

May 2011



## State Street Corporation Credit Summary Report

### Ratings

State Street Corporation  
Long Term  
Short Term  
Outlook

### S&P

A+  
A-1

### Moody's

A1  
P-1  
Negative

### Fitch

A+  
F-1+

### Trend Rating: SV2

State Street Corporation (STT), headquartered in Boston, Massachusetts, is the third-largest custodial bank and the largest institutional asset manager in the world. STT's major global market positions are evidenced by its \$21.53 trillion of assets under custody and administration (AUC) and \$2.01 trillion in assets under management (AUM) at the end of 2010. With assets of \$160.8 billion as of December 31, 2010, STT conducts its business principally through its subsidiary, State Street Bank and Trust Company. Having managed through the financial crisis to maintain its solid position within its sector, expanding operations outside the U.S. remains a key strategic goal of the bank. Moreover, non-U.S. revenues are growing at a faster clip, accounting for 42% of total revenue (versus 31% in 2009), with the expectation that these revenues will double over the next five years. At the same time the bank continues to cultivate growth in core businesses, deepening relationships with clients and winning mandates from new clients, both of which contributed to wins of \$1.4 trillion in assets to be serviced and \$160 billion in assets to be managed in 2010.

The bank manages under two main business lines: Investment Servicing (IS: roughly 89% of operating revenue in 2010) and Investment Management (IM: 11%). IS includes, among other operations, custody, brokerage and securities finance for domestic and international institutional investors. While the bank provides custody servicing to various clients, the U.S. mutual fund industry remains its largest at 26%, or \$5.6 trillion of its AUC. AUC grew 14% in 2010 thanks to new business wins, equity market improvements and acquisitions. During 2Q10, the bank acquired London-based Mourant International Finance Administration (MIFA, \$122 billion in AUA) and Intesa Sanpaolo's securities services business (\$564 billion in AUC), expanding its non U.S. servicing activities. MIFA is a leading provider of fund administrative services, particularly for alternate investments. Intesa positions State Street to be the largest securities service provider in Italy and greatly enhances its presence in Luxembourg. IM clients include investment companies, endowments and charities. Housing State Street Global Advisors (SSgA), this segment utilizes several investment strategies but the majority of assets are invested in passive equity or fixed income strategies, which have lower fees than active strategies. Like IS, this segment also experienced international growth in 2010, announcing its acquisition of Bank of Ireland Asset Management in October, thereby adding EUR 26 billion in AUM. Additionally, improvement in equity markets resulted in a sizeable boost to AUM. Still, AUM grew just 5% in 2010 due in part to outflows related to the lifting of redemptions in some securities lending funds.

During the crisis, several institutional investors suspended their participation in the bank's securities lending program alleging that the bank mismanaged money by failing to comply with certain investment strategies, which resulted in underperformance of certain funds and the decline in the NAV of many pools to less than \$1.00. In relation, the bank saw a significant decline in securities lending revenue, and subsequently established a legal reserve to deal with lawsuits and instituted certain redemption restrictions. To address this issue, the bank announced in July 2010 it took a \$330 million pre-tax charge to support certain collateral pools, thereby lifting the NAV of these pools to \$1.00. This, along with an additional \$75 million in reserves, subsequently enabled the bank to remove its redemption restrictions in August 2010. In a further effort to address reputational and legal risks, STT entered into a settlement with the SEC, having been served a "Wells" notice in June 2009 related to ongoing investigations into disclosures and management of certain fixed-income strategies in its securities lending business. This and all related settlements were amply covered by the established reserves.

For 2010, net income was \$1.56 billion compared to a loss of \$1.88 billion in the prior year, which included an extraordinary loss of \$3.68 billion related to the consolidation of the ABCP conduits. Income for 2010 included the aforementioned charges related to the securities lending business (\$414 million, including \$9 million in legal fees), a \$344 million pretax loss on the restructuring of the securities portfolio and \$156 million in restructuring charges. The latter charge reflects the initial phase of a global multi-year efficiency program, and relates primarily to a reduction in workforce that is intended to be completed by year end 2011. The program will include operational and technology enhancements and management expects charges to total \$400-\$500 million, with an ultimate reduction in annual expenses of \$575-\$625 million by year-end 2014. A 10% increase in fee revenue and a 5% increase in spread revenue partially offset by higher losses related to investment securities resulted in revenue growth of 4%. In particular, asset servicing fees and management fees, which accounted for an aggregate 73% of fee revenue, were up 18% and 8%, respectively. A decline in asset yields as well as a continued low interest rate environment continued to depress spread revenue, with the y/o/y increase in spread revenue largely the result of the Intesa acquisition. Core operating expenses were up 9% due to increased salaries and benefits expense. With expense growth outpacing revenue growth, the cost to income ratio weakened to 88%. Returns were modest with a ROA of 1.02% and a ROE of 9.5%.

Asset quality issues remain de minimis for the bank with loans totaling just \$12 billion, of which \$11.2 billion are institutional loans and \$0.8 billion are CRE loans, acquired due to an indemnified repo agreement with a Lehman affiliate. Troubled debt restructuring in the CRE book totaled \$307 million, with no impairments to-date and nonaccruals of \$158 million. STT's liquidity position is robust due to a significant amount of liquid assets and stable funding from investment servicing and management client deposits. At year-end, the bank had \$3.3 billion of cash and \$22.2 billion of deposits with central banks on balance sheet. Customer deposits remained an important and stable source of funding, with about 6% of the total \$98 billion of deposits wholesale CDs and the remainder client-driven. Additionally, STT has \$24 billion in repo, fed funds and other short-term borrowings, which included about \$2 billion in commercial paper outstandings related to the conduit consolidation. Parent company liquidity remained sufficient with \$2.3 billion in cash net of commercial paper outstandings at year-end, with its next obligation of \$1.7 billion coming due in April 2012. In tandem with the bank's goal of improving its risk profile, the bank restructured its securities portfolio in December 2010, selling \$11 billion of MBS and ABS securities. As of 4Q10, 90% of the \$95.3 billion portfolio was rated AA or better compared to 82% of the prior quarter's \$99.6 billion portfolio. The securities sales enhanced the bank's capital position and positioned it well for the implementation of Basel III. The Tier-1 ratio and Tier-1 common ratio were solid at 20.5% and 18.1%, respectively, at the end of the year. On a proforma basis, the bank estimates Tier-1 common under Basel 3 at 9.4% (minimum requirement is 7%). In March 2011, STT announced a common dividend increase to \$0.18 from \$0.01 per share, in addition to the authorization of a \$675 million share buy-back program for 2011.

In March 2011, S&P revised STT's outlook to stable from negative reflecting good core earnings generation, a highly liquid balance sheet, limited asset-quality risk and an enhanced capital position. In addition, the agency cited the bank's lower risks in its securities lending business and investment portfolio. Fitch maintains a stable outlook and recently upgraded the bank's individual rating. The LT rating is negative at Moody's and benefits from one-notch of uplift from implied systemic support.

## State Street Corporation

**Strengths:**

- Solid market position globally as leading custodian and institutional asset manager
- Highly liquid balance sheet
- Strong capital levels
- Systemically important

**Weaknesses:**

- Although lessened, legal and reputational risks in securities lending business
- Pressure on profitability due to a continued low interest rate environment

**Key Statistics – State Street Corporation**

(\$ millions)	2010	2009	2008	2007	2006	CAGR/Avg
Deposits	98,345	90,062	112,225	95,789	65,646	10.6%
Assets	160,505	157,946	173,631	142,543	107,353	10.6%
Revenue	8,953	8,640	10,693	8,336	6,311	9.1%
Net Income	1,556	(1,881)	1,811	1,261	1,106	8.9%
Return on Equity	9.5%	13.2%	14.8%	13.4%	16.4%	13.5%
Return on Assets	1.02%	1.12%	1.11%	1.02%	1.04%	1.06%
Tier 1 Capital Ratio	20.5%	17.7%	20.3%	11.2%	13.7%	16.7%
Total Capital Ratio	22.0%	19.1%	21.6%	12.7%	15.9%	18.3%

Sources: Company reports and SEC filings.

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