
People's United Financial, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

People's United Financial maintains the allowance for loan losses at a level that is deemed to be adequate to absorb probable losses inherent in the respective loan portfolios, based on a quarterly evaluation of a variety of factors. These factors include, but are not limited to: People's United Financial's historical loan loss experience and recent trends in that experience; risk ratings assigned by lending personnel to commercial real estate, commercial and equipment financing loans, and the results of ongoing reviews of those ratings by People's United Financial's independent loan review function; an evaluation of delinquent and non-performing loans and related collateral values; the probability of loss in view of geographic and industry concentrations and other portfolio risk characteristics; the present financial condition of borrowers; and current economic conditions.

The company's allowance for loan losses consists of three elements: (i) an allowance for larger-balance, non-homogeneous loans that are evaluated on an individual (loan-by-loan) basis; (ii) an allowance for smaller-balance homogeneous loans that are evaluated on a collective basis; and (iii) a specific allowance for individual loans deemed to be impaired.

The company establishes a loan loss allowance for its larger-balance, non-homogeneous loans using a methodology that incorporates (i) the probability of default for a given loan risk rating and (ii) historical default data over a multi-year period. In accordance with the company's loan risk rating system, each loan, with the exception of those included in large groups of smaller-balance homogeneous loans, is assigned a risk rating (using a nine-grade scale) by the originating loan officer, credit management, internal loan review or loan committee. Loans rated one represent those loans least likely to default while loans rated nine represent a loss. The probability of loans defaulting for each risk rating, referred to as default factors, are estimated based on the frequency with which loans migrate from one risk rating to another and to default status over time. Estimated loan default factors are multiplied by loan balances within each risk-rating category and again multiplied by an historical loss-given-default estimate for each loan type (which incorporates estimated recoveries) to determine an appropriate level of allowance by loan type. The historical loss-given-default estimates are updated annually based on actual charge-off experience. This approach is applied to the commercial, commercial real estate and equipment financing components of the loan portfolio.

In developing this element of the allowance for loan losses, the company also gives consideration to certain qualitative factors, including the macroeconomic environment and any potential imprecision inherent in its loan loss model which may result from having limited historical loan loss data which, in turn, may result in inaccurate probability of default and loss-given-default factors. In consideration of these factors, the company may adjust the allowance for loan losses upward or downward based on current economic conditions and portfolio trends. In determining the extent of any such adjustment, the company considers both economic and portfolio-specific data that correlates with loan losses. The company annually reviews this data to determine that such a correlation continues to exist. Additionally, at interim dates between annual reviews, the company evaluates the factors in order to conclude that they continue to be adequate based on current economic conditions.

Pools of smaller-balance, homogeneous loans with similar risk and loss characteristics are also assessed for probable losses. These loan pools include residential mortgage, home equity and other consumer loans. This element of the allowance for loan losses is established based upon a consideration of recent historical loss experience, delinquency trends, and portfolio-specific risk characteristics, including: (i) collateral values/loan-to-value ratios; (ii) borrower credit scores; (iii) portfolio concentrations; and (iv) other relevant portfolio risk elements.

The allowance for loan losses also includes specific allowances for individually impaired loans. Generally, the company's impaired loans consist of (i) classified commercial loans in excess of \$250,000 that have been placed on non-accrual status and (ii) loans classified as TDRs. Individually impaired loans are measured based upon observable market prices; the present value of expected future cash flows discounted at the loan's original effective interest rate; or, in the case of collateral dependent loans, fair values of the collateral (based on appraisals and other market information) less costs to sell. If the recorded investment in a loan exceeds the amount measured as described in the preceding sentence, a specific allowance for loan losses would be

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established as a component of the overall allowance for loan losses or, in the case of a collateral dependent loan, a charge-off would be recorded for the difference between the loan's recorded investment and management's estimate of the fair value of the collateral (less costs to sell). It would be rare for the company to identify a loan that meets the criteria stated above and requires a specific allowance or a charge-off and not deem it impaired solely as a result of the existence of a guarantee.

People's United Financial performs an analysis of its impaired loans, including collateral dependent impaired loans, on a quarterly basis. Individually impaired collateral dependent loans are measured based upon the appraised value of the underlying collateral and other market information. Generally, the company's policy is to obtain updated appraisals for commercial collateral dependent loans when the loan is downgraded to a risk rating of "substandard" or "doubtful", and the most recent appraisal is more than 12 months old or a determination has been made that the property has experienced a significant decline in value. Appraisals are prepared by independent, licensed third-party appraisers and are subject to review by the company's internal commercial appraisal department or external appraisers contracted by the commercial appraisal department. The conclusions of the external appraisal review are reviewed by the company's Chief Commercial Appraiser prior to acceptance. The company's policy with respect to impaired residential mortgage loans is to receive updated appraisals upon the loan being classified as non-performing (typically upon becoming 90 days past due). (8)

(2) In determining the allowance for loan losses, People's United Financial gives appropriate consideration to the age of appraisals through its regular evaluation of other relevant qualitative and quantitative information. Specifically, between scheduled appraisals, property values are monitored within the commercial portfolio by reference to current originations of collateral dependent loans and the related appraisals obtained during underwriting as well as by reference to recent trends in commercial property sales as published by leading industry sources. Property values are monitored within the residential mortgage portfolio by reference to available market indicators, including real estate price indices within the company's primary lending areas.

In most situations where a guarantee exists, the guarantee arrangement is not a specific factor in the assessment of the related allowance for loan losses. However, the assessment of a guarantor's credit strength is reflected in the company's internal loan risk ratings which, in turn, are an important factor in its allowance for loan loss methodology for loans within the commercial and commercial real estate portfolios.

People's United Financial did not change its methodology for determining the allowance for loan losses during 2010. While People's United Financial seeks to use the best available information in determining the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary based on changes in economic conditions, results of regulatory examinations, further information obtained regarding known problem loans, the identification of additional problem loans and other factors. (4)

Loan Charge-Offs

The company's charge-off policies, which comply with standards established by banking regulators, are consistently applied from period to period. Charge-offs are recorded on a monthly basis. Partially charged-off loans continue to be evaluated on a monthly basis and additional charge-offs or loan loss provisions may be recorded on the remaining loan balance based on the same criteria.

For unsecured consumer loans, charge-offs generally occur when the loan is deemed to be uncollectible or 120 days past due, whichever occurs first. For consumer loans secured by real estate, including residential mortgage loans, charge-offs generally occur when the loan is deemed to be uncollectible or 180 days past due, whichever occurs first, unless it can be clearly demonstrated that repayment will occur regardless of the delinquency status. Factors that demonstrate an ability to repay may include (i) a loan that is secured by adequate collateral and is in the process of collection, (ii) a loan supported by a valid guarantee or insurance, or (iii) a loan supported by a valid claim against a solvent estate.

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For commercial banking loans, a charge-off is recorded when the company determines that it will not collect all amounts contractually due based on the fair value of the collateral (less costs to sell), or the present value of expected future cash flows.

The decision whether to charge-off all or a portion of a loan rather than record a specific or general loss allowance is based on an assessment of all available information which aids in determining the loan's net realizable value. Typically this involves consideration of both (i) the fair value of any collateral securing the loan, including whether the estimate of fair value has been derived from an appraisal or other market information, and (ii) other factors affecting the likelihood of repayment, including the existence of guarantees and insurance. If the amount by which the company's recorded investment in the loan exceeds its net realizable value is deemed to be a confirmed loss, a charge-off is recorded. Otherwise, a specific or general reserve is established, as applicable.

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The following table summarizes those securities available for sale as of December 31, 2010 with unrealized losses, segregated by the length of time the securities were in a continuous unrealized loss position:

| <u>As of December 31, 2010 (in millions)</u> | <u>Continuous Unrealized Loss Position</u> | | | | <u>Total</u> | |
|---|--|--------------------------|----------------------------|--------------------------|-------------------|--------------------------|
| | <u>Less Than 12 Months</u> | | <u>12 Months Or Longer</u> | | <u>Fair Value</u> | <u>Unrealized Losses</u> |
| | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> | | |
| GSE residential mortgage-backed securities and CMOs | \$1,125.7 | \$ (12.9) | \$— | \$ — | \$1,125.7 | \$ (12.9) |
| U.S. Treasury and agency | 198.0 | (0.2) | — | — | 198.0 | (0.2) |
| State and municipal (1) | 4.6 | — | 0.3 | — | 4.9 | — |
| Total | <u>\$1,328.3</u> | <u>\$ (13.1)</u> | <u>\$ 0.3</u> | <u>\$ —</u> | <u>\$1,328.6</u> | <u>\$ (13.1)</u> |

(1) Unrealized losses totaled less than \$50,000.

At December 31, 2009, GSE residential mortgage-backed securities with a fair value of \$303.2 million and an unrealized loss of \$4.4 million were in a continuous unrealized loss position for less than 12 months.

Management believes that all impairments within the securities portfolio are temporary in nature. No other-than-temporary impairment losses were recognized in the Consolidated Statements of Income for the years ended December 31, 2010, 2009 and 2008.

NOTE 5 – Loans

For purposes of the new FASB standards related to required disclosures about the credit quality of financing receivables and the allowance for loan losses (see Note 1), People's United Financial has identified two loan portfolio segments: Commercial Banking and Retail. The classes of loans within the loan portfolio segments are: commercial real estate, commercial and industrial, and equipment financing for Commercial Banking; and residential mortgage, home equity and other consumer for Retail.

The following table summarizes People's United Financial's loans by loan portfolio segment and class:

| <u>As of December 31 (in millions)</u> | <u>2010</u> | <u>2009</u> |
|--|-------------------|-------------------|
| Commercial Banking: | | |
| Commercial real estate | <u>\$ 7,306.3</u> | <u>\$ 5,399.4</u> |
| Commercial and industrial | 3,095.6 | 2,805.7 |
| Equipment financing | <u>2,100.4</u> | <u>1,236.8</u> |
| Total commercial | <u>5,196.0</u> | <u>4,042.5</u> |
| Total Commercial Banking | <u>12,502.3</u> | <u>9,441.9</u> |
| Retail: | | |
| Residential mortgage: | | |
| Adjustable-rate | 2,184.2 | 2,244.5 |
| Fixed-rate | 653.8 | 302.4 |
| Total residential mortgage | <u>2,838.0</u> | <u>2,546.9</u> |
| Consumer: | | |
| Home equity | 1,976.8 | 1,986.3 |
| Other consumer | 201.1 | 258.7 |
| Total consumer | <u>2,177.9</u> | <u>2,245.0</u> |
| Total Retail | <u>5,015.9</u> | <u>4,791.9</u> |
| Total loans | <u>\$17,518.2</u> | <u>\$14,233.8</u> |

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Loans acquired in connection with the 2010 acquisitions described in Note 2 were recorded at fair value, without carryover of a historical allowance for loan losses. The discount arising from recording the acquired loans at fair value was due, in part, to credit quality and therefore reflects an estimate of credit losses at the acquisition date. Selected credit quality disclosures have been highlighted to distinguish between the 'originated' portfolio and the 'acquired' portfolios. At December 31, 2010, the net carrying amount of the acquired loans totaled \$2.88 billion.

Net deferred loan costs that are included in total loans and accounted for as interest yield adjustments totaled \$26.5 million and \$25.3 million at December 31, 2010 and 2009, respectively.

Approximately 68% and 81% of the total loan portfolio represents loans to customers within the New England states at December 31, 2010 and 2009, respectively. In addition, approximately 15% of the total loan portfolio represents loans to customers in New York state at December 31, 2010.

Substantially all (approximately 96% at December 31, 2010 and 2009) of the equipment financing portfolio involves customers outside of New England. At December 31, 2010, approximately 34% of the equipment financing portfolio was to customers located in Texas, California and Florida. No other state exposure was greater than 6%.

Commercial real estate loans include construction loans totaling \$1.04 billion and \$819.0 million at December 31, 2010 and 2009, respectively, net of the unadvanced portion of such loans totaling \$176.2 million and \$235.4 million, respectively.

At December 31, 2010, the residential mortgage loan portfolio included \$447.2 million of interest-only residential mortgage loans, of which \$59.2 million are stated-income loans, compared to \$1.0 billion and \$112.7 million, respectively, at December 31, 2009. People's United Financial's underwriting guidelines and requirements for such loans are generally more restrictive than those applied to other types of residential mortgage products. Also included in residential mortgage loans are construction loans totaling \$94.0 million and \$65.4 million at December 31, 2010 and 2009, respectively, net of the unadvanced portion of such loans totaling \$26.1 million and \$9.5 million, respectively.

People's United Financial continues to sell newly-originated residential mortgage loans in the secondary market, without recourse. Net gains on sales of residential mortgage loans totaled \$12.1 million, \$13.9 million and \$6.5 million for the years ended December 31, 2010, 2009 and 2008, respectively. Residential mortgage loans at December 31, 2010 and 2009 included loans held for sale (substantially all to be sold servicing released) of \$88.5 million and \$71.3 million, respectively, which approximate fair value.

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The following is a summary of activity in the allowance for loan losses:

| <u>Years ended December 31 (in millions)</u> | <u>2010</u> | <u>2009</u> | <u>2008</u> |
|--|----------------|----------------|----------------|
| Balance at beginning of year | <u>\$172.5</u> | <u>\$157.5</u> | <u>\$ 72.7</u> |
| Charge-offs: | | | |
| Commercial Banking: | | | |
| Commercial real estate | (27.5) | (10.9) | (3.4) |
| Commercial and industrial | (14.3) | (9.8) | (5.6) |
| Equipment financing | (9.5) | (8.8) | (1.5) |
| Retail: | | | |
| Residential mortgage | (4.3) | (5.4) | (1.5) |
| Home equity | (3.8) | (3.5) | (1.0) |
| Other consumer | <u>(5.3)</u> | <u>(7.1)</u> | <u>(6.2)</u> |
| Total charge-offs | <u>(64.7)</u> | <u>(45.5)</u> | <u>(19.2)</u> |
| Recoveries: | | | |
| Commercial Banking: | | | |
| Commercial real estate | 0.8 | 0.3 | 0.2 |
| Commercial and industrial | 1.0 | 1.0 | 1.3 |
| Equipment financing | 0.3 | 0.2 | 0.3 |
| Retail: | | | |
| Residential mortgage | 0.6 | 0.2 | 0.4 |
| Home equity | 0.4 | 0.2 | 0.1 |
| Other consumer | <u>1.6</u> | <u>1.6</u> | <u>2.0</u> |
| Total recoveries | <u>4.7</u> | <u>3.5</u> | <u>4.3</u> |
| Net loan charge-offs | <u>(60.0)</u> | <u>(42.0)</u> | <u>(14.9)</u> |
| Provision for loan losses | 60.0 | 57.0 | 26.2 |
| Allowance recorded in the Chittenden acquisition | — | — | 73.5 |
| Balance at end of year | <u>\$172.5</u> | <u>\$172.5</u> | <u>\$157.5</u> |

The following is a summary of the allowance for loan losses and related portfolio balances, by loan portfolio segment and impairment methodology, as of December 31, 2010:

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| <u>(in millions)</u> | <u>Originated Loans Individually Evaluated for Impairment</u> | | <u>Originated Loans Collectively Evaluated for Impairment</u> | | <u>Acquired Loans (Discounts Related to Credit Quality)</u> | | <u>Total</u> | |
|----------------------|---|------------------|---|------------------|---|------------------|-------------------|------------------|
| | <u>Portfolio</u> | <u>Allowance</u> | <u>Portfolio</u> | <u>Allowance</u> | <u>Portfolio</u> | <u>Allowance</u> | <u>Portfolio</u> | <u>Allowance</u> |
| Commercial Banking | \$ 174.4 | \$ 27.6 | \$ 9,866.1 | \$ 133.9 | \$2,461.8 | \$ — | \$12,502.3 | \$ 161.5 |
| Retail | 8.2 | — | 4,592.0 | 11.0 | 415.7 | — | 5,015.9 | 11.0 |
| Total | <u>\$ 182.6</u> | <u>\$ 27.6</u> | <u>\$14,458.1</u> | <u>\$ 144.9</u> | <u>\$2,877.5</u> | <u>\$ —</u> | <u>\$17,518.2</u> | <u>\$ 172.5</u> |

Agrees to Impaired Loan table on F-35 → (Total Portfolio, Total Allowance)
FAS 114/Specific Reserves Portion → (Commercial Banking Allowance, Retail Allowance)
F-33 → (Originated Loans Collectively Evaluated for Impairment Allowance)
FAS 5 Portion → (Originated Loans Collectively Evaluated for Impairment Allowance)
Agrees to loan composition table on F-31 → (Total Portfolio, Total Allowance)

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The principal balances of originated non-performing loans, by class of loan, are summarized as follows:

| <u>As of December 31 (in millions)</u> | <u>2010</u> | <u>2009</u> | <u>2008</u> |
|---|----------------|----------------|---------------|
| Commercial Banking: | | | |
| Commercial real estate | \$ 82.5 | \$ 72.4 | \$29.8 |
| Commercial and industrial | 38.2 | 17.4 | 21.1 |
| Equipment financing | 36.0 | 20.6 | 5.8 |
| Retail: | | | |
| Residential mortgage | 78.8 | 52.7 | 24.2 |
| Home equity | 9.1 | 5.3 | 2.8 |
| Other consumer | <u>0.6</u> | <u>0.4</u> | <u>0.6</u> |
| Total originated non-performing loans (1) | <u>\$245.2</u> | <u>\$168.8</u> | <u>\$84.3</u> |

(1) Reported net of government guarantees totaling \$9.4 million, \$8.3 million and \$6.5 million at December 31, 2010, 2009 and 2008, respectively.

The table above excludes acquired loans that meet People's United Financial's definition of a non-performing loan but for which the risk of credit loss has been considered by virtue of our estimate of acquisition-date fair value and/or the existence of an FDIC loss-share agreement. The discounts arising from recording these loans at fair value were due, in part, to credit quality. The acquired loans are accounted for on a pool basis and the accretable yield on the pools is being recognized as interest income over the life of the loans based on expected cash flows at the pool level.

Loans past due 90 days or more and still accruing interest totaled \$1.2 million, \$11.8 million and \$8.0 million at December 31, 2010, 2009 and 2008, respectively.

If interest payments on all originated loans classified as non-performing at December 31, 2010, 2009 and 2008 had been made during the respective years in accordance with the loan agreements, interest income of \$35.0 million, \$12.5 million and \$8.6 million would have been recognized on such loans for the years ended December 31, 2010, 2009 and 2008, respectively. Interest income actually recognized on originated non-performing loans totaled \$13.9 million, \$3.3 million and \$2.4 million for the years ended December 31, 2010, 2009 and 2008, respectively.

People's United Financial's recorded investment in originated loans classified as TDRs totaled \$62.6 million and \$3.6 million at December 31, 2010 and 2009, respectively. The related allowance for loan losses at December 31, 2010 was \$8.4 million (insignificant at December 31, 2009) and interest income recognized on these loans totaled \$2.9 million for the year ended December 31, 2010 (insignificant in 2009 and 2008).

People's United Financial's impaired loans consist of certain Commercial Banking and Retail loans, including TDRs.

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Average recorded investment and interest income recognized need to be disclosed as well. See People's 1st quarter 10-Q filing.

The following is a summary of originated loans individually evaluated for impairment, by Class of loan, as of December 31, 2010:

| <u>(in millions)</u> | <u>Unpaid Principal Balance</u> | <u>Recorded Investment</u> | <u>Related Allowance for Loan Losses</u> |
|--|---|--------------------------------|--|
| Originated loans with no related allowance for loan losses: | | | |
| Commercial Banking: | | | |
| Commercial real estate | \$ 37.4 | \$ 33.6 | \$ — |
| Commercial and industrial | 13.5 | 12.3 | — |
| Equipment financing | 24.9 | 22.4 | — |
| Retail: | | | |
| Residential mortgage | 8.1 | 8.0 | — |
| Home equity | 0.2 | 0.2 | — |
| Other consumer | — | — | — |
| Originated loans with a related allowance for loan losses: | | | |
| Commercial Banking: | | | |
| Commercial real estate | 89.5 | 70.5 | 18.1 |
| Commercial and industrial | 20.6 | 5.8 | 2.4 |
| Equipment financing | 31.1 | 29.8 | 7.1 |
| Retail: | | | |
| Residential mortgage | — | — | — |
| Home equity | — | — | — |
| Other consumer | — | — | — |
| Total | <u>\$ 225.3</u> | <u>\$ 182.6</u> | <u>\$ 27.6</u> |

The recorded investment in impaired loans was \$97.7 million at December 31, 2009. At that date, impaired loans totaling \$53.8 million had a related allowance for loan losses of \$16.6 million and impaired loans totaling \$43.9 million had no allowance for loan losses.

People's United Financial's average recorded investment in impaired loans was approximately \$132.1 million, \$89.6 million and \$40.3 million for the years ended December 31, 2010, 2009 and 2008, respectively. Interest collections and income recognized on loans while considered impaired totaled \$6.1 million, \$1.6 million and \$1.6 million for the years ended December 31, 2010, 2009 and 2008, respectively.

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The following is a summary of aging information, by class of loan, as of December 31, 2010:

| <u>(in millions)</u> | <u>Current</u> | <u>Past Due</u> | | <u>Total</u> | <u>Total</u> |
|---------------------------|-------------------|-------------------|----------------------------|----------------|-------------------|
| | | <u>30-89 Days</u> | <u>90 Days or More (1)</u> | | |
| Originated loans: | | | | | |
| Commercial Banking: | | | | | |
| Commercial real estate | \$ 5,494.6 | \$ 28.0 | \$ 82.5 | \$110.5 | \$ 5,605.1 |
| Commercial and industrial | 2,955.3 | 22.5 | 38.2 | 60.7 | 3,016.0 |
| Equipment financing | 1,377.1 | 6.3 | 36.0 | 42.3 | 1,419.4 |
| Total | <u>9,827.0</u> | <u>56.8</u> | <u>156.7</u> | <u>213.5</u> | <u>10,040.5</u> |
| Retail: | | | | | |
| Residential mortgage | 2,331.8 | 73.9 | 78.8 | 152.7 | 2,484.5 |
| Home equity | 1,896.1 | 14.2 | 9.1 | 23.3 | 1,919.4 |
| Other consumer | 189.1 | 6.6 | 0.6 | 7.2 | 196.3 |
| Total | <u>4,417.0</u> | <u>94.7</u> | <u>88.5</u> | <u>183.2</u> | <u>4,600.2</u> |
| Total originated loans | <u>\$14,244.0</u> | <u>\$151.5</u> | <u>\$245.2</u> | <u>\$396.7</u> | <u>\$14,640.7</u> |

Agrees to amounts below

(1) Reported net of government guarantees totaling \$9.4 million at December 31, 2010.

The following is a summary of credit quality indicators, by class of loan, as of December 31, 2010:

| <u>(in millions)</u> | <u>Commercial Real Estate</u> | <u>Commercial and Industrial</u> | <u>Equipment Financing</u> | <u>Total</u> |
|------------------------|-------------------------------|----------------------------------|----------------------------|-------------------|
| | Commercial Banking: | | | |
| Pass | \$ 5,084.1 | \$ 2,735.7 | \$1,109.3 | \$ 8,929.1 |
| Special mention | 232.3 | 116.7 | 79.0 | 428.0 |
| Substandard | 184.4 | 142.6 | 176.3 | 503.3 |
| Doubtful | 0.2 | 2.9 | 2.6 | 5.7 |
| Impaired | 104.1 | 18.1 | 52.2 | 174.4 |
| Total originated loans | <u>5,605.1</u> | <u>3,016.0</u> | <u>1,419.4</u> | <u>10,040.5</u> |
| Acquired loans | 1,701.3 | 79.6 | 680.9 | 2,461.8 |
| Total | <u>\$ 7,306.4</u> | <u>\$ 3,095.6</u> | <u>\$ 2,100.3</u> | <u>\$12,502.3</u> |
| Retail: | | | | |
| High risk | \$ 11.5 | \$ 79.5 | \$ 23.8 | \$ 114.8 |
| Moderate risk | 883.3 | 623.9 | 7.3 | 1,514.5 |
| Low risk | 1,581.7 | 1,215.8 | 165.2 | 2,962.7 |
| Impaired | 8.0 | 0.2 | — | 8.2 |
| Total originated loans | <u>2,484.5</u> | <u>1,919.4</u> | <u>196.3</u> | <u>4,600.2</u> |
| Acquired loans | 353.5 | 57.8 | 4.4 | 415.7 |
| Total | <u>\$ 2,838.0</u> | <u>\$ 1,977.2</u> | <u>\$ 200.7</u> | <u>\$ 5,015.9</u> |

Agrees to amounts in table above

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Commercial Banking Credit Quality Indicators

The company utilizes an internal loan risk rating system as a means of monitoring portfolio credit quality and identifying both problem and potential problem loans. Under the company's risk rating system, problem and potential problem loans are classified as either "Special Mention," "Substandard," or "Doubtful", which correspond to risk ratings six, seven, and eight, respectively. Substandard loans represent those credits characterized by the distinct possibility that the company will sustain some loss if the deficiencies are not corrected. Loans classified as Doubtful possess all the weaknesses inherent in those classified Substandard with the added characteristic that collection or liquidation in full, on the basis of existing facts, conditions and values, is highly questionable and/or improbable. Loans that do not currently expose the company to sufficient enough risk of loss to warrant classification in one of the aforementioned categories but possess weaknesses that deserve management's close attention, are classified as Special Mention. Loans not meeting the aforementioned criteria are considered to be "Pass"-rated loans. Risk ratings are updated as warranted.

Retail Credit Quality Indicators

Smaller-balance, homogeneous loans possessing similar risk and loss characteristics, such as residential mortgage loans, home equity loans and other consumer loans, are not assigned individual loan risk ratings. As such, the company monitors the credit quality of these portfolios based upon portfolio trends and underlying risk elements.

The company's consideration of portfolio trends involves an analysis of recent loss experience as well as delinquency and non-performing loan levels. Supplementing the company's analysis of portfolio trends is a consideration of relevant portfolio-specific risk characteristics, the combination of which determines whether a loan is classified as "High" risk, "Moderate" risk or "Low" risk. Those risk characteristics include the following:

- (i) collateral values / loan-to-value ratios (above and below 70%);
- (ii) borrower credit scores under the FICO scoring system (above and below a score of 680); and
- (iii) other portfolio risk elements such as income verification at time of underwriting (stated income vs. non-stated income) and the property's intended use (owner occupied, non-owner occupied, second home, etc.).

Acquired Loans Credit Quality Indicators

Acquired loans are risk rated, as appropriate, according to the company's internal loan risk rating system, but such ratings are not a determining factor in the establishment of the allowance for loan losses. Rather, acquired loans are initially recorded at fair value, determined based upon an estimate of the amount and timing of both principal and interest cash flows expected to be collected and discounted using a market interest rate. The difference between contractually required principal and interest payments at the acquisition date and the undiscounted cash flows expected to be collected at the acquisition date is referred to as the "nonaccretable difference", which includes an estimate of future credit losses expected to be incurred over the life of the portfolio. A decrease in the expected cash flows in subsequent periods requires the establishment of an allowance for loan losses at that time. As such, the primary credit quality indicator for these loans is their underlying cash flows. At December 31, 2010, there was no allowance for loan losses on these loans.