WEBSTER FINANCIAL CORP
Form 10-Q
August 04, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2006.

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 001-31486
WEBSTER FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**06-1187536**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Webster Plaza, Waterbury, Connecticut	**06702**
(Address of principal executive offices)	(Zip Code)

(203) 465-4329
(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The number of shares of common stock outstanding as of July 31, 2006 was 52,547,456.

INDEX

EX-32.2: CERTIFICATION

2

Table of Contents

ITEM 1. INTERIM FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CONDITION (unaudited)

(In thousands, except share and per share data)	June 30, 2006	December 31, 2005
Assets:		
Cash and due from depository institutions	$ 327,622	$ 293,706
Short-term investments	59,666	36,302
Securities: (Notes 4 and 13)		
Trading, at fair value	2,698	2,257
Available for sale, at fair value	2,317,645	2,555,419
Held-to-maturity (fair value of $1,049,433 and $1,132,223)	1,088,206	1,142,909
Loans held for sale (Notes 5 and 15)	275,240	267,919
Loans, net (Notes 6 and 7)	12,563,126	12,138,800
Accrued interest receivable	85,719	85,779
Goodwill and other intangible assets (Note 8)	695,014	698,570
Cash surrender value of life insurance	242,740	237,822
Premises and equipment	188,125	182,856
Deferred tax asset (Note 9)	57,963	55,313
Prepaid expenses and other assets	118,378	138,910
Total assets	$18,022,142	$17,836,562
Liabilities and Shareholders Equity:		
Deposits (Note 10)	$12,216,465	$11,631,145
Federal Home Loan Bank advances (Note 11)	1,804,140	2,214,010
Securities sold under agreements to repurchase and other short-term debt (Note 12)	1,528,224	1,522,381
Other long-term debt	622,267	640,906
Reserve for unfunded credit commitments (Note 7)	9,070	9,146
Accrued expenses and other liabilities	187,445	162,171
Total liabilities	16,367,611	16,179,759
Preferred stock of subsidiary corporation	9,577	9,577
Commitments and contingencies (Notes 5 and 6)		
Shareholders equity (Note 13):		
Common stock, $.01 par value;		
Authorized 200,000,000 shares at June 30, 2006 and December 31, 2005		
Issued 54,132,503 shares at June 30, 2006 and 54,117,218 shares at December 31, 2005	541	541
Paid-in capital	622,502	619,644
Retained earnings	1,135,285	1,075,984
	(70,918)	(21,065)

Less: Treasury stock, at cost; 1,522,021 shares at June 30, 2006 and 455,426 shares at December 31, 2005		
Accumulated other comprehensive loss	(42,456)	(27,878)
Total shareholders equity	1,644,954	1,647,226
Total liabilities and shareholders equity	$18,022,142	$17,836,562

See accompanying Notes to Consolidated Interim Financial Statements.

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(In thousands, except per share data)	Three months ended June 30, 2006	Three months ended June 30, 2005	Six months ended June 30, 2006	Six months ended June 30, 2005
Interest Income:				
Loans	$207,097	166,967	$402,671	325,754
Securities and short-term investments	39,134	42,684	80,729	83,583
Loans held for sale	3,317	2,964	6,656	5,696
Total interest income	249,548	212,615	490,056	415,033
Interest Expense:				
Deposits (Note 10)	72,593	44,099	134,947	79,967
Federal Home Loan Bank advances and other borrowings	37,937	28,032	74,263	56,162
Other long-term debt	12,213	10,649	23,882	20,837
Total interest expense	122,743	82,780	233,092	156,966
Net interest income	126,805	129,835	256,964	258,067
Provision for credit losses (Note 7)	3,000	2,000	5,000	5,500
Net interest income after provision for credit losses	123,805	127,835	251,964	252,567
Noninterest Income:				
Deposit service fees	24,150	21,747	46,019	40,876
Insurance revenue	9,988	10,562	20,712	22,364
Loan related fees	9,162	7,274	16,986	16,203
Wealth and investment services	6,930	6,028	13,284	11,423
Gain on sale of loans and loan servicing, net	2,538	3,012	5,811	5,548
Increase in cash surrender value of life insurance	2,314	2,302	4,685	4,540
Gain on sale of securities, net	702	710	1,714	1,466
Other income	1,284	2,013	3,059	4,256
Total noninterest income	57,068	53,648	112,270	106,676
Noninterest Expenses:				
Compensation and benefits	64,585	57,854	129,588	115,756
Occupancy	11,824	10,810	24,006	21,669
Furniture and equipment	13,962	11,611	27,557	22,409
Intangible assets amortization (Note 8)	3,544	5,009	7,921	9,911
Marketing	4,292	3,664	7,916	6,947
Professional services	3,464	3,972	7,008	7,742
Conversion and infrastructure costs		3,506		4,640
Other expenses	15,647	17,079	32,493	32,205

Total noninterest expenses	117,318	113,505	236,489	221,279
Income before income taxes	63,555	67,978	127,745	137,964
Income taxes	20,412	21,720	40,750	44,211
Net Income	$ 43,143	46,258	$ 86,995	93,753

See accompanying Notes to Consolidated Interim Financial Statements.

4

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME (unaudited), continued

(In thousands, except per share data)	Three months ended June 30, 2006	2005	Six months ended June 30, 2006	2005
Net income	$43,143	46,258	$86,995	93,753
Basic earnings per share	$ 0.82	0.86	$ 1.65	1.75
Diluted earnings per share	0.81	0.85	1.63	1.73
Dividends paid per common share	0.27	0.25	0.52	0.48
Average shares outstanding:				
Basic	52,637	53,618	52,864	53,594
Diluted	53,252	54,278	53,468	54,244

Table of Contents

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

	Three months ended June 30,	
(In thousands)	**2006**	**2005**
Net Income	$43,143	46,258
Other comprehensive (loss) income, net of tax:		
Unrealized net holding (loss) gain on securities available for sale arising during period (net of tax effect of $(2,820) and $6,723 for 2006 and 2005, respectively)	(5,237)	12,629
Reclassification adjustment for net security gains included in net income (net of tax effect of $(285) and $(232) for 2006 and 2005, respectively)	(528)	(427)
Reclassification adjustment for cash flow hedge gain amortization included in net income	(42)	(42)
Reclassification adjustment for amortization of unrealized loss upon transfer of securities to held to maturity (net of tax effect of $86 and $149 for 2006 and 2005, respectively)	160	276
Other comprehensive (loss) income	(5,647)	12,436
Comprehensive income	$37,496	58,694

	Six months ended June 30,	
(In thousands)	**2006**	**2005**
Net Income	$ 86,995	93,753
Other comprehensive loss, net of tax:		
Unrealized net holding loss on securities available for sale arising during period (net of tax effect of $(7,408) and $(3,128) for 2006 and 2005, respectively)	(13,755)	(5,661)
Reclassification adjustment for net security gains included in net income (net of tax effect of $(581) and $(485) for 2006 and 2005, respectively)	(1,079)	(902)
Reclassification adjustment for cash flow hedge gain amortization included in net income	(84)	(84)
Reclassification adjustment for amortization of unrealized loss upon transfer of securities to held to maturity (net of tax effect of $184 and $256 for 2006 and 2005, respectively)	340	475
Other comprehensive loss	(14,578)	(6,172)
Comprehensive income	$ 72,417	87,581

See accompanying Notes to Consolidated Interim Financial Statements.

Table of Contents

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (unaudited)

(In thousands, except per share data)	Common Stock	Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total
Six months ended June 30, 2005:						
Balance, December 31, 2004	$536	605,696	942,830	(547)	(4,541)	1,543,974
Net income for the six months ended June 30, 2005			93,753			93,753
Dividends paid: $.48 per common share			(25,810)			(25,810)
Exercise of stock options	3	2,861				2,864
Tax benefit from stock options exercised		1,428				1,428
Common stock repurchased				(4,699)		(4,699)
Stock-based compensation expense		2,502		2,633		5,135
Net unrealized loss on securities available for sale, net of taxes					(6,563)	(6,563)
Amortization of deferred hedging gain					(84)	(84)
Amortization of unrealized loss on securities transferred to held to maturity, net of taxes					475	475
Employee Stock Purchase Plan		438				438
Balance at June 30, 2005	$539	612,925	1,010,773	(2,613)	(10,713)	1,610,911
Six months ended June 30, 2006:						
Balance, December 31, 2005	$541	619,644	1,075,984	(21,065)	(27,878)	1,647,226
Net income for the six months ended June 30, 2006			86,995			86,995
Dividends paid: $.52 per common share			(27,694)			(27,694)
Exercise of stock options		(1,274)		2,747		1,473
Tax benefit from stock options exercised		412				412
Common stock repurchased				(53,542)		(53,542)
Stock-based compensation expense		3,228		942		4,170
Net unrealized loss on securities available for sale, net of taxes					(14,834)	(14,834)
Amortization of deferred hedging gain					(84)	(84)
Amortization of unrealized loss on securities transferred to held to maturity, net of taxes					340	340
Employee Stock Purchase Plan		492				492
Balance at June 30, 2006	$541	622,502	1,135,285	(70,918)	(42,456)	1,644,954

See accompanying Notes to Consolidated Interim Financial Statements.

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(In thousands)	Six months ended June 30, 2006	2005
Operating Activities:		
Net income	$ 86,995	93,753
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	5,000	5,500
Depreciation and amortization	18,631	9,890
Amortization of intangible assets	7,921	9,911
Stock-based compensation	4,170	5,135
Net gain on sale of foreclosed properties	(36)	(17)
Net gain on sale of securities	(1,714)	(1,387)
Net gain on sale of loans and loan servicing	(5,811)	(5,548)
Increase in cash surrender value of life insurance	(4,685)	(4,540)
Net gain on trading securities	(154)	(79)
Increase in trading securities	(287)	(1,329)
Loans originated for sale	(774,301)	(859,732)
Proceeds from sale of loans originated for sale	772,791	767,317
Decrease (increase) in interest receivable	60	(3,037)
Decrease (increase) in prepaid expenses and other assets	17,594	(21,088)
Increase (decrease) in accrued expenses and other liabilities	3,202	(76,718)
Proceeds from surrender of life insurance contracts		792
Company contribution to stock purchased by the Employee Stock Purchase Plan	492	438
Net cash provided by (used in) operating activities	129,868	(80,739)
Investing Activities:		
Purchases of available for sale securities	(37,710)	(511,125)
Purchases of held to maturity securities	(9,818)	(42,556)
Proceeds from maturities and principal payments of available for sale securities	195,632	208,099
Proceeds from maturities and principal payments of held to maturity securities	64,341	75,736
Proceeds from sales of available for sale securities	58,653	139,428
Net (increase) decrease in short-term investments	(23,364)	113,017
Net increase in loans	(438,320)	(2,084)
Proceeds from sale of foreclosed properties	4,260	1,262
Net purchases of premises and equipment	(20,317)	(30,678)
Net cash paid for acquisitions		(27,846)
Net cash used in investing activities	(206,643)	(76,747)
Financing Activities:		
Net increase in deposits	585,320	810,705
Proceeds from FHLB advances	32,330,921	17,962,500

Repayment of FHLB advances	(32,734,200)	(18,421,065)
Net increase (decrease) in federal funds purchased and securities sold under agreement to repurchase	8,001	(84,886)
Repayment of other long-term debt		(10,000)
Cash dividends to common shareholders	(27,694)	(25,810)
Exercise of stock options	1,885	4,292
Common stock repurchased	(53,542)	(4,699)
Net cash provided by financing activities	110,691	231,037
Increase in cash and cash equivalents	33,916	73,551
Cash and cash equivalents at beginning of period	293,706	248,825
Cash and cash equivalents at end of period	$ 327,622	322,376

See accompanying Notes to Consolidated Interim Financial Statements.

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited), continued

(In thousands)	Six months ended June 30, 2006	2005
Supplemental Disclosures:		
Income taxes paid	$ 19,924	$ 45,697
Interest paid	231,151	161,881
Supplemental Schedule of Noncash Investing and Financing Activities:		
Transfer of loans to foreclosed properties	$ 801	$ 546
Purchase Transactions:		
Fair value of noncash assets acquired	$	$235,693
Fair value of liabilities assumed		210,786
Sale Transactions:		
Fair value of noncash assets sold	$	$105,656
Fair value of liabilities sold		56,237

See accompanying Notes to Consolidated Interim Financial Statements.

NOTE 1: Basis of Presentation and Principles of Consolidation

The Consolidated Interim Financial Statements include the accounts of Webster Financial Corporation (Webster or the Company) and its subsidiaries. The Consolidated Interim Financial Statements and Notes thereto have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant inter-company transactions have been eliminated in consolidation. Amounts in prior period financial statements are reclassified whenever necessary to conform to current period presentations. The results of operations for the six months ended June 30, 2006 are not necessarily indicative of the results which may be expected for the year as a whole.

The preparation of the Consolidated Interim Financial Statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, as of the date of the Consolidated Interim Financial Statements, and the reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates. Material estimates that are susceptible to near-term changes include the determination of the allowance for credit losses and the valuation allowance for the deferred tax asset. These Consolidated Interim Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto included in Webster s Annual Report on Form 10-K for the year ended December 31, 2005.

NOTE 2: Share-Based Compensation

Webster has a share-based compensation plan (the Plan) that covers employees and directors and a Director Retainer Fees Plan for non-employee directors (collectively, the Plans). The compensation cost that has been included in compensation and benefits expense for the Plans totaled $2.1 million and $2.3 million for the three months ended June 30, 2006 and 2005, respectively, and $4.3 million and $4.4 million for the six months ended June 30, 2006 and 2005, respectively. The total income tax benefit recognized in the Consolidated Statements of Income for share-based compensation arrangements was $.7 million for both of the three month periods ended June 30, 2006 and 2005 and $1.4 million for both of the six month periods ended June 30, 2006 and 2005.

The Plan, which is shareholder-approved, permits the grant of incentive and nonqualified stock options, restricted stock and stock appreciation rights (SARS) to employees and directors for up to 6.7 million shares of common stock. Webster believes that such awards better align the interests of its employees with those of its shareholders. Option awards are granted with an exercise price equal to the market price of Webster s stock at the date of grant and vest over periods ranging from three to four years. These options grant the holder the right to acquire a share of Webster common stock for each option held and have a contractual life of ten years.

During the six month period ended June 30, 2006, there were 1,052 restricted common shares granted to senior management, which vest over a period ranging from one to three years. No restricted common shares were granted during the second quarter of 2006. The Plan also permits performance-based restricted stock awards. These performance-based awards vest after three years in a range from zero to 200% of the target number of shares under the grant, dependent upon Webster s ranking for total shareholder return among a blended peer group of companies in the S&P Midcap 400 Financial Services Subset index and the KBW 50 index. During the six month period ended June 30, 2006, there were no performance-based restricted stock awards granted while during 2005, two executive officers received performance-based restricted stock awards.

The Director Retainer Fees Plan provides non-employee directors with restricted shares for a portion of their annual retainer for services rendered as directors. During the three and six month periods ended June 30, 2006, 4,806 shares were granted to directors. The grant-date fair value of restricted share awards to directors and management under the Plans is amortized to noninterest expense over the service vesting period and such expense is reflected in compensation and benefits expense.

Table of Contents

On January 1, 2006, Webster adopted the provisions of SFAS No. 123 (R), *Share-Based Payment*, which requires compensation cost relating to share-based payment transactions to be recognized in the financial statements, based upon the fair value of the instruments issued. SFAS No. 123 (R) covers a wide range of share-based compensation arrangements including share options, restricted stock plans, performance-based awards, share appreciation rights and employee purchase plans. SFAS No. 123 (R) replaces SFAS No. 123, which established as preferable a fair value based method of accounting for share-based compensation with employees, but permitted the option of continuing to apply the guidance of APB Opinion No. 25, as long as the notes to the financial statements disclosed the effects of the preferable fair value method. Since Webster adopted the provisions of SFAS No. 123, effective January 1, 2002, the adoption of SFAS No. 123 (R) as of January 1, 2006 did not have a material impact on Webster s Consolidated Financial Statements.

The fair value of each option award is estimated on the date of grant using the Black-Scholes Option-Pricing Model. The weighted-average assumptions used for options granted during the three and six months ended June 30, 2006 and 2005 are noted in the following table. Webster uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the date of grant.

Weighted Average Assumptions

	Three months ended June 30,		**Six months ended June 30,**	
	2006	**2005**	**2006**	**2005**
Expected term (years)	6.07	8.24	6.07	7.87
Expected dividend yield	2.25%	2.00	2.25%	2.00
Expected volatility	25.69	36.96	25.69	35.78
Expected forfeiture rate	5.00	5.00	5.00	5.00
Risk-free interest rate	4.83	4.20	4.83	4.20
Fair value of options granted	$12.72	17.15	$12.72	21.47

A summary of option activity under the Plans as of June 30, 2006, and changes during the six months then ended, is presented below:

	Number	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term (in years)**	**Aggregate Intrinsic Value (in thousands)**
Options outstanding at beginning of the period	3,256,967	$35.22		
Options granted	41,562	47.92		
Options exercised	(59,372)	24.86		
Options forfeited	(14,027)	43.19		
Options expired	(5,979)	25.29		
Options outstanding at end of the period	3,219,151	$35.55	5.5	$ 39,166

Options exercisable at end of the period	2,390,930	$31.81	4.5	$ 37,592

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between Webster s closing stock price on the last trading day of the second quarter of 2006 and the weighted-average exercise price, multiplied by the number of shares) that would have been received by the option holders had all option holders exercised their options on June 30, 2006. The aggregate intrinsic value fluctuates based on changes in the fair market value of Webster s stock.

The total intrinsic value of options exercised during the three month periods ended June 30, 2006 and 2005 was $0.4 million and $0.5 million, respectively, and $1.4 million and $6.3 million for the six month periods ended June 30, 2006 and 2005, respectively.

Table of Contents

The following table summarizes information about options outstanding and options exercisable at June 30, 2006:

		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
$15.01	20.00	102,351	0.7	$18.77	102,351	$18.77
20.01	25.00	601,257	4.1	23.12	601,257	23.12
25.01	30.00	349,576	4.7	28.99	349,576	28.99
30.01	35.00	917,640	3.7	33.61	836,228	33.52
35.01	40.00	137,725	6.0	37.49	133,600	37.49
40.01	45.00	112,468	8.5	43.88	74,366	43.85
45.01	50.00	995,134	8.3	47.63	292,352	47.01
50.01	51.31	3,000	8.0	51.04	1,200	51.14
		3,219,151	5.5	$35.55	2,390,930	$31.81

The following table summarizes Webster s restricted stock activity for the six months ended June 30, 2006:

	Number of Shares	Weighted-Average Grant Date Fair Value
Restricted stock at beginning of the period	259,167	$44.37
Granted	27,486	47.66
Vested	18,354	39.86
Forfeited	4,237	36.13
Restricted stock at end of the period	264,062	$45.17

As of June 30, 2006, there was $13.6 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 2.4 years. The fair value of shares that vested during the six month periods ending June 30, 2006 and 2005 were $488,000 and $792,000, respectively.

NOTE 3: Purchase and Sale Transactions

On April 25, 2006, Webster announced a definitive agreement to acquire NewMil Bancorp, Inc. (NewMil), headquartered in New Milford, Connecticut, in a deal valued at approximately $172.5 million whereby NewMil shareholders will receive $41 in Webster common stock for each NewMil share of common stock, subject to a floating exchange rate. NewMil is the holding company for NewMil Bank, a state-chartered savings bank with $873.0 million in assets, $492.8 million in loans and $616.0 in deposits at December 31, 2005 and 20 branches in Connecticut. Webster will acquire NewMil through a tax-deferred, stock-for-stock exchange of all of the outstanding shares of NewMil s common stock. The transaction is expected to close in the fourth quarter of 2006.

Table of Contents

NOTE 4: Securities
A summary of trading, available for sale and held to maturity securities follows:

	June 30, 2006				December 31, 2005			
(In thousands)	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**
Trading:								
Municipal bonds and notes				$ 2,698				$ 2,257
Available for Sale:								
Corporate bonds and notes	$ 155,493	3,238	(1,202)	157,529	$ 197,101	5,384	(1,162)	201,323
Equity securities (a)	233,707	7,390	(861)	240,236	223,043	5,542	(559)	228,026
Mortgage-backed securities	1,991,807		(71,927)	1,919,880	2,176,121	27	(50,078)	2,126,070
Total available for sale	$2,381,007	10,628	(73,990)	2,317,645	$2,596,265	10,953	(51,799)	2,555,419
Held to maturity:								
Municipal bonds and notes	$ 402,474	3,350	(3,484)	402,340	$ 401,112	8,237	(1,011)	408,338
Mortgage-backed securities	685,732		(38,639)	647,093	741,797		(17,912)	723,885
Total held to maturity	$1,088,206	3,350	(42,123)	1,049,433	$1,142,909	8,237	(18,923)	$1,132,223

(a) As of June 30, 2006, the fair value of equity securities consisted of FHLB stock of $134.1 million, FRB stock of $36.3 million, common stock of $49.6 million and preferred stock of $20.2 million. The fair value of equity securities at December 31, 2005 consisted of FHLB stock of $133.4 million, FRB stock of $36.3 million, common stock of $38.4 million and preferred stock of $19.9 million.

The following table identifies temporarily impaired investment securities as of June 30, 2006 segregated by length of time the securities had been in a continuous unrealized loss position.

	Less Than Twelve Months		Twelve Months or Longer		Total	
(In thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Available for Sale:						
Corporate bonds and notes	$ 18,479	(145)	27,376	(1,057)	45,855	(1,202)
Equity securities	6,457	(172)	3,945	(459)	10,402	(631)
Mortgage-backed securities	100,449	(2,426)	1,819,431	(69,501)	1,919,880	(71,927)
Total available for sale	$125,385	(2,743)	1,850,752	(71,017)	1,976,137	(73,760)
Held to maturity:						
Municipal bonds and notes	$185,512	(2,776)	20,790	(708)	206,302	(3,484)
Mortgage-backed securities			647,093	(38,639)	647,093	(38,639)
Total held to maturity	$185,512	(2,776)	667,883	(39,347)	853,395	(42,123)
Total securities	$310,897	(5,519)	2,518,635	(110,364)	2,829,532	(115,883)

Table of Contents

The following table identifies temporarily impaired investment securities as of December 31, 2005 segregated by length of time the securities had been in a continuous unrealized loss position.

	Less Than Twelve Months		Twelve Months or Longer		Total	
(In thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Available for sale:						
Corporate bonds and notes	$ 8,678	(431)	15,353	(731)	24,031	(1,162)
Equity securities	22,601	(133)	3,979	(426)	26,580	(559)
Mortgage-backed securities	688,628	(10,475)	1,426,055	(39,603)	2,114,683	(50,078)
Total available for sale	719,907	(11,039)	1,445,387	(40,760)	2,165,294	(51,799)
Held to maturity:						
Municipal bonds and notes	62,907	(589)	15,851	(422)	78,758	(1,011)
Mortgage-backed securities	522,006	(12,576)	201,879	(5,336)	723,885	(17,912)
Total held to maturity	584,913	(13,165)	217,730	(5,758)	802,643	(18,923)
Total securities	$1,304,820	(24,204)	1,663,117	(46,518)	2,967,937	(70,722)

Unrealized losses on fixed income securities result from the cost basis of securities being greater than current market value. This will generally occur as a result of an increase in interest rates since the time of purchase, a structural change in an investment or from deterioration in credit quality of the issuer. Management has and will continue to evaluate impairments, whether caused by adverse interest rate or credit movements, to determine if they are other-than-temporary.

In accordance with applicable accounting literature, Webster must demonstrate an ability and intent to hold impaired securities until full recovery of their cost basis. Management uses both internal and external information sources to arrive at the most informed decision. This quantitative and qualitative assessment begins with a review of general market conditions and changes to market conditions, credit, investment performance and structure since the prior review period. The ability to hold the impaired securities will involve a number of factors, including: forecasted recovery period based on average life; whether its return provides satisfactory carry relative to funding sources; Webster s capital, earnings and cash flow positions; and compliance with various debt covenants, among other things. Webster currently has the ability to and intends to hold all temporarily impaired securities to full recovery, which may be until maturity.

Estimating the recovery period for equity securities will include analyst forecasts, earnings assumptions and other company specific financial performance metrics. In addition, this assessment will incorporate general market data, industry and sector cycles and related trends to determine a reasonable recovery period.

Webster s determination of impairment at June 30, 2006 began with a recognition that market yields increased during 2005 through the first half of 2006, reflecting the impact of seventeen interest rate increases of 25 basis points, or 425 basis points in total, by the Federal Reserve from June 2004 through June 2006.

At June 30, 2006, Webster had $2.5 billion of impaired securities with an unrealized loss of $110.4 million for twelve months or longer. These securities have had varying levels of unrealized loss due to higher interest rates subsequent to their purchase. Approximately 63.0 percent of that unrealized loss, or $69.5 million, was concentrated in mortgage-backed securities available for sale totaling $1.9 billion in fair value. These securities carry AAA ratings or Agency-implied AAA credit ratings and are currently performing as expected. Management does not consider these investments to be other-than-temporarily impaired and Webster has the ability and intent to hold these investments to full recovery of the cost basis. Management expects that recovery of temporarily impaired available for sale mortgage-backed securities will occur over the weighted-average estimated remaining life of these securities. Market-accepted pricing and prepayment models are used to project the estimated average life, which for this group of securities is presently estimated to be 3.3 years. Further, the majority of these securities are hybrid adjustable rate mortgage-backed securities, which tend to prepay faster than similar coupon fixed-rate mortgage-backed securities and, as the collateral loans approach their interest rate reset dates, management expects the securities to trade at par or at a premium when fully indexed.

Table of Contents

Available for sale corporate securities totaling $27.4 million at June 30, 2006, with an unrealized loss of $1.1 million, were impaired for twelve consecutive months or longer due to higher interest rates subsequent to their purchase. Several corporate securities are unrated, but have undergone an internal credit review. The remaining securities are a mix of investment grade and below investment grade bonds. As a result of the credit review of the issuers, management has determined that there has been no deterioration in credit quality subsequent to purchase or last review period. These securities are currently performing as projected. Management does not consider these investments to be other-than-temporarily impaired based on experience with these types of investments. Webster has the ability and intent to hold these investments to full recovery of the cost basis. Management expects recovery of temporarily impaired available for sale corporate securities over their weighted-average estimated remaining life, which is presently estimated to be 1.7 years.

Held to maturity mortgage-backed securities totaling $647.1 million at June 30, 2006, with an unrealized loss of $38.6 million, were impaired for twelve consecutive months or longer due to higher interest rates subsequent to their purchase. These securities carry AAA ratings or Agency-implied AAA credit ratings and are currently performing as expected. Management does not consider these investments to be other-than-temporarily impaired. Webster has the ability and intent to hold these investments to full recovery of the cost basis. Management expects that recovery of temporarily impaired held to maturity mortgage-backed securities will occur over the weighted-average estimated remaining life of these securities. Management uses market-accepted pricing and prepayment models to project the estimated average life, which for this group of securities is presently estimated to be 4.4 years. Further, this group of securities continues to record acceptable levels of prepayments monthly at par, which reduces the amount of fair value and unrealized loss accordingly.

Held to maturity municipal securities totaling $20.8 million at June 30, 2006, with an unrealized loss of $0.7 million, were impaired for twelve consecutive months or longer due to higher interest rates subsequent to their purchase. Most of these bonds are insured AAA rated general obligation bonds with stable ratings. There were no credit downgrades since the last review period. These securities are currently performing as anticipated. Management does not consider these investments to be other-than-temporarily impaired. Webster has the ability and intent to hold these investments to full recovery of the cost basis. Management expects recovery of temporarily impaired held to maturity municipal securities over their weighted-average estimated remaining life, which is presently estimated to be 10.8 years.

Available for sale equity securities totaling $3.9 million at June 30, 2006, with an unrealized loss of $0.5 million, were impaired for twelve consecutive months or longer. Most of Webster s equity holdings are issuers in the financial services industry, which is experiencing performance pressures from a flatter yield curve and slowing mortgage originations. The severity of the impairment is consistent with those market developments. Management believes the declines in price have stabilized and the securities are not other-than-temporarily impaired. Based on our internal evaluation and analyst forecasts of future company trends and performance, management believes that Webster has the ability and intent to hold these securities to full recovery of the cost basis.

The unrealized losses of $5.5 million for less than twelve months at June 30, 2006 are attributable to factors similar to those described above for unrealized losses greater than twelve months.

There were no impairment write-downs of securities during the first half of 2006 or 2005.

Table of Contents

NOTE 5: Loans Held for Sale

Loans held for sale totaled $275.2 million and $267.9 million at June 30, 2006 and December 31, 2005, respectively. Included in the June 30, 2006 balance are approximately $1.7 million in consumer loans. Included in the December 31, 2005 balance are approximately $3.2 million in commercial loans and $2.2 million in consumer loans. The remainder of the loans held for sale at June 30, 2006 and December 31, 2005 are residential mortgages.

At June 30, 2006 and December 31, 2005, residential mortgage origination commitments totaled $302.2 million and $137.2 million, respectively. Residential commitments outstanding at June 30, 2006 consisted of adjustable rate and fixed rate mortgages of $20.0 million and $282.2 million, respectively, at rates ranging from 1.3% to 13.3%. Residential commitments outstanding at December 31, 2005 consisted of adjustable rate and fixed rate mortgages of $14.8 million and $122.4 million, respectively, at rates ranging from 1.0% to 12.3%. Commitments to originate loans generally expire within 60 days. At June 30, 2006 and December 31, 2005, Webster also had outstanding commitments to sell residential mortgage loans of $521.8 million and $343.0 million, respectively. See Note 15 for a further discussion of loan origination and sale commitments.

NOTE 6: Loans, Net

A summary of loans, net follows:

(In thousands)	**June 30, 2006**		**December 31, 2005**	
	Amount	%	Amount	%
Residential mortgage loans	$ 4,875,134	38.4%	$ 4,828,564	39.3%
Commercial loans:				
Commercial non-mortgage	1,571,941	12.4	1,435,512	11.7
Asset-based lending	736,583	5.8	661,234	5.4
Equipment financing	851,676	6.7	779,782	6.3
Total commercial loans	3,160,200	24.9	2,876,528	23.4
Commercial real estate	1,819,635	14.3	1,808,494	14.7
Consumer loans:				
Home equity credit loans	2,822,521	22.2	2,736,274	22.3
Other consumer	33,037	0.2	35,426	0.3
Total consumer loans	2,855,558	22.4	2,771,700	22.6
Total loans	12,710,527	100.0%	12,285,286	100.0%
Less: allowance for loan losses	(147,401)		(146,486)	
Loans, net	$ 12,563,126		$ 12,138,800	

At June 30, 2006, total loans included $23.7 million of net premiums and $43.3 million of net deferred costs, compared with $24.5 million of net premiums and $36.9 million of net deferred costs at December 31, 2005. The unadvanced portions of closed loans totaled $528.7 million and $547.5 million at June 30, 2006 and December 31, 2005, respectively.

At June 30, 2006 and December 31, 2005, unused portions of home equity credit lines extended were $2.0 billion and $1.7 billion, respectively. Unused commercial lines of credit, letters of credit, standby letters of credit, equipment financing commitments and outstanding commercial loan commitments totaled $3.1 billion at June 30, 2006 and $3.4 billion at December 31, 2005. Consumer loan commitments totaled $72.4 million and $83.2 million at June 30, 2006 and December 31, 2005, respectively.

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 include commitments to extend credit and commitments to sell residential first mortgage loans and commercial loans. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the Consolidated Statements of Condition.

Table of Contents

The estimated fair value of commitments to extend credit is considered insignificant at June 30, 2006 and December 31, 2005. Future loan commitments represent residential and commercial mortgage loan commitments, commercial loan and equipment financing commitments, letters of credit and commercial and home equity unused credit lines. The interest rates for these loans are generally established shortly before closing. The interest rates on home equity lines of credit adjust with changes in the prime rate.

A majority of the outstanding letters of credit are performance standby letters of credit within the scope of FASB Interpretation No. (FIN) 45. These are irrevocable undertakings by Webster, as guarantor, to make payments in the event a specified third party fails to perform under a nonfinancial contractual obligation. Most of the performance standby letters of credit arise in connection with lending relationships and have a term of one year or less.

The risk involved in issuing stand-by letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet products. At June 30, 2006, Webster s standby letters of credit totaled $190.1 million. At June 30, 2006, the fair value of stand-by letters of credit is not material to the unaudited interim financial statements.

NOTE 7: Allowance for Credit Losses

The allowance for credit losses is maintained at a level adequate to absorb probable losses inherent in the loan portfolio and in unfunded credit commitments. This allowance is increased by provisions charged to operating expense and by recoveries on loans previously charged-off and reduced by charge-offs on loans.

The following table provides a summary of activity in the allowance for credit losses:

	Three months ended June 30,		**Six months ended June 30,**	
(Dollars in thousands)	**2006**	**2005**	**2006**	**2005**
Balance at beginning of period	$155,957	152,519	$155,632	150,112
Provisions charged to operations	3,000	2,000	5,000	5,500
Subtotal	158,957	154,519	160,632	155,612
Charge-offs	(3,079)	(1,811)	(5,145)	(4,275)
Recoveries	593	2,114	984	3,485
Net (charge-offs) recoveries	(2,486)	303	(4,161)	(790)
Balance at end of period	$156,471	154,822	$156,471	154,822

(In thousands)	**June 30, 2006**	**June 30, 2005**
Components:		
Allowance for loan losses	$147,401	154,822
Reserve for unfunded credit commitments[1]	9,070	
Allowance for credit losses	$156,471	154,822
Net loan charge-offs (recoveries) as a percentage of average total loans[2]	0.08%	(0.01)
Allowance for loan losses as a percentage of total loans	1.16	1.31

Allowance for credit losses as a percentage of total loans	1.23	1.31

(1) Effective December 31, 2005, Webster transferred the portion of the allowance for loan losses related to commercial and consumer lending commitments and letters of credit to the reserve for unfunded credit commitments. This reserve amounted to $9.1 million at December 31, 2005.

(2) Net loan charge-offs (recoveries) as a percentage of average loans is calculated using the annualized current quarter charge off amount divided by the current quarter average.

Table of Contents

NOTE 8: Goodwill and Other Intangible Assets

The following tables set forth the carrying values of goodwill and other intangible assets, net of accumulated amortization:

(In thousands)	June 30, 2006	December 31, 2005
Balances not subject to amortization:		
Goodwill	$647,217	642,889
Pension assets	1,881	1,844
Balances subject to amortization:		
Core deposit intangibles	39,645	47,227
Other identified intangibles	6,271	6,610
Total goodwill and other intangible assets	$695,014	698,570

Changes in the carrying amount of goodwill for the six months ended June 30, 2006 are as follows:

(In thousands)	Retail Banking	Commercial Banking	Total
Balance at December 31, 2005	$611,378	31,511	642,889
Purchase price adjustments	(504)	4,832	4,328
Balance at June 30, 2006	$610,874	36,343	647,217

The addition to the Commercial Banking goodwill is due to a final year earn out of contingent consideration related to an earlier acquisition.

Amortization of intangible assets for the six months ended June 30, 2006, totaled $7.9 million. Estimated annual amortization expense of current intangible assets with finite useful lives, absent any impairment or change in estimated useful lives, is summarized below.

(In thousands)	
For years ending December 31,	
2006 (full year)	$14,085
2007	9,441
2008	5,000
2009	4,816
2010	4,745
Thereafter	15,750

Table of Contents

NOTE 9: Deferred Tax Asset

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at June 30, 2006 and December 31, 2005 are summarized below. Temporary differences result from the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance has been established for the full amount of the deferred tax assets applicable to Connecticut, Massachusetts and Rhode Island due to uncertainties of realization.

(In thousands)	**June 30, 2006**	**December 31, 2005**
Deferred tax assets:		
Allowance for credit losses	$ 60,779	60,721
Net operating loss and tax credit carry forwards	22,610	19,350
Net unrealized loss on securities available for sale	22,283	14,296
Compensation and employee benefit plans	11,380	9,265
Intangible assets	4,870	5,314
Deductible acquisition costs	1,863	2,793
Other	3,062	3,594
Total deferred tax assets	126,847	115,333
Less: valuation allowance	(25,523)	(21,320)
Deferred tax assets, net of valuation allowance	101,324	94,013
Deferred tax liabilities:		
Deferred loan costs	16,583	11,575
Premises and equipment	8,521	8,811
Equipment financing leases	7,828	7,174
Purchase accounting and fair-value adjustments	5,295	4,968
Mortgage servicing rights	2,496	2,728
Other	2,638	3,444
Total deferred tax liabilities	43,361	38,700
Deferred tax asset	$ 57,963	55,313

Management believes it is more likely than not that Webster will realize its net deferred tax assets, based upon its recent historical and anticipated future levels of pre-tax income. There can be no absolute assurance, however, that any specific level of future income will be generated.

Table of Contents

NOTE 10: Deposits

The following table summarizes the period end balance and the composition of deposits:

	June 30, 2006		December 31, 2005	
(In thousands)	**Amount**	**% of Total**	**Amount**	**% of Total**
Demand	$1,549,051	12.6%	$1,546,096	13.3%
NOW	1,411,951	11.6	1,412,821	12.2
Money market	1,888,179	15.5	1,789,781	15.4
Savings	1,954,298	16.0	2,015,045	17.3
HSA	275,346	2.3	209,582	1.8
Retail certificates of deposit	4,447,504	36.4	4,249,874	36.5
Treasury certificates of deposit	690,136	5.6	407,946	3.5