

STATE STREET CORP
Form 10-Q
August 03, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2007**

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
(State or other jurisdiction
of incorporation)

One Lincoln Street
Boston, Massachusetts
(Address of principal executive office)

04-2456637
(I.R.S. Employer Identification No.)

02111
(Zip Code)

617-786-3000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The number of shares of State Street's common stock outstanding on July 31, 2007 was 389,515,571.

STATE STREET CORPORATION

Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2007

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

OVERVIEW

State Street Corporation is a financial holding company headquartered in Boston, Massachusetts. Through its subsidiaries, including its principal bank subsidiary, State Street Bank & Trust Company, State Street provides a full range of products and services to meet the needs of institutional investors worldwide. Unless otherwise indicated or unless the context requires otherwise, all references in this Management's Discussion and Analysis to State Street, we, us, our or similar terms mean State Street Corporation and its subsidiaries on a consolidated basis. At June 30, 2007, we had consolidated total assets of \$112.27 billion, total deposits of \$73.04 billion, total shareholders' equity of \$7.75 billion and employed 22,350.

Our customers include mutual funds and other collective investment funds, corporate and public retirement plans, insurance companies, foundations, endowments and other investment pools, and investment managers. Our two lines of business, Investment Servicing and Investment Management, provide products and services including custody, recordkeeping, daily pricing and administration, shareholder services, foreign exchange, brokerage and other trading services, securities finance, deposit and short-term investment facilities, loan and lease financing, investment manager and hedge fund manager operations outsourcing, performance, risk and compliance analytics, investment research and investment management, including passive and active U.S. and non-U.S. equity and fixed income strategies. We had \$13.04 trillion of assets under custody and \$1.93 trillion of assets under management at June 30, 2007. Financial information about our business lines is provided later in the Line of Business Information section.

This Management's Discussion and Analysis is part of our Quarterly Report on Form 10-Q to the SEC, and updates the Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2006, which we refer to as the 2006 Form 10-K, and in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007. We previously filed both of these reports with the SEC. You should read the financial information in this Form 10-Q in conjunction with the financial information contained in those filings. Certain amounts previously reported have been reclassified to conform to current period classifications.

We prepare our consolidated financial statements in accordance with United States generally accepted accounting principles, which we refer to as GAAP, and which require management to make judgments in the application of its accounting policies that involve significant estimates and assumptions about the effect of matters that are inherently uncertain. Accounting policies considered relatively more significant in this respect are accounting for lease financing, goodwill, income taxes and pension costs. Additional information about these accounting policies is included in the Significant Accounting Estimates section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2006 Form 10-K. Other than our application of the provisions of FASB Staff Position No. FAS 13-2 and Interpretation No. 48, which are discussed in note 1 to the consolidated financial statements in this Form 10-Q, there were no significant changes to these accounting policies during the first six months of 2007.

RECENT DEVELOPMENTS

On July 2, 2007, we completed our acquisition of Investors Financial Services Corp., a bank holding company based in Boston with approximately \$17 billion in total assets as of June 30, 2007. We exchanged approximately 60.8 million shares of our common stock, with an aggregate value of approximately

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

\$4.2 billion, for all of the outstanding common stock of Investors Financial. Financial results of Investors Financial will be included in our consolidated financial statements beginning on July 2, 2007. Additional information about this acquisition is included in note 2 to the consolidated financial statements in this Form 10-Q.

During the second quarter of 2007, we issued an aggregate of \$1.5 billion of debt, composed of \$700 million of senior debt and \$800 million of capital securities, and used the net proceeds from these issuances to fund, in substantial part, the accelerated share repurchase and redemptions of debt described below. Additional information with respect to these issuances is included in the Liquidity section of this Management's Discussion and Analysis.

On July 20, 2007, we entered into an accelerated share repurchase, under which we committed to repurchase \$1 billion of our common stock. The total number of shares repurchased will depend, in part, on the weighted average price per share of our common stock paid by our dealer over the repurchase period, which is not expected to exceed six months. The total number of shares to be repurchased is also subject to other conditions and adjustments. Additional information about this repurchase is included in the Capital section of this Management's Discussion and Analysis.

On July 23, 2007, we redeemed an aggregate of \$500 million of unsecured junior subordinated debentures issued by the parent company to two of our statutory business trusts, State Street Capital Trusts A and B, composed of \$200 million of 7.94% debentures issued in 1996 and \$300 million of 8.035% debentures issued in 1997. We paid the trusts the outstanding amount on the debentures plus accrued interest and an aggregate redemption premium of approximately \$20 million. This redemption premium will be included in the merger and integration charge which we will record during the third quarter of 2007 in connection with the Investors Financial acquisition. Additional information about this redemption is included in the Liquidity section of this Management's Discussion and Analysis.

In addition, in July 2007, in connection with an overall evaluation of our requirements for office space as a result of the acquisition, we terminated the operating lease related to one of our office buildings in Boston. The termination resulted in a non-cash charge of approximately \$94 million, which will be included in the merger and integration charge which we will record during the third quarter of 2007.

FORWARD-LOOKING STATEMENTS

This Form 10-Q, particularly this Management's Discussion and Analysis, contains statements that are considered forward-looking statements within the meaning of United States securities laws. In addition, management may make other written or oral communications from time to time that contain forward-looking statements. Forward-looking statements, including statements about industry trends, management's future expectations and other matters that do not relate strictly to historical facts, are based on assumptions by management, and are often identified by such forward-looking terminology as expect, look, believe, anticipate, estimate, seek, may, will, trend, target and goal, or variations of such terms.

These statements are subject to various risks and uncertainties, which change over time, and 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 the parent company and to our principal bank subsidiary, State Street Bank and Trust Company.

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

Factors that could cause changes in the expectations or assumptions on which forward-looking statements are based include, but are not limited to:

- The level and volatility of interest rates, particularly in the U.S. and Europe; the performance and volatility of securities, currency and other markets in the U.S. and internationally; and economic conditions and monetary and other governmental actions designed to address those conditions;
- Our ability to attract non-interest bearing deposits and other low-cost funds;
- The competitive environment in which we operate, including our ability to cross-sell services to our customers and to maintain service levels, technology and product offerings that are sufficient to attract new customers and retain current customers;
- The enactment of legislation, including tax legislation, and changes in regulation and enforcement that impact State Street and its customers;
- Our ability to continue to grow revenue, control expenses and attract the capital necessary to achieve our business goals and comply with regulatory requirements;
- Our ability to control systemic and operating risks;
- Trends in the globalization of investment activity and the growth on a worldwide basis in financial assets;
- Our ability to complete, integrate and convert acquisitions into our business, including our recently completed acquisition of Investors Financial;
- Trends in governmental and corporate pension plans and savings rates;
- Changes in accounting standards and practices, including changes in the interpretation of existing standards, that impact our consolidated financial statements; and
- Changes in tax legislation and in the interpretation of existing tax laws by U.S. and non-U.S. tax authorities that impact the amount of taxes due.

Therefore, actual outcomes and results may differ materially from what is expressed in our forward-looking statements, and those statements should not be relied upon as representing our expectations or beliefs as of any date subsequent to the date this Form 10-Q is filed with the SEC. Additional information about important factors that could cause our actual financial results to differ materially from those indicated by any forward-looking statements is provided in our 2006 Form 10-K, particularly Item 1A, Risk Factors. You should read and consider the risk factors discussed in our 2006 Form 10-K in conjunction with the information in this Form 10-Q. We undertake no obligation to revise the forward-looking statements contained in this Form 10-Q to reflect events after its filing date.

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

(Dollars in millions, except per share amounts)	Quarters Ended June 30,			Six Months Ended June 30,		
	2007	2006	% Change	2007	2006	% Change
Total fee revenue	\$ 1,537	\$ 1,375	12 %	\$ 2,907	\$ 2,635	10 %
Net interest revenue	385	262	47	710	528	34
(Losses) Gains on sales of available-for-sale investment securities, net	(1)	14			11	
Total revenue	1,921	1,651	16	3,617	3,174	14
Total operating expenses	1,358	1,176	15	2,571	2,272	13
Income from continuing operations before income tax expense	563	475	19	1,046	902	16
Income tax expense from continuing operations	197	248		366	393	
Income from continuing operations	366	227	61	680	509	34
Income from discontinued operations					10	
Net income	\$ 366	\$ 227		\$ 680	\$ 519	
Earnings Per Share From Continuing Operations:						
Basic	\$ 1.09	\$.69	58	\$ 2.03	\$ 1.54	32
Diluted	1.07	.68	57	2.00	1.52	32
Earnings Per Share:						
Basic	1.09	.69		2.03	1.57	
Diluted	1.07	.68		2.00	1.55	
Cash dividends declared	.22	.20		.43	.39	
Return on shareholders' equity from continuing operations	19.2	% 14.0	%	18.4	% 15.8	%
Return on shareholders' equity	19.2	14.0		18.4	16.1	

Summary

Our financial results for the second quarter and first six months of 2007 continued to reflect growth in revenue along with our ability to balance expense growth with revenue growth. Other highlights for the second quarter and first six months of 2007 relative to the 2006 periods are as follows:

- Compared to the second quarter of 2006, servicing fees grew 12%, management fees grew 22% and securities finance revenue grew 27%, contributing to aggregate growth of 12% in total fee revenue.
- In the year-to-date comparison, servicing fees grew 11%, management fees grew 21% and securities finance revenue grew 24%, contributing to aggregate growth of 10% in total fee revenue.
- Net interest revenue grew 47% and net interest margin grew 44 basis points compared to last year's second quarter. In the year-to-date comparison, net interest revenue grew 34% and net interest margin grew 33 basis points.
- We achieved positive operating leverage, which we define as the difference between the growth rate of total revenue and the growth rate of total operating expenses, for both the second quarter and first six months of 2007 compared to the corresponding prior-year periods.
- State Street Global Advisors, which we refer to as SSgA, generated \$32 billion of net new business in assets under management during the second quarter and \$108 billion for the first six months of

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

2007. Approximately 75% of SSgA's new business was in active management products, including enhanced indexing, hedge fund strategies and active quantitative management.

- We ended the second quarter of 2007 with State Street record levels of assets under custody and assets under management.

Our financial results are discussed in the following Financial Highlights section, with more detailed information about the second quarter and first six months of 2007 provided in the Consolidated Results of Operations section of this Management's Discussion and Analysis.

Financial Highlights

Second quarter 2007 net income of \$366 million increased 61%, and diluted earnings per share of \$1.07 increased 57%, from net income of \$227 million and diluted earnings per share of \$.68 for the second quarter of 2006. Net income was \$680 million and diluted earnings per share was \$2.00 for the first six months of 2007, compared to income from continuing operations of \$509 million and diluted earnings per share from continuing operations of \$1.52 for the first six months of 2006. Net income of \$519 million for the first six months of 2006 included income from discontinued operations of \$10 million (gross income of \$16 million reduced by related income tax expense of \$6 million), or \$.03 per share, which resulted from the finalization of legal, selling and other costs recorded in connection with our divestiture of Bel Air Investment Advisors LLC. Additional information about the Bel Air divestiture is included in note 2 to the consolidated financial statements in this Form 10-Q.

Comparing the second quarter of 2007 to the second quarter of 2006, our total revenue grew 16%. Total fee revenue was up 12%, with increases in all income statement revenue line items except processing fees and other, which was down 12%. The growth in fee revenue was particularly notable in servicing fees, up 12%, management fees, up 22%, and securities finance revenue, up 27%. Both servicing fees and management fees benefited from increases in net new business and favorable equity market performance. The increase in securities finance revenue was driven by higher securities lending volumes, from both existing and new customers.

Net interest revenue increased 47% compared to the prior year second quarter, with a related increase in net interest margin of 44 basis points. The increase resulted primarily from a higher level of customer deposits, the continued favorable non-U.S. interest rate environment and stable U.S. interest rates. Overall, we continue to benefit from increases in both non-U.S. transaction deposits and non-U.S. interest rates.

Total operating expenses increased 15%, primarily the result of increased incentive compensation due to improved performance and increased headcount to support new business. With growth in total revenue exceeding the growth in total operating expenses for the second quarter of 2006, we achieved positive operating leverage of approximately 90 basis points.

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

SSgA continued to generate increased revenue, principally from increased customer demand for its active investment management products, such as enhanced indexing and active quantitative management, which earn a higher level of fees than other products. SSgA revenue comprised approximately 20% of our consolidated total revenue for the second quarter and first six months of 2007, compared to 19% for the second quarter and first six months of 2006. SSgA achieved a pre-tax operating margin of 38% and 34% for the second quarters of 2007 and 2006, and 36% and 35% for the first six months of 2007 and 2006, respectively. SSgA generated net new business of \$32 billion in assets under management in the second quarter of 2007, compared to net lost business of \$5 billion in last year's second quarter. On a year-to-date basis, SSgA generated net new business of \$108 billion for 2007 compared to \$29 billion for 2006. Net new business is measured as the aggregate value of new asset management business added less asset management business lost during the period.

At June 30, 2007, we had aggregate assets under custody of \$13.04 trillion, which grew 10% from \$11.85 trillion at December 31, 2006, and 20% from \$10.86 trillion at June 30, 2006. At the same date, we had aggregate assets under management of \$1.93 trillion, which grew 10% from \$1.75 trillion at December 31, 2006 and 26% from \$1.53 trillion at June 30, 2006.

Our effective tax rate for the second quarter of 2007 was 35%, compared to 52.1% from continuing operations for the second quarter of 2006, and 38.1% for full-year 2006. The effective rate for the second quarter of 2006 reflected increased income tax expense that resulted from tax-related adjustments recorded in the 2006 period associated with tax legislation and leveraged leases.

Financial Goals

In our 2006 Form 10-K, we reaffirmed our long-term financial goals for State Street. However, we adjusted these financial goals for 2007 in anticipation of our then-planned acquisition of Investors Financial, which we completed in July 2007. These adjusted financial goals for 2007 were:

- Growth in operating-basis revenue of between 16% and 18%;
- Growth in operating-basis earnings per share from continuing operations of between 8% and 10%; and
- Operating-basis return on shareholders' equity from continuing operations of between 12% and 15%.

Operating-basis results, as defined by management, include fully taxable-equivalent net interest revenue, reflecting increases related to tax-equivalent adjustments of \$12 million and \$13 million for the second quarters of 2007 and 2006, respectively, and \$24 million for each of the six-month periods, with a corresponding charge to income tax expense. In addition, operating-basis results for the six months ended June 30, 2006 exclude the previously mentioned tax-related adjustments recorded in the second quarter of 2006 associated with tax legislation and leveraged leases. Operating-basis results for 2007 will exclude merger and integration costs associated with the Investors Financial acquisition.

Management measures our financial goals and related results on an operating basis to provide financial information that is comparable from period to period, and to present comparable financial trends with respect to our ongoing business operations. The use of fully taxable-equivalent net interest revenue facilitates the comparison of revenues from both taxable and non-taxable sources. In addition, the tax-related adjustments and merger-related costs are not part of our normal ongoing business operations, and

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

as a result could prevent a meaningful comparison of earnings per share and return on shareholders' equity with those of other periods. Management believes that operating-basis financial information facilitates an investor's understanding and analysis of State Street's underlying performance and trends in addition to financial information prepared in accordance with GAAP.

For the second quarter of 2007 compared to the second quarter of 2006, we continued to make progress toward achieving our financial goals for 2007. We increased our operating-basis earnings per share from continuing operations by 15%, from \$.93 to \$1.07 (excluding tax-related adjustments of \$.25 per share included in earnings per share from continuing operations of \$.68 for the second quarter of 2006). Our operating-basis revenue increased 16% from \$1.664 billion to \$1.933 billion (including taxable-equivalent adjustments of \$13 million for 2006 and \$12 million for 2007, excluded from \$1.651 billion and \$1.921 billion on a GAAP basis); and we achieved operating-basis return on shareholders' equity of 18.4%, equivalent to 18.4% prepared in accordance with GAAP.

Outlook

As a result of our second quarter 2007 results and those of Investors Financial for the same period, the latter of which are not included in our accompanying consolidated results for the second quarter and first six months of 2007, in July we revised our financial goals for full-year 2007, as follows:

- Growth in operating-basis revenue of between 20% and 22%;
- Growth in operating-basis earnings per share from continuing operations of between 10% and 15%; and
- Operating-basis return on shareholders' equity from continuing operations of between 14% and 17%.

Operating-basis revenue will include fully taxable-equivalent net interest revenue, as described earlier. In addition, operating-basis results for 2007 will exclude merger and integration costs related to the acquisition, and for 2006 will exclude the previously disclosed tax-related adjustments. As discussed earlier in this section, the use of fully taxable-equivalent net interest revenue facilitates the comparison of revenues from both taxable and non-taxable sources. In addition, the merger and integration costs, as well as the tax-related adjustments, are not part of our normal ongoing business operations, and as a result could prevent a meaningful comparison of earnings per share and return on shareholders' equity with those of other periods.

Some of the factors and assumptions that we considered earlier this year in determining our outlook for 2007 were as follows:

- Expected equity market growth, based on S&P 500 and/or MSCI® EAFE indices, of about 7%;
- Growth in revenue generated from active quantitative asset management products;
- Relatively stable domestic interest rates;
- Expected flattening of the U.S. dollar yield curve;
- Continuation of beneficial trends in non-U.S. interest rates;
- Modest growth in non-U.S. deposits, as well as the maintenance of a favorable mix of customer deposits, including demand deposits;

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

- A stable income tax and regulatory environment;
- Achievement of expected cost savings from the Investors Financial acquisition; and
- Retention of, and success in cross-selling to, Investors Financial's customer base.

Actual experience during the first six months of 2007 has differed from our assumptions in many respects. In particular, during the first six months of 2007, increases in our servicing and management fee revenues due in part to the performance of the equity markets, as well as increases in, and spreads on, our non-U.S. deposits have been more favorable than our assumptions. However, these favorable trends may not continue or may lessen over the remainder of 2007. Information about risks and uncertainties which could cause these and other actual results to differ materially from those expected is included in Item 1A of our 2006 Form 10-K.

CONSOLIDATED RESULTS OF OPERATIONS

This section discusses our consolidated results of operations for the second quarter and first six months of 2007 compared to the same periods in 2006, and should be read in conjunction with the accompanying consolidated financial statements and related condensed notes.

TOTAL REVENUE

(Dollars in millions)	Quarters Ended June 30,			Six Months Ended June 30,		
	2007	2006	% Change	2007	2006	% Change
Fee Revenue:						
Servicing fees	\$ 766	\$ 683	12 %	\$ 1,484	\$ 1,340	11 %
Management fees	284	232	22	545	452	21
Trading services	260	258	1	480	488	(2)
Securities finance	162	128	27	260	209	24
Processing fees and other	65	74	(12)	138	146	(5)
Total fee revenue	1,537	1,375	12	2,907	2,635	10
Net Interest Revenue:						
Interest revenue	1,203	1,034	16	2,375	1,995	19
Interest expense	818	772	6	1,665	1,467	13
Net interest revenue	385	262	47	710	528	34
(Losses) Gains on sales of available-for-sale investment securities, net	(1)	14			11	
Total revenue	\$ 1,921	\$ 1,651	16	\$ 3,617	\$ 3,174	14

Fee Revenue

Servicing fees and management fees collectively comprised approximately 68% and 70% of total fee revenue for the second quarter and first six months of 2007, compared to approximately 67% and 68% for the comparable prior-year periods. These fee levels are a function of several factors, including the mix and volume of assets under custody and assets under management, securities positions held and the volume of portfolio transactions, as well as the types of products and services used by customers. These fees are affected by changes in worldwide equity and fixed income valuations. Generally, servicing fees are affected,

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

in part, by changes in daily average valuations of assets under custody, while management fees are affected by changes in month-end valuations of assets under management. However, additional factors, such as the level of transaction volumes, changes in service level, balance credits, customer minimum balances, pricing concessions and other factors, may have a significant impact on servicing fee revenue.

Generally, management fee revenue is more sensitive to changes in market valuations than servicing fee revenue. Performance fees have become a larger component of our management fee revenue over the past two years, and comprised about 9% of our management fee revenue for full-year 2006, compared to about 5% for 2005. For the first six months of 2007, performance fees comprised about 6% of management fee revenue. Performance fees, which are generated when the performance of managed funds exceeds benchmarks specified in the management agreements, are less sensitive to market valuation than to manager performance against the respective benchmarks.

As a result 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.

FEE REVENUE

(Dollars in millions)	Quarters Ended June 30,			Six Months Ended June 30,		
	2007	2006	% Change	2007	2006	% Change
Servicing fees	\$ 766	\$ 683	12 %	\$ 1,484	\$ 1,340	11 %
Management fees	284	232	22	545	452	21
Trading services	260	258	1	480	488	(2)
Securities finance	162	128	27	260	209	24
Processing fees and other	65	74	(12)	138	146	(5)
Total fee revenue	\$ 1,537	\$ 1,375	12	\$ 2,907	\$ 2,635	10

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

Servicing fees are derived from custody, product- and participant-level accounting, daily pricing and administration; recordkeeping; investment manager and hedge fund manager operations outsourcing; master trust and master custody; and performance, risk and compliance analytics. For the quarter and six months ended June 30, 2007 compared to the comparable 2006 periods, the increase in servicing fees was driven primarily by net new business from existing and new customers, as well as higher daily average equity market valuations. The daily average values for the S&P 500 Index were up 17%, and for the MSCI® EAFE Index were up 22%, compared with the second quarter of 2006. For the year, daily average values for the S&P 500 Index and MSCI® EAFE Index were up 14% and 20%, respectively.

ASSETS UNDER CUSTODY (In billions)	June 30, 2007	December 31, 2006	June 30, 2006
Mutual funds	\$ 4,194	\$ 3,738	\$ 3,395
Collective funds	1,828	1,665	1,479
Pension products	3,949	3,713	3,486
Insurance and other products	3,069	2,738	2,504
Total	\$ 13,040	\$ 11,854	\$ 10,864
Financial Instrument Mix:			
Equities	\$ 6,820	\$ 5,821	\$ 5,396
Fixed income	3,960	4,035	3,891
Short-term and other investments	2,260	1,998	1,577
Total	\$ 13,040	\$ 11,854	\$ 10,864

Management fees

The increase in management fees primarily reflected increases in net new business, particularly in the area of quantitative active management, as well as higher month-end equity market valuations. Performance fees were \$18 million and \$34 million for the second quarter and first six months of 2007, up from \$15 million and \$28 million for the second quarter and first six months of 2006. The averages of month-end values for the S&P 500 Index were up 17%, and for the MSCI® EAFE Index were up 22%, compared with the second quarter of 2006.

ASSETS UNDER MANAGEMENT (In billions)	June 30, 2007	December 31, 2006	June 30, 2006
Equities:			
Passive	\$ 747	\$ 691	\$ 623
Active and other	204	181	156
Company stock/ESOP	88	85	78
Total equities	1,039	957	857
Fixed income	222	201	174
Cash and money market	673	591	503
Total fixed income and cash	895	792	677
Total	\$ 1,934	\$ 1,749	\$ 1,534

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

The following table presents a roll-forward of assets under management for the twelve months ended June 30, 2007.

ASSETS UNDER MANAGEMENT

(In billions)

June 30, 2006	\$ 1,534
Net new business	57
Market appreciation	158
December 31, 2006	1,749
Net new business	108
Market appreciation	77
June 30, 2007	\$ 1,934

Trading services

Trading services revenue, which includes foreign exchange trading revenue and brokerage and other trading fees, was up 1% for the second quarter of 2007 compared to the second quarter of 2006 and down 2% in the six-month comparison. Foreign exchange trading revenue for the second quarter and first six months of 2007 totaled \$174 million and \$326 million, respectively, both down 9% from \$192 million and \$357 million in the prior-year periods. The quarterly decrease reflected a 40% decline in currency volatility partly offset by a 13% increase in customer volumes, mostly in foreign exchange for our custody customers. The six-month decrease resulted from a 29% decrease in currency volatility partly offset by an 18% increase in customer volume.

Brokerage and other trading fees totaled \$86 million for the second quarter of 2007, up 30% from \$66 million in the second quarter of 2006, primarily the result of fees from the operations of Currenex, which we acquired in March 2007. Brokerage and other trading fees in the six-month comparison totaled \$154 million for 2007 and \$131 million for 2006.

Securities finance

Securities finance revenue for the second quarter of 2007 increased 27% compared to the second quarter of 2006, and 24% in the six-month comparison, with both increases driven by a 32% increase in the average volume of securities loaned on both a quarterly and a year-to-date basis. The growth in volume resulted from increased demand from existing customers and demand from new customers. Consolidated spread was up slightly from the prior-year quarter and flat on a year-to-date basis compared to 2006.

Processing Fees and Other

The decreases in processing fees and other in both the quarterly and year-to-date comparisons resulted from a decline in revenue from our Structured Products unit, primarily associated with the impact of the consolidation of our tax-exempt investment program onto our balance sheet on September 30, 2006, partly offset by improved results from joint venture investments. As a result of the above-described consolidation, revenue from the tax-exempt investment program, previously recorded in processing fees and other, is currently recorded in net interest revenue.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS (Continued)**
NET INTEREST REVENUE

(Dollars in millions)	Quarters Ended June 30,			Six Months Ended June 30,		
	2007	2006	% Change	2007	2006	% Change
Interest revenue(1)	\$ 1,203	\$ 1,034	16 %	\$ 2,375	\$ 1,995	19 %
Interest expense(1)	818	772	6	1,665	1,467	13
Net interest revenue	385	262	47	710	528	34
Provision for loan losses						
Net interest revenue after provision for loan losses	\$ 385	\$ 262	47	\$ 710	\$ 528	34
Net interest revenue (fully taxable-equivalent basis)(2)	\$ 397	\$ 275	44	\$ 734	\$ 552	33

(1) Additional detail about the components of interest revenue and interest expense is in note 11 to the consolidated financial statements in this Form 10-Q.

(2) Fully taxable-equivalent amounts reflect adjustments computed using a federal income tax rate of 35%, adjusted for applicable state income taxes, net of the related federal tax benefit. Adjustments included in fully taxable-equivalent basis net interest revenue in the preceding table, and in the rates earned on interest-earning assets in the table below, were \$12 million and \$13 million for the second quarters of 2007 and 2006, respectively, and \$24 million for each of the first six months of 2007 and 2006.

NET INTEREST MARGIN

(Dollars in millions)	Quarters Ended June 30,		2006		Six Months Ended June 30,		2006	
	2007	Rate(1)	Average Balance	Rate(1)	2007	Rate(1)	Average Balance	Rate(1)
Interest-earning assets	\$ 96,927	5.03 %	\$ 91,764	4.57 %	\$ 95,636	5.06 %	\$ 91,452	4.45 %
Interest-bearing liabilities	87,363	3.76	83,953	3.68	86,061	3.90	83,114	3.56
Excess of rate earned over rate paid		1.27 %		.89 %		1.16 %		.89 %
Net interest margin		1.64 %		1.20 %		1.55 %		1.22 %

(1) Fully taxable-equivalent basis

Net interest revenue increased 47% and 34%, and net interest margin increased 44 basis points and 33 basis points for the quarter and six months ended June 30, 2007, respectively, compared to the same periods in 2006. The increases were principally due to a favorable funding mix, including a higher volume of non-U.S. transaction deposits at higher spreads, as well as a higher level of low-cost funds; the ongoing impact of our investment securities portfolio repositioning, substantially completed in 2006, which has resulted in the maturity of fixed-rate securities and re-investment in higher yielding securities; and the continued impact of favorable non-U.S. interest rates and stable U.S. interest rates.

Several factors could continue to affect our net interest revenue and margin for 2007, including ongoing actions by the Federal Reserve to manage short-term interest rates; the shape of the yield curve; changes in non-U.S. interest rates; tighter interest-rate spreads on the reinvestment of proceeds from

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

maturities of investment securities; and our maintenance of the high credit quality of our investment securities portfolio.

At June 30, 2007, our investment securities portfolio included a consistent percentage of floating-rate, asset-backed securities (36% of our average investment portfolio for the second quarter of 2007 compared to 37% a year earlier), a higher percentage of collateralized mortgage obligations (19% compared to 11%), and a lower percentage of direct obligations from U.S. Treasury and federal agencies (9% compared to 16%). We continue to invest conservatively in AAA and AA rated securities. AAA and AA rated securities comprised approximately 94% of our investment securities portfolio at June 30, 2007, with approximately 87% AAA rated.

OPERATING EXPENSES

(Dollars in millions)	Quarters Ended June 30,			Six Months Ended June 30,		
	2007	2006	% Change	2007	2006	% Change
Salaries and employee benefits	\$ 808	\$ 684	18 %	\$ 1,547	\$ 1,319	17 %
Information systems and communications	128	129	(1)	253	261	(3)
Transaction processing services	141	134	5	270	254	6
Occupancy	98	95	3	192	188	2
Other	183	134	37	309	250	24
Total operating expenses	\$ 1,358	\$ 1,176	15	\$ 2,571	\$ 2,272	13
Number of employees at quarter end	22,350	21,675				

Salaries and employee benefits expense increases were mainly the result of higher incentive compensation due to improved performance and increased staffing levels. Staffing levels increased to support new business, particularly internationally, and also resulted from the acquisition of Currenex. The year-to-date increase was also affected by higher average salaries.

The slight increases in occupancy costs partly resulted from additional space and facilities needs associated with growth in business in Europe. The decrease in information systems and communications expense for the year-to-date period was primarily the result of lower infrastructure costs, partly offset by technology spending both in Europe and related to the Currenex acquisition.

Transaction processing expense increased in both comparisons primarily as a result of higher external contract services caused by increased volumes in asset servicing, partially offset by lower brokerage expenses. Other expenses increased in both comparisons, primarily the result of our recent acquisitions as well as new business initiatives, and an increase in sales promotion expenses.

Income Taxes

We recorded income tax expense of \$197 million for the second quarter of 2007, compared to \$248 million for the second quarter of 2006, with the decrease due primarily to the absence of the tax-related adjustments recorded in the 2006 quarter associated with tax legislation and leveraged leases, partly offset by higher pre-tax earnings. For the first six months of 2007, income tax expense was \$366 million, compared to \$393 million from continuing operations for the 2006 period. The effective tax rate for the second quarter of 2007 was 35% compared to 52.1% for the second quarter of 2006, the latter rate reflective of the above-described tax-related adjustments.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS (Continued)**
LINE OF BUSINESS INFORMATION

We report two lines of business: Investment Servicing and Investment Management. Given State Street's 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. Additional information about our lines of business is included in note 22 to the consolidated financial statements in our 2006 Form 10-K.

The following is a summary of line of business results on a continuing operations basis.

(Dollars in millions, except where otherwise noted)	For the Quarters Ended June 30,					
	Investment Servicing		Investment Management		Total	
	2007	2006	2007	2006	2007	2006
Fee Revenue:						
Servicing fees	\$ 766	\$ 683			\$ 766	\$ 683
Management fees			\$ 284	\$ 232	284	232
Trading services	260	258			260	258
Securities finance	121	97	41	31	162	128
Processing fees and other	50	57	15	17	65	74
Total fee revenue	1,197	1,095	340	280	1,537	1,375
Net interest revenue after provision for loan losses	341	231	44	31	385	262
(Losses) Gains on sales of available-for-sale investment securities, net	(1)	14			(1)	14
Total revenue	1,537	1,340	384	311	1,921	1,651
Operating expenses	1,118	973	240	203	1,358	1,176
Income from continuing operations before income tax expense	\$ 419	\$ 367	\$ 144	\$ 108	\$ 563	\$ 475
Pre-tax margin	27	% 28	% 38	% 34	%	%
Average assets (in billions)	\$ 109.4	\$ 104.0	\$3.7	\$ 2.9	\$ 113.1	\$ 106.9

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

(Dollars in millions, except where otherwise noted)	For the Six Months Ended June 30,					
	Investment Servicing		Investment Management		Total	
	2007	2006	2007	2006	2007	2006
Fee Revenue:						
Servicing fees	\$ 1,484	\$ 1,340			\$ 1,484	\$ 1,340
Management fees			\$ 545	\$ 452	545	452
Trading services	480	488			480	488
Securities finance	195	158	65	51	260	209
Processing fees and other	108	112	30	34	138	146
Total fee revenue	2,267	2,098	640	537	2,907	2,635
Net interest revenue after provision for loan losses	629	470	81	58	710	528
Gains on sales of available-for-sale investment securities, net		11				11
Total revenue	2,896	2,579	721	595	3,617	3,174
Operating expenses	2,113	1,883	458	389	2,571	2,272
Income from continuing operations before income tax expense	\$ 783	\$ 696	\$ 263	\$ 206	\$ 1,046	\$ 902
Pre-tax margin	27	% 27	% 36	% 35	%	%
Average assets (in billions)	\$ 106.9	\$ 102.5	\$ 3.5	\$ 2.9	\$ 110.4	\$ 105.4

Investment Servicing

Total revenue for the second quarter of 2007 increased 15% compared to the same period in 2006, and 12% in the six-month comparison. Total fee revenue in the same comparison increased 9% and 8%, with the increases primarily attributable to growth in servicing fees and securities finance revenue. The growth in servicing fees was mainly the result of an increase in net new business and favorable equity market performance, and the growth in securities finance revenue resulted from an increase in the average volume of securities loaned resulting from increased demand from existing customers and demand from new customers.

Servicing fees and trading services revenue for Investment Servicing comprise the total consolidated amounts for State Street, and securities finance and processing fees and other revenue for Investment Servicing comprise just over 75% of these types of revenue included in our consolidated results. Refer to the Consolidated Results of Operations Fee Revenue section of this Management's Discussion and Analysis for additional information about the growth in these types of fee revenue.

Net interest revenue for the second quarter of 2007 increased 48% compared to the second quarter of 2006, and 34% for the first six months of 2007 compared to the prior-year period. The increases in both periods were principally due to a more favorable funding mix, including a higher volume of non-U.S. transaction deposits at higher spreads and a higher level of low-cost funds.

Operating expenses for the second quarter of 2007 increased 15%, and for the first six months of 2007 increased 12%, compared to the 2006 periods. The increases were primarily attributable to increased incentive compensation due to improved performance and increased headcount to service new business, particularly internationally.

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

Total revenue for the second quarter of 2007 increased 23% compared to the comparable period in 2006, with the increases driven by growth in management fees (up 22%), securities finance revenue (up 32%) and net interest revenue (up 42%). For the six months ended June 30, 2007, total revenue increased 21% compared to the prior year period, with management fees up 21%, securities finance revenue up 27% and net interest revenue up 40%. Total fee revenue in the quarterly and six-month comparisons increased 21% and 19%, driven largely by a 22% increase quarter to quarter, and a 21% increase six months to six months, in management fees. For the second quarter and first six months of 2007, these fees, generated by State Street Global Advisors, increased mainly as a result of an increase in net new business and favorable equity market performance. These fees comprise the total consolidated management fees for State Street. Refer to the Consolidated Results of Operations Fee Revenue section of this Management's Discussion and Analysis for additional information.

For both the second quarter and first six months of 2007, operating expenses increased 18% from the comparable periods in 2006, primarily attributable to the impact of increased incentive compensation due to improved performance and merit-based compensation increases.

FINANCIAL CONDITION

(In millions)	For the Six Months Ended	
	June 30, 2007 Average Balance	2006 Average Balance
Assets:		
Interest-bearing deposits with non-U.S. banks	\$ 4,767	\$ 11,809
Securities purchased under resale agreements	13,438	11,173
Federal funds sold	491	360
Trading account assets	863	994
Investment securities	66,666	59,694
Loans	9,411	7,422
Total interest-earning assets	95,636	91,452
Cash and due from banks	2,968	3,211
Other assets	11,838	10,701
Total assets	\$ 110,442	\$ 105,364
Liabilities and Shareholders' Equity:		
Interest-bearing deposits:		
U.S.	1,347	2,682
Non-U.S.	57,872	51,915
Total interest-bearing deposits	59,219	54,597
Securities sold under repurchase agreements	17,537	21,457
Federal funds purchased	2,621	2,450
Other short-term borrowings	3,562	1,983
Long-term debt	3,122	2,627
Total interest-bearing liabilities	86,061	83,114
Noninterest-bearing deposits	8,967	8,314
Other liabilities	7,942	7,442
Shareholders' equity	7,472	6,494
Total liabilities and shareholders' equity	\$ 110,442	\$ 105,364

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

Overview of Consolidated Statement of Condition

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

Deposits and other liabilities generated by customer activities are invested in assets that generally match the liquidity and interest-rate characteristics of the liabilities. As a result, our assets consist primarily of high-quality, marketable securities classified as either available for sale or held to maturity, and short-term money-market instruments, such as inter-bank placements, federal funds sold and securities purchased under resale agreements. The actual mix of assets is determined by the characteristics of the customer liabilities and our desire to maintain a well-diversified portfolio of high-quality assets. We manage our consolidated balance sheet structure using a disciplined process conducted within specific Board of Directors-approved policies for interest rate risk, credit risk and liquidity.

For the first six months of 2007, the growth in average interest-bearing liabilities of \$2.9 billion was composed of a \$6.0 billion increase in non-U.S. deposits and a \$.5 billion increase in long-term debt, offset by declines in domestic deposits (\$1.3 billion) and short-term borrowings (\$2.2 billion). These changes are generally representative of the higher levels of customer activity outside the U.S. Average interest-earning assets in 2007 increased \$4.2 billion from 2006, consistent with the increased level of customer liabilities.

For the first six months of 2007, the average investment portfolio increased \$7.0 billion compared to the first six months of 2006. During 2006, we substantially completed the investment portfolio repositioning begun in late 2004. The composition of the investment portfolio continued to favor mortgage- and asset-backed securities because of their high credit quality, higher yields and highly liquid nature. The credit quality of the investment portfolio remained very strong at June 30, 2007, with 87% of the securities rated AAA and 7% rated AA, both consistent with December 31, 2006.

Capital

Regulatory and economic capital management both use key metrics evaluated by management to maintain an actual level of capital commensurate with our risk profile, in compliance with all regulatory requirements, and sufficient to provide us with the financial flexibility to undertake future strategic business initiatives.

Regulatory Capital

Our objective with respect to regulatory capital management is to maintain a strong capital base in order to provide financial flexibility for our business needs, including funding corporate growth and supporting customers' cash management needs, and to provide protection against loss to depositors and creditors. We strive to maintain an optimal level of capital, commensurate with our risk profile, on which an attractive return to shareholders will be realized over both the short and long term, while protecting our obligations to depositors and creditors and satisfying regulatory requirements. You can obtain additional

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

information about our capital management process in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2006 Form 10-K.

At June 30, 2007, State Street and State Street Bank met all capital adequacy requirements to which they were subject. Regulatory capital amounts and ratios were as follows at June 30, 2007, and December 31, 2006:

(Dollars in millions)	Regulatory Guidelines ⁽¹⁾		State Street		State Street Bank	
	Minimum	Well Capitalized	2007	2006	2007	2006
Tier 1 risk-based capital ratio	4 %	6 %	11.5 %	13.7	9.2 %	12.0 %
Total risk-based capital ratio	8	10	13.2	15.9	11.0	14.1
Tier 1 leverage ratio	4	5	6.1	5.8	5.3	5.6
Tier 1 risk-based capital			\$ 6,733	\$ 6,473	\$ 5,234	\$ 5,473
Total risk-based capital			7,708	7,507	6,206	6,440
Adjusted risk-weighted assets and market-risk equivalents:						
Balance sheet risk-weighted assets			\$ 37,433	\$ 31,447	\$ 35,458	\$ 30,000
Off-balance sheet equivalent risk-weighted assets			20,659	15,371	20,665	15,375
Market-risk equivalents			528	395	522	394
Total			\$ 58,620	\$ 47,213	\$ 56,645	\$ 45,769
Quarterly average adjusted assets			\$ 111,092	\$ 110,794	\$ 98,021	\$ 97,132

(1) State Street Bank must meet the regulatory designation of "well capitalized" in order to maintain State Street's status as a financial holding company, including a minimum tier 1 risk-based capital ratio of 6%, a minimum total risk-based capital ratio of 10% and a tier 1 leverage ratio of 5%. In addition, State Street must meet Federal Reserve guidelines for "well capitalized" for a bank holding company to be eligible for a streamlined review process for acquisition proposals. These guidelines require a minimum tier 1 risk-based capital ratio of 6% and a minimum total risk-based capital ratio of 10%.

At June 30, 2007, State Street's and State Street Bank's tier 1 and total risk-based capital ratios decreased compared to year-end 2006. The combined impact of the goodwill and other intangibles recorded in connection with our acquisition of Currenex, and the adjustment to beginning retained earnings recorded in connection with FASB Staff Position No. FAS 13-2, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction*, more than offset year-to-date earnings. In addition, an increase in total risk-weighted assets contributed to the decrease. The growth in total risk-weighted assets was caused by an increase in balance sheet risk-weighted assets, primarily investment securities available for sale and loans, and an increase in off-balance sheet equivalent risk-weighted assets, primarily related to an increase in our securities finance activities. Both ratios for State Street and State Street Bank exceeded the regulatory minimum and well-capitalized thresholds.

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

In 2004, the Committee on Banking Supervision released the final version of its capital adequacy framework, known as Basel II. In 2006, the four U.S. banking regulatory agencies jointly issued their second draft of implementation rules, with industry comment provided by the end of March 2007. Additional supervisory guidance from the agencies was released late in February 2007; comments to the agencies were provided by the end of May 2007. Under the current implementation plan, State Street anticipates adopting the most advanced approaches for assessing capital adequacy, subject to change pending release of the final rules, anticipated to occur by the end of 2007. State Street previously established a comprehensive implementation program to ensure these regulatory requirements are met within prescribed timeframes. At this time, we cannot predict the final form of the rules in the U.S., nor their impact on State Street's or State Street Bank's risk-based capital.

On March 15, 2007, our Board of Directors authorized the purchase of up to 15 million shares of common stock for general corporate purposes, including mitigating the dilutive impact of shares issued under employee benefit plans, in addition to its previous authorization in 2006 of up to 15 million shares. We did not purchase any shares of our common stock during the first six months of 2007, and as of June 30, 2007, 27.2 million shares remained available for future purchase under the combined authorization. We generally employ third-party broker-dealers to acquire shares on the open market in connection with our stock purchase program.

On July 20, 2007, we entered into an accelerated share repurchase, under which we committed to repurchase \$1 billion of our common stock. The total number of shares repurchased will depend, in part, on the weighted average price per share of our common stock paid by our dealer over the repurchase period, which is not expected to exceed six months. The total number of shares to be repurchased is also subject to other conditions and adjustments. Based on the closing sale price per share of our common stock on July 19, 2007, which was \$71.39, we expect that approximately 13.2 million shares will remain available for future purchase under the combined authorization described above after the completion of the accelerated share repurchase.

Economic Capital

We define economic capital as the common equity required to protect debt holders against unexpected economic losses over a one-year period at a level consistent with the solvency of a firm with our target AA debt rating. Our entire economic capital process is the responsibility of our Capital Committee. The framework and methodologies used to quantify economic capital for each of the risk types described below have been developed by our Enterprise Risk Management, Global Treasury and Corporate Finance groups and are designed to be generally consistent with our risk management principles. This framework has been approved by senior management and has been reviewed by the Executive Committee of the Board of Directors. Due to the evolving nature of quantification techniques, we expect to periodically refine the methodologies, assumptions and data used to estimate our economic capital requirements, which could result in a different amount of capital needed to support our risk profile.

We quantify capital requirements for the risks inherent in our business activities and group them into one of the following broadly defined categories:

- **Market risk:** the risk of adverse financial impact due to fluctuations in market prices, primarily as they relate to our trading activities;
- **Interest-rate risk:** the risk of loss in non-trading asset and liability management positions, primarily the impact of adverse movements in interest rates on the repricing mismatches that exist between balance sheet assets and liabilities;

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

- Credit risk: the risk of loss that may result from the default or downgrade of a borrower or counterparty;
- Operational risk: the risk of loss from inadequate or failed internal processes, people and systems, or from external events, which is consistent with the Basel II definition; and
- Business risk: the risk of adverse changes in our earnings from business factors, including changes in the competitive environment, changes in the operational economics of business activities, and the effect of strategic and reputation risks.

Economic capital for each of these five categories is estimated on a stand-alone basis using statistical modeling techniques applied to internally generated and, in some cases, external data. These individual results are then aggregated at the State Street consolidated level. A capital reduction or diversification benefit is then applied to reflect the unlikely event of experiencing an extremely large loss in each risk type at the same time.

Liquidity

The objective of liquidity management is to ensure that we have the ability to meet our financial obligations in a timely and cost-effective manner, and that we maintain sufficient flexibility to fund strategic corporate initiatives as they arise. Effective management of liquidity involves assessing the potential mismatch between the future cash needs of our customers and our available sources of cash under normal and adverse economic and business conditions. Uses of liquidity consist primarily of meeting deposit withdrawals and funding outstanding commitments to extend credit as they are drawn upon. Liquidity is provided by the maintenance of broad access to the global capital markets and by our balance sheet asset structure. You can obtain additional information about our liquidity management process in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2006 Form 10-K.

Material risks to the sources of short-term liquidity would include, among other things, rating agency downgrades of our deposits and debt securities below investment-grade level, which would restrict our ability to access the funding markets and may lead to withdrawals of unsecured deposits by our customers. In addition, a large volume of unanticipated funding requirements, such as fundings under liquidity asset purchase agreements that have met draw conditions, or large draw-downs of existing lines of credit, could require additional liquidity. As of June 30, 2007, there were no circumstances that management considered reasonably likely to occur that would adversely impact our sources of short-term liquidity in any material respect.

While maintenance of a high investment-grade credit rating is of primary importance to our liquidity management program, on-balance sheet liquid assets represent significant liquidity that we can directly control and provide a source of cash in the form of principal maturities and the ability to borrow from the capital markets using our securities as collateral. Our liquid assets consist primarily of short-term money-market assets, such as federal funds sold and interest-bearing deposits with banks, the latter of which are multicurrency instruments invested with major multinational banks; and high-quality marketable investment securities not already pledged, which generally are more liquid than other types of assets and can be sold or borrowed against to quickly generate cash. As of June 30, 2007, our liquid assets, as defined, totaled \$42.58 billion. Securities carried at \$22.88 billion as of June 30, 2007 were designated as pledged for public and trust deposits, borrowed funds and for other purposes as provided by law, and are excluded from the liquid assets calculation.

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

Based upon our level of liquid assets and our ability to access the capital markets for additional funding when necessary, including our ability to issue debt and equity securities under our current universal shelf registration, management considers overall liquidity at June 30, 2007 to be more than sufficient to meet State Street's current commitments and business needs, including accommodating the transaction and cash management needs of our customers.

During the second quarter of 2007, State Street Corporation, which we refer to as the parent company, issued \$700 million of senior debt, consisting of \$250 million of floating-rate notes due in 2012 and \$450 million of fixed-rate notes due in 2017. In addition, State Street Capital Trust IV, a Delaware statutory trust wholly owned by the parent company, issued \$800 million in floating-rate capital securities and used the proceeds to purchase floating-rate junior subordinated debentures from the parent company. The capital securities represent an undivided preferred beneficial interest in those junior subordinated debentures, which are the only assets of the trust. The junior subordinated debentures have an initial scheduled maturity in June 2037 and an initial final repayment date in June 2067, each of which we may extend by ten years in specified circumstances. In accordance with existing accounting standards, we did not record the trust in our consolidated financial statements. The junior subordinated debentures qualify for inclusion in tier 1 capital.

In connection with the issuance of the junior subordinated debentures, the parent company entered into a replacement capital covenant in which it agreed, for the benefit of the holders of its junior subordinated debentures due 2028 underlying the floating-rate capital securities issued by State Street Capital Trust I, that it will not repay, redeem or repurchase, and that none of its subsidiaries will purchase, any part of the newly issued debentures or the floating-rate capital securities on or before June 1, 2047, unless the repayment, redemption or repurchase is made from the net cash proceeds of the issuance of certain qualified securities and pursuant to the other terms and conditions set forth in the covenant.

On July 23, 2007, we redeemed an aggregate of \$500 million of unsecured junior subordinated debentures issued by the parent company to two of our statutory business trusts, State Street Capital Trusts A and B, composed of \$200 million of 7.94% debentures issued in 1996 and \$300 million of 8.035% debentures issued in 1997. We paid the trusts the outstanding amount on the debentures plus accrued interest and an aggregate redemption premium of approximately \$20 million. This redemption premium will be included in the merger and integration charge which we will record during the third quarter of 2007 in connection with the Investors Financial acquisition.

On July 23, 2007, the trusts, consistent with the terms of their applicable governing documents, redeemed their respective outstanding capital securities, with an aggregate liquidation amount of \$500 million, corresponding to the debentures. The trusts paid to the holders of the outstanding capital securities the same amount that was paid by the parent company to the trusts to redeem the debentures.

At June 30, 2007, we had \$540 million of pre-tax net unrealized losses on available-for-sale investment securities, due primarily to a higher level of interest rates compared to when the securities were purchased. Pre-tax net unrealized losses on available-for-sale securities at December 31, 2006 were \$378 million. Management considers the aggregate decline in fair value of \$540 million at June 30, 2007 to be the result of increases in interest rates, and believes that the decline is temporary. Management has the ability and intent to hold the securities until market value recovery. Additional information about our management of the investment securities portfolio is included in the Financial Condition Investment Securities section of Management's Discussion and Analysis of Financial Condition and Results of Operations and in note 3 to the consolidated financial statements in our 2006 Form 10-K.

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

We maintain an effective universal shelf registration that allows for the offering and sale of debt securities, capital securities, common stock, depositary shares and preferred stock, and warrants to purchase such securities, including any shares into which the preferred stock and depositary shares may be convertible, or any combination thereof. In addition, we currently maintain a commercial paper program, under which we can issue up to \$3 billion with original maturities of up to 270 days from the date of issue. At June 30, 2007, we had \$1.01 billion of commercial paper outstanding, compared to \$998 million at December 31, 2006.

State Street Bank currently has authority to issue bank notes up to an aggregate of \$750 million with original maturities ranging from 14 days to five years. At June 30, 2007, no notes payable were outstanding and all \$750 million was available for issuance. In addition, State Street Bank currently has authority to issue up to \$1 billion of subordinated bank notes.

State Street Bank currently maintains a line of credit with a financial institution of CAD \$800 million, or approximately \$751 million, to support its Canadian securities processing operations. The line of credit has no stated termination date and is cancelable by either party with prior notice. As of June 30, 2007, no balance was due on this line of credit.

Risk Management

We employ a comprehensive and well-integrated risk management function to identify, assess, measure and control the risks in our global businesses. The measurement, monitoring and mitigation of risks are essential to the financial performance and successful management of State Street's businesses. These risks, if not effectively managed, can result in current losses to State Street as well as erosion of our capital and damage to our reputation. Our systematic approach also allows for a more precise assessment of risks within a framework for evaluating opportunities for the prudent use of capital. While we believe our risk management program is effective in managing the risks in our businesses, external factors may create risks that cannot always be identified or anticipated. For example, a material counterparty failure or a default of a material obligor could have an adverse effect on our results of operations.

Additional information about our process for managing market risk for both our trading and asset and liability management activities, as well as credit risk, operational risk and business risk, can be found in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2006 Form 10-K.

Market Risk

Market risk is defined as the risk of adverse financial impact due to fluctuations in interest rates, foreign exchange rates and other market-driven rates or prices. State Street is exposed to market risk both in its trading and non-trading, or asset and liability management, activities. The market risk management processes related to these activities, discussed in further detail below, apply to both on-balance sheet and off-balance sheet exposures.

We primarily engage in trading and investment activities to serve our customers' needs and to contribute to overall corporate earnings and liquidity. In the conduct of these activities, we are subject to, and assume, market risk. The level of market risk that we assume is a function of our overall objectives and liquidity needs, customer requirements and market volatility. Interest rate risk, a component of market risk, is more thoroughly discussed in the Asset and Liability Management portion of this Market Risk section.

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

Trading Activities

Market risk associated with foreign exchange and other trading activities is managed through established limits on aggregate and net open positions, sensitivity to changes in interest rates, and concentrations, which are supplemented by stop-loss thresholds. We use an array of risk management tools and methodologies, including value-at-risk, to measure, monitor and manage market risk. All limits and measurement techniques are reviewed and adjusted as necessary on a regular basis by business managers, the market risk management group and the Trading and Market Risk Committee.

We use a variety of derivative financial instruments to support customers' needs, conduct trading activities and manage our interest-rate and currency risk. These activities are designed to create trading revenue or hedge volatility in net interest revenue. In addition, we provide services related to derivatives in our role as both a manager and a servicer of financial assets.

Our customers use derivatives to manage the financial risks associated with their investment goals and business activities. With the growth of cross-border investing, customers have an increasing need for foreign exchange forward contracts to convert currency for international investment and to manage the currency risk in their international investment portfolios. As an active participant in the foreign exchange markets, we provide foreign exchange forward contracts and options in support of these customer needs.

As part of our trading activities, we assume positions in the foreign exchange and interest-rate markets by buying and selling cash instruments and using derivatives, including foreign exchange forward contracts, foreign exchange and interest-rate options and interest-rate swaps. As of June 30, 2007, the notional amounts of all these derivatives were \$650.04 billion, of which \$610.90 billion were foreign exchange forward contracts. In the aggregate, long and short foreign exchange forward positions are closely matched to minimize currency and interest-rate risk. All foreign exchange contracts are valued daily at current market rates. Additional information about trading derivatives is in note 10 to the consolidated financial statements in this Form 10-Q.

We use a variety of risk measurement and estimation techniques, including value-at-risk, which is an estimate of potential loss for a given period within a stated statistical confidence interval. We use a system of risk management to estimate value-at-risk daily. We have adopted standards for estimating value-at-risk, and we maintain capital for market risk in accordance with applicable regulatory guidelines. Value-at-risk is estimated for a 99% one-tail confidence interval and an assumed one-day holding period using a historical observation period of greater than two years. A 99% one-tail confidence interval implies that daily trading losses should not exceed the estimated value-at-risk more than 1% of the time, or approximately three days out of the year. The methodology uses a simulation approach based on observed changes in foreign exchange rates, interest rates (domestic and foreign) and foreign exchange implied volatilities, and takes into account the resulting diversification benefits provided from the mix of our trading positions.

Like all quantitative risk measures, value-at-risk is subject to limitations and assumptions inherent in our methodology. Our methodology gives equal weight to all market-rate observations regardless of how recently the market rates were observed. The estimate is calculated using static portfolios consisting of positions held at the end of the trading day. Implicit in the estimate is the assumption that no intraday action is taken by management during adverse market movements. As a result, the methodology does not represent risk associated with intraday changes in positions or intraday price volatility.

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

The following table presents value-at-risk with respect to our trading activities, as measured by our value-at-risk methodology for the periods indicated:

VALUE-AT-RISK (In millions)	Quarters Ended June 30,			2006		
	2007 Average	Maximum	Minimum	Average	Maximum	Minimum
Foreign exchange products	\$ 2.1	\$ 4.0	\$ 0.8	\$ 1.7	\$ 4.3	\$ 0.7
Interest rate products	2.5	3.5	1.0	1.2	1.8	0.7

We compare daily profits and losses from trading activities to the estimated one-day value-at-risk. This information is reviewed and used to assure that the value-at-risk model is properly calibrated and that all relevant trading positions are taken into account. For the quarters ended June 30, 2007 and 2006, we did not experience any trading losses in excess of our end-of-day value-at-risk estimate.

Asset and Liability Management Activities

The primary objective of asset and liability management is to provide sustainable and growing net interest revenue, or NIR, under varying economic environments, while protecting the economic values of our balance sheet assets and liabilities from the adverse effects of changes in interest rates. Most of our NIR is earned from the investment of deposits generated by our core Investment Servicing and Investment Management businesses. We structure our balance sheet assets to generally conform to the characteristics of our balance sheet liabilities, but we manage our overall interest-rate risk position in the context of current and anticipated market conditions and within internally approved risk guidelines.

Our investment activities and our use of derivatives are the primary tools used in managing interest-rate risk. We invest in financial instruments with currency, repricing, and maturity characteristics we consider appropriate to manage our overall interest-rate risk position. We use certain derivative financial instruments, primarily interest-rate swaps, to alter the interest-rate characteristics of specific balance sheet assets or liabilities. The use of derivatives is subject to internally approved guidelines. Additional information about our use of derivative financial instruments is in note 10 to the consolidated financial statements in this Form 10-Q.

As a result of growth in our non-U.S. operations, non-U.S. dollar denominated customer liabilities are a significant portion of our consolidated balance sheet. This growth results in exposure to changes in the shape and level of non-U.S. dollar yield curves, which we include in our consolidated interest-rate risk management process.

To measure, monitor, and report on our interest-rate risk position, we use (1) NIR simulation, or NIR-at-risk, which measures the impact on NIR over the next twelve months to immediate, or rate shock, and gradual, or rate ramp, changes in market interest rates; and (2) economic value of equity, or EVE, which measures the impact on the present value of all NIR-related principal and interest cash flows of an immediate change in interest rates. NIR-at-risk is designed to measure the potential impact of changes in market interest rates on net interest revenue in the short term. EVE, on the other hand, is a long-term view of interest-rate risk, but with a view toward liquidation of State Street. Both of these measures are subject to internally established guidelines, and are monitored regularly, along with other relevant simulations, scenario analyses and stress tests.

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

The following table presents the estimated exposure of NIR for the next twelve months, calculated as of June 30, 2007, March 31, 2007 and December 31, 2006, due to a \pm 100 basis point rate shock, and a \pm 100 basis point rate ramp, in then-current interest rates. Estimated incremental exposures set forth below are dependent on management's assumptions about asset and liability sensitivities under various interest-rate scenarios, such as those previously discussed, and do not reflect any actions management may undertake in order to mitigate some of the adverse effects of interest-rate changes on State Street's financial performance.

NIR-AT-RISK

(Dollars in millions) Rate Change	Estimated Exposure to Net Interest Revenue		
	June 30, 2007	March 31, 2007	December 31, 2006
+100 bps shock	\$ (78)	\$ (99)	\$ (90)
-100 bps shock	43	56	52
+100 bps ramp	(42)	(62)	(57)
-100 bps ramp	38	47	46

The following table presents estimated EVE exposures, calculated as of June 30, 2007, March 31, 2007 and December 31, 2006, assuming an immediate and prolonged shift in interest rates, the impact of which would be spread over a number of years.

ECONOMIC VALUE OF EQUITY

(Dollars in millions) Rate Change	Estimated Exposure to Economic Value of Equity		
	June 30, 2007	March 31, 2007	December 31, 2006
+200 bps shock	\$ (1,199)	\$ (1,252)	\$ (1,023)
-200 bps shock	579	561	371

While the measures presented in the tables above are not a prediction of future NIR or valuations, they do suggest that if all other variables remained constant, in the short term, falling interest rates would lead to NIR that is higher than it would otherwise have been, and rising rates would lead to lower NIR. Other important factors that impact the levels of NIR are balance sheet size and mix; interest-rate spreads; the slope and interest-rate level of U.S. dollar and non-U.S. dollar yield curves and the relationship between them; the pace of changes in market interest rates; and management's actions taken in response to the preceding conditions.

The incremental decrease from March 31, 2007 in the levels of estimated NIR exposure, as well as estimated EVE exposure related to an upward shift in rates, resulted from the impact of our assessment of the characteristics of our customer liabilities, partly offset by an increase in the duration of mortgage-backed securities. As we discussed in our 2006 Form 10-K, one of the most important assumptions in our management of interest-rate risk is the response of customer liabilities to changes in market interest rates. As such, we regularly reassess the characteristics of customer liabilities. Our most recent assessment was completed during the second quarter of 2007, and resulted in a small lengthening of the estimated duration of these liabilities, which, all other factors being equal, reduces our interest-rate risk.

This reduction in interest-rate risk was partially offset by an increase in the duration of mortgage-backed securities held in our investment portfolio, as expected future principal prepayments have slowed

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

in response to the rise in U.S. interest rates. This increase has a more significant impact on EVE exposure because of the longer-term nature of these securities, compared to the impact of an assessment of customer liabilities, which more significantly affects the shorter-term NIR exposure estimates. We regularly model the potential impact that interest rate movements have on mortgage-backed security prepayment rates, and therefore our interest-rate risk position. The effects we observed as described above were generally as we had anticipated for the change in interest rates that occurred during the second quarter of 2007.

Credit Risk

Credit and counterparty risk is defined as the risk of financial loss if a borrower or counterparty is either unable or unwilling to repay borrowings or settle a transaction in accordance with contractual terms. We assume credit and counterparty risk on both on- and off-balance sheet exposures. The extension of credit and acceptance of counterparty risk by State Street are governed by corporate guidelines based on the prospective customer's risk profile, the markets served, counterparty and country concentrations, and regulatory compliance. Our focus on large institutional investors and their businesses requires that we assume concentrated credit risk in a variety of forms to certain highly rated entities. This concentration risk is mitigated by comprehensive guidelines and procedures to monitor and manage all aspects of credit and counterparty risk that we undertake. Exposures are evaluated on an individual basis at least annually.

At June 30, 2007, total gross loans and leases were \$12.07 billion compared to \$8.95 billion at December 31, 2006, reflecting an increase in daily overdrafts, which primarily result from securities settlement advances related to customer investment activities. Overdrafts included in total gross loans were \$8.83 billion and \$5.69 billion at June 30, 2007 and December 31, 2006, respectively. Average overdrafts were approximately \$7.43 billion for the second quarter of 2007, and \$5.32 billion and \$5.08 billion for the fourth and second quarters of 2006, respectively. These balances do not represent a significant increase in credit risk because of their short-term nature, which is generally overnight, as well as the lack of significant concentration and their occurrence in the normal course of the securities settlement process. The allowance for loan losses was \$18 million at June 30, 2007, December 31, 2006 and June 30, 2006.

Non-performing assets at June 30, 2007 were \$3 million and at December 31, 2006 were \$4 million, consisting of one investment security.

OFF-BALANCE SHEET ARRANGEMENTS

Information related to off-balance sheet arrangements is in notes 7, 8 and 10 to the consolidated financial statements in this Form 10-Q.

RECENT ACCOUNTING DEVELOPMENTS

Information related to recent accounting developments is in note 1 to the consolidated financial statements in this Form 10-Q.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is included in the Risk Management Market Risk section of Management's Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q.

CONTROLS AND PROCEDURES

State Street has established and maintains disclosure controls and other procedures that are designed to ensure that material information relating to State Street and its subsidiaries on a consolidated basis required to be disclosed in its reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to State Street management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. For the quarter ended June 30, 2007, State Street carried out an evaluation, under the supervision and with the participation of State Street management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of State Street's disclosure controls and procedures. Based on the evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that State Street's disclosure controls and procedures were effective as of June 30, 2007.

State Street has also established and maintains internal control over financial reporting as a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States. In the ordinary course of business, State Street routinely enhances its internal controls and procedures for financial reporting by either upgrading its current systems or implementing new systems. Changes have been made and will be made to State Street's internal controls and procedures for financial reporting as a result of these efforts. During the quarter ended June 30, 2007, there was no change in State Street's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, State Street's internal control over financial reporting.

STATE STREET CORPORATION
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

(Dollars in millions, except per share amounts)	Three Months Ended		Six Months Ended	
	June 30, 2007	2006	June 30, 2007	2006
Fee Revenue:				
Servicing fees	\$ 766	\$ 683	\$ 1,484	\$ 1,340
Management fees	284	232	545	452
Trading services	260	258	480	488
Securities finance	162	128	260	209
Processing fees and other	65	74	138	146
Total fee revenue	1,537	1,375	2,907	2,635
Net Interest Revenue:				
Interest revenue	1,203	1,034	2,375	1,995
Interest expense	818	772	1,665	1,467
Net interest revenue	385	262	710	528
Provision for loan losses				
Net interest revenue after provision for loan losses	385	262	710	528
(Losses) Gains on sales of available-for-sale investment securities, net	(1) 14		11
Total revenue	1,921	1,651	3,617	3,174
Operating Expenses:				
Salaries and employee benefits	808	684	1,547	1,319
Information systems and communications	128	129	253	261
Transaction processing services	141	134	270	254
Occupancy	98	95	192	188
Other	183	134	309	250
Total operating expenses	1,358	1,176	2,571	2,272
Income from continuing operations before income tax expense	563	475	1,046	902
Income tax expense from continuing operations	197	248	366	393
Income from continuing operations	366	227	680	509
Income from discontinued operations before income tax expense				16
Income tax expense from discontinued operations				6
Income from discontinued operations				10
Net income	\$ 366	\$ 227	\$ 680	\$ 519
Earnings Per Share From Continuing Operations:				
Basic	\$ 1.09	\$.69	\$ 2.03	\$ 1.54
Diluted	1.07	.68	2.00	1.52
Income Per Share From Discontinued Operations:				
Basic	\$	\$	\$	\$.03
Diluted				.03
Earnings Per Share:				
Basic	\$ 1.09	\$.69	\$ 2.03	\$ 1.57
Diluted	1.07	.68	2.00	1.55
Average Shares Outstanding (in thousands):				
Basic	335,769	330,804	334,908	331,777
Diluted	341,101	335,879	339,338	336,102
Cash Dividends Declared Per Share	\$.22	\$.20	\$.43	\$.39

The accompanying condensed notes are an integral part of these consolidated financial statements.

STATE STREET CORPORATION
CONSOLIDATED STATEMENT OF CONDITION

(Dollars in millions, except per share amounts)	June 30, 2007 (Unaudited)	December 31, 2006 (Note 1)
Assets:		
Cash and due from banks	\$ 4,851	\$ 2,368
Interest-bearing deposits with banks	4,616	5,236
Securities purchased under resale agreements	10,772	14,678
Trading account assets	849	785
Investment securities available for sale	62,748	60,445
Investment securities held to maturity (fair value of \$4,211 and \$4,484)	4,308	4,547
Loans and leases (net of allowance of \$18)	12,050	8,928
Premises and equipment	1,725	1,560
Accrued income receivable	1,671	1,617
Goodwill	1,853	1,384
Other intangible assets	593	434
Other assets	6,232	5,371
Total assets	\$ 112,268	\$ 107,353
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 12,735	\$ 10,194
Interest-bearing U.S.	1,091	1,272
Interest-bearing Non-U.S.	59,210	54,180
Total deposits	73,036	65,646
Securities sold under repurchase agreements	13,089	19,147
Federal funds purchased	2,741	2,147
Other short-term borrowings	3,500	2,835
Accrued taxes and other expenses	3,204	3,143
Other liabilities	4,860	4,567
Long-term debt	4,090	2,616
Total liabilities	104,520	100,101
Commitments and contingencies (note 7)		
Shareholders Equity:		
Preferred stock, no par: authorized 3,500,000 shares; issued none		
Common stock, \$1 par: authorized 750,000,000 shares, issued 337,126,000 and 337,126,000 shares	337	337
Surplus	365	399
Retained earnings	7,339	7,030
Accumulated other comprehensive loss	(276)	(224)
Treasury stock, at cost (408,000 and 4,688,000 shares)	(17)	(290)
Total shareholders equity	7,748	7,252
Total liabilities and shareholders equity	\$ 112,268	\$ 107,353

The accompanying condensed notes are an integral part of these consolidated financial statements.

STATE STREET CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

(Dollars in millions, except per share amounts, shares in thousands)	Common Stock		Surplus	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock		Total
	Shares	Amount				Shares	Amount	
Balance at December 31, 2005	337,126	\$ 337	\$ 266	\$ 6,189	\$ (231)	3,501	\$ (194)	\$ 6,367
Comprehensive income:								
Net income				519				519
Change in net unrealized gain/loss on available-for-sale securities, net of related taxes of \$(153) and reclassification adjustment					(213)			(213)
Foreign currency translation, net of related taxes of \$30					62			62
Change in net unrealized gain/loss on hedges of net investments in non-U.S. subsidiaries, net of related taxes of \$(9)					(16)			(16)
Change in minimum pension liability, net of related taxes of \$3					4			4
Change in unrealized gain/loss on cash flow hedges, net of related taxes of \$11					17			17
Total comprehensive income				519	(146)			373
Cash dividends declared (\$.39 per share)				(129)				(129)
Common stock acquired						5,782	(368)	(368)
Common stock received under COVERS contracts		30				1,199	(26)	4
Common stock issued pursuant to:								
Stock awards and options exercised, including tax benefit of \$23		12				(3,983)	209	221
Other						(4)	1	1
Balance at June 30, 2006	337,126	\$ 337	\$ 308	\$ 6,579	\$ (377)	6,495	\$ (378)	\$ 6,469
Balance at December 31, 2006	337,126	\$ 337	\$ 399	\$ 7,030	\$ (224)	4,688	\$ (290)	\$ 7,252
Adjustment for effect of applying provisions of FSP No. FAS 13-2								
				(226)				(226)
Adjusted balance at January 1, 2007	337,126	\$ 337	\$ 399	\$ 6,804	\$ (224)	4,688	\$ (290)	\$ 7,026
Comprehensive income:								
Net income				680				680
Change in net unrealized gain/loss on available-for-sale securities, net of related taxes of \$(65) and reclassification adjustment					(97)			(97)
Foreign currency translation, net of related taxes of \$22					42			42
Change in net unrealized loss on cash flow hedges, net of related taxes of \$4					7			7
Change in net unrealized loss on hedges of net investments in non-U.S. subsidiaries, net of related taxes					(2)			(2)
Change in minimum pension liability, net of related taxes					(2)			(2)
Total comprehensive income				680	(52)			628
Cash dividends declared (\$.43 per share)				(145)				(145)
Common stock issued pursuant to:								
Stock awards and options exercised, including tax benefit of \$36			(34)			(4,284)	274	240
Other						4	(1)	(1)
Balance at June 30, 2007	337,126	\$ 337	\$ 365	\$ 7,339	\$ (276)	408	\$ (17)	\$ 7,748

The accompanying condensed notes are an integral part of these consolidated financial statements.

STATE STREET CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

(In millions)	Six Months Ended	
	June 30, 2007	2006
Operating Activities:		
Net income	\$ 680	\$ 519
Adjustments to reconcile net income to net cash provided by operating activities:		
Non-cash adjustments for depreciation, amortization, and deferred income tax expense	204	237
Income from discontinued operations		(16)
Securities gains, net		(11)
Change in trading account assets, net	(64)	(178)
Other, net	(723)	(322)
Net Cash Provided by (Used in) Operating Activities	97	229
Investing Activities:		
Net decrease in interest-bearing deposits with banks	620	3,641
Net decrease (increase) in securities purchased under resale agreements and federal funds sold	3,906	(2,107)
Proceeds from sales of available-for-sale securities	1,657	2,664
Proceeds from maturities of available-for-sale securities	10,979	8,850
Purchases of available-for-sale securities	(15,048)	(12,069)
Proceeds from maturities of held-to-maturity securities	463	974
Purchases of held-to-maturity securities	(223)	(611)
Net increase in loans	(3,099)	(2,208)
Business acquisitions, net of cash acquired	(570)	
Purchases of equity investments and other long-term assets	(110)	(93)
Purchases of premises and equipment	(231)	(177)
Other, net	7	33
Net Cash Used in Investing Activities	(1,649)	(1,103)
Financing Activities:		
Net decrease in time deposits	(258)	(949)
Net increase in all other deposits	7,646	4,860
Net decrease in short-term borrowings	(4,799)	(763)
Proceeds of long-term debt, net of issuance costs	1,488	
Payments for long-term debt and obligations under capital leases	(8)	(8)
Proceeds from issuance of treasury stock for options exercised	106	125
Purchases of common stock		(368)
Payments for cash dividends	(140)	(127)
Net Cash Provided by Financing Activities	4,035	2,770
Net Increase	2,483	1,896
Cash and due from banks at beginning of period	2,368	2,684
Cash and Due From Banks at End of Period	\$ 4,851	\$ 4,580

Non-cash investing and financing activities for the six months ended June 30, 2007 and 2006 were composed of commitments for construction costs of \$111 million and \$69 million, respectively, recorded in premises and equipment and other liabilities, in connection with a new foreign office lease agreement.

The accompanying condensed notes are an integral part of these consolidated financial statements.

STATE STREET CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

Unless otherwise indicated or unless the context requires otherwise, all references in these condensed notes to State Street, we, us, our or similar terms mean State Street Corporation and its subsidiaries on a consolidated basis. We are a financial holding company headquartered in Boston, Massachusetts with consolidated total assets of \$112.27 billion, total deposits of \$73.04 billion and total shareholders' equity of \$7.75 billion at June 30, 2007. We report two lines of business:

- Investment Servicing provides services primarily for institutional investors worldwide, including U.S. mutual funds and collective investment funds, corporate and public retirement plans, insurance companies, foundations, endowments and other investment pools worldwide. Products include custody, product- and participant-level accounting, daily pricing and administration; master trust and master custody; recordkeeping; foreign exchange, brokerage and other trading services; securities finance; deposit and short-term investment facilities; loans and lease financing; investment manager and hedge fund manager operations outsourcing; and performance, risk and compliance analytics to support institutional investors.
- Investment Management offers a broad array of services for managing financial assets, including investment management and investment research services, primarily for institutional investors worldwide. These services include passive and active U.S. and non-U.S. equity and fixed income strategies, and other related services, such as securities finance.

The interim consolidated financial statements accompanying these notes are unaudited. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair statement of the results of operations in these financial statements, have been made. The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Results of operations for the three and six months ended June 30, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. Certain previously reported amounts have been reclassified to conform to current period classifications.

The consolidated statement of condition at December 31, 2006, has been derived from the audited financial statements at that date, but does not include all footnotes required by U.S. generally accepted accounting principles for a complete set of financial statements. The accompanying interim consolidated financial statements and these condensed notes should be read in conjunction with the financial and risk factors information included in our 2006 Annual Report on Form 10-K, which we previously filed with the SEC.

New Accounting Standards

In July 2006, the FASB issued FASB Staff Position No. FAS 13-2, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction*. The FSP, which must be applied beginning on January 1, 2007, requires that the recognition of lease income over the term of a lease be recalculated if there is a change in the expected timing of tax-related cash flows. Our application of the FSP's provisions to certain of our leveraged leases resulted in a cumulative after-tax reduction of the beginning balance of retained earnings on January 1, 2007 of

STATE STREET CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

Note 1. Summary of Significant Accounting Policies (Continued)

approximately \$226 million. Future income from the affected leases is expected to increase over the remaining terms of the affected leases by an amount approximately equal to the after-tax reduction.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. This Interpretation, which must be applied beginning on January 1, 2007, clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements, and prescribes thresholds and attributes for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. Our application of the Interpretation's provisions to our tax positions as of January 1, 2007 did not impact our consolidated financial position or results of operations. Disclosures required by the Interpretation are in note 7.

Recent Accounting Developments

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115*. This new standard is designed to reduce complexity in accounting for financial instruments and lessen earnings volatility caused by measuring related assets and liabilities differently. The standard creates presentation and disclosure requirements designed to aid comparisons between companies that use different measurement attributes for similar types of assets and liabilities. The standard, which is expected to expand the use of fair value measurement, permits entities to choose to measure many financial instruments and certain other items at fair value, with unrealized gains and losses on those assets and liabilities recorded in earnings. The fair value option may be applied on a financial instrument by financial instrument basis, with a few exceptions and is irrevocable for those financial instruments once applied. The fair value option may only be applied to entire financial instruments, not portions of instruments.

The standard does not eliminate disclosures required by SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, or SFAS No. 157, *Fair Value Measurements*. The provisions of the standard are effective for our consolidated financial statements beginning January 1, 2008. We are currently evaluating the potential impact of adoption of this standard on our consolidated financial position and results of operations, and as it relates to the potential impact of our adoption of SFAS 157, *Fair Value Measurements*. We discussed SFAS No. 157 in our 2006 Form 10-K.

Note 2. Acquisitions and Divestitures

On July 2, 2007, we completed our acquisition of Investors Financial Services Corp., or Investors Financial, a bank holding company based in Boston with approximately \$17 billion in total assets as of June 30, 2007. We exchanged approximately 60.8 million shares of our common stock, with an aggregate value of approximately \$4.2 billion, for all of the outstanding common stock of Investors Financial. Financial results of Investors Financial will be included in our consolidated financial statements for the period beginning on July 2, 2007.

On March 2, 2007, we completed our acquisition of Currenex, Inc., an independently owned electronic foreign exchange trading platform. We paid approximately \$564 million, net of liabilities assumed, and recorded the following significant assets: goodwill \$437 million; customer relationship and other intangibles \$174 million; and other tangible assets \$25 million. The customer relationship and other intangible assets are being amortized on a straight-line basis over a period of eight to twelve years.

STATE STREET CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

Note 2. Acquisitions and Divestitures (Continued)

Financial results of Currenex are included in the accompanying consolidated statement of income for the period beginning on March 2, 2007.

During the first quarter of 2006, we agreed to a plan of sale to finalize the divestiture of our ownership interest in Bel Air Investment Advisors LLC, and recorded income of approximately \$16 million, or \$10 million after-tax, related to the finalization of legal, selling and other costs recorded in connection with the divestiture. We completed the divestiture in July 2006. Additional information about this divestiture is included in our 2006 Form 10-K.

Note 3. Investment Securities

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Investment securities consisted of the following as of the dates indicated:

(In millions)	June 30, 2007			December 31, 2006			Fair Value	
	Amortized Cost	Unrealized Gains	Losses	Amortized Cost	Unrealized Gains	Losses		
Available for sale:								
U.S. Treasury and federal agencies:								
Direct obligations	\$ 5,062		\$ 67	\$ 4,995	\$ 7,701		\$ 89	\$ 7,612
Mortgage-backed securities	11,513	\$ 9	305	11,217	11,685	\$ 15	246	11,454
Subtotal	16,575	9	372	16,212	19,386	15	335	19,066
Asset-backed securities	25,807	20	41	25,786	25,646	28	40	25,634
Collateralized mortgage obligations								
State and political subdivisions	10,851	9	142	10,718	8,538	17	79	8,476
Other debt investments	5,150	16	20	5,146	3,740	20	11	3,749
Other equity securities	4,268	1	50	4,219	3,043	7	23	3,027
Money-market mutual funds	284			284	201			201
Other equity securities	353	30		383	269	24	1	292
Total	\$ 63,288	\$ 85	\$ 625	\$ 62,748	\$ 60,823	\$ 111	\$ 489	\$ 60,445
Held to maturity:								
U.S. Treasury and federal agencies:								
Direct obligations	\$ 761		\$ 16	\$ 745	\$ 846		\$ 15	\$ 831
Mortgage-backed securities	1,007	\$ 2	23	986	1,084	\$ 5	17	1,072
Subtotal	1,768	2	39	1,731	1,930	5	32	1,903
Collateralized mortgage obligations								
Other investments	2,260	1	59	2,202	2,357	5	41	2,321
Other investments	280		2	278	260	1	1	260
Total	\$ 4,308	\$ 3	\$ 100	\$ 4,211	\$ 4,547	\$ 11	\$ 74	\$ 4,484

Aggregate investment securities carried at \$22.88 billion and \$23.28 billion at June 30, 2007 and December 31, 2006, respectively, were designated as pledged for public and trust deposits, short-term borrowings and for other purposes as required by law.

STATE STREET CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

Note 3. Investment Securities (Continued)

Gross gains and losses realized from sales of available-for-sale securities were as follows for the periods indicated:

(In millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Gross gains	\$ 3	\$ 24	\$ 5	\$ 24
Gross losses	4	10	5	13
Net (losses) gains	\$ (1)	\$ 14	\$	\$ 11

Note 4. Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill were as follows for the six months ended June 30, 2007:

(In millions)	Investment Servicing	Investment Management	Total
Balance at December 31, 2006	\$ 1,376	\$ 8	\$ 1,384
Acquisition of Currenex	437		437
Other additions	24		