STATE STREET CORP
Form 10-Q
May 03, 2018
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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 March 31, 2018

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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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 April 30, 2018 was 365,408,056.

STATE STREET CORPORATION
QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTERLY PERIOD ENDED
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We use acronyms and other defined terms for certain business terms and abbreviations, as defined on the acronyms list and glossary following the consolidated financial statements in this Form 10-Q.

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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, we provide a broad range of financial products and services to institutional investors worldwide, with $33.28 trillion of AUCA and $2.73 trillion of AUM as of March 31, 2018.

As of March 31, 2018, we had consolidated total assets of $250.29 billion, consolidated total deposits of $191.52 billion, consolidated total shareholders' equity of $22.40 billion and 37,192 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 into two lines of business, Investment Servicing and Investment Management, which are defined based on products and services provided.

Additional information about our lines of business is provided in Line of Business Information in this Management's Discussion and Analysis and Note 17 to the consolidated financial statements in this Quarterly Report on Form 10-Q (Form 10-Q).

This Management's Discussion and Analysis is part of our Form 10-Q for the quarter ended March 31, 2018, and updates the Management's Discussion and Analysis in our 2017 Annual Report on Form 10-K previously filed with the SEC (2017 Form 10-K). 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 2017 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. For additional information about these significant accounting policies refer to pages 115 to 118, “Significant Accounting Estimates” included under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in our 2017 Form 10-K. We did not change these significant accounting policies in the first quarter of 2018.

Certain financial information provided in this Form 10-Q, including in 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 then 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, and 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 then currently applicable regulatory ratio or U.S. GAAP-basis measure.

We further believe that our presentation of fully taxable-equivalent NII, a non-GAAP measure, which reports non-taxable revenue, such as interest income 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) and the liquidity coverage ratio, 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"

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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 in the acronyms list and glossary following the consolidated financial statements in 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, may contain statements (including statements in the Management's Discussion and Analysis included in such reports, as applicable) 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, cost savings and transformation initiatives, investment portfolio performance, dividend and stock purchase programs, outcomes of legal proceedings, market growth, acquisitions, joint ventures and divestitures, client growth and new technologies, services and opportunities, as well as industry, governmental, 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 of the counterparties with which we or our clients do business and to which we have investment, credit or financial exposures or to which our clients have such exposures as a result of our acting as agent, including as an asset manager;
- increases in the volatility of, or declines in the level of, our NII, 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 changes in 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; the liquidity of the assets on our balance sheet and changes or volatility in the sources of such funding, particularly the deposits of our clients; and demands upon our liquidity, including the liquidity demands and 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; and the impact of monetary and fiscal policy in the U.S. and internationally on prevailing rates of interest and currency exchange rates in the markets in which we provide services to our clients;
- 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 such 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 the level and pricing 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 or reevaluate the regulatory framework applicable to our operations (as well as changes to that framework), including implementation or modification of the Dodd-Frank Act and related stress testing and resolution planning requirements, implementation of international standards applicable to financial institutions, such as those proposed by the Basel Committee and

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European legislation (such as the AIFMD, UCITS, the Money Market Funds Regulation and MiFID II / MiFIR); among other consequences, these regulatory changes impact the levels of regulatory capital and liquidity we must maintain, acceptable levels of credit exposure to third parties, margin requirements applicable to derivatives, restrictions on banking and financial activities and the manner in which we structure and implement our global operations and servicing relationships. 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, compliance programs and changes in governmental enforcement approaches to perceived failures to comply with regulatory or legal obligations;

- adverse changes in the regulatory ratios that we are, or will be, required to meet, whether arising under the Dodd-Frank Act or implementation of international standards applicable to financial institutions, such as those proposed by the Basel Committee, 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 or liquidity ratios that cause changes in those ratios as they are measured from period to period;
- requirements to obtain the prior approval or non-objection of the Federal Reserve or other U.S. and non-U.S. regulators for the use, allocation or distribution of our capital or other specific capital actions or corporate activities, including, without limitation, acquisitions, investments in subsidiaries, dividends and stock purchases, without which our growth plans, distributions to shareholders, share repurchase programs or other capital or corporate 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 those which may result from recessions or political instability; for

example, the U.K.'s decision to exit from the European Union may continue to disrupt financial markets or economic growth in Europe or potential changes in trade policy and bi-lateral and multi-lateral trade agreements proposed by the U.S.;

- our ability to create cost efficiencies through changes in our operational processes and to further digitize our processes and interfaces with our clients, 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 meets 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 impact on our compliance and controls enhancement programs associated with the appointment of a monitor under the deferred prosecution agreement with the DOJ and compliance consultant appointed under a settlement with the SEC, including the potential for such monitor and compliance consultant to require changes to our programs or to identify other issues that require substantial expenditures, changes in our operations, or payments to clients or reporting to U.S. authorities;
- the results of our review of our billing practices, including additional findings or amounts we may be required to reimburse clients, as well as potential consequences of such review, including damage to our client relationships or our reputation 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;

- 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;
- the large institutional clients on which we focus are often able to exert considerable market influence and have diverse investment activities, and this, combined with strong competitive market forces, subjects us to significant pressure to reduce the fees we charge, to potentially significant changes in our AUCA or our AUM in the event of the acquisition or loss of a client, in whole or in part, and to potentially significant changes in our fee revenue in the event a client re-balances or

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changes its investment approach or otherwise re-directs assets to lower- or higher-fee asset classes;
- 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, the possibility of significant reductions in the liquidity or valuation of assets underlying those pools and the potential that clients will seek to hold us liable for such losses;
- 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;
- 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;
- 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, operational and product innovation 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 evolving 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;
- 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 in accounting standards and practices; and
- the impact of the U.S. tax legislation enacted in 2017, and changes in tax legislation and in the interpretation of existing tax laws by U.S. and non-U.S. tax authorities that affect the amount of taxes due.

Actual outcomes and results may differ materially from what is expressed in our forward- looking statements and from our historical financial results due to the factors discussed in this section and elsewhere in this Form 10-Q or disclosed in our other SEC filings. Forward-looking statements in this Form 10-Q should not be relied on as representing our expectations or assumptions as of any time 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.

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OVERVIEW OF FINANCIAL RESULTS

TABLE 1: OVERVIEW OF FINANCIAL RESULTS

	Quarters Ended March 31,		
(Dollars in millions, except per share amounts)	2018	2017	% Change
Total fee revenue	$2,363	$2,198	8 %
Net interest income	658	510	29
Gains (losses) related to investment securities, net	(2)	(40)	(95)
Total revenue	3,019	2,668	13
Provision for loan losses	—	(2)	nm
Total expenses	2,256	2,086	8
Income before income tax expense	763	584	31
Income tax expense	102	82	24
Net income	$661	$502	32
Adjustments to net income:			
Dividends on preferred stock[(1)]	$(55)	$(55)	—
Earnings allocated to participating securities[(2)]	(1)	(1)	—
Net income available to common shareholders	$605	$446	36
Earnings per common share:			
Basic	$1.65	$1.17	41
Diluted	1.62	1.15	41
Average common shares outstanding (in thousands):			
Basic	367,439	381,224	(4)
Diluted	372,619	386,417	(4)
Cash dividends declared per common share	$.42	$.38	11
Return on average common equity	12.8 %	9.9 %	
Pre-tax margin	25.3	21.9	

[(1)] Additional information about our preferred stock dividends is provided in Note 12 to the consolidated financial statements in this Form 10-Q.

[(2)] Represents the portion of net income available to common equity allocated to participating securities, composed of unvested and fully vested SERP shares and fully vested deferred director stock awards, which are equity-based awards that contain non-forfeitable rights to dividends, and are considered to participate with the common stock in undistributed earnings.

[nm] Not meaningful

The following “Financial Results and Highlights” section provides information related to significant events, as well as highlights of our consolidated financial results for the quarter ended March 31, 2018 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 March 31, 2018 to those for the quarter ended March 31, 2017, is provided under “Consolidated Results of Operations,” "Line of Business Information" and "Capital" which follows these sections, as well as in our consolidated financial statements included in this Form 10-Q. 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 2017 period to the relevant 2018 period results.

Financial Results and Highlights

- EPS of $1.62 in the first quarter of 2018 increased 41% compared to $1.15 in the first quarter of 2017.

- First quarter of 2018 ROE of 12.8% and pre-tax margin of 25.3% increased from 9.9% and 21.9%, respectively, in the first quarter of 2017.
- Operating leverage was 5.0%. Operating leverage represents the difference in the percentage change in total revenue less the percentage change in total expenses, in each case relative to the prior year period.
- Fee operating leverage was (0.6)%. Fee operating leverage represents the difference in the percentage change in total fee revenue less the percentage change in total expenses, in each case relative to the prior year period. The negative fee operating leverage was primarily due to lower processing fees and other revenue.

Revenue

- Total revenue[1] and fee revenue increased 13%, and 8%, respectively, in the first quarter of 2018 compared to the first quarter of 2017, primarily driven by higher servicing fees, management fees and NII.
- Servicing fee revenue increased 10% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to higher global equity markets, new business, client activity and the favorable impact of currency translation, partially offset by modest hedge fund outflows.
- Management fee revenue increased 24% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to higher global equity markets, the favorable impact of currency translation and the adoption of the new revenue recognition accounting standard.
- Processing fees and other revenue decreased 78% in the first quarter of 2018 compared to the first quarter of 2017, largely reflecting the absence of a $30 million gain from the sale of a business in the first quarter of 2017 and the impact of $22 million higher FX swap costs not included in the net interest income deposit hedging program in the first quarter of 2018.
- NII increased 29% in the first quarter of 2018 compared to the first quarter of 2017, driven by higher U.S. interest rates, disciplined liability pricing, higher client balances, and a continued shift away from wholesale certificate of deposits (wholesale CDs).

[1] The impact of adopting the new revenue recognition standard was an increase in both total revenue and total expense of $65 million, or 3% of the change in both total revenue and total expenses compared to the first quarter of 2017. Revenues increased approximately $45 million in management fee revenue, $15 million in trading services and

$5 million across other revenue lines. Expenses increased approximately $45 million in other expenses, $15 million in transaction processing and $5 million across other expense lines.

Expenses

- Total expenses[(1)] increased 8% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to investments to support new business, compensation and employee benefit costs, transaction processing costs, the expense impact of the new revenue recognition accounting standard and the unfavorable impact of currency translation, partially offset by the absence of restructuring charges and the effects of Beacon savings, net of Beacon investments.

AUCA/AUM

- AUCA increased 12% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to strength in equity markets, new business and client activity. Asset servicing mandates newly announced in the first quarter of 2018 totaled approximately $1.3 trillion. Servicing assets remaining to be installed in future periods totaled approximately $1.6 trillion as of March 31, 2018.
- AUM increased 7% in the first quarter of 2018 compared to the first quarter of 2017, primarily driven by strength in equity markets and ETF net inflows, partially offset by thinner-yielding institutional outflows.

Capital

- We declared aggregate common stock dividends of $0.42 per share, totaling approximately $154 million in the first quarter of 2018, compared to $0.38 per share, totaling $144 million in the first quarter of 2017, representing an increase of approximately 11% on a per share basis.
- In the first quarter of 2018, we acquired 3.3 million shares of common stock at an average per-share cost of $105.31 and an aggregate cost of approximately $350 million under the common stock purchase program approved by our Board in June 2017.
- CET1 capital ratio decreased to 10.8% as of March 31, 2018 compared to 11.9% as of December 31, 2017 primarily due to an increase in overdraft exposure as of March 31, 2018. Subsequent to March 31, 2018 such overdrafts have been covered by our clients.
- Tier 1 leverage ratio decreased to 6.9% as of March 31, 2018, compared to 7.3% as of December 31, 2017. The decrease was primarily due to an increase in client deposits.

(1) The impact of adopting the new revenue recognition standard was an increase in both total revenue and total expense of $65 million, or 3% of the change in both total revenue and total expenses compared to the first quarter of 2017. Revenues increased approximately $45 million in management fee revenue, $15 million in trading services and $5 million across other revenue lines. Expenses increased approximately $45 million in other expenses, $15 million in transaction processing and $5 million across other expense lines.

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CONSOLIDATED RESULTS OF OPERATIONS

This section discusses our consolidated results of operations for the quarter ended March 31, 2018 compared to the quarter ended March 31, 2017, 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 March 31,		
(Dollars in millions)	2018	2017	% Change
Fee revenue:			
Servicing fees	$1,421	$1,296	10 %
Management fees	472	382	24
Trading services:			
Foreign exchange trading	181	164	10
Brokerage and other trading services	123	111	11
Total trading services	304	275	11
Securities finance	141	133	6
Processing fees and other	25	112	(78)
Total fee revenue	2,363	2,198	8
Net interest income:			
Interest income	857	650	32
Interest expense	199	140	42
Net interest income	658	510	29
Gains (losses) related to investment securities, net	(2)	(40)	(95)
Total revenue	$3,019	$2,668	13

Fee Revenue

Table 2: Total Revenue, provides the breakout of fee revenue for the quarters ended March 31, 2018 and 2017. Servicing and management fees collectively made up approximately 80% of total fee revenue in the first quarter of 2018, compared to approximately 76% in the first quarter of 2017. The level of these fees is influenced by several factors, including the mix and volume of our AUCA and our AUM, 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 AUCA. 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 generally are affected by changes in month-end valuations of AUM. Management fees for certain components of managed assets, such as ETFs, are affected by daily average valuations of AUM. 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 AUM and the investment strategies employed, management fees may reflect other factors, 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 AUM than for passive products. Actively managed products may also include performance fee arrangements which are recorded when the fee is earned, based on predetermined benchmarks associated with the applicable fund's performance.

In light of the above, we estimate, using relevant information as of March 31, 2018 and assuming that all other factors remain constant, that:

- A 10% increase or decrease in worldwide equity valuations, on a weighted average basis, over the relevant periods for which our servicing and management fees are calculated, would result in a corresponding change in our total servicing and management fee revenues of approximately 3%; and
- A 10% increase or decrease in worldwide fixed income valuations, on a weighted average basis, over the relevant periods for which our servicing and management fees are calculated, would result in a corresponding change in our total servicing and management fee revenues of approximately 1%.

See Table 3: Daily, Month-End and Quarter-End Equity Indices and Table 4: Quarter-End Debt Indices, for selected 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, month-end averages and quarter-end indices demonstrate worldwide changes in equity and debt markets that affect our servicing and management fee revenue. Quarter-end indices affect the values of AUCA and AUM as of those dates.

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Further discussion of fee revenue is provided under Line of Business Information in this Management's Discussion and Analysis in this Form 10-Q.

TABLE 3: DAILY, MONTH-END AND QUARTER-END EQUITY INDICES[(1)]

	Daily Averages of Indices			Averages of Month-End Indices			Quarter-End Indices		
	Quarters Ended March 31,			Quarters Ended March 31,			Quarters Ended March 31,		
	2018	2017	% Change	2018	2017	% Change	2018	2017	% Change
S&P 500®	2,733	2,326	17 %	2,726	2,335	17 %	2,641	2,363	12 %
MSCI EAFE®	2,072	1,749	18	2,070	1,759	18	2,006	1,793	12
MSCI® Emerging Markets	1,204	927	30	1,207	935	29	1,171	958	22
HFRI Asset Weighted Composite®	NA	NA	NA	1,406	1,323	6	1,392	1,331	5

(1) The index names listed in the table are service marks of their respective owners.
NA Not applicable

TABLE 4: QUARTER-END DEBT INDICES[(1)]

	As of March 31,		
	2018	2017	% Change
Barclays Capital U.S. Aggregate Bond Index®	2,016	1,993	1 %
Barclays Capital Global Aggregate Bond Index®	491	459	7

(1) The index names listed in the table are service marks of their respective owners.

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Net Interest Income
See Table 2: Total Revenue, for the breakout of interest income and interest expense for the quarters ended March 31, 2018 and 2017. NII was $658 million and $510 million for the quarters ended March 31, 2018 and 2017, respectively. NII is defined as interest income 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.
NIM represents the relationship between annualized fully taxable-equivalent NII and average total interest-earning assets for the period. It is calculated by dividing fully taxable-equivalent NII 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 the U.S. federal and state statutory income tax rates.
TABLE 5: AVERAGE BALANCES AND INTEREST RATES - FULLY TAXABLE-EQUIVALENT BASIS[1]

	Quarters Ended March 31,					
	2018			2017		
(Dollars in millions; fully taxable-equivalent basis)	Average Balance	Interest Revenue/ Expense	Rate	Average Balance	Interest Revenue/ Expense	Rate
Interest-bearing deposits with banks	$51,492	$ 82	.64 %	$48,893	$ 34	.28 %
Securities purchased under resale agreements[2]	2,872	77	10.89	2,056	46	9.07
Trading account assets	1,138	—	—	914	—	—
Investment securities	95,362	484	2.03	97,219	471	1.94
Loans and leases	23,959	158	2.68	20,139	108	2.17
Other interest-earning assets	17,733	77	1.78	22,619	34	.62
Average total interest-earning assets	$192,556	$ 878	1.85	$191,840	$ 693	1.47
Interest-bearing deposits:						
U.S.	$48,638	$ 34	.28 %	$25,928	$ 32	.50 %
Non-U.S.[3]	78,582	14	.07	94,990	12	.05
Securities sold under repurchase agreements[4]	2,617	—	—	3,894	—	—
Other short-term borrowings	1,255	3	1.09	1,341	2	.63
Long-term debt	11,412	97	3.37	11,421	73	2.56
Other interest-bearing liabilities	5,260	51	3.87	5,240	21	1.63
Average total interest-bearing liabilities	$147,764	$ 199	.55	$142,814	$ 140	.40
Interest-rate spread			1.30 %			1.07%
Net interest income—fully taxable-equivalent basis		$ 679			$ 553	
Net interest margin—fully taxable-equivalent basis			1.43 %			1.17%
Tax-equivalent adjustment		(21)			(43)	
Net interest income—GAAP basis		$ 658			$ 510	

(1) Rates earned/paid on interest-earning assets and interest-bearing liabilities include the impact of hedge activities associated with our asset and liability management activities where applicable.
(2) Reflects the impact of balance sheet netting under enforceable netting agreements of approximately $32 billion and $31 billion for the quarters ended March 31, 2018 and 2017, respectively. Excluding the impact of netting, the average interest rates would be approximately 0.89% and 0.56% for the quarters ended March 31, 2018 and 2017, respectively.

(3) Average rate includes the impact of FX swap costs of approximately $19 million and $32 million for the quarters ended March 31, 2018 and 2017, respectively. Average rates for total interest-bearing deposits excluding the impact of FX swap costs were 0.09% and 0.04% for the quarters ended March 31, 2018 and 2017, respectively.
(4) Interest for the quarters ended March 31, 2018 and 2017 was less than $1 million, representing an average interest rate of 0.16% and 0.03%, respectively.
See Table 5: Average Balances and Interest Rates - Fully Taxable-Equivalent Basis, for the breakout of NII on a fully taxable-equivalent (FTE) basis for the quarters ended March 31, 2018 and 2017. NII on a FTE basis increased in the first quarter of 2018 compared to the first quarter of 2017, primarily due to higher U.S. interest rates, disciplined liability pricing and a continued shift away from wholesale CDs. Average interest-bearing and non-interest-bearing deposits were relatively stable in the first quarter of 2018 compared to the first quarter of 2017, primarily due to a $4.22 billion reduction in wholesale CDs, offset by an increase in client deposits.

We recorded aggregate discount accretion in interest income of approximately $5 million in both the first quarters of 2018 and 2017 related to the assets we consolidated onto our balance sheet in 2009 from our asset-backed commercial paper conduits. Assuming that we hold the former conduit securities remaining in our investment portfolio until they mature or are sold, we expect to generate aggregate discount accretion in future periods of approximately $116 million over their remaining terms.
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.

Changes in the components of interest-earning assets and interest-bearing liabilities are discussed in more detail below. Additional information about the components of interest income 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 approximately $716 million higher in the quarter ended March 31, 2018 compared to the quarter ended March 31, 2017. The increase was primarily driven by higher interest-bearing client deposits, offset by lower wholesale CDs and non-interest-bearing client deposits.

Interest-bearing deposits with banks averaged $51.49 billion in the quarter ended March 31, 2018 compared to $48.89 billion in the quarter ended March 31, 2017. These deposits primarily reflect our maintenance of cash balances at the Federal Reserve, the ECB and other non-U.S. central banks.

Securities purchased under resale agreements averaged $2.87 billion in the quarter ended March 31, 2018 compared to $2.06 billion in the quarter ended March 31, 2017, which reflects the impact of balance sheet netting under enforceable netting agreements of approximately $32 billion and $31 billion for the quarters ended March 31, 2018 and 2017, respectively. We maintain an agreement with a clearing organization that enables us to net all securities sold under repurchase agreements against those purchased under resale agreements with counterparties that are also members of the clearing organization.

Investment securities averaged $95.36 billion in the quarter ended March 31, 2018 compared to $97.22 billion in the quarter ended March 31, 2017. The decrease in average investment securities was driven by a reduction in U.S. Treasury and asset-backed securities, partially offset by an increase in foreign sovereign bonds. We sold approximately $12 billion of non-HQLA securities during the quarter, primarily asset-backed securities, municipal bonds and covered bonds. These sales were part of our strategy to prioritize capital efficient client lending while managing OCI sensitivity. Sale proceeds will be reinvested into additional interest earning assets.

Loans and leases averaged $23.96 billion in quarter ended March 31, 2018 compared to $20.14 billion in the quarter ended March 31, 2017. The increase in average loans and leases was primarily driven by higher levels of overdrafts and senior secured bank loans. Loans and leases also includes U.S. and non-U.S. overdrafts, which provide liquidity to clients in support of investment activities. Average U.S. and non-U.S. overdrafts were $734 million higher in the quarter ended March 31, 2018 compared to the quarter ended March 31, 2017.

Our average other interest-earning assets, largely associated with our enhanced custody business, comprised approximately 9% and 12% of our average total assets in the quarters ended March 31, 2018 and 2017, respectively. The enhanced custody business is our securities financing business where we act as principal with respect to our custody clients and generate securities finance revenue. The NII earned on these transactions is generally lower than the interest earned on other alternative investments. Average other interest-earning assets decreased to $17.73 billion in the quarter ended March 31, 2018 from $22.62 billion in the quarter ended March 31, 2017, largely driven by a reduction in the level of cash collateral posted by our enhanced custody business.

Aggregate average U.S. and non-U.S. interest-bearing deposits increased to $127.22 billion in the quarter ended March 31, 2018 from $120.92 billion in the quarter ended March 31, 2017. The higher levels compared to the prior year period were a result of higher client deposit levels, offset by management actions to reduce wholesale CDs. Future deposit levels will be influenced by the underlying asset servicing business, client deposit behavior and market conditions, including the general levels of U.S. and non-U.S. interest rates.

Average other short-term borrowings declined to $1.26 billion in the quarter ended March 31, 2018 from $1.34 billion in the quarter ended March 31, 2017, as bonds matured in the tax-exempt investment program.

Average other interest-bearing liabilities were $5.26 billion in the quarter ended March 31, 2018 compared to $5.24 billion in the quarter ended March 31, 2017. Other interest-bearing liabilities primarily reflect our level of cash collateral received from clients in connection with our enhanced custody business, which is presented on a net basis where we have enforceable netting agreements.

Several factors could affect future levels of NII and NIM, including the volume and mix of client liabilities; actions of various central banks; changes in the level and slope of U.S. and non-U.S. interest rates; revised or proposed regulatory capital or liquidity standards, or interpretations of those standards; the yields earned on securities purchased compared to the yields earned on securities sold or matured and changes in the type and amount of credit or other loans we extend.

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Based on market conditions and other factors, including regulatory standards, 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 MBS and U.S. and non-U.S. mortgage- and ABS. 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, including interpretation of those 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 NII and NIM.

Expenses

Table 6: Expenses, provides the breakout of expenses for the quarters ended March 31, 2018 and 2017.

TABLE 6: EXPENSES

	Quarters Ended March 31,		
(Dollars in millions)	2018	2017	% Change
Compensation and employee benefits	$1,249	$1,166	7 %
Information systems and communications	315	287	10
Transaction processing services	242	197	23
Occupancy	120	110	9
Acquisition costs	—	12	(100)
Restructuring charges, net	—	17	(100)
Other:			
Professional services	79	94	(16)
Amortization of other intangible assets	50	52	(4)
Regulatory fees and assessments	27	27	—
Other	174	124	40
Total other	330	297	11
Total expenses	$2,256	$2,086	8
Number of employees at quarter-end	37,192	34,817	7

Compensation and employee benefits expenses increased 7% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to increased costs to support new business, annual merit and performance based incentives and the unfavorable impact of currency translation, partially offset by Beacon savings.

Compensation and employee benefits expenses in the first quarter of 2018 and the first quarter of 2017 included approximately $148 million and $154 million, respectively, of deferred incentive compensation expense for retirement-eligible employees and payroll taxes.

Headcount increased 7% in the first quarter of 2018 compared to the first quarter of 2017. The growth in headcount was all within low cost locations and was driven by new business and strategic initiatives, as well as regulatory initiatives and contractor conversions to full-time employees, partially offset by reductions from

Beacon. Headcount in high cost locations fell compared to the first quarter of 2017.

Information systems and communications expenses increased 10% in the first quarter of 2018 compared to the first quarter of 2017. The increases were primarily related to higher technology costs.

Other expenses increased 11% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to the $45 million impact of the adoption of the new revenue recognition accounting standard.

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 regulatory compliance requirements and expectations will continue to affect our expenses.

Restructuring Charges

In connection with Beacon, we announced in 2016 that we expected:

(i) to incur aggregate pre-tax restructuring charges of approximately $300 million to $400 million beginning in 2016 through December 31, 2020, including approximately $250 million to $300 million in severance and benefits costs associated with targeted staff reductions (a substantial portion of which would result in future cash expenditures) and approximately $50 million to $100 million in information technology application rationalization and real estate actions; and

(ii) to achieve estimated annual pre-tax net run-rate expense savings of $550 million by the end of 2020, relative to 2015, all else equal, for full effect in 2021. Actual expenses may increase or decrease in the future due to other factors.

In the first quarter of 2018, we recorded no restructuring charges, compared to $17 million in the first quarter of 2017, related to Beacon. In aggregate, we have recorded restructuring charges of approximately $385 million related to Beacon, including $300 million in severance costs and $85 million in information technology application rationalization and real estate action.

In the first quarter of 2018, we achieved approximately $58 million of Beacon pre-tax run rate savings, net of Beacon investments, and expect total target pre-tax run rate net savings of $550 million to be realized by mid-2019, of which $385 million has been realized as of March 31, 2018.

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

TABLE 7: RESTRUCTURING CHARGES

(In millions)	Employee Related Costs	Real Estate Actions	Asset and Other Write-offs	Total
Accrual Balance at December 31, 2016	$ 37	$ 17	$ 2	$56
Accruals for Beacon	186	32	27	245
Payments and Other Adjustments	(57)	(17)	(26)	(100)
Accrual Balance at December 31, 2017	$ 166	$ 32	$ 3	$201
Accruals for Beacon	—	—	—	—
Payments and Other Adjustments	(22)	(4)	—	(26)
Accrual Balance at March 31, 2018	$ 144	$ 28	$ 3	$175

Income Tax Expense

Income tax expense was $102 million in the first quarter of 2018 compared to $82 million in the first quarter of 2017. Our effective tax rate in the first quarter of 2018 was 13.5%, compared to 14.0% in the same period of 2017. The 2018 tax expense included net benefits from the enactment of the Tax Cuts and Jobs Act and an increase in excess deductions related to stock based compensation, partially offset by a decrease in tax advantaged investments.

In the first quarter of 2018, we continued to perform our analysis and evaluate interpretations and other guidance regarding the Tax Cuts and Jobs Act, but did not record any adjustments to the amounts recorded on a provisional basis in the year ended December 31, 2017 or deem any such amounts as complete.

LINE OF BUSINESS INFORMATION

Our operations are organized 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.

Investment Servicing provides services for institutional clients, including mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, investment managers, 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; our enhanced custody product, which integrates principal securities lending and custody; 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 passive and active 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 information about our two lines of business, as well as the revenues, expenses and capital allocation methodologies associated with them, refer to pages 179 to 181 in Note 24 to the consolidated financial statements included under Item 8, Financial Statements and Supplementary Data, in our 2017 Form 10-K and Note 17 to the consolidated financial statements included in this Form 10-Q.

Investment Servicing

TABLE 8: INVESTMENT SERVICING LINE OF BUSINESS RESULTS

	Quarters Ended March 31,	
(Dollars in millions, except where otherwise noted)	2018	2017

			% Change
Servicing fees	$1,421	$1,296	10 %
Trading services	274	257	7
Securities finance	141	133	6
Processing fees and other	25	106	(76)
Total fee revenue	1,861	1,792	4
Net interest income	663	509	30
Gains (losses) related to investment securities, net	(2)	(40)	(95)
Total revenue	2,522	2,261	12
Provision for loan losses	—	(2)	nm
Total expenses	1,858	1,728	8
Income before income tax expense	$664	$535	24
Pre-tax margin	26 %	24 %	

nm Not meaningful

Servicing Fees

Servicing fees increased 10% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to higher global equity markets, new business, client activity and the favorable impact of currency translation, partially offset by modest hedge fund outflows.

Servicing fees generated outside the U.S. were approximately 46% and 43% of total servicing fees in the first quarters of 2018 and 2017, respectively.

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TABLE 9: ASSETS UNDER CUSTODY AND ADMINISTRATION BY PRODUCT

(In billions)	March 31, 2018	December 31, 2017	March 31, 2017
Mutual funds	$7,503	$ 7,603	$7,033
Collective funds	9,908	9,707	8,024
Pension products	6,802	6,704	5,775
Insurance and other products	9,071	9,105	9,001
Total	$33,284	$ 33,119	$29,833

TABLE 10: ASSETS UNDER CUSTODY AND ADMINISTRATION BY ASSET CLASS

(In billions)	March 31, 2018	December 31, 2017	March 31, 2017
Equities	$19,198	$ 19,214	$16,651
Fixed-income	10,186	10,070	9,786
Short-term and other investments	3,900	3,835	3,396
Total	$33,284	$ 33,119	$29,833

TABLE 11: ASSETS UNDER CUSTODY AND ADMINISTRATION BY GEOGRAPHY[(1)]

(In billions)	March 31, 2018	December 31, 2017	March 31, 2017
North America	$24,336	$ 24,418	$22,361
Europe/Middle East/Africa	7,211	7,028	5,979
Asia/Pacific	1,737	1,673	1,493
Total	$33,284	$ 33,119	$29,833

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

Asset servicing mandates newly announced in the first quarter of 2018 totaled approximately $1.3 trillion. Servicing assets remaining to be installed in future periods totaled approximately $1.6 trillion as of March 31, 2018, which will be reflected in AUCA in future periods after installation and will generate servicing fee revenue in subsequent periods. The full revenue impact of such mandates will be realized over several quarters as the assets are installed and additional services are added over that period.

We expect that for the remainder of the year newly announced asset servicing mandates will return to levels more commonly reflected historically. New asset servicing mandates and servicing assets remaining to be installed in future periods exclude new business which has been contracted, but for which the client has not yet provided permission to publicly disclose and is not yet installed. These excluded assets, which from time to time may be significant, will be included in new asset servicing mandates and reflected in servicing assets remaining to be installed in the period in which the client provides its permission. Newly announced servicing asset mandates for the first quarter of 2018 include a significant amount of assets contracted for in the fourth quarter of 2017 for which we received client consent to disclose in the first quarter of 2018. Servicing mandates and servicing assets remaining to be installed in future periods are presented on a gross basis and therefore also do not include the impact of clients who have notified us during the period of their intent to terminate or reduce their relationship with us.

With respect to these new servicing mandates, once installed we may 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. Revenues associated with new servicing mandates may vary based on the breadth of services provided and the timing of installation, and the types of assets.

For additional information about the impact of worldwide equity and fixed income valuations on our fee revenue, including servicing fee revenue, refer to "Fee Revenue" in "Consolidated Results of Operations" included in this Management's Discussion and Analysis in this Form 10-Q.

As a result of a decision to diversify providers, one of our large clients will move a portion of its assets, largely common trust funds, currently with us to another service provider. We expect to remain a significant service provider to this client. The transition will principally occur in 2018 and beyond and represents approximately $1 trillion in assets with respect to which we will no longer derive revenue post-transition.

Trading Services

Trading services revenue increased 11% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to stronger client FX volumes, the adoption of the new revenue recognition accounting standard and higher electronic trading activity. Trading services revenue is composed of revenue generated by FX trading, as well as revenue generated by brokerage and other trading services as noted in Table 2: Total Revenue.

Foreign Exchange Trading Revenue

We primarily earn FX trading revenue by acting as a principal market-maker through both "direct sales and trading” and “indirect foreign exchange trading.”

- Direct sales and trading: Represent FX transactions at negotiated rates with clients and investment managers that contact our trading desk directly. These principal market-making activities include transactions for funds serviced by third party custodians or prime brokers, as well as those funds under custody with us.
- Indirect FX trading: Represent FX transactions with clients or their investment managers routed to our FX desk through our asset-servicing operation; in which all cases, we are the funds' custodian. We execute indirect FX trades as a principal at rates disclosed to our clients.

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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 bid-offer spreads across product mix tend to result in increases or decreases, as the case may be, in client-related FX revenue.

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.

Brokerage and Other Trading Services

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. These products and services are generally offered by us as 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.

Total brokerage and other trading services revenue primarily consists of "electronic FX services" and "other trading, transition management and brokerage revenue."

- Electronic FX services: Our clients may choose to execute FX transactions through one of our electronic trading platforms. These transactions generate revenue through a "click" fee.
- Other trading, transition management and brokerage revenue: As our clients look to us to enhance and preserve portfolio values, they may choose to utilize our Transition or Currency Management capabilities or transact with our Equity Trade execution group. These transactions generate revenue via commissions charged for trades transacted during the management of these portfolios.

In recent years, our transition management revenue was adversely affected by compliance issues in our U.K. business during 2010 and 2011, including settlements with the FCA in 2014 and the DOJ and SEC

in 2017, including a deferred prosecution agreement. The reputational and regulatory impact of those compliance issues continues and may adversely affect our results in future periods.

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.

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 or other market participants and then lends such securities to the subsequent borrower, either our 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 assets under custody and administration from clients who have designated State Street as an eligible borrower.

Securities finance revenue as presented in Table 8: Investment Servicing Line of Business Results, increased 6% in the first quarter of 2018 compared to the first quarter of 2017, primarily as a result of higher lending activity from our agency business.

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, including revised or proposed capital and liquidity standards, interpretations of those standards, and our own balance sheet management activities, may influence modifications to the way in which we deliver our agency lending or enhanced custody businesses, the volume of our securities lending activity and related revenue and profitability in future periods.

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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 other assets, derivative financial instruments to support our clients' needs and to manage our interest-rate and currency risk, and amortization of our tax-advantaged investments.
Processing fees and other revenue, presented in Table 8: Investment Servicing Line of Business Results, decreased 76% in the first quarter of 2018 compared to the first quarter of 2017. The decrease is primarily due to the absence of a $30 million gain in the first quarter of 2017 from the sale of a business and the impact of $22 million higher FX swap costs not included in our net interest income deposit hedging program in the first quarter of 2018.
Expenses
Total expenses for Investment Servicing increased 8% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to higher technology costs, costs to support new business, higher annual merit and performance based incentive compensation and the unfavorable impact of currency translation, partially offset by the effects of Beacon savings. Seasonal deferred incentive compensation expense for retirement eligible employees and payroll taxes was $132 million and $137 million for the quarters ended March 31, 2018 and 2017, respectively.
Additional information about expenses is provided under Expenses in Consolidated Results of Operations included in this Management's Discussion and Analysis of this Form 10-Q.
Investment Management
TABLE 12: INVESTMENT MANAGEMENT LINE OF BUSINESS RESULTS

	Quarters Ended March 31,		
(Dollars in millions)	2018	2017	% Change
Management fees	$472	$382	24 %
Trading services[1]	30	18	67
Processing fees and other	—	6	nm
Total fee revenue	502	406	24
Net interest income	(5)	1	nm
Total revenue	497	407	22
Total expenses	398	329	21
Income before income tax expense	$99	$78	27
Pre-tax margin	20 %	19 %	

[1] Includes revenues associated with the SPDR® Gold Shares ETF and SPDR® Long Dollar Gold Trust ETF, for which we act as the marketing agent.
nm Not meaningful

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 AUM 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 24% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to higher global equity markets, the adoption of the new revenue recognition accounting standard and the favorable impact of currency translation.

Management fees generated outside the U.S. were approximately 27% of total management fees in both the first quarters of 2018 and 2017.

TABLE 13: ASSETS UNDER MANAGEMENT BY ASSET CLASS AND INVESTMENT APPROACH

(In billions)	March 31, 2018	December 31, 2017	March 31, 2017
Equity:			
Active	$94	$ 95	$77
Passive	1,576	1,650	1,482
Total Equity	1,670	1,745	1,559
Fixed-Income:			
Active	79	77	69
Passive	354	337	312
Total Fixed-Income	433	414	381
Cash[1]	336	330	335
Multi-Asset-Class Solutions:			
Active	18	18	19
Passive	128	129	113
Total Multi-Asset-Class Solutions	146	147	132
Alternative Investments[2]:			
Active	23	23	26
Passive	121	123	128
Total Alternative Investments	144	146	154
Total	$2,729	$ 2,782	$2,561

(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 Shares ETF and SPDR® Long Dollar Gold Trust ETF. We are not the investment manager for the SPDR® Gold Shares ETF and SPDR® Long Dollar Gold Trust ETF, but acts as the marketing agent.

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TABLE 14: EXCHANGE - TRADED FUNDS BY ASSET CLASS[(1)(2)]

(In billions)	March 31, 2018	December 31, 2017	March 31, 2017
Alternative Investments[(2)]	$ 48	$ 48	$ 46
Cash	3	2	2
Equity	513	531	457
Fixed-income	65	63	53
Total Exchange-Traded Funds	$ 629	$ 644	$ 558

[(1)] ETFs are a component of AUM presented in the preceding table.
[(2)] Includes real estate investment trusts, currency and commodities, including SPDR® Gold Shares ETF and SPDR® Long Dollar Gold Trust ETF. We are not the investment manager for the SPDR® Gold Shares ETF and SPDR® Long Dollar Gold Trust ETF, but acts as the marketing agent.

TABLE 15: GEOGRAPHIC MIX OF ASSETS UNDER MANAGEMENT[(1)]

(In billions)	March 31, 2018	December 31, 2017	March 31, 2017
North America	$1,885	$ 1,931	$1,772
Europe/Middle East/Africa	511	521	486
Asia/Pacific	333	330	303
Total	$2,729	$ 2,782	$2,561

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

TABLE 16: ACTIVITY IN ASSETS UNDER MANAGEMENT BY PRODUCT CATEGORY

(In billions)	Equity	Fixed-Income	Cash[(1)]	Multi-Asset-Class Solutions	Alternative Investments[(2)]	Total
Balance as of March 31, 2017	$1,559	$ 381	$ 335	$ 132	$ 154	$2,561
Long-term institutional inflows[(3)]	199	72	—	44	12	327
Long-term institutional outflows[(3)]	(259)	(67)	—	(41)	(23)	(390)
Long-term institutional flows, net	(60)	5	—	3	(11)	(63)
ETF flows, net	16	9	—	—	—	25
Cash fund flows, net	—	—	(11)	—	—	(11)
Total flows, net	(44)	14	(11)	3	(11)	(49)
Market appreciation	212	13	4	9	(1)	237
Foreign exchange impact	18	6	2	3	4	33
Total market/foreign exchange impact	230	19	6	12	3	270
Balance as of December 31, 2017	$1,745	$ 414	$ 330	$ 147	$ 146	$2,782
Long-term institutional inflows[(3)]	62	47	—	19	6	134
Long-term institutional outflows[(3)]	(109)	(29)	—	(18)	(5)	(161)
Long-term institutional flows, net	(47)	18	—	1	1	(27)
ETF flows, net	(8)	2	1	—	—	(5)
Cash fund flows, net	—	—	6	—	—	6
Total flows, net	(55)	20	7	1	1	(26)
Market appreciation	(28)	(5)	(2)	(3)	(2)	(40)

Foreign exchange impact	8	4	1	1	(1)	13
Total market/foreign exchange impact	(20)	(1)	(1)	(2)	(3)	(27)
Balance as of March 31, 2018	$1,670	$ 433	$336	$ 146	$ 144	$2,729

(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 Shares ETF and SPDR® Long Dollar Gold Trust ETF. We are not the investment manager for the SPDR® Gold Shares ETF and SPDR® Long Dollar Gold Trust ETF, but acts as the marketing agent.
(3) Amounts represent long-term portfolios, excluding ETFs.

The preceding table does not include approximately $22 billion of new asset management business which was awarded but not installed as of March 31, 2018. 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 March 31, 2018 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 as the timing can vary significantly.

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

Expenses
Total expenses for Investment Management increased 21% in the first quarter of 2018 compared to the first quarter of 2017, primarily due to the $60 million impact from the adoption of the new revenue recognition accounting standard, costs to support new business and the unfavorable impact of currency translation. Seasonal deferred incentive compensation expense for retirement eligible employees and payroll taxes was $16 million and $17 million for the quarters ended March 31, 2018 and 2017, respectively.
Additional information about expenses is provided under Expenses in Consolidated Results of Operations included in this Management's Discussion and Analysis of this Form 10-Q.
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 AFS or HTM 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 17: AVERAGE STATEMENT OF CONDITION[(1)]

	Quarters Ended March 31,	
	2018	2017
(In millions)	Average Balance	Average Balance
Assets:		
Interest-bearing deposits with banks	$51,492	$48,893
Securities purchased under resale agreements	2,872	2,056
Trading account assets	1,138	914
Investment securities	95,362	97,219
Loans and leases	23,959	