STATE STREET CORP
Form 10-Q
August 04, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
Form 10-Q

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

For the quarterly period ended June 30, 2017

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	02111
(Address of principal executive office)	(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 Data 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company ¨
Emerging growth company ¨		(Do not check if a smaller reporting company)	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

The number of shares of the registrant's common stock outstanding as of July 31, 2017 was 373,955,415.

STATE STREET CORPORATION
QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTERLY PERIOD ENDED
June 30, 2017

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We use acronyms and other defined terms for certain business terms and abbreviations, as defined on the acronyms list and glossary following the consolidated financial statements in this Form 10-Q.

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GENERAL

State Street Corporation, referred to as the Parent Company, is a financial holding company organized in 1969 under the laws of the Commonwealth of Massachusetts. Our executive offices are located at One Lincoln Street, Boston, Massachusetts 02111 (telephone (617) 786-3000). For purposes of this Form 10-Q, unless the context requires otherwise, references to “State Street,” “we,” “us,” “our” or similar terms mean State Street Corporation and its subsidiaries on a consolidated basis. The Parent Company is a source of financial and managerial strength to our subsidiaries.

Through our subsidiaries, including our principal banking subsidiary, State Street Bank, we provide a broad range of financial products and services to institutional investors worldwide, with $31.04 trillion of AUCA and $2.61 trillion of AUM as of June 30, 2017.

As of June 30, 2017, we had consolidated total assets of $238.27 billion, consolidated total deposits of $181.42 billion, consolidated total shareholders' equity of $22.07 billion and 35,606 employees. We operate in more than 100 geographic markets worldwide, including in the U.S., Canada, Europe, the Middle East and Asia.

Our operations are organized into two lines of business, Investment Servicing and Investment Management, which are defined based on products and services provided.

Additional information about our lines of business is provided in “Line of Business Information” in this Management's Discussion and Analysis and Note 17 to the consolidated financial statements in this Form 10-Q.

This Management's Discussion and Analysis is part of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, and updates the Management's Discussion and Analysis in our 2016 Form 10-K previously filed with the SEC. You should read the financial information contained in this Management's Discussion and Analysis and elsewhere in this Form 10-Q in conjunction with the financial and other information contained in our 2016 Form 10-K. Certain previously reported amounts presented in this Form 10-Q have been reclassified to conform to current-period presentation.

We prepare our consolidated financial statements in conformity with U.S. GAAP. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions in its application of certain accounting policies that materially affect the reported amounts of assets, liabilities, equity, revenue and expenses.

The significant accounting policies that require us to make judgments, estimates and assumptions that are difficult, subjective or complex about matters that are uncertain and may change in subsequent periods include:

- accounting for fair value measurements;
- other-than-temporary impairment of investment securities;
- impairment of goodwill and other intangible assets; and
- contingencies.

These significant accounting policies require the most subjective or complex judgments, and underlying estimates and assumptions could be subject to revision as new information becomes available. For additional information about these significant accounting policies, refer to pages 119 - 122, “Significant Accounting Estimates” included under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in our 2016 Form 10-K. We did not change these significant accounting policies in the first six months of 2017.

Certain financial information provided in this Form 10-Q, including in this Management's Discussion and Analysis, is prepared on both a U.S. GAAP, or reported basis, and a non-GAAP basis, including certain non-GAAP measures used in the calculation of identified regulatory ratios. We measure and compare certain financial information on a non-GAAP basis, including information (such as capital ratios calculated under regulatory standards scheduled to be effective in the future) that management uses in evaluating our business and activities.

Non-GAAP financial information should be considered in addition to, and not as a substitute for or superior to, financial information prepared in conformity with U.S. GAAP. Any non-GAAP financial information presented in this Form 10-Q, including this Management’s Discussion and Analysis, is reconciled to its most directly comparable

currently applicable regulatory ratio or U.S. GAAP-basis measure.
We further believe that our presentation of fully taxable-equivalent NII, a non-GAAP measure, which reports non-taxable revenue, such as interest income associated with tax-exempt investment securities, on a fully taxable-equivalent basis, facilitates an investor's understanding and analysis of our underlying financial performance and trends.
We provide additional disclosures required by applicable bank regulatory standards, including supplemental qualitative and quantitative information with respect to regulatory capital (including market

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risk associated with our trading activities) and the liquidity coverage ratio, summary results of semi-annual State Street-run stress tests which we conduct under the Dodd-Frank Act, and resolution plan disclosures required under the Dodd-Frank Act. These additional disclosures are accessible on the "Investor Relations" section of our corporate website at www.statestreet.com.

We have included our website address in this report as an inactive textual reference only. Information on our website is not incorporated by reference into this Form 10-Q.

We use acronyms and other defined terms for certain business terms and abbreviations, as defined in the acronyms list and glossary following the consolidated financial statements in this Form 10-Q.

Forward-Looking Statements

This Form 10-Q, as well as other reports and proxy materials submitted by us under the Securities Exchange Act of 1934, registration statements filed by us under the Securities Act of 1933, our annual report to shareholders and other public statements we may make, may contain statements (including statements in the Management's Discussion and Analysis included in such reports, as applicable) that are considered "forward-looking statements" within the meaning of U.S. securities laws, including statements about our goals and expectations regarding our business, financial and capital condition, results of operations, strategies, financial portfolio performance, dividend and stock purchase programs, outcomes of legal proceedings, market growth, acquisitions, joint ventures and divestitures, cost savings and transformation initiatives, client growth and new technologies, services and opportunities, as well as industry, regulatory, economic and market trends, initiatives and developments, the business environment and other matters that do not relate strictly to historical facts.

Terminology such as "plan," "expect," "intend," "objective," "forecast," "outlook," "believe," "priority," "anticipate," "estimat "may," "will," "trend," "target," "strategy" and "goal," or similar statements or variations of such terms, are intended to identif forward-looking statements, although not all forward-looking statements contain such terms.

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, regulatory environment and 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 cannot be foreseen with certainty and include, but are not limited to:

- the financial strength and continuing viability of the counterparties with which we or our clients do business and to which we have investment, credit or financial exposure, including, for example, the direct and indirect effects on counterparties of the sovereign-debt risks in the U.S., Europe and other regions;
- increases in the volatility of, or declines in the level of, our NII, changes in the composition or valuation of the assets recorded in our consolidated statement of condition (and our ability to measure the fair value of investment securities) and the possibility that we may change the manner in which we fund those assets;
- the liquidity of the U.S. and international securities markets, particularly the markets for fixed-income securities and inter-bank credits, and the liquidity requirements of our clients;
- the level and volatility of interest rates, the valuation of the U.S. dollar relative to other currencies in which we record revenue or accrue expenses and the performance and volatility of securities, credit, currency and other markets in the U.S. and internationally; and the impact of monetary and fiscal policy in the United States and internationally on prevailing rates of interest and currency exchange rates in the markets in which we provide services to our clients;
- 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;
-

our ability to attract deposits and other low-cost, short-term funding, our ability to manage levels of such deposits and the relative portion of our deposits that are determined to be operational under regulatory guidelines and our ability to deploy deposits in a profitable manner consistent with our liquidity needs, regulatory requirements and risk profile;

- the manner and timing with which the Federal Reserve and other U.S. and foreign regulators implement or reevaluate changes to the regulatory framework applicable to our operations, including implementation or modification of the Dodd-Frank Act, the Basel III final rule and European legislation (such as the Alternative Investment Fund Managers Directive, Undertakings for Collective Investment in Transferable Securities Directives and Markets in Financial Instruments Directive II); among other consequences, these regulatory changes impact the levels of regulatory capital we must maintain, acceptable levels of credit exposure to third parties, margin requirements applicable to derivatives, and restrictions on banking and financial activities. In addition, our regulatory posture and related expenses have been and will continue to be affected by changes in regulatory expectations for global systemically important financial institutions applicable to, among other things, risk management, liquidity and capital planning, resolution planning, compliance programs, and changes in governmental enforcement approaches to perceived failures to comply with regulatory or legal obligations;

- our resolution plan, submitted to the Federal Reserve and FDIC in June 2017, may not be considered to be sufficient by the Federal Reserve and the FDIC, due to a number of factors, including, but not limited to, challenges we may experience in interpreting and addressing regulatory expectations, failure to implement remediation in a timely manner, the complexities of development of a comprehensive plan to resolve a global custodial bank and related costs and dependencies. If we fail to meet regulatory expectations to the satisfaction of the Federal Reserve and the FDIC in our resolution plan submission filed in June 2017 or any future submission, we could be subject to more stringent capital, leverage or liquidity requirements, or restrictions on our growth, activities or operations;
- adverse changes in the regulatory ratios that we are required or will be required to meet, whether arising under the Dodd-Frank Act or the Basel III final rule, or due to changes in regulatory positions, practices or regulations in jurisdictions in which we engage in banking activities, including changes in internal or external data, formulae, models, assumptions or other advanced systems used in the calculation of our capital ratios that cause changes in those ratios as they are measured from period to period;
- requirements to obtain the prior approval or non-objection of the Federal Reserve or other U.S. and non-U.S. regulators for the use, allocation or distribution of our capital or other specific capital actions or corporate activities, including,

without limitation, acquisitions, investments in subsidiaries, dividends and stock purchases, without which our growth plans, distributions to shareholders, share repurchase programs or other capital or corporate initiatives may be restricted;

- changes in law or regulation, or the enforcement of law or regulation, that may adversely affect our business activities or those of our clients or our counterparties, and the products or services that we sell, including additional or increased taxes or assessments thereon, capital adequacy requirements, margin requirements and changes that expose us to risks related to the adequacy of our controls or compliance programs;
- economic or financial market disruptions in the U.S. or internationally, including those which may result from recessions or political instability; for example, the U.K.'s decision to exit from the European Union may continue to disrupt financial markets or economic growth in Europe or, similarly, financial markets may react sharply or abruptly to actions taken by the new administration in the United States;
- our ability to develop and execute State Street Beacon, our multi-year transformation program to digitize our business, deliver significant value and innovation for our clients and lower expenses across the organization, any failure of which, in whole or in part, may among other things, reduce our competitive position, diminish the cost-effectiveness of our systems and processes or provide an insufficient return on our associated investment;
- our ability to promote a strong culture of risk management, operating controls, compliance oversight, ethical behavior and governance that meets our expectations and those of our clients and our regulators, and the financial, regulatory, reputation and other consequences of our failure to meet such expectations; the impact on our compliance and controls enhancement programs of the appointment of a monitor under the deferred prosecution agreement with the DOJ and compliance consultant expected to be appointed under a potential settlement with the SEC, including the potential for such monitor and compliance consultant to require changes to our programs or to identify other issues that require substantial expenditures, changes in our operations, or payments to clients or reporting to U.S. authorities;

- the results of our review of our billing practices, including additional amounts we may be required to reimburse clients, as well as

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potential consequences of such review, including damage to our client relationships and adverse actions by governmental authorities;
- the results of, and costs associated with, governmental or regulatory inquiries and investigations, litigation and similar claims, disputes, or civil or criminal proceedings;
- changes or potential changes in the amount of compensation we receive from clients for our services, and the mix of services provided by us that clients choose;
- the large institutional clients on which we focus are often able to exert considerable market influence, and this, combined with strong competitive market forces, subjects us to significant pressure to reduce the fees we charge, to potentially significant changes in our assets under custody and administration or our assets under management in the event of the acquisition or loss of a client, in whole or in part, and to potentially significant changes in our fee revenue in the event a client re-balances or changes its investment approach or otherwise re-directs assets to lower- or higher-fee asset classes;
- the potential for losses arising from our investments in sponsored investment funds;
- the possibility that our clients will incur substantial losses in investment pools for which we act as agent, and the possibility of significant reductions in the liquidity or valuation of assets underlying those pools;
- our ability to anticipate and manage the level and timing of redemptions and withdrawals from our collateral pools and other collective investment products;
- the credit agency ratings of our debt and depositary obligations and investor and client perceptions of our financial strength;
- adverse publicity, whether specific to State Street or regarding other industry participants or industry-wide factors, or other reputational harm;
- our ability to control operational risks, data security breach risks and outsourcing risks, 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 prove insufficient, fail or be circumvented;
- our ability to expand our use of technology to enhance the efficiency, accuracy and reliability of our operations and our dependencies on information technology and our ability to control related risks, including cyber-crime and other threats to our information technology

infrastructure and systems (including those of our third-party service providers) and their effective operation both independently and with external systems, and complexities and costs of protecting the security of such systems and data;
- our ability to grow revenue, manage expenses, attract and retain highly skilled people and raise the capital necessary to achieve our business goals and comply with regulatory requirements and expectations;
- changes or potential changes to the competitive environment, including changes due to regulatory and technological changes, the effects of industry consolidation and perceptions of State Street as a suitable service provider or counterparty;
- our ability to complete acquisitions, joint ventures and divestitures, including the ability to obtain regulatory approvals, the ability to arrange financing as required and the ability to satisfy closing conditions;
- the risks that our acquired businesses and joint ventures will not achieve their anticipated financial and operational benefits or will not be integrated successfully, or that the integration will take longer than anticipated, that expected synergies will not be achieved or unexpected negative synergies or liabilities will be experienced, that client 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 our relationships with our clients, our employees or regulators;
- our ability to recognize evolving needs of our clients and to develop products that are responsive to such trends and profitable to us, the performance of and demand for the products and services we offer, and 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 affect the amount of taxes due.

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. Forward-looking statements in

MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

this Form 10-Q should not be relied on as representing our expectations or beliefs as of any time subsequent to the time this Form 10-Q is filed with the SEC. We undertake no obligation to revise our forward-looking statements after the time they are made. The factors discussed herein are not intended to be a complete statement of all risks and uncertainties that may affect our businesses. We cannot anticipate all developments that may adversely affect our business or operations or our consolidated results of operations, financial condition or cash flows.
Forward-looking statements should not be viewed as predictions, and should not be the primary basis on 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 annual reports on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 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 the “Investor Relations” section of our corporate website at www.statestreet.com.

OVERVIEW OF FINANCIAL RESULTS

TABLE 1: OVERVIEW OF FINANCIAL RESULTS

	Quarters Ended June 30,		
(Dollars in millions, except per share amounts)	2017	2016	% Change
Total fee revenue	$2,235	$2,053	9 %
Net interest income	575	521	10
Gains (losses) related to investment securities, net	—	(1)	nm
Total revenue	2,810	2,573	9
Provision for loan losses	3	4	(25)
Total expenses	2,031	1,860	9
Income before income tax expense	776	709	9
Income tax expense (benefit)	156	92	70
Net Income (loss) from non-controlling interest	—	2	nm
Net income	$620	$619	—
Adjustments to net income:			
Dividends on preferred stock[(1)]	(36)	(33)	9
Earnings allocated to participating securities[(2)]	—	(1)	nm
Net income available to common shareholders	$584	$585	—
Earnings per common share:			
Basic	$1.56	$1.48	5
Diluted	1.53	1.47	4
Average common shares outstanding (in thousands):			
Basic	375,395	394,160	
Diluted	380,915	398,847	
Cash dividends declared per common share	$.38	$.34	
Return on average common equity	12.6 %	12.4 %	

	Six Months Ended June 30,		
(Dollars in millions, except per share amounts)	2017	2016	% Change
Total fee revenue	$4,433	$4,023	10 %
Net interest income	1,085	1,033	5

Gains (losses) related to investment securities, net	(40)	1	nm
Total revenue	5,478	5,057	8
Provision for loan losses	1	8	(88)
Total expenses	4,117	3,910	5
Income before income tax expense	1,360	1,139	19
Income tax expense (benefit)	238	154	55
Net income from non-controlling interest	—	2	nm
Net income	$1,122	$987	14
Adjustments to net income:			
Dividends on preferred stock[1]	$(91)	$(82)	11
Earnings allocated to participating securities[2]	(1)	(1)	nm
Net income available to common shareholders	$1,030	$904	14
Earnings per common share:			
Basic	$2.72	$2.28	19
Diluted	2.69	2.25	20
Average common shares outstanding (in thousands):			
Basic	378,293	396,790	
Diluted	383,489	401,113	
Cash dividends declared per common share	$.76	$.68	
Return on average common equity	11.3 %	9.6 %	

[1] Additional information about our preferred stock dividends is provided in Note 12 to the consolidated financial statements in this Form 10-Q.
[2] Represents the portion of net income available to common equity allocated to participating securities, composed of unvested and fully vested SERP shares and fully vested deferred director stock awards, which are equity-based awards that contain non-forfeitable rights to dividends, and are considered to participate with the common stock in undistributed earnings.
[nm] Not meaningful

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The following “Highlights” and “Financial Results” sections provide information related to significant events, as well as highlights of our consolidated financial results for the quarter ended June 30, 2017 presented in Table 1: Overview of Financial Results. More detailed information about our consolidated financial results, including comparisons of our financial results for the quarter ended June 30, 2017 to those for the quarter ended June 30, 2016 and for the six months ended June 30, 2017 to those for the six months ended June 30, 2016, is provided under “Consolidated Results of Operations,” which follows these sections. In this Management’s Discussion and Analysis, where we describe the effects of changes in foreign exchange rates, those effects are determined by applying applicable weighted average foreign exchange rates from the relevant 2016 period to the relevant 2017 results.

Highlights

- EPS of $1.53 increased 4% in the second quarter of 2017 compared to $1.47 in the second quarter of 2016, reflecting growth in fee revenue driven by higher global equity markets, new business wins and higher client volumes, the contribution of the acquired GEAM operations and savings associated with State Street Beacon. The growth in EPS also reflected higher NII as a result of the higher market interest rates in the U.S., disciplined liability pricing and improvement of our liability mix. These increases were partially offset by restructuring costs of $62 million in the second quarter of 2017 as compared to $13 million in the second quarter of 2016.
- Second quarter 2017 ROE of 12.6% increased 20 bps compared to 12.4% in the second quarter of 2016, reflecting strong earnings and capital return via stock purchases and dividend payouts, partially offset by the aforementioned restructuring charges.
- Strength in equity markets and new business drove increases in both AUCA and AUM.

AUCA increased 12% in the second quarter of 2017 compared to the second quarter of 2016, primarily due to higher global equity markets, net new business and client flows. The AUCA growth contributed to revenue growth across the geographic regions we serve and across a range of products and client segments. In the second quarter of 2017, we secured new asset servicing mandates of approximately $135 billion. Our AUCA

pipeline of asset servicing mandates that have been won but not yet installed as of June 30, 2017 totaled approximately $370 billion.

AUM increased 13% in the second quarter of 2017 compared to the second quarter of 2016, primarily due to higher global equity markets, the impact of the acquired GEAM operations and positive ETF flows, partially offset by continuing institutional net outflows.

Additional information about AUCA and AUM is provided in "Servicing Fees" and "Management Fees," respectively, in "Line of Business - Investment Servicing" and "Line of Business - Investment Management," respectively, in this Management's Discussion and Analysis in this Form 10-Q.

- We declared a quarterly common stock dividend of $0.38 per share, totaling approximately $142 million, in the second quarter of 2017, compared to $0.34 per share, totaling $133 million in the second quarter of 2016.
- In the second quarter of 2017, we acquired approximately 2.7 million shares of common stock at an average per-share cost of $83.84 and an aggregate cost of approximately $227 million under the common stock purchase program approved by our Board in June 2016.
- Subsequent to the Federal Reserve's June 2017 non-objection to our capital plan under its 2017 CCAR process, our Board approved a new common stock purchase program, authorizing the purchase of up to $1.4 billion of common stock from July 1, 2017 through June 30, 2018 and, in July 2017, approved a third quarter quarterly common stock dividend of $0.42 per share, an increase of approximately 11% over the second quarter of 2017 quarterly common stock dividend.

Additional information with respect to our common stock purchase program and stock dividends are provided under "Capital" in "Financial Condition" in this Management's Discussion and Analysis in this Form 10-Q.

- In May 2017, we issued $750 million of fixed-to-floating rate senior notes due on May 15, 2023.

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Financial Results

- Total revenue in the second quarter of 2017 increased 9% compared to the second quarter of 2016, reflecting growth in total fee revenue and NII. The increase was primarily due to higher global equity markets, the acquired GEAM business, higher market interest rates in the U.S. and net new business. The second quarter of 2016 also included a revenue reduction of $48 million to servicing fees related to reimbursements to our clients related to the manner in which we invoiced certain expenses to our clients, as further discussed within "Investment Servicing" in "Line of Business Information" in this Management's Discussion and Analysis.
- Servicing fee revenue increased 8% in the second quarter of 2017 compared to the second quarter of 2016, primarily due to higher global equity markets, net new business and higher client volumes.
- Management fee revenue increased 36% in the second quarter of 2017 compared to the second quarter of 2016, primarily due to approximately $72 million from the acquired GEAM business, higher global equity markets and higher revenue-yielding ETF flows.
- Processing and other fee revenue decreased 68% in the second quarter of 2017 compared to the second quarter of 2016, primarily due to a pre-tax gain of approximately $53 million related to the sale of the WM/Reuters business in the second quarter of 2016 and unfavorable foreign exchange swap costs in the second quarter of 2017.
- NII increased 10% in the second quarter of 2017 compared to the second quarter of 2016, primarily due to higher market interest rates in the U.S. and disciplined liability pricing as well as improved liability mix, partially offset by lower investment portfolio securities balances.
- In the second quarter of 2017, we recorded restructuring charges of $62 million related to State Street Beacon, our multi-year transformation program to digitize our business, deliver significant value and innovation for our clients and lower expenses across the organization. We expect to achieve estimated annual pre-tax net run-rate expense savings of $550 million by the end of 2020, relative to 2015, all else equal, for full effect in 2021. We expect to generate at least $140 million in annual pre-tax expense savings in 2017. Actual expenses may

increase or decrease in the future due to other factors.

- Total expenses increased 9% in the second quarter of 2017 compared to the second quarter of 2016, primarily driven by costs to support new business (including technology infrastructure), expenses associated with the acquired GEAM operations, increases in restructuring expenses related to State Street Beacon as well as incentive compensation and annual merit increases. The increases to total expenses were partially offset by savings associated with State Street Beacon.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CONSOLIDATED RESULTS OF OPERATIONS

This section discusses our consolidated results of operations for the second quarter and first six months ended June 30, 2017 compared to the same periods in 2016, and should be read in conjunction with the consolidated financial statements and accompanying condensed notes to the consolidated financial statements included in this Form 10-Q.

Total Revenue

TABLE 2: TOTAL REVENUE

	Quarters Ended June 30,		
(Dollars in millions)	2017	2016	% Change
Fee revenue:			
Servicing fees	$1,339	$1,239	8 %
Management fees	397	293	36
Trading services:			
Foreign exchange trading	178	157	13
Brokerage and other trading services	111	110	1
Total trading services	289	267	8
Securities finance	179	156	15
Processing fees and other	31	98	(68)
Total fee revenue	2,235	2,053	9
Net interest income:			
Interest income	700	620	13
Interest expense	125	99	26
Net interest income	575	521	10
Gains (losses) related to investment securities, net	—	(1)	nm
Total revenue	$2,810	$2,573	9

	Six Months Ended June 30,		
(Dollars in millions)	2017	2016	% Change
Fee revenue:			
Servicing fees	$2,635	$2,481	6 %
Management fees	779	563	38
Trading services:			
Foreign exchange trading	342	313	9
Brokerage and other trading services	222	226	(2)
Total trading services	564	539	5
Securities finance	312	290	8
Processing fees and other	143	150	(5)
Total fee revenue	4,433	4,023	10
Net interest income:			
Interest income	1,350	1,249	8
Interest expense	265	216	23
Net interest income	1,085	1,033	5
Gains (losses) related to investment securities, net	(40)	1	nm
Total revenue	$5,478	$5,057	8

nm Not meaningful

Fee Revenue

Table 2: Total Revenue, provides the breakout of fee revenue for the quarters and six months ended June 30, 2017 and 2016.

Servicing and management fees collectively made up approximately 78% and 77% of total fee revenue in the second quarter and first six months of 2017, respectively, compared to approximately 75% and 76% in the second quarter and first six months of 2016, respectively. The level of these fees is influenced by several factors, including the mix and volume of our AUCA and our AUM, the value and type of securities positions held (with respect to assets under custody), the volume of portfolio transactions, and the types of products and services used by our clients, and is generally affected by changes in worldwide equity and fixed-income security valuations and trends in market asset class preferences.

Generally, servicing fees are affected by changes in daily average valuations of AUCA. Additional factors, such as the relative mix of assets serviced, the level of transaction volumes, changes in service level, the nature of services provided, balance credits, client minimum balances, pricing concessions, the geographical location in which services are provided and other factors, may have a significant effect on our servicing fee revenue.

Management fees are generally affected by changes in month-end valuations of AUM. Management fees for certain components of managed assets, such as ETFs, are affected by daily average valuations of AUM. Management fee revenue is more sensitive to market valuations than servicing fee revenue, as a higher proportion of the underlying services provided, and the associated management fees earned, are dependent on equity and fixed-income security valuations. Additional factors, such as the relative mix of assets managed, may have a significant effect on our management fee revenue. While certain management fees are directly determined by the values of AUM and the investment strategies employed, management fees may reflect other factors as well, including performance fee arrangements, as well as our relationship pricing for clients using multiple services.

Asset-based management fees for actively managed products are generally charged at a higher percentage of assets under management than for passive products. Actively managed products may also include performance fee arrangements which are recorded when the performance period is complete. Performance fees are generated when the performance of certain managed portfolios exceeds benchmarks specified in the management agreements. Generally, we experience more volatility

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with performance fees than with more traditional management fees.
In light of the above, we estimate, using relevant information as of June 30, 2017 and assuming that all other factors remain constant, that:

- A 10% increase or decrease in worldwide equity valuations, on a weighted average basis, over the relevant periods for which our servicing and management fees are calculated, would result in a corresponding change in our total servicing and management fee revenues of approximately 3%; and
- A 10% increase or decrease in worldwide fixed income markets, on a weighted average basis, over the relevant periods for which our servicing and management fees are calculated, would result in a corresponding change in our total servicing and management fee revenues of approximately 1%.

See Table 3: Daily, Month-End and Quarter-End Equity Indices and Table 4: Quarter-End Debt Indices, for selected indices. While the specific indices presented are indicative of general market trends, the asset types and classes relevant to individual client portfolios can and do differ, and the performance of associated relevant indices can therefore differ from the performance of the indices presented.
Daily averages, month-end averages, and quarter-end indices demonstrate worldwide changes in equity and debt markets that affect our servicing and management fee revenue. Quarter-end indices affect the values of AUCA and AUM as of those dates. The index names listed in the table are service marks of their respective owners.
Further discussion of fee revenue is provided under “Line of Business Information” in this Management's Discussion and Analysis in this Form 10-Q.

TABLE 3: DAILY, MONTH-END AND QUARTER-END EQUITY INDICES

	Daily Averages of Indices			Averages of Month-End Indices			Quarter-End Indices		
	Quarters Ended June 30,			Quarters Ended June 30,			As of June 30,		
	2017	2016	% Change	2017	2016	% Change	2017	2016	% Change
S&P 500®	2,398	2,075	16 %	2,406	2,087	15 %	2,423	2,099	15 %
MSCI EAFE®	1,856	1,648	13	1,869	1,656	13	1,883	1,608	17
MSCI® Emerging Markets	993	819	21	998	827	21	1,011	834	21
HFRI Asset Weighted Composite®	N/A	N/A	N/A	1,339	1,250	7	1,336	1,250	7

	Daily Averages of Indices			Averages of Month-End Indices		
	Six Months Ended June 30,			Six Months Ended June 30,		
	2017	2016	% Change	2017	2016	% Change
S&P 500®	2,362	2,015	17 %	2,371	2,032	17 %
MSCI EAFE®	1,802	1,621	11	1,814	1,629	11
MSCI® Emerging Markets	960	788	22	966	800	21
HFRI Asset Weighted Composite®	N/A	N/A	N/A	1,331	1,245	7

TABLE 4: QUARTER-END DEBT INDICES

	Quarter-End Indices		
	As of June 30,		
	2017	2016	% Change
Barclays Capital U.S. Aggregate Bond Index®	2,021	2,028	— %
Barclays Capital Global Aggregate Bond Index®	471	482	(2)

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Net Interest Income

See Table 2: Total Revenue, for the breakout of interest income and interest expense for the quarters and six months ended June 30, 2017 and 2016.

NII is defined as interest income earned on interest-earning assets less interest expense incurred on interest-bearing liabilities. Interest-earning assets, which principally consist of investment securities, interest-bearing deposits with banks, repurchase agreements, loans and leases and other liquid assets, are financed primarily by client deposits, short-term borrowings and long-term debt.

Net interest margin represents the relationship between annualized fully taxable-equivalent NII and average total interest-earning assets for the period. It is calculated by dividing fully taxable-equivalent NII by average interest-earning assets. Revenue that is exempt from income taxes, mainly that earned from certain investment securities (state and political subdivisions), is adjusted to a fully taxable-equivalent basis using a federal statutory income tax rate of 35%, adjusted for applicable state income taxes, net of the related federal tax benefit.

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TABLE 5: AVERAGE BALANCES AND INTEREST RATES - FULLY TAXABLE-EQUIVALENT BASIS

	Quarters Ended June 30,					
	2017			2016		
(Dollars in millions; fully taxable-equivalent basis)	Average Balance	Interest Revenue/ Expense	Rate	Average Balance	Interest Revenue/ Expense	Rate
Interest-bearing deposits with banks	$53,146	$41	.31 %	$51,084	$30	.24 %
Securities purchased under resale agreements[1]	2,352	69	11.77	2,673	35	5.32
Trading account assets	941	—	—	870	—	—
Investment securities	94,637	466	1.97	102,391	492	1.92
Loans and leases	21,070	122	2.31	18,662	93	2.00
Other interest-earning assets	23,141	44	.76	22,563	10	.18
Average total interest-earning assets	$195,287	$742	1.52	$198,243	$660	1.34
Interest-bearing deposits:						
U.S.	$25,770	$24	.38 %	$30,363	$31	.41 %
Non-U.S.[2]	99,389	(10)	(.04)	96,446	(15)	(.06)
Securities sold under repurchase agreements[3]	4,028	—	—	4,103	—	—
Federal funds purchased	2	—	—	61	—	—
Other short-term borrowings	1,322	3	.80	1,928	2	.38
Long-term debt	11,515	75	2.61	10,998	62	2.24
Other interest-bearing liabilities	5,355	33	2.44	5,054	19	1.54
Average total interest-bearing liabilities	$147,381	$125	.34	$148,953	$99	.27
Interest-rate spread			1.18 %			1.07 %
Net interest income—fully taxable-equivalent basis		$617			$561	
Net interest margin—fully taxable-equivalent basis			1.27 %			1.14 %
Tax-equivalent adjustment		(42)			(40)	
Net interest income—GAAP basis		$575			$521	

	Six Months Ended June 30,					
	2017			2016		
(Dollars in millions; fully taxable-equivalent basis)	Average Balance	Interest Revenue/ Expense	Rate	Average Balance	Interest Revenue/ Expense	Rate
Interest-bearing deposits with banks	$51,031	$76	.30 %	$49,815	$73	.29 %
Securities purchased under resale agreements[1]	2,205	115	10.52	2,581	71	5.58
Trading account assets	928	(1)	(.13)	865	1	.12
Investment securities	95,921	936	1.95	101,645	980	1.93
Loans and leases	20,607	230	2.25	18,639	184	1.98
Other interest-earning assets	22,882	78	.69	22,617	22	.20
Average total interest-earning assets	$193,574	$1,434	1.49	$196,162	$1,331	1.37
Interest-bearing deposits:						