deems it unlikely that the borrower will return to a status of compliance in the near term. Once a loan is classified as a TDR it retains that classification for the life of the loan; however, some TDRs may demonstrate acceptable performance allowing the TDR loan to be placed on accruing TDR status. The increase in accruing TDRs is attributable to the addition of six new commercial business and commercial real estate accruing TDRs in the first nine months of 2013 totaling \$3.7 million.

The following tables provide detail of TDR balances and activity for the periods presented:

### **Troubled Debt Restructuring Balances**

(In thousands)	At September 30, 2013	At December 31, 2012
Recorded investment in TDRs:		
Accrual status	\$ 4,980	\$ 625
Non-accrual status	2,079	3,135
Total recorded investment	<u>\$ 7,059</u>	<u>\$ 3,760</u>
Accruing TDRs performing under modified terms more than one year	\$ 863	\$ 625
TDR allocated reserves included in the balance of allowance for loan losses	\$ —	\$ —
Additional funds committed to borrowers in TDR status	\$ —	\$ —



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### Troubled Debt Restructuring Activity

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
TDRs, beginning of period	\$ 6,914	\$ 4,618	\$ 3,760	\$3,367
New TDR status	1,080	—	5,074	1,530
Paydowns/draws on existing TDRs, net	(935)	(101)	(1,623)	(380)
Charge-offs post modification	—	—	(152)	—
TDRs, end of period	<u>\$ 7,059</u>	<u>\$ 4,517</u>	<u>\$ 7,059</u>	<u>\$4,517</u>

### Allowance for Loan Losses

The allowance for loan losses and the reserve for unfunded credit commitments are maintained at a level estimated by management to provide for probable losses inherent within the loan portfolio. Probable losses are estimated based upon a quarterly review of the loan portfolio, which includes historic default and loss experience, specific problem loans, risk rating profile, economic conditions and other pertinent factors which, in management's judgment, warrant current recognition in the loss estimation process. The Company's Risk Management Committee meets quarterly to review and conclude on the adequacy of the reserves and to present their recommendation to executive management and the Board of Directors.

Management considers the adequacy of the ALL a critical accounting estimate. The adequacy of the ALL is subject to considerable assumptions and judgment used in its determination. Therefore, actual losses could differ materially from management's estimate if actual conditions differ significantly from the assumptions utilized. These conditions include economic factors in the Company's market and nationally, industry trends and concentrations, real estate values and trends, and the financial condition and performance of individual borrowers. While management believes the ALL is adequate as of September 30, 2013, actual results may prove different and the differences could be significant.

The Company's general practice is to identify problem credits early and recognize full or partial charge-offs as promptly as practicable when it is determined that the collection of loan principal is unlikely. The Company recognized full or partial charge-offs on collateral dependent impaired loans when the collateral is deemed to be insufficient to support the carrying value of the loan. The Company does not recognize a recovery when an updated appraisal indicates a subsequent increase in value.

The Company has a loan loss allowance of \$18.7 million, or 1.13%, of total loans as compared to a loan loss allowance of \$18.5 million, or 1.15% of total loans at December 31, 2012. Management believes that the allowance for loan losses is adequate and consistent with asset quality indicators and that it represents the best estimate of probable losses inherent in the loan portfolio.

The unallocated portion of the ALL represents general valuation allowances that are not allocated to a specific loan portfolio. The unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses and reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio. The unallocated portion of the ALL at September 30, 2013 decreased \$460,000 compared to December 31, 2012. See Note 7, "Loans Receivable and Allowance for Loan Losses" in the Notes to the Unaudited Consolidated Financial Statements contained elsewhere in this report for a table providing the activity in the Company's allowance for loan losses for the three and nine months ended September 30, 2013 and 2012.

In addition to the ALL, the Company maintains a reserve for unfunded credit commitments. The allowance for credit losses analysis includes consideration of the risks associated with unfunded loan commitments. The reserve calculation includes factors that are consistent with ALL methodology for funded loans. The combination of ALL and unfunded reserves is calculated in a manner to capture the entirety of the underlying business relationship of the customer. The amounts of unfunded commitments and the associated reserves may be subject to fluctuations due to originations, the timing and volume of loan funding, as well as changes in risk ratings. At September 30, 2013, the reserve for unfunded credit commitments was \$645,000 compared to a reserve for unfunded credit commitments of \$431,000 at December 31, 2012.

### Sources of Funds

The primary source of the Company's cash flows, for use in lending and meeting its general operational needs, is deposits. Additional sources of funds are from Federal Home Loan Bank of Boston advances, reverse repurchase agreements, fed funds lines, loan and mortgage-backed securities repayments, securities sales proceeds and maturities, and earnings. While scheduled loan and securities repayments are a relatively stable source of funds, loan and investment security prepayments and deposit inflows are influenced by prevailing interest rates and local economic conditions and are inherently uncertain.

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### Deposits

The Company offers a wide variety of deposit products to consumer, business and municipal customers. Deposit customers can access their accounts in a variety of ways including branch banking, ATM's, internet banking, mobile banking and telephone banking. Effective advertising, direct mail, well-designed product offerings, customer service and competitive pricing policies have been successful in attracting and retaining deposits. A key strategic objective is to grow the base of checking customers by retaining existing relationships while attracting new customers.

Deposits provide an important source of funding for the Bank as well as an ongoing stream of fee revenue. The Company attempts to control the flow of funds in its deposit accounts according to its need for funds and the cost of alternative sources of funding. A Retail Pricing Committee meets weekly and a Management ALCO Committee meets monthly, to determine pricing and marketing initiatives. Actions of the committee influence the flow of funds primarily by the pricing of deposits, which is affected to a large extent by competitive factors in its market area and asset/liability management strategies.

The following table presents deposits by category as of the dates indicated:

### Deposits

(In thousands)	September 30, 2013	December 31, 2012
Demand deposits	\$ 259,773	\$ 238,924
NOW accounts	157,802	149,611
Regular savings and club accounts	220,808	214,480
Money market and investment savings	501,358	366,690
Total core deposits	1,139,741	969,705
Time deposits	552,331	534,975
Total deposits	\$ 1,692,072	\$ 1,504,680

Deposits totaled \$1.69 billion at September 30, 2013, up \$187.4 million from the balance at December 31, 2012. Core deposits increased \$170.0 million, or 17.5%, from year end as the Company's strategy has been to increase core deposits and reduce rates paid on interest-bearing deposits, particularly on time deposits, in order to improve the net interest margin and the interest rate spread while continuing to build core relationships. This strategy included promoting commercial deposit and cash management deposit products, competitive rate shorter term deposits and money market accounts in response to the competition within our marketplace.

Time deposits included brokered certificate of deposits of \$81.8 million and \$65.2 million at September 30, 2013 and December 31, 2012, respectively. The Company utilizes out-of-market brokered time deposits as part of its overall funding program along with other sources. Excluding out-of-market brokered certificates of deposits, in market deposits totaled \$1.61 billion at September 30, 2013. Rockville Bank is a member of the Certificate Deposit Account Registry Service network.

### Borrowings

The Company also uses various types of short-term and long-term borrowings in meeting funding needs. While customer deposits remain the primary source for funding loan originations, management uses short-term and long-term borrowings as a supplementary funding source for loan growth and other liquidity needs when the cost of these funds are favorable compared to alternative funding, including deposits.

Rockville Bank is a member of the Federal Home Loan Bank System, which consists of twelve district Federal Home Loan Banks, each subject to the supervision and regulation of the Federal Housing Finance Agency. Members are required to own capital stock in the FHLBB in order for the Bank to access advances and borrowings which are collateralized by certain home mortgages or securities of the U.S. Government and its agencies. The capital stock investment is restricted in that there is no market for it, and it can only be redeemed by the Federal Home Loan Bank of Boston.

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Total Federal Home Loan Bank of Boston advances increased \$30.0 million to \$173.1 million at September 30, 2013 compared to \$143.1 million at December 31, 2012. This increase is a result of greater utilization of FHLBB advances at lower interest rates, combined with the growth in our core deposits, which assisted the Company in funding growth in our securities and loans portfolios, and in meeting other liquidity needs while effectively managing interest rate risk. At September 30, 2013, all of the Company's outstanding FHLBB advances were at fixed rates ranging from 0.19% to 4.39%. FHLBB borrowings represented 7.8% and 7.2% of assets at September 30, 2013 and December 31, 2012, respectively.

In addition, advances outstanding under reverse purchase agreements totaled \$23.2 million as of September 30, 2013. The outstanding advances consisted of three individual borrowings with remaining terms of five months or less and a weighted average cost of 0.45%.

### **Liquidity and Capital Resources**

Liquidity is the ability to meet cash needs at all times with available cash or by conversion of other assets to cash at a reasonable price and in a timely manner. The Company maintains liquid assets at levels the Company considers adequate to meet its liquidity needs. The Company adjusts its liquidity levels to fund loan commitments, repay its borrowings, fund deposit outflows, pay escrow obligations on all items in the loan portfolio and to fund operations. The Company also adjusts liquidity as appropriate to meet asset and liability management objectives.

The Company's primary sources of liquidity are deposits, amortization and prepayment of loans, the sale in the secondary market of loans held for sale, maturities and sales of investment securities and other short-term investments, periodic pay downs of mortgage-backed securities, 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 market interest rates, economic conditions, and rates offered by our competition. The Company sets the interest rates on our deposits to maintain a desired level of total deposits. In addition, the Company invests excess funds in short-term interest-earning assets, which provide liquidity to meet lending requirements.

A portion of the Company's liquidity consists of cash and cash equivalents, which are a product of our operating, investing and financing activities. At September 30, 2013, \$54.5 million of the Company's assets were invested in cash and cash equivalents compared to \$35.3 million at December 31, 2012. The Company's primary sources of cash are principal repayments on loans, proceeds from the calls and maturities of investment securities, increases in deposit accounts, proceeds from residential loan sales and advances from the Federal Home Loan Bank of Boston.

Liquidity management is both a daily and longer-term function of business management. If the Company requires funds beyond its ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of Boston, which provide an additional source of funds. At September 30, 2013, the Company had \$173.1 million in advances from the Federal Home Loan Bank of Boston and an additional available borrowing limit of \$98.5 million based on collateral requirements of the Federal Home Loan Bank of Boston inclusive of the line of credit. In addition, the Bank has a relationship with a brokered sweep deposit provider by which the Bank could borrow an additional \$90.9 million through this relationship. Internal policies limit wholesale borrowings to 30% of total assets, or \$665.7 million, at September 30, 2013. In addition, the Company has uncommitted federal funds line of credit with four counterparties totaling \$92.5 million at September 30, 2013. No federal funds purchased were outstanding at September 30, 2013. At September 30, 2013, the Company had outstanding commitments to originate loans of \$76.9 million and unfunded commitments under construction loans, lines of credit and stand-by letters of credit of \$277.4 million. At September 30, 2013, time deposits scheduled to mature in less than one year totaled \$259.6 million. Based on prior experience, management believes that a significant portion of such deposits will remain with the Company, although there can be no assurance that this will be the case. In the event a significant portion of its deposits are not retained by the Company, it will have to utilize other funding sources, such as Federal Home Loan Bank of Boston advances in order to maintain its level of assets. Alternatively, we would reduce our level of liquid assets, such as our cash and cash equivalents in order to meet funding needs. In addition, the cost of such deposits may be significantly higher if market interest rates are higher or there is an increased amount of competition for deposits in our market area at the time of renewal.

Rockville's main source of liquidity at the parent company level is dividends from Rockville Bank. The main uses of liquidity are payments of dividends to common stockholders, repurchase of Rockville Bank's common stock, and corporate operating expenses. There are certain restrictions on the payment of dividends. See Note 13, "Regulatory Matters" in the Company's 2012 Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 for further information on dividend restrictions.

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The Company and the Bank are subject to various regulatory capital requirements. As of September 30, 2013, the Company and the Bank are categorized as “well-capitalized” under the regulatory framework for prompt corrective action. See Note 13, “Regulatory Matters” in the Notes to the Unaudited Consolidated Financial Statements contained elsewhere in this report for discussion of capital requirements.

The liquidity position of the Company is continuously monitored and adjustments are made to balance between sources and uses of funds as deemed appropriate. Management is not aware of any events that are reasonably likely to have a material adverse effect on the Company’s liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, which if implemented would have a material adverse effect on the Company. The Company has a detailed liquidity contingency plan which is designed to respond to liquidity concerns in a prompt and comprehensive manner. It is designed to provide early detection of potential problems and details specific actions required to address liquidity stress scenarios.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

**General:** The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, in general have longer contractual maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, our Board of Directors has established an Asset/Liability Committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the Board of Directors. Management monitors the level of interest rate risk on a regular basis and the Asset/Liability Committee meets at least quarterly to review our asset/liability policies and interest rate risk position.

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. During the low interest rate environment that has existed in recent years, we have implemented the following strategies to manage our interest rate risk: (i) emphasizing adjustable rate loans including, adjustable rate one-to-four family, commercial and consumer loans, (ii) selling longer-term 1-4 family fixed rate mortgage loans in the secondary market, (iii) reducing and shortening the expected average life of the investment portfolio, (iv) periodically lengthening the term structure of our wholesale funding, (v) a forward starting hedge strategy for future dated wholesale funding and (vi) a loan level hedging program. These measures should serve to reduce the volatility of our future net interest income in different interest rate environments.

#### **Quantitative Analysis**

**Income Simulation:** Simulation analysis is used to estimate our interest rate risk exposure at a particular point in time. Beginning June 30, 2013, the Company transitioned from a dynamic method that incorporated forecasted balance sheet growth assumptions to a static method in which a stable balance sheet (both size and mix) is projected throughout the modeling horizon. This adoption was made in a continued effort to align with regulatory best practices and to highlight the current level of risk in the Company’s positions without the effects of growth assumptions. We utilize the income simulation method to analyze our interest rate sensitivity position to manage the risk associated with interest rate movements. At least quarterly, our Asset/Liability Committee of the Board of Directors reviews the potential effect changes in interest rates could have on the repayment or repricing of rate sensitive assets and funding requirements of rate sensitive liabilities. Our most recent simulation uses projected repricing of assets and liabilities at September 30, 2013 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rate assumptions as well as deposit characterization assumptions can have a significant impact on interest income simulation results. Because of the large percentage of loans and mortgage-backed assets we hold, rising or falling interest rates may have a significant impact on the actual prepayment speeds of our mortgage related assets that may in turn effect our interest rate sensitivity position. When interest rates rise, prepayment speeds slow and the average expected life of our assets would tend to lengthen more than the expected average life of our liabilities and therefore would most likely result in a decrease to our asset sensitive position.

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	Percentage Increase (Decrease) in Estimated Net Interest Income	
	Over 12 Months	Over 12 - 24 Months
300 basis point increase in rates	(3.68)%	0.50 %
50 basis point decrease in rates	(2.38)	(4.37)

Rockville Bank's Asset/Liability policy currently limits projected changes in net interest income based on a matrix of projected total risk-based capital relative to the interest rate change for each twelve month period measured compared to the flat rate scenario. As a result, the higher a level of projected risk-based capital, the higher the limit of projected net interest income volatility the Company will accept. As the level of projected risk-based capital is reduced, the policy requires that net interest income volatility also is reduced, making the limit dynamic relative to the capital level needed to support it. These policy limits are re-evaluated on a periodic basis (not less than annually) and may be modified, as appropriate. Because of the liability-sensitivity of our balance sheet, coupled with little opportunity to decrease deposit rates further due to their current low nominal level, income is projected to decrease if interest rates rise. Also included in the decreasing rate scenario is the assumption that further declines are reflective of a deeper recession as well as narrower credit spreads from Federal Open Market Committee actions. At September 30, 2013, income at risk (i.e., the change in net interest income) decreased 3.68% and decreased 2.38% based on a 300 basis point average increase or a 50 basis point average decrease, respectively. While we believe the assumptions used are reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed security and loan repayment activity.

### Item 4. Controls and Procedures

**Evaluation of Disclosure Controls and Procedures:** Our disclosure controls and procedures are designed to ensure that information the Company must disclose in its reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized, and reported on a timely basis. Our management has evaluated, with the participation and under the supervision of our chief executive officer ("CEO") and chief financial officer ("CFO"), the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, our CEO and CFO have concluded that, as of such date, the Company's disclosure controls and procedures are effective in ensuring that information relating to the Company, including its consolidated subsidiaries, required to be disclosed in reports that it files under the Exchange Act is (1) recorded, processed, summarized and reported within time periods specified in the SEC's rules and forms, and (2) accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Controls:** During the quarter under report, there was no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## Part II – OTHER INFORMATION

### Item 1. Legal Proceedings

The Company is not involved in any legal proceedings deemed to be material as of September 30, 2013 which have arisen in the normal course of business.

### Item 1A. Risk Factors

There have been no material changes in the Risk Factors previously disclosed in Item 1A of the Company's annual report on Form 10-K for the period ended December 31, 2012.

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### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information with respect to net purchases made by Rockville Financial, Inc. of its common stock during the period ended September 30, 2013.

<b>Period</b>	<b>Total number of shares purchased</b>	<b>Average<sup>(1)</sup> price paid per share</b>	<b>Total number of shares purchased as Part of Publicly Announced Program</b>	<b>Maximum number of shares that may yet be purchased under the plans or programs <sup>(2)</sup></b>
July 1—31, 2013	15,317	\$ 13.08	1,209,456	1,957,001
August 1—31, 2013	144,299	13.08	1,353,755	1,812,702
September 1—30, 2013	142,567	13.07	1,496,322	1,670,135
Total	<u>302,183</u>	<u>\$ 13.08</u>	<u>1,496,322</u>	<u>1,670,135</u>

(1) Includes dealer commission expense to purchase the securities

(2) Includes 2,730,026 of shares authorized for repurchase by the Board of Directors on May 20, 2013

On May 17, 2013, the Company authorized a new stock repurchase program pursuant to which the Company may purchase up to 2,730,026 shares, or 10% of the then outstanding stock, from time to time, subject to certain conditions. The Company has no intentions to terminate this plan or cease any potential future purchases. As of September 30, 2013, there were 1,670,135 maximum shares that may yet be purchased under this publicly announced plan.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

None.

### Item 5. Other Information

None.

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### **Item 6. Exhibits**

- 2.1 Amended and Restated Plan of Conversion and Reorganization (incorporated herein by reference to Exhibit 2.1 to the Registration Statement filed on the Form S-1 for Rockville Financial New, Inc. on September 16, 2010)
- 3.1 Certificate of Incorporation of Rockville Financial New, Inc. (incorporated herein by reference to Exhibit 3.1 to the Registration Statement on the Form S-1 filed for Rockville Financial New, Inc. on September 16, 2010)
  - 3.1.1 Amendment of Certificate of Incorporation of Rockville Financial New, Inc. (incorporated herein by reference to Exhibit 3.1.1 to the Registration Statement on the Form S-1 filed for Rockville Financial New, Inc. on September 16, 2010)
  - 3.1.2 Restated Certificate of Incorporation of Rockville Financial, Inc. effective March 3, 2011 filed herewith
- 3.2 Bylaws of Rockville Financial New, Inc. (incorporated herein by reference to Exhibit 3.2 to the Registration Statement on the Form S-1 filed for Rockville Financial New, Inc. on September 16, 2010)
  - 3.2.1 The Bylaws, as amended and restated, and amended Article III (incorporated herein by reference to Exhibit 3.2.1 to the Current Report on the Company's Form 8-K filed on March 21, 2013)
- 10.2 Employment Agreement as amended and restated by and among Rockville Financial, Inc., Rockville Bank and John T. Lund, effective January 9, 2012 (incorporated herein by reference to Exhibit 10.2 to the Current Report on the Company's Form 8-K filed on January 13, 2012)
- 10.2.1 Supplemental Executive Retirement Agreement of Rockville Bank for John T. Lund effective December 6, 2010 (incorporated by reference to Exhibit 10.3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 filed on March 10, 2011)
- 10.2.3 Change-in-Control and Restricted Covenant Agreement by and among Rockville Financial, Inc., Rockville Bank and John T. Lund, effective January 2, 2009 (incorporated herein by reference to Exhibit 10.3 to the Annual Report on Rockville Financial, Inc.'s Form 10-K for the year ended December 31, 2008 filed on March 11, 2009 (File No. 000-51239))
- 10.4 Employment Agreement as amended and restated by and among Rockville Financial, Inc., Rockville Bank and Richard J. Trachimowicz, effective January 9, 2012 (incorporated herein by reference to Exhibit 10.4 to the Current Report on the Company's Form 8-K filed on January 13, 2012)
- 10.4.2 Supplemental Executive Retirement Agreement of Rockville Bank for Richard J. Trachimowicz effective December 6, 2010 (incorporated by reference to Exhibit 10.5.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 filed on March 10, 2011)
- 10.5 Supplemental Savings and Retirement Plan of Rockville Bank as amended and restated effective December 31, 2007 (incorporated herein by reference to Exhibit 10.5 to the Current Report on Form 8-K filed for Rockville Financial, Inc. filed on December 18, 2007)
- 10.6 Rockville Bank Officer Incentive Compensation Plan (incorporated herein by reference to Exhibit 10.2.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005 filed on March 31, 2006 (File No. 000-52139))
- 10.7 Rockville Bank Supplemental Executive Retirement Agreement for Joseph F. Jeamel, Jr. (incorporated herein by reference to Exhibit 10.8 to the Registration Statement filed on Form S-1 filed for Rockville Financial New, Inc. on September 16, 2010)
- 10.7.1 First Amendment to the Supplemental Executive Retirement Agreement for Joseph F. Jeamel, Jr. (incorporated herein by reference to Exhibit 10.7.1 to the Current Report on Form 8-K filed for Rockville Financial, Inc. filed on December 18, 2007)

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- 10.8 Executive Split Dollar Life Insurance Agreement for Joseph F. Jeamel, Jr. (incorporated herein by reference to Exhibit 10.11 to the Registration Statement filed on Form S-1 filed for Rockville Financial, Inc. filed on December 17, 2004 (File No. 333-121421))
- 10.9 Rockville Bank Supplemental Executive Retirement Plan as amended and restated effective December 31, 2007 (incorporated herein by reference to Exhibit 10.9 to the Current Report on Form 8-K filed for Rockville Financial, Inc. filed on December 18, 2007)
- 10.10 Rockville Financial, Inc. 2006 Stock Incentive Award Plan (incorporated herein by reference to Appendix B in the Definitive Proxy Statement on Form 14A for Rockville Financial, Inc. filed on July 3, 2006 (File No. 000-51239))
- 10.11 Employment Agreement by and among Rockville Financial, Inc., Rockville Bank and William H.W. Crawford, IV, effective January 3, 2011 (incorporated herein by reference to Exhibit 10.15 to the Current Report on the Company's Form 8-K filed on January 6, 2011)
- 10.11.1 Employment Agreement as amended by and among Rockville Financial, Inc., Rockville Bank and William H.W. Crawford, IV, effective February 24, 2012 (incorporated herein by reference to Exhibit 10.11.1 to the Current Report on the Company's Form 8-K filed on February 24, 2012)
- 10.11.2 Supplemental Executive Retirement Agreement of Rockville Bank for William H.W. Crawford, IV effective December 26, 2012 (incorporated by reference to Exhibit 10.11.2 to the Current Report on the Company's Form 8-K filed on January 2, 2013)
- 10.11.3 On June 10, 2013, Rockville Financial, Inc. and its subsidiary Rockville Bank entered into an employment agreement with William H. W. Crawford, IV effective January 1, 2014 (incorporated by reference to Exhibit 10.11.3 to the Current Report on the Company's Form 8-K filed on June 10, 2013)
- 10.12 Supplemental Executive Retirement Agreement of Rockville Bank for Mark A. Kucia effective December 6, 2010 (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 filed on March 10, 2011)
- 10.12.1 Employment Agreement as amended and restated by and among Rockville Financial, Inc., Rockville Bank and Mark A. Kucia, effective January 9, 2012 (replaces former Exhibit 10.12.1) (incorporated herein by reference to Exhibit 10.12.1 to the Current Report on the Company's Form 8-K filed on January 13, 2012)
- 10.13 Employment Agreement by and among Rockville Financial, Inc., Rockville Bank and Marino J. Santarelli effective January 9, 2012 (replaces former Exhibits 10.2 and 10.2.2) (incorporated herein by reference to Exhibit 10.2 to the Current Report on the Company's Form 8-K filed on January 13, 2012)
- 10.14 Rockville Financial, Inc. 2012 Stock Incentive Award Plan (incorporated herein by reference to Appendix A in the Definitive Proxy Statement on Form 14A for Rockville Financial, Inc. filed on April 4, 2012 (File No. 0001193125-12-149948))
- 14. Rockville Financial, Inc., Rockville Bank, Standards of Conduct Policy - Employees (incorporated herein by reference to Exhibit 14 to the Company's Annual Report on Form 10-K for the year ended December 31, 2007 filed on March 17, 2008)
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer filed herewith
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer filed herewith
- 32.0 Section 1350 Certification of the Chief Executive Officer and Chief Financial Officer attached hereto
- 101. Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition, (ii) the Consolidated Statements of Net Income, (iii) the Consolidated Statements of Changes in Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows, and (v) the Notes to Unaudited Consolidated Financial Statements filed herewith



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Rockville Financial, Inc.

By: /s/ John T. Lund  
John T. Lund  
EVP, Chief Financial Officer and Treasurer

Date: November 8, 2013

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## Section 2: EX-3.1.2 (EX-3.1.2)

**Exhibit 3.1.2**

**RESTATED  
CERTIFICATE OF INCORPORATION  
OF  
ROCKVILLE FINANCIAL, INC.  
(A Connecticut Stock Corporation)**

The undersigned Incorporator hereby forms a corporation under the Connecticut Business Corporation Act.

**Section 1. Name of Corporation.**

The name of the corporation shall be ROCKVILLE FINANCIAL, INC., hereinafter referred to as the "Corporation."

**Section 2. Registered Office and Registered Agent.**

The street address of the initial registered office of the Corporation is 25 Park Street, Rockville, Connecticut 06066, and the name and address of the registered agent of the Corporation at that office is William J. McGurk, with a residence address of 21 Stillmeadow Lane, Somers, Connecticut 06071, and with a business address of 25 Park Street, Rockville, Connecticut 06066.

**Section 3. Duration.**

The duration of the Corporation is perpetual.

**Section 4. Purpose and Powers of Corporation.**

The nature of the activities to be transacted and the purposes to be promoted, carried out and engaged in by the Corporation are the following:

A. To pursue any or all of the lawful objectives of a bank holding company chartered pursuant to the laws of the State of Connecticut, and to exercise all of the express, implied and incidental powers conferred by such laws and by all amendments or supplements to such laws, subject to all lawful and applicable rules, regulations and orders of the Banking Commissioner of the State of Connecticut (the "Commissioner"), the Federal Reserve Board, or any other state or federal agency having the authority to supervise or regulate the Corporation and the conduct of its business.

B. Subject to the foregoing paragraph A hereof, to engage generally in any business that may be promoted, carried out and engaged in by a corporation organized under the Connecticut Business Corporation Act.

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## Section 5. Authorized Capital Stock.

The total number of shares of all classes of capital stock which the Corporation is authorized to issue is sixty-two million (62,000,000), of which sixty million (60,000,000) shall be common stock, no par value per share, and of which two million shares (2,000,000) shall be preferred stock, no par value per share. The shares may be issued from time to time as authorized by the Board of Directors without further approval of shareholders, except as otherwise provided in this Section 4, or subject to applicable law. The consideration for the issuance of the shares shall be paid in full before their issuance and otherwise shall comply with all requirements of Connecticut law. Upon payment of such consideration, such shares shall be deemed to be fully paid and nonassessable.

Nothing contained in this Section 5 (or in any other sections herein) shall entitle the holders of any class or series of capital stock to vote as a separate class or series or to more than one vote per share.

A description of the different classes and series (if any) of the Corporation's capital stock and a statement of the designations, and the relative rights, preferences and limitations of the shares of each class of and series (if any) of capital stock are as follows:

A. Common Stock. Except as provided in this Section 5 (or in any resolution or resolutions adopted by the Board of Directors pursuant hereto), the holders of the Common Stock shall exclusively possess all voting power. Each holder of shares of Common Stock shall be entitled to one vote for each share held by such holder. There shall be no cumulative voting rights in the election of Directors. Each share of Common Stock shall have the same relative rights as and be identical in all respects with all other shares of Common Stock.

Whenever there shall have been paid, or declared and set aside for payment, to the holders of the outstanding shares of any class of stock having preference over the Common Stock as to the payment of dividends, the full amount of dividends and of any sinking fund or retirement fund or other retirement payments, if any, to which such holders are respectively entitled in preference to the Common Stock, then dividends may be paid on the Common Stock and on any class or series of stock entitled to participate therewith as to dividends, out of any assets legally available for the payment of dividends, but only when and as declared by the Board of Directors.

In the event of any liquidation, dissolution or winding up of the Corporation, after there shall have been paid to or set aside for the holders of any class having preferences over the Common Stock in the event of liquidation, dissolution or winding up of the Corporation the full preferential amounts of which they are respectively entitled, the holders of the Common Stock, and of any class or series of stock entitled to participate therewith, in whole or in part, as to distribution of assets, shall be entitled after payment or provision for payment of all debts and liabilities of the Corporation, to receive the remaining assets of the Corporation available for distribution, in cash or in kind.

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**B. Preferred Stock.** Shares of preferred stock may be issued from time to time in one or more series as may from time to time be determined by the Board of Directors, each of such series to be distinctly designated. All shares of anyone series of preferred stock shall be identical. Shares of preferred stock shall not entitle the holder or holders thereof to vote except when specifically authorized to vote by the Board of Directors or if required to vote as a class pursuant to the Connecticut General Statutes. All other preferences and relative, participating, optional and other special rights of each of such series, and the qualifications, limitations or restrictions thereof, if any, may differ from those of any and all other series at any time outstanding; and the Board of Directors of the Corporation is hereby expressly granted exclusive authority to fix, by resolution or resolutions adopted prior to the issuance of any shares of a particular series of preferred stock, the designations, preferences and relative, participating, optional and other special rights, and the qualifications, limitations and restrictions, of such series including, but without limiting the generality of the foregoing, the following:

- i) The distinctive designation of and the number of shares of preferred stock that shall constitute such series, which number may be increased or decreased (but not below the number of shares then outstanding) from time to time by action of the Board of Directors;
- ii) The rate and times at which, and the terms and conditions on which, dividends, if any, on preferred stock of such series shall be paid, the extent of the preference or relation, if any, of such dividends to the dividends payable on any other class or classes or series of the same or other classes of capital stock and whether (and the dates from which) such dividends shall be cumulative or noncumulative;
- iii) The right, if any, of the holders of preferred stock of such series to convert the shares thereof into or exchange the same for, shares of any other class or classes or of any series of the same or any other class or classes of capital stock of the Corporation or any other corporation and the terms and conditions of such conversion or exchange;
- iv) Whether or not preferred stock of such series shall be subject to redemption, and the redemption price or prices and the time or times at which, and the terms and conditions on which, the shares of such series may be redeemed;
- v) The rights, if any, of the holders of preferred stock of such series upon the voluntary or involuntary liquidation, merger, consolidation, distribution or sale of assets, dissolution or winding-up of the Corporation;
- vi) The terms of the sinking fund or redemption or purchase account, if any, to be provided for the preferred stock of such series; and
- vii) The voting rights, if any, of the holders of preferred stock in any particular series.

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Unless otherwise provided in this Certificate of Incorporation or in the Bylaws of the Corporation, to constitute a quorum for the transaction of business on any matter at a meeting of shareholders, there must be present, in person or by proxy, a majority of the shares of voting stock of the Corporation entitled to vote thereon. The shareholders present at a duly held meeting at which a quorum is present may continue to transact business notwithstanding the withdrawal of enough shares to leave less than a quorum.

The Corporation may from time to time, pursuant to authorization by the Board of Directors of the Corporation and without action by the shareholders, purchase or otherwise acquire shares of any class, bonds, debentures, notes, scrip, warrants, obligations, evidences of indebtedness, or other securities of the Corporation in such a manner, upon such terms, and in such amounts as the Board of Directors shall determine; subject, however, to such limitations or restrictions, if any, as are contained in the express terms of any class of shares of the Corporation outstanding at the time of the purchase or acquisition in question or as are imposed by law or by regulation or order of the Commissioner. Such shares shall constitute authorized but unissued shares.

#### **Section 6. Restrictions on Ownership of Stock**

Notwithstanding anything contained in this Certificate of Incorporation or Bylaws of the Corporation to the contrary, for a period of five (5) years from the date the Corporation becomes the owner of 100% of the capital stock of Rockville Bank, the following provision shall apply:

No person shall directly or indirectly offer to acquire or acquire the beneficial ownership of ten percent (10%) or more of any class of any equity security of the Corporation without the prior approval of two-thirds (2/3) of the Board of Directors and the prior written approval of the Commissioner. In the event shares are acquired in violation of this Section 6, all shares beneficially owned by any person in excess of ten percent (10%) shall be considered "excess shares" and shall not be counted as shares entitled to vote, shall not be voted by any person or counted as voting shares in connection with any matter submitted to the shareholders for a vote, and shall not be counted as outstanding for purposes of determining the affirmative vote necessary to approve any matter submitted to the shareholders for a vote.

Notwithstanding anything contained in this Certificate of Incorporation or Bylaws of the Corporation to the contrary, the provisions requiring prior approval of two-thirds (2/3) of the Board of Directors in the event the acquisition of the beneficial ownership of ten percent (10%) or more of any class of any equity security of the Corporation is perpetual, and not limited to the five (5) year period.

"Beneficial ownership" shall be determined pursuant to Rule 13d-3 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended (or any successor rule or statutory provision), or, if said Rule 13d-3 shall be rescinded and there shall be no successor rule or

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provision thereto, pursuant to said Rule] 3d-3 as in effect on the date of filing of this Certificate of Incorporation; *provided, however*, that a person shall, in any event, also be deemed the “beneficial owner” of any common stock: .

(1) which such person or any of its Affiliates (as defined in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended, as in effect on the date of filing of this Certificate of Incorporation) beneficially owns, directly or indirectly; or

(2) which such person or any of its Affiliates has: (a) the right to acquire (whether such right is exercisable immediately or only after the passage of time), pursuant to any agreement, arrangement or understanding, or upon the exercise of conversion rights, exchange rights, warrants or options or otherwise, or (b) sole or shared voting or investment power with respect thereto pursuant to any agreement, arrangement, understanding, relationship or otherwise (but shall not be deemed to be the beneficial owner of any voting shares solely by reason of a revocable proxy granted for a particular meeting of stockholders, pursuant to a public solicitation of proxies for such meeting, with respect to shares of which neither such person nor any such Affiliate is otherwise deemed the beneficial owner); or

(3) which are beneficially owned, directly or indirectly, by any other person with which such first mentioned person or any of its Affiliates acts as a partnership, limited partnership, syndicate or other group pursuant to any agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of any shares of capital stock of the Corporation; and

*provided further, however*, that: (a) no director or officer of the Corporation (or any Affiliate of any such director or officer) shall, solely by reason of any or all of such directors or officers acting in their capacities as such, be deemed, for any purposes hereof, to beneficially own any common stock beneficially owned by any other such director or officer (or any Affiliate thereof); and (b) neither any employee stock ownership plan or similar plan of the Corporation or any subsidiary of the Corporation, nor any trustee with respect thereto or any Affiliate of such trustee (solely by reason of such capacity of such trustee), shall be deemed, for any purposes hereof, to beneficially own any common stock held under any such plan.

The Board of Directors shall have the power to construe and apply the provisions of this Section and to make all determinations necessary or desirable to implement such provisions, including but not limited to matters with respect to: (a) the number of shares of common stock beneficially owned by any person; (b) whether a person is an Affiliate of another; (c) whether a person has an agreement, arrangement or understanding with another as to the matters referred to in the definition of beneficial ownership; (d) the application of any other definition or operative provision of this Section to the given facts; or (e) any other matter relating to the applicability or effect of this Section.

The Board of Directors shall have the right to demand that any person who is reasonably believed to beneficially own shares of common stock that are “excess shares” (or holds of record common stock beneficially owned by any person in excess of the limit described above) supply the

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Corporation with complete information as to: (a) the record owner(s) of all shares beneficially owned by such person who is reasonably believed to own shares in excess of the limit described above; and (b) any other factual matter relating to the applicability or effect of this Section as may reasonably be requested of such person.

Special meetings of shareholders relating to changes in control of the Corporation or amendments to its Certificate of Incorporation shall be called only at the direction of the Board of Directors. This provision is perpetual, and not limited to the five (5) year period,

#### **Section 7. Preemptive Rights.**

Holders of the stock of the Corporation are not entitled to preemptive rights with respect to any shares of the Corporation that may be issued.

#### **Section 8. Directors.**

The business and affairs of the Corporation shall be managed under the direction of its Board of Directors. The authorized number of Directors, as stated in the Corporation's Bylaws, shall not be fewer than eight (8) nor more than sixteen (16). The Directors of the Corporation shall be divided into four (4) classes, namely, Class I, Class II, Class III and Class IV, as nearly equal in number as possible with each class consisting of no fewer than two (2) or more than four (4) Directors. Each member of the Board of Directors in Class I shall hold office until the annual meeting of the Corporation in 2012, each member of the Board of Directors of Class II shall hold office until the annual meeting of the Corporation in 2013, each member of the Board of Directors in Class III shall hold office until the annual meeting of the Corporation in 2014, and each member of the Board of Directors in Class IV shall hold office until the annual meeting of the Corporation in 2015. At each annual meeting, the successors, if any, to the class of directors whose terms expire at that meeting shall be elected to serve four (4) year terms and until their successors are elected and qualified.

The personal liability of any Director to the Corporation or its shareholders for monetary damages for breach of duty as a Director is hereby limited to the amount of the compensation received by the Director for serving the Corporation during the year of the violation if such breach did not (i) involve a knowing and culpable violation of law by the Director, (ii) enable the Director or an associate, as defined in subdivision (3) of Section 33-843 of the Connecticut General Statutes, to receive an improper personal economic gain, (iii) show a lack of good faith and a conscious disregard for the duty of the Director to the Corporation under circumstances in which the Director was aware that his or her conduct or omission created an unjustifiable risk of serious injury to the Corporation, (iv) constitute a sustained and unexcused pattern of inattention that amounted to an abdication of the Director's duty to the Corporation, or (v) create liability under Section 36a-58 of the Connecticut General Statutes. Any lawful repeal or modification of this provision by the shareholders and the Board of Directors of the Corporation shall not adversely affect any right or protection of a Director existing at or prior to the time of such repeal or modification.

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The name, address and initial term of each prospective initial Director of the Corporation are as set forth below:

<b>Name</b>	<b>Address</b>	<b>Next Date of Election</b>
C. Perry Chilberg	111 Debbie Drive South Windsor, Connecticut	2011
Joseph F. Jeamel, Jr.	121 Cliffwood Drive South Windsor, Connecticut	2011
Kristen Johnson	19B Folkstone Road Broad Brook, Connecticut	2011
Rosemarie Novello Papa	229 Bobby Lane Manchester, Connecticut	2011
Michael A. Bars	181 Mohegan Trail South Windsor, Connecticut	2012
Pamela J. Guenard	47 Ellington Avenue Ellington, Connecticut	2012
Thomas S. Mason	183 Reservoir Road Vernon, Connecticut	2012
Peter F. Olson	39 Tolland Avenue Rockville, Connecticut	2012
Raymond H. LeFurge	1 Boulder Crest Lane Vernon, Connecticut	2013
Stuart E. Magdefrau	55 Hayes Avenue Ellington, Connecticut	2013
William J. McGurk	21 Stillmeadow Lane Somers, Connecticut	2013
David A. Engelson	82 Meadowview Lane Vernon, Connecticut	2014
Richard M. Tkacz	III Abbe Road Enfield, Connecticut	2014

#### **Section 9. Consideration of a Merger or Other Business Combinations**

The Directors shall consider the following criteria when determining whether to authorize the Corporation to engage in a merger, consolidation, share exchange, or sale of assets other than in the ordinary course of business:

- (a) the long and short-term interests of the Corporation;

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- (b) the long and short-term interests of the Corporation's shareholders;
  - (c) the interests of the Corporation's employees, customers, creditors and suppliers; and
  - (d) community and societal considerations including those of any community in which the Corporation or its subsidiary, Rockville Bank, has an office.

A Director may also, in his/her discretion, consider any other factors he/she considers appropriate in determining what he/she believes to be in the Corporation's best interest.

#### **Section 10. Removal of Directors.**

Any Director may be removed from office at any time, for cause only, by the affirmative vote of at least two-thirds (2/3) of the Directors then in office or by the affirmative vote of the holders of at least eighty percent (80%) of the voting power of the issued and outstanding shares of the capital stock of the Corporation entitled to vote for the election of Directors.

#### **Section 11. Certain Business Combinations.**

Without limiting the restrictions of Section 6 above, the provisions of Section 33-844 of the Connecticut General Statutes as in effect on the date hereof (or any succeeding, substantially similar statutory provisions) regarding the prohibition of a business combination with an Interested Shareholder for five (5) years as described therein shall also apply to the Corporation and are incorporated herein by reference.

#### **Section 12. Mergers, Consolidations and Other Business Combinations.**

Without limiting the restrictions of Section 6 and 11 above, the Corporation may only engage in a merger, consolidation, share exchange or sale of substantially all of the assets of the Corporation other than in the ordinary course of business upon receiving the vote of at least two-thirds (2/3) of the Directors then in office and by the affirmative vote of the holders of shares of capital stock having two-thirds (2/3) of the voting power of all issued and outstanding shares of the capital stock of the Corporation entitled to vote upon such approval, authorization, ratification or determination.

#### **Section 13. Amendment of Certificate of Incorporation.**

Except as provided in Section 5, no amendment, addition, alteration, change or repeal of this Certificate of Incorporation shall be made, unless such is first proposed by the Board of Directors of the Corporation and thereafter approved by the shareholders by the affirmative vote of a majority of the total votes eligible to be cast at a meeting.; provided that, a vote of not less than eighty percent (80%) of the total votes eligible to be cast will be required to amend Sections 5, 6, 7, 8, 9, 10, II, 12, 13 and 14.



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## Section 14. Liquidation Account.

Under the regulations of the State of Connecticut Department of Banking, the Corporation must establish and maintain a liquidation account (the "Liquidation Account") for the benefit of certain Eligible Account Holders and Supplemental Eligible Account Holders as defined in the Plan of Conversion and Reorganization dated September 16, 2010 (the "Plan of Conversion"). In the event of a complete liquidation involving the (i) Rockville Bank or (ii) the Corporation and Rockville Bank, the Corporation must comply with the regulations of the Connecticut Department of Banking and the provisions of the Plan of Conversion with respect to the amount and priorities of each Eligible Account Holder's and Supplemental Eligible Account Holder's interests in the Liquidation Account. The interest of an Eligible Account Holder or Supplemental Eligible Account Holder in the Liquidation Account does not entitle such account holders to voting rights.

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## Section 3: EX-31.1 (EX-31.1)

**Exhibit 31.1**

### Certification

I, William H.W. Crawford, IV, certify that:

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

November 8, 2013

/s/ William H.W. Crawford, IV

William H.W. Crawford, IV

President and Chief Executive Officer

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## Section 4: EX-31.2 (EX-31.2)

**Exhibit 31.2**

## Certification

I, John T. Lund, certify that:

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

November 8, 2013

/s/ John T. Lund

John T. Lund

EVP, Chief Financial Officer and Treasurer

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## Section 5: EX-32 (EX-32)

**Exhibit 32**

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADDED BY  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Rockville Financial, Inc. (the "Company") on Form 10-Q for the quarterly period ended September 30, 2013, as filed with the Securities and Exchange Commission (the "Report"), I hereby certify pursuant to 18 U.S.C. Section 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in this Report fairly presents, in all material respects, the consolidated financial condition and results of the Company as of and for the period covered by this Report.

By: /s/ William H.W. Crawford, IV

William H.W. Crawford, IV

President and Chief Executive Officer

November 8, 2013

By: /s/ John T. Lund

John T. Lund

EVP, Chief Financial Officer and Treasurer

November 8, 2013

The forgoing certification is being furnished solely pursuant to 12 U.S.C. Section 1350 and is not being filed as part of the Report or as a separate disclosure document.

Note: A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to Rockville Financial, Inc. and will be retained by Rockville Financial, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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