

STATE STREET CORP
Form 10-Q
November 02, 2007

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2007

or

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

For the transition period from _____ to _____

Commission File No. 001-07511

STATE STREET CORPORATION

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction
of incorporation)

04-2456637

(I.R.S. Employer Identification No.)

One Lincoln Street

Boston, Massachusetts

(Address of principal executive office)

02111

(Zip Code)

617-786-3000

(Registrant's telephone number, including area code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares of State Street's common stock outstanding on October 31, 2007 was 386,205,577.

STATE STREET CORPORATION

Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 2007

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

OVERVIEW

State Street Corporation is a financial holding company headquartered in Boston, Massachusetts. Through its subsidiaries, including its principal bank subsidiary, State Street Bank and Trust Company, State Street provides a full range of products and services to meet the needs of institutional investors worldwide. Unless otherwise indicated or unless the context requires otherwise, all references in this Management's Discussion and Analysis to "State Street," "we," "us," "our" or similar terms mean State Street Corporation and its subsidiaries on a consolidated basis. At September 30, 2007, we had consolidated total assets of \$139.89 billion, total deposits of \$93.00 billion, total shareholders' equity of \$11.25 billion and employed 26,425.

Our customers include mutual funds and other collective investment funds, corporate and public retirement plans, insurance companies, foundations, endowments and other investment pools, and investment managers. Our two lines of business, Investment Servicing and Investment Management, provide products and services including custody, recordkeeping, daily pricing and administration, shareholder services, foreign exchange, brokerage and other trading services, securities finance, deposit and short-term investment facilities, loan and lease financing, investment manager and hedge fund manager operations outsourcing, performance, risk and compliance analytics, investment research and investment management, including passive and active U.S. and non-U.S. equity and fixed income strategies. We had \$15.15 trillion of assets under custody and \$2 trillion of assets under management at September 30, 2007. Financial information about our business lines is provided later in the "Line of Business Information" section.

This Management's Discussion and Analysis is part of our Quarterly Report on Form 10-Q to the SEC, and updates the Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2006, which we refer to as the 2006 Form 10-K, and in our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2007 and June 30, 2007. We previously filed these reports with the SEC. You should read the financial information in this Form 10-Q in conjunction with the financial information contained in those filings. Certain amounts previously reported have been reclassified to conform to current period classifications.

We prepare our consolidated financial statements in accordance with United States generally accepted accounting principles, which we refer to as GAAP, and which require management to make judgments in the application of its accounting policies that involve significant estimates and assumptions about the effect of matters that are inherently uncertain. Accounting policies considered relatively more significant in this respect are accounting for lease financing, goodwill, income taxes and pension costs. Additional information about these accounting policies is included in the "Significant Accounting Estimates" section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2006 Form 10-K. Other than our application of the provisions of FASB Staff Position No. FAS 13-2 and Interpretation No. 48, which are discussed in note 1 to the consolidated financial statements in this Form 10-Q, there were no significant changes to these accounting policies during the first nine months of 2007.

THIRD QUARTER DEVELOPMENTS

On July 2, 2007, we completed our acquisition of Investors Financial Services Corp., a bank holding company based in Boston with approximately \$17 billion in total assets and approximately \$1.9 trillion in assets under custody. We acquired Investors Financial in order to enhance our position as a worldwide service provider to institutional investors. We exchanged approximately 60.8 million shares of our common stock, with an aggregate value of approximately \$4.2 billion, for all of the

outstanding common stock of Investors Financial. Results of operations of Investors Financial are included in our consolidated financial statements beginning on July 2, 2007. Accordingly, our financial results for the third quarter of 2007, included in the accompanying consolidated financial statements and discussed in this Management's Discussion and Analysis, include results for the third quarter of 2007 of the acquired Investors Financial business.

In connection with the acquisition, we recorded goodwill of \$2.7 billion and other intangible assets, specifically customer relationship and core deposit intangibles, of \$1.4 billion. In addition, we recorded merger and integration costs of \$141 million in our statement of income during the third quarter of 2007. Additional information about the acquisition, including the goodwill and other intangible assets and the merger and integration costs, is provided in notes 2 and 4 to the consolidated financial statements in this Form 10-Q.

During the third quarter of 2007, we repurchased 13.4 million shares of our common stock in connection with the \$1 billion accelerated share repurchase program announced on July 20, 2007. The total number of shares repurchased will depend, in part, on the weighted-average price per share of our common stock over the repurchase period. This period is not expected to exceed six months from commencement of the program. The total number of shares to be repurchased is also subject to other conditions and adjustments. Additional information with respect to this accelerated share repurchase program is in the "Capital Regulatory Capital" section of this Management's Discussion and Analysis.

FORWARD-LOOKING STATEMENTS

This Form 10-Q, particularly this Management's Discussion and Analysis, and the discussion in Part II Item 1A, "Risk Factors," in this Form 10-Q, contains statements that are considered "forward-looking statements" within the meaning of United States securities laws. In addition, management may make other written or oral communications from time to time that contain forward-looking statements. Forward-looking statements, including statements about industry trends, management's future expectations and other matters that do not relate strictly to historical facts, are based on assumptions by management, and are often identified by such forward-looking terminology as "expect," "look," "believe," "anticipate," "estimate," "seek," "may," "will," "trend," "target" and "goal," or similar statements or variations of such terms.

These statements are subject to various risks and uncertainties, which change over time, and are based on management's expectations and assumptions at the time the statements are made, and are not guarantees of future results. Management's expectations and assumptions, and the continued validity of the forward-looking statements, are subject to change due to a broad range of factors affecting the national and global economies, the equity, debt, currency and other financial markets, as well as factors specific to the parent company and to our principal bank subsidiary, State Street Bank and Trust Company.

Factors that could cause changes in the expectations or assumptions on which forward-looking statements are based include, but are not limited to:

Our ability to integrate and convert acquisitions into our business, including our acquisition of Investors Financial;

The level and volatility of interest rates, particularly in the U.S. and Europe; the performance and volatility of securities, currency and other markets in the U.S. and internationally; and economic conditions and monetary and other governmental actions designed to address those conditions;

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The liquidity of the U.S. and European securities markets, particularly the markets for fixed-income securities, including asset-backed commercial paper, as well as the liquidity requirements of our customers;

Our ability to attract non-interest bearing deposits and other low-cost funds;

The performance of, and demand for, the investment products we offer;

The competitive environment in which we operate, including our ability to cross-sell services to our customers and to maintain service levels, technology and product offerings that are sufficient to attract new customers and retain current customers;

The enactment of legislation, including tax legislation, and changes in regulation and enforcement that impact State Street and its customers, as well as the effects of legal and regulatory proceedings, including litigation;

Our ability to continue to grow revenue, control expenses and attract the capital necessary to achieve our business goals and comply with regulatory requirements;

Our ability to control systemic and operating risks;

Trends in the globalization of investment activity and the growth on a worldwide basis in financial assets;

Trends in governmental and corporate pension plans and savings rates;

Changes in accounting standards and practices, including changes in the interpretation of existing standards, that impact our consolidated financial statements; and

Changes in tax legislation and in the interpretation of existing tax laws by U.S. and non-U.S. tax authorities that impact the amount of taxes due.

Therefore, actual outcomes and results may differ materially from what is expressed in our forward-looking statements, and those statements should not be relied upon as representing our expectations or beliefs as of any date subsequent to the date this Form 10-Q is filed with the SEC. Additional information about important factors that could cause our actual financial results to differ materially from those indicated by any forward-looking statements is provided in our 2006 Form 10-K and in this Form 10-Q, particularly in Item 1A, "Risk Factors," in each report. You should read and consider the risk factors discussed in our 2006 Form 10-K and in this Form 10-Q in conjunction with the information provided in this Form 10-Q. We undertake no obligation to revise the forward-looking statements contained in this Form 10-Q to reflect events after its filing date.

OVERVIEW OF FINANCIAL RESULTS

(Dollars in millions, except per share amounts)	Quarters Ended September 30,			Nine Months Ended September 30,		
	2007 ⁽¹⁾	2006	% Change	2007 ⁽¹⁾	2006	% Change
Total fee revenue	\$ 1,782	\$ 1,246	43%	\$ 4,689	\$ 3,881	21%
Net interest revenue	464	266	74	1,174	794	48
(Losses) Gains on sales of available-for-sale investment securities, net	(6)	3		(6)	14	
Total revenue	2,240	1,515	48	5,857	4,689	25
Total operating expenses ⁽²⁾	1,689	1,090	55	4,260	3,362	27
Income from continuing operations before income tax expense	551	425	30	1,597	1,327	20
Income tax expense from continuing operations	193	147	31	559	540	4
Income from continuing operations	358	278	29	1,038	787	32
Income from discontinued operations					10	
Net income	\$ 358	\$ 278		\$ 1,038	\$ 797	
Earnings Per Share From Continuing Operations ⁽³⁾ :						
Basic	\$.92	\$.84	10	\$ 2.95	\$ 2.38	24
Diluted	.91	.83	10	2.91	2.35	24
Earnings Per Share ⁽³⁾ :						
Basic	.92	.84		2.95	2.41	
Diluted	.91	.83		2.91	2.38	
Cash dividends declared	.22	.20		.65	.59	
Return on shareholders' equity from continuing operations	12.6%	16.4%		15.9%	16.0%	
Return on shareholders' equity	12.6	16.4		15.9	16.2	

(1) Financial results for the third quarter and first nine months of 2007 include results of the acquired Investors Financial business for the third quarter of 2007.

(2) Amounts for third quarter and first nine months of 2007 include merger and integration costs of \$141 million, or \$91 million after-tax, recorded in connection with the acquisition of Investors Financial.

(3) Earnings per share for the third quarter and first nine months of 2007 reflect the issuance of 60.8 million shares on July 2, 2007 in connection with the acquisition of Investors Financial.

Summary

Our financial results for the third quarter and first nine months of 2007 continued to reflect growth in revenue along with our ability to balance expense growth with revenue growth. Other

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highlights for the third quarter and first nine months of 2007 relative to the 2006 periods are as follows:

Compared to the third quarter of 2006, servicing fees grew 37%, management fees grew 26%, trading service revenue grew 87% and securities finance revenue grew 90%, contributing to aggregate growth of 43% in total fee revenue, of which the acquired Investors Financial business contributed a 16% increase, primarily in servicing fees.

In the year-to-date comparison, servicing fees grew 20%, management fees grew 22%, trading services revenue grew 21% and securities finance revenue grew 44%, contributing to aggregate growth of 21% in total fee revenue.

Net interest revenue grew 74% and net interest margin grew 51 basis points compared to last year's third quarter. In the year-to-date comparison, net interest revenue grew 48% and net interest margin grew 40 basis points.

Total operating expenses grew 55% compared to last year's third quarter, with Investors Financial contributing a 16% increase, and grew 27% in the nine-month comparison. These expenses for 2007 included \$141 million of merger and integration costs recorded in connection with our acquisition of Investors Financial.

State Street Global Advisors, which we refer to as SSgA, generated \$26 billion of net new business in assets under management during the third quarter and \$134 billion for the first nine months of 2007.

We ended the third quarter of 2007 with record levels, for State Street, of assets under custody and assets under management.

Our financial results for the third quarter of 2007 are discussed in the following "Financial Highlights" section, with more detailed information about the third quarter and first nine months of 2007 provided in the "Consolidated Results of Operations" section of this Management's Discussion and Analysis.

Financial Highlights

Third quarter 2007 net income of \$358 million increased 29%, and diluted earnings per share of \$.91 increased 10%, from net income of \$278 million and diluted earnings per share of \$.83 for the third quarter of 2006. Net income was \$1,038 million and diluted earnings per share was \$2.91 for the first nine months of 2007, compared to income from continuing operations of \$787 million and diluted earnings per share from continuing operations of \$2.35 for the first nine months of 2006. Net income of \$797 million for the first nine months of 2006 included income from discontinued operations of \$10 million (gross income of \$16 million reduced by related income tax expense of \$6 million), or \$.03 per share, which resulted from the finalization of legal, selling and other costs recorded in connection with our divestiture of Bel Air Investment Advisors LLC. Additional information about the Bel Air divestiture is included in note 2 to the consolidated financial statements in this Form 10-Q.

Comparing the third quarter of 2007 to the third quarter of 2006, our total revenue grew 48% to \$2.2 billion. Total fee revenue was up 43%, with increases in all income statement revenue line items except processing fees and other, which was down 6%. The growth in fee revenue was composed of growth in servicing fees, up 37%, management fees, up 26%, trading services revenue, up 87% and securities finance revenue, up 90%. The acquired Investors Financial business contributed about one-third of the increase in total fee revenue.

Both servicing fees and management fees benefited from increases in net new business and favorable equity market performance, with servicing fees also reflecting the contribution of the acquired Investors Financial business. Trading services revenue benefited from increases in customer volumes and currency volatility, both of which were driven by the disruption experienced in the global fixed-income securities markets during the third quarter of 2007, as well as the contribution of the acquired Investors Financial business. Trading services revenue also benefited from the contribution of revenue from the Currenex business, which we acquired in March 2007. The increase in securities finance revenue was driven by higher securities lending volumes from both existing and new customers and by wider spreads, which benefited from an increase in volatility attributable to the above-mentioned fixed-income markets disruption. Spreads also benefited from the Federal Reserve's 50-basis-point reduction in the federal funds rate in September 2007. The decline in processing fees and other revenue primarily reflected the impact of the fixed-income markets disruption experienced during the third quarter, as revenue from our Structured Products group's asset-backed commercial paper business decreased.

Net interest revenue increased 74% compared to the prior year third quarter, with a related increase in net interest margin of 51 basis points. The increases were primarily due to a favorable funding mix, including a higher volume of non-U.S. transaction deposits at higher spreads, as well as the addition of interest-earning assets from the acquired Investors Financial business and the ongoing impact of our investment securities portfolio repositioning. Overall, we continue to benefit from higher levels of customer deposits and the continued favorable non-U.S. interest rate environment and stable U.S. interest rates.

Total operating expenses increased 55% to \$1.69 billion, primarily the result of increased incentive compensation due to improved performance, the addition of the operating expenses of the acquired Investors Financial business, which contributed a 16% increase, and increased staffing levels to support new business. Total operating expenses for the third quarter of 2007 included \$141 million of merger and integration costs recorded in connection with the acquisition of Investors Financial. Excluding the merger and integration costs, total operating expenses were \$1.55 billion, which represents 42% growth over the third quarter of 2006. With growth in total revenue of 48% exceeding the growth in total operating expenses of 42%, excluding the merger and integration costs, for the third quarter of 2007, we achieved positive operating leverage of approximately 580 basis points. We define operating leverage as the difference between the growth rate of total revenue and the growth rate of total operating expenses, with total operating expenses adjusted to exclude the impact of non-recurring expenses.

Our Investment Management business continued to generate increased revenue, principally from increased customer demand for active investment management products, such as enhanced indexing and active quantitative management, which earn a higher level of fees than other products. Revenue from the Investment Management business line increased 26% for the third quarter of 2007 compared to the third quarter of 2006. Net new business totaled \$26 billion in assets under management in the third quarter of 2007, compared to net new business of \$33 billion in last year's third quarter. On a year-to-date basis, net new business totaled \$134 billion for 2007 compared to \$62 billion for the 2006 period. Net new business is measured as the aggregate value of new asset management business added less asset management business lost during the period.

At September 30, 2007, we had aggregate assets under custody of \$15.15 trillion, which grew 28% from \$11.85 trillion at December 31, 2006, and 34% from \$11.27 trillion at September 30, 2006. The total assets under custody at September 30, 2007 included assets under custody contributed by the acquired Investors Financial business of \$1.9 trillion. At the same date, we had aggregate assets under management of \$2 trillion, which grew 14% from \$1.75 trillion at December 31, 2006 and 22% from \$1.63 trillion at September 30, 2006.

Our effective tax rate for the third quarter of 2007 was 35%, compared to 34.6% from continuing operations for the third quarter of 2006, and 38.1% for full-year 2006. The effective rate for full-year 2006 reflected increased income tax expense that resulted from tax-related adjustments recorded in the second and fourth quarters of 2006 primarily associated with tax legislation and leveraged leases.

Financial Goals

In our 2006 Form 10-K, we reaffirmed our long-term financial goals for State Street. However, in anticipation of our then-planned acquisition of Investors Financial, and subsequently as a result of our financial results and those of Investors Financial for the second quarter of 2007, we adjusted our financial goals for full-year 2007, as follows:

Growth in operating-basis revenue of between 20% and 22%;

Growth in operating-basis earnings per share from continuing operations of between 10% and 15%; and

Operating-basis return on shareholders' equity from continuing operations of between 14% and 17%.

Operating-basis results, as defined by management, include fully taxable-equivalent net interest revenue, reflecting increases related to tax-equivalent adjustments of \$17 million and \$9 million for the third quarters of 2007 and 2006, respectively, and \$41 million and \$33 million respectively for each of the nine-month periods of 2007 and 2006, with a corresponding charge to income tax expense. Operating-basis results for the quarter and nine months ended September 30, 2007 exclude \$141 million (\$91 million after-tax), equivalent to \$.24 per share, of merger and integration costs recorded in connection with the Investors Financial acquisition. Operating-basis results for the nine months ended September 30, 2006 exclude tax-related adjustments of \$83 million recorded in the second quarter of 2006 primarily associated with tax legislation and leveraged leases.

Management measures our financial goals and related results on an operating basis to provide financial information that is comparable from period to period, and to present comparable financial trends with respect to our ongoing business operations. The use of fully taxable-equivalent net interest revenue facilitates the comparison of revenues from both taxable and non-taxable sources. In addition, the merger and integration costs and the tax-related adjustments are not associated with our normal ongoing business operations, and as a result could prevent a meaningful comparison of earnings per share and return on shareholders' equity with those of other periods. Management believes that operating-basis financial information, which includes the impact of revenue from non-taxable sources and excludes the impact of these non-recurring expenses, facilitates an investor's understanding and analysis of State Street's underlying performance and trends in addition to financial information prepared in accordance with GAAP.

For the first nine months of 2007 compared to the first nine months of 2006, we continued to make progress toward achieving our financial goals for 2007. As presented in the table below, we increased our operating-basis earnings per share from continuing operations by 21%, from \$2.60 to \$3.15; our operating-basis revenue increased 25% from \$4.722 billion to \$5.898 billion; and we achieved operating-basis return on shareholders' equity of 17.3%.

RECONCILIATION OF REPORTED RESULTS TO OPERATING-BASIS RESULTS

(Dollars in millions, except per share amounts)	Nine Months Ended September 30, 2007			Nine Months Ended September 30, 2006			2007 vs 2006
	Reported Results	Adjustments	Operating Results	Reported Results	Adjustments	Operating Results	% Change ⁽⁴⁾
Fee revenue	\$ 4,689		\$ 4,689	\$ 3,881		\$ 3,881	21%
Net interest revenue	1,174	\$ 41 ⁽¹⁾	1,215	794	\$ 33 ⁽¹⁾	827	47
(Losses) Gains on sales of available-for-sale investment securities, net	(6)		(6)	14		14	
Total revenue	5,857	41	5,898	4,689	33	4,722	25
Total operating expenses	4,260	(141) ⁽²⁾	4,119	3,362		3,362	23
Income from continuing operations before income tax expense	1,597	182	1,779	1,327	33	1,360	31
Income tax expense	559	50 ⁽²⁾	609	540	(83) ⁽³⁾	457	
Taxable-equivalent adjustment		41 ⁽¹⁾	41		33 ⁽¹⁾	33	
Income from continuing operations	\$ 1,038	\$ 91	\$ 1,129	\$ 787	\$ 83	\$ 870	30
Diluted earnings per share	\$ 2.91	\$.24	\$ 3.15	\$ 2.35	\$.25	\$ 2.60	21
Return on equity from continuing operations	15.9%	1.4%	17.3%	16.0%	1.7%	17.7%	

(1) Taxable-equivalent adjustments are not included in reported results.

(2) Merger and integration costs are direct and incremental costs to integrate the acquired Investors Financial business into our operations, and do not include ongoing costs of the combined organization.

(3) Tax-related adjustments were related to additional income tax expense primarily associated with tax legislation and leveraged leases.

(4) The percent change represents the change in operating-basis results for the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006.

Outlook

Some of the factors and assumptions that we considered earlier this year in determining our outlook for 2007 were as follows:

Expected equity market growth, based on S&P 500 and/or MSCI® EAFE indices, of about 7%;

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Growth in revenue generated from active quantitative asset management products;

Relatively stable U.S. interest rates;

Expected flattening of the U.S. dollar yield curve;

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Continuation of beneficial trends in non-U.S. interest rates;

Modest growth in non-U.S. deposits, as well as the maintenance of a favorable mix of customer deposits, including demand deposits;

A stable income tax and regulatory environment;

Achievement of expected cost savings from the Investors Financial acquisition; and

Retention of, and success in cross-selling to, Investors Financial's customer base.

Actual experience during the first nine months of 2007 has differed from our assumptions in many respects. In particular, during the first nine months of 2007, increases in our servicing and management fee revenues, due in part to the performance of the equity markets, as well as increases in, and higher spreads on, our non-U.S. deposits have been more favorable than our assumptions. However, these favorable trends may not continue or may lessen over the remainder of 2007. In addition, changes in U.S. and non-U.S. interest rates could affect our net interest revenue. Additional information about factors that could affect our net interest revenue for 2007 are described in the "Net Interest Revenue" section of this Management's Discussion and Analysis. Information about risks and uncertainties which could cause these and other actual results to differ materially from those expected is included in Item 1A of our 2006 Form 10-K and this Form 10-Q.

CONSOLIDATED RESULTS OF OPERATIONS

This section discusses our consolidated results of operations for the third quarter and first nine months of 2007 compared to the same periods in 2006, and should be read in conjunction with the accompanying consolidated financial statements and related condensed notes.

TOTAL REVENUE

(Dollars in millions)	Quarters Ended September 30,			Nine Months Ended September 30,		
	2007	2006	% Change	2007	2006	% Change
Fee Revenue:						
Servicing fees	\$ 937	\$ 685	37%	\$ 2,421	\$ 2,025	20%
Management fees	299	238	26	844	690	22
Trading services	320	171	87	800	659	21
Securities finance	165	87	90	425	296	44
Processing fees and other	61	65	(6)	199	211	(6)
Total fee revenue	1,782	1,246	43	4,689	3,881	21
Net Interest Revenue:						
Interest revenue	1,383	1,103	25	3,758	3,098	21
Interest expense	919	837	10	2,584	2,304	12
Net interest revenue	464	266	74	1,174	794	48
(Losses) Gains on sales of available-for-sale investment securities, net	(6)	3		(6)	14	
Total revenue	\$ 2,240	\$ 1,515	48	\$ 5,857	\$ 4,689	25

Fee Revenue

Servicing fees and management fees collectively comprised approximately 69% and 70% of total fee revenue for the third quarter and first nine months of 2007. These fee levels are a function of several factors, including the mix and volume of assets under custody and assets under management, securities positions held and the volume of portfolio transactions, as well as the types of products and services used by customers. These fees are affected by changes in worldwide equity and fixed income valuations. Generally, servicing fees are affected, in part, by changes in daily average valuations of assets under custody, while management fees are affected by changes in month-end valuations of assets under management. However, additional factors, such as the level of transaction volumes, changes in service level, balance credits, customer minimum balances, pricing concessions and other factors, may have a significant impact on servicing fee revenue.

Generally, management fee revenue is more sensitive to changes in market valuations than servicing fee revenue. Performance fees have become a larger component of our management fee revenue over the past two years, and comprised about 9% of our management fee revenue for full-year 2006, compared to about 5% for 2005. For the first nine months of 2007, performance fees comprised about 6% of management fee revenue. Performance fees are generated when the performance of managed funds exceeds benchmarks specified in the management agreements.

As a result of the above, we estimate, assuming all other factors remain constant, that a 10% increase or decrease in worldwide equity values would result in a corresponding change in our total revenue of approximately 2%. If fixed income security values were to increase or decrease by 10%, we would anticipate, under the same assumptions, a corresponding change of approximately 1% in our total revenue.

FEE REVENUE

(Dollars in millions)	Quarters Ended September 30,			Nine Months Ended September 30,		
	2007	2006	% Change	2007	2006	% Change
Servicing fees	\$ 937	\$ 685	37%	\$ 2,421	\$ 2,025	20%
Management fees	299	238	26	844	690	22
Trading services	320	171	87	800	659	21
Securities finance	165	87	90	425	296	44
Processing fees and other	61	65	(6)	199	211	(6)
Total fee revenue	\$ 1,782	\$ 1,246	43	\$ 4,689	\$ 3,881	21

Servicing fees

Servicing fees are derived from custody, product- and participant-level accounting, daily pricing and administration; recordkeeping; investment manager and hedge fund manager operations outsourcing; master trust and master custody; and performance, risk and compliance analytics. For the quarter and nine months ended September 30, 2007, compared to the corresponding 2006 periods, the increase in servicing fees was driven primarily by the contribution of servicing fee revenue from the acquired Investors Financial business, net new business from existing and new customers, and higher daily average equity market valuations. The quarterly comparison also benefited from higher transaction volumes. The daily average values for the S&P 500 Index were up 16%, and for the MSCI®

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EAFE Index were up 20%, compared with the third quarter of 2006. For the year to date, daily average values for the S&P 500 Index increased 15% and for the MSCI® EAFE Index increased 20%.

ASSETS UNDER CUSTODY	September 30, 2007 ⁽¹⁾	December 31, 2006	September 30, 2006
(In billions)			
Mutual funds	\$ 4,771	\$ 3,738	\$ 3,536
Collective funds	3,146	1,665	1,554
Pension products	3,934	3,713	3,546
Insurance and other products	3,297	2,738	2,630
Total	\$ 15,148	\$ 11,854	\$ 11,266
Financial Instrument Mix:			
Equities	\$ 8,210	\$ 5,821	\$ 5,595
Fixed income	4,347	4,035	3,928
Short-term and other investments	2,591	1,998	1,743
Total	\$ 15,148	\$ 11,854	\$ 11,266

(1) Total assets under custody at September 30, 2007 included \$1,889 billion from the acquired Investors Financial business.

Management fees

The increase in management fees primarily reflected increases in net new business, as well as higher month-end equity market valuations. Performance fees were \$18 million and \$51 million for the third quarter and first nine months of 2007, compared to \$28 million and \$56 million for the third quarter and first nine months of 2006. The averages of month-end values for the S&P 500 Index on both a quarter and year-to-date basis were up 14%, and for the MSCI® EAFE Index were up 20%, compared with the third quarter and first nine months of 2006.

ASSETS UNDER MANAGEMENT	September 30, 2007	December 31, 2006	September 30, 2006
(In billions)			
Equities:			
Passive	\$ 781	\$ 691	\$ 638
Active and other	216	181	158
Company stock/ESOP	87	85	80
Total equities	1,084	957	876
Fixed income	244	201	184
Cash and money market	666	591	572
Total fixed income and cash	910	792	756
Assets under management from Investors Financial	4		
Total	\$ 1,998	\$ 1,749	\$ 1,632

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The following table presents a roll-forward of assets under management for the twelve months ended September 30, 2007.

ASSETS UNDER MANAGEMENT

(In billions)

September 30, 2006	\$ 1,632
Net new business	24
Market appreciation	93
December 31, 2006	1,749
Net new business	134
Market appreciation	111
Assets under management from Investors Financial	4
September 30, 2007	\$ 1,998

Trading services

Trading services revenue, which includes foreign exchange trading revenue and brokerage and other trading fees, was up 87% for the third quarter of 2007 compared to the third quarter of 2006 and up 21% in the nine-month comparison. Foreign exchange trading revenue for the third quarter and first nine months of 2007 totaled \$224 million and \$550 million, respectively, up 98% and 17% from \$113 million and \$470 million in the prior-year periods. The quarterly increase reflected a 55% increase in customer volumes, mostly in foreign exchange trading, the contribution of revenue from the acquired Investors Financial business, and a 9% increase in currency volatility. The nine-month increase resulted from a 29% increase in customer volumes and the contribution from the acquired Investors Financial business, partially offset by an 18% decline in currency volatility.

Brokerage and other trading fees totaled \$96 million for the third quarter of 2007, up 66% from \$58 million in the third quarter of 2006, primarily the result of the contribution of fees from the operations of Currenex, which we acquired in March 2007, and increased fees from transition management. Brokerage and other trading fees in the nine-month comparison totaled \$250 million for 2007 and \$189 million for 2006, primarily the result of the contribution of revenue from the acquired Currenex operations and increased transition management fees.

Securities finance

Securities finance revenue for the third quarter of 2007 increased 90% compared to the third quarter of 2006, and 44% on a year-to-date comparison, with both increases driven by an increase in the average volume of securities loaned, up 34% quarter to quarter and up 33% on a year-to-date comparison. The growth in volume resulted from increased demand from existing customers and demand from new customers. Consolidated spread was increased 43% in the quarterly comparison and 13% on a year-to-date comparison. Spreads benefited from the disruption in the global fixed-income securities markets experienced during the third quarter of 2007, as well as from the Federal Reserve Board's 50 basis point reduction in the federal funds rate in September 2007.

Processing Fees and Other

The decreases in processing fees and other in both the quarterly and year-to-date comparisons resulted from a decline in revenue from our Structured Products group, primarily associated with the previously described fixed-income markets disruption, which impacted fees from asset-backed

commercial paper activities, as rates paid on commercial paper increased and spreads between the overall yield on the assets collateralizing the commercial paper and the rates paid on the commercial paper narrowed. The decline also resulted from the impact of the September 30, 2006 consolidation of our tax-exempt investment program onto our balance sheet. As a result of the consolidation, revenue from the program, previously recorded in processing fees and other, is currently recorded in net interest revenue.

NET INTEREST REVENUE

(Dollars in millions)	Quarters Ended September 30,			Nine Months Ended September 30,		
	2007	2006	% Change	2007	2006	% Change
Interest revenue ⁽¹⁾	\$ 1,383	\$ 1,103	25%	\$ 3,758	\$ 3,098	21%
Interest expense ⁽¹⁾	919	837	10	2,584	2,304	12
Net interest revenue	464	266	74	1,174	794	48
Provision for loan losses						
Net interest revenue after provision for loan losses	\$ 464	\$ 266	74	\$ 1,174	\$ 794	48
Net interest revenue (fully taxable-equivalent basis) ⁽²⁾	\$ 481	\$ 275	75	\$ 1,215	\$ 827	47

(1) Additional detail about the components of interest revenue and interest expense is in note 11 to the consolidated financial statements in this Form 10-Q.

(2) Fully taxable-equivalent amounts reflect adjustments computed using a federal income tax rate of 35%, adjusted for applicable state income taxes, net of the related federal tax benefit. Adjustments included in fully taxable-equivalent basis net interest revenue in the preceding table, and in the rates earned on interest-earning assets in the table below, were \$17 million and \$9 million for the third quarters of 2007 and 2006, respectively, and \$41 million and \$33 million for the first nine months of 2007 and 2006.

NET INTEREST MARGIN

(Dollars in millions)	Quarters Ended September 30,				Nine Months Ended September 30,			
	2007		2006		2007		2006	
	Average Balance	Rate ⁽¹⁾	Average Balance	Rate ⁽¹⁾	Average Balance	Rate ⁽¹⁾	Average Balance	Rate ⁽¹⁾
Interest-earning assets	\$ 109,968	5.05%	\$ 89,880	4.91%	\$ 100,465	5.05%	\$ 90,922	4.60%
Interest-bearing liabilities	98,260	3.71	81,739	4.06	90,172	3.83	82,650	3.72
Excess of rate earned over rate paid		1.34%		.85%		1.22%		.88%
Net interest margin		1.73%		1.22%		1.62%		1.22%

(1) Fully taxable-equivalent basis.

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Net interest revenue increased 74% and 48%, and net interest margin increased 51 basis points and 40 basis points, for the quarter and nine months ended September 30, 2007, respectively, compared to the same periods in 2006. The increases were principally due to a favorable funding mix, including a higher volume of non-U.S. transaction deposits at higher spreads, as well as the addition of interest-earning assets from the acquired Investors Financial business and the ongoing impact of our investment securities portfolio repositioning, substantially completed in 2006, which has resulted in the maturity of fixed-rate securities and re-investment in higher yielding securities. The increases were offset by a decline in fees from domestic overdrafts and an increase in higher-cost time deposits.

Several factors could continue to affect our net interest revenue and margin for 2007, including ongoing actions by the Federal Reserve to manage short-term interest rates; the shape of the yield curve; changes in non-U.S. interest rates; interest-rate spreads on the reinvestment of proceeds from maturities of investment securities; and our maintenance of the high credit quality of our investment securities portfolio.

For the third quarter of 2007, our average investment securities portfolio of \$74.6 billion included fixed-and floating-rate asset-backed securities (\$26.4 billion, or 35% of the average investment portfolio for the third quarter of 2007), collateralized mortgage obligations (\$14.6 billion, or 20% of the average portfolio for the third quarter of 2007), and mortgage-backed securities from U.S. Treasury and federal agencies (\$16.3 billion, or 22%). Asset-backed securities that were collateralized by sub-prime mortgages totaled \$6.6 billion at September 30, 2007. Of this total, 73% were AAA rated, and 27% were AA rated. Overall, we continue to invest primarily in AAA and AA rated securities. AAA and AA rated securities comprised approximately 95% of our investment securities portfolio at September 30, 2007, with approximately 89% AAA rated.

OPERATING EXPENSES

(Dollars in millions)	Quarters Ended September 30,			Nine Months Ended September 30,		
	2007	2006	% Change	2007	2006	% Change
Salaries and employee benefits	\$ 916	\$ 639	43%	\$ 2,463	\$ 1,958	26%
Information systems and communications	145	121	20	398	382	4
Transaction processing services	165	121	36	435	375	16
Occupancy	109	91	20	301	279	8
Merger and integration	141			141		
Other	213	118	81	522	368	42
Total operating expenses	\$ 1,689	\$ 1,090	55	\$ 4,260	\$ 3,362	27
Number of employees at quarter end	26,425	21,500				

Salaries and employee benefits expense increases were mainly the result of higher incentive compensation due to improved performance, the addition of the acquired Investors Financial business' salaries and benefits expenses for the third quarter and increased staffing levels. Staffing levels increased to support new business, particularly internationally, and also resulted from the acquisition of Currenex. The year-to-date increase was also affected by higher average salaries attributable to annual merit increases.

The increases in occupancy costs primarily resulted from costs contributed by the acquired Investors Financial business related to leased space, as well as additional costs to support the growth in business in Europe and Asia. The increase in information systems and communications expense for both periods was primarily the result of the contribution of costs from the acquired Investors Financial business and technology spending both in Europe and related to the Currenex acquisition. Transaction processing expense increased in both comparisons primarily as a result of the contribution of expenses from the acquired Investors Financial business and higher volumes in asset servicing.

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Other expenses increased in both comparisons, primarily the result of the impact of the acquired Investors Financial business, which contributed increases in professional services and intangible amortization, and costs to support growth in business. The year-to-date increase also resulted from increased charitable contributions and sales promotion expenses.

During the third quarter of 2007, in connection with the Investors Financial acquisition, we recorded merger and integration costs in our consolidated statement of income. These costs consisted only of direct and incremental costs to integrate the acquired Investors Financial business into our operations. These expenses do not include on-going expenses of the combined organization. The expenses included a non-cash charge of approximately \$91 million resulting from the termination of an operating lease related to one of our office buildings in Boston. This termination was completed in connection with an overall evaluation of our requirements for office space as a result of the acquisition.

We also recorded costs totaling \$20 million associated with retention and other compensation paid to employees of Investors Financial, \$8 million related to the integration of the acquired Investors Financial business's accounting and management systems and customers, and \$2 million of other costs. In addition, subsequent to the completion of the acquisition, we redeemed an aggregate of \$500 million of unsecured junior subordinated debentures issued by the parent company to two of our statutory business trusts, State Street Capital Trusts A and B, composed of \$200 million of 7.94% debentures issued in 1996 and \$300 million of 8.035% debentures issued in 1997. We paid the trusts the outstanding amount on the debentures plus accrued interest and an aggregate redemption premium of approximately \$20 million, which was included in the merger and integration costs.

Income Taxes

We recorded income tax expense of \$193 million for the third quarter of 2007, compared to \$147 million for the third quarter of 2006, with the increase due primarily to higher pre-tax earnings. For the first nine months of 2007, income tax expense was \$559 million, compared to \$540 million from continuing operations for the 2006 period, which included \$83 million of additional income tax expense recorded in the second quarter of 2006 primarily associated with tax legislation and leveraged leases. The effective tax rate for the third quarter of 2007 was 35% compared to 34.6% for the third quarter of 2006, the latter rate reflective of the above-described additional income tax expense.

LINE OF BUSINESS INFORMATION

We report two lines of business: Investment Servicing and Investment Management. Given State Street's services and management organization, the results of operations for these lines of business are not necessarily comparable with those of other companies, including companies in the financial services industry. Additional information about our lines of business is included in note 22 to the consolidated financial statements in our 2006 Form 10-K.

The following is a summary of line of business results on a continuing operations basis. The amount presented in the "Other/One-Time" column represents the merger and acquisition costs

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recorded in connection with the acquisition of Investors Financial. These costs were not allocated to State Street's business lines.

For the Quarters Ended September 30,

	Investment Servicing		Investment Management		Other/ One-Time		Total	
	2007	2006	2007	2006	2007	2006	2007	2006
(Dollars in millions, except where otherwise noted)								
Fee Revenue:								
Servicing fees	\$ 937	\$ 685					\$ 937	\$ 685
Management fees			\$ 299	\$ 238			299	238
Trading services	320	171					320	171
Securities finance	128	66	37	21			165	87
Processing fees and other	52	51	9	14			61	65
Total fee revenue	1,437	973	345	273			1,782	1,246
Net interest revenue after provision for loan losses	427	235	37	31			464	266
(Losses) Gains on sales of available-for-sale investment securities, net	(6)	3					(6)	3
Total revenue	1,858	1,211	382	304			2,240	1,515
Operating expenses	1,292	903	256	187	\$ 141		1,689	1,090
Income from continuing operations before income tax expense	\$ 566	\$ 308	\$ 126	\$ 117	\$ (141)		\$ 551	\$ 425
Pre-tax margin	30%	25%	33%	39%			25%	28%
Average assets (in billions)	\$ 128.4	\$ 99.9	\$ 3.6	\$ 2.9			\$ 132.0	\$ 102.8

For the Nine Months Ended September 30,

	Investment Servicing		Investment Management		Other/ One-Time		Total	
	2007	2006	2007	2006	2007	2006	2007	2006
(Dollars in millions, except where otherwise noted)								
Fee Revenue:								
Servicing fees	\$ 2,421	\$ 2,025					\$ 2,421	\$ 2,025
Management fees			\$ 844	\$ 690			844	690
Trading services	800	659					800	659
Securities finance	323	224	102	72			425	296
Processing fees and other	160	163	39	48			199	211
Total fee revenue	3,704	3,071	985	810			4,689	3,881
Net interest revenue after provision for loan losses	1,056	705	118	89			1,174	794
(Losses) Gains on sales of available-for-sale investment securities, net	(6)	14					(6)	14
Total revenue	4,754	3,790	1,103	899			5,857	4,689
Operating expenses	3,405	2,786	714	576	\$ 141		4,260	3,362

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For the Nine Months Ended September 30,

Income from continuing operations before income tax expense	\$ 1,349	\$ 1,004	\$ 389	\$ 323	\$ (141)	\$ 1,597	\$ 1,327
Pre-tax margin	28%	26%	35%	36%		27%	28%
Average assets (in billions)	\$ 114.2	\$ 101.6	3.5	\$ 2.9		\$ 117.7	\$ 104.5

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Investment Servicing

Total revenue for the third quarter of 2007 increased 53% compared to the same period in 2006, and 25% in the nine-month comparison. Total fee revenue in the same comparisons increased 48% and 21%, respectively, with the increases primarily attributable to growth in servicing fees, trading services revenue and securities finance revenue. The growth in servicing fees over the prior year was primarily due to the contribution of the acquired Investors Financial business, increases in net new business, the impact of favorable equity market performance and, in the quarterly comparison, an increase in transaction volumes. Trading services revenue increased mainly as the result of increased volume and higher volatility in our foreign exchange trading business, and the growth in securities finance revenue resulted from an improvement in spreads and an increase in volume attributable to the disruption in the global fixed-income securities markets, as well as increased demand from existing customers and demand from new customers.

Servicing fees and trading services revenue for Investment Servicing comprise the total consolidated amounts for State Street, and securities finance and processing fees and other revenue for Investment Servicing comprise just over 80% of these types of revenue included in our consolidated results. Refer to the "Consolidated Results of Operations Fee Revenue" section of this Management's Discussion and Analysis for additional information about the growth in these types of fee revenue.

Net interest revenue for the third quarter of 2007 increased 82% compared to the third quarter of 2006 and 50% for the first nine months of 2007, compared to the prior-year periods. The increases in both periods were principally due to a more favorable funding mix, including a higher volume of non-U.S. transaction deposits at higher spreads, and the addition of interest-earning assets from the acquired Investors Financial business.

Total operating expenses for the third quarter of 2007 increased 43%, and for the first nine months of 2007 increased 22%, compared to the 2006 periods. The increases were primarily attributable to increased incentive compensation due to improved performance and costs related to the acquired Investors Financial business, in addition to increased headcount to support new business.

Investment Management

Total revenue for the third quarter of 2007 increased 26% compared to the comparable period in 2006, with the increases driven by growth in management fees (up 26%), securities finance revenue (up 76%) and net interest revenue (up 19%). For the first nine months of 2007, total revenue increased 23% compared to the prior year period, with management fees up 22%, securities finance revenue up 42% and net interest revenue up 33%.

Total fee revenue in the quarterly and nine-month comparisons increased 26% and 22%, driven largely by a 26% increase quarter to quarter, and a 22% increase nine months to nine months, in management fees. For the third quarter and first nine months of 2007, these fees, generated by SSgA, increased mainly as a result of an increase in net new business and favorable equity market performance. This increase was slightly offset by a decrease in performance fees for the comparable periods. Management fees for Investment Management comprise the total consolidated management fees for State Street. Refer to the "Consolidated Results of Operations Fee Revenue" section of this Management's Discussion and Analysis for additional information.

For the third quarter and first nine months of 2007, total operating expenses increased 37% and 24%, respectively, from the comparable periods in 2006, primarily attributable to the impact of

increased incentive compensation due to improved performance and merit-based compensation increases, as well as an increase in headcount to support new business.

During the third quarter of 2007, the global markets for fixed-income securities, particularly the markets for financial instruments collateralized by sub-prime mortgages, experienced significant disruption. This disruption affected the liquidity and pricing of securities traded in these markets, as well as the returns of, and levels of redemptions in, investment vehicles investing in those instruments. Additional information about the impact of these market conditions on the asset-backed commercial paper conduits administered by State Street is provided in the "Off Balance Sheet Arrangements" section of this Management's Discussion and Analysis and in Part II Item 1A, "Risk Factors," in this Form 10-Q.

As of June 30, 2007, SSgA had approximately \$222 billion of global fixed-income assets under management, of which approximately \$38 billion was under active management. Approximately \$13.9 billion of the assets under active management described above represented SSgA customer assets which were invested in strategies that were adversely affected by a combination of holdings in financial instruments collateralized by sub-prime mortgages, illiquidity in the fixed-income markets generally, and customer redemptions. SSgA's customers had significant losses in these strategies during the third quarter of 2007. Each of these strategies have different investment objectives and risk profiles. As of June 30, 2007, these strategies included approximately \$7.8 billion of institutional customer investments in non-registered pooled investment funds; approximately \$2.9 billion of unit investments by other SSgA investment funds in the same non-registered pooled investment funds; approximately \$2.6 billion of institutional customer investments in separately-managed customer accounts; and approximately \$0.6 billion of customer investments in mutual funds.

As of September 30, 2007, global fixed-income assets under management totaled approximately \$244 billion, an increase of approximately \$22 billion compared to June 30, 2007, with approximately \$36 billion under active management. This amount included approximately \$8.2 billion of SSgA customer assets which were invested in strategies that were adversely affected by a combination of holdings in financial instruments collateralized by sub-prime mortgages, illiquidity in the fixed-income markets generally, and customer redemptions during the third quarter of 2007. These strategies included approximately \$2.6 billion of institutional customer investments in non-registered pooled investment funds; approximately \$2.1 billion of unit investments by other SSgA investment funds in the same non-registered pooled investment funds; approximately \$3.1 billion of institutional customer investments in separately-managed customer accounts; and approximately \$0.4 billion of customer investments in mutual funds.

In October 2007, three customers filed litigation claims, two of which are putative class actions purportedly on behalf of ERISA plans invested in certain of SSgA's bond funds, against State Street Bank and SSgA related to investment losses in one or more of SSgA's strategies associated with sub-prime investments. We intend to vigorously defend ourselves against these claims. We are currently in discussions with other customers regarding the performance of these strategies, and it is possible that some additional legal proceedings may be commenced. The potential consolidated financial statement impact on State Street of the pending or potential claims cannot currently be estimated.

Information about the liquidity and other risks inherent in our investment management activities is included in Part II Item 1A, "Risk Factors" in this Form 10-Q.

FINANCIAL CONDITION

(In millions)	For the Nine Months Ended September 30,	
	2007 Average Balance	2006 Average Balance
Assets:		
Interest-bearing deposits with non-U.S. banks	\$ 5,895	\$ 10,664
Securities purchased under resale agreements	12,734	11,281
Federal funds sold	1,369	299
Trading account assets	974	1,027
Investment securities	69,345	60,193
Loans	10,148	7,458
Total interest-earning assets	100,465	90,922
Cash and due from banks	3,137	3,150
Other assets	14,089	10,426
Total assets	\$ 117,691	\$ 104,498
Liabilities and Shareholders' Equity:		
Interest-bearing deposits:		
U.S.	4,808	2,553
Non-U.S.	59,486	52,415
Total interest-bearing deposits	64,294	54,968
Securities sold under repurchase agreements	16,706	20,772
Federal funds purchased	2,002	2,510
Other short-term borrowings	3,843	1,779
Long-term debt	3,327	2,621
Total interest-bearing liabilities	90,172	82,650
Noninterest-bearing deposits	9,957	8,165
Other liabilities	8,817	7,108
Shareholders' equity	8,745	6,575
Total liabilities and shareholders' equity	\$ 117,691	\$ 104,498

Overview of Consolidated Statement of Condition

The structure of our consolidated statement of condition, or balance sheet, is primarily driven by the liabilities generated by our core Investment Servicing and Investment Management businesses, while the volume, mix and currency denomination of the balance sheet is determined by both our customers' needs and our operating objectives. As our customers execute their worldwide cash management and investment activities, they use short-term investments and deposits that constitute the majority of our liabilities, generally non-interest-bearing demand deposits; interest-bearing transaction account deposits denominated in a variety of currencies; and repurchase agreements, which generally serve as short-term investment alternatives for our customers.

Deposits and other liabilities generated by customer activities are invested in assets that generally match the liquidity and interest-rate characteristics of the liabilities. As a result, our assets consist primarily of high-quality, marketable securities classified as either available for sale or held to maturity,

and short-term money-market instruments, such as inter-bank placements, federal funds sold and securities purchased under resale agreements. The actual mix of assets is determined by the characteristics of the customer liabilities and our desire to maintain a well-diversified portfolio of high-quality assets. We manage our consolidated balance sheet structure using a disciplined process conducted within specific Board of Directors-approved policies for interest rate risk, credit risk and liquidity.

For the first nine months of 2007, the growth in average total interest-bearing liabilities of \$7.5 billion was composed of a \$7.1 billion increase in non-U.S. deposits and a \$.7 billion increase in long-term debt, as well as an increase in domestic deposits of \$2.3 billion, offset by a decrease in short-term borrowings of \$2.5 billion. These changes are generally representative of the higher levels of customer activity outside the U.S. Average total interest-earning assets in the 2007 period increased \$9.5 billion from 2006, consistent with the increased level of customer liabilities and the third quarter 2007 acquisition of the Investors Financial business.

For the first nine months of 2007, the average investment portfolio increased \$9.2 billion compared to the first nine months of 2006. During 2006, we substantially completed the investment portfolio repositioning begun in late 2004. The composition of the investment portfolio continued to favor mortgage- and asset-backed securities because of their high credit quality, higher yields and highly liquid nature. The credit quality of the investment portfolio remained very strong at September 30, 2007, with 89% of the securities rated AAA and 6% rated AA, both consistent with December 31, 2006.

Capital

Regulatory and economic capital management both use key metrics evaluated by management to maintain an actual level of capital commensurate with our risk profile, in compliance with all regulatory requirements, and sufficient to provide us with the financial flexibility to undertake future strategic business initiatives.

Regulatory Capital

Our objective with respect to regulatory capital management is to maintain a strong capital base in order to provide financial flexibility for our business needs, including funding corporate growth and supporting customers' cash management needs, and to provide protection against loss to depositors and creditors. We strive to maintain an optimal level of capital, commensurate with our risk profile, on which an attractive return to shareholders will be realized over both the short and long term, while protecting our obligations to depositors and creditors and satisfying regulatory requirements. You can obtain additional information about our capital management process in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2006 Form 10-K.

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At September 30, 2007, State Street and State Street Bank met all capital adequacy requirements to which they were subject. Regulatory capital amounts and ratios were as follows at September 30, 2007, and December 31, 2006:

(Dollars in millions)	Regulatory Guidelines ⁽¹⁾		State Street		State Street Bank	
	Minimum	Well Capitalized	2007	2006	2007	2006
Tier 1 risk-based capital ratio	4%	6%	11.7%	13.7%	11.1%	12.0%
Total risk-based capital ratio	8	10	13.3	15.9	12.8	14.1
Tier 1 leverage ratio	4	5	5.4	5.8	5.4	5.6
Tier 1 risk-based capital			\$ 6,836	\$ 6,473	\$ 6,343	\$ 5,473
Total risk-based capital			7,798	7,507	7,309	6,440
Adjusted risk-weighted assets and market-risk equivalents:						
Balance sheet risk-weighted assets			\$ 39,387	\$ 31,447	\$ 37,688	\$ 30,000
Off-balance sheet equivalent risk-weighted assets			18,905	15,371	18,908	15,375
Market-risk equivalents			404	395	401	394
Total			\$ 58,696	\$ 47,213	\$ 56,997	\$ 45,769
Quarterly average adjusted assets			\$ 126,612	\$ 110,794	\$ 117,105	\$ 97,132

(1) State Street Bank must meet the regulatory designation of "well capitalized" in order to maintain State Street's status as a financial holding company, including a minimum tier 1 risk-based capital ratio of 6%, a minimum total risk-based capital ratio of 10% and a tier 1 leverage ratio of 5%. In addition, State Street must meet Federal Reserve guidelines for "well capitalized" for a bank holding company to be eligible for a streamlined review process for acquisition proposals. These guidelines require a minimum tier 1 risk-based capital ratio of 6% and a minimum total risk-based capital ratio of 10%.

At September 30, 2007, State Street's and State Street Bank's tier 1 and total risk-based capital ratios decreased compared to year-end 2006. An increase in risk-based capital that resulted from the issuance of common stock in connection with the acquisition of Investors Financial, net of common stock repurchased under the accelerated share repurchase program, and year-to-date earnings, was partly offset by increased goodwill and other intangible assets that resulted from the acquisitions of Currenex and Investors Financial. This increase in risk-based capital was more than offset by an increase in total risk-weighted assets. The increase generally resulted from the addition of on-balance sheet assets from the acquisition of Investors Financial and an increase in off-balance sheet equivalent risk-weighted assets, primarily the impact of increases in foreign exchange derivative financial instruments and our securities finance activities. Both ratios for State Street and State Street Bank exceeded the regulatory minimum and well-capitalized thresholds.

In 2004, the Committee on Banking Supervision released the final version of its capital adequacy framework, known as Basel II. In 2006, the four U.S. banking regulatory agencies jointly issued their second draft of implementation rules, with industry comment provided by the end of March 2007. Additional supervisory guidance from the agencies was released late in February 2007; comments to the agencies were provided by the end of May 2007. Under the current implementation plan, State Street anticipates adopting the most advanced approaches for assessing capital adequacy, subject to change pending release of the final rules, anticipated to occur by the end of 2007. State Street previously

established a comprehensive implementation program to ensure these regulatory requirements are met within prescribed timeframes. At this time, we cannot predict the final form of the rules in the U.S., nor their impact on State Street's or State Street Bank's risk-based capital.

In March 2007, our Board of Directors authorized the purchase of up to 15 million shares of common stock for general corporate purposes, including mitigating the dilutive impact of shares issued under employee benefit plans, in addition to its previous authorization in 2006 of up to 15 million shares, of which 12.2 million shares remained available for purchase at December 31, 2006. We generally employ third-party broker-dealers to acquire shares on the open market in connection with our stock purchase program.

During the third quarter of 2007, we repurchased 13.4 million shares of our common stock in connection with the \$1 billion accelerated share repurchase program announced on July 20, 2007. The total number of shares repurchased will depend, in part, on the weighted-average price per share of our common stock over the repurchase period. This period is not expected to exceed six months from commencement of the program. The total number of shares to be repurchased is also subject to other conditions and adjustments. As of September 30, 2007, we had approximately 13.8 million shares available for future purchase under the combined authorization described above.

Economic Capital

We define economic capital as the common equity required to protect debt holders against unexpected economic losses over a one-year period at a level consistent with the solvency of a firm with our target AA debt rating. Our entire economic capital process is the responsibility of our Capital Committee. The framework and methodologies used to quantify economic capital for each of the risk types described below have been developed by our Enterprise Risk Management, Global Treasury and Corporate Finance groups and are designed to be generally consistent with our risk management principles. This framework has been approved by senior management and has been reviewed by the Executive Committee of the Board of Directors. Due to the evolving nature of quantification techniques, we expect to periodically refine the methodologies, assumptions and data used to estimate our economic capital requirements, which could result in a different amount of capital needed to support our risk profile.

We quantify capital requirements for the risks inherent in our business activities and group them into one of the following broadly defined categories:

Market risk: the risk of adverse financial impact due to fluctuations in market prices, primarily as they relate to our trading activities;

Interest-rate risk: the risk of loss in non-trading asset and liability management positions, primarily the impact of adverse movements in interest rates on the repricing mismatches that exist between balance sheet assets and liabilities;

Credit risk: the risk of loss that may result from the default or downgrade of a borrower or counterparty;

Operational risk: the risk of loss from inadequate or failed internal processes, people and systems, or from external events, which is consistent with the Basel II definition; and

Business risk: the risk of adverse changes in our earnings from business factors, including changes in the competitive environment, changes in the operational economics of business activities, and the effect of strategic and reputation risks.

Economic capital for each of these five categories is estimated on a stand-alone basis using statistical modeling techniques applied to internally generated and, in some cases, external data. These individual results are then aggregated at the State Street consolidated level. A capital reduction or diversification benefit is then applied to reflect the unlikely event of experiencing an extremely large loss in each risk type at the same time.

Liquidity

The objective of liquidity management is to ensure that we have the ability to meet our financial obligations in a timely and cost-effective manner, and that we maintain sufficient flexibility to fund strategic corporate initiatives as they arise. Effective management of liquidity involves assessing the potential mismatch between the future cash needs of our customers and our available sources of cash under normal and adverse economic and business conditions. Uses of liquidity consist primarily of meeting deposit withdrawals and funding outstanding commitments to extend credit as they are drawn upon. Liquidity is provided by the maintenance of broad access to the global capital markets and by our balance sheet asset structure. You can obtain additional information about our liquidity management process in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2006 Form 10-K.

Material risks to the sources of short-term liquidity would include, among other things, rating agency downgrades of our deposits and debt securities below investment-grade level, which would restrict our ability to access the funding markets and may lead to withdrawals of unsecured deposits by our customers. In addition, a large volume of unanticipated funding requirements, such as fundings under liquidity asset purchase agreements that support our asset-backed commercial paper programs, that have met draw conditions, or large draw-downs of existing lines of credit, could require additional liquidity. As of September 30, 2007, no circumstances existed that management considered reasonably likely to occur that would adversely impact our sources of short-term liquidity in any material respect.

While maintenance of a high investment-grade credit rating is of primary importance to our liquidity management program because it allows us to access the capital markets for incremental funding at reasonable costs, on-balance sheet liquid assets represent significant liquidity that we can directly control. These assets provide a source of cash in the form of principal maturities and the ability to borrow from the capital markets using our securities as collateral, or simply to sell them. Our liquid assets consist primarily of short-term money-market assets, such as federal funds sold and interest-bearing deposits with banks, the latter of which are multicurrency instruments invested with major multinational banks; and high-quality marketable investment securities not already pledged, which generally are more liquid than other types of assets and can be sold or borrowed against to quickly generate cash. As of September 30, 2007, our liquid assets, as defined, totaled \$59.36 billion. Securities carried at \$32.01 billion as of September 30, 2007 were designated as pledged for public and trust deposits, borrowed funds and for other purposes as provided by law, and excluded from the liquid assets calculation.

Liquid assets increased \$16.78 billion from June 30, 2007 mainly as a result of two factors. First, the contribution of Investors Financial's balance sheet, largely investment securities and customer deposits, increased liquid assets. Second, we intentionally increased our liquid assets by approximately \$7 billion during the quarter in response to the unstable and illiquid conditions that developed in the global fixed-income markets for asset-backed securities and asset-backed commercial paper during the third quarter of 2007 in connection with the concern about sub-prime mortgages. This resulted in the increase in domestic interest-bearing deposits from customers that were then invested in overnight or short-term assets, including federal funds sold, interest-bearing deposits with banks and securities

purchased under resale agreements. In spite of the turmoil in the markets, we did not experience any material customer deposit withdrawals, which would increase our funding needs, and in fact, we were able to accept incremental deposits at reasonable rates. Refer to the "Off-Balance Sheet Arrangements" section of this Management's Discussion and Analysis for additional information with respect to our asset-backed commercial paper programs.

Based upon our level of liquid assets and our ability to access the capital markets for additional funding when necessary, including our ability to issue debt and equity securities under our current universal shelf registration, management considers overall liquidity at September 30, 2007 to be more than sufficient to meet State Street's current commitments and business needs, including accommodating the transaction and cash management needs of our customers.

During the second quarter of 2007, State Street Corporation, which we refer to as the parent company, issued \$700 million of senior debt, consisting of \$250 million of floating-rate notes due in 2012 and \$450 million of fixed-rate notes due in 2017. In addition, State Street Capital Trust IV, a Delaware statutory trust wholly owned by the parent company, issued \$800 million in floating-rate capital securities and used the proceeds to purchase floating-rate junior subordinated debentures from the parent company. The capital securities represent an undivided preferred beneficial interest in those junior subordinated debentures, which are the only assets of the trust. The junior subordinated debentures have an initial scheduled maturity in June 2037 and an initial final repayment date in June 2067, each of which we may extend by ten years in specified circumstances. In accordance with existing accounting standards, we did not record the trust in our consolidated financial statements. The junior subordinated debentures qualify for inclusion in tier 1 capital.

In connection with the issuance of the junior subordinated debentures, the parent company entered into a replacement capital covenant in which it agreed, for the benefit of the holders of its junior subordinated debentures due 2028 underlying the floating-rate capital securities issued by State Street Capital Trust I, that it will not repay, redeem or repurchase, and that none of its subsidiaries will purchase, any part of the newly issued debentures or the floating-rate capital securities on or before June 1, 2047, unless the repayment, redemption or repurchase is made from the net cash proceeds of the issuance of certain qualified securities and pursuant to the other terms and conditions set forth in the covenant.

In July 2007, we redeemed an aggregate of \$500 million of unsecured junior subordinated debentures issued by the parent company to two of our statutory business trusts, State Street Capital Trusts A and B, composed of \$200 million of 7.94% debentures issued in 1996 and \$300 million of 8.035% debentures issued in 1997. We paid the trusts the outstanding amount on the debentures plus accrued interest and an aggregate redemption premium of approximately \$20 million. This redemption premium was included in the merger and integration costs which we recorded during the third quarter of 2007 in connection with the Investors Financial acquisition. Additional information about these costs is in the "Consolidated Results of Operations Operating Expenses" section of this Management's Discussion and Analysis.

In July 2007, the trusts, consistent with the terms of their applicable governing documents, redeemed their respective outstanding capital securities, with an aggregate liquidation amount of \$500 million, corresponding to the debentures. The trusts paid to the holders of the outstanding capital securities the same amount that was paid by the parent company to the trusts to redeem the debentures.

At September 30, 2007, we had \$789 million of pre-tax net unrealized losses on available-for-sale investment securities, due primarily to a higher level of interest rates compared to when the securities

were purchased. Pre-tax net unrealized losses on available-for-sale securities at December 31, 2006 were \$378 million. Management considers the aggregate decline in fair value of \$789 million at September 30, 2007 to be the result of increases in interest rates, and believes that the decline is temporary. Management has the ability and intent to hold the securities until market value recovery. Additional information about our management of the investment securities portfolio is included in the "Financial Condition Investment Securities" section of Management's Discussion and Analysis of Financial Condition and Results of Operations and in note 3 to the consolidated financial statements in our 2006 Form 10-K.

We maintain an effective universal shelf registration that allows for the offering and sale of debt securities, capital securities, common stock, depositary shares and preferred stock, and warrants to purchase such securities, including any shares into which the preferred stock and depositary shares may be convertible, or any combination thereof. In addition, we currently maintain a commercial paper program, under which we can issue up to \$3 billion with original maturities of up to 270 days from the date of issue. At September 30, 2007, we had \$1.55 billion of commercial paper outstanding, compared to \$998 million at December 31, 2006.

State Street Bank currently has authority to issue bank notes up to an aggregate of \$750 million with original maturities ranging from 14 days to five years. At September 30, 2007, no notes payable were outstanding and all \$750 million was available for issuance. In addition, State Street Bank currently has authority to issue up to an aggregate of \$1 billion of subordinated bank notes.

State Street Bank currently maintains a line of credit with a financial institution of CAD \$800 million, or approximately \$804 million as of September 30, 2007, to support its Canadian securities processing operations. The line of credit has no stated termination date and is cancelable by either party with prior notice. As of September 30, 2007, no balance was outstanding on this line of credit.

Risk Management

We employ a comprehensive and well-integrated risk management function to identify, assess, measure and control the risks in our global businesses. The measurement, monitoring and mitigation of risks are essential to the financial performance and successful management of State Street's businesses. These risks, if not effectively managed, can result in current losses to State Street as well as erosion of our capital and damage to our reputation. Our systematic approach also allows for a more precise assessment of risks within a framework for evaluating opportunities for the prudent use of capital. While we believe our risk management program is effective in managing the risks in our businesses, external factors may create risks that cannot always be identified or anticipated. For example, a material counterparty failure or a default of a material obligor could have an adverse effect on our results of operations.

Additional information about our process for managing market risk for both our trading and asset and liability management activities, as well as credit risk, operational risk and business risk, can be found in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2006 Form 10-K.

Market Risk

Market risk is defined as the risk of adverse financial impact due to fluctuations in interest rates, foreign exchange rates and other market-driven rates or prices. State Street is exposed to market risk both in its trading and non-trading, or asset and liability management, activities. The market risk management processes related to these activities, discussed in further detail below, apply to both on-balance sheet and off-balance sheet exposures.

We primarily engage in trading and investment activities to serve our customers' needs and to contribute to overall corporate earnings and liquidity. In the conduct of these activities, we are subject to, and assume, market risk. The level of market risk that we assume is a function of our overall objectives and liquidity needs, customer requirements and market volatility. Interest rate risk, a component of market risk, is more thoroughly discussed in the "Asset and Liability Management" portion of this "Market Risk" section.

Trading Activities

Market risk associated with foreign exchange and other trading activities is managed through established limits on aggregate and net open positions, sensitivity to changes in interest rates, and concentrations, which are supplemented by stop-loss thresholds. We use an array of risk management tools and methodologies, including value-at-risk, to measure, monitor and manage market risk. All limits and measurement techniques are reviewed and adjusted as necessary on a regular basis by business managers, the market risk management group and the Trading and Market Risk Committee.

We use a variety of derivative financial instruments to support customers' needs, conduct trading activities and manage our interest-rate and currency risk. These activities are designed to create trading revenue and to hedge potential earnings volatility. In addition, we provide services related to derivatives in our role as both a manager and a servicer of financial assets.

Our customers use derivatives to manage the financial risks associated with their investment goals and business activities. With the growth of cross-border investing, customers have an increasing need for foreign exchange forward contracts to convert currency for international investment and to manage the currency risk in their international investment portfolios. As an active participant in the foreign exchange markets, we provide foreign exchange forward contracts and options in support of these customer needs.

As part of our trading activities, we assume positions in the foreign exchange and interest-rate markets by buying and selling cash instruments and using derivatives, including foreign exchange forward contracts, foreign exchange and interest-rate options and interest-rate swaps. As of September 30, 2007, the notional amounts of all these derivatives were \$836.13 billion, of which \$784.91 billion were foreign exchange forward, swap and spot contracts. In the aggregate, long and short foreign exchange forward positions are closely matched to minimize currency and interest-rate risk. All foreign exchange contracts are valued daily at current market rates. Additional information about trading derivatives is in note 10 to the consolidated financial statements in this Form 10-Q.

We use a variety of risk measurement and estimation techniques, including value-at-risk, which is an estimate of potential loss for a given period within a stated statistical confidence interval. We use a system of risk management to estimate value-at-risk daily. We have adopted standards for estimating value-at-risk, and we maintain capital for market risk in accordance with applicable regulatory guidelines. Value-at-risk is estimated for a 99% one-tail confidence interval and an assumed one-day

holding period using a historical observation period of greater than two years. A 99% one-tail confidence interval implies that daily trading losses should not exceed the estimated value-at-risk more than 1% of the time, or approximately three days out of the year. The methodology uses a simulation approach based on observed changes in foreign exchange rates, interest rates (domestic and foreign) and foreign exchange implied volatilities, and takes into account the resulting diversification benefits provided from the mix of our trading positions.

Like all quantitative risk measures, value-at-risk is subject to limitations and assumptions inherent in our methodology. Our methodology gives equal weight to all market-rate observations regardless of how recently the market rates were observed. The estimate is calculated using static portfolios consisting of positions held at the end of each business day. Therefore, implicit in the value-at-risk estimate is the assumption that no intraday actions are taken by management during adverse market movements. As a result, the methodology does not include risk associated with intraday changes in positions or intraday price volatility.

The following table presents value-at-risk with respect to our trading activities, as measured by our value-at-risk methodology for the periods indicated:

VALUE-AT-RISK (In millions)	Nine Months Ended September 30,					
	2007			2006		
	Average	Maximum	Minimum	Average	Maximum	Minimum
Foreign exchange products	\$ 1.8	\$ 4.0	\$ 0.7	\$ 1.6	\$ 4.3	\$ 0.7
Interest rate products	1.6	3.7	0.1	1.0	1.8	0.2

We back-test the estimated one-day value-at-risk on a daily basis. This information is reviewed and used to assure that all relevant trading positions are properly modeled. For the nine months ended September 30, 2007 and 2006, we did not experience any trading losses in excess of our end-of-day value-at-risk estimate.

Asset and Liability Management Activities

The primary objective of asset and liability management is to provide sustainable and growing net interest revenue, or NIR, under varying economic environments, while protecting the economic values of our balance sheet assets and liabilities from the effects of adverse changes in interest rates. Most of our NIR is earned from the investment of deposits generated by our core Investment Servicing and Investment Management businesses. We structure our balance sheet assets to generally conform to the characteristics of our balance sheet liabilities, but we manage our overall interest-rate risk position in the context of current and anticipated market conditions and within internally approved risk guidelines.

Our investment activities and our use of derivatives are the primary tools used in managing interest-rate risk. We invest in financial instruments with currency, repricing, and maturity characteristics we consider appropriate to manage our overall interest-rate risk position. We use certain derivative financial instruments, primarily interest-rate swaps, to alter the interest-rate characteristics of specific balance sheet assets or liabilities. The use of derivatives is subject to internally approved guidelines. Additional information about our use of derivative financial instruments is in note 10 to the consolidated financial statements in this Form 10-Q.

As a result of growth in our non-U.S. operations, non-U.S. dollar denominated customer liabilities are a significant portion of our consolidated balance sheet. This growth results in exposure to changes

in the shape and level of non-U.S. dollar yield curves, which we include in our consolidated interest-rate risk management process.

To measure, monitor, and report on our interest-rate risk position, we use (1) NIR simulation, or NIR-at-risk, which measures the impact on NIR over the next twelve months to immediate, or rate shock, and gradual, or rate ramp, changes in market interest rates; and (2) economic value of equity, or EVE, which measures the impact on the present value of all NIR-related principal and interest cash flows of an immediate change in interest rates. NIR-at-risk is designed to measure the potential impact of changes in market interest rates on net interest revenue in the short term. EVE, on the other hand, is a long-term view of interest-rate risk, but with a view toward liquidation of State Street's existing assets and liabilities under current market conditions. Both of these measures are subject to internally established guidelines, and are monitored regularly, along with other relevant simulations, scenario analyses and stress tests.

The following table presents the estimated exposure of NIR for the next twelve months, calculated as of September 30, 2007, June 30, 2007 and December 31, 2006, due to a \pm 100 basis point rate shock, and a \pm 100 basis point rate ramp, in then-current interest rates. Estimated incremental exposures set forth below are dependent on management's assumptions about asset and liability sensitivities under various interest-rate scenarios, such as those previously discussed, and do not reflect any actions management may undertake in order to mitigate some of the adverse effects of interest-rate changes on State Street's financial performance.

NIR-AT-RISK

(Dollars in millions) Rate Change	Estimated Exposure to Net Interest Revenue		
	September 30, 2007	June 30, 2007	December 31, 2006
+100 bps shock	\$ (96)	\$ (78)	\$ (90)
-100 bps shock	51	43	52
+100 bps ramp	(46)	(42)	(57)
-100 bps ramp	40	38	46

The following table presents estimated EVE exposures, calculated as of September 30, 2007, June 30, 2007 and December 31, 2006, assuming an immediate and prolonged shift in interest rates, the impact of which would be spread over a number of years.

ECONOMIC VALUE OF EQUITY

(Dollars in millions) Rate Change	Estimated Exposure to Economic Value of Equity		
	September 30, 2007	June 30, 2007	December 31, 2006
+200 bps shock	\$ (1,078)	\$ (1,199)	\$ (1,023)
-200 bps shock	418	579	371

While the measures presented in the tables above are not a prediction of future NIR or valuations, they do suggest that if all other variables remained constant, in the short term, falling interest rates would lead to NIR that is higher than it would otherwise have been, and rising rates would lead to lower NIR. Other important factors that impact the levels of NIR are balance sheet size and mix; interest-rate spreads; the slope and interest-rate level of U.S. dollar and non-U.S. dollar yield curves

and the relationship between them; the pace of changes in market interest rates; and management's actions taken in response to the preceding conditions.

With respect to the September 30, 2007 information presented in the tables above, the balance sheet of Investors Financial is reflected in the estimated exposure of NIR and the estimated EVE exposure. Information for prior periods was not restated. The increases in NIR-at-risk from June 30, 2007 were largely driven by the contribution of NIR from the acquired Investors Financial business. Although the amounts of NIR-at-risk increased, the rate of increase was at a lower level than the growth in NIR reported for the quarter ended September 30, 2007 compared to June 30, 2007. EVE decreased from June 30, 2007 because of a reduced interest-rate risk profile that more than offset the increase in consolidated balance sheet size. U.S. interest rates declined during the third quarter of 2007, which shortened the estimated duration of the mortgage-backed securities in our investment portfolio, as our expectations for increasing principal prepayments rose in response to the decrease in rates. The impact of the shorter estimated duration is more significant with respect to estimated EVE exposure than NIR-at-risk because of the long-term nature of both EVE and the mortgage-backed securities.

Credit Risk

Credit and counterparty risk is defined as the risk of financial loss if a borrower or counterparty is either unable or unwilling to repay borrowings or settle a transaction in accordance with contractual terms. We assume credit and counterparty risk on both on- and off-balance sheet exposures. The extension of credit and acceptance of counterparty risk by State Street are governed by corporate guidelines based on the prospective customer's risk profile, the markets served, counterparty and country concentrations, and regulatory compliance. Our focus on large institutional investors and their businesses requires that we assume concentrated credit risk in a variety of forms to certain highly rated entities. This concentration risk is mitigated by comprehensive guidelines and procedures to monitor and manage all aspects of credit and counterparty risk that we undertake. Exposures are evaluated on an individual basis at least annually.

At September 30, 2007, total gross loans and leases were \$11.31 billion compared to \$8.95 billion at December 31, 2006, reflecting an increase in daily overdrafts, which primarily result from securities settlement advances related to customer investment activities. Overdrafts included in total gross loans were \$7.93 billion and \$5.69 billion at September 30, 2007 and December 31, 2006, respectively. Average overdrafts were approximately \$8.11 billion for the third quarter of 2007, and \$4.54 billion for the third quarter of 2006, respectively. These balances do not represent a significant increase in credit risk because of their short-term nature, which is generally overnight, as well as the lack of significant concentration and their occurrence in the normal course of the securities settlement process. The allowance for loan losses was \$18 million at September 30, 2007, December 31, 2006 and September 30, 2006.

Non-performing assets at September 30, 2007 were \$3 million and at December 31, 2006 were \$4 million, consisting of one investment security.

OFF-BALANCE SHEET ARRANGEMENTS

As more fully described in note 8 to the consolidated financial statements in this Form 10-Q, we administer four third-party-owned, special-purpose, multi-seller asset-backed commercial paper programs, commonly referred to as "conduits," the first of which was established in 1992. These conduits, which are structured as bankruptcy-remote entities and are not recorded in our consolidated

financial statements under existing accounting standards, are designed to satisfy the demand of our institutional customers, particularly mutual fund customers, for commercial paper and to provide access to the efficiencies of the global commercial paper markets.

Total assets in the four unconsolidated conduits were approximately \$29.21 billion at September 30, 2007, \$28.81 billion at June 30, 2007 and \$25.25 billion at December 31, 2006. The conduits obtain funding through the issuance of commercial paper and hold diversified portfolios of investments, which are predominately composed of securities purchased in the capital markets. These investments are collateralized by mortgages, student loans, automobile and equipment loans and credit card receivables, most of which securities are investment grade. Conduit assets are not sourced from our consolidated balance sheet.

The following tables provide additional information regarding the composition of the conduits' asset portfolios, in the aggregate, as of September 30, 2007. As of this date, none of the conduits' portfolio securities were collateralized by direct investments in sub-prime mortgages.

CONDUIT ASSETS BY COLLATERAL TYPE

(Dollars in billions)	Amount	Percent of Total Conduit Assets
Australian residential mortgage-backed securities	\$ 5.0	18%
U.S. residential mortgage-backed securities	4.4	15
European residential mortgage-backed securities	4.5	15
United Kingdom residential mortgage-backed securities	2.3	8
Student loans	3.3	11
Auto and equipment loans	2.6	9
Credit cards	2.1	7
Other ⁽¹⁾	5.0	17
Total conduit assets	\$ 29.2	100%

(1)

"Other" included trade receivables, collateralized debt obligations, business/commercial loans and other financial instruments. No individual asset class represented more than 2% of total conduit assets, except trade receivables, which were 3% of total conduit assets.

CONDUIT ASSETS BY RATING

(Dollars in billions)	Amount	Percent of Total Conduit Assets
AAA/Aaa	\$ 17.9	62%
AA/Aa	4.5	15
A/A	2.2	8
BBB/Baa	1.5	5
Not rated ⁽²⁾	3.1	10
Total conduit assets	\$ 29.2	100%

(2)

These assets reflect structured transactions. The transactions have been reviewed by rating agencies and have been structured to maintain the conduits' P1 or similar rating.

CONDUIT ASSETS BY ASSET ORIGIN

(Dollars in billions)	Amount	Percent of Total Conduit Assets
U.S.	\$ 12.4	42%
Australia	6.3	22
Great Britain	3.2	11
Spain	1.9	7
Italy	1.8	6
Portugal	0.7	2
Germany	0.7	2
Netherlands	0.5	2
Greece	0.3	1
Other	1.4	5
Total conduit assets	\$ 29.2	100%

Since the conduits were first organized beginning in 1992, we have entered into contractual obligations in the form of liquidity asset purchase agreements to support most or all of the liquidity of the conduits. We also provide credit enhancement to the conduits in the form of standby letters of credit. Other institutions can and do provide contractual liquidity to the conduits. As provided for in these agreements, we provide back-up liquidity in the event that the conduits cannot meet their funding needs through the issuance of commercial paper. In the event that maturing commercial paper cannot be reissued into the market by the conduits' dealer group, we and the other institutions providing liquidity may be required to provide liquidity by purchasing portfolio assets from the conduits. State Street may also provide liquidity by purchasing commercial paper or providing other extensions of credit to the conduits. As of September 30, 2007, State Streets' commitments under these liquidity asset purchase agreements and back-up lines of credit totaled approximately \$29.20 billion, and our commitments under standby letters of credit totaled \$1.04 billion. These amounts totaled \$27.87 billion and \$1.02 billion, respectively, at June 30, 2007.

The conduits generally sell commercial paper to third-party investors; however, we sometimes purchase commercial paper from the conduits. At September 30, 2007, we held on our consolidated balance sheet an aggregate of approximately \$730 million of commercial paper issued by the conduits, representing less than 1% of our consolidated total assets. These holdings were higher than the levels of commercial paper we have historically held. This was reflective of both the reduced liquidity in the asset-backed commercial paper markets during the third quarter and our desire to provide short-term stability to funding costs given the lack of liquidity in the marketplace.

The highest total overnight position in the conduits' commercial paper held by State Street was approximately \$1.25 billion during the third quarter of 2007. There were no draw-downs on the liquidity asset purchase agreements or standby letters of credit during the quarter ended September 30, 2007. At October 31, 2007, we held approximately \$500 million of the conduits' commercial paper.

As the third quarter of 2007 progressed and investors became increasingly concerned about the credit quality of the underlying assets generally held in asset-backed commercial paper conduits and similar vehicles, the resulting reduction in liquidity in the global fixed-income securities markets made the funding of the State Street-administered conduits more challenging than in normal market conditions, and the yields that issuers had to pay on asset-backed commercial paper increased. Consistent with the experience of other market participants, commercial paper was generally being placed by the State Street-administered conduits with shorter maturities and higher investor yields than historically experienced. This compressed the spread between the rate earned on the conduits' assets

and the conduits' funding costs. The weighted-average maturity of the conduits' commercial paper was approximately 15 days as of September 30, 2007, compared to approximately 22 days as of June 30, 2007 and approximately 21 days as of September 30, 2006. However, the conduits continue to roll over the commercial paper as it matures, i.e., place the commercial paper with investors and dealers, including State Street. Since the end of the third quarter of 2007, the asset-backed commercial paper market has modestly improved, but we remain cautious.

We intend to continue to manage the liquidity of the programs, if and as needed, through purchases of commercial paper as necessary; however, if due to further deterioration in the liquidity of the fixed-income markets or otherwise, it would become necessary to purchase assets from the conduits, we anticipate that we could fund those purchases.

During the third quarter of 2007, we did not experience any losses in connection with the conduits, whether in our role as a liquidity and credit enhancement provider or otherwise, although the margins that we generate from administration of the conduits have been significantly compressed by the increased yields required by market participants to buy the commercial paper. As a result, the fee revenue we generated from our involvement with the conduits decreased to approximately \$11 million for the third quarter of 2007 from approximately \$14 million for the third quarter of 2006. For the nine months ended September 30, 2007, this revenue totaled approximately \$50 million, compared to approximately \$42 million for the first nine months of 2006. We earn fees from our role as administrator, liquidity or credit enhancement provider and as one of the dealers, which fees are priced on a market basis. These fees are recorded in processing fees and other revenue in our consolidated statement of income. Our overall conduit business activities generated a pre-tax loss of approximately \$4 million for the third quarter of 2007. This loss, which included the fee revenue described above, primarily resulted from the change in fair value of basis swaps, as well as other conduit operating expenses.

As described above, we provide the conduits with contractual liquidity in the form of liquidity asset purchase agreements. If a conduit experienced a problem with an asset, such as a default or credit rating downgrade, subject to certain conditions, the liquidity asset purchase agreement could be invoked by the conduit, requiring State Street to purchase the asset from the conduit at prices which may exceed the fair value of the assets. If that occurred, we would be required to recognize a loss upon purchase of the asset. Any loss from a credit default would first be offset by the level of funding provided by the subordinated note holder. Currently, in light of the recent reduction in liquidity in the markets, with spreads on virtually all asset classes except U.S. treasuries having widened, we expect that an asset purchase would result in a loss. This loss may be recovered in future periods, depending on State Street's actions after the asset is purchased.

It is also possible that we would be required to consolidate one or more of the conduits' assets and liabilities onto our consolidated balance sheet. This would occur if we were determined to be the primary beneficiary of the conduits as defined in FASB Interpretation No. 46(R), or FIN 46(R). For example, if changes in market conditions require us to update the assumptions in our expected loss model, we may be required to increase the amount of first-loss notes in order for the investors in the first-loss notes to continue to be considered the primary beneficiaries of the conduits. If, for some reason, the conduits are not able to issue additional first-loss notes or take other actions, we may be determined to be the primary beneficiary of the conduits, and would be required to consolidate the conduits' assets and liabilities onto our consolidated balance sheet. Additional information about our use of an expected loss model and the third-party investors in first-loss notes is provided in note 8 to the consolidated financial statements in this Form 10-Q. Our accounting treatment of the conduits is reviewed at least quarterly, and more frequently if specific events warrant.

During the third quarter of 2007, as a result of the events in the global fixed-income securities markets, we reviewed the underlying assumptions incorporated in our FIN 46(R) expected loss model. We concluded that our model assumptions were appropriate and were reflective of market participant assumptions, and appropriately considered the probability of, and potential for, the recurrence of these events.

If consolidation were to occur because we were determined to be the primary beneficiary of the conduits as defined in FIN 46(R), we would consolidate the conduits' assets and liabilities onto our consolidated balance sheet at fair value. We would recognize an extraordinary loss on the date of consolidation if the fair value of the conduits' liabilities exceeded the fair value of the conduits' assets, as they do currently. This loss would accrete back into income over the remaining lives of the assets, assuming that the assets were held to maturity and that we recovered the full principal amount of the securities.

Purchasing or consolidating all or a significant portion of the assets of the conduits would affect the size and composition of our consolidated balance sheet and alter our financial and regulatory capital ratios, and may affect our earnings. In light of our continued ability to manage the liquidity of the commercial paper, we do not currently anticipate that this action will become necessary. However, for illustrative purposes only, assuming estimated fair values of the conduits' assets as of September 30, 2007, if all of the conduits' assets were purchased under the liquidity asset purchase agreements, or if the conduits' assets and liabilities were consolidated onto our consolidated balance sheet, we estimate that we would recognize an after-tax loss of approximately \$215 million in our consolidated statement of income.

This estimate assumes that all of the conduits, with total assets of approximately \$29 billion as of September 30, 2007, are consolidated; that the assets of the conduits are recorded at fair value, which is based on State Street's consistent application of its pricing policies for conduit assets; and that the pre-tax loss is tax-effected at a 40% marginal income tax rate. If consolidation were to occur in the future, or we were required to purchase assets pursuant to the liquidity asset purchase agreements at prices in excess of the fair value of the assets, the ultimate amount of loss will be based upon market conditions at the date such a determination is made, which could differ from the estimate provided above. If the assets were consolidated for accounting purposes pursuant to FIN 46(R), we expect that this loss would be recorded as an extraordinary loss, after income from continuing operations. If we were to purchase the assets under the liquidity asset purchase agreements, to the extent that a loss was incurred, we expect that the loss would be recognized in continuing operations.

We consider the activities of the conduits in our liquidity management process, as more fully described in the "Liquidity" section of this Management's Discussion and Analysis. We would be able to access multiple sources of liquidity to fund required asset purchases, including sales of other assets, asset repurchase agreements, the issuance of corporate commercial paper, the issuance of bank certificates of deposit and time deposits, and accessing the Federal Reserve discount window or similar facilities in other jurisdictions in which we maintain significant banking operations. The consolidation of the conduits for accounting purposes alone would not require additional funding or liquidity for the conduits to fund their asset portfolios, unless the reasons for consolidation related to an inability of the conduits to issue commercial paper.

If we were required to consolidate the conduits' assets and liabilities, our regulatory capital ratios would be negatively impacted for a period of time. With respect to regulatory capital, the consolidation of the conduits' assets and liabilities would cause only a modest reduction of our tier 1 and total risk-based capital ratios. The impact of consolidation on our tier 1 leverage ratio would be more

significant, but the degree of impact would depend on how and when consolidation occurred, since this ratio is a function of our consolidated total average assets over an entire quarter. We currently estimate that if we consolidated the conduits' assets and liabilities, we would be able to continue to meet the regulatory capital threshold for "well capitalized."

Assuming estimated fair values of the conduits' assets as of September 30, 2007, priced as described above, if all of the conduits' assets and liabilities were consolidated onto our consolidated balance sheet and no other management actions were taken with respect to capital, the following table presents the estimated impact on State Street's and State Street Bank's regulatory capital ratios.

	State Street		State Street Bank	
	Reported as of September 30, 2007	Adjusted as of September 30, 2007	Reported as of September 30, 2007	Adjusted as of September 30, 2007
Tier 1 leverage ratio	5.4%	5.2%	5.4%	5.2%
Tier 1 risk-based capital ratio	11.7	11.3	11.1	10.7
Total risk-based capital ratio	13.3	12.9	12.8	12.5

Information related to other off-balance sheet arrangements is in notes 7, 8 and 10 to the consolidated financial statements in this Form 10-Q.

RECENT ACCOUNTING DEVELOPMENTS

Information related to recent accounting developments is in note 1 to the consolidated financial statements in this Form 10-Q.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is included in the "Risk Management Market Risk" section of Management's Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q.

CONTROLS AND PROCEDURES

State Street has established and maintains disclosure controls and procedures that are designed to ensure that material information relating to State Street and its subsidiaries on a consolidated basis required to be disclosed in its reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to State Street management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. For the quarter ended September 30, 2007, State Street carried out an evaluation, under the supervision and with the participation of State Street management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of State Street's disclosure controls and procedures. Based on the evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that State Street's disclosure controls and procedures were effective as of September 30, 2007.

State Street has also established and maintains internal control over financial reporting as a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States. In the ordinary course of business, State Street routinely enhances its internal controls and procedures for financial reporting by either upgrading its current systems or implementing new systems. Changes have been made and will be made to State Street's internal controls and procedures for financial reporting as a result of these efforts. During the quarter ended September 30, 2007, there was no change in State Street's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, State Street's internal control over financial reporting.

STATE STREET CORPORATION
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

(Dollars in millions, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Fee Revenue:				
Servicing fees	\$ 937	\$ 685	\$ 2,421	\$ 2,025
Management fees	299	238	844	690
Trading services	320	171	800	659
Securities finance	165	87	425	296
Processing fees and other	61	65	199	211
	1,782	1,246	4,689	3,881
Net Interest Revenue:				
Interest revenue	1,383	1,103	3,758	3,098
Interest expense	919	837	2,584	2,304
	464	266	1,174	794
Net interest revenue	464	266	1,174	794
Provision for loan losses				
	464	266	1,174	794
Net interest revenue after provision for loan losses	464	266	1,174	794
(Losses) Gains on sales of available-for-sale investment securities, net	(6)	3	(6)	14
	2,240	1,515	5,857	4,689
Operating Expenses:				
Salaries and employee benefits	916	639	2,463	1,958
Information systems and communications	145	121	398	382
Transaction processing services	165	121	435	375
Occupancy	109	91	301	279
Merger and integration	141		141	
Other	213	118	522	368
	1,689	1,090	4,260	3,362
Total operating expenses	1,689	1,090	4,260	3,362
Income from continuing operations before income tax expense	551	425	1,597	1,327
Income tax expense from continuing operations	193	147	559	