STATE STREET CORP
Form 10-Q
August 03, 2012
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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 June 30, 2012

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 or organization)	(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 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 ¨ (Do not check if a smaller reporting company) 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 July 31, 2012 was 479,105,319

STATE STREET CORPORATION
QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTERLY PERIOD ENDED
JUNE 30, 2012

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

GENERAL

State Street Corporation, the parent company, is a financial holding company headquartered in Boston, Massachusetts. 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. Our principal banking subsidiary is State Street Bank and Trust Company, or State Street Bank. At June 30, 2012, we had total assets of $200.78 billion, total deposits of $143.77 billion, total shareholders' equity of $19.90 billion and 29,665 employees. With $22.42 trillion of assets under custody and administration and $1.91 trillion of assets under management at June 30, 2012, we are a leading specialist in meeting the needs of institutional investors worldwide.

We have two lines of business:

Investment Servicing provides services for U.S. mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, foundations and endowments worldwide. Products include custody, product- and participant-level accounting, daily pricing and administration; master trust and master custody; record-keeping; foreign exchange, brokerage and other trading services; securities finance; deposit and short-term investment facilities; loans and lease financing; investment manager and alternative investment manager operations outsourcing; and performance, risk and compliance analytics to support institutional investors.

Investment Management, through State Street Global Advisors, or SSgA, provides a broad range of investment management strategies, specialized investment management advisory services and other financial services, such as securities finance, for corporations, public funds, and other sophisticated investors. Management strategies offered by SSgA include passive and active, such as enhanced indexing and hedge fund strategies, using quantitative and fundamental methods for both U.S. and non-U.S. equity and fixed-income securities. SSgA also offers exchange-traded funds.

For financial and other information about our lines of business, refer to "Line of Business Information" in this Management's Discussion and Analysis and note 14 to the consolidated financial statements included 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, 2012, and updates the Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2011, referred to as our 2011 Form 10-K, and in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2012. 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 those reports. Certain previously reported amounts presented in this Form 10-Q have been reclassified to conform to current period classifications.

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the U.S., referred to as GAAP. The preparation of financial statements in conformity with 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 estimates and assumptions that are difficult, subjective or complex about matters that are uncertain and may change in subsequent periods, are accounting for fair value measurements; interest revenue recognition and other-than-temporary impairment; and impairment of goodwill and other intangible assets. 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. An understanding of the judgments, estimates and assumptions underlying these significant accounting policies is essential in order to understand our reported consolidated results of operations and financial condition.

Additional information about these significant accounting policies is included under "Significant Accounting Estimates" in Management's Discussion and Analysis in our 2011 Form 10-K. We did not change these significant accounting policies during the first six months of 2012.

Certain financial information presented in this Management's Discussion and Analysis is prepared on both a GAAP, or reported, basis and a non-GAAP, or operating, basis. We measure and compare certain financial information on an operating basis, as we believe that 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. We believe that operating-basis financial information, which reports revenue from non-taxable sources on a fully taxable-equivalent basis and excludes the impact 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 and reported in conformity with GAAP. Operating-basis financial information should be considered in addition to, not as a substitute for or superior to, financial information prepared in conformity with GAAP. Any non-GAAP, or operating-basis, financial information presented in this Management's Discussion and Analysis is reconciled to its nearest GAAP-basis measure.

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FORWARD-LOOKING STATEMENTS

This Form 10-Q, as well as other reports filed 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, contain statements (including statements in this Management's Discussion and Analysis) that are considered "forward-looking statements" within the meaning of U.S. securities laws, including statements about industry, regulatory, economic and market trends, management's expectations about our financial performance, market growth, acquisitions and divestitures, new technologies, services and opportunities and earnings, management's confidence in our strategies and other matters that do not relate strictly to historical facts. Terminology such as "expect," "look," "believe," "anticipate," "intend," "plan," "estimate," "forecast," "seek," "may," "will," "trend," "target" and "goal," or or variations of such terms, are intended to identify 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, 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 may 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 to the current sovereign debt risks in Europe and other regions and of their actual or perceived creditworthiness, as reflected in recent credit downgrades of many major banks;
- financial market disruptions or economic recession, whether in the U.S., Europe or other regions internationally;
- increases in the volatility of, or declines in the level of, our net interest revenue, the impact of a prolonged period of low interest rates on our net interest margin and operating model, changes in the composition of the assets recorded in our consolidated statement of condition and the possibility that we may be required to 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 and the performance and volatility of securities, credit, currency and other markets in the U.S. and internationally;
- 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, and our ability to deploy deposits in a profitable manner consistent with our liquidity requirements and risk profile;
- the manner in which the Federal Reserve and other regulators implement the Dodd-Frank Act, Basel III, European directives with respect to banking and financial instruments and other regulatory initiatives in the U.S. and internationally, including regulatory developments that result in changes to our operating model, increased costs or other changes to the provision of our services;
- adverse changes in required regulatory capital ratios, whether arising under the Dodd-Frank Act, Basel II or Basel III, or due to changes in regulatory positions or regulations in jurisdictions in which we engage in banking activities;
- our ability to obtain approvals required by the Federal Reserve or other regulators for the use, allocation or distribution of our capital or other specific capital actions or programs, including acquisitions, dividends and equity repurchases or redemptions, that may restrict or limit our growth plans, distributions to shareholders, equity purchase programs or other capital initiatives, which approvals with respect to certain matters, such as capital plans, are subject

to reconsideration by regulators in light of changes in market conditions or developments specific to us;

- our ability to implement our regulatory capital plans submitted to, with no objection raised by, the Federal Reserve, and the effects of market conditions or other factors on the results of the stress tests underlying those capital plans,

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particularly if the Federal Reserve determines that our consolidated results of operations or financial prospects or our intended uses of our regulatory capital change our regulatory capital outlook, to the extent that such outlook does not permit us to continue to return capital to shareholders at the levels contemplated by our capital plans;

- changes in law or regulation that may adversely affect our, our clients' or our counterparties' business activities and the products or services that we sell, including additional or increased taxes or assessments thereon, capital adequacy requirements and changes that expose us to risks related to compliance;
- the maintenance of credit agency ratings for our debt and depository obligations as well as the level of credibility of credit agency ratings;
- delays or difficulties in the execution of our previously announced business operations and information technology transformation program, which could lead to changes in our estimates of the charges, expenses or savings associated with the planned program, resulting in increased volatility of our earnings;
- the results of, and costs associated with, government investigations, litigation, and similar claims, disputes, or proceedings, including results requiring the payment of multiple, punitive, consequential or other damages that may substantially exceed the amount of direct damages;
- the possibility that our clients will incur substantial losses in investment pools where we act as agent, and the possibility of significant reductions in the valuation of assets;
- adverse publicity or other reputational harm;
- dependencies on information technology, complexities and costs of protecting the security of our systems and difficulties with protecting our intellectual property rights;
- 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;
- potential changes to the competitive environment, including changes due to regulatory and technological changes, the effects of consolidation, and perceptions of State Street as a suitable service provider or counterparty;
- potential changes in how clients compensate us for our services, and the mix of services that clients choose from us;
- the risks that 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 disynergies 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 relationships with clients, employees or regulators;
- the ability to complete acquisitions, divestitures and joint ventures, including the ability to obtain regulatory approvals, the ability to arrange financing as required and the ability to satisfy closing conditions;
- our ability to recognize emerging needs of clients and to develop products that are responsive to such trends and profitable to the company; the performance of and demand for the products and services we offer, including the level and timing of redemptions and withdrawals from our collateral pools and other collective investment products; and the potential for new products and services to impose additional costs on us and expose us to increased operational risk;
- our ability to measure the fair value of the investment securities recorded in our consolidated statement of condition;
- our ability to control operating risks, data security breach 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 prove insufficient, fail or be circumvented;
- 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, including the risk factors discussed in our 2011 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 our forward-looking statements after the time they are made. The factors discussed above are

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not intended to be a complete summary of all risks and uncertainties that may affect our businesses. We cannot anticipate all developments that may adversely affect our consolidated results of operations and financial condition. 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 June 30,			Six Months Ended June 30,		
(Dollars in millions, except per share amounts)	2012	2011	% Change	2012	2011	% Change
Total fee revenue	$1,778	$1,892	(6)%	$3,563	$3,683	(3)%
Net interest revenue	672	572	17	1,297	1,149	13
Gains (Losses) related to investment securities, net	(27)	27		(16)	20	
Total revenue	2,423	2,491	(3)	4,844	4,852	—
Provision for loan losses	(1)	2		(1)	1	
Expenses:						
Expenses from operations	1,728	1,757	(2)	3,527	3,440	3
Acquisition costs	15	13		28	27	
Restructuring charges	22	4		30	9	
Litigation settlement costs	7	—		22	—	
Total expenses	1,772	1,774	—	3,607	3,476	4
Income before income tax expense	652	715	(9)	1,238	1,375	(10)
Income tax expense	162	202		321	391	
Net income	$490	$513	(4)	$917	$984	(7)
Adjustments to net income:						
Dividends on preferred stock	$(7)	$(7)		$(14)	$(7)	
Earnings allocated to participating securities(1)	(3)	(4)		(6)	(9)	
Net income available to common shareholders	$480	$502		$897	$968	
Earnings per common share:						
Basic	$1.00	$1.01		$1.86	$1.95	
Diluted	.98	1.00	(2)	1.83	1.93	(5)
Average common shares outstanding (in thousands):						
Basic	481,404	496,806		483,165	497,137	
Diluted	488,518	501,044		489,145	500,753	
Cash dividends declared per common share	$.24	$.18		$.48	$.36	
Return on average common equity	10.0%	10.6%		9.4%	10.6%	

(1) Refer to note 13 to the consolidated financial statements included in this Form 10-Q.

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Highlights

On July 17, 2012, we announced an agreement to acquire Goldman Sachs Administration Services, or GSAS, a global hedge fund administrator with approximately $200 billion in hedge fund assets under administration, in a cash transaction with a total purchase price of approximately $550 million, subject to certain adjustments. Pending regulatory approvals and other customary closing conditions, we expect to complete the acquisition in the fourth quarter of 2012. As of June 30, 2012, we had hedge fund assets under administration of approximately $497 billion and aggregate alternative assets under administration of approximately $877 billion. GSAS hedge fund assets under administration are not included in these amounts.

The following "Significant Developments" and "Financial Results" sections provide information related to notable actions we took in the second quarter of 2012, as well as highlights of our financial results for the second quarter of 2012 presented in the preceding table. Additional information about our financial results is provided under "Consolidated Results of Operations," which follows these sections.

Significant Developments

During the second quarter, we declared a quarterly common stock dividend of $0.24 per share, or approximately $115 million, which was paid in July 2012. This dividend, together with a dividend of $0.24 per share, or approximately $118 million, declared in the first quarter of this year and paid in April 2012, totals $0.48 per share, or approximately $233 million, for the first half of 2012, compared to aggregate dividends of $0.36 per share, or approximately $181 million, for the first six months of 2011. We also purchased approximately 11.1 million shares of our common stock under the program approved by the Board of Directors in March 2012, under which we are authorized to purchase up to $1.8 billion of our common stock through March 31, 2013. The shares were purchased at an average and aggregate cost of $43.26 and $480 million, respectively. This new program follows our 2011 common stock purchase program, under which we purchased 16.31 million shares of our common stock at an average and aggregate cost of $41.38 and $675 million, respectively, from May 2011 through November 2011.

During the second quarter, we continued the implementation of our business operations and information technology transformation program. With respect to this program, in 2011 we achieved approximately $86 million of annual pre-tax, run-rate expense savings compared to our 2010 run-rate expense base, previously disclosed in our 2011 Form 10-K, of approximately $6.18 billion of expenses from operations, all else being equal. In addition to the $86 million of annual pre-tax, run-rate expense savings already achieved in 2011, we expect to achieve additional annual pre-tax, run-rate expense savings in 2012 in the range of approximately $90 million to $100 million compared to our above-described 2010 run-rate expense base, all else being equal. These annual pre-tax, run-rate expense savings relate only to the business operations and information technology transformation program. Our actual expenses from operations may increase or decrease as a result of other factors.

Additional information about our business operations and information technology transformation program is provided under "Consolidated Results of Operations – Expenses" in this Management's Discussion and Analysis.

Financial Results

Total revenue for the second quarter of 2012 decreased 3% compared to the same period in 2011, primarily the result of a 6% decrease in fee revenue, partly offset by a 17% increase in net interest revenue.

Servicing fees declined 3% from last year's second quarter, generally reflective of weakness in non-U.S. markets and the impact of the weaker Euro, as well as changes in asset mix, partly offset by the impact of new business installed and slight improvement in the S&P 500 index. Servicing fees generated outside the U.S. during the second quarter of 2012 and the second quarter of 2011 were approximately 42% and 43%, respectively, of total servicing fees.

Management fees declined 2% in the same comparison, as changes in worldwide equity market valuations were mixed. Average month-end equity valuations for the S & P 500 Index were up 1%, and for the MSCI® EAFE Index[es] were down approximately 18%, from the second quarter of 2011. Management fees generated outside the U.S. during the second quarter of 2012 and the second quarter of 2011 were approximately 36% and 45%, respectively, of total management fees.

Trading services revenue declined 18% from last year's second quarter, mainly from lower currency volatility in foreign exchange, reflective of weak capital markets, partly offset by higher foreign exchange trading volumes, and lower revenue from both transition management and sales and trading. Securities finance revenue increased 4% as a result of higher spreads, partly offset by lower lending volumes associated with reduced demand.

During the second quarter of 2012, we recorded net interest revenue of $672 million, a 17% increase compared to $572 million for the second quarter of 2011. On a fully taxable-equivalent basis, net interest revenue in the second quarter of 2012 increased 16%, to $703 million from $605 million. These net interest revenue amounts included $74 million and $51 million, respectively, of discount accretion related to investment securities added to our consolidated statement of condition in connection with the 2009 asset-backed commercial paper conduit consolidation. Fully taxable-equivalent net interest revenue also reflected tax-equivalent adjustments for the second quarter of 2012 and 2011 of $31 million and $33 million, respectively. Discount accretion is more fully discussed in "Net Interest Revenue" under "Consolidated Results of Operations" in this Management's Discussion and Analysis.

Both increases in net interest revenue (GAAP-basis and fully taxable-equivalent) were the result of the impact of higher levels of interest-earning assets associated with the investment of a higher level of client deposits, mainly increases in interest-bearing deposits with banks and investment portfolio securities; higher yields on U.S. floating-rate securities due to movements in short-term LIBOR rates; lower funding costs; and the above-described increase in discount accretion. These increases were partly offset by lower yields on fixed-rate securities. Net interest margin, calculated on fully taxable-equivalent net interest revenue, declined 4 basis points to 1.72% in the second quarter of 2012 from 1.76% in the second quarter of 2011. The investment of the incremental client deposits increased our average interest-earning assets; however, they negatively affected our net interest margin.

Total expenses of $1.77 billion for the second quarter of 2012 were approximately flat with the second quarter of 2011. Compensation and employee benefits expenses declined 7%, or $67 million, compared to the second quarter of 2011, due to lower incentive compensation, offset by increases in other expenses and acquisition and restructuring costs. Total expenses for the second quarter of 2012 included approximately $25 million of non-recurring costs related to the business operations and information technology transformation program, $20 million of which were included in compensation and benefits expenses, compared to $16 million of non-recurring costs for the second quarter of 2011. The 2011 costs were substantially all in compensation and benefits expenses. These non-recurring costs are not expected to be incurred after the program is fully implemented.

During the second quarter of 2012, we secured mandates for approximately $133 billion of new business in assets to be serviced; of the total, $79 billion was installed prior to June 30, 2012, with the remaining $54 billion expected to be installed during the remainder of 2012 and later. In the second quarter of 2012, we also installed approximately $51 billion of new business in assets to be serviced that we were awarded in periods prior to the second quarter of 2012. The new business not installed by June 30, 2012 was not included in assets under custody and administration at that date, and had no impact on servicing fee revenue for the second quarter of 2012, as the assets are not included until their installation is complete and we begin to service them. Once installed, the assets generate servicing fee revenue in subsequent periods. We will provide various services for these assets including accounting, fund administration, custody, foreign exchange, securities finance, transfer agency, performance analytics, compliance reporting and monitoring, hedge fund servicing, private equity administration, real estate administration, depository banking services, wealth management services and investment manager operations outsourcing.

During the second quarter of 2012, SSgA recorded net lost business in managed assets of approximately $6 billion; this net lost business was composed of $7 billion of net inflows into exchange-traded funds, or ETFs; approximately $1 billion of net inflows into institutional and fixed-income funds, primarily passive; approximately $12 billion of outflows from managed cash, mainly related to declines in securities lending collateral as the impact of dividend season in Europe abated; and approximately $2 billion of outflows from active and enhanced equity funds, as clients shifted their investment preferences.

An additional $21 billion of new business, awarded to SSgA but not installed by June 30, 2012, was not included in assets under management at that date, and had no impact on management fee revenue for the second quarter of 2012, as the assets are not included until their installation is complete and we begin to manage them. Once installed, the assets generate management fee revenue in subsequent periods.

CONSOLIDATED RESULTS OF OPERATIONS

This section discusses our consolidated results of operations for the second quarter and first six months of 2012 compared to the same periods in 2011, and should be read in conjunction with the consolidated financial statements and accompanying condensed notes included in this Form 10-Q.

TOTAL REVENUE

Information with respect to the sources of our revenue, the products and activities that generate it, and the factors that influence the levels of revenue generated during any period is provided under “Consolidated Results of Operations – Total Revenue” in Management’s Discussion and Analysis included in our 2011 Form 10-K.

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	Quarters Ended June 30,			Six Months Ended June 30,		
(Dollars in millions)	2012	2011	% Change	2012	2011	% Change
Fee revenue:						
Servicing fees	$1,086	$1,124	(3)%	$2,164	$2,219	(2)%
Management fees	246	250	(2)	482	486	(1)
Trading services	255	311	(18)	535	613	(13)
Securities finance	143	137	4	240	203	18
Processing fees and other	48	70	(31)	142	162	(12)
Total fee revenue	1,778	1,892	(6)	3,563	3,683	(3)
Net interest revenue:						
Interest revenue	786	719	9	1,551	1,453	7
Interest expense	114	147	(22)	254	304	(16)
Net interest revenue	672	572	17	1,297	1,149	13
Gains (Losses) related to investment securities, net	(27)	27		(16)	20	
Total revenue	$2,423	$2,491	(3)	$4,844	$4,852	—

Fee Revenue

Servicing and management fees collectively composed approximately 75% and 74% of our total fee revenue for the second quarter and first six months of 2012, respectively, compared to approximately 73% of our total fee revenue for both corresponding periods in 2011. The level of these fees is influenced by 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 clients, and is generally affected by changes in worldwide equity and fixed-income security 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 management. Additional factors, such as asset mix, the level of transaction volumes, changes in service level, balance credits, client minimum balances, pricing concessions and other factors, may have a significant effect on our servicing fee revenue. Generally, management fee revenue is more sensitive to market valuations than servicing fee revenue. Management fees for actively managed products are generally earned at higher rates than those for passive products. Actively managed products may also involve performance fee arrangements.

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.

The following table presents selected equity market indices as of June 30, 2012 and 2011, and for the quarters and six months then ended. Daily averages and the averages of month-end indices demonstrate worldwide changes in equity market valuations that affect our servicing and management fee revenue, respectively. Quarter-end indices affect the value of assets under custody and administration and assets under management as of those dates. The index names listed in the table are service marks of their respective owners.

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	Daily Averages of Indices Quarters Ended June 30,			Averages of Month-End Indices Quarters Ended June 30,			Quarter-End Indices As of June 30,		
	2012	2011	% Change	2012	2011	% Change	2012	2011	% Change
S&P 500®	1,350	1,318	2 %	1,357	1,343	1 %	1,362	1,321	3 %
NASDAQ®	2,926	2,765	6	2,936	2,827	4	2,935	2,774	6
MSCI EAFE®	1,427	1,710	(17)	1,424	1,746	(18)	1,423	1,708	(17)

	Daily Averages of Indices Six Months Ended June 30,			Averages of Month-End Indices Six Months Ended June 30,		
	2012	2011	% Change	2012	2011	% Change
S&P 500®	1,349	1,310	3 %	1,359	1,328	2 %
NASDAQ®	2,917	2,752	6	2,947	2,791	6
MSCI EAFE®	1,471	1,705	(14)	1,480	1,731	(15)

Servicing Fees

The decreases in servicing fees of 3% and 2% for the second quarter and first six months of 2012, respectively, compared to the same periods in 2011 primarily resulted from weakness in non-U.S. markets and the impact of the weaker Euro, as well as changes in asset mix, as clients shifted their investment preferences from equity funds to fixed-income and government funds. These factors were partly offset by the impact of new business installed on current-period revenue and slight improvement in the S&P 500 index, as presented in the foregoing "INDEX" table.

For both the second quarter and first six months of 2012, servicing fees generated outside the U.S. were approximately 42% of total servicing fees compared to approximately 43% and 42% for the second quarter and first six months of 2011, respectively.

As of June 30, 2012, our total assets under custody and administration, presented in the following tables, were $22.42 trillion, compared to $21.81 trillion as of December 31, 2011 and $22.76 trillion as of June 30, 2011. The increase from December 2011 to June 2012 primarily resulted from net increases in equity market valuations, as well as the installation of new servicing business and net client subscriptions, partially offset by the impact of foreign currency translation. The slight decrease in the June-to-June comparison primarily resulted from the impact of foreign currency translation, partly offset by the installation of new servicing business. Servicing asset levels as of June 30, 2012 did not reflect $54 billion of new business in assets to be serviced that was awarded to us during the second quarter of 2012 and had not been installed prior to June 30, 2012. The value of assets under custody and administration is a broad measure of the relative size of various markets served. Changes in the values of assets under custody and administration do not necessarily result in proportional changes in our servicing fee revenue.

The following tables present the components, financial instrument mix and geographic mix of assets under custody and administration as of June 30, 2012, December 31, 2011 and June 30, 2011:

ASSETS UNDER CUSTODY AND ADMINISTRATION

(In billions)	June 30, 2012	December 31, 2011	June 30, 2011
Mutual funds	$5,572	$ 5,265	$5,584
Collective funds	4,597	4,437	4,708
Pension products	4,955	4,837	5,185
Insurance and other products	7,299	7,268	7,285
Total	$22,423	$ 21,807	$22,762

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MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
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FINANCIAL INSTRUMENT MIX OF ASSETS UNDER CUSTODY AND ADMINISTRATION

(In billions)	June 30, 2012	December 31, 2011	June 30, 2011
Equities	$11,242	$ 10,849	$12,601
Fixed-income	8,403	8,317	7,392
Short-term and other investments	2,778	2,641	2,769
Total	$22,423	$ 21,807	$22,762

GEOGRAPHIC MIX OF ASSETS UNDER CUSTODY AND ADMINISTRATION[1]

(In billions)	June 30, 2012	December 31, 2011	June 30, 2011
United States	$16,335	$ 15,745	$16,486
Other Americas	643	622	674
Europe/Middle East/Africa	4,445	4,400	4,553
Asia/Pacific	1,000	1,040	1,049
Total	$22,423	$ 21,807	$22,762

(1) Geographic mix is based on the location at which the assets are custodied or serviced.

Management Fees

Management fees decreased 2% and 1% during the second quarter and first six months of 2012, respectively, compared to the same periods in 2011. Both decreases were primarily the result of weaker international equity markets, partially offset by the impact of net new business installed on current-period revenue. Average month-end equity market valuations, individually presented in the foregoing “INDEX” table, were down an average of 3% for the second quarter of 2012 compared to the second quarter of 2011, and were down an average of 1% in the six-month comparison. For the second quarter and first six months of 2012, management fees generated outside the U.S. were approximately 36% and 37%, respectively, of total management fees, compared to approximately 45% and 40%, respectively, for the same periods in 2011.

As of June 30, 2012, assets under management, presented in the following tables, were $1.91 trillion, compared to $1.85 trillion as of December 31, 2011 and $2.10 trillion as of June 30, 2011. Such amounts included assets of the SPDR® Gold Fund, for which we act as distribution agent rather than investment manager. In addition, the assets under management as of December 31, 2011 and June 30, 2011 included certain assets managed for the U.S. government under programs adopted during the financial crisis. While certain management fees are directly determined by the value of assets under management and the investment strategy employed, management fees reflect other factors as well, including our relationship pricing for clients using multiple services.

The overall increase in assets under management as of June 30, 2012 compared to December 31, 2011, reflected in the table of activity in assets under management that follows this discussion, mainly reflected net market appreciation during the the six-month period in the values of the assets managed, as well as net new business of $4 billion. This net new business reflects the impact of the planned redemption of $31 billion of assets in connection with the Department of the U.S. Treasury's portfolio of agency-guaranteed mortgage-backed securities. In the first six months of 2012, exchange-traded funds, or ETFs, increased 11%, due partly to $17 billion of net inflows, and passive equities increased 8%. These increases were partly offset by a 9% decline in passive fixed-income assets under management, mainly reflective of the above-described U.S. Treasury asset redemptions.

The net new business of $4 billion described above does not include $21 billion of new business awarded to SSgA that had not been installed prior to June 30, 2012. This new business will be included in assets under management in future periods after installation, and will generate management fee revenue in subsequent periods.

The overall decrease in assets under management as of December 31, 2011 compared to June 30, 2011, reflected in the table of activity in assets under management that follows this discussion, mainly reflected net lost business of $139 billion, which included approximately $77 billion of the above-described planned U.S. Treasury asset redemptions, as

well as net market depreciation during the six-month period in the values of the assets managed.
The following tables present the components and geographic mix of assets under management as of June 30, 2012,

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

December 31, 2011 and June 30, 2011:

ASSETS UNDER MANAGEMENT

(In billions)	June 30, 2012	December 31, 2011	June 30, 2011
Passive:			
Equities	$688	$ 638	$706
Fixed-income	223	246	325
Exchange-traded funds[1]	305	274	267
Other	195	195	218
Total Passive	1,411	1,353	1,516
Active:			
Equities	47	50	62
Fixed-income	18	19	19
Other	53	45	41
Total Active	118	114	122
Cash	379	378	459
Total	$1,908	$ 1,845	$2,097

(1) Includes SPDR® Gold Fund, for which State Street is not the investment manager but acts as distribution agent.

GEOGRAPHIC MIX OF ASSETS UNDER MANAGEMENT[1]

(In billions)	June 30, 2012	December 31, 2011	June 30, 2011
United States	$1,324	$ 1,285	$1,465
Other Americas	36	30	34
Europe/Middle East/Africa	320	320	374
Asia/Pacific	228	210	224
Total	$1,908	$ 1,845	$2,097

(1) Geographic mix is based on the location at which the assets are managed.

The following table presents activity in assets under management during the twelve months ended June 30, 2012:

ASSETS UNDER MANAGEMENT

(In billions)	
June 30, 2011	$2,097
Net lost business[1]	(139)
Market depreciation	(113)
December 31, 2011	$1,845
Net new business[1]	4
Market appreciation	59
June 30, 2012	$1,908

(1) Amounts for the last six months of 2011 and the first six months of 2012 included redemptions of approximately $77 billion and $31 billion, respectively, of U.S. government securities associated with the Department of the U.S. Treasury's portfolio of agency-guaranteed mortgage-backed securities.

Trading Services

Trading services revenue includes revenue from foreign exchange trading, as well as brokerage and other trading services. We earn foreign exchange trading revenue by acting as a market maker. We offer a range of foreign exchange, or FX, products, services and execution models which focus on clients' global requirements for our proprietary research and the execution of trades in any time zone. Most of our FX products and execution services can be grouped into three broad categories: "direct FX," "indirect FX," and electronic trading. Direct and indirect FX revenue is recorded in foreign exchange trading revenue. Revenue from electronic trading is recorded in brokerage and other trading services revenue.

We also offer a range of brokerage and other trading products tailored specifically to meet the needs of the global pension community, including transition management, commission recapture and self-directed brokerage. These products are differentiated by our position as an agent of the institutional investor.

Trading services revenue was $255 million and $311 million for the second quarter of 2012 and 2011, respectively, and $535 million and $613 million for the six months ended June 30, 2012 and 2011, respectively. Such revenue declined 18% for the second quarter of 2012 compared to the second quarter of 2011 and decreased 13% in the six-month comparison. The components of these declines, composed of changes related to foreign exchange trading and brokerage and other trading services, are explained below.

Foreign exchange trading revenue of $129 million declined 24% for the second quarter of 2012 from $169 million for the second quarter of 2011 and decreased 15% to $278 million from $329 million in the six-month comparison. The decreases in the second quarter and first six months of 2012 were primarily the result of 16% and 11% declines, respectively, in currency volatility, partly offset by higher client volumes.

Brokerage and other trading services revenue of $126 million declined 11% for the second quarter of 2012 compared to $142 million for the second quarter of 2011, with the decrease largely related to lower levels of revenue from transition management. For the first six months of 2012, brokerage and other trading services revenue was $257 million, down 10% from $284 million for the first six months of 2011. Our transition management revenue and expenses in 2011 and 2012 were adversely affected by compliance issues in our U.K. business, the reputational and regulatory impact of which may continue to adversely affect our revenue from transition management in the remainder of 2012.

With respect to foreign exchange trading, we enter into FX transactions with clients and investment managers that contact our trading desk directly. These trades are all executed at negotiated rates. We refer to this activity, and our market-making activities, as "direct FX." Alternatively, clients or their investment managers may elect to route FX transactions to our FX desk through our asset servicing operation; we refer to this activity as "indirect FX." We execute indirect FX trades as a principal at rates based on a published formula. We calculate revenue for indirect FX using an attribution methodology based on estimated effective mark-ups/downs and observed client volumes.

For the second quarter and first six months of 2012, our estimated indirect FX revenue was approximately $66 million and $141 million, respectively, compared to $85 million and $171 million, respectively, for the same periods in 2011. All other FX revenue, other than this indirect FX revenue estimate and FX revenue from electronic trading, is estimated and considered by us to be direct FX revenue. For the second quarter and first six months of 2012, our estimated direct FX revenue was $63 million and $137 million, respectively, compared to $84 million and $158 million, respectively, for the same periods in 2011.

Our clients may choose to execute FX transactions through one of our electronic trading platforms. This service generates revenue through a "click" fee. For the second quarter and first six months of 2012, our revenue from electronic FX trading platforms was approximately $54 million and $109 million, respectively, compared to $61 million and $120 million, respectively, for the same periods in 2011. As described above, this revenue was recorded in brokerage and other trading services revenue.

During the first six months of 2012, some of our clients who relied on our indirect model to execute their FX transactions transitioned to other methods to conduct their FX transactions. Through State Street Global Markets, a unit of our Investment Servicing line of business, they can transition to either direct FX execution, including our

“Street FX” service which enables our clients to define their FX execution strategy and automate the foreign exchange trade execution process, where State Street continues to act as a principal market maker, or to one of our electronic trading platforms. We continue to expect that some clients may choose, over time, to reduce their level of indirect foreign exchange transactions in favor of other execution methods, including either direct foreign exchange transactions or electronic trading.

Securities Finance

Our agency securities finance business consists of two principal components: investment funds with a broad range of investment objectives which are managed by SSgA and engage in agency securities lending, which we refer to as the SSgA lending funds; and an agency lending program for third-party investment managers and asset owners, which we refer to as the agency lending funds.

We also participate in securities lending transactions as a principal rather than an agent. As a principal, we borrow securities from the lending client and then lend such securities to the subsequent borrower, either a State Street client or a broker/dealer. Our involvement as principal is utilized when the lending client is unable to, or elects not to, transact directly with the market and requires us to execute the transaction and furnish the securities. We provide our credit rating to the transaction, as well as our ability to source securities through our assets under custody and administration.

Securities finance revenue, composed of our split of both the spreads related to cash collateral and the fees related to non-cash collateral, is principally a function of the volume of securities on loan and the interest-rate spreads and fees earned on the underlying collateral. For the second quarter of 2012, securities finance revenue increased 4% from the second quarter of 2011, and for the first six months of 2012 increased 18% compared to the corresponding period in 2011. The increases were substantially the result of higher spreads across all lending programs, partly offset by 11% and 9% decreases in average lending volumes comparing the second quarter and first six months of 2012, respectively, to the same periods in 2011. Average spreads increased 26% and 37% for the second quarter and first six months of 2012, respectively, compared to the same periods in 2011. Securities on loan averaged approximately $337 billion and $334 billion for the second quarter and first six months of 2012, respectively, compared to approximately $379 billion and $369 billion, respectively, for the same periods in 2011.

Market influences will continue to affect our revenue from, and the profitability of, our securities lending activities during 2012, and may do so in future periods. As long as securities lending spreads remain below the levels generally experienced prior to late 2007, client demand is likely to remain at a reduced level and our revenues from our securities lending activities will be similarly affected. In addition, proposed or anticipated regulatory changes may affect the volume of our securities lending activity and related revenue in future periods.

Processing Fees and Other

Processing fees and other revenue for the second quarter and first six months of 2012 decreased by 31% and 12%, respectively, compared to the same periods in 2011. The decreases were primarily the result of a gain on an early termination of a lease in the second quarter of 2011 and amortization expense related to tax-advantaged investments in the second quarter of 2012.

NET INTEREST REVENUE

Net interest revenue is defined as total interest revenue 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 net interest revenue and total average interest-earning assets for the period. 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.

The following table presents the components of average interest-earning assets and average interest-bearing liabilities, related interest revenue and interest expense, and rates earned and paid, for the periods indicated:

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

	Quarters Ended June 30,							
	2012				2011			
(Dollars in millions; fully taxable-equivalent basis)	Average Balance	Interest Revenue/ Expense	Rate		Average Balance	Interest Revenue/ Expense	Rate	
Interest-bearing deposits with banks	$25,205	$35	.55	%	$10,325	$28	1.05	%
Securities purchased under resale agreements	7,944	13	.64		2,556	6	.94	
Trading account assets	648	—	.14		2,421	—	—	
Investment securities	112,670	697	2.48		104,570	650	2.49	
Loans and leases	11,304	71	2.50		12,720	67	2.14	
Other interest-earning assets	6,677	1	.04		5,346	1	.03	
Total average interest-earning assets	$164,448	$817	2.00		$137,938	$752	2.18	
Interest-bearing deposits:								
U.S.	$7,448	$4	.27	%	$1,605	$—	.09	%
Non-U.S.	88,048	33	.15		83,358	44	.21	
Securities sold under repurchase agreements	8,288	1	.01		9,179	3	.14	
Federal funds purchased	976	—	.10		1,104	—	.09	
Other short-term borrowings	4,737	18	1.49		4,971	21	1.71	
Long-term debt	6,939	54	3.14		9,541	76	3.16	
Other interest-bearing liabilities	4,851	4	.33		3,426	3	.27	
Total average interest-bearing liabilities	$121,287	$114	.38		$113,184	$147	.52	
Interest-rate spread			1.62	%			1.66	%
Net interest revenue—fully taxable-equivalent basis		$703				$605		
Net interest margin—fully taxable-equivalent basis			1.72	%			1.76	%
Tax-equivalent adjustment		(31)				(33)		
Net interest revenue—GAAP basis		$672				$572		

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

	Six Months Ended June 30,					
	2012			2011		
(Dollars in millions; fully taxable-equivalent basis)	Average Balance	Interest Revenue/ Expense	Rate	Average Balance	Interest Revenue/ Expense	Rate
Interest-bearing deposits with banks	$25,383	$77	.61 %	$12,181	$55	.90 %
Securities purchased under resale agreements	7,715	22	.58	3,710	16	.87
Trading account assets	683	—	.03	2,279	—	—
Investment securities	111,205	1,386	2.49	100,161	1,297	2.61
Loans and leases	11,033	126	2.30	12,729	148	2.35
Other interest-earning assets	6,807	2	.04	4,586	1	.03
Total average interest-earning assets	$162,826	$1,613	1.99	$135,646	$1,517	2.26
Interest-bearing deposits:						
U.S.	$4,952	$7	.30 %	$3,368	$6	.36 %
Non-U.S.	87,538	83	.19	81,053	96	.24
Securities sold under repurchase agreements	7,864	1	.01	9,117	5	.12
Federal funds purchased	892	—	.07	1,139	—	.06
Other short-term borrowings	4,705	36	1.51	5,335	46	1.72
Long-term debt	7,540	120	3.19	9,228	147	3.18
Other interest-bearing liabilities	5,853	7	.25	2,784	4	.26
Total average interest-bearing liabilities	$119,344	$254	.43	$112,024	$304	.55
Interest-rate spread			1.56 %			1.71 %
Net interest revenue—fully taxable-equivalent basis		$1,359			$1,213	
Net interest margin—fully taxable-equivalent basis			1.68 %			1.80 %
Tax-equivalent adjustment		(62)			(64)	
Net interest revenue—GAAP basis		$1,297			$1,149	

For the first six months of 2012 compared to the first six months of 2011, average interest-earning assets increased, mainly the result of the investment of higher levels of interest-bearing and noninterest-bearing client deposits into interest-bearing deposits with banks and investment securities. The increases in average interest-bearing deposits with banks resulted from the additional deposits placed with us by clients amid market and public concerns related to various economic events; the growth in investment securities resulted from our ongoing re-investment strategy.

The incremental client deposits were invested primarily with the Federal Reserve, the European Central Bank and other non-U.S. central banks. These invested deposits increased our average interest-earning assets; however, they negatively affected our net interest margin. Securities purchased under resale agreements increased to meet client liquidity needs as we reduced our U.S. Treasury holdings.

On a GAAP and fully taxable-equivalent basis, net interest revenue increased 17% and 16%, respectively, for the second quarter of 2012 compared to the second quarter of 2011 and increased 13% and 12%, respectively, for the first six months of 2012 compared to the same period in 2011. These increases were driven by the impact of higher levels of interest-earning assets, mainly the result of higher levels of client deposits, with the excess deposits invested primarily with the Federal Reserve, the European Central Bank and other non-U.S. central banks; the above-described growth in the investment portfolio; lower funding costs; and higher levels of discount accretion associated with former conduit securities. These increases were partly offset by the impact of lower rates on interest-earning assets.

If conduit-related discount accretion were excluded, fully taxable-equivalent net interest revenue for the second quarter of 2012 would have increased 14%, from $554 million ($605 million presented in the preceding table less accretion of $51 million) in the second quarter of 2011 to $629 million ($703 million presented in the preceding table less accretion of $74 million). For the six-month period, fully taxable-equivalent net interest revenue would have increased 12%, from $1.10 billion ($1.21 billion presented in the preceding six-month table less accretion of $113 million) in 2011 to $1.24 billion ($1.36 billion presented in the preceding six-month table less accretion of $123 million). Discount accretion increased in both comparisons due to pay-offs of two conduit securities in the second quarter of 2012.

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Subsequent to the 2009 conduit consolidation, we have recorded aggregate discount accretion in interest revenue of $1.68 billion ($621 million in 2009, $712 million in 2010, $220 million in 2011 and $123 million in the first six months of 2012). The timing and ultimate recognition of discount accretion depends, in part, on factors that are outside of our control, including anticipated prepayment speeds and credit quality. The impact of these factors is uncertain and can be significantly influenced by general economic and financial market conditions. The timing and recognition of discount accretion can also be influenced by our ongoing management of the risks and other characteristics associated with our investment securities portfolio, including sales of securities which would otherwise generate accretion, such as the December 2010 investment portfolio repositioning.

Depending on the factors discussed above, among others, we anticipate that, until the former conduit securities remaining in our investment portfolio mature or are sold, discount accretion will continue to contribute to our net interest revenue. Assuming that we hold the remaining former conduit securities to maturity, all other things equal, we expect the remaining former conduit securities carried in our investment portfolio as of June 30, 2012 to generate aggregate discount accretion in future periods of approximately $900 million over their remaining terms, with approximately half of this aggregate discount accretion to be recorded over the next four years.

Changes in the components of interest-earning assets and interest-bearing liabilities are discussed in more detail below. Additional detail about the components of interest revenue and interest expense is provided in note 11 to the consolidated financial statements included in this Form 10-Q.

Interest-bearing deposits with banks, which include cash balances maintained at the Federal Reserve, the European Central Bank and other non-U.S. central banks to satisfy reserve requirements, averaged $25.21 billion for the second quarter of 2012, compared to $10.33 billion for the second quarter of 2011, and for the first six months of 2012 averaged $25.38 billion, compared to $12.18 billion for the same period in 2011. The significant increases in both comparisons reflected the impact of the investment of higher levels of noninterest-bearing client deposits. Average aggregate excess deposits approximated $15 billion and $4 billion for the second quarter of 2012 and 2011, respectively, with both periods exceeding minimum reserve requirements.

Average securities purchased under resale agreements increased to $7.94 billion for the second quarter of 2012 from $2.56 billion for the second quarter of 2011, and increased to $7.72 billion from $3.71 billion in the six-month comparison, largely due to an increase in client demand. Average trading account assets declined from $2.42 billion for the second quarter of 2011 to $648 million for the second quarter of 2012, and for the six-month period decreased from $2.28 billion to $683 million, the result of our withdrawal from our fixed-income trading initiative.

Our average investment securities portfolio increased to $112.67 billion for the second quarter of 2012 from $104.57 billion for the second quarter of 2011, and for the six-month period increased to $111.21 billion compared to $100.16 billion in 2011. The increases were generally the result of ongoing purchases of securities, partly offset by maturities and sales. As of June 30, 2012, securities rated "AAA" and "AA" comprised approximately 89% of our portfolio, compared to 90% rated "AAA" and "AA" as of June 30, 2011.

Loans and leases averaged $11.30 billion for the second quarter of 2012, compared to $12.72 billion for the same period in 2011, and $11.03 billion for the first six months of 2012, down from $12.73 billion in the 2011 period. The decline in both comparisons was mainly related to lower client demand for short-duration liquidity, particularly with respect to non-U.S. clients, as well as decreases in leveraged leases and purchased receivables, mainly from maturities and pay-downs. For both the second quarter and first six months of 2012, approximately 29% of our average loan and lease portfolio was composed of short-duration advances that provided liquidity to clients in support of their investment activities related to securities settlement, flat with both the second quarter and first six months of 2011.

The following table presents average U.S. and non-U.S. short-duration advances for the periods indicated:

	Quarters Ended June 30,		Six Months Ended June 30,	
(In millions)	2012	2011	2012	2011
Average U.S. short-duration advances	$1,830	$1,989	$1,816	$1,912
Average non-U.S. short-duration advances	1,499	1,734	1,383	1,729
Total average short-duration advances	$3,329	$3,723	$3,199	$3,641

The decreases in average non-U.S. short-duration advances for the second quarter and first six months of 2012 compared to the same periods in 2011 were mainly due to lower levels of advances to clients associated with the acquired Intesa securities services business.

Average other interest-earning assets increased to $6.68 billion for the second quarter of 2012 from $5.35 billion for the same period in 2011, and to $6.81 billion from $4.59 billion in the six-month comparison. The increases were primarily the result of higher levels of cash collateral provided in connection with our role as principal in certain securities borrowing activities.

Aggregate average interest-bearing deposits increased to $95.50 billion for the second quarter of 2012 from $84.96 billion for the second quarter of 2011, and in the six-month comparison increased to $92.49 billion for the 2012 period from $84.42 billion for the 2011 period. The quarter-over-quarter increase primarily reflected higher levels of wholesale certificates of deposit issued in connection with our management of liquidity (refer to our discussion of liquidity management under "Liquidity" in "Financial Condition" in this Management's Discussion and Analysis), as well as higher levels of non-U.S. transaction accounts associated with new and existing business in assets under custody and administration. The increase in the year-to-date comparison primarily reflected the above-described higher levels of non-U.S. transaction accounts.

Average other short-term borrowings declined slightly to $4.74 billion for the second quarter of 2012 from $4.98 billion in 2011 and decreased to $4.71 billion for the first six months of 2012 from $5.34 billion for the corresponding period in 2011, as higher levels of client deposits provided additional liquidity. Average long-term debt decreased from $9.54 billion in the second quarter of 2011 to $6.94 billion for the second quarter of 2012, and decreased from $9.23 billion to $7.54 in the six-month comparison. The decreases in average long-term debt reflected the maturities of $1.45 billion of senior notes in September 2011 and $1.50 billion of senior notes in April 2012, and the year-to-date comparison also reflected the maturity of $1 billion of senior notes in February 2011, all previously issued by us or State Street Bank under the FDIC's Temporary Liquidity Guarantee Program. The year-to-date decrease was partly offset by the issuance of an aggregate of $2 billion of senior notes by us in March 2011.

Average other interest-bearing liabilities increased to $4.85 billion for the second quarter of 2012 from $3.43 billion for the same period in 2011, and increased to $5.85 billion from $2.78 billion in the six-month comparison, primarily the result of higher levels of client cash collateral received in connection with our role as principal in certain securities lending activities.

Several factors could affect future levels of our net interest revenue and margin, including the mix of client liabilities; actions of the various central banks; changes in U.S. and non-U.S. interest rates; the various yield curves around the world; the amount of discount accretion generated by the former conduit securities that remain in our investment securities portfolio; and the relative impact of the yields earned on the securities purchased by us with the proceeds from the December 2010 portfolio repositioning and other maturities compared to the yields earned on the securities sold or matured.

Based on market conditions and other factors, we have continued to re-invest the proceeds from pay-downs and maturities of securities in highly rated investment securities, such as U.S. Treasuries and federal agency mortgage-backed securities and U.S. and non-U.S. mortgage- and asset-backed securities. The pace at which we continue to re-invest and the types of securities purchased will depend on the impact of market conditions and other factors over time. These factors and the level of interest rates worldwide are expected to dictate what effect our re-investment program will have on future levels of our net interest revenue and net interest margin. In addition, in a prolonged period of low interest rates and low spreads, certain products that we offer, including deposit services, cash funds and securities lending, may be less attractive to our clients, and any resulting declines in assets invested in such products could adversely affect our results of operations and liquidity management.

Gains (Losses) Related to Investment Securities, Net

From time to time, in connection with our ongoing management of our investment securities portfolio, we sell available-for-sale securities, to manage risk, to take advantage of favorable market conditions, or for other reasons. During the second quarter of 2012, we recorded net realized losses of $14 million from sales of approximately $1.36 billion of such investment securities, and net realized gains of $5 million from sales of approximately $2.45 billion during the first six months of 2012, compared to net realized gains of $62 million and $66 million, respectively, in the 2011 periods.

The net realized losses for the second quarter of 2012 included a loss of $46 million from the sale of all of our Greek investment securities, which were previously classified as held to maturity. The sale was undertaken as a result of the effect of significant deterioration in the creditworthiness of the underlying collateral, including significant downgrades of the securities' external credit ratings.

The aggregate unrealized losses on securities for which other-than-temporary impairment was recorded in the second quarter and first six months of 2012 were $21 million and $46 million, respectively. Of this total, $8 million and $25 million, respectively, related to factors other than credit, and were recognized, net of taxes, as a component of other comprehensive income in our consolidated statement of condition. For the second quarter and first six months of 2012, we recorded the remaining $13 million and $21 million, respectively, of losses ($9 million and $13 million, respectively, associated with expected credit losses and $4 million and $8 million, respectively, associated with adverse changes in timing of expected future cash flows) in our consolidated statement of income.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
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In both the second quarter and first six months of 2012, $6 million of the above-described other-than-temporary impairment of $9 million and $13 million, respectively, associated with expected credit losses was related to non-U.S. mortgage- and asset-backed securities. The remaining $3 million and $7 million for the second quarter and first six months of 2012, respectively, was related to U.S. non-agency residential mortgage-backed securities. The other-than-temporary impairment of $4 million and $8 million for the second quarter and first six months of 2012, respectively, associated with adverse changes in timing of expected future cash flows was substantially related to non-U.S. mortgage-backed securities.

The following table presents net realized gains from sales of securities and the components of net impairment losses, included in net gains and losses related to investment securities, for the periods indicated:

	Quarters Ended June 30,		Six Months Ended June 30,	
(In millions)	2012	2011	2012	2011
Net realized gains (losses) from sales of available-for-sale securities	$(14)	$62	$5	$66
Losses from other-than-temporary impairment	(21)	(44)	(46)	(79)
Losses not related to credit	8	9	25	33
Net impairment losses	(13)	(35)	(21)	(46)
Gains (Losses) related to investment securities, net	$(27)	$27	$(16)	$20
Impairment associated with expected credit losses	$(9)	$(24)	$(13)	$(29)
Impairment associated with management's intent to sell the impaired securities prior to their recovery in value	—	(8)	—	(8)
Impairment associated with adverse changes in timing of expected future cash flows	(4)	(3)	(8)	(9)
Net impairment losses	$(13)	$(35)	$(21)	$(46)

We regularly review the investment securities portfolio to identify other-than-temporary impairment of individual securities. Additional information about investment securities, the gross gains and losses that compose the net gains and losses from sales of securities and our process to identify other-than-temporary impairment is provided in note 2 to the consolidated financial statements included in this Form 10-Q.

EXPENSES

The following table presents the components of expenses for the periods indicated:

	Quarters Ended June 30,			Six Months Ended June 30,		
(Dollars in millions)	2012	2011	% Change	2012	2011	% Change
Compensation and employee benefits	$942	$1,009	(7)%	$2,006	$1,983	1%
Information systems and communications	208	199	5	399	390	2
Transaction processing services	172	193	(11)	353	373	(5)
Occupancy	115	113	2	234	220	6
Acquisition costs	15	13		28	27	
Restructuring charges, net	22	4		30	9	
Other:						
Professional services	96	84	14	177	166	7
Amortization of other intangible assets	48	50	(4)	99	99	—
Securities processing costs (recoveries)	25	(12)		24	(17)	
Regulator fees and assessments	12	16	(25)	25	22	14
Other	117	105	11	232	204	14
Total other	298	243	23	557	474	18

Total expenses	$1,772	$1,774	—	$3,607	$3,476	4
Number of employees at quarter-end	29,665	29,450				

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Expenses from Operations

The decrease in compensation and employee benefits expenses for the second quarter of 2012 compared to the second quarter of 2011 resulted from a decline in incentive compensation and employee benefits, as well as the continued implementation of our business operations and information technology transformation program. These factors were partially offset by the effect of compensation adjustments primarily related to merit and promotional increases. The slight increase for the first six months of 2012 compared to the same period in 2011 resulted from increases in staff related to new business in assets to be serviced and the effect of compensation adjustments, partly offset by a decline in incentive compensation. Independent of the restructuring charges presented separately in the table above, compensation and employee benefits expenses included non-recurring costs associated with the business operations and information technology transformation program of approximately $20 million and $37 million for the second quarter and first six months of 2012, respectively, compared to $15 million and $21 million, respectively, for the same periods in 2011.

The increase in aggregate other expenses (professional services, amortization of other intangible assets, securities processing costs (recoveries), regulator fees and assessments and other costs) for the second quarter and first six months of 2012 compared to the same periods in 2011 resulted primarily from securities processing costs compared to securities processing recoveries in 2011, as well as an increase in professional services costs for acquisitions and litigation settlements.

Acquisition Costs

Acquisition costs for the second quarter and first six months of 2012 were substantially related to integration costs incurred in connection with our acquisition of the Intesa securities services business. Acquisition costs incurred in the 2011 periods were mainly related to integration costs associated with the Intesa securities services business, Mourant International Finance Administration and Bank of Ireland Asset Management acquisitions.

Restructuring Charges

The net restructuring charges of $22 million and $30 million incurred in the second quarter and first six months of 2012, respectively, more fully described below, included $18 million and $33 million, respectively, related to the continuing implementation of our business operations and information technology transformation program. The remaining restructuring charges of $4 million and $(3) million, respectively, were related to actions initiated by us in 2011 associated with expense control measures, specifically our withdrawal from our fixed-income trading initiative. The restructuring charges of $4 million and $9 million incurred in the second quarter and first six months of 2011, respectively, related solely to the business operations and information technology transformation program.

Information with respect to both initiatives (the business operations and information technology transformation program and the expense control measures), including charges, staff reductions and aggregate activity in the related accruals, is provided in the two sections that follow.

Business Operations and Information Technology Transformation Program

In November 2010, we announced a global multi-year business operations and information technology transformation program. The program includes operational, information technology and targeted cost initiatives, including plans related to reductions in both staff and occupancy costs.

With respect to our business operations, we are standardizing certain core business processes, primarily through our execution of the State Street Lean methodology, and driving automation of these business processes. We are currently creating a new technology platform, including transferring certain core software applications to a private cloud, and have expanded our use of service providers associated with components of our technology infrastructure and application maintenance and support. We expect the transfer of core software applications to a private cloud to occur primarily in 2013 and 2014.

To implement this program, we expect to incur aggregate pre-tax restructuring charges of approximately $400 million to $450 million over the four-year period ending December 31, 2014. To date, we have recorded aggregate restructuring charges of $322 million in our consolidated statement of income, composed of $156 million in 2010, $133 million in 2011 and $33 million in the first six months of 2012. The following table presents the charges by type of cost:

(In millions)	Employee-Related Costs	Real Estate Consolidation	Information Technology Costs	Total
2010	$ 105	$ 51	—	$ 156
2011	85	7	$ 41	133
First Six Months of 2012	14	6	13	33
Total	$ 204	$ 64	$ 54	$ 322

The employee-related costs included costs related to severance, benefits and outplacement services. Real estate consolidation costs resulted from actions taken to reduce our occupancy costs through consolidation of leases and properties. Information technology costs included transition fees related to the above-described expansion of our use of service providers.

In 2010, in connection with the program, we initiated the involuntary termination of 1,400 employees, or approximately 5% of our global workforce, which was substantially complete at the end of 2011. In addition, in 2011, in connection with the expansion of our use of service providers associated with our information technology infrastructure and application maintenance and support, we identified 530 employees to be provided with severance and outplacement services as their roles were eliminated. As of June 30, 2012, in connection with the planned aggregate staff reduction of 1,930 employees described above, 1,613 employees had been involuntarily terminated and left State Street, composed of 550 employees in 2010, 782 employees in 2011 and 281 employees in the first six months of 2012.

In connection with the implementation of our business operations and information technology transformation program, we achieved approximately $86 million of annual pre-tax run-rate expense savings in 2011, compared to our 2010 run-rate expense base, previously disclosed in our 2011 Form 10-K, of approximately $6.18 billion of expenses from operations, all else equal. In addition to the $86 million, we expect to achieve additional annual pre-tax run-rate expense savings in the range of an additional $90 million to $100 million in 2012 compared to our above-described 2010 run-rate expense base, all else equal.

Excluding the expected aggregate restructuring charges of $400 million to $450 million described earlier, we expect the program to reduce our pre-tax expenses from operations, on an annualized basis, by approximately $575 million to $625 million by the end of 2014 compared to 2010, all else equal, with the full effect realized in 2015. We expect the business operations transformation component of the program to result in approximately $440 million of these savings, with the majority of these savings expected to be achieved by the end of 2013. In addition, we expect the information technology transformation component of the program to result in approximately $160 million of these savings.

These annual pre-tax run-rate savings relate only to the business operations and information technology transformation program. Our actual operating expenses may increase or decrease as a result of other factors. The majority of the annual savings will affect compensation and employee benefits expenses; these savings will be modestly offset by increases in information systems and communications expenses as we implement the program.

Expense Control Measures

During the fourth quarter of 2011, in connection with expense control measures designed to calibrate our expenses to our outlook for our capital markets-facing businesses in 2012, we took two actions. First, we withdrew from our fixed-income trading initiative, under which we traded in fixed-income securities and derivatives as principal with our custody clients and other third-parties that trade in these securities and derivatives. Second, we undertook other targeted staff reductions. As a result of these actions, we recorded aggregate pre-tax restructuring charges of $120 million in 2011, and a net credit adjustment of $(3) million in the six months ended June 30, 2012, in our consolidated statement of income. The following table presents the charges by type of cost:

(In millions)	Employee-Related Costs	Fixed-Income Trading Portfolio	Asset and Other Write-Offs	Total
2011	$ 62	$ 38	$ 20	$ 120
First Quarter of 2012	3	(10)	—	(7)
Second Quarter of 2012	(2)	1	5	4
Total	$ 63	$ 29	$ 25	$ 117

The employee-related costs included costs associated with severance, benefits and outplacement services related to both aspects of the expense control measures. In connection with these measures, we identified 442 employees to be provided with severance and outplacement services as their roles are eliminated. As of June 30, 2012, 301 employees

had been involuntarily terminated and left State Street, composed of 15 employees in 2011 and 286 employees in the first six months of 2012.
The fixed-income trading portfolio-related costs resulted primarily from fair-value adjustments to the initiative's trading portfolio related to our decision to withdraw from the initiative. In connection with our withdrawal, during the first half of 2012, we wound down substantially all of that initiative's remaining trading portfolio. Costs for asset and other write-offs were related to other asset write-downs and contract terminations.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Aggregate Restructuring-Related Accrual Activity
The following table presents aggregate activity associated with accruals that resulted from the charges associated with the business operations and information technology transformation program and expense control measures:

(In millions)	Employee-Related Costs	Real Estate Consolidation	Information Technology Costs	Fixed-Income Trading Portfolio	Asset and Other Write-Offs	Total
Initial restructuring-related accrual	$105	$51				$156
Payments	(15)	(4)				(19)
Balance at December 31, 2010	90	47				137
Additional accruals for business operations and information technology transformation program	85	7	$41			133
Accruals for expense control measures	62	—	—	$38	$20	120
Payments and adjustments	(75)	(15)	(8)	—	(5)	(103)
Balance at December 31, 2011	162	39	33	38	15	287
Additional accruals for business operations and information technology transformation program	14	6	13	—	—	33
Accruals for expense control measures	1	—	—	(9)	5	(3)
Payments and adjustments	(69)	(4)	(23)	(26)	(6)	(128)
Balance at June 30, 2012	$108	$41	$23	$3	$14	$189

INCOME TAX EXPENSE
Income tax expense was $162 million during the second quarter of 2012, compared to $202 million for the corresponding period in the prior year. For the first six months of 2012, income tax expense was $321 million, compared to $391 million for the corresponding 2011 period. Our effective tax rates for the second quarter and first six months of 2012 were 24.9% and 26.0%, respectively, compared to 28.2% and 28.4% for the second quarter and first six months of 2011, respectively. Both declines were primarily associated with an increase in tax-advantaged investments in renewable energy and changes in the geographic mix of earnings.
LINE OF BUSINESS INFORMATION
We have two lines of business: Investment Servicing and Investment Management. Given our 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. Information about our two lines of business, as well as the revenues, expenses and capital allocation methodologies associated with these lines of business, is provided in note 24 to the consolidated financial statements included in our 2011 Form 10-K.
The following is a summary of our line of business results for the periods indicated. The "Other" columns for 2012 included the net realized loss from the sale of all of our Greek investment securities; acquisition-related integration costs; restructuring charges associated with our business operations and information technology transformation program and expense control measures; and litigation settlement costs. The "Other" columns for 2011 included acquisition-related integration costs and restructuring charges associated with our business operations and information technology transformation program. The amounts in the "Other" columns were not allocated to State Street's business lines. Results for the 2011 periods reflect the retroactive effect of management changes in methodology related to

funds transfer pricing and expense allocation in 2012.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS (Continued)

	Quarters Ended June 30,							
	Investment Servicing		Investment Management		Other		Total	
(Dollars in millions, except where otherwise noted)	2012	2011	2012	2011	2012	2011	2012	2011
Fee revenue:								
Servicing fees	$1,086	$1,124					$1,086	$1,124
Management fees	—	—	$246	$250			246	250
Trading services	255	311	—	—			255	311
Securities finance	127	116	16	21			143	137
Processing fees and other	37	53	11	17			48	70
Total fee revenue	1,505	1,604	273	288			1,778	1,892
Net interest revenue	650	546	22	26			672	572
Gains (Losses) related to investment securities, net	19	27	—	—	$(46)		(27)	27
Total revenue	2,174	2,177	295	314	(46)		2,423	2,491
Provision for loan losses	(1)	2	—	—	—		(1)	2
Expenses from operations	1,511	1,529	217	228	—		1,728	1,757
Acquisition and restructuring costs	—	—	—	—	37	$17	37	17
Litigation settlement costs	—	—	—	—	7	—	7	—
Total expenses	1,511	1,529	217	228	44	17	1,772	1,774
Income before income tax expense	$664	$646	$78	$86	$(90)	$(17)	$652	$715
Pre-tax margin	31%	30%	26%	27%				
Average assets (in billions)	$184.9	$159.1	$4.2	$5.2			$189.1	$164.3

	Six Months Ended June 30,							
	Investment Servicing		Investment Management		Other		Total	
(Dollars in millions, except where otherwise noted)	2012	2011	2012	2011	2012	2011	2012	2011
Fee revenue:								
Servicing fees	$2,164	$2,219					$2,164	$2,219
Management fees	—	—	$482	$486			482	486
Trading services	535	613	—	—			535	613
Securities finance	215	175	25	28			240	203
Processing fees and other	97	122	45	40			142	162
Total fee revenue	3,011	3,129	552	554			3,563	3,683
Net interest revenue	1,254	1,094	43	55			1,297	1,149
Gains (Losses) related to investment securities, net	30	20	—	—	$(46)		(16)	20
Total revenue	4,295	4,243	595	609	(46)		4,844	4,852
Provision for loan losses	(1)	1	—	—	—		(1)	1
Expenses from operations	3,074	2,977	453	463	—		3,527	3,440
Acquisition and restructuring costs, net	—	—	—	—	58	$36	58	36
Litigation settlement costs	—	—	—	—	22	—	22	—

Total expenses	3,074	2,977	453	463	80	36	3,607	3,476
Income before income tax expense	$1,222	$1,265	$142	$146	$(126)	$(36)	$1,238	$1,375
Pre-tax margin	28 %	30 %	24 %	24 %				
Average assets (in billions)	$184.5	$156.5	$4.1	$4.9			$188.6	$161.4

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Investment Servicing

Total revenue for the second quarter of 2012 was essentially flat from the second quarter of 2011 and increased 1% in the six-month comparison. Total fee revenue in the same comparison decreased 6% and 4%, respectively. The decline in total fee revenue generally resulted from declines in trading services revenue, servicing fees and processing fees and other revenue, partially offset by an increase in securities finance revenue.

Servicing fees declined 3% in the second quarter and 2% in first six months of 2012 compared to the same periods in 2011. The decreases were primarily due to weakness in international markets and the impact of the weaker Euro, as well as changes in asset mix, partly offset by the impact of new business installed on current-period revenue and a slight improvement in the S&P 500 index. Trading services revenue decreased 18% during the second quarter of 2012 compared to the same period in 2011, and 13% in the six-month comparison, primarily due to a decline in foreign exchange trading revenue associated with lower currency volatility, which was partly offset by an increase in client volumes. Securities finance revenue for both the second quarter and six-month comparisons increased as a result of higher spreads.

Servicing fees, trading services revenue and gains (losses) related to investment securities, net, for our Investment Servicing business line are identical to the respective consolidated results. Refer to "Servicing Fees," "Trading Services" and "Gains (Losses) Related to Investment Securities, Net" under "Total Revenue" in this Management's Discussion and Analysis for a more in-depth discussion. A discussion of securities finance is provided in "Securities Finance" under "Total Revenue."

Net interest revenue for both the second quarter and first six months of 2012 increased 19% and 15%, respectively, compared to the same periods in 2011, primarily the result of the impact on interest-earning assets of higher levels of client deposits, as well as higher yields on U.S. floating-rate securities and lower funding costs, partially offset by the impact of lower rates on interest-earning assets.

Total expenses from operations decreased 1% for the second quarter of 2012 compared to the same period in 2011 primarily due to lower compensation and employee benefits expenses and increased 3% for the first six months of 2012 compared to the corresponding period in 2011, primarily due an increase in staff associated with new business in assets to be serviced and the effect of merit increases, partly offset by a decrease in incentive compensation.

Investment Management

Total revenue for the second quarter of 2012 decreased 6% compared to the second quarter of 2011, and decreased 2% for the first six months of 2012 compared to the first six months of 2011, mainly the result of declines in securities finance revenue, management fees and processing fees and other revenue.

Management fees decreased 2% in the second quarter of 2012 compared to the second quarter of 2011, and 1% in the six-month comparison. Both decreases were primarily the result of weaker international equity markets, nearly offset by the impact of net new business installed on current-period revenue. Average month-end equity valuations for the S & P 500 Index were up 1% for the second quarter of 2012 compared to the second quarter of 2011, and were up 2% in the six-month comparison. Average month-end equity valuations for the MSCI® EAFE Index[es] were down approximately 18% for the second quarter of 2012 compared to the second quarter of 2011, and were down 15% in the six-month comparison.

Management fees for the Investment Management business line are identical to the respective consolidated results. Refer to "Management Fees" under "Total Revenue" in this Management's Discussion and Analysis for a more-in depth discussion. A discussion of securities finance revenue, processing fees and other revenue and net interest revenue is provided in "Securities Finance," "Processing Fees and Other" and "Net Interest Revenue," respectively, under "Total Revenue."

Through SSgA, we acted as collateral manager for several collateralized debt obligation, or CDO, transactions structured and offered through other financial institutions. A CDO is a structured investment vehicle which purchases a portfolio of assets funded through the issuance of several classes of debt and equity, the repayment of and return on which are linked to the performance of the underlying assets. In February 2012, we entered into a settlement with the Massachusetts Secretary of State to resolve their investigation into disclosures made with respect to one CDO (Carina CDO, Ltd.).

FINANCIAL CONDITION

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

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MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Deposits and other liabilities generated by client activities are invested in assets that generally match the liquidity and interest-rate characteristics of the liabilities, although the weighted-average maturities of our assets are significantly longer than the contractual maturities of our liabilities. Our assets consist primarily of securities held in our available-for-sale or held-to-maturity portfolios and short-duration financial instruments, such as interest-bearing deposits and securities purchased under resale agreements. The actual mix of assets is determined by the characteristics of the client liabilities and our desire to maintain a well-diversified portfolio of high-quality assets.

In connection with the growth in our non-U.S. business, our cross-border outstandings have increased as we have invested in higher levels of non-U.S. assets. For additional information with respect to our non-U.S. exposures, refer to “Investment Securities” and “Cross-Border Outstandings” that follow.

The following table presents the components of our average total interest-earning and noninterest-earning assets, average total interest-bearing and noninterest-bearing liabilities, and average preferred and common shareholders' equity for the six months ended June 30, 2012 and 2011. Additional information about our average statement of condition, primarily our interest-earning assets and interest-bearing liabilities, is included under “Consolidated Results of Operations - Total Revenue - Net Interest Revenue” in this Management's Discussion and Analysis.

(In millions)	2012 Average Balance	2011 Average Balance
Assets:		
Interest-bearing deposits with banks	$25,383	$12,181
Securities purchased under resale agreements	7,715	3,710
Trading account assets	683	2,279
Investment securities	111,205	100,161
Loans and leases	11,033	12,729
Other interest-earning assets	6,807	4,586
Total interest-earning assets	162,826	135,646
Cash and due from banks	2,738	2,664
Other noninterest-earning assets	23,073	23,137
Total assets	$188,637	$161,447
Liabilities and shareholders’ equity:		
Interest-bearing deposits:		
U.S.	$4,952	$3,368
Non-U.S.	87,538	81,053
Total interest-bearing deposits	92,490	84,421
Securities sold under repurchase agreements	7,864	9,117
Federal funds purchased	892	1,139
Other short-term borrowings	4,705	5,335
Long-term debt	7,540	9,228
Other interest-bearing liabilities	5,853	2,784
Total interest-bearing liabilities	119,344	112,024
Non-interest-bearing deposits	36,536	17,220
Other noninterest-bearing liabilities	12,897	13,233
Preferred shareholders’ equity	500	298
Common shareholders’ equity	19,360	18,672
Total liabilities and shareholders’ equity	$188,637	$161,447

Investment Securities

The following table presents the carrying values of investment securities by type as of the dates indicated:

(In millions)	June 30, 2012	December 31, 2011
Available for sale:		
U.S. Treasury and federal agencies:		
Direct obligations	$1,289	$2,836
Mortgage-backed securities	34,149	30,021
Asset-backed securities:		
Student loans[1]	16,735	16,545
Credit cards	9,796	10,487
Sub-prime	1,330	1,404
Other	3,857	3,465
Total asset-backed securities	31,718	31,901
Non-U.S. debt securities:		
Mortgage-backed securities	10,815	10,875
Asset-backed securities	5,642	4,303
Government securities	1,821	1,671
Other	3,673	2,825
Total non-U.S. debt securities	21,951	19,674
State and political subdivisions	7,308	7,047
Collateralized mortgage obligations	4,730	3,980
Other U.S. debt securities	4,449	3,615
U.S. equity securities	676	640
Non-U.S. equity securities	108	118
Total	$106,378	$99,832
Held to Maturity:		
U.S. Treasury and federal agencies:		
Mortgage-backed securities	$206	$265
Asset-backed securities	17	31
Non-U.S. debt securities:		
Mortgage-backed securities	4,087	4,973
Asset-backed securities	432	436
Government securities	3	3
Other	166	172
Total non-U.S. debt securities	4,688	5,584
State and political subdivisions	86	107
Collateralized mortgage obligations	2,810	3,334
Total	$7,807	$9,321

(1) Substantially composed of securities guaranteed by the federal government with respect to at least 97% of defaulted principal and accrued interest on the underlying loans.

Additional information about our investment securities portfolio is provided in note 2 to the consolidated financial statements included in this Form 10-Q.

We manage our investment securities portfolio to align with the interest-rate and duration characteristics of our client liabilities and in the context of the overall structure of our consolidated statement of condition, and in consideration of the global interest-rate environment. We consider a well-diversified, high-credit quality investment securities portfolio to be an important element in the management of our consolidated statement of condition.

The portfolio is concentrated in securities with high credit quality, with approximately 89% of the carrying value of the portfolio rated “AAA” or “AA” as of June 30, 2012. The following table presents the percentages of the carrying value of the portfolio, by external credit rating, as of the dates indicated:

	June 30, 2012	December 31, 2011
AAA[1]	69 %	75 %
AA	20	14
A	7	7
BBB	2	2
Below BBB	2	2
	100 %	100 %

(1) Includes U.S. Treasury securities that are split-rated, “AAA” by Moody’s Investors Service and “AA+” by Standard & Poor’s.

As of June 30, 2012, the investment portfolio of approximately 11,250 securities was diversified with respect to asset class. Approximately 83% of the aggregate carrying value of the portfolio as of that date was composed of mortgage-backed and asset-backed securities. The predominantly floating-rate asset-backed portfolio consisted primarily of student loan-backed and credit card-backed securities. Mortgage-backed securities were composed of securities issued by the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, as well as U.S. and non-U.S. large-issuer collateralized mortgage obligations.

Non-U.S. Debt Securities

Approximately 23% of the aggregate carrying value of the portfolio as of June 30, 2012 was composed of non-U.S. debt securities. The following table presents our non-U.S. debt securities available for sale and held to maturity, included in the preceding table of investment securities carrying values, by significant country of issuer or location of collateral, as of the dates indicated:

(In millions)	June 30, 2012	December 31, 2011
Available for sale:		
United Kingdom	$9,699	$8,851
Australia	3,498	3,154
Netherlands	2,995	3,109
Canada	1,985	1,905
Germany	1,840	1,510
France	890	329
Belgium	170	109
Japan	150	—
Finland	139	—
Italy	127	231
Spain	89	228
Other	369	248
Total	$21,951	$19,674
Held to maturity:		
Australia	$2,379	$2,572
United Kingdom	1,703	2,259
Italy	276	297
Spain	200	220

Other	130	236
Total	$4,688	$5,584

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Approximately 87% and 88% of the aggregate carrying value of these non-U.S. debt securities was rated "AAA" or "AA" as of June 30, 2012 and December 31, 2011, respectively. The majority of these securities comprise senior positions within the security structures; these positions are protected through subordination and other forms of credit protection. As of June 30, 2012, the securities had an aggregate pre-tax net unrealized gain of approximately $27 million and an average market-to-book ratio of 100.1%. The majority are floating-rate securities, and accordingly the aggregate holdings are considered to have minimal interest-rate risk.

The underlying collateral primarily includes U.K. prime mortgages, Australian and Netherlands mortgages, Canadian government securities and German automobile loans. The "other" category of available-for-sale securities included approximately $51 million and $49 million of securities as of June 30, 2012 and December 31, 2011, respectively, related to Portugal and Ireland, all of which were mortgage-backed securities. The "other" category of held-to-maturity securities included approximately $128 million and $233 million of securities as of June 30, 2012 and December 31, 2011, respectively, related to Portugal and Ireland, all of which were mortgage-backed securities. During the second quarter of 2012, we sold all of our Greek securities, which had an aggregate carrying value of approximately $91 million, and recorded a pre-tax loss of $46 million in our consolidated statement of income. Additional information about this sale is provided under "Gains (Losses) Related to Investment Securities, Net" in "Consolidated Results of Operations" in this Management's Discussion and Analysis.

Our aggregate exposure to the other four peripheral European countries of Spain, Italy, Ireland and Portugal as of June 30, 2012 included no direct sovereign debt exposure to these countries. Our indirect exposure to these countries totaled approximately $872 million, including approximately $697 million of mortgage- and asset-backed securities with an aggregate pre-tax gross unrealized loss of approximately $71 million as of June 30, 2012. We recorded $6 million of other-than-temporary impairment associated with expected credit losses on these mortgage- and asset-backed securities in the second quarter of 2012. We recorded no other-than-temporary impairment associated with expected credit losses on these mortgage- and asset-backed securities in the first quarter of 2012 or in the second quarter and first six months of 2011.

The global economic downturn, coupled with the failure of the Eurozone countries to abide by the terms of the Eurozone stability pact, led to significant sovereign borrowing at advantageous rates, particularly by the above-mentioned peripheral countries, while some of those countries failed to address their underlying uncompetitive economies. These events led to the sovereign debt crisis when these fundamental issues caused severe stresses within the Eurozone. This sovereign crisis in Europe has deteriorated with little sign of improvement in the peripheral countries' economies. In response, the major independent credit rating agencies have downgraded, and may in the future do so again, U.S. and non-U.S. financial institutions and sovereign issuers which have been, and may in the future be, significant counterparties to us, or whose financial instruments serve as collateral on which we rely for credit risk mitigation purposes. As a result, we may be exposed to increased counterparty risk resulting from our role as principal, or because of commitments we make in our capacity as a financial intermediary.

Peripheral country risks are identified, assessed and monitored by our Country and Counterparty Exposure Committee. Country limits are defined in our credit and counterparty risk guidelines, in accordance with our credit and counterparty risk policy. These limits are monitored on a daily basis by Enterprise Risk Management. All peripheral country exposures are subject to ongoing surveillance and stress test analysis, conducted by the investment portfolio management team. The stress tests performed reflect the structure and nature of the exposure, its past and likely future performance based on macroeconomic and environmental analysis, with key underlying assumptions varied under a range of scenarios, reflecting likely downward pressure on collateral performance from the sovereign crisis and related austerity measures. The results of the stress tests are presented to senior management and Enterprise Risk Management as part of the surveillance process.

In addition, Enterprise Risk Management conducts independent stress test analyses and evaluates the structured asset exposures in European peripheral countries for the assessment of other-than-temporary impairment. The assumptions used in these evaluations reflect expected downward pressure on collateral performance from the sovereign crisis, the related austerity measures and their economic impact. Stress scenarios are subject to regular review, and are updated to reflect changes in the economic environment, measures taken in response to the sovereign crisis and collateral performance, with particular attention to our peripheral country exposures.

Municipal Securities

We carried an aggregate of approximately $7.39 billion of municipal securities, classified as state and political subdivisions in the preceding table of investment securities carrying values, in our investment portfolio as of June 30, 2012. Substantially all of these securities are classified as available for sale, with the remainder classified as held to maturity. As of the same date, we also provided approximately $8.44 billion of credit and liquidity facilities to municipal issuers as a form of credit enhancement. The following tables present our combined credit exposure to state and municipal obligors which represented 5% or more of our aggregate municipal credit exposure of approximately $15.83 billion and $15.43 billion across

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our businesses as of the dates indicated, grouped by state to display geographic dispersion:

June 30, 2012 (Dollars in millions)	Total Municipal Securities	Credit and Liquidity Facilities	Total	% of Total Municipal Exposure
State of Issuer:				
Texas	$1,026	$ 1,994	$3,020	19 %
California	189	1,303	1,492	9
New York	477	821	1,298	8
Massachusetts	869	402	1,271	8
Florida	158	685	843	5
Wisconsin	434	395	829	5
New Jersey	794	—	794	5
Total	$3,947	$ 5,600	$9,547	

December 31, 2011 (Dollars in millions)	Total Municipal Securities	Credit and Liquidity Facilities	Total	% of Total Municipal Exposure
State of Issuer:				
Texas	$1,002			