STATE STREET Corp
Form 10-Q
May 07, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

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	**04-2456637**

(State or other jurisdiction of incorporation)	(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 x No ¨

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

(Do not check if a smaller reporting company)

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

The number of shares of State Street s common stock outstanding on April 30, 2010 was 501,714,719

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STATE STREET CORPORATION

Quarterly Report on Form 10-Q for the Quarterly Period Ended March 31, 2010

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CONDITION AND RESULTS OF OPERATIONS

GENERAL

State Street Corporation is a financial holding company headquartered in Boston, Massachusetts. Through its subsidiaries, including its principal banking subsidiary, State Street Bank and Trust Company, which we refer to as State Street Bank, State Street Corporation 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 Corporat and its subsidiaries on a consolidated basis. All references in this Form 10-Q to the parent company are to State Street Corporation. At March 31, 2010, we had consolidated total assets of $153.97 billion, consolidated total deposits of $90.34 billion, consolidated total shareholders equity of $15.41 billion and employed 27,700.

Our customers include mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, foundations, endowments 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 alternative investment operations outsourcing, performance, risk and compliance analytics, investment research services and investment management, including passive and active U.S. and non-U.S. equity and fixed-income strategies. We had $19.04 trillion of assets under custody and administration and $1.93 trillion of assets under management at March 31, 2010. Information about these assets, and financial information about our business lines, is provided in the Consolidated Results of Operations Total Revenue and Line of Business Information sections of this Management s Discussion and Analysis.

This Management s Discussion and Analysis is part of our Quarterly Report on Form 10-Q for the first quarter of 2010 which we filed with the SEC, and updates the Management s Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009, which we refer to as the 2009 Form 10-K. You should read the financial information in this Management s Discussion and Analysis and elsewhere in this Form 10-Q in conjunction with the financial and other information contained in the 2009 Form 10-K. Certain previously reported amounts have been reclassified to conform to current period classifications as presented in this Form 10-Q.

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. Certain accounting policies are considered by management to be relatively more significant in this respect. These policies relate to the accounting for fair value measurement; the accounting for interest revenue recognition and other-than-temporary impairment; and the accounting for goodwill and other intangible assets. Additional information about these accounting policies is included in the Significant Accounting Estimates section of Management s Discussion and Analysis in our 2009 Form 10-K. There were no changes to these accounting policies during the first quarter of 2010.

Certain financial information provided in this Management s Discussion and Analysis has been prepared on both a GAAP basis and a non-GAAP, or operating basis. Management measures and compares certain financial information on an operating basis, as it believes this presentation supports meaningful comparisons from period to period and the analysis of comparable financial trends with respect to State Street s normal ongoing business operations. Management believes that operating-basis financial information, which reports

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revenue from non-taxable sources on a fully taxable-equivalent basis and excludes the effect of revenue and expenses outside of the normal course of our business, facilitates an investor s understanding and analysis of State Street s underlying financial performance and trends in addition to financial information prepared in accordance with GAAP.

FORWARD-LOOKING STATEMENTS

This Form 10-Q, including this Management s Discussion and Analysis, contains statements that are considered forward-looking statements within the meaning of U.S. securities laws, including statements about industry trends, management s future expectations and other matters that do not relate strictly to historical facts and are based on assumptions by management. Forward-looking statements are often identified by such forward-looking terminology as plan, expect, look, believe, anticipate, estimate, seek, may, will, trend, target and goal, variations of such terms. Forward-looking statements include, among other things, statements about our confidence in our strategies and our expectations about our financial performance, market growth, acquisitions and divestitures, new technologies, services and opportunities, the outcome of legal proceedings and our earnings.

Forward-looking statements are subject to various risks and uncertainties, which change over time, 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 State Street and its subsidiaries, including State Street Bank. Factors that could cause changes in the expectations or assumptions on which forward-looking statements are based include, but are not limited to:

- financial market disruptions and the economic recession, whether in the U.S. or internationally, and monetary and other governmental actions, including regulation, taxes and fees, designed to address or otherwise be responsive to such disruptions and recession, including actions taken in the U.S. and internationally to address the financial and economic disruptions that began in 2007;

- increases in the volatility of, or declines in the levels of, our net interest revenue or other revenue influenced by market factors, changes in the composition of the assets on our consolidated balance sheet and the possibility that we may be required to change the manner in which we fund those assets;

- the financial strength and continuing viability of the counterparties with which we or our customers do business and to which we have investment, credit or financial exposure;

- the liquidity of the U.S. and international securities markets, particularly the markets for fixed-income securities, and the liquidity requirements of our customers;

- the credit quality, credit agency ratings, and fair values of the securities in our investment securities portfolio, a deterioration or downgrade of which could lead to other-than-temporary impairment of the respective securities and the recognition of an impairment loss in our consolidated statement of income;

the maintenance of credit agency ratings for our debt and depository obligations as well as the level of credibility of credit agency ratings;

the ability to complete our announced and pending acquisitions, as well as future acquisitions, divestitures and joint ventures, including the ability to obtain regulatory approvals, the ability to arrange financing as required, and the ability to satisfy other closing conditions;

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the risks that acquired businesses will not be integrated successfully, or that the integration will take longer than anticipated, that expected synergies will not be achieved or unexpected disynergies will be experienced, that customer and deposit retention goals will not be met, that other regulatory or operational challenges will be experienced and that disruptions from the transaction will harm relationships with customers, employees or regulators;

the possibility of our customers incurring substantial losses in investment pools where we act as agent, and the possibility of general reductions in the valuation of customer assets under our management;

our ability to attract deposits and other low-cost, short-term funding;

potential changes to the competitive environment, including changes due to the effects of consolidation, and perceptions of State Street as a suitable service provider or counterparty;

the level and volatility of interest rates and the performance and volatility of securities, credit, currency and other markets in the U.S. and internationally;

our ability to measure the fair value of the investment securities on our consolidated balance sheet;

the results of litigation, government investigations and similar disputes or proceedings;

the enactment of new legislation and changes in governmental regulation and enforcement that affect us or our customers, and which may increase our costs and expose us to risk related to compliance;

current proposals for legislative and regulatory changes that may impose special taxes or assessments on us, change the activities in which we are permitted to engage or change the standard of liability for certain services that we provide;

adverse publicity or other reputational harm;

the performance and demand for the products and services we offer, including the level and timing of withdrawals from our collective investment products;

our ability to grow revenue, attract and/or retain and compensate highly skilled people, control expenses and attract the capital necessary to achieve our business goals and comply with regulatory requirements;

our ability to control operating risks, information technology systems risks and outsourcing risks and our ability to protect our intellectual property rights, the possibility of errors in the quantitative models we use to manage our business and the possibility that our controls will fail or be circumvented;

the potential for new products and services to impose additional costs on us and expose us to increased operational risk;

changes in accounting standards and practices; 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 from our historical financial results due to the factors discussed in this section and elsewhere in this Form 10-Q or disclosed in our other SEC filings, including the risk factors included in our 2009 Form 10-K. Forward-looking statements should not be relied upon as representing our expectations or beliefs as of any date subsequent to the time this Form 10-Q is filed with the SEC. We undertake no obligation to revise the forward-looking statements contained in this Form 10-Q to reflect events after the time it is filed with the SEC. The factors discussed above are not intended to be a complete summary of all risks and uncertainties that may affect our businesses. We cannot anticipate all potential economic, operational and financial developments that may adversely affect our consolidated results of operations and financial condition.

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Forward-looking statements should not be viewed as predictions, and should not be the primary basis upon which investors evaluate State Street. Any investor in State Street should consider all risks and uncertainties disclosed in our SEC filings, including our filings under the Securities Exchange Act of 1934, in particular our reports on Forms 10-K, 10-Q and 8-K, or registration statements filed under the Securities Act of 1933, all of which are accessible on the SEC s website at *www.sec.gov* or on our website at *www.statestreet.com*.

OVERVIEW OF FINANCIAL RESULTS

	Quarters Ended March 31,	
(Dollars in millions, except per share amounts)	**2010**	**2009**
Total fee revenue	**$ 1,540**	$ 1,422
Net interest revenue	**661**	564
Gains related to investment securities, net	**95**	16
Total revenue	**2,296**	2,002
Provision for loan losses	**15**	84
Expenses	**1,579**	1,304
Income before income tax expense	**702**	614
Income tax expense	**207**	138
Net income	**$ 495**	$ 476
Adjustments to net income[1]		(31)
Net income available to common shareholders	**$ 495**	$ 445
Earnings per common share:		
Basic	**$ .99**	$ 1.03
Diluted	**.99**	1.02
Average common shares outstanding (in thousands):		
Basic	**494,588**	432,179
Diluted	**498,056**	435,299
Cash dividends declared	**$ .01**	$ .01
Return on average common shareholders equity	**13.4%**	15.7%

(1) Adjustments were related to preferred stock issued in connection with the U.S. Treasury s TARP program in 2008 and redeemed in June 2009.

Financial Highlights

For the first quarter of 2010, we recorded net income of $495 million, or $0.99 per diluted common share, compared to $445 million, or $1.02 per diluted common share, for the first quarter of 2009. Return on average common equity was 13.4% for the first quarter of 2010 compared to 15.7% for the same period in 2009.

Total revenue for the first quarter of 2010 increased 15% compared to the same period in 2009, with total fee revenue up 8% in the same comparison. Servicing fee and management fee revenue were up 15% and 25%, respectively, generally the result of increases in equity market valuations as measured by the published indices presented in the INDEX table in this Management s Discussion and Analysis on page 8. Both servicing and management fees also benefited compared to the first quarter of 2009 from the impact of new business won in prior periods on current-period revenue. Trading services revenue compared to the first quarter of 2009 decreased

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slightly, primarily due to a decline in foreign exchange trading revenue attributable to lower market volatility, which was largely offset by an increase in brokerage fees related to higher electronic trading volumes. Securities finance revenue decreased 60% primarily as a result of lower spreads, partly offset by slightly higher lending volumes. Processing fees and other revenue increased 145%, primarily the result of net revenue related to certain tax-advantaged investments, including a gain from a leasing transaction.

Net interest revenue increased 17% for the first quarter of 2010 compared to the prior-year first quarter, or 16% on a fully taxable-equivalent basis ($693 million compared to $596 million, each reflecting increases from tax-equivalent adjustments of $32 million). These increases were the result of $212 million of discount accretion recorded in the first quarter of 2010, generated by the assets added to our balance sheet in connection with the May 2009 conduit consolidation. See Total Revenue Net Interest Revenue in this Management s Discussion and Analysis for additional information. This increase in net interest revenue was partially offset by the continuing impact of lower interest-rate spreads.

Net interest margin, computed on fully taxable-equivalent net interest revenue, increased 33 basis points, from 2.01% in the first quarter of 2009 to 2.34% in the first quarter of 2010. The above-mentioned $212 million of discount accretion accounted for 72 basis points of net interest margin for the first quarter of 2010, compared to none for the first quarter of 2009. Excluding the effect of the accretion, fully taxable-equivalent net interest revenue for the first quarter of 2010 would have been $481 million compared to the above-mentioned $693 million, a decrease of 19% from $596 million for the first quarter of 2009, and net interest margin for the first quarter of 2010 would have been 1.62% compared to the reported margin of 2.34%.

We realized net gains of $192 million from sales of available-for-sale securities during the first quarter of 2010, compared to net gains of $29 million during the first quarter of 2009. We also recorded other-than-temporary impairment related to credit of $97 million during the first quarter of 2010, compared to $13 million during the 2009 quarter. The aggregate of the net gains and impairment losses resulted in net gains related to investment securities of $95 million for the first quarter of 2010, compared to net gains of $16 million for the 2009 quarter.

We recorded provisions for loan losses of $15 million during the first quarter of 2010, of which $10 million resulted from changes in management s expectations with respect to future cash flows from certain of the commercial real estate loans acquired in 2008 in connection with indemnification obligations.

Total expenses increased 21% to $1.58 billion for the first quarter of 2010 compared to $1.30 billion for the 2009 first quarter, primarily the result of a 21% increase in salaries and benefits expense, the majority of which was attributable to our reinstatement of cash incentive compensation accruals, higher benefit requirements in payroll taxes and higher contract services. During the first quarter of 2009, we did not accrue cash incentive compensation as a component of a plan to increase our tangible common equity. The increase in total expenses also reflected higher levels of transaction processing expenses, securities processing costs and professional services fees for the first quarter of 2010 compared to the first quarter of 2009.

At March 31, 2010, we had aggregate assets under custody and administration of $19.04 trillion, which increased $246 billion, or 1%, from $18.79 trillion at December 31, 2009, and increased $4.01 trillion, or 27%, from $15.03 trillion at March 31, 2009. At March 31, 2010, we had aggregate assets under management of $1.93 trillion, which increased $18 billion, or 1%, from $1.91 trillion at December 31, 2009, and increased $534 billion, or 38%, from $1.40 trillion at March 31, 2009. The increases in servicing assets from March 31, 2009 to March 31, 2010 and from December 31, 2009 to March 31, 2010 resulted from increases in asset valuations associated with the improvement in the global financial markets and new business. The increase in assets under management from March 31, 2009 to

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March 31, 2010 reflected increases in asset valuations and net new business. The increase in assets under management from December 31, 2009 to March 31, 2010 reflected asset appreciation offset by a modest amount of net lost business.

During the first quarter of 2010, we won mandates for approximately $164 billion in assets to be serviced, for which we will provide various services including accounting, fund administration, custody, foreign exchange, securities finance, transfer agency, performance analytics, compliance reporting and monitoring, hedge fund servicing and private equity administration, and investment manager operations outsourcing. This new business is not fully reflected in servicing assets at March 31, 2010; we expect to earn fee revenue in future periods as we install the business and begin to service the assets.

Our effective tax rate for the first quarter of 2010 was 29.5% compared to 22.5% for the same period in 2009.

CONSOLIDATED RESULTS OF OPERATIONS

This section discusses our consolidated results of operations for the first quarter of 2010 compared to the same period in 2009, and should be read in conjunction with the consolidated financial statements and accompanying condensed notes included elsewhere in this Form 10-Q.

TOTAL REVENUE

	Quarters Ended March 31,		
(Dollars in millions)	**2010**	**2009**	**% Change**
Fee revenue:			
Servicing fees	**$ 880**	$ 766	15%
Management fees	**226**	181	25
Trading services	**242**	245	(1)
Securities finance	**72**	181	(60)
Processing fees and other	**120**	49	145
Total fee revenue	**1,540**	1,422	8
Net interest revenue:			
Interest revenue	**878**	738	19
Interest expense	**217**	174	25
Net interest revenue	**661**	564	17
Gains related to investment securities, net	**95**	16	
Total revenue	**$ 2,296**	$ 2,002	15

Fee Revenue

Servicing and management fees collectively comprised approximately 72% of our total fee revenue for the first quarter of 2010 compared to approximately 67% for the corresponding quarter in 2009. These fees are a function of several factors, including the mix and volume of assets under custody and administration and assets under management, securities positions held and the volume of portfolio transactions, and the types of products and services used by customers, and are generally 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 and administration, while management fees are affected by changes in month-end valuations of assets under

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management. 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 effect on servicing fee revenue. Generally, management fee revenue is more sensitive to market valuations than servicing fee revenue. Management fees for enhanced index and actively managed products are generally earned at higher rates than those for passive products. Enhanced index and actively managed products may also involve performance fee arrangements. Performance fees are generated when the performance of certain managed funds exceeds benchmarks specified in the management agreements. Generally, we experience more volatility with performance fees compared with more traditional management fees.

In light 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 a corresponding change of approximately 1% in our total revenue. We would expect the foregoing relationships to exist in normalized financial markets, which we have not experienced since mid-2007. The disrupted conditions that began during the second half of 2007 have adversely affected our servicing and management fee revenues, which are based, in part, on the value of assets under custody and administration or assets under management, as well as our market-driven revenues, particularly foreign exchange trading services and securities finance. Even though the financial markets began to improve during the second half of 2009, the effect of the disrupted conditions on our total revenue, particularly our market-driven revenue, has been more significant than we would anticipate in normalized markets.

The following table presents selected equity market indices for the quarters ended March 31, 2010 and 2009. Daily averages and the averages of month-end indices demonstrate worldwide changes in equity market valuations that affect servicing and management fee revenue, respectively. Quarter-end indices are indicative of the factors influencing the value of assets under custody and administration and assets under management at those dates. The index names listed in the table are service marks of their respective owners.

INDEX

	Daily Averages of Indices			Average of Month-End Indices			Quarter-End Indices		
	2010	**2009**	**% Change**	**2010**	**2009**	**% Change**	**2010**	**2009**	**% Change**
S&P 500®	**1,124**	808	39%	**1,116**	786	42%	**1,169**	798	46%
NASDAQ®	**2,281**	1,483	54	**2,261**	1,461	55	**2,398**	1,529	57
MSCI EAFE®	**1,549**	1,085	43	**1,531**	1,056	45	**1,584**	1,056	50

Servicing Fees

Servicing fees include fee revenue from U.S. mutual funds, collective investment funds worldwide, corporate and public retirement plans, insurance companies, foundations, endowments, and other investment pools. Products and services include custody; product- and participant-level accounting; daily pricing and administration; recordkeeping; investment manager and alternative investment manager operations outsourcing services; master trust and master custody; and performance, risk and compliance analytics.

The 15% increase in servicing fees for the first quarter of 2010 compared to the first quarter of 2009 primarily resulted from the effect of new business on current-period revenue, as well as increases in daily average equity market valuations. For the first quarter of 2010, servicing fees generated from customers outside the U.S. were approximately 39% of total servicing fees compared to approximately 37% for the first quarter of 2009. The following tables set forth the composition of assets under custody and administration.

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ASSETS UNDER CUSTODY AND ADMINISTRATION

(In billions)	March 31, 2010	December 31, 2009	March 31, 2009
Mutual funds	**$ 4,931**	$ 4,734	$ 3,910
Collective funds	**3,697**	3,580	2,601
Pension products	**4,449**	4,395	3,412
Insurance and other products	**5,964**	6,086	5,112
Total	**$ 19,041**	$ 18,795	$ 15,035

FINANCIAL INSTRUMENT MIX OF ASSETS UNDER CUSTODY AND ADMINISTRATION

(In billions)	March 31, 2010	December 31, 2009	March 31, 2009
Equities	**$ 9,217**	$ 8,828	$ 5,786
Fixed-income	**7,090**	7,236	6,649
Short-term and other investments	**2,734**	2,731	2,600
Total	**$ 19,041**	$ 18,795	$ 15,035

Management Fees

The 25% increase in management fees for the first quarter of 2010 compared to the first quarter of 2009 resulted primarily from increases in average month-end equity market valuations and the effect of new business on current-period revenue. Average month-end equity market valuations, individually presented in the preceding INDEX table, were up an average of 49% for the first quarter of 2010 compared to the first quarter of 2009. The relative percentage of our assets under management at March 31, 2010 related to passive equity and fixed-income strategies, which generally earn management fees at lower rates compared with active strategies, increased compared to March 31, 2009. For the first quarter of 2010, management fees generated from customers outside the U.S. were approximately 33% of total management fees compared to approximately 30% for the first quarter of 2009.

Assets under management consisted of the following:

ASSETS UNDER MANAGEMENT

(In billions)	March 31, 2010	December 31, 2009	March 31, 2009
Equities:			
Passive	**$ 809**	$ 787	$ 502
Active and other	**86**		