



# STANDISH



## State Street Bank & Trust Company

**RATING:** Q2  
**Other Ratings as of:** December 2008  
**Moody's:** Aa1  
**S & P:** AA  
**Fitch:** AA-

**Domicile:** Boston, Massachusetts  
**Holding Company:** State Street Corporation

State Street Bank & Trust Company is the main subsidiary of State Street Corporation (STT) making up more than 90% of STT's asset base. STT is the largest provider of institutional investment services in the world with \$15.3 trillion of assets under custody. Through its subsidiary, State Street Global Advisors (SSgA), it is also the largest institutional money manager in the United States with \$2.0 trillion in assets under management, and one of the largest globally.

STT, as a leading securities servicer, is focused on custodial operations for global institutional investors. The company continues to expand into a variety of value-added custodial services including securities lending, foreign exchange trading, fund accounting and valuation. STT's established business and reputation have enabled the firm to develop strong market positions in custody servicing for U.S. mutual funds and pensions. The firm has also branched out into several non-traditional custodial business lines such as trade and risk management, investment research and middle and back office support functions. Although STT has a leading position as an investment servicer, its prospects continue to improve as demand for portfolio analytics, compliance monitoring and back office outsourcing are increasing and barriers to entry, due to high technology costs, discourage new entrants.

STT's asset management business is conducted through SSgA. The division applies a variety of investment strategies, including both passive and active equity methods; the largest investment strategies are equity index assets and money market assets. SSgA also provides services in the areas of tax-exempt investing, enhanced equity management, real estate and private equity.

In 2008, the US Treasury bought \$2 billion in preferred shares from SST through the Temporary Asset Relieve Program (TARP). SST can purchase these shares back in three years at par, but they can be purchased back earlier with certain restrictions attached. SST maintains it did not need the capital injection, but it will use the money to lend more and provide liquidity to the financial system.

STT's strategy revolves around signing clients to multi-year, generally low-margin custody contracts, and then cross-selling additional services to maximize profitability and client retention. In recent years STT has narrowed its business focus, selling business units that are non-core or underperforming, including its corporate trust and private wealth management businesses in recent years. In 2003, STT purchased Deutsche Bank AG's global securities services (GSS) business, which included record keeping and securities lending business lines. In 2007, STT acquired Investors Financial Services (IFIN), the parent of Investors Bank & Trust, for \$4.5 billion in an all-stock transaction, enhancing STT's position as one of the largest securities servicers globally.

STT plans to increase non-US revenues to more than 50% of the total in the next four years, and has targeted Europe and Asia as areas for growth potential. For 2007, non-US revenues were 41% of total revenues, down slightly from the 43% in 2006 due to the acquisition of IFIN. Several global macro trends are working in STT's favor, including an aging population and asset globalization. STT has strong market share in key countries, including servicing 18% of UK pension funds, 16% of German institutional and retail fund assets and 36% of trust assets in Japan held by non-domestic banks. For the past ten years, revenue growth outside the US has averaged 21%, compared to total STT revenue growth of 13%.

In 2007, STT's revenues grew 53% (including IFIN results) to \$2.5 billion with a solid ROE of 18.7%. In the fourth quarter of 2007, STT established a legal reserve (\$618 million) to cover costs associated with the underperformance of several SSgA fixed income funds. Several clients are suing STT, alleging that investments held in certain funds were inappropriate. In addition to this litigation, STT has direct exposure to subprime mortgages in its investment portfolio, with \$6.2 billion in subprime asset-backed securities at year-end. About half of the exposure is from vintages 2005 or earlier and credit enhancement, according to management, is currently 40%. This exposure may require additional write-downs in 2008, however, depending on how the US housing market performs. Another credit concern for STT in 2007 was its asset-backed commercial paper conduit exposure, with \$29 billion in year-end exposure in four STT-sponsored conduits. The largest two are US (\$11.5 billion) and US/Euro (\$11.4 billion) programs that remain outstanding, although with wider spreads than one year ago and slightly shorter duration. Although the ABCP market appears to have stabilized following the sharp disruption last summer, we continue to monitor STT's ABCP funding ability. STT's capital would be strained if one or more conduits needed to be consolidated on its balance sheet.

STT's capital base grew rapidly over recent years as retained earnings boosted capital; capital generation is fairly robust at STT due in part to a fairly modest dividend payout ratio. Although STT has lowered its Tier 1 and total capital ratios in recent years as its risk-weighted assets have come down, both levels are adequate and well above medians for US banks. With widespread investor focus on capital strength, STT issued a \$500 million hybrid in early 2008 that boosts Tier 1 capital levels. STT targets a leverage ratio of 5.25% to 5.75%, with tangible leverage ratios targeted at 4.25% to 4.75%. Both adequate for the bank's risk profile.

Due to State Street's strong market share and established custody business, focused expansion, low risk profile, steady profitability and healthy capitalization we continue to rate the company Q2 in our Universe.

## State Street Bank & Trust Company

### Strengths:

- Strong, established core custodial business where barriers to entry are high
- Focused business development, looking to capitalize on core and complementary lines
- Continued improvement in profitability, strong fee-based revenue

### Weaknesses:

- Profitability in core custodial business is low (volume must be maintained)
- Nature of business lends itself to heavy technology spending
- Lack of diversity in revenue base (80-85% related to investment servicing)

### Key Statistics

(\$ millions)	2007	2006	2005	2004	2003	CAGR/ Average
Total Assets	142,543	107,353	97,968	94,047	87,534	10.69%
Equity	11,299	7,233	6,367	6,159	5,748	18.74%
Equity/Assets	7.93%	6.74%	6.50%	6.55%	6.57%	6.86%
Net Income	1,261	1,106	838	798	722	4.44%
Tier 1 Capital Ratio	11.2%	13.7%	11.7%	13.3%	14.0%	12.8%
Total Capital Ratio	12.7%	15.9%	14.0%	14.7%	15.8%	14.6%
Return on Average Assets	1.01%	1.08%	0.87%	0.88%	0.83%	0.93%
Return on Average Equity	13.6%	16.2%	13.4%	13.4%	13.7%	14.1%

Source: Company reports and SEC filings.



► A BNY MELLON ASSET MANAGEMENT COMPANY<sup>SM</sup>

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