Strong customer relationships build shareholder value.

1998 Annual Report

WEBSTER FINANCIAL CORPORATION

Corporate Profile

Webster Financial Corporation is the holding company for Connecticut-based Webster Bank. The company has grown steadily and profitably by emphasizing customer service, asset quality, recurring earnings and expense control. Recent acquisitions have strengthened Webster's franchise as a full-service retail and business bank. Webster is organized along five business lines — consumer, business, mortgage, trust & investments, and insurance — each focused on the needs of our customers. By helping customers reach their financial goals, Webster builds strong, lasting relationships that create shareholder value. Pro forma with the pending acquisitions of Maritime Bank & Trust Company and Village Bancorp, Inc., Webster will have approximately $9.3 billion in assets and 115 full-service offices combined with an extensive ATM network throughout Connecticut. Webster's Access National Mortgage, Inc. subsidiary originates low-cost mortgages over the Internet. The company measures the Economic Value Added (EVA) in each line of business.

Mission

To help individuals, families and businesses achieve their financial goals.

The Webster Way

We take personal responsibility for meeting our customers' financial needs.

We respect the dignity of every individual.

We earn people's confidence through ethical behavior.

We give of ourselves in the communities we serve.

We strive for excellence in everything we do.

With uncompromising commitment to these core principles, we will add value for our customers, shareholders, employees and the communities we serve.

Financial Highlights

(Dollars in thousands, except share data)	At or For the Year Ended December 31, 1998	1997	1996
Statement of Condition Data			
Total assets	$ 9,033,917	$ 9,095,887	$ 7,368,941
Loans receivable, net	4,993,509	4,995,851	4,737,883
Securities	3,462,090	3,589,273	2,105,173
Intangible assets	78,380	78,493	81,936
Deposits	5,651,273	5,719,030	5,826,264
Shareholders' equity	554,879	517,262	472,824
Operating Data			
Net interest income	$ 245,435	$ 251,050	$ 222,118
Provision for loan losses	6,800	24,813	13,054
Noninterest income	74,163	42,264	52,009
Noninterest expenses:			
Acquisition-related expenses	17,400	29,792	500
Other noninterest expenses	180,389	171,871	173,977
Total noninterest expenses	197,789	201,663	174,477
Income before income taxes	115,009	66,838	86,596
Income taxes	44,544	25,725	32,602
Net income	70,465	41,113	53,994
Preferred stock dividends	—	—	1,149
Income available to common shareholders	$ 70,465	$ 41,113	$ 52,845
Significant Statistical Data			
Interest-rate spread	2.64%	3.00%	3.12%
Net interest margin	2.81%	3.19%	3.24%
Return on average shareholders' equity	13.16%	8.44%	11.32%
Net income per common share:			
Basic	$ 1.86	$ 1.10	$ 1.44
Diluted	$ 1.83	$ 1.07	$ 1.36
Dividends declared per common share	$ 0.44	$ 0.40	$ 0.34
Noninterest expenses to average assets	2.13%	2.45%	2.42%
Noninterest expenses to average assets-Adjusted(a)	1.73%	1.90%	2.34%
Diluted weighted average shares	38,571	38,473	39,560
Book value per common share	$ 14.87	$ 13.78	$ 12.73
Tangible book value per common share	$ 12.77	$ 11.69	$ 10.48
Shareholders' equity to total assets	6.14%	5.69%	6.42%

(a) Noninterest expenses excluding foreclosed property, acquisition-related, non-recurring tax, capital securities and preferred dividend expenses divided by average assets.

All per share data and the number of outstanding shares of common stock have been adjusted retroactively to give effect to a stock dividend and a stock split effected in the form of a stock dividend.

James C. Smith
Chairman and Chief Executive Officer

Dear Shareholders

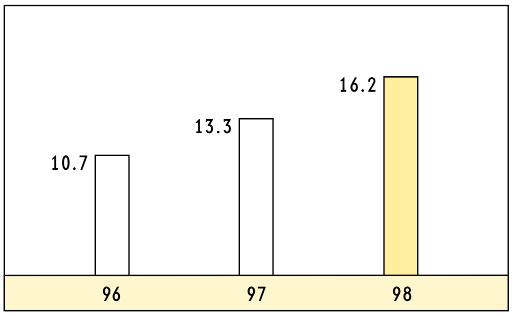
I am pleased to report that 1998 was marked by significant accomplishments at Webster, including record operating earnings. Webster's growth and progress strengthened our position as a leading Connecticut-based financial services provider. Our positive performance stems from our strategic focus, our adherence to unshakable core values, and our belief that Webster has emerged as a modern mid-size bank with unlimited potential.

We have improved our competitive standing and prepared ourselves for the future by ensuring that every one of our 1998 initiatives was focused on two complementary strategic objectives: building strong customer relationships and increasing shareholder value. These efforts were supported by company-wide commitments to capital and expense management, operational efficiency, risk management, and the establishment of a sales and marketing culture.

Our success in achieving our objectives was clearly reflected in our financial results. We reported a 35% increase in net operating income in 1998 despite a challenging interest rate environment. We made significant progress in our evolution to a commercial bank-like structure as evidenced by our growth in commercial assets and core deposits and by our 40% increase in income from fee-based services.

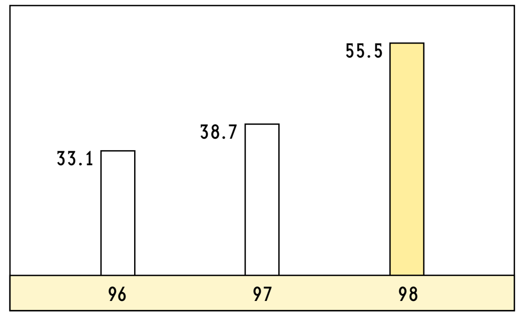
The five strategic acquisitions that we initiated or finalized this past year are notable for expanding and enhancing our Connecticut franchise and for broadening and deepening our lines of business. Our combination with

Operating Return on Average Shareholders' Equity* (%)



* Excludes non-recurring items

Noninterest Income* (Dollars in Millions)



* Excludes gains/losses on sale of loans and securities

Eagle Financial Corp. gave us a market share boost, particularly in Hartford and Litchfield counties, and contributed important economies of scale. Our acquisitions of Village Bancorp, Inc. and Maritime Bank & Trust Company, both scheduled to close in the 2nd quarter 1999, are expected to enhance shareholder value by extending our presence into highly attractive communities in Fairfield County and along the Connecticut shoreline.

The addition of Damman Insurance, a full service regional agency, has given us a whole new line of business and new opportunities to deliver valuable fee-based services. We can now provide our customers with tailored insurance plans to protect their assets and earning capabilities. We will be able to strengthen customer relationships by collaborating across the company to integrate insurance products with offerings from our other lines of business.

We recently completed the exciting acquisition of Access National Mortgage, Inc., a privately held Internet-based mortgage lender. Together, Access and Webster create a dynamic force in mortgage lending. We are now on the cutting edge of this new delivery channel and have established a low-cost nationwide capacity for mortgage origination. We expect to originate a significant volume of first mortgage loans through this channel in 1999.

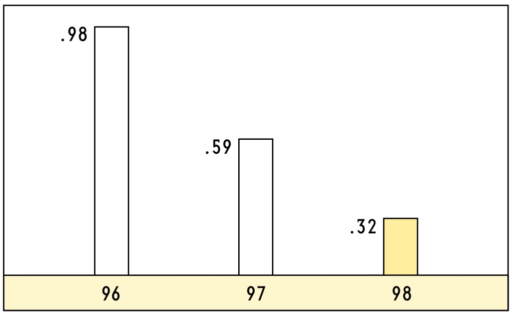
Our 1998 acquisitions helped us achieve our strategic goals by expanding our customer base, broadening our product offerings and enhancing shareholder value. We intend to build on our acquisition record in the years ahead by pursuing other value adding acquisitions.

Reaching beyond our walls for new partners is only one of the means by which we enhance our business. Included in this report you will find profiles of each of our lines of business and updates on their progress against our strategic goals. In addition, I call your attention to the special section on Corporate Initiatives, highlighting five programs that cut across the entire company and involve virtually every employee. Our relentless strategic focus is beginning to have a positive impact on customer relationships and shareholder value. I wish to mention briefly two of those efforts here.

In terms of technological capability, we have created a sophisticated database management capability that will enable us to perform what is known as "relationship" or "one-to-one" marketing. In other words, we will be able to analyze our customers' needs with remarkable precision and design targeted products and solicitations for specific market segments or even individual customers.

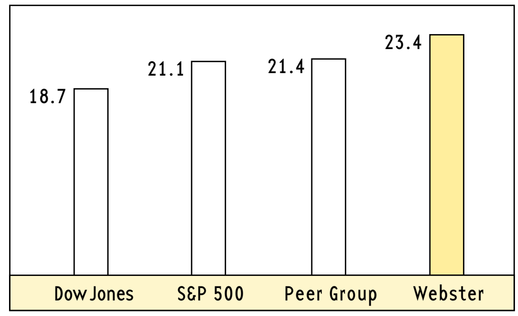
The second initiative involves the efforts we made this year to expand the application of Economic Value Added (EVA®) throughout the company and to tie EVA to the incentive compensation of our senior officers. EVA measures true economic profit after subtracting

Nonaccrual Assets to Total Assets*(%)



* Restated for pooled acquisitions

Five Year Total Annualized Return*(%)



* All nationwide thrifts and banks with market capitalization between $750 million – $2 billion

the cost of capital. This financial management tool imposes uniformity and discipline on our decision making, and allows us to calculate the impact of our decisions and actions on shareholder value. We worked hard this year to ensure that every Webster employee understands how EVA enhances shareholder value and how to apply this understanding to their jobs. In short, EVA has become the key performance measurement tool for Webster's employees.

I am pleased to report that Webster Bank recently became the third financial services institution in the nation to receive Year 2000 certification from the Information Technology Association of America (ITAA). This leading trade group on Year 2000 issues performed a rigorous evaluation of Webster Bank's approach to Year 2000 date conversion and concluded we have demonstrated the core capabilities needed to address the century date change on internal information systems. In addition, because no company stands alone on the Year 2000 computing issue, we have spent the last year sharing information with suppliers and business groups around the state, so that we all can be better prepared to address the century date change challenge.

Among our efforts and accomplishments this year, we reinforced our tradition as a committed corporate citizen through The Harold Webster Smith Foundation, which we announced in early 1998. This lasting memorial to my father, a founder and former Chairman and CEO of Webster Bank, complements our existing corporate giving efforts with grants to help underwrite economic development and other worthy causes such as support for the United Way.

I was also honored this year to be appointed to serve with Governor John G. Rowland as co-chair of the Governor's Council on Economic Competitiveness and Technology. This nonpartisan collaboration among business, government, educational, and labor leaders was formed to improve Connecticut's economic competitiveness, which complements perfectly our own mission here at Webster. We are not content as a financial institution merely to reflect the economic climate in our markets; rather, we seek to be a catalyst for positive economic change.

Webster's success is directly attributed to the hard work and dedication of our employees and to the loyalty of our customers and shareholders. On behalf of the Board of Directors and the employees of Webster, we appreciate your investment.

Sincerely,

James C. Smith
Chairman and Chief Executive Officer

EVA is a registered trademark of Stern Stewart & Co.

Corporate Initiatives

For Webster Bank, 1998 was noteworthy, not only for the accomplishments within our lines of business, but also for programs that encompassed the entire company. Webster may be expanding in size and reach, but the following initiatives demonstrate that we are also becoming a more cohesive, unified organization as we evolve into a modern, full service financial provider.

A Bold, New Branding Campaign

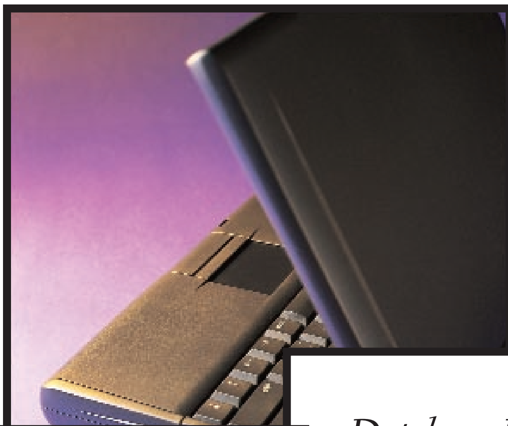
We launched a campaign that unites all of our products and services under one banner: *The simpler. The better.*[SM]

This initiative, which includes innovative television, print, and outdoor advertising, is designed to reinforce our image as a leading brand in our market.

Branding is more than an advertising hook. It represents a philosophy articulated directly from our strategic plan and encompasses the total customer experience. Our objective is to tie every offering and every customer interaction to the promise that "No bank can make your banking simpler and easier than Webster." Our employees strive daily to fulfill that promise in a manner that builds strong customer relationships, and, in turn, increases shareholder value.

Best Practices

We are committed to becoming a company that exemplifies "operational excellence." Our Best Practices initiative, which was rolled out company-wide this year, moves us toward that goal. Best Practices teams are mapping and analyzing internal processes, such as procurement and loan application-to-approval turnaround time, to determine which ones can be simplified, automated, or eliminated. The goals in each case are to save time and money and to improve customer service by streamlining steps and avoiding redundancies.



Sales Culture

Webster's Best Sales Program and the Fall Switch Campaign are two initiatives aimed at instilling a sales culture at Webster Bank.

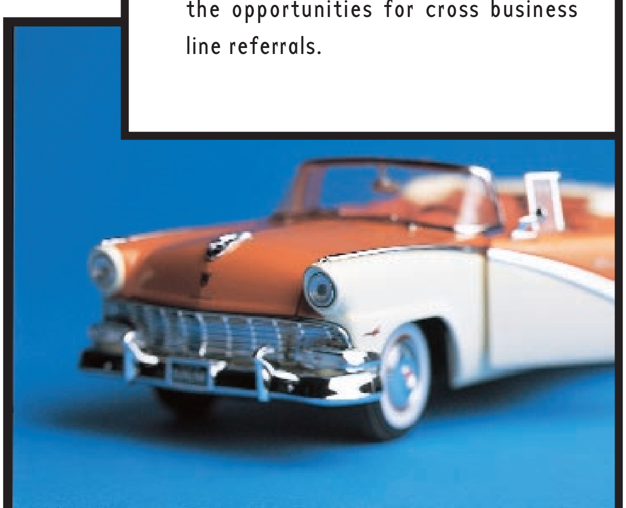
Best Sales, now entering its third year, involves extensive training and the alignment of organizational elements to energize the Bank to be sales oriented. These efforts include: imparting product knowledge, a uniform sales language, and sales and service skills; redefining roles and responsibilities and matching them with the right people; implementing sales tracking and performance measurements; and creating new and highly motivating recognition and incentive programs.

The Fall Switch Campaign was a bank-wide effort to win new relationships from our competitors. Supported by a major advertising program, this initiative involved the development of targeted sales programs that leveraged our new marketing database and the opportunities for cross business line referrals.

Database Marketing

We adopted database management technology that enables us to better understand both our customers' behavior and what drives profitability. We learn from our customers by analyzing what products are purchased, how they are used, and what marketing is most effective. This information is used in our product development efforts and includes the creation of targeted marketing programs to unique customer segments. We can also enhance our own accountability by monitoring and tracking the results of our campaigns. The system is already improving our marketing and sales efficiency, enabling us to create more customer-focused products and programs, and putting up-to-date customer information at our employees' fingertips.

Creation of a customer profitability information system in 1998 as part of our marketing database enables us to understand the drivers of profitability. With the help of this new technology, we launched three major initiatives this year to improve retention of high value customers, measure sales effectiveness and redesign our products.



EVA - The Driving Force

Every one of the initiatives described above, in fact every decision made at Webster Bank, from making an acquisition to using email instead of paper, is now driven by a decision making tool called Economic Value Added (EVA). EVA is a financial model that measures how successful a company is at creating wealth. It differs from other financial measurements because it assumes that, to create real wealth, a company must generate enough income to exceed the return that shareholders expect. Because of this direct correlation with shareholder value, we chose EVA to guide our financial decision making. We have structured our incentive programs, performance appraisals, and senior executive compensation plans around EVA. We began using EVA at the corporate level in 1996. This year, the EVA "discipline" was spread throughout our organization.

Directors

James C. Smith,
Chairman and Chief Executive Officer

Achille A. Apicella, C.P.A.,
President, Apicella, Testa & Company, P.C.

Richard H. Alden, Esq.
Principal, Anderson, Alden, Hayes,
Ziogas & Storm, L.L.C.

Joel S. Becker,
Chairman and Chief Executive Officer,
Torrington Supply Co., Inc.

O. Joseph Bizzozero, Jr., M.D.,
President, Bizzozero Assoc. P.C.

George T. Carpenter,
President and Treasurer, S. Carpenter
Construction Co., and Carpenter Realty Co.

John J. Crawford,
President and Chief Executive Officer,
South Central Connecticut Regional Water
Authority and President and Chief Executive
Officer, Aristotle Corporation

Harry P. DiAdamo,
Former President and Chief Executive Officer,
DS Bancor and Derby Savings Bank

Robert A. Finkenzeller,
President, Eyelet Crafters, Inc.

Walter R. Griffin, Esq.,
Griffin & Griffin, P.C.

J. Gregory Hickey,
Retired Managing Partner
of Hartford Office of Ernst & Young, LLP

C. Michael Jacobi,
President and Chief Executive Officer,
Timex Corporation

J. Allen Kosowsky, C.P.A.,*
J. Allen Kosowsky, C.P.A., P.C.

John F. McCarthy,
President, J&M Sales Co., Inc.

Sr. Marguerite Waite,
President, Chief Executive Officer and
Treasurer, St. Mary's Hospital

Joseph A. Welna, M.D.,*
New Britain Obstetrical and
Gynecological Group

*Webster Bank only

Senior Management Group

(letter indicates picture at right)

John V. Brennan, *(a)*
Executive Vice President,
Chief Financial Officer and Treasurer

William T. Bromage, *(d)*
Executive Vice President, Business Banking

Jeffrey N. Brown, *(g)*
Executive Vice President,
Marketing and Communications*

Thomas N. Howe, *(e)*
Executive Vice President, Trust and Investment
Management Services*; President and Chief
Executive Officer, Webster Trust Company, N.A.

Peter K. Mulligan, *(f)*
Executive Vice President,
Consumer and Small Business Banking

John J. Queirolo, *(i)*
President and Chief Executive Officer,
Damman Insurance Associates

Renee P. Seefried, *(c)*
Executive Vice President, Human Resources*

James C. Smith,
Chairman and Chief Executive Officer
(pictured on page 3)

Ross M. Strickland, *(b)*
Executive Vice President, Mortgage Banking

Harriet Munrett Wolfe, Esq. *(h)*
Senior Vice President, Counsel and Secretary

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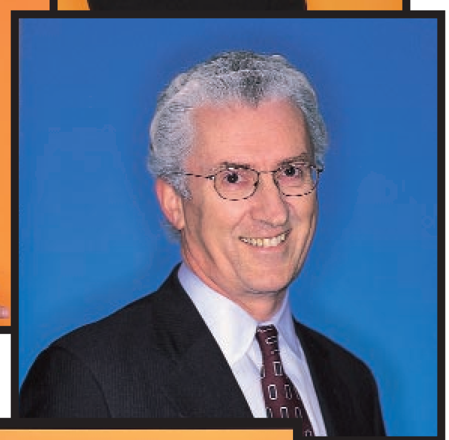
b

c

i

d



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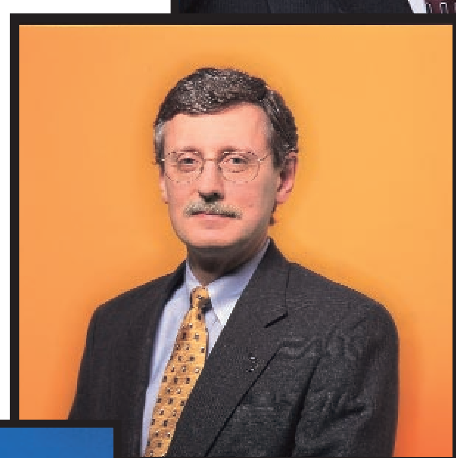

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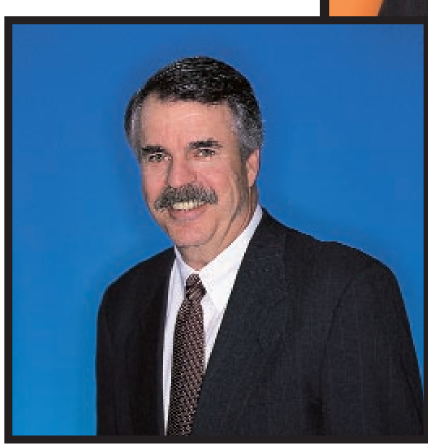

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Consumer & Small Business

Business Banking

Mortgage Banking

Trust & Investment Management

Insurance

Building on Webster's commitment to customer relationships and shareholder value, we made impressive strides in putting Webster on the cutting-edge of the banking industry. We are positioning Webster for the future by expanding our delivery channels, refining our product designs, investing in employee training, and deepening our customer relationships.

Laying the Foundation for the Future of Consumer Banking

One of our most important efforts of 1998 was the launch of an initiative appropriately called Project Momentum. This effort, spearheaded by experts in marketing and communications, consumer and small business banking, and information technology, will drive virtually all of our retail operations in 1999.

Using our data management system, we analyzed and segmented our entire retail customer base. Then, working in three teams, we focused on: Customer Retention – developing strategies for retaining and rewarding valuable customers; Sales Effectiveness – analyzing the effectiveness of our sales training, goals, and incentive programs; and Value for Cost – examining the scope, design, and pricing of all consumer products to ensure that every offering is valuable for customers and delivers an acceptable return for Webster.

Project Momentum is resulting in extensive product redesign and pricing, as well as new marketing strategies targeted to specific customer groups. This effort is complemented by our Webster's Best Sales Program, which is bringing sales training to all employees involved in consumer and small business banking.

Consumer and Small Business Banking

Anytime Anywhere Access

Consistent with our new brand identity, *The simpler. The better.*[SM], we kept pace with our industry and the public by providing more self-service and electronic delivery options. We expanded the capabilities of our dialup PC banking program, Automated Voice Response unit, and our Web site (www.websterbank.com), began construction of a state-of-the-art call center, and added more functionality to many of our ATMs. As a result of these and other initiatives, our percentage of transactions processed electronically grew to more than 55% of all transactions.

Strides in the Debit Card Arena

The Visa® Check Card has become the cornerstone of Webster's commitment to anytime anywhere access. We enhanced our support of debit cards as a versatile, cost effective payment system by becoming the first bank in the nation to promote and link our Visa Check Card with the Mobil® Speedpass™. This popular promotion increased check card usage and boosted checking account signups by more than 25%. Now at the end of its third year, our program ranks among the top 75 Visa Check Card programs in the U.S. in terms of customer purchases.

Greater Penetration in the Small Business Sector

Our Small Business deposits and loans continued progressive growth in excess of 50% in 1998. Webster's penetration in this sector is the result of our acquisitions, product offerings, and the improved expertise of our employees at needs-based selling. We also put more business development officers and relationship managers in the field, and are reaping the benefits of Webster's commitment to sales training and skill development for all employees.

Home Equity Loans

We continue to be committed to the Connecticut homeowner with a successful home equity program that has posted record originations in the face of active first mortgage refinancing activity. Home equity borrowing continues to be an attractive source of financing for consumers and one for which there is increasing competition. Innovations in our speed of delivery, sales effectiveness and target marketing have all contributed to our success.

We now have the ability to maximize the value of every customer relationship, because we have the skills and tools to design the right products, deliver exceptional service, and give every customer anytime anywhere access to Webster Bank.

— Peter Mulligan

Mobil is a registered trademark of Mobil Oil Corp. Speedpass is a trademark of Mobil Oil Corp.

Webster Bank has firmly established itself as a leader in meeting the financial needs of Connecticut's businesses. Investments in staffing and technology have sharpened our responsiveness and broadened our product lines. Webster has built its reputation on a foundation of superior customer service by seasoned business professionals. In the last year, we have continued to add senior lenders with a deep understanding of the Connecticut marketplace as well as expertise in specialized product offerings.

On the technology front, we implemented a contact management system that supports the entire business process. From their computers, our relationship managers can access, update and share customer information with colleagues, helping to significantly reduce processing time and improve customer service.

As a result of our initiatives, Webster is rated higher by our customers than our competitors are rated by their customers, according to a respected independent survey.

Having established a solid reputation for serving our traditional core middle market customers, we are now making important inroads in providing specialized products and services and developing targeted customer segments.

Penetration into Connecticut's Health Care Industry

We strengthened our state-wide reputation as a preferred provider of financial services to the health care industry. We have been building our expertise across the continuum of care, including hospitals, physician practices, visiting nurse associations, skilled nursing firms, and assisted living facilities.

Business Banking

We offer the expertise and complete range of services that a Connecticut company would need from a full-service bank.

— Bill Bromage

Cash Management

Our capabilities as a full service cash management provider continue to grow. Among our 1998 accomplishments, we designed a payroll solution for a physician group with 84 locations, provided full treasury management services for a variety of companies, and delivered one-day turnaround for a property management company needing 20 accounts, lockbox service, and electronic cash management capability. We doubled the number of companies using our online banking product, Webster PC-Link™, which enables clients to get real-time account status and authorize fund transfers from their desktops.

Commercial Real Estate

The strengthening of our Commercial Real Estate staff has enabled us to expand our involvement and finance an array of high quality projects. Among our Connecticut projects were major residential developments in Middletown and Avon, a retail center in Simsbury, and an office complex in West Hartford.

Asset-Based Lending

Our financing capabilities allow us to support successful companies in need of permanent working capital. Included in the companies we financed in 1998 were two firms identified by the Connecticut Technology Council as among the 50 fastest growing companies in Connecticut. For example, we designed a $6 million package for a high-tech producer of aerospace and medical products to support its goal of achieving 200% improvement in production capacity in 1999.

Specialized Industries

We became a participant in the syndicated loan market and completed transactions representing more than $100 million in outstanding loans. Selective participation in this market provides diversity of credit risk both on an industry and geographic basis. These loans meet our credit quality standards and are measured against EVA targets.

International Banking

In 1998, we established a new program to develop international loans and a new source of fee income for Webster. Under this program, these loans are protected by guarantees from the Export-Import Bank of the United States. We also established marketing arrangements in Mexico, Venezuela, Brazil, and Turkey to refer these loans. These arrangements help to facilitate foreign trade by providing financing options to foreign businesses seeking to import U.S. goods.

Mortgage Banking

By combining advanced technology, process refinements and innovative program design with Best Practices tools and skills, we were able to reduce expenses and produce improvements in efficiency and productivity. We cut direct origination expenses by more than $500 per loan, and reduced residential per-loan servicing costs by 34%.

Instant Decisioning

No initiative does a better job of differentiating us in the marketplace and demonstrating our organization's effectiveness than our instant decisioning process, which became fully operational this year. Webster is one of the few lenders in the nation that has integrated advanced technologies with a front-end loan processing system to deliver mortgage commitments *at the point of sale.* Our loan officers now visit with customers, complete applications on laptop computers, and connect via phone line to computers that perform risk analyses and deliver decisions in minutes. This simple, streamlined process has reduced mortgage processing and credit approval time for many borrowers from two or three weeks to less than an hour. As of Fall 1998, more than 50% of our mortgage credit approvals were being completed electronically. We are now extending this capability with the goal of automating every kind of consumer and small business loan offered by Webster Bank.

Customer Retention

To keep pace with periods of heavy refinancing while making refinancing less burdensome, we developed a Mortgage Modification Program that is a win-win for Webster and our customers. For customers whose loans meet specific criteria, we can provide a streamlined refinancing process featuring a modest fee, virtually no paperwork, and fast turnaround. The program has improved retention, especially among customers with high-balance loans, and reduced average per loan expenses.

New Approaches

We are continually reevaluating ways to better meet the needs of our customers and the markets we serve. This year we initiated a program to assist both eligible families in danger of foreclosure and applicants in search of a mortgage who do not qualify for traditional programs. Through a sub-prime lender partnership, we make referrals to a third party lender that offers unique programs to address their special financing needs.

Internet Mortgages

We opened a new business channel by acquiring Access National Mortgage, Inc., a privately held online (www.discountmortgages.com) lender that closed over $325 million in new mortgage loans in 1998. By combining our automated decisioning and processing capabilities with Access's online origination expertise, we are developing an innovative, cost efficient national network for origination of mortgages. Access complements Webster's reputation for quick turnarounds, easy availability, and competitive pricing in mortgage lending.

Even with an 80% increase in our application and closing volume, we reduced average approval time by 60%, significantly reduced origination expenses, and had 95% of our customers telling us that they would recommend us to people they know.

— Ross Strickland

Nineteen ninety-eight marked a major reorganization of Webster Trust Company, N.A., encompassing everything from our staff to our product mix, office locations, and technological capabilities. This effort was aimed at making us a more efficient operation and aligning our products and resources in ways that benefit our entire range of customers, from organizations that control major endowments and retirement plans to individuals wishing to make modest investments.

Trust and Investment Management

This will always be a relationship business, but within those relationships are customer transactions. Now we have technology that gives us the power to respond to customers' requests with unprecedented speed and accuracy.

— Tom Howe

Expanded In-house Expertise

Among our key staff changes, we made important additions to our management team with a new Chief Operating Officer and a Chief Investment Officer. Both individuals bring impressive credentials and experience to Webster Trust.

Consolidation

We greatly improved operational efficiency by consolidating Webster Trust's five offices into two, centralizing our staff in a new Kensington-based headquarters while maintaining a satellite office in Greenwich.

Advanced Data Management

In a move that enhanced both efficiency and customer relationships, we converted our main computer operating system to a state-of-the-art platform provided by SEI Co. that is as advanced as any in the industry. The system supports our newly standardized product lines and strengthens our competitive position by giving us exceptional processing and customer service functionality. Our relationship management teams now have real-time access to every client's account activity and the ability to respond immediately to customer requests. If a customer calls in the morning to request a new account statement or a check for a real estate closing, we can enter the transaction on the spot and have the check or statement sent out before the end of the day. In other words, transactions that took days to process are being completed in a matter of hours with fewer people and with greater accuracy.

Webster Investment Services

Through our subsidiary, Webster Investment Services, Inc., we are implementing a plan to complement our full time investment sales staff with a new team of in-house broker-dealers. We filed an application with the National Association of Securities Dealers that is enabling us to train and license up to 100 of Webster's personal bankers to sell mutual funds and annuities. These employees, based throughout our branch system, will work with the full time investment sales staff to sell a limited menu of products. Together with the Consumer Banking division, we are making investing easier for customers, bringing investment services to a wider range of customers, and offering attractive advancement opportunities to our branch employees.

Insurance

Damman Insurance Associates joined Webster as a wholly-owned subsidiary in June 1998. This addition gives Webster the ability to serve any of its commercial or retail customers as a single source for banking, investment, and insurance services.

Incorporated in 1957, Damman is a highly successful regional insurance brokerage with three operating divisions: individual and family insurance, financial services, and business and professional insurance. Damman offers a full range of plans for individuals including auto and homeowner's coverage, as well as life, medical, and disability insurance for both individuals and businesses. In addition, we offer commercial property casualty, worker's compensation and general liability protection for domestic and international businesses.

Year One Objectives

As a new line of business for Webster, Damman has three primary objectives: continue to grow the original agency; leverage the relationship with the bank for cross-sell opportunities; and pursue strategic acquisitions. Introduction of insurance services to the bank's customer base through referrals and cross selling affords a significant opportunity and will contribute to the building of strong customer relationships, thereby enhancing shareholder value. Finally, we see opportunities to pursue value-added acquisitions of other regional or local insurance agencies that would help us expand geographically while providing opportunities for greater economies of scale.

Communications and Training

To achieve these objectives, the most immediate effort is focused in the area of communications. We are educating our staff about Webster's other business lines and familiarizing the other lines with our products and services. We have begun to identify opportunities and form action plans with the business lines to better understand customer needs and guide the development of products, services, delivery systems, and marketing programs. We have also taken steps, which will be completed in 1999, to transition to a new agency management system that will further improve our work flows.

This is such a natural combination — banking, investments, and insurance. The exciting thing is that we are finding optimal ways to deliver products and services, and that's truly in the best interest of customers.

— John Queirolo

Glossary of Terms

Allowance for Loan Losses: A reserve for estimated loan losses at a particular balance sheet date.

Basic Earnings Per Common Share: Net income applicable to common stock (after deducting dividends on preferred stock) divided by the weighted average number of common shares outstanding during the period.

Book Value Per Common Share: Total common shareholders' equity divided by the number of shares of common stock outstanding.

Capital Components and Ratios for Webster Bank:

> *Leverage Ratio:* Tier 1 capital as a percentage of adjusted total assets.
>
> *Risk-Weighted Assets:* The sum of risk-weighted assets plus the risk-weighted credit equivalent amounts of off-balance sheet items, less core deposit intangibles and certain other non-qualifying intangible assets and the non-qualifying portion of the allowance for loan losses.
>
> *Tier 1 Capital:* The sum of common shareholders' equity (excluding net unrealized gains or losses on available for sale securities, except for net unrealized gains/losses on marketable equity securities) less other non-qualifying intangible assets.
>
> *Tier 1 Risk-Weighted Capital Ratio:* The ratio of Tier 1 capital to net risk-weighted assets.
>
> *Total Capital:* The sum of Tier 1 capital plus the qualifying portion of the allowance for loan losses.
>
> *Total Risk-Weighted Capital Ratio:* The ratio of total capital to net risk-weighted assets.

Comprehensive Income: The change in equity of a business enterprise during a period from transactions and other events except from changes resulting from investments by or distributions to owners.

Core Deposit Intangible: The excess of the purchase price over the fair value of the tangible net assets acquired in a purchase transaction that represents the estimated value of the deposit base.

Derivatives: Interest-rate or currency swaps, futures, forwards, option contracts, interest-rate caps and floors or other off-balance sheet financial instruments used for asset/liability management or trading purposes. These instruments derive their values or contractually determined cash flows from the price of an underlying asset or liability, reference rate, index or other security.

Diluted Earnings Per Common Share: Net income divided by the weighted average number of common shares outstanding during the period, plus common-equivalent shares (such as stock options) and common shares issuable upon assumed conversion of any outstanding convertible preferred stock.

EVA: Economic Value Added. A measure of financial performance to maximize long-term growth and profitability.

Foreclosed Properties: Real estate acquired in foreclosure or comparable proceedings under which possession of the collateral has been taken.

Interest-Earning Assets: The sum of loans, securities and short-term investments.

Interest-Bearing Liabilities: The sum of interest-bearing deposits, Federal Home Loan Bank advances, securities sold under agreements to repurchase and other borrowings.

Interest-Rate Spread: The difference between the average yields earned on interest-earning assets and the average rates paid on interest-bearing liabilities.

Net Interest Income: The difference between interest and dividends on earning assets and interest paid on interest-bearing liabilities, adjusted for the effect of off-balance-sheet derivative financial instruments utilized to hedge interest rate risk.

Net Interest Margin: Net interest income as a percentage of average interest-earning assets.

Nonaccrual Assets: The sum of nonaccrual loans plus foreclosed properties.

Nonaccrual Loans: The sum of loans on nonaccrual status for purposes of interest income recognition.

Reserve Coverage: Allowance for loan losses divided by nonaccrual loans.

Return on Average Equity: Net income as a percentage of average shareholders' equity.

Introduction

Webster Financial Corporation ("Webster" or the "Corporation"), through its subsidiaries, Webster Bank (the "Bank") and Damman Insurance Associates ("Damman"), delivers financial services to individuals, families and businesses throughout Connecticut. Webster emphasizes five business lines - consumer banking, business banking, mortgage lending, trust and investment services, and insurance services, each supported by centralized administration and operations. Webster has grown significantly in recent years, primarily through a series of acquisitions which have expanded and strengthened its franchise.

Assets at December 31, 1998 were $9.0 billion compared to $9.1 billion a year earlier. Net loans receivable amounted to $5.0 billion at December 31, 1998 and 1997. Deposits were $5.7 billion at December 31, 1998 and 1997.

Business Combinations Pending at December 31, 1998

The Access Acquisition

Effective January 1, 1999, Webster purchased Access National Mortgage, Inc. ("Access"). Access was founded in 1996 as a privately held Internet-based mortgage lender located in Wilmington, Massachusetts. Access will initially continue to sell all originated mortgage loans. This acquisition was accounted for as a purchase.

The Village Acquisition

On November 11, 1998, Webster announced a definitive agreement to acquire Village Bancorp, Inc. ("Village"), the holding company for Village Bank & Trust Company for $23.50 per share in a tax-free, stock-for-stock exchange. At the time of the original announcement, Village, based in Ridgefield, Connecticut, had approximately $230 million in total assets, $152 million in loans and $215 million in deposits at six branches. Webster expects to consummate the acquisition in the second quarter of 1999 and expects to account for this transaction as a purchase.

The Maritime Acquisition

On November 4, 1998, Webster announced a definitive agreement to acquire Maritime Bank & Trust Company ("Maritime") for $26.67 per share in a tax-free, stock-for-stock exchange. At the time of the original announcement, Maritime, based in Essex, Connecticut, had approximately $100 million in total assets and $90 million in deposits at three branches. Webster expects to consummate the acquisition in the second quarter of 1999 and expects to account for this transaction as a purchase.

Business Combinations

The Damman Acquisition

On June 1, 1998, Webster completed its acquisition of Damman. Damman is a full service insurance agency, providing property-casualty, life and group coverage to commercial and individual customers and is headquartered in Westport with an additional office in Wallingford, Connecticut. Under the terms of the merger agreement, Webster issued 274,609 shares of common stock and recorded goodwill of $10 million. The transaction was accounted for as a purchase and therefore results are reported only for the periods subsequent to the acquisition.

The Eagle Acquisition

On April 15, 1998, Webster acquired Eagle Financial Corp. ("Eagle") and its subsidiary, Eagle Bank, a $2.1 billion savings bank with headquarters in Bristol, Connecticut. In connection with the merger with Eagle, Webster issued 10,615,156 shares of its common shares for all the outstanding shares of Eagle common stock. Under the terms of the agreement, each outstanding share of Eagle common stock was converted into 1.68 shares of Webster common stock. This acquisition was accounted for as a pooling of interests, and as such, the Consolidated Financial Statements include Eagle's financial data as if Eagle had been combined at the beginning of the earliest period presented. Prior to the acquisition, Eagle's fiscal year ended on September 30. In recording the pooling of interests business combination, Eagle's financial statements as of and for the twelve months ended September 30, 1997, were combined with Webster's financial statements as of and for the twelve months ended December 31, 1997. See Note 2 to the Consolidated Financial Statements.

The Sachem Acquisition

On August 1, 1997, Webster acquired Sachem Trust National Association ("Sachem Trust"), a trust company headquartered in Guilford, Connecticut with $300 million of assets under management, in a tax-free stock-for-stock exchange. This acquisition was accounted for as a purchase and therefore results are reported only for the periods subsequent to the acquisition.

The People's Acquisition

On July 31, 1997, Webster acquired People's Savings Financial Corp. ("People's") and its subsidiary, People's Savings Bank & Trust, based in New Britain, Connecticut which had $482 million of assets. In connection with the merger with People's, Webster issued 3,151,992 shares of its common stock for all the outstanding shares of People's common stock. Under the terms of the merger agreement each outstanding share of People's common stock was converted into .85 shares of Webster common stock. This acquisition was accounted for as a pooling of interests, and as such, the Consolidated Financial Statements include People's financial data as if People's had been combined at the beginning of the earliest period presented.

The MidConn Acquisition

On May 31, 1997, Webster acquired MidConn Bank ("MidConn") as a result of its acquisition of Eagle. In connection with the merger, Webster effectively issued 2,869,440 shares of its common stock for all the outstanding shares of MidConn common stock after adjusting for the conversion factor related to the Eagle Acquisition and common stock split of 1998. The acquisition was accounted for as a pooling of interests, and as such, the Consolidated Financial Statements include MidConn's financial data as if MidConn had been combined at the beginning of the earliest period presented.

The Derby Acquisition

On January 31, 1997, Webster acquired DS Bancor, Inc. ("Derby") and its subsidiary, Derby Savings Bank, based in Derby, Connecticut which had $1.2 billion of assets. In connection with the merger with Derby, Webster issued 7,002,740 shares of its common stock for all the outstanding shares of Derby common stock. Under the terms of the merger agreement, each outstanding share of Derby common stock was converted into 1.14158 shares of Webster common stock. This acquisition was accounted for as a pooling of interests, and as such, the Consolidated Financial Statements include Derby's financial data as if Derby had been combined at the beginning of the earliest period presented.

The Shawmut Transaction

During the first quarter of 1996, Webster Bank acquired 25 branches in the Greater Hartford market from Shawmut Bank Connecticut, National Association (the "Shawmut Transaction"), as part of a divestiture in connection with the merger of Shawmut and Fleet Bank. In the branch purchase, Webster Bank acquired approximately $1.1 billion in deposits and $622 million in loans. As a result of this transaction, Webster recorded $64.1 million as a core deposit intangible asset. In connection with the Shawmut Transaction, Webster raised net proceeds of $32.1 million through the sale of 2,499,200 shares of its common stock in an underwritten public offering in December 1995. The Shawmut Transaction was accounted for as a purchase, therefore operating results are reported only for the periods subsequent to the consummation of the Shawmut Transaction.

Asset Quality

Nonaccrual Assets

Webster devotes significant attention to maintaining high asset quality through conservative underwriting standards, active servicing of loans, aggressively managing nonaccrual assets and maintaining adequate reserve coverage on nonaccrual assets. The aggregate amount of nonaccrual assets decreased to $28.9 million at December 31, 1998 from $54.1 million at December 31, 1997 and declined as a percentage of total assets to .32% at December 31, 1998 from .59% at December 31, 1997. Nonaccrual loans decreased $16.8 million in 1998 and foreclosed properties decreased $8.4 million due primarily to the bulk sale of $26.3 million of nonaccrual residential assets and write-downs and sales of foreclosed properties. The allowance for loan losses at December 31, 1998 was $55.1 million and represented 217% of nonaccrual loans. Total allowances for nonaccrual assets of $55.3 million represented 191% of nonaccrual assets. The following table details nonaccrual assets for the last five years.

	December 31,				
(In thousands)	1998	1997	1996	1995	1994
Nonaccrual Assets:					
Loans accounted for on a nonaccrual basis:					
Residential real estate	$ 9,040	$ 26,640	$ 33,901	$ 39,495	$ 37,257
Commercial	14,703	12,229	15,004	21,583	22,431
Consumer	1,636	3,274	4,571	4,785	4,094
Foreclosed Properties:					
Residential and Consumer	1,153	7,711	9,191	12,171	17,353
Commercial	2,373	4,232	9,407	15,000	25,635
Total	$ 28,905	$ 54,086	$ 72,074	$ 93,034	$ 106,770

A summary of the activity in the allowance for loan losses for the last five years follows:

	For the Years Ended December 31,				
(Dollars in thousands)	1998	1997	1996	1995	1994
Balance at beginning of period	$ 59,518	$ 53,692	$ 59,892	$ 65,671	$ 60,513
Charge-offs:					
Residential real estate	(11,939)	(15,309)	(17,645)	(11,914)	(15,989)
Consumer	(3,383)	(4,175)	(3,944)	(1,260)	(1,528)
Commercial	(1,742)	(5,310)	(7,616)	(5,786)	(5,164)
	(17,064)	(24,794)	(29,205)	(18,960)	(22,681)
Recoveries:					
Residential real estate	834	4,008	761	964	546
Consumer	239	491	335	1,033	1,827
Commercial	2,159	1,308	1,984	1,320	1,045
Net charge-offs	(13,832)	(18,987)	(26,125)	(15,643)	(19,263)
Allowances for purchase transactions	—	—	6,871	—	17,647
Reclassification of Allowance for Segregated Asset Losses	2,623	—	—	—	—
Provisions charged to operations	6,800	24,813	13,054	9,864	6,774
Balance at end of period	$ 55,109	$ 59,518	$ 53,692	$ 59,892	$ 65,671
Ratio of net charge-offs to average loans outstanding	0.3%	0.4%	0.6%	0.4%	0.5%

Net charge-offs decreased $5.2 million to $13.8 million in 1998 due primarily to decreases in residential nonaccrual loans. Included in the 1998 and 1997 charge-offs were writedowns of $8.6 million and $5.8 million, respectively, related to the bulk sales of $26.3 million and $17.7 million, respectively, of primarily nonaccrual and delinquent loans. Included in the 1996 loan charge-offs were write-downs of $6.3 million related to a bulk sale of $18.0 million of nonaccrual residential loans and foreclosed properties. The 1998 provisions charged to operations include $1.5 million specifically related to the acquisition of Eagle. The 1997 provisions charged to operations include $9.9 million specifically related to the Derby, MidConn and People's acquisitions and $3.4 million related to the sale of nonaccrual and delinquent loans. See Note 12 to the Consolidated Financial Statements for a summary of activity in the allowance for losses on foreclosed properties. Management believes that the allowance for loan losses at December 31, 1998 is adequate to cover expected losses in the portfolio.

Liquidity and Capital Resources

The Bank is required to maintain minimum levels of liquid assets as defined by regulations adopted by the Office of Thrift Supervision ("OTS"). This requirement, which may be varied by the OTS, is based upon a percentage of net withdrawable deposits and short-term borrowings. The required liquidity ratio as revised by the OTS is currently 4.00% and the Bank's liquidity ratio at December 31, 1998 exceeded the requirement. Webster Bank is also required by regulation to maintain sufficient liquidity to ensure safe and sound operations. Adequate liquidity as assessed by the OTS may vary from institution to institution depending on such factors as the institution's overall asset/liability structure, market conditions, competition and the requirements of the institution's deposit and loan customers. The OTS considers both an institution's adherence to the liquidity ratio requirement, as well as safety and soundness issues, in assessing whether an institution has sufficient liquidity.

The primary sources of liquidity for Webster are net cash flows provided from operating, investing and financing activities. Net cash flows from operating activities primarily include net income, the sale of loans originated for sale, trading account net changes, net changes in other assets and liabilities and adjustments for noncash items such as depreciation, intangibles amortization, investment securities net amortization and accretion and the provisions for loan losses and foreclosed properties. Net cash flows from investing activities primarily include the purchase, sale, maturity and paydowns of investment securities and mortgage-backed securities that are classified as available for sale or held to maturity and the net change in loans and interest-bearing deposits. Net cash flows from financing activities primarily include proceeds and repayments related to Federal Home Loan Bank ("FHL Bank") and other borrowings, the net change in deposits, the issuance of debt securities and changes in stockholders' equity generally related to stock issuances, repurchases and dividend payments.

While scheduled loan amortization, maturing securities, short-term investments and securities paydowns generally are predictable sources of funds, loan and mortgage-backed securities prepayments are greatly influenced by general interest-rates, economic conditions and competition. One of the inherent risks of investing in loans and mortgage-backed securities is the ability of such instruments to incur prepayments of principal prior to maturity at rates different than those estimated at the time of purchase. This generally occurs because of changes in market interest rates. The market values of fixed-rate loans and mortgage-backed securities are sensitive to fluctuations in market interest rates, declining in value as interest rates rise. If interest rates decrease, the market value of fixed-rate loans and mortgage-backed securities generally will tend to increase with the level of prepayments also normally increasing. Lower yields on such loans and mortgage-backed securities may be offset by a lower cost of funds. Material changes in the level of nonaccrual assets held also affects liquidity. The utilization of particular sources of funds depends on comparative costs and availability. The Bank has, from time to time, chosen not to pay rates on deposits as high as certain competitors, and when necessary, supplements deposits with various borrowings. The Bank manages the prices of its deposits to maintain a stable, cost-effective deposit base as a source of liquidity.

The Bank had additional borrowing capacity from the FHL Bank of $700 million at December 31, 1998. At that date, the Bank had FHL Bank advances outstanding of $1.8 billion compared to $1.5 billion at December 31, 1997. See Note 8 to the Consolidated Financial Statements.

Webster's main sources of liquidity at the holding company level are dividends from the Bank, investment income and net proceeds from capital offerings and borrowings, while the main outflows are purchases of available for sale securities, the payment of dividends to preferred and common stockholders, repurchases of Webster's common stock, and the payment of interest to holders of Webster's senior notes and capital securities. There are certain restrictions on the payment of dividends by the Bank to Webster. See Note 14 to the Consolidated Financial Statements. Webster also maintains $80 million in revolving lines of credit with correspondent banks. The sale of $100 million and $50 million of Webster's Capital Trust I Capital Securities and Webster's Capital Trust II Capital Securities, respectively, were completed further increasing Webster's capital resources. The Capital Trust Securities are further discussed in Note 19 to the Consolidated Financial Statements.

During 1998, Webster repurchased a total of 1,396,551 shares of its common stock under three announced repurchase programs. The 1998 repurchases included 274,609 shares related to the Damman acquisition and 305,215 shares repurchased in connection with the settlement of warrants previously issued to Fleet related to the Shawmut Transaction. During 1997, Webster repurchased 260,466 shares of its common stock of which 170,666 was related to the acquisition of Sachem Trust and 89,800 was to complete repurchases under a repurchase plan announced in November of 1996.

Applicable OTS regulations require the Bank, as a federal savings bank, to satisfy certain minimum capital requirements, including a leverage capital requirement and risk-based capital requirements. As an OTS regulated savings institution, the Bank is also subject to a minimum tangible capital requirement. At December 31, 1998, the Bank was in full compliance with all applicable capital requirements. See Note 14 to the Consolidated Financial Statements.

Asset/Liability Management and Market Risk

Interest-rate risk is the sensitivity of the market value of assets and liabilities to changes in interest rates over short-term and long-term time horizons. The market values of certain financial assets and liabilities of Webster are sensitive to fluctuations in market interest rates. Changes in interest rates can affect the amount of loans originated by the Bank, as well as the value of its loans and other interest-earning assets and interest-bearing liabilities. Also, increases in interest rates may cause depositors to shift funds from accounts that have a comparatively lower cost such as regular savings accounts to accounts with a higher cost such as certificates of deposit. If the cost of interest-bearing liabilities increases at a rate that is greater than the increase in yields on interest-earning assets, the interest-rate spread would be negatively affected. Changes in Webster's asset and liability mix also affects interest-rate spread. Webster is unable to predict future fluctuations in interest rates.

The primary goals of interest-rate risk management are to control risk within limits approved by the Board of Directors and more narrow guidelines established by the Asset/Liability Committee while managing interest-rate risk to maximize net interest income and net market value over time in changing interest-rate environments. To this end, Webster's strategies for controlling interest-rate risk are responsive to changes in the interest-rate environment and market demands for particular types of deposit and loan products. Management measures interest-rate risk using simulation analyses with particular emphasis on measuring changes in the market value of portfolio equity and changes in net interest income in different interest-rate environments. Market value is measured as the net present value of future cash flows. The simulation analyses incorporate assumptions about balance sheet changes such as asset and liability growth, loan and deposit pricing and changes due to the mix and maturity of such assets and liabilities. The key assumptions relate to the behavior of interest rates and spreads, the fluctuations in product balances, and prepayment and decay rates on loans and deposits. From such simulations, interest-rate risk is quantified and appropriate strategies are formulated. The overall interest-rate risk position is reviewed on an ongoing basis by the Asset/Liability Committee, which includes Executive Management and has representation by members of each major line of business. Strategies employed during 1998 to improve the interest-rate sensitive position included, (i) promotion of adjustable-rate mortgage loans, particularly adjustable rate mortgage loans which have lower prepayment speeds than one-year adjustable rate mortgage loans, (ii) promotion of prepayment protected residential mortgage loans, (iii) emphasis on the origination of variable-rate home equity credit lines and commercial loans, (iv) emphasis on the purchase of short duration mortgage-backed securities, (v) the purchase of prepayment protected mortgage-backed securities, and (vi) emphasis on deposits and borrowed funds that meet asset/liability management objectives.

Webster also uses as part of its asset/liability management strategy various interest-rate contracts including short futures positions, interest-rate swaps and interest-rate caps and floors. Webster utilized interest-rate financial instruments to hedge mismatches in interest-rate maturities to reduce exposure to movements in interest-rates. These interest-rate financial instruments involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur if a counterparty to a transaction fails to perform according to the terms of the contract. Market risk is the effect of a change in interest rates or currency rates on the value of the financial instruments. The notional amount of interest-rate financial instruments is the amount upon which interest and other payments under the contract are based. For interest-rate financial instruments, the notional amount is not exchanged and therefore, the notional amounts should not be taken as a measure of credit or market risk. See Notes 3 and 10 to the Consolidated Financial Statements.

Webster holds short futures positions, long options positions and interest-rate contracts to minimize the price volatility of certain adjustable-rate assets held as Trading Securities. Changes in the market value of short futures positions and options are recognized as a gain or loss in the Consolidated Statements of Income in the period for which the change occurred.

The following table summarizes the estimated market value of Webster's interest-sensitive assets and interest-sensitive liabilities at December 31, 1998 and 1997, and the projected change to market values if interest rates instantaneously increase or decrease by 100 basis points.

(In thousands)	Book Value	Market Value	Estimated Market Value Impact -100 BP	+100 BP
1998:				
Interest-Sensitive Assets:				
Trading	$ 91,114	$ 91,114	$ (84)	$ (1,236)
Non-Trading	8,187,091	8,334,598	137,345	(177,909)
Interest-Sensitive Liabilities	8,164,754	8,315,981	(131,580)	126,715
1997:				
Interest-Sensitive Assets:				
Trading	$ 84,749	$ 84,749	$ (438)	$ (399)
Non-Trading	8,398,573	8,485,329	105,605	(159,488)
Interest-Sensitive Liabilities	8,492,402	8,512,618	(45,929)	46,918

The tables above exclude interest-earning assets that are not directly impacted by changes in interest rates. These assets include equity securities of $214.4 million at December 31, 1998 and $224.0 million at December 31, 1997 (See Note 3 to Consolidated Financial Statements) and nonaccrual loans of $25.4 million at December 31, 1998 and $42.1 million at December 31, 1997 (See "Asset Quality" within the MD&A). Values for mortgage servicing rights have been included in the tables above as movements in interest rates affect the valuation of the servicing rights. Equity securities and nonaccrual assets not included in the above tables are however, subject to fluctuations in market value based on other risks.

Interest-sensitive assets, net of interest-sensitive liabilities, when impacted by a minus 100 basis point rate change, results in a favorable $5.7 million change in net market values for 1998 compared to a $59.2 million favorable net market value change in 1997. A plus 100 basis point rate change results in an unfavorable $52.4 million change in net market values for 1998 compared to a $113.0 million unfavorable net market value change in 1997.

Based on Webster's asset/liability mix at December 31, 1998, management's sensitivity analysis of the effects of changing interest rates estimates that an instantaneous 100 basis point increase in interest rates would decrease net interest income over the next twelve months by an estimated 2.6% compared to an estimated 3.2% decrease at December 31, 1997. An instantaneous 100 basis point decline in interest rates would decrease net interest income over the next twelve months by less than 2.0% compared to less than 1.0% at December 31, 1997. The estimated market values in the preceding tables are subject to factors that could cause actual results to differ from such projections and estimates. Management believes that Webster's interest-rate risk position at December 31, 1998, represents a reasonable level of risk.

Comparison of 1998 and 1997 Years

General

For 1998, Webster reported net income of $70.5 million, or $1.83 per share on a diluted basis. Included in the 1998 results are acquisition-related expenses of $17.4 million and provisions for loan losses of $1.5 million specifically related to the Eagle acquisition. Also, included in the 1998 results is a non-recurring net tax expense of $3.2 million. Excluding the effect of acquisition-related expenses and provisions for loan losses and non-recurring net tax expense, net income for the 1998 year would have been $86.9 million or $2.25 per diluted share. Net income for 1997 amounted to $41.1 million, or $1.07 per share on a diluted basis. Included in the 1997 results are acquisition-related expenses of $29.8 million and provisions for loan losses of $9.9 million specifically related to the Derby, MidConn and People's acquisitions. Excluding the effect of acquisition-related expenses and provisions for loan losses, net income for the 1997 year would have been $64.5 million or $1.68 per diluted share.

Net Interest Income

Net interest income before provision for loan losses decreased $5.7 million in 1998 to $245.4 million from $251.1 million in 1997. The decrease is primarily attributable to a reduction of the yield on interest-earning assets mainly related to a lower return on investment securities. The cost of interest-bearing liabilities was higher in 1998 due primarily to a higher volume of borrowings. Interest-rate spread for the 1998 year decreased to 2.64% compared to 3.00% in 1997 due primarily to a higher level of average interest-earning assets that yielded a return that was approximately twenty-eight basis points lower than realized in 1997. The average balance for investment securities was $3.9 billion with a yield of 6.17% for the 1998 year compared to $2.8 billion with a yield of 6.62% for 1997.

Interest Income

Total interest income for 1998 amounted to $622.5 million, an increase of $43.6 million, or 7.5% compared to $578.9 million in 1997. The higher interest income was due primarily to an increase in the average volume of securities partially offset by decreases in net loans and interest-bearing deposits.

Interest Expense

Interest expense for 1998 totaled $377.0 million, an increase of $49.2 million compared to $327.8 million in 1997. The higher interest expense was due primarily to an increase in the average volume of borrowings in 1998 compared to 1997.

The following table shows the major categories of average assets and average liabilities together with their respective interest income or expense and the rates earned or paid by Webster.

Years Ended December 31,

	1998			1997			1996		
(Dollars in thousands)	**Average Balance**	**Interest**	**Average Yield**	Average Balance	Interest	Average Yield	Average Balance	Interest	Average Yield
Loans, net(a)	$4,883,585	$ 382,906(b)	7.84%	$4,949,366	$ 386,416(b)	7.81%	$4,706,292	$ 367,003(b)	7.80%
Securities and Interest-Bearing Deposits	3,904,203	239,547	6.14(c)	2,920,303	192,438	6.59(c)	2,148,770	140,023	6.52(c)
Total Interest-Earning Assets	8,787,788	622,453	7.07	7,869,669	578,854	7.35	6,855,062	507,026	7.40
Other Assets	499,692			372,883			357,571		
Total Assets	$9,287,480			$8,242,552			$7,212,633		
Savings and Escrow	$1,245,658	$ 31,046	2.49%	$1,238,203	$ 29,615	2.39%	$1,222,830	$ 26,975	2.21%
Money Market Savings, NOW and DDA	1,124,502	12,807	1.14	1,100,750	14,572	1.32	1,175,046	20,245	1.72
Time Deposits	3,367,975	177,435	5.27	3,398,843	179,292	5.28	3,343,197	182,003	5.44
FHL Bank Advances	1,654,533	94,825	5.73	1,171,612	67,904	5.80	685,268	40,808	5.96
Repurchase Agreements and Other Borrowings	1,017,470	57,245	5.63	593,029	32,761	5.52	197,083	11,217	5.69
Senior Notes	40,000	3,660	9.15	40,000	3,660	9.15	40,000	3,660	9.15
Total Interest-Bearing Liabilities	8,450,138	377,018	4.43	7,542,437	327,804	4.35	6,663,424	284,908	4.28
Other Liabilities	301,721			212,953			72,087		
Shareholders' Equity	535,621			487,162			477,122		
Net Interest Income and Interest-Rate Spread		$ 245,435	2.64%		$ 251,050	3.00%		$ 222,118	3.12%
Total Liabilities and **Shareholders' Equity**	$9,287,480			$8,242,552			$7,212,633		
Net Interest Margin			2.81%			3.19%			3.24%

(a) Interest on nonaccrual loans has been included only to the extent reflected in the Consolidated Statements of Income. Nonaccrual loans, however, are included in the average balances outstanding.

(b) Includes amortization of net deferred loan costs and premiums (net of discounts) of: $1.7 million, $3.9 million and $939,000 in 1998, 1997 and 1996, respectively.

(c) Yields are adjusted to a fully tax equivalent basis.

Net interest income also can be analyzed in terms of the impact of changing rates and changing volumes. The following table describes the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected Webster's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate), (ii) changes attributable to changes in rates (changes in rates multiplied by prior volume) and (iii) the net change. The change attributable to the combined impact of volume and rate has been allocated proportionately to the change due to volume and the change due to rate.

	Years Ended December 31, 1998 v. 1997			Years Ended December 31, 1997 v. 1996		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
(In thousands)	Rate	Volume	Total	Rate	Volume	Total
Interest on interest-earning assets:						
Loans	$ 1,658	$ (5,168)	$ (3,510)	$ 436	$ 18,977	$ 19,413
Securities	(12,111)	59,220	47,109	1,591	50,824	52,415
Total	(10,453)	54,052	43,599	2,027	69,801	71,828
Interest on interest-bearing liabilities:						
Deposits	(2,204)	13	(2,191)	(7,884)	2,140	(5,744)
FHL Bank advances and other borrowings	(719)	52,124	51,405	(2,259)	50,899	48,640
Total	(2,923)	52,137	49,214	(10,143)	53,039	42,896
Net change in net interest income	$ (7,530)	$ 1,915	$ (5,615)	$ 12,170	$ 16,762	$ 28,932

Provision for Loan Losses

The provision for loan losses for 1998 was $6.8 million compared to $24.8 million in 1997. The decrease for 1998 is attributable to approximately $8.4 million less in provisions related to acquisitions and an overall reduction in nonaccrual loans. The provision for loan losses for 1997 included additional provisions of $9.9 million related to the acquisitions of Derby, MidConn and People's. The allowance for losses on loans totaled $55.1 million and represented 217% of nonaccrual loans at December 31, 1998 versus $59.5 million or 141% of nonaccrual loans at December 31, 1997.

Noninterest Income

Noninterest income for 1998 totaled $74.2 million, compared to $42.3 million in 1997. Fees and service charges were $43.2 million in 1998, an increase of $11.2 million, or 35% from 1997 due primarily to an increase in the customer base and fees generated as a result of the Damman and Sachem Trust acquisitions. Gains on the sale of loans and mortgage loan servicing rights increased to $3.3 million in 1998 compared to $793,000 in 1997, due primarily to the sale of the credit card portfolio. Gains on the sale of securities amounted to $15.4 million in 1998 compared to $3.1 million in 1997. Other noninterest income was $12.3 million, an increase of $5.6 million from $6.7 million in 1997 due primarily to the implementation of a life insurance program.

Noninterest Expenses

Noninterest expenses for 1998 were $197.8 million compared to $201.7 million in 1997. Included in the 1998 total are acquisition-related expenses totaling $17.4 million for the Eagle acquisition. The 1997 results also include acquisition-related expenses totaling $29.8 million which include: $19.9 million related to the Derby acquisition, $7.2 million related to the People's acquisition and $2.7 million related to the MidConn acquisition. Excluding acquisition-related expenses, noninterest expenses for 1998 increased $8.5 million compared to 1997. Increases in salaries and benefits, furniture and equipment, intangible amortization, and capital securities expenses were partially offset by lower expenses for occupancy, federal deposit insurance, foreclosed property, marketing, and other expenses. Salaries and benefits expenses included a $1.5 million reduction in expenses related to the consolidation of the Eagle pension and post-retirement benefits other than pension plans into Webster's plans.

Income Taxes

Income tax expense for 1998 increased to $44.5 million from $25.7 million in 1997. The increase in income tax expense is due primarily to a $48.2 million increase in income before taxes and a $3.2 million non-recurring net tax expense related primarily to the planned formation of a Connecticut Passive Investment Company, "See Tax Legislation".

Comparison of 1997 and 1996 Years

General

For 1997, Webster reported net income of $41.1 million, or $1.07 per share on a diluted basis. Included in the 1997 results are acquisition-related expenses of $29.8 million and provisions for loan losses of $9.9 million specifically related to the Derby, People's and MidConn acquisitions. Excluding the effect of acquisition-related expenses and additional provisions for loan losses, net income for the 1997 year would have been $64.5 million or $1.68 per diluted share. Net income for 1996 amounted to $54.0 million, or $1.36 per share on a diluted basis. Included in the 1996 results are expenses of $10.1 million related to a special assessment associated with the recapitalization of the Savings Association Insurance Fund ("SAIF"), $500,000 of acquisition-related charges for the Shawmut Transaction and a $15.9 million gain on the sale of deposits resulting from Eagle's sale of seven Danbury, Connecticut region branch offices. Excluding the effects of these items, net income for the 1996 year would have been $50.9 million or $1.29 per diluted share. Results for the Shawmut Transaction are included in the accompanying Consolidated Financial Statements from the date of acquisition on February 16, 1996.

Net Interest Income

Net interest income before provision for loan losses increased $28.9 million in 1997 to $251.0 million from $222.1 million in 1996. The increase is primarily attributable to an increased volume of average interest-earning assets and interest-bearing liabilities as a result of balance sheet growth. The balance sheet growth was due in part to the utilization of the proceeds of the Capital Trust I and II Capital Securities offerings in 1997, which supported increases in interest-earning assets and interest-bearing liabilities. See Note 19 to the Consolidated Financial Statements. The interest-rate spread for the 1997 year decreased to 3.00% compared to 3.12% in 1996 due primarily to the change in mix of interest-earning assets and interest-bearing liabilities. During 1997, the average balance of securities increased $771.9 million and the average balance of borrowings increased $882.3 million from the year earlier period.

Interest Income

Total interest income for 1997 amounted to $578.9 million, an increase of $71.8 million, or 14.2% compared to $507.0 million in 1996. This improvement was due primarily to an increase in the average volume of loans and securities offset by a decrease in the average yield on all interest-earning assets to 7.35% in 1997 from 7.40% in 1996.

Interest Expense

Interest expense for 1997 totaled $327.8 million, an increase of $42.9 million compared to $284.9 million in 1996. The higher interest expense was due primarily to an increase in the average volume of borrowings and an increase in the average cost of funds on all interest-bearing liabilities to 4.35% in 1997 from 4.28% in 1996.

Provision for Loan Losses

The provision for loan losses for 1997 was $24.8 million compared to $13.1 million in 1996. The increase for 1997 is attributable to $9.9 million in provisions made at the time of the acquisitions of Derby, MidConn and People's and $3.4 million related to the sale of nonaccrual and delinquent loans. The allowance for losses on loans totaled $59.5 million and represented 141% of nonaccrual loans at December 31, 1997 versus $53.7 million or 100% of nonaccrual loans at December 31, 1996.

Noninterest Income

Noninterest income for 1997 totaled $42.3 million, compared to $52.0 million in 1996. Included in the 1996 results is a $15.9 million gain on the sale of deposits resulting from the sale of seven Danbury, Connecticut region branch offices. Fees and service charges were $32.0 million in 1997, an increase of $5.9 million, or 22.8% from 1996 due primarily to an increase in the customer base. Gains on the sale of loans and mortgage loan servicing rights amounted to $793,000 in 1997 compared to a loss of $705,000 in 1996. Gains on the sale of securities amounted to $3.1 million in 1997 compared to $3.7 million in 1996. Other noninterest income was $6.7 million for 1997 and $7.1 million for 1996. Also included as a charge to noninterest income in the 1997 period was a loss on disposal of premises and equipment of $915,000.

Noninterest Expenses

Noninterest expenses for 1997 were $201.7 million compared to $174.5 million in 1996. Included in the 1997 results are acquisition-related expenses totaling $29.8 million which include: $19.9 million related to the Derby acquisition, $7.2 million related to the People's acquisition and $2.7 million related to the MidConn acquisition. Other components of the increase were higher occupancy, furniture and equipment, intangible amortization and Capital Securities expenses. Offsetting such increases were lower salaries and employee benefits due to decreases in pension and post-retirement benefits and decreased foreclosed property expenses and provisions due to fewer foreclosed properties. Included in the 1996 results are expenses of $10.1 million related to a special assessment associated with the recapitalization of the SAIF and $500,000 related to the Shawmut Transaction.

Income Taxes

Income tax expense for 1997 decreased to $25.7 million from $32.6 million in 1996. The decrease in income tax expense is due primarily to lower pre-tax income and to lower state income tax rates.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, virtually all of the assets and liabilities of a banking institution are monetary in nature. As a result, interest rates have a more significant impact on a banking institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services.

Recent Financial Accounting Standards

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. Under this statement, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk. SFAS No. 133 is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. Initial application of this statement should be as of the beginning of an entity's fiscal quarter; on that date, hedging relationships must be designated anew and documented pursuant to the provisions of this statement. Early adoption is permitted, however, retroactive application is prohibited. Management is in the process of evaluating the impact of this statement on its financial position and results of operations.

In February 1998, the FASB issued SFAS No. 132, "Employer's Disclosures about Pensions and Other Postretirement Benefits". This statement standardizes the disclosure requirements of Statements No. 87 and No. 106 to the extent practicable and recommends a parallel format for presenting information about pensions and other postretirement benefits. This statement addresses disclosure only and does not change any measurement or recognition provisions provided in previous statements. Webster implemented this statement for the year ended December 31, 1998. See Note 16.

Tax Legislation

Federal tax law changes were enacted in August 1996 to eliminate the "thrift bad debt" method of calculating bad debt deductions for tax years after 1995 and to impose a requirement to recapture into taxable income (over a six-year period) all bad debt reserves accumulated after 1987. Since Webster previously recorded a deferred tax liability with respect to these post 1987 reserves, its total income tax expense for financial reporting purposes will not be affected by the recapture requirement. The tax law changes also provide that taxes associated with the recapture of pre-1988 bad debt reserves would become payable under more limited circumstances than under prior law. Under the tax laws, as amended, events that would result in recapture of the pre-1988 bad debt reserves include stock and cash distributions to the holding company from the Bank in excess of specified amounts. Webster does not expect such reserves to be recaptured into taxable income.

The State of Connecticut enacted tax law changes in May 1998, allowing for the formation of a Passive Investment Company ("PIC") by financial institutions. This new legislation exempts Passive Investment Companies from state income taxation in Connecticut, and exempts from inclusion in Connecticut taxable income the dividends paid from a passive investment company to a related financial institution. Webster Bank qualifies as a financial institution under the new statute, and has taken steps to organize a PIC that will begin operations in the first quarter of 1999. The legislation is effective for tax years beginning on or after January 1, 1999. Webster's formation of a PIC is expected to reduce its Connecticut tax liability beginning in 1999 and, as a result, a deferred tax charge was taken in the fourth quarter of 1998.

Year 2000 Readiness Disclosure Statement

The "Year 2000" issue refers to the potential impact of the failure of computer programs and equipment to give proper recognition of dates beyond December 31, 1999 and other issues related to the Year 2000 century date change. The Corporation has completed its assessment of Year 2000 issues and has determined that, if not addressed, the consequences of Year 2000 issues would have a material effect on business operations. The following discussion addresses the Corporation's Year 2000 preparedness and focuses on four categories of information: I. The Corporation's state of readiness, II. The costs to address the Corporation's Year 2000 issues, III. The risks of the Corporation's Year 2000 issues and IV. The Corporation's contingency plans.

I. The Corporation's State of Readiness

In accordance with guidelines provided by the Federal Financial Institutions Examination Council ("FFIEC"), the Corporation developed a five phase Year 2000 plan. Plan phases are: Awareness, Assessment, Renovation, Validation, and Implementation. Descriptions of each phase, including excerpts of the FFIEC phase definitions, are as follows:

Awareness

FFIEC requires the Corporation to 1) define the Year 2000 problem as it relates to its particular circumstances and gain executive support for the resources necessary to perform compliance work, 2) establish a Year 2000 program team and 3) develop an overall strategy that encompasses in-house systems, service bureaus for systems that are outsourced, vendors, auditors, customers, and suppliers (including correspondents).

The Corporation has completed the Awareness phase. The Corporation formed a Year 2000 Task Force, headed by a senior technology officer. The Task Force developed and implemented a strategy to minimize the impact of Year 2000 technology problems. The Corporation's strategic plan incorporates the FFIEC recommended guidelines and includes regular reporting of progress to the Corporation's Board of Directors and executive management. In addition to addressing the Corporation's technology issues, the strategy includes a community awareness program. The Corporation has held seminars for the business community and sent an informational pamphlet to all retail customers. The Corporation has also placed information on its Web site to address the Corporation's preparedness and related Year 2000 issues and will continue to do so throughout 1999.

Assessment

FFIEC requires the Corporation to assess the size and complexity of the problem and detail the magnitude of the effort necessary to address Year 2000 issues. During this phase, the Corporation must identify all hardware, software, networks, automated teller machines, other various processing platforms, and customer and vendor dependencies affected by the Year 2000 date change. The assessment must go beyond information systems and include environmental systems that are dependent on embedded microchips, such as security systems, elevators, and vaults.

The Corporation has completed the Assessment phase. The assessment included inventorying all Information Technology (IT) and non-IT systems, including vaults, security, and environmental systems. Inventoried items were then prioritized by their impact on the Corporation's business. A determination was made as to whether failure to remediate for the Year 2000 date change would adversely impact customers, shareholders, or employees. Systems meeting this criteria were labeled mission critical. During this assessment, 25% of the Corporation's IT system applications and services were classified as mission critical, requiring testing and validation. Examination of non-IT systems indicated that no significant replacements are required for Year 2000 readiness. Security systems have already been upgraded, automated teller machines (ATM's) are being upgraded by each respective vendor or manufacturer and are anticipated to be Year 2000 ready by the end of the first quarter of 1999. Vaults do not have date related issues, and therefore no remediation is required.

Renovation

FFIEC requirements for this phase include code enhancements, hardware and software upgrades, system replacements, vendor certification, and other associated changes. Work should be prioritized based on information gathered during the assessment phase. For institutions relying on outside servicers or third-party software providers, ongoing discussions and monitoring of vendor progress is necessary.

The Corporation has significantly completed activities related to the Renovation phase. The majority of mission critical systems were Year 2000 ready by December 31, 1998. The remainder of systems, both mission critical and essential, are targeted for completion by the end of the second quarter of 1999. Most of the Corporation's systems are vendor supplied and are being remediated by the vendors. The vendor for the Corporation's primary system of records has provided the Corporation with a Year 2000 ready release which has been installed. This release has been validated by the Year 2000 Task Force for future date processing accuracy.

Validation

This phase focuses on the actual testing of the project plan. FFIEC states that "testing is a multifaceted process that is critical to the Year 2000 project and inherent in each phase of the project management plan. This process includes testing of incremental changes to hardware and software components. In addition to testing upgraded components, connections with other systems must be verified, and all changes should be accepted by internal and external users".

Vendor supplied updates, subject to regulatory review, are tested by the vendor prior to their release. The Corporation's focus is to perform validation and testing for Year 2000 readiness of the release on its systems. The Corporation has a team of Year 2000 Task Force members responsible for testing the primary systems of record and all mission critical server-based applications for Year 2000 readiness. The Corporation has created a Test Lab with all necessary hardware and software that simulates live production. Test scripts were developed for all mission critical applications. Primary functional transaction types such as: deposits, withdrawals, payments, maturities, interest postings, inquiries on deposit and loan accounts, and other typical business processes, were tested for key date validity and accuracy. Key dates include dates before, during, and after the century change and the century leap year. As of December 31, 1998, future date testing on mission critical systems has been successfully completed. The Corporation anticipates that this process will be substantially completed for other essential systems by June 30, 1999. Testing will continue as needed on newly acquired applications and new vendor upgrades.

Implementation

In accordance with FFIEC, "In this phase, systems should be certified as Year 2000 compliant and be accepted by the business users. For any system failing certification, the business effect must be assessed clearly and the organization's Year 2000 contingency plans should be implemented".

A significant number of the Corporation's mission critical applications are supplied by third party vendors. Remediation of the software is performed by the vendor, tested by the vendor, and then provided to the Corporation. The majority of the remediated, vendor supplied software has already been installed and is in production. The Corporation is continuing the process of validating the software for Year 2000 readiness on its systems. Validation of the majority of core functionality on mission critical applications was completed by December 31, 1998, with the remainder targeted for completion by the end of the first quarter of 1999.

II. The Costs to Address the Corporation's Year 2000 Issues

The Corporation began implementing a four year Year 2000 readiness project plan in mid 1996. Estimated total direct costs for Year 2000 remediation during this four year period are approximately $1 million. Estimated outlays for Year 2000 remediation are included in the Information Technology department budget. Approximately $560,000 of direct costs have been incurred to date. Included in these direct costs, are expenses related to the replacement or upgrade of hardware and software that amounted to approximately $136,000 and expenses related to consulting services for Year 2000 project management and systems testing that amounted to approximately $410,000. During the next 12 months, the Corporation anticipates Year 2000 readiness direct expenses to total approximately $460,000. A significant portion of these future expenses will be attributed to consulting fees.

III. The Risks of the Corporation's Year 2000 Issues

The Corporation is in the process of identifying and evaluating potential Year 2000 related scenarios that could result from 1) the Corporation's failure to identify, test, and validate all critical date dependent applications and embedded microchips that affect core business processes and 2) the failure of external forces, such as third party vendors, the Corporation's business customers, and utilities, to have properly remediated their systems.

Planning scenarios being addressed, include: excessive levels of cash withdrawals prior to and through the century date change, extended electrical power outage, extended telephone communication outage, extended ATM service outage, ACH and payroll deposit file transmission difficulties, and excessive negative media coverage that could exacerbate public fear.

The Corporation has implemented a plan, in accordance with FFIEC guidelines, to identify and evaluate potential Year 2000 risks to the Corporation's commercial loan customers. Customers borrowing more than $250,000 have been contacted and were provided with a questionnaire. The questionnaire assists the Corporation in evaluating the customer's state of Year 2000 readiness and serves to raise customer awareness. At this time, all targeted customers have been contacted. The Corporation is in the process of evaluating the responses and will follow up with customers to monitor progress toward Year 2000 readiness. The Corporation has also implemented an enhanced small business loan program specific to Year 2000 expenditures.

The Corporation is unable to estimate lost revenue related to Year 2000 issues due to the uncertainties of the impact and effects of external forces and their potential extended disruptions.

IV. The Corporation's Contingency Plans

The Corporation is proactively addressing each critical core business area in terms of developing contingency plans which cover alternate processing means should problems arise. In compliance with regulatory guidance, it is expected that all such plans will be developed and in place by the end of the first quarter, 1999. The Corporation will utilize the remainder of 1999 to refine the contingency plans and preplan actions to be taken before, during, and after the century date change. The contingency plans now under development address most likely scenarios related to a Year 2000 technological fault. Alternative solutions for business resumption and approaches to minimize the impact of each scenario are being formulated. Proposed approaches to address potential scenarios include: increasing cash reserves, designating regional offices as emergency branch locations with alternate power sources, identifying alternate communication methods, increasing customer and community awareness, and having staff available over the January 1, 2000 weekend and as needed.

Forward Looking Statements

This annual report contains forward-looking statements within the meaning of the Securities and Exchange Act of 1934, as amended. Actual results could differ materially from those management expectations, projections and estimates. Factors that could cause future results to vary from current management expectations include, but are not limited to, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the federal government, changes in tax policies, rates and regulations of federal, state and local tax authorities, changes in interest rates, deposits flows, the cost of funds, demand for loan products, demand for financial services, competition, changes in the quality or composition of Webster's loan and investment portfolios, changes in accounting principles, policies or guidelines, and other economic, competitive, governmental and technological factors affecting Webster's operations, markets, products services and prices. Such developments could have an adverse impact on Webster's financial position and results of operations.

Consolidated Statements of Condition

(Dollars in thousands, except share data)	December 31, 1998	1997
Assets:		
Cash and Due from Depository Institutions	$ 173,863	$ 151,322
Interest-bearing Deposits	3,560	77,104
Securities: (Note 3)		
Trading, at Fair Value	91,114	84,749
Available for Sale, at Fair Value	2,969,822	3,092,287
Held to Maturity, (Fair Value: $404,365 in 1998; $412,061 in 1997)	401,154	412,237
Loans Receivable, Net (Note 4)	4,993,509	4,995,851
Accrued Interest Receivable	55,012	52,658
Premises and Equipment, Net (Note 5)	79,324	71,887
Foreclosed Properties, Net (Note 12)	3,526	11,943
Intangible Assets (Note 2)	78,380	78,493
Cash Surrender Value of Life Insurance	141,059	12,750
Prepaid Expenses and Other Assets (Note 6)	43,594	54,606
Total Assets	$ 9,033,917	$ 9,095,887
Liabilities and Shareholders' Equity:		
Deposits (Note 7)	$ 5,651,273	$ 5,719,030
Federal Home Loan Bank Advances (Note 8)	1,774,560	1,516,634
Reverse Repurchase Agreements and Other Borrowings (Note 9)	738,921	1,032,963
Advance Payments by Borrowers for Taxes and Insurance	32,293	30,570
Accrued Expenses and Other Liabilities	82,414	84,851
Total Liabilities	$ 8,279,461	$ 8,384,048
Corporation-Obligated Mandatorily Redeemable Capital Securities of Subsidiary Trusts (Note 19)	150,000	145,000
Preferred Stock of Subsidiary Corporation (Note 20)	49,577	49,577
Shareholders' Equity: (Notes 14, 15 and 16)		
Common Stock, $.01 par value:		
Authorized - 50,000,000 shares;		
Issued - 38,353,424 shares at December 31, 1998 and 37,574,177 shares in 1997	384	376
Paid-in Capital	249,819	241,552
Retained Earnings	314,791	257,954
Less Treasury Stock at cost, 1,026,770 shares at December 31, 1998 and 45,916 shares at December 31, 1997	(27,914)	(1,116)
Less Employee Stock Ownership Plan Shares Purchased with Debt	(1,339)	(1,971)
Accumulated Other Comprehensive Income	19,138	20,467
Total Shareholders' Equity	554,879	517,262
Commitments and Contingencies (Notes 4, 5 and 21)		
Total Liabilities and Shareholders' Equity	$ 9,033,917	$ 9,095,887

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income

(Dollars in thousands, except per share data)	Years Ended December 31, 1998	1997	1996
Interest Income:			
Loans	$ 382,906	$ 386,416	$ 367,004
Securities and Interest-bearing Deposits	239,547	192,438	140,022
Total Interest Income	622,453	578,854	507,026
Interest Expense:			
Deposits (Note 7)	221,288	223,479	229,223
Borrowings	155,730	104,325	55,685
Total Interest Expense	377,018	327,804	284,908
Net Interest Income	245,435	251,050	222,118
Provision for Loan Losses (Note 4)	6,800	24,813	13,054
Net Interest Income After Provision for Loan Losses	238,635	226,237	209,064
Noninterest Income:			
Fees and Service Charges	43,181	32,013	26,060
Gain (Loss) on Sale of Loans and Loan Servicing, Net	3,290	793	(705)
Gain on Sale of Securities, Net (Note 3)	15,351	3,142	3,670
Gain on Sale of Deposits	—	546	15,904
Other Noninterest Income	12,341	5,770	7,080
Total Noninterest Income	74,163	42,264	52,009
Noninterest Expenses:			
Salaries and Employee Benefits	76,861	74,369	77,676
Occupancy Expense of Premises	16,295	16,408	15,393
Furniture and Equipment Expenses	17,363	14,030	12,995
Federal Deposit Insurance Premiums	1,317	1,657	3,366
SAIF Recapitalization Expense	—	—	10,128
Foreclosed Property Expenses and Provisions, Net (Note 12)	576	4,184	5,158
Intangible Amortization	9,642	9,249	8,102
Marketing Expenses	6,604	7,576	7,740
Acquisition-Related Expenses (Note 17)	17,400	29,792	500
Capital Securities Expense (Note 19)	14,708	11,368	—
Dividends on Preferred Stock of Subsidiary Corporation (Note 20)	4,151	85	—
Other Operating Expenses	32,872	32,945	33,419
Total Noninterest Expenses	197,789	201,663	174,477
Income Before Income Taxes	115,009	66,838	86,596
Income Taxes (Note 13)	44,544	25,725	32,602
Net Income	$ 70,465	$ 41,113	$ 53,994
Preferred Stock Dividends	—	—	1,149
Net Income Available to Common Shareholders	$ 70,465	$ 41,113	$ 52,845
Net Income Per Common Share (Note 15):			
Basic	$ 1.86	$ 1.10	$ 1.44
Diluted	1.83	1.07	1.36

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(In thousands, except per share data)	Preferred Stock	Common Stock	Paid-In Capital	Retained Earnings	Treasury Stock	Employee Stock Ownership Plan Shares Purchased With Debt	Accumulated Other Comprehensive Income	Total
Balance, December 31, 1995	$ 2	$ 374	$ 273,554	$ 190,318	$ (3,290)	$ (3,301)	$ 3,134	$ 460,791
Net Income for 1996	–	–	–	53,994	–	–	–	53,994
Dividends Paid:								
$.34 Per Common Share	–	–	–	(5,546)	–	–	–	(5,546)
Cash Dividends Declared by Pooled Companies Prior to Mergers	–	–	–	(7,741)	–	–	–	(7,741)
Dividends Paid or Accrued:								
Preferred Series B	–	–	–	(1,149)	–	–	–	(1,149)
Allocation of ESOP Shares	–	–	94	–	–	727	–	821
Exercise of Stock Options	–	4	1,468	(2)	3,351	–	–	4,821
Conversion of Preferred Series B to Common Stock	(1)	–	(8,724)	–	8,725	–	–	–
Common Stock Repurchased	–	–	–	–	(27,611)	–	–	(27,611)
Pooling Adjustments, Net	–	(3)	(3,215)	2	–	–	(1,365)	(4,581)
Net Unrealized Loss on Securities Available for Sale, Net of Taxes	–	–	–	–	–	–	(1,549)	(1,549)
Other, Net	–	–	550	–	24	–	–	574
Balance, December 31, 1996	$ 1	$ 375	$ 263,727	$ 229,876	$ (18,801)	$ (2,574)	$ 220	$ 472,824
Net Income for 1997	–	–	–	41,113	–	–	–	41,113
Dividends Paid:								
$.40 Per Common Share	–	–	–	(9,037)	–	–	–	(9,037)
Cash Dividends Declared by Pooled Companies Prior to Mergers	–	–	–	(6,846)	–	–	–	(6,846)
Allocation of ESOP Shares	–	–	166	–	–	603	–	769
Exercise of Stock Options	–	8	264	(4)	5,058	–	–	5,326
Conversion of Preferred Series B to Common Stock	(1)	–	(18,499)	–	18,500	–	–	–
Common Stock Repurchased	–	–	–	–	(6,020)	–	–	(6,020)
Common Stock Issued in Consideration for Acquisitions	–	2	3,971	(1)	–	–	–	3,972
Pooling Adjustments, Net	–	(5)	(8,833)	2,913	–	–	(4,020)	(9,945)
Net Unrealized Gain on Securities Available for Sale, Net of Taxes	–	–	–	–	–	–	24,615	24,615
Other, Net	–	(4)	756	(60)	147	–	(348)	491
Balance, December 31, 1997	$ –	$ 376	$ 241,552	$ 257,954	$ (1,116)	$ (1,971)	$ 20,467	$ 517,262

See accompanying notes to consolidated financial statements.

(In thousands, except per share data)	Preferred Stock	Common Stock	Paid-In Capital	Retained Earnings	Treasury Stock	Employee Stock Ownership Plan Shares Purchased With Debt	Accumulated Other Comprehensive Income	Total
Net Income for 1998	—	—	—	70,465	—	—	—	70,465
Dividends Paid:								
$.43 Per Common Share	—	—	—	(15,299)	—	—	—	(15,299)
Cash Dividends Declared by								
Pooled Companies Prior to Mergers	—	—	—	(3,226)	—	—	—	(3,226)
Allocation of ESOP Shares	—	—	411	—	—	632	—	1,043
Exercise of Stock Options	—	3	7,687	—	3,778	—	—	11,468
Common Stock Repurchased	—	—	(12)	—	(39,873)	—	—	(39,885)
Common Stock Issued in								
Consideration for Acquisitions	—	—	185	—	9,083	—	—	9,268
Net Unrealized Loss on								
Securities Available for								
Sale, Net of Taxes	—	—	—	—	—	—	(1,329)	(1,329)
Adjustment for the Effect of the Change								
of Eagle's Fiscal Year End (Note 2)	—	—	—	4,898	—	—	—	4,898
Other, Net	—	5	(4)	(1)	214	—	—	214
Balance, December 31, 1998	$ —	$ 384	$ 249,819	$ 314,791	$ (27,914)	$ (1,339)	$ 19,138	$ 554,879

Consolidated Statements of Comprehensive Income

	Years Ended December 31,		
(Dollars in thousands)	1998	1997	1996
Net Income	$ 70,465	$ 41,113	$ 53,994
Other Comprehensive Income (Loss), Net of Tax			
Unrealized Gains (Losses) on Securities Available for Sale:			
Unrealized Holding Gain (Loss) Arising During Year			
(Net of Income Taxes (Benefit) of $5,231, $13,516 and			
($981) for 1998, 1997 and 1996, respectively)	7,631	21,591	(1,626)
Less: Reclassification Adjustment for Net Gains			
Included in Net Income (Net of Income Tax Expense			
of ($5,664), ($841) and ($778) for 1998, 1997 and 1996, respectively)	8,960	1,344	1,288
Other Comprehensive Income (Loss)	(1,329)	20,247	(2,914)
Comprehensive Income	$ 69,136	$ 61,360	$ 51,080

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(In thousands)	1998	1997	1996
		Years Ended December 31,	
Operating Activities:			
Net Income	$ 70,465	$ 41,113	$ 53,994
Adjustments to Reconcile Net Income to Net			
Cash Provided by Operating Activities:			
Provision for Loan Losses	6,800	24,813	13,054
Provision for Foreclosed Property Losses	330	1,637	2,523
Provision for Depreciation and Amortization	12,789	11,298	9,441
Amortization (Accretion) of Securities Premiums, Net	3,704	(1,700)	5,067
Amortization and Write-down of Intangibles	9,642	9,249	8,102
Amortization of Hedging Costs, Net	4,669	2,985	780
Amortization of Mortgage Servicing Rights	1,949	1,215	615
Gains on Sale of Deposits	–	(546)	(15,904)
Gains on Sale of Foreclosed Properties, Net	(908)	(1,274)	(1,650)
Gains on Sale of Loans and Securities, Net	(19,408)	(3,706)	(2,050)
Losses (Gains) on Sale of Trading Securities, Net	767	(229)	(915)
Loss on Disposal of Premises and Equipment	–	915	–
(Increase) Decrease in Trading Securities	(2,278)	(40,952)	24,539
Loans Originated for Sale	(101,401)	(59,543)	(136,814)
Sale of Loans, Originated for Sale	100,952	70,372	112,370
(Increase) Decrease in Interest Receivable	(2,109)	(6,019)	194
Decrease (Increase) in Prepaid Expenses and Other Assets	21,967	(2,668)	(15,242)
Increase (Decrease) in Interest Payable	2,890	18,389	(866)
(Decrease) Increase in Accrued Expenses and Other Liabilities, Net	(51,018)	9,310	(12,736)
Increase in Cash Surrender Value of Life Insurance	(3,396)	–	–
Adjustment to Conform Eagle's Fiscal Year End	7,860	–	–
Net Cash Provided by Operating Activities	64,266	74,659	44,502
Investing Activities:			
Purchases of Securities, Available for Sale	(2,398,584)	(2,139,050)	(945,317)
Purchases of Securities, Held to Maturity	(151,988)	(24,213)	(162,564)
Principal Collected on Mortgage-Backed Securities	1,110,411	368,000	302,037
Investment in Subsidiaries	(11,068)	(4,069)	–
Maturities of Securities	193,342	210,682	207,689
Proceeds from Sales of Securities, Available for Sale	1,501,680	156,203	473,753
Net Decrease (Increase) in Interest-bearing Deposits	71,109	(41,045)	57,513
Purchase of Loans	(66,173)	(191,078)	(113,582)
Net Increase in Loans	53,476	(58,119)	(20,679)
Proceeds from Sale of Foreclosed Properties	13,529	38,487	26,694
Purchases of Life Insurance	(124,913)	(12,750)	–
Purchase of Premises and Equipment, Net	(19,802)	(11,436)	(14,041)
Proceeds from Sales of Premises and Equipment	–	–	735
Net Cash and Cash Equivalents Received in Bank Acquisition	–	–	310,336
Net Cash Provided (Used) by Investing Activities	171,019	(1,708,388)	122,574
Financing Activities:			
Net Decrease in Deposits	(84,671)	(96,929)	(55,141)
Sale of Deposits	–	(9,179)	(168,506)
Repayment of FHL Bank Advances	(4,422,636)	(5,167,029)	(2,093,849)
Proceeds from FHL Bank Advances	4,638,265	5,906,775	2,288,661
Repayment of Reverse Repurchase Agreements and Other Borrowings	(18,404,261)	(4,448,386)	(1,631,765)
Proceeds from Reverse Repurchase Agreements and Other Borrowings	18,111,564	5,301,170	1,561,053
Net Proceeds from Issuance of Capital Securities	–	141,327	–
Net Proceeds from Preferred Stock of Subsidiary Corporation	–	49,577	–
Cash Dividends to Common and Preferred Shareholders	(18,524)	(15,883)	(14,436)
Net (Decrease) Increase in Advance Payments for Taxes and Insurance	(4,089)	(7,747)	2,429
Exercise of Stock Options	11,468	5,808	5,476
Common Stock Repurchased	(39,860)	(6,020)	(27,611)
Net Cash (Used) Provided by Financing Activities	$ (212,744)	$ 1,653,484	$ (133,689)

Consolidated Statements of Cash Flows (Continued)

(In thousands)	Years Ended December 31, 1998	1997	1996
Increase in Cash and Cash Equivalents	22,541	19,755	33,387
Cash and Cash Equivalents at Beginning of Period	151,322	131,567	98,180
Cash and Cash Equivalents at End of Period	$ 173,863	$ 151,322	$ 131,567

(In thousands)	Years Ended December 31, 1998	1997	1996
Supplemental Disclosures:			
Income Taxes Paid	$ 35,205	$ 27,662	$ 40,202
Interest Paid	373,238	315,293	282,699
Supplemental Schedule of Noncash Investing and Financing Activities:			
Transfer of Loans to Foreclosed Properties	13,963	29,552	25,015
Transfer of Securities from Held to Maturity to Available for Sale	—	109,329	90,858
Securitization of Loans into Mortgage-Backed Securities Available for Sale	—	—	83
Securitization of Loans into Trading Mortgage-Backed Securities	—	—	16,888

Assets acquired and liabilities assumed in 1996 purchase business combinations were as follows:

(In thousands)	Year Ended December 31, 1996
Assets Acquired:	
Loans	$ 621,955
Premises and Equipment	8,008
Other Assets	3,059
Total Assets Acquired	633,022
Liabilities Assumed:	
Deposits	1,099,551
Less Deposits Exchanged	(95,163)
Net Deposits Assumed	1,004,388
Other Liabilities	1,883
Total Liabilities Assumed	1,006,271
Net Liabilities Assumed	373,249
Net Premium Paid for Deposits	(62,913)
Net Cash and Cash Equivalents Received from Bank Acquisition	$ 310,336

See accompanying notes to consolidated financial statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Business

Webster Financial Corporation ("Webster"), through its subsidiaries, Webster Bank and Damman Insurance Associates, delivers financial services to individuals, families and businesses throughout Connecticut. Webster emphasizes five business lines - consumer banking, business banking, mortgage lending, trust and investment services, and insurance services, and each is supported by centralized administration and operations. Webster Bank was founded in 1935 and converted from a federal mutual to a federal stock institution in 1986.

b) Basis of Financial Statement Presentation

The Consolidated Financial Statements include the accounts of Webster and its subsidiaries. The Consolidated Financial Statements and notes hereto have been retroactively restated to include the accounts of Eagle Financial Corp. ("Eagle") acquired on April 15, 1998, People's Savings Financial Corp. ("People's") acquired on July 31, 1997, MidConn Bank ("MidConn") acquired on May 31, 1997 (through Webster's acquisition of Eagle), and DS Bancor, Inc. ("Derby") acquired on January 31, 1997 as if the mergers had occurred at the beginning of the earliest period presented (See Note 2). The number of common shares have been retroactively restated for stock dividends and stock splits (See Note 14). The financial statements have been prepared in conformity with generally accepted accounting principles and all significant intercompany transactions have been eliminated in consolidation.

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported assets and liabilities as of the date of the balance sheets and revenues and expenses for the periods presented. The actual results of Webster could differ from those estimates. Material estimates that are susceptible to near-term changes include the determination of the allowance for loan losses and the valuation allowance for the deferred tax asset.

c) Allowance for Loan Losses

An allowance for loan losses is established based upon a review of the loan portfolio, loss experience, specific problem loans, current and anticipated economic conditions and other pertinent factors which, in management's judgment, deserve current recognition in estimating loan losses. Effective January 1, 1995, Webster adopted Statement of Financial Accounting Standards ("SFAS") No. 114, "Accounting by Creditors for Impairment of a Loan", as amended by SFAS No. 118. Under this standard, commercial and commercial real estate loans are considered impaired when it is probable that Webster will not collect all amounts due in accordance with the contractual terms of the loan. Certain loans are exempt from the provisions of SFAS No. 114, including large groups of smaller balance homogenous loans that are collectively evaluated for impairment, such as consumer and residential mortgage loans.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review Webster's allowance for loan losses. Such agencies may require Webster to recognize additions to the allowance for loan losses based on judgments different from those of management.

d) Foreclosed Properties

Foreclosed properties are acquired through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. Foreclosed properties are reported at the lower of fair value less estimated selling expenses or cost with an allowance for losses to provide for declines in value. Operating expenses are charged to current period earnings and gains and losses upon disposition are reflected in the Consolidated Statements of Income when realized.

e) Loans

Loans are stated at the principal amounts outstanding. Interest on loans is credited to income as earned based on the rate applied to principal amounts outstanding. Interest which is more than 90 days past due is not accrued. Such interest ultimately collected, if any, is credited to income in the period received. Loan origination fees, net of certain direct origination costs and premiums and discounts on loans purchased, are recognized in interest income over the lives of the loans using a method approximating the interest method. Loans held for sale are carried at the lower of cost or market value in aggregate. Net unrealized losses on loans held for sale, if any, are recognized in a valuation allowance by charges to income.

f) Securities

Securities are classified into one of three categories. Securities with fixed maturities that management has the intent and ability to hold to maturity are classified as Held to Maturity and are carried at cost, adjusted for amortization of premiums and accretion of discounts over the estimated terms of the securities using a method which approximates the level yield method. Securities that management intends to hold for indefinite periods of time, including securities that management intends to use as part of its asset/liability strategy, or that may be sold in response to changes in interest-rates, changes in prepayment risk, the need to increase regulatory capital or other similar factors, are classified as Available for Sale. All Equity Securities are classified as Available for Sale. Securities Available for Sale are carried at fair value with unrealized gains and losses recorded as adjustments to shareholders' equity on a tax-effected basis. Securities classified as Trading Securities are carried at fair value with unrealized gains and losses included in earnings. Gains and losses on the sales of securities are recorded using the specific identification method.

Mortgage-backed securities, which include collateralized mortgage obligations ("CMOs"), are either U.S. Government Agency securities or are rated in at least the top two ratings categories by at least one of the major rating agencies at the time of purchase. One of the risks inherent when investing in mortgage-backed securities and CMOs is the ability of such instruments to incur prepayments of principal prior to maturity. Because of prepayments, the weighted-average yield of these securities may also change, which could affect earnings.

g) Interest-rate Instruments
Webster uses as part of its asset/liability management strategy various interest-rate contracts including short futures positions, interest-rate swaps and interest-rate caps and floors. Webster holds short futures and long options positions to minimize the price volatility of certain adjustable rate assets held as Trading Securities. Changes in the market value of short futures positions are recognized as a gain or loss in the Consolidated Statements of Income in the period for which the change occurred.

Interest-rate caps, interest-rate floors and interest-rate swaps are entered into as hedges against future interest rate fluctuations. Webster does not trade in unmatched interest-rate contracts. Those agreements meeting the criteria for hedge accounting treatment are designated as hedges and are accounted for as such. If a contract is terminated, any unrecognized gain or loss is deferred and amortized as an adjustment to the yield of the related asset or liability over the remainder of the period that was being hedged. If the linked asset or liability is disposed of prior to the end of the period being managed, the related interest-rate contract is marked to fair value, with any resulting gain or loss recognized in current period income as an adjustment to the gain or loss on the disposal of the related asset or liability. Interest income or expense associated with interest-rate caps and swaps is recorded as a component of net interest income. Interest-rate instruments that hedge Available for Sale assets are marked to fair value monthly with adjustments to shareholders' equity on a tax-effected basis.

h) Interest-bearing Deposits
Interest-bearing deposits consist primarily of deposits in the Federal Home Loan Bank ("FHL Bank") or other short-term overnight investments. These deposits are carried at cost which approximates market value.

i) Premises and Equipment
Depreciation of premises and equipment is accumulated on a straight-line basis over the estimated useful lives of the related assets. Estimated lives are 15 to 40 years for buildings and improvements and 3 to 20 years for furniture, fixtures and equipment. Amortization of leasehold improvements is calculated on a straight-line basis over the terms of the related leases.

Maintenance and repairs are charged to expense as incurred and improvements are capitalized. The cost and accumulated depreciation relating to premises and equipment retired or otherwise disposed of are eliminated from the accounts and any resulting gains and losses are credited or charged to income.

j) Intangible Assets
Intangible assets consist of core deposit intangibles and goodwill. The core deposit intangibles are the excess of the purchase price over the fair value of the tangible net assets acquired in bank acquisitions accounted for using the purchase method of accounting and allocated to deposits. The core deposit intangibles are being amortized on a straight-line basis over a period of ten years from the acquisition dates. On a periodic basis, management assesses the recoverability of the core deposit intangibles. Such assessments encompass a projection of future earnings from the deposit base as compared to the original expectations, based upon a discounted cash flow analysis. If an assessment of the core deposit intangibles indicates that they are impaired, a charge to income for the most recent period is recorded for the amount of the impairment. Goodwill is the excess of cost over the fair value of tangible net assets acquired in bank acquisitions accounted for using the purchase method of accounting and not allocated to any specific asset or liability category. Goodwill is being amortized on a straight-line basis over periods up to fifteen years from the acquisition date. The Corporation also reviews goodwill on a periodic basis for events or changes in circumstances that may indicate that the carrying amount of goodwill may not be recoverable.

k) Income Taxes
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. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance has been provided for a portion of the deferred tax asset that may not be realized. The valuation allowance is adjusted as facts and circumstances warrant.

l) Employee Benefit Plans
The Bank has a noncontributory pension plan covering substantially all employees. Pension costs are accrued in accordance with generally accepted accounting principles and are funded in accordance with the requirements of the Employee Retirement Income Security Act ("ERISA"). The Bank also accrues costs related to post-retirement benefits. The provisions of SFAS No. 132, "Employers' Disclosure about Pensions and Other Post-retirement Benefits," were adopted on December 31, 1998. SFAS No. 132 revised disclosures about pension and other post-retirement benefit plans; it did not change the measurement or recognition of these plans. Prior period disclosures have been revised to conform with SFAS No. 132.

m) Net Income Per Common Share
Basic net income per share is calculated by dividing net income available to common shareholders by the weighted-average number of shares of common stock outstanding.

Diluted net income per share is calculated by dividing adjusted net income by the weighted-average diluted common shares, including the effect of common stock equivalents and for 1996 the hypothetical conversion into common stock of the Series B cumulative convertible preferred stock. The common stock equivalents consist of common stock options and warrants.

n) Stock Compensation

SFAS No. 123 "Accounting for Stock-Based Compensation," encourages all companies to adopt a new fair value based method of accounting for stock-based employee compensation plans. Under the provisions of this statement, Webster has elected to continue to measure compensation for its stock option plans using the accounting method prescribed by Accounting Principal Board Opinion No. 25 ("APB No. 25") "Accounting for Stock Issued to Employees." Entities electing to maintain accounting standards under APB No. 25 must make pro forma disclosures for net income and earnings per share as if the fair value based method of accounting had been applied. See Note 16.

o) Statements of Cash Flows

For the purposes of the Statements of Cash Flows, Webster considers cash on hand and in banks to be cash equivalents.

p) Loan Sales and Servicing Sales

Gains or losses on sales of loans are recognized at the time of sale. During the 1995 second quarter, Webster elected early adoption of SFAS No. 122 "Accounting for Mortgage Servicing Rights", that was superseded by SFAS No. 125 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 122 required, and SFAS No. 125 continues to require that a mortgage banking entity recognize as a separate asset the value of the right to service mortgage loans for others, regardless of how those servicing rights are acquired. Fair values are estimated considering loan prepayment predictions, historical prepayment rates, interest-rates, and other economic factors. For purposes of impairment evaluation and measurement, Webster stratifies mortgage servicing rights based on predominate risk characteristics of the underlying loans including loan type, interest-rate and amortization type (fixed or adjustable). To the extent that the carrying value of mortgage servicing rights exceeds fair value by individual stratum, a valuation allowance is established. The allowance may be adjusted for changes in fair value. The cost basis of mortgage servicing rights is amortized into noninterest income over the estimated period of servicing revenue. See Note 6.

q) Cash Surrender Value of Life Insurance

The investment in life insurance represents the cash surrender value of life insurance policies on officers of the Bank. Increases in the cash surrender value are recorded as other noninterest income.

r) Comprehensive Income

The provisions of SFAS No. 130, "Reporting Comprehensive Income" were adopted as of January 1, 1998. SFAS No. 130 establishes standards for the reporting and display of comprehensive income and its components. Comprehensive income includes net income and any changes in equity from non-owner sources that bypass the statements of income (such as changes in net unrealized gains and losses on securities available for sale). The purpose of reporting comprehensive income is to report a measure of all changes in equity of an enterprise that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. The adoption of SFAS No. 130 resulted in a change in financial statement disclosures only and had no effect on Webster's financial position or results.

s) Reclassifications

Certain financial statement balances as previously reported have been reclassified to conform to the 1998 Consolidated Financial Statements presentation.

NOTE 2: BUSINESS COMBINATIONS

Pooling of Interests Transactions

All acquisitions accounted for under the pooling of interests method include financial data as if the combination occurred at the beginning of the earliest period presented.

The Eagle Acquisition

On April 15, 1998, Webster acquired Eagle and its subsidiary, Eagle Bank, a $2.1 billion savings bank, headquartered in Bristol, Connecticut. In connection with the merger with Eagle, Webster issued 10,615,156 shares of its common shares for all of the outstanding shares of Eagle common stock. Under the terms of the agreement, each outstanding share of Eagle common stock was converted into 1.68 shares of Webster common stock. Prior to the acquisition, Eagle's fiscal year ended on September 30. In recording the pooling of interests combination, Eagle's financial statements as of and for the twelve months ended September 30, 1997 were combined with Webster's financial statements as of and for the twelve months ended December 31, 1997. An adjustment has been made to shareholders' equity as of December 31, 1998 to include Eagle's unaudited results of operations for the period October 1, 1997 to December 31, 1997 as the results of this period, which included net interest income of $15.7 million and net income of $4.9 million, are not included in the results of operations of the combined entity for the year ended December 31, 1998.

The People's Acquisition

On July 31, 1997, Webster acquired People's and its subsidiary, People's Savings Bank & Trust, a $482 million savings bank headquartered in New Britain, Connecticut. In connection with the merger with People's, Webster issued 3,151,992 shares of its common stock for all the outstanding shares of People's common stock. Under the terms of the agreement, each outstanding share of People's common stock was converted into .85 shares of Webster common stock.

The MidConn Acquisition

On May 31, 1997, Webster acquired MidConn as a result of its acquisition of Eagle Financial Corp. ("Eagle"). In connection with the merger, Webster effectively issued 2,869,440 shares of its common stock for all the outstanding shares of MidConn common stock after adjusting for the conversion factor related to the Eagle Acquisition and subsequent common stock split.

The Derby Acquisition
On January 31, 1997, Webster acquired Derby and its subsidiary, Derby Savings Bank, a $1.2 billion savings bank headquartered in Derby, Connecticut. In connection with the merger with Derby, Webster issued 7,002,740 shares of its common stock for all the outstanding shares of Derby common stock. Under the terms of the agreement each outstanding share of Derby common stock was converted into 1.14158 shares of Webster common stock.

Purchase Transactions Pending Consummation at December 31, 1998 (Unaudited)

The Access Acquisition
In January 1999, Webster announced the purchase of Access National Mortgage, Inc. ("Access"). Access was founded in 1996 as a privately held Internet-based mortgage lender located in Wilmington, Massachusetts. Access is currently able to originate mortgages in 44 states and will initially continue to sell all originated mortgages. The Access principals continue as senior officers and as minority owners of Access National Mortgage, L.L.C., which is a subsidiary of Webster Bank.

The Village Acquisition
In November 1998, Webster announced a definitive agreement to acquire Village Bancorp, Inc. ("Village"), the holding company for Village Bank & Trust Company for $23.50 per share in a tax-free, stock-for-stock exchange. At the time of the original announcement, Village had approximately $230 million in total assets, $152 million in loans and $215 million in deposits at 6 branches. Webster expects to consummate the acquisition in the second quarter of 1999 and complete the conversion in the second quarter of 1999.

The Maritime Acquisition
In November 1998, Webster announced a definitive agreement to acquire Maritime Bank & Trust Company ("Maritime") for $26.67 per share in a tax-free, stock-for-stock exchange. At the time of the original announcement, Maritime had approximately $100 million in total assets and $90 million in deposits at 3 branches. Webster expects to consummate the acquisition in the second quarter of 1999 and complete the conversion in the second quarter of 1999.

Purchase Transactions

The following acquisitions were accounted for as purchase transactions, and as such, results of operations are included in the Consolidated Financial Statements subsequent to acquisition.

The Damman Acquisition
On June 1, 1998, Webster completed its acquisition of Damman Insurance Associates ("Damman"). Damman is a full service Westport-based insurance company, providing property-casualty, life and group coverage to commercial and individual customers. Damman has offices in Westport and Wallingford and approximately 50 employees. During 1998, Webster began offering a full array of insurance services to its consumer and commercial customer base.

The Sachem Acquisition
On August 1, 1997, Webster acquired Sachem Trust National Association ("Sachem Trust"), a trust company headquartered in Guilford, Connecticut which had approximately $300 million of trust assets under management, in a tax-free stock-for-stock exchange.

The Shawmut Transaction
In the first quarter of 1996, Webster Bank acquired 25 branches in the Hartford market from Shawmut Bank Connecticut, National Association, as part of a divestiture in connection with the merger of Shawmut and Fleet Bank (the "Shawmut Transaction"). In the branch purchase, Webster Bank acquired approximately $1.1 billion in deposits and $622 million in loans. As a result of this transaction, Webster recorded $64.1 million as a core deposit intangible asset. In connection with the Shawmut Transaction, Webster raised net proceeds of $32.1 million through the sale of 2,499,200 shares of its common stock in an underwritten public offering in December 1995.

NOTE 3: SECURITIES

A summary of securities follows:

	December 31,							
	1998				1997			
(In thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Trading Securities:								
Mortgage-Backed Securities	$ 91,114(a)	$ –	$ –	$ 91,114	$ 84,749(a)	$ –	$ –	$ 84,749
	91,114	–	–	91,114	84,749	–	–	84,749
Available for Sale Portfolio:								
U.S. Treasury Notes	13,514	123	–	13,637	19,522	37	(8)	19,551
U.S. Government Agency	16,501	278	–	16,779	50,229	220	(24)	50,425
Municipal Bonds and Notes	14,688	516	–	15,204	14,685	–	(126)	14,559
Corporate Bonds and Notes	81,452	454	(2,148)	79,758	10,045	33	(227)	9,851
Equity Securities(b)	211,871	7,241	(4,664)	214,448	210,041	14,983	(1,049)	223,975
Mortgage-Backed Securities	2,582,759	39,937	(5,248)	2,617,448	2,737,522	36,307	(7,720)	2,766,109
Purchased Interest-Rate Contracts (Note 10)	15,985	–	(3,437)	12,548	15,079	–	(7,262)	7,817
	2,936,770	48,549	(15,497)	2,969,822	3,057,123	51,580	(16,416)	3,092,287
Held to Maturity Portfolio:								
U.S. Treasury Notes	2,455	12	–	2,467	2,447	28	–	2,475
U.S. Government Agency	6,000	15	–	6,015	32,274	14	(65)	32,223
Municipal Bonds and Notes	12,500	347	–	12,847	12,500	93	(1)	12,592
Corporate Bonds and Notes	151,536	2,626	(1,171)	152,991	1,199	3	–	1,202
Money Market Preferred Stock	–	–	–	–	1,000	–	–	1,000
Mortgage-Backed Securities	228,663	2,426	(1,044)	230,045	362,817	2,533	(2,781)	362,569
	401,154	5,426	(2,215)	404,365	412,237	2,671	(2,847)	412,061
Total	$3,429,038	$ 53,975	$ (17,712)	$3,465,301	$3,554,109	$ 54,251	$ (19,263)	$3,589,097

(a) Stated at fair market value.

(b) Equity securities at December 31, 1998, consisted of FHL Bank stock of $97.6 million, mutual funds of $35.1 million, preferred stock of $36.0 million and common stock of $45.7 million. At December 31, 1997, equity securities consisted of FHL Bank stock of $87.1 million, mutual funds of $37.5 million, preferred stock of $55.6 million and common stock of $43.8 million.

A summary of realized gains and losses follows:

	Years Ended December 31,								
	1998			1997			1996		
(In thousands)	Gains	Losses	Net	Gains	Losses	Net	Gains	Losses	Net
Trading Securities:									
Mortgage-Backed Securities	$ 4,789	$ (3,548)	$ 1,241	$ 4,052	$ (2,647)	$ 1,405	$ 3,033	$ (2,719)	$ 314
Futures and Options Contracts	8,015	(10,023)	(2,008)	7,318	(8,494)	(1,176)	10,704	(10,434)	270
Equity Securities	–	–	–	–	–	–	366	(35)	331
	12,804	(13,571)	(767)	11,370	(11,141)	229	14,103	(13,188)	915
Available for Sale:									
Mortgage-Backed Securities	7,148	(222)	6,926	566	(119)	447	2,401	(1,652)	749
U.S. Treasury Notes	–	–	–	6	–	6	5	(7)	(2)
U.S. Government Agencies	–	–	–	18	(45)	(27)	11	(39)	(28)
Corporate Debt	–	–	–	77	–	77	4	(364)	(360)
Mutual Funds	1,156	–	1,156	1,210	(58)	1,152	227	(463)	(236)
Other Equity Securities	7,966	(867)	7,099	945	(21)	924	2,773	(197)	2,576
Other	982	(45)	937	920	(586)	334	56	–	56
	17,252	(1,134)	16,118	3,742	(829)	2,913	5,477	(2,722)	2,755
Total	$ 30,056	$ (14,705)	$ 15,351	$ 15,112	$ (11,970)	$ 3,142	$ 19,580	$(15,910)	$ 3,670

There were no sales of securities from the held to maturity portfolio for the years ended December 31, 1998, 1997 and 1996.

On June 30, 1997 Eagle transferred securities with a book value of $109.3 million from held to maturity to available for sale. The transfer resulted in an unrealized gain of approximately $299,000 which is net of income taxes of approximately $200,000, being recorded as an increase to shareholders' equity. The securities were transferred due to a change in intent with respect to holding the securities to maturity precipitated by changes in the balance sheet following the merger with MidConn.

Webster enters into short futures and long options positions to minimize the price volatility of certain adjustable-rate assets held as Trading Securities. At December 31, 1998, Webster had 216 short positions in Eurodollar futures contracts ($216.0 million notional amount) and 220 short positions in 5 and 10 year Treasury note futures ($22.0 million notional amount). Changes in the market value of short futures positions are recognized as a gain or loss in the period for which the change occurred. All gains and losses resulting from short futures positions are reflected in gains (losses) on sale of securities, net in the Consolidated Statements of Income.

The following table sets forth the contractual maturities of the Bank's securities and mortgage-backed securities at December 31, 1998 and the weighted-average yields of such securities (based upon the financial statement carrying amount of such securities).

	Due Within One Year		Due After One, But Within Five Years		Due After Five, But Within 10 Years		Due After 10 Years		Total	
(Dollars in thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
Available For Sale Portfolio:										
U.S. Treasury Notes	$ 13,111	5.90%	$ 526	6.25%	$ —	—%	$ —	—%	$ 13,637	5.92%
U.S. Government Agency	—	—	10,670	6.67	6,109	7.19	—	—	16,779	6.86
Municipal Bonds and Notes(a)	—	—	—	—	—	—	15,204	5.31	15,204	5.31
Corporate Bonds and Notes	2,019	6.88	—	—	1,833	6.16	75,906	8.79	79,758	8.68
Equity Securities	214,448	4.45	—	—	—	—	—	—	214,448	4.45
Mortgage-Backed Securities	1,128	6.22	43,910	6.15	397,520	6.71	2,174,890	6.71	2,617,448	6.70
Purchased Interest-Rate Contracts	—	—	9,485	—	3,063	—	—	—	12,548	—
	230,706	4.56%	64,591	5.34%	408,525	6.66%	2,266,000	6.77%	2,969,822	6.56%
Held to Maturity Portfolio:										
U.S. Treasury Notes	2,455	6.02	—	—	—	—	—	—	2,455	6.02
U.S. Government Agency	6,000	5.46	—	—	—	—	—	—	6,000	5.46
Municipal Bonds and Notes(a)	—	—	—	—	12,500	6.68	—	—	12,500	6.68
Corporate Bonds and Notes	350	6.54	—	—	100	6.29	151,086	7.38	151,536	7.38
Mortgage-Backed Securities	4,229	6.11	27,489	6.08	26,703	6.70	170,242	7.20	228,663	6.98
	$ 13,034	5.80%	$ 27,489	6.08%	$ 39,303	6.69%	$ 321,328	7.28%	$ 401,154	7.10%
Totals	$ 243,740	5.61%	$ 92,080	5.56%	$ 447,828	6.66%	$2,587,328	6.83%	$3,370,976	6.62%

(a) Yield is adjusted to a fully tax equivalent basis.

The above table shows contractual maturities of securities. At December 31, 1998 the duration of the available for sale and held to maturity portfolios, are approximately 2.5 years and 3.0 years, respectively.

NOTE 4: LOANS RECEIVABLE, NET

A summary of loans receivable, net follows:

(Dollars in thousands)	December 31, 1998 Amount	1998 %	1997 Amount	1997 %
Loans Secured by Mortgages on Real Estate:				
Conventional, VA and FHA	$ 3,479,388	69.7%	$ 3,744,766	75.7%
Conventional, VA and FHA Loans Held for Sale	1,688	—	3,515	0.1
Residential Participation	55,820	1.1	12,244	0.2
Residential Construction	294,542	5.9	151,275	3.0
Commercial Construction	43,855	0.9	34,974	0.7
Other Commercial	371,358	7.5	309,966	6.2
	4,246,651	85.1	4,256,740	85.9
Consumer Loans:				
Home Equity Loans	436,139	8.7	471,872	9.5
Other Consumer Loans	41,874	0.9	47,479	1.0
Credit Cards	—	—	33,112	0.7
	478,013	9.6	552,463	11.2
Commercial Non-Mortgage Loans	403,411	8.1	239,826	4.8
Gross Loans Receivable	5,128,075	102.6	5,049,029	101.9
Less:				
Loans in Process	96,646	1.9	51,263	1.0
Allowance for Losses on Loans	55,109	1.1	59,518	1.2
Premiums on Loans Purchased, Deferred Loan Fees and Unearned Discounts, Net	(17,189)	(0.4)%	(16,565)	(0.3)
Loans Receivable, Net Excluding Segregated Assets	$ 4,993,509	100.0%	$ 4,954,813	98.2%
Segregated Assets, Net	—	—	41,038	0.8
Loans Receivable, Net	$ 4,993,509	100.0%	$ 4,995,851	100.0%

The segregated assets disclosed in 1997 are certain loans purchased from the Federal Deposit Insurance Corporation ("FDIC") in the First Constitution acquisition. In 1998, these loans are included in commercial mortgage and non-mortgage loans. Also in 1998, Webster sold credit card receivables of $31.4 million.

Webster adopted SFAS No. 114 "Accounting by Creditors for Impairment of a Loan," on January 1, 1995 as amended by SFAS No. 118, with no impact on its results of operations. At December 31, 1998, Webster had $16.1 million of impaired loans, of which $5.8 million were measured based upon the fair value of the underlying collateral and $10.3 million were measured based upon the expected future cash flows of the impaired loans. The $5.8 million of impaired loans have an allowance for loan losses of $1.5 million and the $10.3 million of impaired loans had no related specific allowance for loan losses. At December 31, 1997, there were $7.3 million of impaired loans with an allowance of $1.1 million and $9.6 million of impaired loans for which there was no related allowance for loan losses. In 1998, 1997 and 1996, the average balance of impaired loans was $14.8 million, $29.0 million and $35.0 million, respectively.

Webster's policy with regard to the recognition of interest income on impaired loans includes an individual assessment of each loan. Interest which is more than 90 days past due is not accrued. When payments on impaired loans are received, interest income is recorded on a cash basis or is applied to principal based on an individual assessment of each loan. Cash basis interest income recognized on impaired loans for the years ended December 31, 1998, 1997 and 1996 amounted to $598,000, $724,000 and $520,000, respectively.

A detail of the changes in the allowances for loan losses for the three years follows:

(In thousands)	December 31, 1998	1997	1996
Balance at Beginning of Period	$ 59,518	$ 53,692	$ 59,892
Provisions Charged to Operations	6,800	24,813	13,054
Acquired Allowance for Purchased Loans	—	—	6,871
Reclassification of Allowance for Segregated Asset Losses	2,623	—	—
Charge-offs	(17,064)	(24,794)	(29,205)
Recoveries	3,232	5,807	3,080
Balance at End of Period	$ 55,109	$ 59,518	$ 53,692

Webster is a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments included commitments to extend credit and commitments to sell residential first mortgage loans. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized on the Consolidated Statements of Condition.

The estimated fair value of commitments to extend credit is considered insignificant at December 31, 1998 and 1997. Future loan commitments represent residential mortgage loan commitments, letters of credit, standby letters of credit, as well as unused credit card lines and home equity and commercial credit lines. Rates for these loans are generally established shortly before closing. The rates on home equity lines of credit generally vary with the prime rate.

At December 31, 1998 and 1997, residential mortgage commitments outstanding totaled $104.9 million and $91.6 million, respectively. Residential commitments outstanding at December 31, 1998 consisted of adjustable-rate and fixed-rate mortgages of $43.0 million and $61.9 million, respectively, at rates ranging from 5.7% to 10.5%. Commitments to originate loans generally expire within 60 days. In addition, at December 31, 1998 and 1997, there were unused portions of home equity credit lines extended of $336.9 million and $312.9 million, respectively. Unused commercial lines of credit, letters of credit, standby letters of credit and outstanding commercial new loan commitments totaled $269.5 million and $129.2 million at December 31, 1998 and 1997, respectively. Unused credit card lines were $102.3 million at December 31, 1997.

Webster uses forward commitments to sell residential first mortgage loans which are entered into for the purpose of reducing the market risk associated with originating loans held for sale. The types of risk that may arise are from the possible inability of Webster or the other party to fulfill the contracts. At December 31, 1998 and 1997, Webster had forward commitments to sell loans totaling $1.7 million and $5.5 million, respectively, at rates between 5.9% and 7.5% and 5.8% and 8.3%, respectively. The estimated fair value of commitments to sell loans is considered insignificant at December 31, 1998 and 1997.

At December 31, 1998, 1997 and 1996, Webster serviced, for the benefit of others, mortgage loans aggregating approximately $1.3 billion, $1.3 billion and $1.5 billion, respectively.

NOTE 5: PREMISES AND EQUIPMENT, NET

A summary of premises and equipment, net follows:

	December 31,	
(In thousands)	1998	1997
Land	$ 10,433	$ 10,431
Buildings and Improvements	57,983	52,149
Leasehold Improvements	4,864	6,273
Furniture, Fixtures and Equipment	71,935	55,774
Total Premises and Equipment	145,215	124,627
Accumulated Depreciation and Amortization	65,891	52,740
Premises and Equipment, Net	$ 79,324	$ 71,887

At December 31, 1998, Webster was obligated under various non-cancelable operating leases for properties used as branch office facilities. The leases contain renewal options and escalation clauses which provide for increased rental expense based primarily upon increases in real estate taxes over a base year. Rental expense under leases was $4.8 million, $4.6 million and $4.3 million in 1998, 1997 and 1996, respectively. Webster is also entitled to rental income under various non-cancelable operating leases for properties owned. Rental income under these leases was $2.8 million, $2.0 million and $1.9 million in 1998, 1997 and 1996, respectively.

The following is a schedule of future minimum rental payments and receipts required under these leases as of December 31, 1998:

(In thousands)	Payments	Receipts
Years ending December 31:		
1999	$ 4,882	$ 756
2000	4,268	507
2001	3,723	392
2002	3,261	264
2003	2,785	176
Later years	20,835	872
Total	$ 39,754	$ 2,967

NOTE 6: PREPAID EXPENSES AND OTHER ASSETS

A summary of prepaid expenses and other assets follows:

	December 31,	
(In thousands)	1998	1997
Due from FDIC	$ 769	$ 1,660
Income Taxes Receivable	3,260	4,866
Deferred Tax Asset, Net (Note 13)	14,737	24,569
Mortgage Servicing Rights, Net	4,686	5,906
Other Assets	20,142	17,605
Prepaid Expenses and Other Assets	$ 43,594	$ 54,606

The $769,000 due from the FDIC at December 31, 1998, is net of a $366,000 payable amount that represents the FDIC's 80% reimbursement for fourth quarter 1998 recoveries less certain permitted expenses on Segregated Assets which will be paid in the first quarter of 1999. The $1.1 million receivable balance represents the additional 15% net reimbursement for charge-offs and expenses less the 15% reimbursement payable on recoveries, which Webster will receive at the end of 1999.

During 1998 and 1997, Webster capitalized mortgage servicing assets of $571,000 and $981,000, respectively, related to originating loans and selling them servicing retained. Also, during 1996, Webster purchased mortgage loan servicing assets with a principal balance of $272.5 million and recorded a mortgage loan servicing asset of $2.8 million. Amortization of mortgage servicing rights was $1.1 million, $911,000 and $615,000 for the years ended December 31, 1998, 1997 and 1996, respectively. In 1996, Webster established an allowance to provide for the decrease in value of mortgage servicing rights due to declining interest-rates and an increased rate of prepayments. At December 31, 1998 and 1997, the allowance totaled $1.2 million and $458,000, respectively. During 1998 and 1997, provisions to this allowance totaled $712,000 and $363,000, respectively.

NOTE 7: DEPOSITS

Deposits categories are summarized as follows:

	December 31,					
	1998			1997		
(Dollars in thousands)	**Weighted Average Rate**	**Balance**	**% of Total**	Weighted Average Rate	Balance	% of Total
Demand Deposits and NOW Accounts	1.23%	$1,070,814	18.9%	1.19%	$ 948,589	16.6%
Regular Savings and Money Market Deposit Accounts	2.55	1,429,271	25.3	2.47	1,400,325	24.5
Time Deposits	5.04	3,151,188	55.8	5.35	3,370,116	58.9
Total Deposits	3.59%	$5,651,273	100.0%	3.86%	$5,719,030	100.0%

Interest expense on deposits is summarized as follows:

	Years Ended December 31,		
(In thousands)	1998	1997	1996
NOW Accounts	$ 11,642	$ 9,385	$ 7,132
Regular Savings and Money Market Deposit Accounts	32,211	34,802	40,016
Time Deposits	177,435	179,292	182,075
Total	$ 221,288	$ 223,479	$ 229,223

Time deposits of $100,000 or more amounted to $302.1 million and represented 5.35% of total deposits at December 31, 1998. The following table presents the amount of these deposits maturing during the periods indicated:

(In thousands) Maturing	Amount
January 1, 1999 to March 31, 1999	$ 56,153
April 1, 1999 to June 30, 1999	84,843
July 1, 1999 to December 31, 1999	105,281
January 1, 2000 and beyond	55,866
Total	$ 302,143

NOTE 8: FEDERAL HOME LOAN BANK ADVANCES

Advances payable to the Federal Home Loan Bank are summarized as follows:

	December 31,	
(Dollars in thousands)	1998	1997
Fixed Rate:		
4.99% to 8.19% Due in 1998	$ —	$ 1,099,700
4.54% to 8.86% Due in 1999	1,316,027	62,862
4.75% to 9.16% Due in 2000	227,360	31,570
5.52% to 8.20% Due in 2001	27,405	7,845
6.87% Due in 2002	2,000	2,000
5.69% to 6.14% Due in 2003	28,346	4,157
6.01% Due in 2004	—	80,000
5.25% Due in 2005	10,000	—
6.31% Due in 2006	3,169	3,577
6.98% Due in 2007	2,592	2,675
4.99% Due in 2008	25,000	—
6.60% Due in 2011	2,661	2,828
	$1,644,560	$ 1,297,214
Variable Rate:		
5.65% Due in 1998	$ —	$ 219,420
5.07% to 5.09% Due in 1999	50,000	—
5.76% Due in 2004	80,000	—
Total Federal Home Loan Bank Advances	$1,774,560	$ 1,516,634

The following table sets forth certain information as to the Bank's FHL Bank short-term borrowings at the dates and for the years indicated.

	December 31,		
(Dollars in thousands)	1998	1997	1996
Average amount outstanding during the period	$1,654,533	$ 954,306	$ 452,018
Amount outstanding at end of period	1,366,027	1,319,120	559,345
Highest month end balance	1,824,729	1,319,120	573,948
Weighted-average interest-rate at end of period	5.33%	5.74%	5.68%
Weighted-average interest-rate during the period	4.93%	5.65%	5.61%

At December 31, 1998, the Bank had additional borrowing capacity of $700 million from the FHL Bank, including a line of credit of approximately $41.3 million. Advances are secured by the Bank's investment in FHL Bank stock and a blanket security agreement. This agreement requires the Bank to maintain as collateral certain qualifying assets, principally mortgage loans and securities. At December 31, 1998 and 1997, the Bank was in compliance with the FHL Bank collateral requirements.

NOTE 9: REVERSE REPURCHASE AGREEMENTS AND OTHER BORROWINGS

The following table summarizes reverse repurchase agreements and other borrowings:

	December 31,	
(In thousands)	1998	1997
Reverse Repurchase Agreements	$ 669,374	$ 980,835
Senior Notes	40,000	40,000
Bank Lines of Credit	17,180	10,000
ESOP Borrowings	1,367	1,978
Federal Funds Purchased	11,000	—
Other Borrowings	—	150
Total	$ 738,921	$1,032,963

The weighted-average rates on these borrowings were 5.69% and 5.75% at December 31, 1998 and 1997, respectively.

During 1998, reverse repurchase agreement transactions inclusive of dollar roll transactions were the primary source of borrowed funds with the exception of FHL Bank advance borrowings (See Note 8). The average balance and weighted-average rate for reverse repurchase agreements for 1998 were $975.2 million and 5.23% as compared to $557.2 million and 5.65% for 1997. Securities underlying the reverse repurchase transactions held as collateral are primarily U.S. government agency securities consisting of FNMA, GNMA and FHLMC securities. Securities for reverse repurchase agreements related to Webster's funding operations are delivered to broker-dealers who arrange the transactions. Webster also enters into reverse repurchase agreement transactions directly with commercial and municipal customers through its money desk operations.

Information concerning short-term and long-term borrowings under reverse repurchase agreements as of the end of the current period is summarized below:

(Dollars in thousands)

Balance at December 31, 1998	Weighted-Average Rate	Weighted-Average Maturity	Book Value of Collateral	Market Value of Collateral
$ 669,374	5.18%	8.2 months	$ 664,873	$ 676,000

While the Bank used several types of short-term borrowings as part of funding its daily operations, only reverse repurchase agreement transactions had an average balance that was 30% or more of the Bank's total equity at the end of the 1998 and 1997 periods. The following table sets forth certain information as to the Bank's reverse repurchase agreement short-term borrowings at the dates and for the years indicated.

		December 31,	
(Dollars in thousands)	1998	1997	1996
Average amount outstanding during the period	$ 931,112	$ 557,199	$ 184,966
Amount outstanding at end of period	589,374	900,836	113,755
Highest month end balance	1,189,927	901,156	287,404
Weighted-average interest rate at end of period	5.06%	5.70%	5.48%
Weighted-average interest rate during the period	5.08%	5.65%	5.63%

During 1998, Webster at times also used variable-rate lines of credit through correspondent banks and purchased federal funds. Webster has established various sources of funding and uses the most favorable source in conjunction with asset and liability management strategies. The Employee Stock Ownership Plan ("ESOP") borrowings are from a correspondent bank at a floating rate based on the correspondent bank's base (prime) rate and the weighted rates at December 31, 1998 and 1997 were 7.75% and 7.90% respectively. The terms of the loan agreements call for the ESOP to make annual scheduled principal repayments through the year 2004. Interest is paid quarterly and the borrowings are guaranteed and secured by unallocated shares of Webster common stock under the ESOP Plan.

In 1993, Webster completed a registered offering of $40 million of 8 3/4% Senior Notes due 2000 (the "Senior Notes"). Webster used $18.25 million from the net proceeds of the offering to redeem the remaining shares of Series A Stock issued by Webster to the FDIC in connection with the First Constitution acquisition. The Senior Notes may not be redeemed by Webster prior to the maturity date of June 30, 2000, and are not exchangeable for any shares of Webster's common stock.

NOTE 10: INTEREST-RATE FINANCIAL INSTRUMENTS

Webster employs as part of its asset/liability management strategy various interest-rate contracts including short futures positions, interest-rate swaps and interest-rate caps and floors. See Note 3 for disclosures on futures positions. Webster uses interest-rate financial instruments to hedge mismatches in interest-rate maturities to reduce exposure to movements in interest-rates. These interest-rate financial instruments involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur if a counterparty to a transaction fails to perform according to the terms of the contract. Market risk is the effect of a change in interest rates or currency rates on the value of the financial instrument. The notional amount of interest-rate financial instruments is the amount upon which interest and other payments under the contract are based. For interest-rate financial instruments, the notional amount is not exchanged and therefore, the notional amounts should not be taken as a measure of credit or market risk.

The fair value, which approximates the cost to replace the contract at the current market rates, is generally representative of market risk. Credit risk related to the interest-rate swaps, interest-rate caps and floors at December 31, 1998 is not considered to be significant due to counterparty ratings. In the event of a default by a counterparty, the cost to Webster, if any, would be the replacement cost of the contract at the current market rate.

Interest-rate financial instruments are summarized as follows:

	Notional Amount December 31,		Fair Market Value December 31,		Amortized Cost December 31,	
(In thousands)	1998	1997	1998	1997	1998	1997
Interest-rate swap agreements	$ 25,000	$ 75,000	$ (219)	$ 291	$ —	$ —
Interest-rate floor agreements	500,000	100,000	8,501	954	4,148	1,138
Interest-rate cap agreements	451,000	501,000	4,047	7,226	11,837	14,630
Total	$ 976,000	$ 676,000	$ 12,329	$ 8,471	$ 15,985	$ 15,768

Interest-rate swap agreements involve the exchange of fixed and variable interest payments based upon notional amounts paid to a maturity date. At December 31, 1998, Webster had one interest-rate swap agreement, hedging $25 million of brokered certificates of deposit, in which Webster receives a fixed rate of 6.65% and pays a variable rate based on LIBOR. For the year ended December 31, 1998, net income recorded on the deposit swap was $263,000.

Interest-rate cap agreements will result in cash payments to be received by Webster only if current interest rates rise above a predetermined interest rate. At December 31, 1998, Webster had five outstanding cap agreements with notional amounts of $410 million related to the available for sale securities portfolio with interest-rate caps ranging from 6.00% to 9.00%. The amount paid for entering into the interest-rate cap is amortized over the life of the agreement as an adjustment to mortgage-backed securities available for sale interest income. At December 31, 1998, this portfolio had $11.3 million of unamortized interest-rate cap balances and during the 1998 period amortized $3.5 million as a reduction of interest income. Similarly, interest-rate floor agreements will result in cash payments to be received by Webster only if current interest rates fall below a predetermined interest rate. At December 31, 1998, Webster had two outstanding interest-rate floor agreements with notional amounts of $500 million and interest-rate floors of 5.25% and 5.75%. The amount paid for entering into an interest-rate floor agreement is amortized over the life of the agreement as an adjustment to mortgage-backed securities available for sale interest income. At December 31, 1998, Webster had $4.1 million of unamortized floor income costs and during the 1998 period amortized $396,000 as a reduction of available for sale interest income. In August 1997, Webster purchased a separate interest-rate cap contract with a notional amount of $41 million, a cap rate of 7.00% and a termination date of August 19, 2002. The cost of the interest-rate cap contract was $713,400. The interest-rate cap contract is matched against two fixed-rate borrowings with maturities of one and two years, respectively, and a five year fixed-rate borrowing that is callable after three years.

NOTE 11: SUMMARY OF ESTIMATED FAIR VALUES

A summary of estimated fair values consisted of the following:

	December 31,			
	1998		1997	
(In thousands)	**Carrying Amount**	**Estimated Fair Value**	Carrying Amount	Estimated Fair Value
Assets:				
Cash and Due from Depository Institutions	$ 173,863	$ 173,863	$ 151,322	$ 151,322
Interest-bearing Deposits	3,560	3,560	77,104	77,104
Securities	3,449,542	3,452,753	3,581,456	3,581,280
Residential Loans	3,749,152	3,881,160	3,855,489	3,927,674
Consumer Loans	42,122	43,884	81,139	81,774
Home Equity Loans	439,369	458,727	474,995	490,352
Commercial Loans	817,975	814,075	602,708	599,716
Less Allowance for Loan Losses	55,109	—	59,518	—
Segregated Assets, Net	—	—	41,038	42,417
Interest-Rate Contracts	12,548	12,548	7,817	7,817
Mortgage Servicing Rights, Net	4,686	6,322	5,906	8,379
Liabilities:				
Deposits Other than Certificates	$ 2,500,085	$ 2,500,085	$ 2,348,914	$ 2,348,914
Time Deposits:				
Maturing in Less than One Year	2,642,908	2,643,754	2,483,946	2,490,362
Maturing in One Year and Beyond	508,280	517,717	886,170	888,803
Federal Home Loan Bank Advances	1,774,560	1,781,391	1,516,634	1,517,263
Reverse Repurchase Agreements and Other Borrowings	738,921	741,697	1,032,963	1,033,503
Capital Securities and Preferred Stock of Subsidiary Corp.	199,577	215,326	194,577	201,001

In December 1991, the FASB issued SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," which requires all entities to disclose the fair value of financial instruments, including both assets and liabilities recognized and not recognized in the statement of condition, for which it is practicable to estimate fair value.

The carrying amounts for interest-bearing deposits approximate fair value since they mature in 90 days or less and do not present unanticipated credit concerns. The fair value of securities (See Note 3) is estimated based on prices published in financial newspapers or quotations received from securities dealers or pricing services. The fair value of interest-rate contracts was based on the amount Webster could receive or pay to terminate the agreements. FHL Bank stock has no active market and is required to be held by member banks. The estimated fair value of FHL Bank stock equals the carrying amount.

In estimating the fair value of loans, portfolios with similar financial characteristics were classified by type. Loans were segmented into four generic types: residential, consumer, home equity and commercial. Residential loans were further segmented into 15 and 30 year fixed-rate contractual maturities, with the remaining classified as variable-rate loans. The fair value of each category is calculated by discounting scheduled cash flows through estimated maturity using market discount rates. Adjustments were made to reflect credit and rate risks inherent in the portfolio.

The estimated fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, regular savings, NOW accounts and money market accounts, is equal to the amount payable on demand. The estimated fair values of time deposits, FHL Bank advances, and other borrowings were calculated using the discounted cash flow method. The discount rate is estimated using rates currently offered for deposits and FHL Bank advances of similar remaining maturities. The discount rate used for the senior notes was calculated using a spread over treasury notes consistent with the spread used to price the senior notes at their inception. The discount rates used for the capital securities and minority interest liabilities were calculated using market rates for current instruments with similar terms.

The calculation of fair value estimates of financial instruments is dependent upon certain subjective assumptions and involves significant uncertainties, resulting in variability in estimates with changes in assumptions. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed. Fair value estimates are not intended to reflect the liquidation value of the financial instruments.

NOTE 12: FORECLOSED PROPERTY EXPENSES AND PROVISIONS, NET AND ALLOWANCE FOR LOSSES ON FORECLOSED PROPERTIES

Foreclosed property expenses and provisions, net are summarized as follows:

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Gain on Sale of Foreclosed Properties			
Acquired in Settlement of Loans, Net	$ (908)	$ (1,274)	$ (1,650)
Provision for Losses on Foreclosed Properties	330	1,637	2,523
Rental Income	(146)	(202)	(369)
Foreclosed Property Expenses	1,300	4,023	4,654
Total	$ 576	$ 4,184	$ 5,158

Webster has an allowance for losses on foreclosed properties. A detail of the changes in the allowance follows:

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Balance at Beginning of Period	$ 1,222	$ 819	$ 1,511
Provisions	330	1,637	2,523
Losses Charged to Allowance	(1,466)	(1,355)	(3,359)
Recoveries Credited to Allowance	121	121	144
Balance at End of Period	$ 207	$ 1,222	$ 819

NOTE 13: INCOME TAXES

Charges for income taxes in the Consolidated Statements of Income are comprised of the following:

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Current:			
Federal	$ 32,953	$ 28,980	$ 22,974
State	975	5,112	5,777
	33,928	34,092	28,751
Deferred:			
Federal	13	(6,894)	2,063
State	10,603	(1,473)	1,788
	10,616	(8,367)	3,851
Total:			
Federal	32,966	22,086	25,037
State	11,578	3,639	7,565
	$ 44,544	$ 25,725	$ 32,602

Income tax expense of $44.5 million, $25.7 million and $32.6 million for the years ended December 31, 1998, 1997 and 1996, respectively, differed from the amounts computed by applying the Federal income tax rate of 35% in 1998, 1997 and 1996 to pre-tax income as a result of the following:

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Computed "Expected" Tax Expense	$ 40,253	$ 23,394	$ 30,309
Increase (Decrease) in Income Taxes Resulting From:			
Dividends Received Deduction	(653)	(364)	(603)
State Income Taxes, Net of Federal Income Tax Benefit			
Including Change in Valuation Allowance and Rate	7,526	2,365	5,243
Acquisition-Related Expenses	1,208	1,225	—
Increase in Bank Owned Life Insurance Value	(1,963)	—	—
Other, Net	(1,827)	(895)	(2,347)
Income Taxes	$ 44,544	$ 25,725	$ 32,602

At December 31, 1998, Webster had a net deferred tax asset of $14.7 million. In order to fully realize the net deferred tax asset, Webster must either generate future taxable income or incur tax losses to carryback. Based on Webster's historical and current taxable earnings, management believes that Webster will realize the net deferred tax asset. There can be no assurance, however, that Webster will generate taxable earnings or a specific level of continuing taxable earnings in the future.

A deferred tax valuation allowance has been established for the state portion of temporary differences that may not be realized due to tax minimization strategies.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1998 and 1997 are presented below.

	December 31,	
(In thousands)	1998	1997
Deferred Tax Assets:		
Loan Loss Allowances & Other Allowances, Net	$ 22,906	$ 30,363
Accrued Compensation and Pensions	5,488	4,632
Deferred Expenses	3,438	3,671
Intangibles	5,812	5,231
Other	1,318	2,480
Total Gross Deferred Tax Assets	38,962	46,377
Less State Valuation Allowance, Net of Federal Benefit	(5,000)	—
Deferred Tax Asset after Valuation Allowance	33,962	46,377
Deferred Tax Liabilities:		
Loan Discount	2,829	4,062
Premises and Equipment	—	1,309
Unrealized Gain on Securities	13,913	14,697
Other	2,483	1,740
Total Gross Deferred Tax Liabilities	19,225	21,808
Net Deferred Tax Asset	$ 14,737	$ 24,569

NOTE 14: SHAREHOLDERS' EQUITY

Shareholders' equity increased $37.6 million to $554.9 million at December 31, 1998 from $517.3 million at December 31, 1997 due primarily to net income of $70.5 million partially offset by common stock repurchases, net of reissuances, of $30.6 million, the effect of option exercises and common stock dividend payments. During 1998, Webster repurchased a total of 1,396,551 shares of its common stock.

On June 1, 1998, Webster acquired Damman Insurance Associates (see Note 2). In connection with the acquisition, Webster issued 274,609 shares of its common stock for 100% ownership interest of Damman.

In May of 1998, Webster repurchased 305,215 shares of Webster common stock related to the settlement of warrants to purchase 600,000 shares issued to Fleet Financial Group in 1996. The warrants were issued in connection with Webster's purchase of former Shawmut Bank branches divested following the Fleet-Shawmut merger. The repurchase was accounted for as a reduction of shareholders' equity.

On April 15, 1998, Webster acquired Eagle (see Note 2). In connection with the acquisition, Webster issued 10,615,156 shares of its common stock for all the outstanding shares of Eagle's common stock. Under the terms of the agreement, Eagle's shareholders received 1.68 shares of Webster common stock after giving effect to a two-for-one stock split in a tax-free exchange for each of their shares of Eagle's common stock.

On April 6, 1998, Webster's common stock split two-for-one; the stock split was effected in the form of a stock dividend. Basic and diluted common shares have been restated for all periods presented as if the stock split took place at the beginning of the earliest period shown. Also, shareholders' equity accounts for all periods presented have been restated to give retroactive recognition of the stock split.

On July 31, 1997, Webster acquired People's (see Note 2). In connection with the acquisition, Webster issued 3,151,992 shares of its common stock for all the outstanding shares of People's common stock. Under the terms of the agreement, People's shareholders received .85 shares of Webster common stock in a tax-free exchange for each of their shares of People's common stock.

On May 31, 1997, Webster acquired MidConn (see Note 2) as a result of the Eagle acquisition. In connection with the acquisition, Webster effectively issued 2,869,440 shares of its common stock for all the outstanding common shares of MidConn.

On January 31, 1997, Webster acquired Derby (see Note 2). In connection with the acquisition, Webster issued 7,002,740 shares of its common stock for all the outstanding shares of Derby common stock. Under the terms of the agreement, Derby shareholders received 1.14158 shares of Webster common stock in a tax-free exchange for each of their shares of Derby common stock.

Retained earnings at December 31, 1998 included $41.0 million of earnings of the Bank appropriated to bad debt reserves (pre-1988), which were deducted for federal income tax purposes. Tax law changes were enacted in August 1996 to eliminate the "thrift bad debt" method of calculating bad debt deductions for tax years after 1995 and to impose a requirement to recapture into taxable income (over a six-year period) all bad debt reserves accumulated after 1987. Since Webster previously recorded a deferred tax liability with respect to these post-1987 reserves, its total income tax expense for financial reporting purposes will not be affected by the recapture requirement. The tax law changes also provide that taxes associated with the recapture of pre-1988 bad debt reserves would become payable under more limited circumstances than under prior law. Under the tax laws, as amended, events that would result in recapture of the pre-1988 bad debt reserves include stock and cash distributions to the holding company from the Bank in excess of specified amounts. Webster does not expect such reserves to be recaptured into taxable income.

Applicable Office of Thrift Supervision ("OTS") regulations require federal savings banks such as the Bank, to satisfy certain minimum capital requirements, including a leverage capital requirement (expressed as a ratio of core or Tier 1 capital to adjusted total assets) and risk-based capital requirements (expressed as a ratio of core or Tier 1 capital and total capital to total risk-weighted assets). As an OTS regulated institution, the Bank is also subject to a minimum tangible capital requirement (expressed as a ratio of tangible capital to adjusted total assets). At December 31, 1998 and 1997, the Bank exceeded all OTS regulatory capital requirements and met the FDIC requirements for a "well capitalized" institution. In order to be considered "well capitalized" a depository institution must have a ratio of Tier 1 capital to adjusted total assets of 5%, a ratio of Tier 1 capital to risk-weighted assets of 6% and a ratio of total capital to risk-weighted assets of 10%. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on Webster's Consolidated Financial Statements. Webster's capital amounts and classifications are also subject to qualitative judgments by the OTS about components, risk weightings, and other factors.

At December 31, 1998 and 1997, the Bank was in full compliance with all applicable capital requirements as detailed below:

	Actual		OTS Minimum Capital Requirements		Well Capitalized	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
At December 31, 1998						
Total Capital (to Risk-Weighted Assets)	$ 560,712	12.58%	$ 356,435	8.00%	$ 445,543	10.00%
Tier 1 Capital (to Risk-Weighted Assets)	507,778	11.40	178,217	4.00	267,326	6.00
Tier 1 Capital (to Adjusted Total Assets)	507,778	5.79	262,933	3.00	438,221	5.00
Tangible Capital (to Adjusted Total Assets)	502,602	5.74	131,389	1.50	No Requirement	
At December 31, 1997						
Total Capital (to Risk-Weighted Assets)	$ 591,066	14.42%	$ 328,015	8.00%	$ 410,019	10.00%
Tier 1 Capital (to Risk-Weighted Assets)	542,149	13.22	164,007	4.00	246,011	6.00
Tier 1 Capital (to Adjusted Total Assets)	542,149	6.07	268,115	3.00	446,858	5.00
Tangible Capital (to Adjusted Total Assets)	537,446	6.02	133,987	1.50	No Requirement	

At the time of the respective conversions of the Bank and certain predecessors from mutual to stock form, each institution established a liquidation account for the benefit of eligible depositors who continue to maintain their deposit accounts after conversion. In the event of a complete liquidation of the Bank, each eligible depositor will be entitled to receive a liquidation distribution from the liquidation account. The Bank may not declare or pay a cash dividend on or repurchase any of its capital stock if the effect thereof would cause its regulatory capital to be reduced below applicable regulatory capital requirements or the amount required for its liquidation accounts.

The OTS capital distribution regulations establish three tiers of institutions for purposes of determining the level of dividends that can be paid. Since the Bank's capital levels exceeded all fully phased-in OTS capital requirements at December 31, 1998, it is considered a Tier 1 Institution. Tier 1 Institutions generally are able to pay dividends up to an amount equal to one-half of their excess capital at the beginning of the year plus all income for the calendar year. In accordance with the OTS capital distribution regulations, the Bank must provide a 30 day notice prior to the payment of any dividends to Webster. As of December 31, 1998, the Bank had $114.8 million available for the payment of dividends under the OTS capital distribution regulations. The Bank has paid dividends and made distributions to Webster amounting to $127.2 million and $45.6 million for 1998 and 1997, respectively. Under the prompt corrective action regulations adopted by the OTS and the FDIC, the Bank is precluded from paying any dividends if such action would cause it to fail to comply with applicable minimum capital requirements.

The Bank has an ESOP that invests in Webster common stock as discussed in Notes 9 and 16. Since Webster has secured and guaranteed the ESOP debt, the outstanding ESOP loan balance which is considered unearned compensation expense and is recorded as a reduction of shareholders' equity. Both the loan obligation and the unearned compensation expense are reduced by the amount of any loan repayments made by the ESOP. Principal repayments totaled $420,000, $568,000 and $677,000 during the years ended December 31, 1998, 1997 and 1996, respectively.

In February 1996, Webster's Board of Directors adopted a stockholders' rights plan in which preferred stock purchase rights have been granted as a dividend at the rate of one right for each share of common stock held of record as of the close of business on February 16, 1996. The plan is designed to protect all Webster shareholders against hostile acquirers who may seek to take advantage of Webster and its shareholders through coercive or unfair tactics aimed at gaining control of Webster without paying all shareholders a fair price. Each right initially would entitle the holder thereof to purchase under certain circumstances one 1/1,000th of a share of a new Series C Preferred Stock at an exercise price of $100 per share. The rights will expire in February 2006. The rights will be exercisable only if a person or group in the future becomes the beneficial owner of 15% or more of the common stock, or announces a tender or exchange offer which would result in its ownership of 15% or more of the common stock, or if the Board declares any person or group to be an "adverse person" upon a determination that such person or group has acquired beneficial ownership of 10% or more and that such ownership is not in the best interests of the company.

NOTE 15: EARNINGS PER SHARE

The following tables reconcile the components of basic and diluted earnings per share.

	Years Ended December 31,		
(Dollars in thousands, except per share data)	1998	1997	1996
Basic EPS:			
Net income	$ 70,465	$ 41,113	$ 53,994
Preferred stock dividends	—	—	1,149
Income available to common stockholders	$ 70,465	$ 41,113	$ 52,845
Weighted-average common shares outstanding	37,899,897	37,445,418	36,810,846
Basic earnings per share	$ 1.86	$ 1.10	$ 1.44
Diluted EPS:			
Net income	$ 70,465	$ 41,113	$ 53,994
Weighted-average common shares outstanding	37,899,897	37,445,418	36,810,846
Dilutive common stock equivalents:			
Effect of conversion of preferred stock series B	—	34,106	1,776,172
Common stock equivalents due to dilutive effect of options	670,656	799,584	903,124
Common stock equivalents due to dilutive effect of warrant	—	194,088	69,388
Total weighted-average diluted shares	38,570,553	38,473,196	39,559,530
Diluted earnings per share	$ 1.83	$ 1.07	$ 1.36

At December 31, 1998 and 1997, options to purchase 664,423 and 239,400 shares of common stock at exercise prices between $31.75 and $35.38 and $24.82 and $32.25 respectively, were not included in the computation of diluted earnings per share since the options' exercise prices were greater than the average market price of Webster common shares for 1998 and 1997, respectively.

NOTE 16: EMPLOYEE BENEFIT AND STOCK OPTION PLANS

The Bank has an employee investment plan under section 401(k) of the Internal Revenue Code. Under the savings plan, the Bank will match $.50 for every $1.00 of the employee's contribution up to 6% of the employee's annual compensation. Operations were charged with $1.2 million, $1.2 million and $1.1 million for the years ended December 31, 1998, 1997 and 1996, respectively, for contributions to the investment plan.

The Bank's ESOP, which is noncontributory by employees, is designed to invest in Webster common stock on behalf of employees of the Bank who meet certain minimum age and service requirements. The Bank may make contributions to the ESOP in such amounts as the Board of Directors may determine on an annual basis. To the extent that the Bank's contributions are used to repay the ESOP loan, Webster common stock is allocated to the accounts of participants in the ESOP. Stock and other amounts allocated to a participant's account become fully vested after the participant has completed five years of participation service under the ESOP. Total principal paydown on the ESOP loan during 1998 totaled $610,900. Operations were charged with $1.2 million for each of the years ended December 31, 1998 and 1997, and $1.3 million for the year ended December 31, 1996 for costs related to the ESOP. The 1998 ESOP charge includes $420,000 for principal payments, $36,093 of interest payments (net of $80,404 of dividends on unallocated ESOP shares) and $79,946 of administrative costs. As required under the Accounting Standards Executive Committee's Statement of Position 93-6, "Employers Accounting for Stock Ownership Plans", the 1998 ESOP charge also includes an additional $622,749 in order to measure compensation expense based on the fair value of the shares allocated during the year.

The Bank maintains a noncontributory pension plan for employees who meet certain minimum service and age requirements. Pension benefits are based upon earnings of covered employees during the period of credited service. The following tables set forth changes in benefit obligation, changes in plan assets and the funded status of the Bank's pension plan and amounts recognized in Webster's Consolidated Statements of Condition at December 31, 1998 and 1997.

	December 31,	
(In thousands)	1998	1997
Change in Benefit Obligation:		
Projected Benefit Obligation-Beginning of Year	$ 20,829	$ 24,023
Service Cost	2,257	2,027
Interest Cost	1,536	1,554
Plan Amendment	114	1,033
Actuarial Loss (Gain)	3,675	(152)
Acquisition-related	651	—
Benefits Paid	(2,007)	(2,979)
Curtailment Adjustments	(304)	(4,677)
Projected Benefit Obligation-End of Year	$ 26,751	$ 20,829
Change in Plan Assets:		
Plan Assets at Fair Value-Beginning of Year	$ 24,351	$ 21,119
Actual Return on Plan Assets	2,982	6,223
Contributions	624	1,010
Acquisition-related	651	—
Benefits Paid	(2,007)	(2,979)
Settlements	—	(1,022)
Plan Assets at Fair Value-End of Year	$ 26,601	$ 24,351
Funded Status	$ (150)	$ 3,522
Unrecognized Prior Service Cost	(1,207)	(1,403)
Unrecognized Net Gain	(362)	(3,531)
Unrecognized Net Asset	(112)	(121)
Accrued Pension (Liability)	$ (1,831)	$ (1,533)

The pension plan held, in its asset portfolio, 62,000 and 88,000 shares of Webster common stock as of December 31, 1998 and 1997, respectively.

The discount rate, the rate of increase of future compensation levels and the expected long-term rate of return on assets used in determining the actuarial present value of the projected benefit obligation were 6.25%, 4.50% and 9.00%, respectively for 1998, and 7.00%, 4.75% and 9.00%, respectively for 1997.

Net pension expense for 1998, 1997 and 1996 included the following components.

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Service Cost-Benefits Earned During the Period	$ 2,257	$ 2,027	$ 2,260
Interest Cost on Projected Benefit Obligations	1,536	1,554	1,623
Expected Return on Plan Assets	(2,242)	(2,476)	(2,229)
Amortization and Deferral	(630)	516	384
Total	$ 921	$ 1,621	$ 2,038

The Bank also provides other post-retirement benefits to certain retired employees. The following tables set forth the changes in benefit obligation and the funded status of the plan at December 31, 1998 and 1997:

	December 31,	
(In thousands)	1998	1997
Change in Benefit Obligation:		
Accumulated Benefit Obligation-Beginning of Year	$ 3,655	$ 5,837
Service Cost	11	58
Interest Cost	277	249
Actuarial Loss	443	291
Benefits Paid	(231)	(180)
Curtailment Adjustments	(412)	(2,600)
Accumulated Benefit Obligation-End of Year	$ 3,743	$ 3,655
Fair Value of Plan Assets	$ —	$ —
Fund Status	$ (3,743)	$ (3,655)
Unrecognized Prior Service	—	(331)
Unrecognized Net (Gain) Loss	359	(184)
Accrued Post-Retirement (Liability)	$ (3,384)	$ (4,170)

The discount rate used in determining the accumulated other post-retirement benefit obligation was 6.25% and 7.00% for 1998 and 1997, respectively. The assumed healthcare cost-trend rate is 6.50% for 1999, decreasing 0.5% per year to 5.0% for 2002 and thereafter. An increase of 1% in the assumed healthcare cost-trend rate would increase net periodic post-retirement benefit cost by $17,800 and increase the accumulated benefit obligation by $318,900. A decrease of 1% in the assumed healthcare cost trend rate would decrease net periodic post-retirement cost by $15,400 and decrease the accumulated benefit obligation by $275,800.

The components of post-retirement benefits cost were as follows:

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Service Cost	$ 11	$ 58	$ 329
Interest Cost	277	249	425
Amortization	112	(49)	33
Net Periodic Post-Retirement Benefit Cost	$ 400	$ 258	$ 787

Webster maintains stock option plans (the "Option Plans") for the benefit of its directors and officers. Webster applies the provisions of APB Opinion No. 25 and related interpretations in accounting for fixed stock option plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans in the Consolidated Statements of Income. Had compensation cost for Webster's stock option based compensation plans been determined consistent with SFAS No. 123 and recorded in the Consolidated Statements of Income, Webster's net income and earnings per share would have been reduced to the pro forma amounts indicated as follows:

	Years Ended December 31,		
(Dollars in thousands, except per share data)	1998	1997	1996
Net Income:			
As Reported	$ 70,465	$ 41,113	$ 53,994
Pro Forma	66,693	39,518	53,057
Basic Earnings Per Share:			
As Reported	$ 1.86	$ 1.10	$ 1.44
Pro Forma	1.76	1.06	1.40
Diluted Earnings Per Share:			
As Reported	$ 1.83	$ 1.07	$ 1.36
Pro Forma	1.72	1.03	1.34

Webster had five active fixed stock option plans at December 31, 1998. Three of the option plans were acquired through the Eagle, People's and Derby acquisitions. The acquired plans had options outstanding of 413,900, 118,776 and 66,944 respectively, at December 31, 1998. The 1992 option plan was amended in 1994, 1996 and 1998. Stock appreciation rights ("SARS") were granted in tandem with stock options issued under the Derby option plan. In accordance with generally accepted accounting principles, compensation expense for the SARS is recorded when the market value of Webster's common stock exceeds the SARS' strike price. Compensation expense recorded for 1998, 1997 and 1996 was $89,695, $229,000 and $18,800, respectively. During the years ended December 31, 1998, 1997 and 1996, the number of SARS exercised for each respective period were 4,612, 1,050 and 2,204, respectively. Under the terms of the plans, the exercise price of each option granted equals the approximate market price of Webster's stock on the date of grant and each option has a maximum contractual life of ten years.

The fair value of each option grant is estimated based on the date of grant using the Black-Scholes Option-Pricing Model with the following weighted-average assumptions used for grants issued during 1998: expected option term 8.7 years, expected dividend yield 1.70%, expected volatility 31.19%, expected forfeiture rate 2.13%, and risk-free interest-rate of 4.96%, the following weighted-average assumptions were used for grants issued during 1997: 8.6 years, 1.85%, 25.14%, 2.23% and 5.83%, respectively; and for 1996 were 10 years, 1.91%, 21.0%, 1.14% and 6.42%, respectively.

A summary of the status of Webster's fixed stock option plans at December 31, 1998, 1997, and 1996 and changes during the years then ended is presented below:

	1998		1997		1996	
	Shares	**Weighted Average Exercise Price**	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options Outstanding at Beginning of Year	2,471,748	$ 13.61	2,487,791	$ 10.02	3,316,310	$ 8.38
Granted	627,350	31.92	548,358	24.86	467,780	15.33
Exercised	(614,111)	12.26	(532,043)	8.25	(1,269,303)	7.71
Forfeited/Canceled	(38,163)	25.88	(32,358)	16.08	(26,996)	9.63
Options Outstanding at End of Year	2,446,824	$ 18.46	2,471,748	$ 13.61	2,487,791	$ 10.02
Options Exercisable at Year End	1,912,138		1,763,608		1,793,383	
Weighted Average Per Share Fair Value of Options Granted During the Year		$ 12.30		$ 8.73		$ 5.60

The following table summarizes information about Webster's fixed stock option plans by price range for options outstanding and exercisable at December 31, 1998:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (In years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 3.54 and under	25,960	1.9	$ 2.27	25,960	$ 2.27
$ 3.55 - $ 7.08	226,213	1.8	$ 4.96	226,213	$ 4.96
$ 7.09 - $ 10.61	558,831	5.0	$ 9.62	558,831	$ 9.62
$ 10.62 - $ 14.15	466,069	5.8	$ 12.35	461,469	$ 12.33
$ 14.16 - $ 17.69	31,888	7.4	$ 15.79	16,800	$ 15.98
$ 17.70 - $ 21.23	261,690	7.8	$ 18.84	167,082	$ 18.71
$ 21.24 - $ 24.76	55,400	3.4	$ 23.56	35,960	$ 23.66
$ 24.77 - $ 28.30	163,350	9.3	$ 26.39	10,000	$ 25.00
$ 28.31 - $ 31.84	188,423	8.9	$ 31.75	1,823	$ 31.75
$ 31.85 - $ 35.38	469,000	9.4	$ 33.77	408,000	$ 33.84
	2,446,824	6.5	$ 18.46	1,912,138	$ 16.01

Webster also has two restricted stock plans consisting of a Director Fee Retainer Restricted Stock Plan, which was established in 1996 and a Restricted Stock Plan, which was established in 1992. Under the Director Fee Restricted Stock Plan, a total of 6,480 shares were issued to fifteen directors in 1998 with each receiving 432 shares. These restricted shares were reissued from treasury stock and the cost was measured as of the grant date using the fair market value of Webster's stock as of the grant date. There were no shares granted in 1998, 1997 and 1996 under the Restricted Stock Plan. The cost of all restricted shares is amortized to compensation expense over the contractual service period and such expense is reflected in Webster's Consolidated Statements of Income.

NOTE 17: ACQUISITION-RELATED EXPENSES

A summary of acquisition-related expenses follows:

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Shawmut Transaction	$ —	$ —	$ 500
Derby	—	19,858	—
People's	—	7,200	—
MidConn	—	2,734	—
Eagle	17,400	—	—
Total	$ 17,400	$ 29,792	$ 500

In connection with the acquisition of Eagle, which was completed on April 15, 1998, Webster recorded approximately $17.4 million of acquisition-related expenses during 1998. In addition, in 1998 Webster recorded an increase of $1.5 million to the provision for loan losses related to the acquisition of Eagle for conformity to Webster's credit policies. In connection with the acquisitions of Derby, MidConn and People's, which were completed on January 31, 1997, May 31, 1997 and July 31, 1997, respectively, Webster recorded approximately $29.8 million of acquisition-related expenses.

The following table presents a summary of the acquisition-related accrued liabilities:

(In thousands)	Derby	People's	MidConn	Eagle
Balance of acquisition-related accrued liabilities at December 31, 1996	$ —	$ —	$ —	$ —
Additions/Provisions	19,900	7,200	2,700	—
Payments and charges against the liabilities:				
Compensation (severance and related costs)	(6,700)	(2,400)	(800)	—
Data processing contract termination	(1,600)	—	—	—
Write-down of fixed assets	(1,200)	—	—	—
Transaction costs (including investment bankers, attorneys and accountants)	(2,200)	(1,300)	(1,700)	—
Acquisition-related and miscellaneous expenses	(2,800)	(1,100)	(200)	—
Balance of acquisition-related accrued liabilities at December 31, 1997	$ 5,400	$ 2,400	$ —	$ —
Additions/Provisions	—	—	—	17,400
Payments and charges against the liabilities:				
Compensation (severance and related costs)	(400)	(300)	—	(7,800)
Data processing contract termination	(600)	—	—	—
Transaction costs (including investment bankers, attorneys and accountants)	—	—	—	(4,100)
Acquisition-related and miscellaneous expenses	(600)	(500)	—	(4,100)
Balance of acquisition-related accrued liabilities at December 31, 1998	$ 3,800	$ 1,600	$ —	$ 1,400

The remaining total accrued liability of $6.8 million at December 31, 1998 represents, for the most part, an accrual for data processing contract termination costs payable over future periods and the estimated loss on sale of excess fixed assets due to consolidation of overlapping branch locations.

NOTE 18: BUSINESS SEGMENTS

Webster has four segments for business segment reporting purposes. These segments include consumer banking, business banking, mortgage lending and treasury. The accounting policies of the segments are consistent with those described in the summary of significant accounting policies. The organizational hierarchies that define the business segments are periodically reviewed and revised. Results may be restated in future periods to reflect changes in methodologies and organizational structure. The following table presents the statement of operations for Webster's reportable segments.

Operating income and total assets by business segment are as follows:

	Year Ended December 31, 1998					
(In thousands)	Consumer Banking	Business Banking	Mortgage Lending	Treasury	All Other	Total Segments
Net Interest Income	$ 128,762	$ 26,285	$ 76,165	$ 13,905	$ 318	$ 245,435
Provision for Loan Losses	1,097	1,151	4,552	—	—	6,800
Net Interest Income After Provision	127,665	25,134	71,613	13,905	318	238,635
Noninterest Income	32,421	1,379	7,802	17,945	7,402	66,949
Noninterest Expense	115,567	11,521	21,683	7,774	9,137	165,682
Income (Loss) Before Income Taxes	44,519	14,992	57,732	24,076	(1,417)	139,902
Income Taxes	16,472	5,547	21,361	8,907	(525)	51,762
Net Income (Loss) After Taxes	$ 28,047	$ 9,445	$ 36,371	$ 15,169	$ (892)	$ 88,140
Total Assets	$ 720,703	$ 666,947	$3,636,046	$3,847,654	$ 21,508	$8,892,858

Management allocates expenses not directly incurred to its business segments. These expenses include administration, finance, operations and other support related functions. In addition, net income after income taxes for the segments do not include certain income and expense categories, totaling $17.7 million, that do not directly relate to the segments. The major categories on a before tax basis include interest expense of $14.7 million on debt reflected as capital at the segment level, $17.4 million of acquisition-related expenses and other income not related to the segments of $7.2 million.

The consumer banking segment includes consumer lending and the Bank's deposit generation and direct banking activities, which include the operation of automated teller machines and telebanking customer support, sales and small business lending. The business banking segment includes the Bank's investment in commercial and industrial loans and commercial real estate loans. The business banking segment also includes deposit and cash management activities for business banking. The mortgage lending segment includes the Bank's investment in residential real estate loans and the Bank's residential real estate loan origination, servicing and secondary marketing activities. The treasury segment includes the Bank's investment in assets and liabilities managed by the treasury department and includes interest-bearing deposits, securities, FHL Bank advances, reverse repurchase agreements and other borrowings. All other includes the results of Webster's trust and investment and insurance subsidiaries, which offer products to both consumer and business customers.

NOTE 19: CAPITAL SECURITIES OF SUBSIDIARY TRUSTS

During 1997, Webster formed a statutory business trust, Webster Capital Trust I ("Trust I"), of which Webster owns all of the common stock. Trust I exists for the sole purpose of issuing trust securities and investing the proceeds in an equivalent amount of subordinated debentures of the Corporation. On January 31, 1997, Trust I completed a $100 million underwritten public offering of 9.36% Corporation-Obligated Manditorily Redeemable Capital Securities of Webster Capital Trust I ("capital securities"). The sole asset of Trust I is the $100 million of Webster's 9.36% junior subordinated deferrable interest debentures due in 2027 ("subordinated debt securities"), purchased by Trust I on January 30, 1997.

On April 1, 1997, Eagle Financial Capital Trust I, subsequently renamed Webster Capital Trust II ("Trust II"), completed a $50 million private placement of 10.00% capital securities. Proceeds from the issue were invested by Trust II in junior subordinated deferrable debentures issued by Eagle due in 2027. These debentures represent the sole assets of Webster Capital Trust II.

At December 31, 1997, Webster owned $5.0 million of Trust II Securities which were eliminated as a result of the pooling of interests. Subsequent to December 31, 1997 and prior to Webster's acquisition of Eagle, these securities were sold to a third party and were outstanding at December 31, 1998.

The subordinated debt securities are unsecured obligations of Webster and are subordinate and junior in right of payment to all present and future senior indebtedness of Webster. Webster has entered into a guarantee, which together with Webster's obligations under the subordinated debt securities and the declaration of trust governing Trust I and Trust II, including its obligations to pay costs, expenses, debts and liabilities (other than trust securities), provides a full and unconditional guarantee of amounts on the capital securities.

NOTE 20: PREFERRED STOCK OF SUBSIDIARY CORPORATION

The Bank formed and incorporated Webster Preferred Capital Corporation ("WPCC") in March 1997. WPCC was formed to provide a cost-effective means of raising funds, including capital, on a consolidated basis for the Bank. WPCC's strategy is to acquire, hold and manage real estate mortgage assets.

In December 1997, WPCC raised $50.0 million in a public offering in which $40 million was issued as Series A 7.375% cumulative redeemable preferred stock and $10.0 million was issued as Series B 8.625% cumulative redeemable preferred stock that is quoted under NASDAQ listing (WBSTP). All of WPCC's common stock is owned by the Bank. The preferred shares are not exchangeable into common stock or any other securities of the Bank or Webster, and will not constitute regulatory capital of either the Bank or Webster.

NOTE 21: LEGAL PROCEEDINGS

Webster is party to various legal proceedings normally incident to the kind of business conducted. Management believes that no material liability will result from such proceedings.

NOTE 22: PARENT COMPANY CONDENSED FINANCIAL INFORMATION

The Statements of Condition for 1998 and 1997 and the Statements of Income and Cash Flows for the three-year period ended December 31, 1998 (parent only) are presented below.

Statements of Condition

	December 31,	
(In thousands)	1998	1997
Assets:		
Cash and Due from Depository Institutions	$ 915	$ 1,830
Interest-Bearing Deposits	—	2,893
Securities Available for Sale	148,218	68,641
Investment in Subsidiaries	607,072	631,164
Due from Subsidiaries	22	—
Accrued Interest Receivable	1,191	251
Other Assets	4,992	9,813
Total Assets	$ 762,410	$ 714,592
Liabilities and Shareholders' Equity:		
Senior Notes due 2000	$ 40,000	$ 40,000
Lines of Credit	10,000	—
ESOP Borrowings	1,367	1,978
Due to Subsidiaries	—	2,578
Other Liabilities	6,164	7,774
Corporation-Obligated Mandatorily Redeemable Capital Securities of Subsidiary Trusts	150,000	145,000
Shareholders' Equity	554,879	517,262
Total Liabilities and Shareholders' Equity	$ 762,410	$ 714,592

Statements of Income

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Dividends from Subsidiary	$ 77,230	$ 45,571	$ 24,726
Interest on Securities	5,726	2,067	1,012
Gain on Sale of Securities	7,141	937	1,520
Other Noninterest Income	17	11	139
Interest Expense on Borrowings	5,018	3,812	3,780
Capital Securities Expense	14,708	11,368	—
Other Noninterest Expenses	6,538	6,720	3,996
Income Before Income Taxes and Equity in Undistributed Earnings of Subsidiaries	63,850	26,686	19,621
Income Tax Benefit	4,000	7,227	1,950
Income Before Equity in Undistributed Earnings of Subsidiaries	67,850	33,913	21,571
Equity in Undistributed Earnings of Subsidiaries	2,615	7,200	32,423
Net Income	70,465	41,113	53,994
Preferred Stock Dividends	—	—	1,149
Income Available to Common Shareholders	$ 70,465	$ 41,113	$ 52,845

Statements of Cash Flows

	Years Ended December 31,		
(In thousands)	1998	1997	1996
Operating Activities:			
Net Income	$ 70,465	$ 41,113	$ 53,994
(Increase) Decrease in Interest Receivable	(940)	(186)	42
Decrease (Increase) in Other Assets	11,428	(3,483)	(828)
Gains on Sale of Securities	(7,141)	(937)	(1,520)
Equity in Undistributed Earnings of Subsidiaries	(2,615)	(7,200)	(32,423)
Other, Net	(801)	11,978	2,861
Net Cash Provided by Operating Activities	70,396	41,285	22,126
Investing Activities:			
Purchases of Securities Available for Sale	(265,132)	(114,640)	(35,076)
Decrease (Increase) in Interest-Bearing Deposits	2,893	(2,088)	149
Sales and Maturities of Securities Available for Sale	175,411	61,986	76,465
Investment in Insurance Subsidiary	(11,068)	—	—
Net Cash (Used) Provided by Investing Activities	(97,896)	(54,742)	41,538
Financing Activities:			
Repayment of Borrowings	(85,611)	(28,400)	(7,584)
Proceeds from Borrowings	95,000	10,000	25,400
Net Proceeds from Issuance of Capital Securities	4,846	141,327	—
Common Stock Issued for Purchase Acquisition	9,268	—	—
Exercise of Stock Options	11,468	5,808	5,476
Cash Dividends to Shareholders	(18,525)	(15,883)	(14,436)
Common Stock Repurchases	(39,861)	(6,020)	(27,611)
Distribution from (Investment in) Bank Subsidiary	50,000	(93,793)	(44,000)
Net Cash Provided (Used) by Financing Activities	26,585	13,039	(62,755)
(Decrease) Increase in Cash and Cash Equivalents	(915)	(418)	909
Cash and Cash Equivalents at Beginning of Year	1,830	2,248	1,339
Cash and Cash Equivalents at End of Year	$ 915	$ 1,830	$ 2,248

NOTE 23: SELECTED QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED)

Selected quarterly data for 1998 and 1997 follows:

(Dollars in thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1998:				
Interest Income	$ 159,199	$ 159,628	$ 152,283	$ 151,343
Interest Expense	95,802	99,977	92,640	88,599
Net Interest Income	63,397	59,651	59,643	62,744
Provision for Loan Losses	1,900	1,900	1,500	1,500
Gain on Sale of Loans, Loan Servicing and Securities, Net	3,364	9,327	1,378	4,572
Other Noninterest Income	11,962	12,483	15,016	16,061
Noninterest Expenses	45,463	62,848	45,980	43,498
Income Before Income Taxes	31,360	16,713	28,557	38,379
Income Taxes	11,639	7,313	8,474	17,118
Net Income	$ 19,721	$ 9,400	$ 20,083	$ 21,261
Net Income Per Common Share:				
Basic	$ 0.52	$ 0.25	$ 0.53	$ 0.56
Diluted	0.51	0.24	0.52	0.56

The quarter ended June 30, 1998 includes $1.5 million of provision for loan losses and $17.4 million of Eagle acquisition-related expenses.

(Dollars in thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1997:				
Interest Income	$ 131,807	$ 141,355	$ 150,508	$ 155,184
Interest Expense	72,631	78,552	85,444	91,177
Net Interest Income	59,176	62,803	65,064	64,007
Provision for Loan Losses	7,990	3,320	10,828	2,675
Gain on Sale of Loans, Loan Servicing and Securities, Net	562	471	1,363	1,539
Other Noninterest Income	8,932	9,217	9,532	10,648
Noninterest Expenses	62,059	41,898	55,370	42,336
Income (Loss) Before Income Taxes	(1,379)	27,273	9,761	31,183
Income Taxes	(1,076)	10,504	4,386	11,911
Net Income (Loss)	$ (303)	$ 16,769	$ 5,375	$ 19,272
Net Income (Loss) Per Common Share:				
Basic	$ (0.01)	$ 0.45	$ 0.14	$ 0.52
Diluted	(0.01)	0.43	0.14	0.50

The quarter ended March 31, 1997 includes $5.7 million of provision for loan losses and $19.9 million of Derby acquisition-related expenses. The quarter ended September 30, 1997 includes $1.5 million of provision for loan losses and $7.2 million of People's acquisition-related expenses.

All periods presented have been retroactively restated to reflect the inclusion of the results of Eagle, People's, MidConn and Derby, which were acquired on April 15, 1998, July 31, 1997, May 31, 1997, and January 31, 1997, respectively, and were accounted for using the pooling of interests method.

Management's Report

To Our Shareholders:

The management of Webster is responsible for the integrity and objectivity of the financial and operating information contained in this annual report, including the consolidated financial statements covered by the Independent Auditors' Report. These statements were prepared in conformity with generally accepted accounting principles and include amounts that are based on the best estimates and judgments of management.

Webster has internal controls which provide management with reasonable assurance that transactions are recorded and executed in accordance with its authorizations, that assets are properly safeguarded and accounted for, and that financial records are maintained so as to permit preparation of financial statements in accordance with generally accepted accounting principles. The internal control components include formal procedures, an organizational structure that segregates duties, and a comprehensive program of periodic audits by the internal auditors. Webster has also instituted policies which require employees to maintain the highest level of ethical standards.

In addition, the Audit Committee of the Board of Directors, consisting solely of outside directors, meets periodically with management, the internal auditors and the independent auditors to review internal controls, audit results and accounting principles and practices, and annually recommends to the Board of Directors the selection of independent auditors.

James C. Smith
Chairman and Chief Executive Officer

John V. Brennan
Executive Vice President,
Chief Financial Officer and Treasurer

Independent Auditors' Report

The Board of Directors and Shareholders of
Webster Financial Corporation
Waterbury, Connecticut

We have audited the accompanying consolidated statements of condition of Webster Financial Corporation and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 1998. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Webster Financial Corporation and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles.

KPMG LLP
Hartford, Connecticut
January 21, 1999

Corporate Headquarters
Webster Financial Corporation and Webster Bank
Webster Plaza
Waterbury, CT 06702
(203) 753-2921
www.websterbank.com

Transfer Agent and Registrar
American Stock Transfer & Trust Co.
Shareholder Services
40 Wall Street
New York, NY 10005
1-800-937-5449

Dividend Reinvestment and Stock Purchase Plan
Stockholders wishing to receive a prospectus for the Dividend Reinvestment and Stock Purchase Plan are invited to write to American Stock Transfer & Trust Co. at the address listed above, or call 1-800-278-4353.

Stock Listing Information
The common stock of Webster is traded over-the-counter on the NASDAQ National Market System under the symbol "WBST."

Investor Relations Contact:
James M. Sitro, CPA, Vice President,
Investor Relations (203) 578-2399
jsitro@websterbank.com

Form 10-K and Other Reports
Our annual report to the Securities and Exchange Commission (Form 10K), additional copies of this report, and quarterly reports may be obtained free of charge by accessing our Web site (www.websterbank.com) or by contacting James M. Sitro, CPA, Vice President, Investor Relations, Webster Plaza, Waterbury, CT 06702.

Common Stock Dividends and Market Prices
The following table shows dividends declared and the market price per share by quarter for 1998 and 1997.

	Common Stock (Per Share)			Market Price
1998	Cash Dividends Declared	Low	High	End of Period
Fourth	$ .11	$ 18 7/8	$ 28 1/8	$ 27 7/16
Third	.11	20 5/8	34 5/8	24 3/8
Second	.11	31 7/16	36 1/4	33 1/4
First	.11	28 9/16	35	34 3/4

1997	Cash Dividends Declared	Low	High	End of Period
Fourth	$ .10	$ 28 1/2	$ 33 7/8	$ 33 1/4
Third	.10	21 11/16	29 7/8	29 3/8
Second	.10	17 5/16	22 7/8	22 3/4
First	.10	17 9/16	20 11/16	17 9/16

Market Makers:
Advest, Inc.
Brean Murray, Foster Secs Inc.
First Albany Corporation
Fox-Pitt, Kelton, Inc.
Friedman, Billings, Ramsey & Co., Inc.
Herzog, Heine, Geduld, Inc.
Island System Corporation
Jeffries & Company, Inc.
Keefe, Bruyette & Woods, Inc.
Knight Securities, L.P.
Legg Mason Wood Walker Inc.
Lehman Brothers Inc.
MacAllister Pitfield MacKay
Mayer & Schweitzer Inc.
Merrill Lynch, Pierce, Fenner
Paine Webber Inc.
Rom-Bo Trading Co.
Ryan Beck & Co., Inc.
Sandler O'Neill & Partners
Sherwood Securities Corp.
Solomon Smith Barney Inc.
Troster Singer Corp.
Tucker Anthony Incorporated
USCC Trading, Div. Fleet Secs

Electronic Communications Network:
B-Trade Services
The Brass Utility, L.L.C.
Instinet Corporation
Island System Corporation
Spear, Leeds & Kellogg
Strike Technologies
Terra Nova Trading, L.L.C.

Research Coverage:
Advest, Inc.
BT Alex, Brown
Duff & Phelps Credit Rating Co.
First Albany Corporation
Fitch IBCA, Inc.
Fox-Pitt, Kelton
Friedman, Billings, Ramsey & Co., Inc.
Keefe, Bruyette & Woods, Inc.
Josephthal & Co.
JW Genesis Capital Markets
Lehman Brothers, Inc.
Merrill Lynch, Pierce, Fenner
Sandler O'Neil & Partners
Standard and Poor's
Tucker Anthony Incorporated
Value Line

Annual Meeting

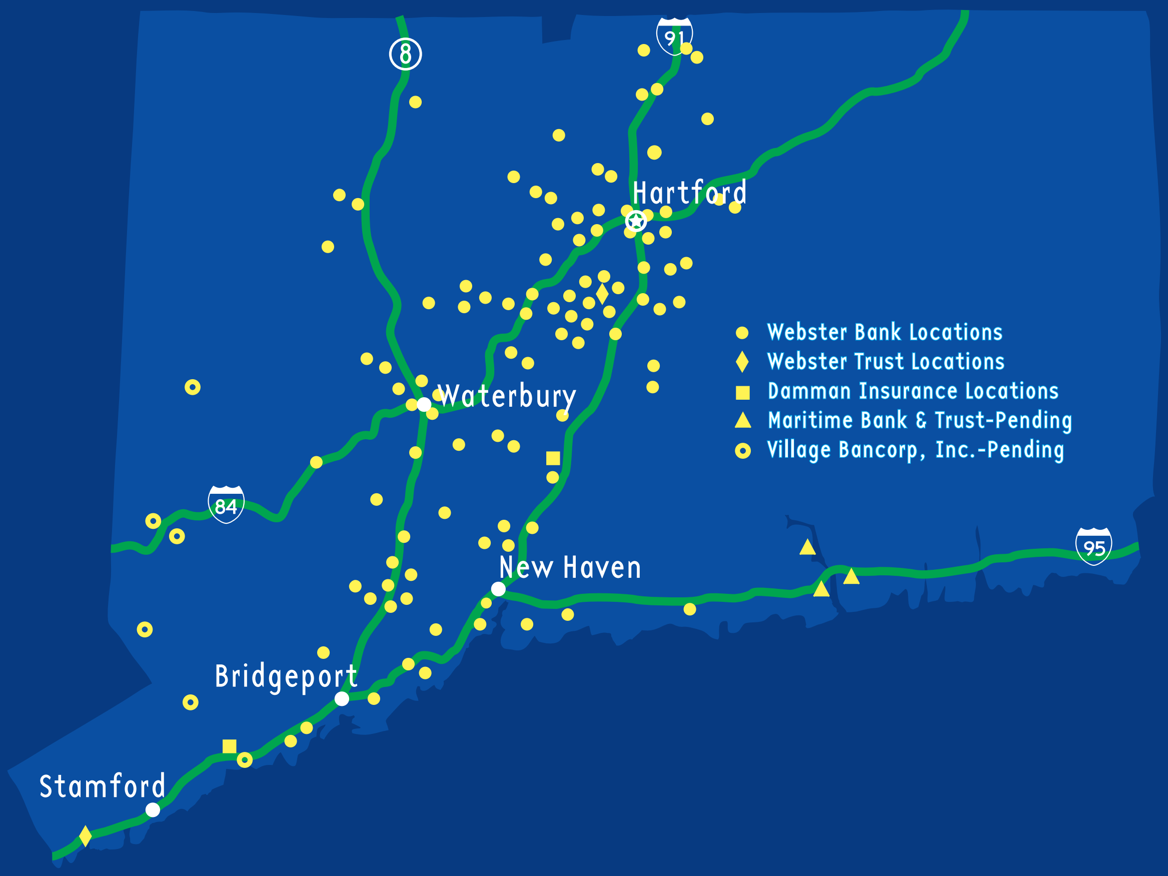
The annual meeting of shareholders of Webster Financial Corporation will be held on April 22, 1999 at 4:00 P.M. at the Courtyard by Marriott, 63 Grand Street, Waterbury, Connecticut. As of February 28, 1999 there were 36,056,462 shares of common stock outstanding and approximately 6,997 shareholders of record.

Webster Bank Information

For more information on Webster Bank products and services, call 1-800-325-2424, or write:

Webster Bank
Telebanking Center
P.O. Box 191
CH420
Waterbury, Connecticut 06720-0191
www.websterbank.com

Webster Bank Locations



Ansonia
Avon
Berlin
Bethany
Bloomfield
Branford
Bristol
Canton
Cheshire
Cromwell
Danbury
Derby
East Hartford
East Haven
East Windsor
Enfield
Essex
Fairfield
Farmington
Forestville
Glastonbury
Greenwich
Guilford
Hamden
Hartford
Kensington
Litchfield
Madison
Manchester
Meriden
Middletown
Milford
Naugatuck
New Britain
New Haven
New Milford
Newington
North Haven
Old Lyme
Old Saybrook
Orange
Oxford
Plainville
Prospect
Ridgefield
Rocky Hill
Seymour
Shelton
Simsbury
Southbury
Southington
Stratford
Suffield
Terryville
Torrington
Trumbull
Wallingford
Waterbury
Watertown
West Hartford
West Haven
Westport
Wethersfield
Wilton
Windsor
Windsor Locks
Winsted

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WEBSTER FINANCIAL
CORPORATION