STATE STREET CORP
Form 10-Q
November 03, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
Form 10-Q

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from to

Commission File No. 001-07511

STATE STREET CORPORATION
(Exact name of registrant as specified in its charter)

Massachusetts	04-2456637
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
One Lincoln Street Boston, Massachusetts	02111
(Address of principal executive office)	(Zip Code)

617-786-3000
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

The number of shares of the registrant’s common stock outstanding as of October 31, 2016 was 385,734,628.

STATE STREET CORPORATION
QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTERLY PERIOD ENDED
September 30, 2016

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ACRONYMS

2015 Form 10-K	State Street Corporation Annual Report on Form 10-K for the year ended December 31, 2015	FHLB	Federal Home Loan Bank of Boston
ABS	Asset-backed securities	FRBB	Federal Reserve Bank of Boston
AFS	Available-for-sale	FSB	Financial Stability Board
ALLL	Allowance for loan and lease losses	FX	Foreign exchange
AML	Anti-money laundering	GAAP	Generally accepted accounting principles
AOCI	Accumulated other comprehensive income (loss)	G-SIB	Global systemically important bank
ASU	Accounting Standards Update	HQLA(1)	High-quality liquid assets
AUCA	Assets under custody and administration	HTM	Held-to-maturity
AUM	Assets under management	LCR(1)	Liquidity coverage ratio
BCBS	Basel Committee on Banking Supervision	MRAC	Management Risk and Capital Committee
Board	Board of Directors	NIR	Net interest revenue
CCAR	Comprehensive Capital Analysis and Review	OCI	Other comprehensive income (loss)
CD	Certificates of deposit	OCIO	Outsourced Chief Investment Officer
CET1(1)	Common equity tier 1	OFAC	Office of Foreign Assets Control
CLO	Collateralized loan obligations	OTC	Over-the-counter
CRE	Commercial real estate	OTTI	Other-than-temporary-impairment
CVA	Credit valuation adjustment	Parent Company	State Street Corporation
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act	PCA	Prompt corrective action
ECB	European Central Bank	P&L	Profit-and-loss
EPS	Earnings per share	RC	Risk Committee
ERISA	Employee Retirement Income Security Act	RWA(1)	Risk-weighted assets
ERM	Enterprise Risk Management	SEC	Securities and Exchange Commission
ETF	Exchange-Traded Fund	SLR(1)	Supplementary leverage ratio
EVE	Economic value of equity	SSGA	State Street Global Advisors
FASB	Financial Accounting Standards Board	State Street Bank	State Street Bank and Trust Company
FCA	Financial Conduct Authority	TMRC	Trading and Markets Risk Committee
FDIC	Federal Deposit Insurance Corporation	VaR	Value-at-risk
Federal Reserve	Board of Governors of the Federal Reserve System	VIE	Variable interest entity

(1) As defined by the applicable U.S. regulations.

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We use acronyms and other defined terms for certain business terms and abbreviations, as defined on the acronyms list following the table of contents to this Form 10-Q.

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

GENERAL

State Street Corporation, referred to as the parent company, is a financial holding company organized in 1969 under the laws of the Commonwealth of Massachusetts. Our executive offices are located at One Lincoln Street, Boston, Massachusetts 02111 (telephone (617) 786-3000). For purposes of this Form 10-Q, unless the context requires otherwise, references to "State Street," "we," "us," "our" or similar terms mean State Street Corporation and its subsidiaries on a consolidated basis. The parent company is a source of financial and managerial strength to our subsidiaries. Through our subsidiaries, including our principal banking subsidiary, State Street Bank and Trust Company, referred to as State Street Bank, we provide a broad range of financial products and services to institutional investors worldwide, with \$29.18 trillion of AUCA and \$2.45 trillion of AUM as of September 30, 2016.

As of September 30, 2016, we had consolidated total assets of \$256.14 billion, consolidated total deposits of \$198.77 billion, consolidated total shareholders' equity of \$22.15 billion and 33,332 employees. We operate in more than 100 geographic markets worldwide, including in the U.S., Canada, Europe, the Middle East and Asia.

Our operations are organized for management reporting purposes into 2 lines of business: Investment Servicing and Investment Management, which are defined based on products and services provided.

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

Investment Management, through SSGA, provides a broad array of investment management, investment research and investment advisory services to corporations, public funds and other sophisticated investors. SSGA offers active and passive asset management strategies across equity, fixed-income, alternative, multi-asset solutions (including OCIO), and cash asset classes. Products

are distributed directly and through intermediaries using a variety of investment vehicles, including ETFs, such as the SPDR® ETF brand.

For financial and other information about our lines of business, refer to "Line of Business Information" included in this Management's Discussion and Analysis and Note 17 to the consolidated financial statements included in this Form 10-Q.

This Management's Discussion and Analysis is part of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, and updates the Management's Discussion and Analysis in our 2015 Form 10-K previously filed with the SEC. You should read the financial information contained in this Management's Discussion and Analysis and elsewhere in this Form 10-Q in conjunction with the financial and other information contained in our 2015 Form 10-K. Certain previously reported amounts presented in this Form 10-Q have been reclassified to conform to current-period presentation.

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

The significant accounting policies that require us to make judgments, estimates and assumptions that are difficult, subjective or complex about matters that are uncertain and may change in subsequent periods include accounting for fair value measurements; other-than-temporary impairment of investment securities; impairment of goodwill and other intangible assets; and contingencies. These significant accounting policies require the most subjective or complex judgments, and underlying estimates and assumptions could be subject to revision as new information becomes available. Additional information about these significant accounting policies is included under “Significant Accounting Estimates” in Management's Discussion and Analysis in our 2015 Form 10-K. We did not change these significant accounting policies in the first nine months of 2016.

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

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

We further believe that our presentation of fully taxable-equivalent net interest revenue, which reports non-taxable revenue, such as interest revenue associated with tax-exempt investment securities, on a fully taxable-equivalent basis, facilitates an investor's understanding and analysis of our underlying financial performance and trends.

We provide additional disclosures required by applicable bank regulatory standards, including supplemental qualitative and quantitative information with respect to regulatory capital (including market risk associated with our trading activities), summary results of semi-annual State Street-run stress tests which we conduct under the Dodd-Frank Act, and resolution plan disclosures required under the Dodd-Frank Act. These additional disclosures are accessible on the "Investor Relations" section of our corporate website at www.statestreet.com.

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

We use acronyms and other defined terms for certain business terms and abbreviations, as defined on the acronyms list following the table of contents to this Form 10-Q.

Forward-Looking Statements

This Form 10-Q, as well as other reports and proxy materials submitted by us under the Securities Exchange Act of 1934, registration statements filed by us under the Securities Act of 1933, our annual report to shareholders and other public statements we may make, contain statements (including statements in the Management's Discussion and Analysis) that are considered "forward-looking statements" within the meaning of U.S. securities laws, including statements about our goals and expectations regarding our business, financial and capital condition, results of operations, strategies, financial portfolio performance, dividend and stock purchase programs, expected outcomes of legal proceedings, market growth, acquisitions, joint ventures and divestitures and new technologies, services and opportunities, as well as regarding industry, regulatory, economic and market

trends, initiatives and developments, the business environment and other matters that do not relate strictly to historical facts.

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

Forward-looking statements are subject to various risks and uncertainties, which change over time, are based on management's expectations and assumptions at the time the statements are made, and are not guarantees of future results. Management's expectations and assumptions, and the continued validity of the forward-looking statements, are subject to change due to a broad range of factors affecting the national and global economies, regulatory environment and the equity, debt, currency and other financial markets, as well as factors specific to State Street and its subsidiaries, including State Street Bank. Factors that could cause changes in the expectations or assumptions on which forward-looking statements are based cannot be foreseen with certainty and include, but are not limited to:

- the financial strength and continuing viability of the counterparties with which we or our clients do business and to which we have investment, credit or financial exposure, including, for example, the direct and indirect effects on counterparties of the sovereign-debt risks in the U.S., Europe and other regions;
- increases in the volatility of, or declines in the level of, our net interest revenue, changes in the composition or valuation of the assets recorded in our consolidated statement of condition (and our ability to measure the fair value of investment securities) and the possibility that we may change the manner in which we fund those assets;

- the liquidity of the U.S. and international securities markets, particularly the markets for fixed-income securities and inter-bank credits, and the liquidity requirements of our clients;
- the level and volatility of interest rates, the valuation of the U.S. dollar relative to other currencies in which we record revenue or accrue expenses and the performance and volatility of securities, credit, currency and other markets in the U.S. and internationally;
- the credit quality, credit-agency ratings and fair values of the securities in our investment

securities portfolio, a deterioration or downgrade of which could lead to other-than-temporary impairment of the respective securities and the recognition of an impairment loss in our consolidated statement of income;

- our ability to attract deposits and other low-cost, short-term funding, our ability to manage levels of such deposits and the relative portion of our deposits that are determined to be operational under regulatory guidelines and our ability to deploy deposits in a profitable manner consistent with our liquidity needs, regulatory requirements and risk profile;
- the manner and timing with which the Federal Reserve and other U.S. and foreign regulators implement changes to the regulatory framework applicable to our operations, including implementation of the Dodd-Frank Act, the Basel III final rule and European legislation (such as the Alternative Investment Fund Managers Directive, Undertakings for Collective Investment in Transferable Securities Directives and Markets in Financial Instruments Directive II); among other consequences, these regulatory changes impact the levels of regulatory capital we must maintain, acceptable levels of credit exposure to third parties, margin requirements applicable to derivatives, and restrictions on banking and financial activities. In addition, our regulatory posture and related expenses have been and will continue to be affected by changes in regulatory expectations for global systemically important financial institutions applicable to, among other things, risk management, liquidity and capital planning, resolution planning, and compliance programs, and changes in governmental enforcement approaches to perceived failures to comply with regulatory or legal obligations;
- we may not successfully implement our plans to have a credible resolution plan by July 2017, including the sufficiency of the actions taken to address the deficiencies jointly identified by the Federal Reserve and the FDIC in April 2016 with respect to our 2015 resolution plan, or those plans may not be considered to be sufficient by the Federal Reserve and the FDIC, due to a number of factors, including, but not limited to challenges we may experience in interpreting and addressing regulatory expectations, failure to implement remediation in a timely

manner, the complexities of development of a comprehensive plan to resolve a global custodial bank and related costs and dependencies. If we fail to meet regulatory expectations to the satisfaction of the Federal Reserve and the FDIC in our resolution plan submission filed on October 1, 2016 or in any future submission, we could be subject to more stringent capital, leverage or liquidity requirements, or restrictions on our growth, activities or operations;

- adverse changes in the regulatory ratios that we are required or will be required to meet, whether arising under the Dodd-Frank Act or the Basel III final rule, or due to changes in regulatory positions, practices or regulations in jurisdictions in which we engage in banking activities, including changes in internal or external data, formulae, models, assumptions or other advanced systems used in the calculation of our capital ratios that cause changes in those ratios as they are measured from period to period;
- increasing requirements to obtain the prior approval of the Federal Reserve or our other U.S. and non-U.S. regulators for the use, allocation or distribution of our capital or other specific capital actions or programs, including acquisitions, dividends and stock purchases, without which our growth plans, distributions to shareholders, share repurchase programs or other capital initiatives may be restricted;
- changes in law or regulation, or the enforcement of law or regulation, that may adversely affect our business activities or those of our clients or our counterparties, and the products or services that we sell, including additional or increased taxes or assessments thereon, capital adequacy requirements, margin requirements and changes that expose us to risks related to the adequacy of our controls or compliance programs;
- economic or financial market disruptions in the U.S. or internationally, including that which may result from recessions or political instability, for example, the U.K.'s referendum to exit from the European Union may continue to disrupt financial markets or economic growth in Europe;
- our ability to develop and execute State Street Beacon, our multi-year transformation program to digitize our business, deliver significant value and innovation for our clients and lower expenses across the organization, any failure of which, in whole or in part, may

among other things, reduce our competitive position, diminish the cost-effectiveness of our systems and processes or provide an insufficient return on our associated investment;

- our ability to promote a strong culture of risk management, operating controls, compliance oversight, ethical behavior and governance that meet our expectations and those of our clients and our regulators, and the financial, regulatory, reputation and other consequences of our failure to meet such expectations;
- the results of our review of our billing practices, including additional amounts we may be required to reimburse clients, as well as potential consequences of such review, including damage to our client relationships and adverse actions by governmental authorities;
- the results of, and costs associated with, governmental or regulatory inquiries and investigations, litigation and similar claims, disputes, or civil or criminal proceedings;
- the potential for losses arising from our investments in sponsored investment funds;
- the possibility that our clients will incur substantial losses in investment pools for which we act as agent, and the possibility of significant reductions in the liquidity or valuation of assets underlying those pools;
- our ability to anticipate and manage the level and timing of redemptions and withdrawals from our collateral pools and other collective investment products;
- the credit agency ratings of our debt and depositary obligations and investor and client perceptions of our financial strength;
- adverse publicity, whether specific to State Street or regarding other industry participants or industry-wide factors, or other reputational harm;
- our ability to control operational risks, data security breach risks and outsourcing risks, our ability to protect our intellectual property rights, the possibility of errors in the quantitative models we use to manage our business and the possibility that our controls will prove insufficient, fail or be circumvented;
- our ability to expand our use of technology to enhance the efficiency, accuracy and reliability of our operations and our dependencies on information technology and our ability to control related risks, including cyber-crime and other threats to our

information technology infrastructure and systems (including those of our third-party service providers) and their effective operation both independently and with external systems, and complexities and costs of protecting the security of such systems and data;

- our ability to grow revenue, manage expenses, attract and retain highly skilled people and raise the capital necessary to achieve our business goals and comply with regulatory requirements and expectations;
- changes or potential changes to the competitive environment, including changes due to regulatory and technological changes, the effects of industry consolidation and perceptions of State Street as a suitable service provider or counterparty;
- changes or potential changes in the amount of compensation we receive from clients for our services, and the mix of services provided by us that clients choose;
- our ability to complete acquisitions, joint ventures and divestitures, including the ability to obtain regulatory approvals, the ability to arrange financing as required and the ability to satisfy closing conditions;
- the risks that our acquired businesses and joint ventures will not achieve their anticipated financial and operational benefits or will not be integrated successfully, or that the integration will take longer than anticipated, that expected synergies will not be achieved or unexpected negative synergies or liabilities will be experienced, that client and deposit retention goals will not be met, that other regulatory or operational challenges will be experienced, and that disruptions from the transaction will harm our relationships with our clients, our employees or regulators;
- our ability to recognize emerging needs of our clients and to develop products that are responsive to such trends and profitable to us, the performance of and demand for the products and services we offer, and the potential for new products and services to impose additional costs on us and expose us to increased operational risk;

- changes in accounting standards and practices; and
- changes in tax legislation and in the interpretation of existing tax laws by U.S. and non-U.S. tax authorities that affect the amount of taxes due.

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Actual outcomes and results may differ materially from what is expressed in our forward-looking statements and from our historical financial results due to the factors discussed in this section and elsewhere in this Form 10-Q or disclosed in our other SEC filings, including the risk factors discussed in our 2015 Form 10-K. Forward-looking statements in this Form 10-Q should not be relied on as representing our expectations or beliefs as of any date subsequent to the time this Form 10-Q is filed with the SEC. We undertake no obligation to revise our forward-looking statements after the time they are made. The factors discussed herein are not intended to be a complete statement of all risks and uncertainties that may affect our businesses. We cannot anticipate all developments that may adversely affect our business or operations or our consolidated results of operations, financial condition or cash flows.
Forward-looking statements should not be viewed as predictions, and should not be the primary basis on which investors evaluate State Street. Any investor in State Street should consider all risks and uncertainties disclosed in our SEC filings, including our filings under the Securities Exchange Act of 1934, in particular our annual reports on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K, or registration statements filed under the Securities Act of 1933, all of which are accessible on the SEC's website at www.sec.gov or on the "Investor Relations" section of our corporate website at www.statestreet.com.

OVERVIEW OF FINANCIAL RESULTS

TABLE 1: OVERVIEW OF FINANCIAL RESULTS

	Quarters Ended September 30,		
(Dollars in millions, except per share amounts)	2016	2015	% Change
Total fee revenue	$2,079	$2,103	(1)%
Net interest revenue	537	513	5
Gains (losses) related to investment securities, net	4	(2)	nm
Total revenue	2,620	2,614	—
Provision for loan losses	—	5	nm
Total expenses	1,984	1,962	1
Income before income tax expense	636	647	(2)
Income tax expense	72	67	7
Net Income (loss) from non-controlling interest	(1)	1	nm
Net income	$563	$581	(3)
Adjustments to net income:			
Dividends on preferred stock[1]	(55)	(42)	31
Earnings allocated to participating securities[2]	(1)	—	nm
Net income available to common shareholders	$507	$539	(6)
Earnings per common share:			
Basic	$1.31	$1.33	(2)
Diluted	1.29	1.31	(2)
Average common shares outstanding (in thousands):			
Basic	388,358	406,612	
Diluted	393,212	412,167	
Cash dividends declared per common share	$.38	$.34	
Return on average common equity	10.6%	11.3%	

Nine Months
Ended September

(Dollars in millions, except per share amounts)	30, 2016	2015	% Change
Total fee revenue	$6,102	$6,234	(2)%
Net interest revenue	1,570	1,594	(2)
Gains (losses) related to investment securities, net	5	(6)	nm
Total revenue	7,677	7,822	(2)
Provision for loan losses	8	11	(27)
Total expenses	5,894	6,193	(5)
Income before income tax expense	1,775	1,618	10
Income tax expense	226	215	5
Net income from non-controlling interest	1	1	nm
Net income	$1,550	$1,404	10
Adjustments to net income:			
Dividends on preferred stock[1]	(137)	(102)	34
Earnings allocated to participating securities[2]	(2)	(1)	nm
Net income available to common shareholders	$1,411	$1,301	8
Earnings per common share:			
Basic	$3.58	$3.18	13
Diluted	3.54	3.13	13
Average common shares outstanding (in thousands):			
Basic	393,959	409,816	
Diluted	398,413	415,772	
Cash dividends declared per common share	$1.06	$.98	
Return on average common equity	9.9 %	9.1 %	

[1] Refer to Note 12 of the consolidated financial statements included in this Form 10-Q for additional information regarding our preferred stock dividends.
[2] Represents the portion of net income available to common equity allocated to participating securities, composed of fully vested deferred director stock and unvested restricted stock that contain non-forfeitable rights to dividends during the vesting period on a basis equivalent to dividends paid to common shareholders.
[nm] Not meaningful

The following “Highlights” and “Financial Results” sections provide information related to significant events, as well as highlights of our consolidated financial results for the quarter ended September 30, 2016 presented in Table 1: Overview of Financial Results. More detailed information about our consolidated financial results, including comparisons of our financial results for the quarter ended September 30, 2016 to those for the quarter ended September 30, 2015 and for the nine months ended September 30, 2016 to those for the nine months ended September 30, 2015, is provided under “Consolidated Results of Operations,” which follows these sections. In this Management’s Discussion and Analysis, where we describe the effects of changes in foreign exchange rates, those effects are determined by applying applicable weighted average foreign exchange rates from the relevant 2015 period to the relevant 2016 results.

Highlights

- We secured new asset servicing mandates of $212 billion in the third quarter and $1,225 billion in the first nine months of 2016, of which approximately $95 billion and $886 billion was installed in the third quarter and first nine months of 2016, respectively. The remaining amount is expected to be installed in the remainder of 2016 or later.
- On July 1, 2016, we completed our previously announced acquisition of GE Asset Management ("GEAM") from General Electric Company, with a total initial purchase price of approximately $437 million and approximately $46 million in potential incremental purchase price related to future opportunities with General Electric. This acquisition extends our core investment management capabilities, including in the high growth OCIO markets, and enhances our capabilities in connection with the delivery of value-added solutions to our client base. In the third quarter of 2016, we incurred acquisition and restructuring costs associated with the acquisition of approximately $29 million and expect to incur approximately $80 million of such costs through 2018, including the third quarter costs.
- Excluding AUM associated with the acquired GEAM operations of $112 billion, net outflows of AUM totaled $36 billion and $58 billion in the quarter and nine months ended September 30, 2016, respectively.
- We declared common stock dividends of $0.38 per share, totaling approximately $147 million, in the third quarter of 2016.

- In the third quarter of 2016, we purchased approximately 4.7 million shares of our common stock at an average per-share cost of $69.03 and an aggregate cost of approximately $325 million under our current common stock purchase program approved by our Board in July 2016.

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

Financial Results

- Total revenue in the third quarter of 2016 increased slightly compared to the third quarter of 2015, primarily due to a 28% increase in management fee revenue, partially offset by a decrease in processing fees and other revenue.
- Servicing fee revenue increased 1% in the third quarter of 2016 compared to the third quarter of 2015, due to net new business.
- Management fee revenue increased 28% in the third quarter of 2016 compared to the third quarter of 2015, primarily due to the impact of the acquired GEAM business and lower money market fee waivers and higher global equity markets.
- Return on average common shareholders' equity decreased to 10.6% in the third quarter of 2016 compared to 11.3% in the third quarter of 2015.
- In the third quarter of 2016, we recorded restructuring charges of $10 million related to State Street Beacon, our multi-year transformation program to digitize our business, deliver significant value and innovation for our clients and lower expenses across the organization. We are on track to generate at least $165 million in estimated annual year-over-year pre-tax savings in 2016 related to State Street Beacon, all else equal. These savings include the effects of the targeted staff reductions announced in October 2015. The full effect of these 2016 savings will be felt in 2017. Actual expenses may increase or decrease in the future due to other factors.

- In the third quarter of 2016, we recorded a pre-tax charge of approximately $42 million to establish a legal reserve related to previously disclosed investigations by U.S. governmental agencies concerning our transition management business activities in 2010 and 2011.

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- Total expenses in the third quarter of 2016 increased 1% compared to the third quarter of 2015, primarily driven by increases in acquisition costs, primarily associated with the acquired GEAM business, and information systems and communications expenses, partially offset by decreases in compensation and employee benefits and professional services expenses.

CONSOLIDATED RESULTS OF OPERATIONS

This section discusses our consolidated results of operations for the third quarter and first nine months of 2016 compared to the same periods in 2015, and should be read in conjunction with the consolidated financial statements and accompanying condensed notes to the consolidated financial statements included in this Form 10-Q.

TOTAL REVENUE

TABLE 2: TOTAL REVENUE

	Quarters Ended September 30,		
(In millions)	2016	2015	% Change
Fee revenue:			
Servicing fees	$1,303	$1,289	1 %
Management fees	368	287	28
Trading services:			
Foreign exchange trading	159	177	(10)
Brokerage and other trading services	108	117	(8)
Total trading services	267	294	(9)
Securities finance	136	113	20
Processing fees and other	5	120	(96)
Total fee revenue	2,079	2,103	(1)
Net interest revenue:			
Interest revenue	647	614	5
Interest expense	110	101	9
Net interest revenue	537	513	5
Gains (losses) related to investment securities, net	4	(2)	nm
Total revenue	$2,620	$2,614	—

	Nine Months Ended September 30,		
(In millions)	2016	2015	% Change
Fee revenue:			
Servicing fees	$3,784	$3,876	(2)%
Management fees	931	892	4
Trading services:			
Foreign exchange trading	472	547	(14)
Brokerage and other trading services	334	352	(5)
Total trading services	806	899	(10)
Securities finance	426	369	15
Processing fees and other	155	198	(22)
Total fee revenue	6,102	6,234	(2)

Net interest revenue:			
Interest revenue	1,896	1,885	1
Interest expense	326	291	12
Net interest revenue	1,570	1,594	(2)
Gains (losses) related to investment securities, net	5	(6)	nm
Total revenue	$7,677	$7,822	(2)

nm Not meaningful

FEE REVENUE

Table 2: Total Revenue, provides the breakout of fee revenue for the quarters and nine months ended September 30, 2016 and 2015.

Servicing and management fees collectively made up approximately 80% and 77% of our total fee revenue in the third quarter and first nine months of 2016, respectively, compared to approximately 75% and 76% in the third quarter and first nine months of 2015, respectively. The level of these fees is influenced by several factors, including the mix and volume of our assets under custody and administration and our assets under management, the value and type of securities positions held (with respect to assets under custody), the volume of portfolio transactions, and the types of products and services used by our clients, and is generally affected by changes in worldwide equity and fixed-income security valuations and trends in market asset class preferences.

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

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

Asset-based management fees for actively managed products are generally charged at a higher percentage of assets under management than for passive products. Actively managed products may also include performance fee arrangements which are recorded when the performance period is complete.

Performance fees are generated when the performance of certain managed portfolios exceeds benchmarks specified in the management agreements. Generally, we experience more volatility with performance fees than with more traditional management fees.

In light of the above, we estimate, using relevant information as of September 30, 2016 and assuming that all other factors remain constant, that:

- A 10% increase or decrease in worldwide equity valuations, over the relevant periods for which our servicing and management fees are calculated, would result in a corresponding change in our total revenue of approximately 2%; and
- A 10% increase or decrease in worldwide fixed income security valuations, over the relevant periods for which our servicing and management fees are calculated, would result in a corresponding change in our total revenue of approximately 1%.

See Table 3: Daily, Month-End and Quarter-End Indices, for selected equity market indices. While the specific indices presented are indicative of general market trends, the asset types and classes relevant to individual client portfolios can and do differ, and the performance of associated relevant indices can therefore differ from the performance of the indices presented.

Daily averages and the averages of month-end indices demonstrate worldwide changes in equity markets that affect our servicing and management fee revenue. Quarter-end indices affect the values of assets under custody and administration and assets under management as of those dates. The index names listed in the table are service marks of their respective owners.

Further discussion of fee revenue is provided under “Line of Business Information” in this Management's Discussion and Analysis.

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

	Daily Averages of Indices			Averages of Month-End Indices			Quarter-End Indices		
	Quarters Ended September 30,			Quarters Ended September 30,			As of September 30,		
	2016	2015	% Change	2016	2015	% Change	2016	2015	% Change
S&P 500®	2,162	2,027	7 %	2,171	1,999	9 %	2,168	1,920	13 %
NASDAQ®	5,169	4,924	5	5,229	4,842	8	5,312	4,620	15
MSCI® EAFE®	1,678	1,785	(6)	1,692	1,754	(4)	1,702	1,644	4
MSCI® Emerging Markets	887	860	3	890	837	6	903	792	14

	Daily Averages of Indices			Averages of Month-End Indices		
	Nine Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
S&P 500®	2,065	2,064	— %	2,078	2,047	2 %
NASDAQ®	4,880	4,928	(1)	4,922	4,891	1
MSCI EAFE®	1,640	1,836	(11)	1,650	1,827	(10)
MSCI® Emerging Markets	821	948	(13)	830	940	(12)

NET INTEREST REVENUE

See Table 2: Total Revenue, for the breakout of interest revenue and interest expense for the quarters and nine months ended September 30, 2016 and 2015.

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

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

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

TABLE 4: AVERAGE BALANCES AND INTEREST RATES - FULLY TAXABLE-EQUIVALENT BASIS

	Quarters Ended September 30,					
	2016			2015		
(Dollars in millions; fully taxable-equivalent basis)	Average Balance	Interest Revenue/ Expense	Rate	Average Balance	Interest Revenue/ Expense	Rate
Interest-bearing deposits with banks	$57,580	$29	.20 %	$73,466	$53	.29 %
Securities purchased under resale agreements[1]	2,667	40	6.01	4,838	18	1.51
Trading account assets	994	—	—	1,338	—	—
Investment securities	100,449	505	2.01	100,175	505	2.02
Loans and leases	18,744	97	2.06	17,606	79	1.77
Other interest-earning assets	21,721	18	.30	24,001	2	.03
Average total interest-earning assets	$202,155	$689	1.35	$221,424	$657	1.18
Interest-bearing deposits:						
U.S.	$33,668	$42	.49 %	$36,033	$15	.16 %
Non-U.S.	95,617	(22)	(.09)	101,297	13	.05
Securities sold under repurchase agreements[1]	3,976	—	—	9,220	—	—
Federal funds purchased	24	—	—	17	—	—
Other short-term borrowings	1,566	2	.57	3,791	1	.18
Long-term debt	11,885	68	2.27	10,497	62	2.36
Other interest-bearing liabilities	5,647	20	1.41	4,463	10	.88
Average total interest-bearing liabilities	$152,383	$110	.29	$165,318	$101	.24
Interest-rate spread			1.06 %			.94 %
Net interest revenue—fully taxable-equivalent basis		$579			$556	
Net interest margin—fully taxable-equivalent basis			1.14 %			1.00%
Tax-equivalent adjustment		(42)			(43)	
Net interest revenue—GAAP basis		$537			$513	

	Nine Months Ended September 30,					
	2016			2015		
(Dollars in millions; fully taxable-equivalent basis)	Average Balance	Interest Revenue/ Expense	Rate	Average Balance	Interest Revenue/ Expense	Rate
Interest-bearing deposits with banks	$52,423	$101	.26 %	$74,830	$161	.29 %
Securities purchased under resale agreements[1]	2,610	112	5.73	3,325	45	1.79
Trading account assets	908	1	.09	1,234	—	—
Investment securities	101,243	1,486	1.96	107,216	1,574	1.96
Loans and leases	18,674	281	2.01	17,711	229	1.73
Other interest-earning assets	22,316	39	.24	22,731	7	.04
Average total interest-earning assets	$198,174	$2,020	1.36	$227,047	$2,016	1.19
Interest-bearing deposits:						
U.S.	$30,388	$99	.44 %	$31,479	$34	.14 %
Non-U.S.	95,013	(26)	(.04)	105,347	33	.04
Securities sold under repurchase agreements[1]	4,107	1	.03	9,576	—	—

Federal funds purchased	33	—	—	21	—	—
Other short-term borrowings	1,727	4	.34	4,211	5	.16
Long-term debt	11,306	191	2.24	9,779	185	2.52
Other interest-bearing liabilities	5,550	57	1.38	6,835	34	.65
Average total interest-bearing liabilities	$148,124	$326	.29	$167,248	$291	.23
Interest-rate spread			1.07 %			.95 %
Net interest revenue—fully taxable-equivalent basis		$1,694			$1,725	
Net interest margin—fully taxable-equivalent basis			1.14 %			1.02%
Tax-equivalent adjustment		(124)			(131)	
Net interest revenue—GAAP basis		$1,570			$1,594	

(1) Reflects the impact of balance sheet netting under enforceable netting agreements.

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See Table 4: Average Balances and Interest Rates - Fully Taxable-Equivalent Basis, for the breakout of net interest revenue on a fully taxable-equivalent basis for the quarters and nine months ended September 30, 2016 and 2015. Net interest revenue increased 4% on a fully taxable-equivalent basis in the third quarter of 2016 compared to the third quarter of 2015. Benefits during the third quarter of 2016 from the U.S. rate hike in December 2015 were partially offset by lower global interest rates that affected our revenue from certain floating-rate assets, the rate at which payments from the maturity or prepayment of portfolio holdings could be reinvested, and the effect of the stronger U.S. dollar. The third quarter of 2016 also reflects our management actions toward the end of the third quarter of 2015 to manage the size and composition of our investment portfolio as we seek to optimize our capital and liquidity positions in light of the evolving regulatory environment. Net interest revenue decreased 2% in the nine months ended September 30, 2016 compared to the same period in 2015. The decrease is primarily the result of the previously mentioned management actions, which contributed to a reduction of average interest and non-interest bearing deposits of $22 billion for the nine months ended September 30, 2016 compared to the same period in 2015.

The effect of the stronger U.S. dollar relative to other currencies, particularly the GBP, also negatively impacted our net interest revenue. The stronger U.S. dollar had the effect of reducing fully taxable-equivalent net interest revenue by approximately $5 million in the third quarter of 2016 compared to the third quarter of 2015.

We recorded aggregate discount accretion in interest revenue of $42 million and $72 million for the third quarter and first nine months of 2016, respectively, related to the assets we consolidated onto our balance sheet in 2009 from our asset-backed commercial paper conduits. Subsequent to the commercial paper conduit consolidation in 2009, we have recorded total discount accretion in interest revenue as follows:

TABLE 5: TOTAL DISCOUNT ACCRETION IN INTEREST REVENUE

(In millions)	Discount Accretion in Interest Revenue
Twelve Months Ended December 31, 2009	$ 621
Twelve Months Ended December 31, 2010	712
Twelve Months Ended December 31, 2011	220
Twelve Months Ended December 31, 2012	215
Twelve Months Ended December 31, 2013	137
Twelve Months Ended December 31, 2014	119
Twelve Months Ended December 31, 2015	98
Nine Months Ended September 30, 2016	72
Total Discount Accretion	$ 2,194

The timing and ultimate recognition of any applicable discount accretion depends, in part, on factors that are outside of our control, including anticipated prepayment speeds and credit quality. The impact of these factors is uncertain and can be significantly influenced by general economic and financial market conditions. The timing and recognition of any applicable discount accretion can also be influenced by our ongoing management of the risks and other characteristics associated with our investment securities portfolio, including sales of securities which would otherwise generate interest revenue through accretion.

Depending on the factors discussed above, among others, we anticipate that until the former conduit securities remaining in our investment portfolio mature or are sold, discount accretion will continue to contribute to our net interest revenue, though generally in declining amounts. Assuming that we hold them to maturity, all else being equal, we expect the remaining former conduit securities carried in our investment portfolio as of September 30, 2016 to generate aggregate discount accretion in future periods of approximately $173 million over their remaining terms, with approximately one third of this discount accretion to be recorded through 2019. We estimate that we will have approximately $10 million to $15 million of discount accretion in the fourth quarter of 2016, excluding the impact of potential significant prepayments.

Changes in the components of interest-earning assets and interest-bearing liabilities are discussed in more detail below. Additional detail about the components of interest revenue and interest expense is provided in Note 14 to the consolidated financial statements included in this Form 10-Q.

Average total interest-earning assets were lower for the third quarter and first nine months ended September 30, 2016 compared to the same periods in 2015 as a result of the previously described management actions.

Even though we have seen reductions in the overall level of excess deposits during the past year, our clients have continued to place elevated levels of deposits with us, as central bank actions have resulted in high levels of liquidity and low global interest rates. We evaluate deposits as either inherent in our relationship with our custodial clients, which we generally invest in our investment portfolio, or transient, or excess deposits, which we generally deposit with central banks. Deposits with central banks generate low returns. Consequently, the elevated levels of these transient deposits have contributed to a reduction of our net interest margin relative to historical levels.

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The deposits with central banks are also included in our total consolidated assets, and lower deposit levels impact our regulatory leverage ratios. If global interest rates increase, we would expect to see some additional decreases in client deposits. In general, we continue to anticipate higher levels of client deposits when compared to longer-term historical trends, irrespective of the interest rate environment, particularly during periods of market stress. If ECB monetary policy continues to pressure European interest rates downward and the U.S. dollar remains strong or strengthens, the negative effects on our net interest revenue may continue or worsen.

Interest-bearing deposits with banks averaged $57.58 billion and $52.42 billion for the third quarter and first nine months of 2016, respectively, compared to $73.47 billion and $74.83 billion for the same periods in 2015, respectively. These decreases reflect management's effort to reduce elevated client deposit levels as a component of our balance sheet management actions. These lower levels of deposits reflected our maintenance of cash balances at the Federal Reserve, the ECB and other non-U.S. central banks both to satisfy regulatory reserve requirements, and elevated levels of client deposits and our investment of the excess deposits with central banks.

We expect to continue to invest deposits we deem as elevated in investment securities or short-term assets, including central bank deposits, depending on our assessment of the underlying characteristics of the deposits.

Loans and leases averaged $18.74 billion and $18.67 billion for the third quarter and first nine months of 2016, respectively, compared to $17.61 billion and $17.71 billion for the same periods in 2015, respectively. The increase in average loans and leases resulted from growth in municipal loans and our continued investment in senior secured loans, offset by a reduction in mutual fund lending.

TABLE 6: U.S. AND NON-U.S. SHORT-DURATION ADVANCES

	Quarters Ended September 30,	
(Dollars in millions, except where otherwise noted)	2016	2015
Average U.S. short-duration advances	$2,114	$2,226
Average non-U.S. short-duration advances	1,299	1,325
Average total short-duration advances	$3,413	$3,551
Average short-duration advances to average loans and leases	18 %	20 %

	Nine Months Ended September 30,	
(Dollars in millions, except where otherwise noted)	2016	2015
Average U.S. short-duration advances	$2,163	$2,284
Average non-U.S. short-duration advances	1,345	1,432
Average total short-duration advances	$3,508	$3,716
Average short-duration advances to average loans and leases	19 %	21 %

Average loans and leases also includes short-duration advances. The decline in the proportion of average short-duration advances to average loans and leases is primarily due to growth in the other segments of the loan and lease portfolio. Short-duration advances provide liquidity to clients in support of their investment activities.

Average other interest-earning assets decreased to $21.72 billion and $22.32 billion for the third quarter and first nine months of 2016, respectively, from $24.00 billion and $22.73 billion for the same periods in 2015, respectively. Our average other interest-earning assets, largely associated with our enhanced custody business, comprised approximately 11% of our average total interest-earning assets for both the third quarter and first nine months of 2016, compared to approximately 11% and 10% of our average total interest-earning assets for the same periods in 2015, respectively. The enhanced custody business, which is our principal securities financing business for our custody clients, generates securities finance revenue. The net interest revenue earned on these transactions is generally lower than the interest earned on other alternative investments.

Aggregate average interest-bearing deposits decreased to $129.29 billion and $125.40 billion for the third quarter and first nine months of 2016, respectively, from $137.33 billion and $136.83 billion for the same periods in 2015, respectively. The lower levels in the third quarter and first nine months of 2016 were primarily the result of management's actions to reduce both U.S. and non-U.S. transaction accounts, offset by increases in time deposits. Future deposit levels will be influenced by the underlying asset servicing business, client deposit behavior, as well as market conditions, including the general levels of U.S. and non-U.S. interest rates.

Average other short-term borrowings declined to $1.57 billion and $1.73 billion for the third quarter and first nine months of 2016, respectively, from $3.79 billion and $4.21 billion for the same periods in 2015, respectively. The decrease was the result of the phase-out of our commercial paper program during 2015, consistent with the objectives of our 2015 recovery and resolution plan developed pursuant to the requirements of the Dodd-Frank Act.

Average long-term debt increased to $11.89 billion and $11.31 billion for the third quarter and first nine months of 2016, respectively, from $10.50 billion and $9.78 billion for the same periods in 2015, respectively. The increase primarily reflected the issuance of $3.0 billion of senior debt in August 2015 and $1.5 billion of senior debt in May 2016 which was offset by a $900 million extendible note called at the end of February 2015 and the maturities of $200 million of senior debt in December 2015, $400 million of senior debt in January 2016 and $1.0 billion of senior debt in March 2016.

Average other interest-bearing liabilities were $5.65 billion and $5.55 billion for the third quarter and first nine months of 2016, respectively, compared to $4.46 billion and $6.84 billion for the same periods in 2015, respectively, primarily the result of changes in the level of cash collateral received from clients in connection with our enhanced custody business, which is presented on a net basis in accordance with enforceable netting agreements.

Several factors could affect future levels of our net interest revenue and margin, including the volume and mix of client liabilities; actions of various central banks; changes in U.S. and non-U.S. interest rates; changes in the various yield curves around the world; revised or proposed regulatory capital or liquidity standards, or interpretations of those standards; the amount of discount accretion generated by the former conduit securities that remain in our investment securities portfolio; the yields earned on securities purchased compared to the yields earned on securities sold or matured; and changes in our enhanced custody business.

Based on market conditions and other factors, including regulatory requirements, we continue to reinvest the majority of the proceeds from pay-downs and maturities of investment securities in highly-rated securities, such as U.S. Treasury and agency securities, municipal securities, federal agency mortgage-backed securities and U.S. and non-U.S. mortgage- and asset-backed securities. The pace at which we continue to reinvest and the types of investment securities purchased will depend on the impact of market conditions, the implementation of regulatory standards, and other factors over time. We expect these factors and the levels of global interest rates to influence what effect our reinvestment program will have on future levels of our net interest revenue and net interest margin.

EXPENSES

Table 7: Expenses, provides the breakout of expenses for the quarters and nine months ended September 30, 2016 and 2015.

TABLE 7: EXPENSES

	Quarters Ended September 30,		
(Dollars in millions, except where otherwise noted)	2016	2015	% Change
Compensation and employee benefits	$1,013	$1,051	(4)%
Information systems and communications	285	265	8
Transaction processing services	200	201	—
Occupancy	107	110	(3)
Acquisition costs	33	7	371
Restructuring charges, net	9	3	200
Other:			
Professional services	95	136	(30)
Amortization of other intangible assets	55	48	15
Securities processing costs	10	40	(75)
Regulatory fees and assessments	28	31	(10)
Other	149	70	113
Total other	337	325	4
Total expenses	$1,984	$1,962	1
Number of employees at quarter-end	33,332	31,860	

	Nine Months Ended September 30,		
(In millions)	2016	2015	% Change
Compensation and employee benefits	$3,109	$3,122	— %
Information systems and communications	827	761	9
Transaction processing services	601	599	—
Occupancy	331	332	—
Acquisition costs	47	15	213
Restructuring charges, net	119	4	2,875
Other:			
Professional services	270	368	(27)
Amortization of other intangible assets	153	147	4
Securities processing costs	20	75	(73)
Regulatory fees and assessments	65	90	(28)
Other	352	680	(48)
Total other	860	1,360	(37)
Total expenses	$5,894	$6,193	(5)

Compensation and employee benefits expenses decreased 4% in the third quarter of 2016 compared to the third quarter of 2015. The decrease was primarily due to lower severance costs and savings related to State Street Beacon, partially offset by higher costs related to the acquired GEAM business and increased costs to support regulatory initiatives and new business.

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

Information systems and communications expenses increased 8% in the third quarter of 2016 compared to the third quarter of 2015 and 9% in the nine months ended September 30, 2016 compared to the same period in 2015. The increase for both comparative periods was primarily related to investments supporting new business and State Street Beacon, the impact of the acquired GEAM business, and costs related to regulatory initiatives.

Other expenses increased 4% in the third quarter of 2016 compared to the third quarter of 2015 and decreased 37% in the nine months ended September 30, 2016 compared to the same period in 2015. The increase in the third quarter of 2016 was primarily due to establishing a legal reserve of approximately $42 million related to the previously disclosed investigations by U.S. governmental agencies concerning our transition management business activities and the impact of the acquired GEAM business, partially offset by lower professional services expenses. The decrease in the nine months ended September 30, 2016 was primarily due to legal accruals of approximately $400 million recorded in 2015, relating to our indirect foreign exchange business, as well as lower levels of professional services, securities processing, travel and insurance expenses in 2016.

Our compliance obligations have increased due to new regulations in the U.S. and internationally that have been adopted or proposed in response to the financial crisis. As a systemically important financial institution, we are subject to enhanced supervision and prudential standards. Our status as a G-SIB has also resulted in heightened prudential and conduct expectations of our U.S. and international regulators with respect to our capital and liquidity management and our compliance and risk oversight programs. These heightened expectations have increased our regulatory compliance costs, including personnel and systems, as well as significant additional implementation and related costs to enhance our regulatory compliance programs. We anticipate that these evolving and increasing regulatory compliance requirements and expectations, including our efforts

to complete our 2017 resolution plan (due to be submitted on July 1, 2017), as discussed within the Liquidity Risk Management section included in this Form 10-Q, will continue to affect our expenses. Our employee compensation and benefits, information systems and other expenses could increase, as we further adjust our operations in response to new or proposed requirements and heightened expectations.

Acquisition Costs

We recorded acquisition costs of $33 million in the third quarter of 2016 compared to $7 million in the third quarter of 2015, and $47 million in the nine months ended September 30, 2016 compared to $15 million during the nine months ended September 30, 2015. These amounts include approximately $29 million related to our acquisition of GEAM on July 1, 2016. As we integrate GEAM's operations into our business, we expect to incur total merger and integration costs of approximately $80 million through 2018. For further information on the GEAM acquisition, refer to Note 1 to the consolidated financial statements included in this Form 10-Q.

Restructuring Charges

We expect to incur aggregate pre-tax restructuring charges of approximately $300 million to $400 million beginning in 2016 through December 31, 2020 to implement State Street Beacon, our previously announced multi-year transformation program to fully digitize our business, deliver significant value and innovation for our clients and lower expenses across the organization. We estimate those charges will include approximately $250 million to $300 million in severance and benefits costs associated with targeted staff reductions (a substantial portion of which will result in future cash expenditures) and approximately $50 million to $100 million in information technology application rationalization and real estate actions.

In the third quarter and nine months ended September 30, 2016, we recorded net restructuring charges of $10 million and $120 million, respectively, associated with State Street Beacon.

The following table presents aggregate restructuring activity for the periods indicated.

TABLE 8: RESTRUCTURING CHARGES

(In millions)	Total

	Employee Related Costs	Real Estate Consolidation	Asset and Other Write-offs	
Balance at December 31, 2015	$ 9	$ 11	$ 3	$ 23
Accruals for State Street Beacon	86	—	11	97
Payments and Other Adjustments	(4)	(1)	(7)	(12)
Balance at March 31, 2016	91	10	7	108
Accruals for State Street Beacon	(1)	15	(1)	13
Payments and Other Adjustments	(35)	(3)	(1)	(39)
Balance at June 30, 2016	55	22	5	82
Accruals for State Street Beacon	8	3	(1)	10
Payments and Other Adjustments	(14)	(3)	(1)	(18)
Balance at September 30, 2016	$ 49	$ 22	$ 3	$ 74

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

INCOME TAX EXPENSE

Income tax expense was $72 million in the third quarter of 2016 compared to $67 million in the third quarter of 2015. In the first nine months of 2016 and 2015, income tax expense was $226 million and $215 million, respectively. Our effective tax rate for the first nine months of 2016 was 12.8% compared to 13.3% for the same period in 2015. The effective tax rate for the first nine months 2016 reflects a benefit from additional alternative energy investments in 2016. The 2015 tax rate benefited from the approval of a prior year tax refund and the reduction of an Italian deferred tax liability, partially offset by a change in New York tax law and a non-deductible legal accrual.

LINE OF BUSINESS INFORMATION

Our operations are organized for management reporting purposes into two lines of business: Investment Servicing and Investment Management, which are defined based on products and services provided. 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. For information about our two lines of business, as well as the revenues, expenses and capital allocation methodologies associated with them, refer to Note 24 to the consolidated financial statements included in our 2015 Form 10-K and Note 17 to the consolidated financial statements included in this Form 10-Q.

Investment Servicing

TABLE 9: INVESTMENT SERVICING LINE OF BUSINESS RESULTS

	Quarters Ended September 30,			Nine Months Ended September 30,		
(Dollars in millions, except where otherwise noted)	2016	2015	% Change	2016	2015	% Change
Servicing fees	$1,303	$1,289	1 %	$3,784	$3,876	(2)%
Trading services	254	283	(10)	771	869	(11)
Securities finance	136	113	20	426	369	15
Processing fees and other	6	131	(95)	153	212	(28)
Total fee revenue	1,699	1,816	(6)	5,134	5,326	(4)
Net interest revenue	536	514	4	1,567	1,593	(2)
Gains (losses) related to investment securities, net	4	(2)	nm	5	(6)	nm
Total revenue	2,239	2,328	(4)	6,706	6,913	(3)
Provision for loan losses	—	5	nm	8	11	(27)
Total expenses	1,634	1,673	(2)	4,920	5,389	(9)
Income before income tax expense	$605	$650	(7)	$1,778	$1,513	18
Pre-tax margin	27 %	28 %		27 %	22 %	

nm Not meaningful

Net interest revenue increased 4% in the third quarter of 2016 compared to the same period in 2015. Benefits during the third quarter of 2016 from the U.S. rate hike in December 2015 were partially offset by lower global interest rates that affected our revenue from certain floating-rate assets, the rate at which payments from the maturity or prepayment of portfolio holdings could be reinvested, and the effect of the stronger U.S. dollar. The third quarter of 2016 also reflects our management actions toward the end of the third quarter of 2015 to manage the size and composition of our investment portfolio as we seek to optimize our capital and liquidity positions in light of the evolving regulatory environment.

Net interest revenue decreased 2% in the first nine months of 2016 compared to the same period in 2015. The decrease is primarily the result of the previously mentioned management actions, which contributed to a reduction of average interest and non-interest bearing deposits, as well as lower global interest rates, that affected our revenue from floating-rate assets, and the effect of the stronger U.S. dollar, partially offset by the benefit of higher levels of certain interest-earning assets. A discussion of net interest revenue is provided under “Net Interest Revenue” in

“Total Revenue” in this Management's Discussion and Analysis.

Total expenses decreased 2% and 9% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. The decreases primarily resulted from savings related to State Street Beacon and other expense reduction initiatives, partially offset by higher regulatory spending, net new business activity, and expenses for legal accruals recorded in the first nine months of 2015 in connection with outstanding and potential claims arising out of our indirect FX client activities.

In December 2015, we announced a review of the manner in which we invoiced certain expenses to certain of our Investment Servicing clients, primarily in the United States, during a period going back to 1998. We have informed our clients that we will pay to them the expenses we concluded were incorrectly invoiced to them, plus interest. In conjunction with that review, we are evaluating other aspects of invoicing relating to billing our Investment Servicing clients, including calculation of asset-based fees. See Note 10 to the consolidated financial statements included in this Form 10-Q.

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Servicing Fees

Servicing fees increased 1% in the third quarter of 2016 compared to the same period in 2015, primarily due to net new business. Servicing fees decreased 2% in the first nine months of 2016 compared to the same period in 2015, primarily due to lower international market levels and the effect of the strong U.S. dollar, partially offset by net new business.

Servicing fees generated outside the U.S. were approximately 43% and 42% of total servicing fees in the third quarter and first nine months of 2016, respectively, compared to approximately 41% for the same periods in 2015, respectively.

TABLE 10: COMPONENTS OF ASSETS UNDER CUSTODY AND ADMINISTRATION

(In billions)	September 30, 2016	December 31, 2015	September 30, 2015
Mutual funds	$ 6,906	$ 6,768	$ 6,698
Collective funds	7,541	7,088	6,883
Pension products	5,671	5,510	5,497
Insurance and other products	9,060	8,142	8,187
Total	$ 29,178	$ 27,508	$ 27,265

TABLE 11: COMPOSITION OF ASSETS UNDER CUSTODY AND ADMINISTRATION

(In billions)	September 30, 2016	December 31, 2015	September 30, 2015
Equities	$ 16,012	$ 14,888	$ 14,223
Fixed-income	9,891	9,264	9,470
Short-term and other investments	3,275	3,356	3,572
Total	$ 29,178	$ 27,508	$ 27,265

TABLE 12: GEOGRAPHIC MIX OF ASSETS UNDER CUSTODY AND ADMINISTRATION(1)

(In billions)	September 30, 2016	December 31, 2015	September 30, 2015
North America	$ 21,561	$ 20,842	$ 20,536
Europe/Middle East/Africa	6,107	5,387	5,452
Asia/Pacific	1,510	1,279	1,277
Total	$ 29,178	$ 27,508	$ 27,265

(1) Geographic mix is based on the location in which the assets are serviced.

Asset levels as of September 30, 2016 did not reflect the estimated $506 billion of new business in assets to be serviced, which was awarded to us in the second quarter of 2016 and prior periods but not installed prior to September 30, 2016. This new business will be reflected in AUCA in future periods after installation and will generate servicing fee revenue in subsequent periods.

With respect to these new assets, we will provide various services, including accounting, bank loan servicing, compliance reporting and monitoring, custody, depository banking services, foreign exchange, fund administration, hedge fund servicing, middle-office outsourcing, performance and analytics, private equity administration, real estate administration, securities finance, transfer agency, and wealth management services.

Trading Services

TABLE 13: TRADING SERVICES REVENUE

(In millions)	Quarters Ended September 30, 2016	2015	% Change
Foreign exchange trading:			
Direct sales and trading	$94	$108	(13)%
Indirect foreign exchange trading	65	69	(6)
Total foreign exchange trading	159	177	(10)
Brokerage and other trading services:			
Electronic foreign exchange services	41	46	(11)
Other trading, transition management and brokerage	54	60	(10)
Total brokerage and other trading services	95	106	(10)
Total trading services revenue	$254	$283	(10)

(In millions)	Nine Months Ended September 30, 2016	2015	% Change
Foreign exchange trading:			
Direct sales and trading	$271	$331	(18)%
Indirect foreign exchange trading	201	216	(7)
Total foreign exchange trading	472	547	(14)
Brokerage and other trading services:			
Electronic foreign exchange services	128	138	(7)
Other trading, transition management and brokerage	171	184	(7)
Total brokerage and other trading services	299	322	(7)
Total trading services revenue	$771	$869	(11)

Trading services revenue is composed of revenue generated by FX trading, as well as revenue generated by brokerage and other trading services. We primarily earn FX trading revenue by acting as a principal market-maker. We offer a range of FX products, services and execution models. Most of our FX products and execution services can be grouped into three broad categories, which are further explained below: “direct sales and trading,” “indirect FX trading” and “electronic FX services.” With respect to electronic FX services, we provide an execution venue, but do not act as agent or principal.

We also offer a range of brokerage and other trading products tailored specifically to meet the needs of the global pension community, including transition management and commission recapture. In addition, we act as distribution agent for the SPDR® Gold ETF. These products and services are generally differentiated by our role as an agent of the institutional investor. Revenue earned from these services is recorded in other trading, transition management and brokerage revenue within brokerage and other trading services revenue.

Our FX trading revenue is influenced by multiple factors, including: the volume and type of client FX transactions and related spreads; currency volatility, reflecting market conditions; and our management of exchange rate, interest rate and other market risks associated with our foreign exchange activities. The relative impact of these factors on our total FX trading revenues often differs from period to period. For example, assuming all other factors remain constant, increases or decreases in volumes or spreads across product mix tend to result in increases or decreases, as the case may be, in client-related FX revenue. Revenue earned from direct sales and trading and indirect FX trading is recorded in FX trading revenue.

Total FX trading revenue decreased 10% and 14% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015, primarily due to lower volumes and market volatility. In 2015, significant market events in Europe and China stimulated trading activity, in contrast to the same periods in 2016, which included reduced trading volumes during the first and second quarters of 2016 in advance of the U.K.'s referendum to exit from the European Union, or "Brexit," which largely leveled off during the third quarter of 2016.

We enter into FX transactions with clients and investment managers that contact our trading desk directly. These trades are all executed at negotiated rates. We refer to this activity, and our principal market-making activities, as “direct sales and trading” and it includes many transactions for funds serviced by third party custodians or prime brokers, as well as those funds under custody at State Street. Direct sales and trading revenue represented 59% and 57% of total foreign exchange trading revenue in the third quarter and first nine months of 2016, respectively, compared to 61% for each of the same periods in 2015.

Alternatively, clients or their investment managers may elect to route FX transactions to our FX desk through our asset-servicing operation; we refer to this activity as “indirect FX trading” and, in all cases, we are the funds' custodian. We execute indirect FX trades as a principal at rates disclosed to our clients. Estimated indirect sales and trading revenue represented 41% and 43% of total foreign exchange trading revenue in the third quarter and first nine months of 2016, respectively, as compared to 39% for each of the same periods in 2015. We calculate revenue for indirect FX trading using an attribution methodology. This methodology takes into consideration estimated mark-ups/downs and observed client volumes. Direct sales and trading revenue is all other FX trading revenue other than the revenue attributed to indirect FX trading.

Our clients that utilize indirect FX trading can, in addition to executing their FX transactions through dealers not affiliated with us, transition from indirect FX trading to either direct sales and trading execution, including our “Street FX” service, or to one of our electronic trading platforms. Street FX, in which we continue to act as a principal market-maker,

enables our clients to define their FX execution strategy and automate the FX trade execution process, both for funds under custody with us as well as those under custody at another bank.

Our direct sales and trading revenue decreased by 13% and 18% for the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. The decreases are primarily due to lower volumes and volatility. Our estimated indirect FX trading revenue decreased 6% and 7% in the third quarter and first nine months of 2016, respectively, as compared to the same periods in 2015. The decreases mainly resulted from lower volumes and volatility.

We continue to expect that some clients may choose, over time, to reduce their level of indirect FX trading transactions in favor of other execution methods, including either direct sales and trading transactions or electronic FX services which we provide. To the extent that clients shift to other execution methods that we provide, our FX trading revenue may decrease, even if volumes remain consistent.

Total brokerage and other trading services revenue decreased 10% and 7% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. The decreases were primarily due to lower transition management revenues, a non-recurring gain in the prior year, and reduced client volumes.

Our clients may choose to execute FX transactions through one of our electronic trading platforms. These transactions generate revenue through a “click” fee. Revenue from such electronic FX services decreased 11% and 7% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015, mainly due to reduced client volumes.

Other trading, transition management and brokerage revenue decreased 10% and 7% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015, primarily due to a non-recurring gain in the prior year.

In recent years, our transition management revenue was adversely affected by compliance issues in our U.K. business during 2010 and 2011. The reputational and regulatory impact of those compliance issues continues and may adversely affect our results in future periods. See Note 10 to the consolidated financial statements included in this Form 10-Q.

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Securities Finance

Our securities finance business consists of three components:

(1) an agency lending program for SSGA-managed investment funds with a broad range of investment objectives, which we refer to as the SSGA lending funds;

(2) an agency lending program for third-party investment managers and asset owners, which we refer to as the agency lending funds; and

(3) security lending transactions which we enter into as principal, which we refer to as our enhanced custody business.

See Table 9: Investment Servicing Line of Business Results, for the comparison of securities finance revenue for the quarters and nine months ended September 30, 2016 and 2015.

Securities finance revenue earned from our agency lending activities, which is composed of our split of both the spreads related to cash collateral and the fees related to non-cash collateral, is principally a function of the volume of securities on loan, the interest-rate spreads and fees earned on the underlying collateral, and our share of the fee split.

As principal, our enhanced custody business borrows securities from the lending client and then lends such securities to the subsequent borrower, either a State Street client or a broker/dealer. We act as principal when the lending client is unable to, or elects not to, transact directly with the market and execute the transaction and furnish the securities. In our role as principal, we provide support to the transaction through our credit rating. While we source a significant proportion of the securities furnished by us in our role as principal from third parties, we have the ability to source securities through our assets under custody and administration from clients who have designated State Street as an eligible borrower.

Securities finance revenue increased 20% and 15% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. The increase was primarily the result of growth in our enhanced custody business and higher agency lending.

Market influences may continue to affect client demand for securities finance, and as a result our revenue from, and the profitability of, our securities lending activities in future periods. In addition, the constantly evolving regulatory environment may affect the volume of our securities lending activity and related revenue and profitability in future periods.

Processing Fees and Other

Processing fees and other revenue includes diverse types of fees and revenue, including fees from our structured products business, fees from software licensing and maintenance, equity income from our joint venture investments, gains and losses on sales of leased equipment and other assets, and amortization of our tax-advantaged investments.

Processing fees and other revenue, presented in Table 9: Investment Servicing Line of Business Results, decreased 95% in the third quarter of 2016 compared to the same period in 2015. The decrease was primarily due to a non-recurring gain of $83 million on the sale of commercial real estate in the third quarter of 2015. Processing fees and other revenue decreased 28% in the first nine months of 2016 compared to the same period in 2015, primarily due to the aforementioned non-recurring gain as well as lower earnings from equity method investments, partially offset by a pre-tax gain of $53 million on the sale of WM/Reuters in the second quarter of 2016.

Investment Management

TABLE 14: INVESTMENT MANAGEMENT LINE OF BUSINESS RESULTS

	Quarters Ended September 30,		
(Dollars in millions, except where otherwise noted)	2016	2015	% Change
Management fees	$368	$287	28 %
Trading services	13	11	18

Processing fees and other	(1)	(11)	nm
Total fee revenue	380	287	32
Net interest revenue	1	(1)	nm
Total revenue	381	286	33
Total expenses	317	204	55
Income before income tax expense	$64	$82	(22)
Pre-tax margin	17 %	29 %	

	Nine Months Ended September 30,		
(Dollars in millions, except where otherwise noted)	2016	2015	% Change
Management fees	$931	$892	4 %
Trading services	35	30	17
Processing fees and other	2	(14)	nm
Total fee revenue	968	908	7
Net interest revenue	3	1	nm
Total revenue	971	909	7
Total expenses	817	711	15
Income before income tax expense	$154	$198	(22)
Pre-tax margin	16 %	22 %	

nm Not meaningful

Total revenue for our Investment Management Line of Business, presented in Table 14: Investment Management Line of Business Results, increased 33% and 7% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015. Total fee revenue increased 32% and 7% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015.

Total expenses increased in the third quarter of 2016 and first nine months of 2016 compared to the same periods in 2015 primarily due to costs related to the acquisition of GEAM, partially offset by savings related to State Street Beacon.

In July 2016, we completed our acquisition of GEAM in a cash transaction with a total initial purchase price of approximately $437 million and approximately $46 million in potential incremental purchase price related to future opportunities with General Electric. AUM associated with the acquired GEAM operations totaled $112 billion as of September 30, 2016. Our consolidated financial statements include the operating results for the acquired business from the date of acquisition, July 1, 2016.

Management Fees

Through SSGA, we provide a broad range of investment management strategies, specialized investment management advisory services, OCIO and other financial services for corporations, public funds, and other sophisticated investors. SSGA offers an array of investment management strategies, including passive and active, such as enhanced indexing, using quantitative and fundamental methods for both U.S. and global equity and fixed income securities. SSGA also offers ETFs, such as the SPDR® ETF brand. While certain management fees are directly determined by the values of assets under management and the investment strategies employed, management fees reflect other factors as well, including our relationship pricing for clients who use multiple services, and the benchmarks specified in the respective management agreements related to performance fees.

Management fees increased 28% in the third quarter of 2016 compared to the same period in 2015, primarily due to the acquisition of GEAM on July 1, 2016 and a decline in money market fee waivers. Management fees increased 4% in the first nine months of 2016 compared to the same period in 2015, primarily due to the aforementioned acquisition and a decline in money market fee waivers, partially offset by weaker international markets and the effect of the strong U.S. dollar.

Management fees generated outside the U.S. were approximately 29% and 33% of total management fees in the third quarter and first nine months of 2016, respectively, compared to 34% and 35% for the same periods in 2015, respectively.

TABLE 15: ASSETS UNDER MANAGEMENT BY ASSET CLASS AND INVESTMENT APPROACH

(In billions)	September 30, 2016	December 31, 2015	September 30, 2015
Equity:			
Active	$ 70	$ 32	$ 29
Passive	1,340	1,294	1,237
Total Equity	1,410	1,326	1,266
Fixed-Income:			
Active	73	18	16
Passive	318	294	300
Total Fixed-Income	391	312	316
Cash(1)	351	368	380
Multi-Asset-Class Solutions:			
Active	19	17	26
Passive	106	86	85
Total Multi-Asset-Class Solutions	125	103	111
Alternative Investments(2):			

Active	29	17	17
Passive	140	119	113
Total Alternative Investments	169	136	130
Total	$ 2,446	$ 2,245	$ 2,203

(1) Includes both floating- and constant-net-asset-value portfolios held in commingled structures or separate accounts.
(2) Includes real estate investment trusts, currency and commodities, including SPDR® Gold Fund, for which State Street is not the investment manager, but acts as distribution agent.

TABLE 16: EXCHANGE - TRADED FUNDS BY ASSET CLASS(1)(2)

(In billions)	September 30, 2016	December 31, 2015	September 30, 2015
Alternative Investments(2)	$ 54	$ 34	$ 35
Cash	2	3	3
Equity	370	350	323
Fixed-income	52	41	39
Total Exchange-Traded Funds	$ 478	$ 428	$ 400

(1) ETFs are a component of assets under management presented in the preceding table.
(2) Includes SPDR® Gold Fund, for which State Street is not the investment manager, but acts as distribution agent.

TABLE 17: GEOGRAPHIC MIX OF ASSETS UNDER MANAGEMENT(1)

(In billions)	September 30, 2016	December 31, 2015	September 30, 2015
North America	$ 1,641	$ 1,452	$ 1,409
Europe/Middle East/Africa	495	489	500
Asia/Pacific	310	304	294
Total	$ 2,446	$ 2,245	$ 2,203

(1) Geographic mix is based on client location or fund management location.

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TABLE 18: ACTIVITY IN ASSETS UNDER MANAGEMENT BY PRODUCT CATEGORY

(In billions)	Equity	Fixed-Income	Cash[(2)]	Multi-Asset-Class Solutions	Alternative Investments[(3)]	Total
Balance as of September 30, 2015	$1,266	$ 316	$380	$ 111	$ 130	$2,203
Long-term institutional inflows[(1)]	59	14	—	9	3	85
Long-term institutional outflows[(1)]	(72)	(22)	—	(7)	(3)	(104)
Long-term institutional flows, net	(13)	(8)	—	2	—	(19)
ETF flows, net	10	3	(1)	—	(1)	11
Cash fund flows, net	—	—	(10)	—	—	(10)
Total flows, net	(3)	(5)	(11)	2	(1)	(18)
Market appreciation	65	3	—	(9)	7	66
Foreign exchange impact	(2)	(2)	(1)	(1)	—	(6)
Total market/foreign exchange impact	63	1	(1)	(10)	7	60
Balance as of December 31, 2015	1,326	312	368	103	136	2,245
Long-term institutional inflows[(1)]	161	62	—	34	9	266
Long-term institutional outflows[(1)]	(206)	(71)	—	(26)	(16)	(319)
Long-term institutional flows, net	(45)	(9)	—	8	(7)	(53)
ETF flows, net	(3)	7	(1)	—	13	16
Cash fund flows, net	—	—	(21)	—	—	(21)
Total flows, net	(48)	(2)	(22)	8	6	(58)
Market appreciation	84	19	1	11	15	130
Foreign exchange impact	10	6	—	—	1	17
Total market/foreign exchange impact	94	25	1	11	16	147
Acquisitions and transfers[(4)]	38	56	4	3	11	112
Balance as of September 30, 2016	$1,410	$ 391	$351	$ 125	$ 169	$2,446

(1) Amounts represent long-term portfolios, excluding ETFs.
(2) Includes both floating- and constant-net-asset-value portfolios held in commingled structures or separate accounts.
(3) Includes real estate investment trusts, currency and commodities, including SPDR® Gold Fund, for which State Street is not the investment manager, but acts as distribution agent.
(4) Includes assets under management acquired as part of the acquisition of GEAM on July 1, 2016.

The preceding table did not include new asset management business which was awarded to SSGA but not installed as of September 30, 2016. New business will be reflected in AUM in future periods after installation and will generate management fee revenue in subsequent periods. Total AUM as of September 30, 2016 included managed assets lost but not liquidated. Lost business occurs from time to time and it is difficult to predict the timing of client behavior in transitioning these assets. This timing can vary significantly.

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

FINANCIAL CONDITION

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

Deposits and other liabilities resulting from client initiated transactions are invested in assets that generally have contractual maturities significantly longer than our liabilities; however, we evaluate the operational nature of our deposits and seek to maintain appropriate short-term liquidity of those liabilities that are not operational in nature and maintain longer-termed assets for our operational deposits. Our assets consist primarily of securities held in our available-for-sale or held-to-maturity portfolios and short-duration financial instruments, such as interest-bearing deposits with banks and securities purchased under resale agreements. The actual mix of assets is determined by the characteristics of the client liabilities and our desire to maintain a well-diversified portfolio of high-quality assets.

TABLE 19: AVERAGE STATEMENT OF CONDITION[1]

	Nine Months Ended September 30,	
	2016	2015
(In millions)	Average Balance	Average Balance
Assets:		
Interest-bearing deposits with banks	$52,423	$74,830
Securities purchased under resale agreements	2,610	3,325
Trading account assets	908	1,234
Investment securities	101,243	107,216
Loans and leases	18,674	17,711
Other interest-earning assets	22,316	22,731
Average total interest-earning assets	198,174	227,047
Cash and due from banks	3,402	2,577
Other noninterest-earning assets	27,052	28,313
Average total assets	$228,628	$257,937
Liabilities and shareholders’ equity:		
Interest-bearing deposits:		
U.S.	$30,388	$31,479
Non-U.S.	95,013	105,347
Total interest-bearing deposits	125,401	136,826
Securities sold under repurchase agreements	4,107	9,576
Federal funds purchased	33	21
Other short-term borrowings	1,727	4,211
Long-term debt	11,306	9,779
Other interest-bearing liabilities	5,550	6,835
Average total interest-bearing liabilities	148,124	167,248
Noninterest-bearing deposits	43,806	54,153
Other noninterest-bearing liabilities	14,697	15,231

Preferred shareholders’ equity	3,015	2,322
Common shareholders’ equity	18,986	18,983
Average total liabilities and shareholders’ equity	$228,628	$257,937

(1) Additional information about our average statement of condition, primarily our interest-earning assets and interest-bearing liabilities, is included under “Consolidated Results of Operations - Total Revenue - Net Interest Revenue” in this Management's Discussion and Analysis.

Investment Securities

TABLE 20: CARRYING VALUES OF INVESTMENT SECURITIES

(In millions)	September 30, 2016	December 31, 2015
Available-for-sale:		
U.S. Treasury and federal agencies:		
Direct obligations	$ 5,302	$ 5,718
Mortgage-backed securities	17,995	18,165
Asset-backed securities:		
Student loans[1]	7,307	7,176
Credit cards	1,375	1,341
Sub-prime	354	419
Other	1,273	1,764
Total asset-backed securities	10,309	10,700
Non-U.S. debt securities:		
Mortgage-backed securities	7,161	7,071
Asset-backed securities	2,529	3,267
Government securities	5,984	4,355
Other	5,919	4,834
Total non-U.S. debt securities	21,593	19,527
State and political subdivisions	10,756	9,746
Collateralized mortgage obligations	2,806	2,987
Other U.S. debt securities	2,338	2,624
U.S. equity securities	41	39
Non-U.S. equity securities	3	3
U.S. money-market mutual funds	361	542
Non-U.S. money-market mutual funds	16	19
Total	$ 71,520	$ 70,070
Held-to-maturity:		
U.S. Treasury and federal agencies:		
Direct obligations	$ 17,553	$ 20,878
Mortgage-backed securities	4,280	610
Asset-backed securities:		
Student loans[1]	1,440	1,592
Credit cards	897	897
Other	76	366
Total asset-backed securities	2,413	2,855
Non-U.S. debt securities:		
Mortgage-backed securities	1,581	2,202
Asset-backed securities	697	1,415
Government securities	288	239
Other	119	65
Total non-U.S. debt securities	2,685	3,921
State and political subdivisions	—	1

Collateralized mortgage obligations	1,437	1,687
Total	$ 28,368	$ 29,952

[1] Primarily composed of securities guaranteed by the federal government with respect to at least 97% of defaulted principal and accrued interest on the underlying loans.
Additional information about our investment securities portfolio is provided in Note 3 to the consolidated financial statements included in this Form 10-Q.

We manage our investment securities portfolio to align with the interest-rate and duration characteristics of our client liabilities that we consider to be operational deposits and in the context of the overall structure of our consolidated statement of condition, in consideration of the global interest-rate environment. We consider a well-diversified, high-credit quality investment securities portfolio to be an important element in the management of our consolidated statement of condition.
Approximately 92% of the carrying value of the portfolio was rated “AAA” or “AA” as of both September 30, 2016 and December 31, 2015.

TABLE 21: INVESTMENT PORTFOLIO BY EXTERNAL CREDIT RATING

	September 30, 2016		December 31, 2015	
AAA[1]	78	%	80	%
AA	14		12	
A	5		5	
BBB	2		2	
Below BBB	1		1	
	100	%	100	%

[1] Includes U.S. Treasury and federal agency securities that are split-rated, “AAA” by Moody’s Investors Service and “AA+” by Standard & Poor’s.
As of September 30, 2016, the investment portfolio of 12,194 securities was diversified with respect to asset class. Approximately 51% of the aggregate carrying value of the portfolio as of September 30, 2016 and December 31, 2015 was composed of mortgage-backed and asset-backed securities. The asset-backed securities portfolio, of which approximately 92% of the carrying value as of both September 30, 2016 and December 31, 2015 was floating-rate, consisted primarily of student loan-backed and credit card-backed securities. Mortgage-backed securities were composed of securities issued by the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, as well as U.S. and non-U.S. large-issuer collateralized mortgage obligations.
In December 2013, U.S. regulators issued final regulations to implement the Volcker rule. The Volcker rule will prohibit banking entities, including us and our affiliates, from engaging in certain prohibited proprietary trading activities, as defined in the final Volcker rule regulations, subject to exemptions for market making-related activities, risk-mitigating hedging, underwriting and certain other activities. The Volcker rule will require banking entities to either restructure or divest certain ownership interests in, and relationships with, covered funds (as such terms are defined in the final Volcker rule regulations).

The Volcker rule became effective in July 2012, and the final implementing regulations became effective in April 2014. Under a 2016 conformance period extension issued by the Federal Reserve, all investments in and relationships with investments in a covered fund made or entered into after December 31, 2013 by a banking entity and its affiliates, and all proprietary trading activities of those entities, were required to be in conformance with the Volcker rule and its final implementing regulations by July 21, 2016. On July 7, 2016, the Federal Reserve announced a final one-year extension of the general conformance period for banking entities to conform ownership interests in and relationships with legacy covered funds to July 21, 2017.

Whether certain types of investment securities or structures such as CLOs constitute covered funds, as defined in the final Volcker rule regulations, and do not benefit from the exemptions provided in the Volcker rule, and whether a banking organization's investments therein constitute ownership interests remain subject to (1) market, and ultimately regulatory, interpretation, and (2) the specific terms and other characteristics relevant to such investment securities and structures.

As of September 30, 2016, we held approximately $1.39 billion of investments in CLOs. As of the same date, these investments had an aggregate pre-tax net unrealized gain of approximately $17 million, composed primarily of gross unrealized gains of $17 million. Comparatively, as of December 31, 2015, we held approximately $2.10 billion of investments in CLOs which had an aggregate pre-tax net unrealized gain of approximately $43 million, composed of gross unrealized gains of $46 million and gross unrealized losses of $3 million. In the event that we or our banking regulators conclude that such investments in CLOs, or other investments, are covered funds under the Volker rule, we may be required to divest of such investments. If other banking entities reach similar conclusions with respect to similar investments held by them, the prices of such investments could decline significantly, and we may be required to divest of such investments at a significant discount compared to the investments' book value. This could result in a material adverse effect on our consolidated results of operations or on our consolidated financial condition in the period in which such a divestiture occurs.

The final Volcker rule regulations also require banking entities to establish extensive programs designed to ensure compliance with the restrictions of the Volcker rule. We have established a compliance program which we believe complies with the final Volcker rule regulations as currently in effect. Such compliance program restricts our ability in the future to engage in certain activities including priority trading

and service certain types of funds, in particular covered funds for which SSGA acts as an advisor and certain types of trustee relationships. Consequently, Volcker rule compliance entails both the cost of a compliance program and loss of certain revenue and future opportunities.

Non-U.S. Debt Securities

Approximately 24% of the aggregate carrying value of our investment securities portfolio was non-U.S. debt securities as of September 30, 2016, compared to approximately 23% as of December 31, 2015.

TABLE 22: NON-U.S. DEBT SECURITIES

(In millions)	September 30, 2016	December 31, 2015
Available-for-sale:		
United Kingdom	$ 5,694	$ 5,754
Australia	4,130	3,316
Canada	3,109	2,400
Japan	1,600	1,348
Netherlands	1,517	1,839
South Korea	941	1,052
France	872	954
Germany	731	990

Italy	666	389
Hong Kong	557	—
Norway	546	524
Belgium	315	234
Finland	256	319
Sweden	186	123
Spain	195	150
Ireland	118	29
Other[(1)]	160	106
Total	$ 21,593	$ 19,527
Held-to-maturity:		
Netherlands	$ 673	$ 684
United Kingdom	607	1,067
Australia	539	917
Germany	449	832
Singapore	174	129
Spain	106	108
Italy	53	59
Ireland	—	10
Other[(2)]	84	115
Total	$ 2,685	$ 3,921

[(1)] Included approximately $91 million and $26 million as of September 30, 2016 and December 31, 2015, respectively, related to Portugal and Austria, all of which were related to mortgage-backed securities and auto loans.
[(2)] Included approximately $38 million and $31 million as of September 30, 2016 and December 31, 2015, respectively, related to Portugal and Norway, all of which were related to mortgage-backed securities and auto loans.
Approximately 88% and 89% of the aggregate carrying value of these non-U.S. debt securities was rated "AAA" or "AA" as of September 30, 2016 and December 31, 2015, respectively. The majority of these securities comprised senior positions within the security structures; these positions have a level of protection provided through subordination and other forms of credit protection. As of September 30, 2016 and December 31, 2015, approximately 66% and

70%, respectively, of the aggregate carrying value of these non-U.S. debt securities was floating-rate, and accordingly, we consider these securities to have minimal interest-rate risk.

As of September 30, 2016, our non-U.S. debt securities had an average market-to-book ratio of 100.7%, and an aggregate pre-tax net unrealized gain of approximately $171 million, composed of gross unrealized gains of $203 million and gross unrealized losses of $32 million. These unrealized amounts included a pre-tax net unrealized gain of $100 million, composed of gross unrealized gains of $114 million and gross unrealized losses of $14 million, associated with non-U.S. debt securities available-for- sale.

As of September 30, 2016, the underlying collateral for non-U.S. mortgage- and asset-backed securities primarily included U.K. prime mortgages, Australian and Dutch mortgages and German automobile loans. The securities listed under "Canada" were composed of Canadian government securities and corporate debt and covered bonds. The securities listed under "France" were composed of automobile loans, prime mortgages, and corporate debt and covered bonds. The securities listed under "Japan" were substantially composed of Japanese government securities and corporate debt. The securities listed under "South Korea" were composed of South Korean government securities.

Additional information on our exposures relating to Spain, Italy, Ireland and Portugal as of September 30, 2016 is provided under "Financial Condition - Cross-Border Outstandings" in this Management's Discussion and Analysis.

Municipal Obligations

We carried approximately $10.76 billion of municipal securities classified as state and political subdivisions in our investment securities portfolio as of September 30, 2016 as shown in Table 20: Carrying Values of Investment Securities. Substantially all of these securities were classified as AFS, with the remainder classified as HTM. As of the same date, we also provided approximately $9.17 billion of credit and liquidity facilities to municipal issuers.

TABLE 23: STATE AND MUNICIPAL OBLIGORS[(1)]

(In millions)	Total Municipal Securities	Credit and Liquidity Facilities[(2)]	Total	% of Total Municipal Exposure	
September 30, 2016					
State of Issuer:					
Texas	$ 1,830	$ 1,773	$3,603	18	%
California	531	2,342	2,873	14	
Massachusetts	951	1,073	2,024	10	
New York	779	1,146	1,925	10	
Maryland	512	413	925	5	
Total	$ 4,603	$ 6,747	$11,350		
December 31, 2015					
State of Issuer:					
Texas	$ 1,250	$ 1,962	$3,212	17	%
California	444	2,220	2,664	14	
New York	817	1,259	2,076	11	
Massachusetts	927	731	1,658	9	
Maryland	454	413	867	5	
Total	$ 3,892	$ 6,585	$10,477		

(1) Represented 5% or more of our aggregate municipal credit exposure of approximately $19.93 billion and $18.50 billion across our businesses as of September 30, 2016 and December 31, 2015, respectively.
(2) Includes municipal loans which are also presented within Table 25.

Our aggregate municipal securities exposure presented in Table 23: State and Municipal Obligors, was concentrated primarily with highly-rated counterparties, with approximately 92% of the obligors rated “AAA” or “AA” as of September 30, 2016. As of that date, approximately 51% and 43% of our aggregate municipal securities exposure was associated with general obligation and revenue bonds, respectively. In addition, we had no exposures associated with industrial development or land development bonds. The portfolios are also diversified geographically, with the states that represent our largest exposures widely dispersed across the U.S.

Impairment

Impairment exists when the fair value of an individual security is below its amortized cost basis. Impairment of a security is further assessed to determine whether such impairment is other-than-temporary. When the impairment is deemed to be other-than-temporary, we record the loss in our consolidated statement of income. In addition, for AFS and HTM debt securities, we record impairment in our consolidated statement of income when management intends to sell (or may be required to sell) the securities before they recover in value, or when management expects the present value of cash flows expected to be collected from the securities to be less than the amortized cost of the impaired security (a credit loss).

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The increase in the net unrealized gain position as of September 30, 2016 as compared to December 31, 2015, presented in Table 24: Amortized Cost, Fair Value and Net Unrealized Gains (Losses) of Investment Securities, was primarily attributable to the decline in interest rates.

TABLE 24: AMORTIZED COST, FAIR VALUE AND NET UNREALIZED GAINS (LOSSES) OF INVESTMENT SECURITIES

	September 30, 2016			December 31, 2015		
(In millions)	Amortized Cost	Net Unrealized Gains(Losses)	Fair Value	Amortized Cost	Net Unrealized Gains(Losses)	Fair Value
Available-for-sale[1]	$70,795	$ 725	$71,520	$69,843	$ 227	$70,070
Held-to-maturity[1]	28,368	412	28,780	29,952	(154)	29,798
Total investment securities	$99,163	$ 1,137	$100,300	$99,795	$ 73	$99,868
Net after-tax unrealized gain (loss)		$ 682				