INVESTORS FINANCIAL SERVICES CORP
Form 10-Q
May 02, 2007

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly period ended March 31, 2007

or

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

For the Transition period from to

0-26996
(Commission File Number)

INVESTORS FINANCIAL SERVICES CORP.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**04-3279817** (IRS Employer Identification No.)
200 Clarendon Street, **P.O. Box 9130, Boston, MA** (Address of principal executive offices)	**02116-9130** (Zip Code)

(617) 937-6700

(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 o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

As of April 30, 2007 there were 67,032,629 shares of common stock outstanding.

INVESTORS FINANCIAL SERVICES CORP.

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PART I. FINANCIAL INFORMATION

Item 1. Unaudited Consolidated Financial Statements

Investors Financial Services Corp.

Unaudited Consolidated Balance Sheets

March 31, 2007 and December 31, 2006 (Dollars in thousands, except share data)

	March 31, 2007	December 31, 2006
Assets		
Cash and due from banks	$ 142,448	$ 92,776
Interest-bearing deposits with other banks	20,868	21,218
Other short-term investments	1,134	1,971
Federal funds sold and securities purchased under resale agreements	2,950,000	300,000
Securities held to maturity (including securities pledged of $4,169,418 and $4,096,013 at March 31, 2007 and December 31, 2006, respectively) (approximate fair value of $5,222,865 and $5,508,788 at March 31, 2007 and December 31, 2006, respectively) (Note 3)	5,248,480	5,532,330
Securities available for sale (including securities pledged of $3,730,234 and $3,071,503 at March 31, 2007 and December 31, 2006, respectively) (Note 3)	5,050,836	4,799,740
Nonmarketable equity securities	38,962	40,054
Loans, less allowance for loan losses of $100 at March 31, 2007 and December 31, 2006 (Note 4)	258,955	270,693
Accrued interest and fees receivable	142,106	134,748
Equipment and leasehold improvements, less accumulated depreciation of $66,477 and $64,290 at March 31, 2007 and December 31, 2006, respectively	131,768	113,287
Goodwill, net	79,969	79,969
Other assets	139,822	171,420
Total Assets	$ 14,205,348	$ 11,558,206
Liabilities and Stockholders Equity		
Liabilities:		
Deposits (Note 5):		
Demand	$ 1,353,144	$ 695,821
Savings	6,499,626	4,924,735
Time	630,260	524,386
Total deposits	8,483,030	6,144,942
Securities sold under repurchase agreements (Note 6)	4,424,073	3,727,800
Short-term and other borrowings (Note 7)	62,497	517,051
Due to brokers for open trades payable		26,359
Junior subordinated deferrable interest debentures	24,774	24,774
Accrued taxes and other expenses	76,067	77,821
Other liabilities	110,648	100,721
Total liabilities	13,181,089	10,619,468
Commitments and contingencies (Note 12)		
Stockholders Equity:		
Preferred stock, par value $0.01 (shares authorized: 1,000,000; issued: none at March 31, 2007 and December 31, 2006)		
Common stock, par value $0.01 (shares authorized: 175,000,000; issued: 69,660,108 and 68,523,129 at March 31, 2007 and December 31, 2006, respectively)	697	685
Surplus	372,773	334,929
Retained earnings	759,284	720,433
Accumulated other comprehensive loss, net	(5,700)	(14,514)
Treasury stock, at cost (2,895,021 shares at March 31, 2007 and December 31, 2006)	(102,795)	(102,795)

Total stockholders equity		1,024,259		938,738
Total Liabilities and Stockholders Equity	$	14,205,348	$	11,558,206

See Notes to Unaudited Consolidated Financial Statements.

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Investors Financial Services Corp.

Unaudited Consolidated Statements of Income and Comprehensive Income

Three Months Ended March 31, 2007 and 2006 (Dollars in thousands, except per share data)

	March 31, 2007	March 31, 2006
Fees and Other Revenue:		
Asset servicing fees:		
Core service fees	$ 129,026	$ 107,759
Value-added service fees	40,627	40,544
Total asset servicing fees	169,653	148,303
Other operating income	1,479	1,164
Total fees and other revenue	171,132	149,467
Interest income	157,985	134,437
Interest expense	108,819	91,116
Net interest income	49,166	43,321
Net operating revenue	220,298	192,788
Operating Expenses:		
Compensation and benefits	97,420	76,998
Technology and telecommunications	18,535	17,338
Transaction processing services	15,341	13,672
Occupancy	10,018	7,551
Depreciation and amortization	9,691	7,806
Professional fees	2,273	3,461
Travel and sales promotion	2,126	1,931
Insurance	980	973
Other operating expenses	3,010	5,954
Total operating expenses	159,394	135,684
Income Before Income Taxes	60,904	57,104
Provision for income taxes	20,403	19,701
Net Income	$ 40,501	$ 37,403
Basic Earnings Per Share	$ 0.61	$ 0.57
Diluted Earnings Per Share	$ 0.60	$ 0.56
Comprehensive Income:		
Net income	$ 40,501	$ 37,403
Other comprehensive income (loss):		
Net unrealized investment gain (loss)	11,329	(9,197)
Net unrealized derivative instrument (loss) gain	(2,577)	2,691
Cumulative translation adjustment	62	129
Other comprehensive income (loss)	8,814	(6,377)
Comprehensive income	$ 49,315	$ 31,026

See Notes to Unaudited Consolidated Financial Statements.

Investors Financial Services Corp.

Unaudited Consolidated Statements of Stockholders Equity

Three Months Ended March 31, 2007 and 2006 (Dollars in thousands, except share data)

	March 31, 2007	March 31, 2006
Common shares		
Balance, beginning of period	68,523,129	67,177,306
Exercise of stock options	863,175	478,635
Restricted stock issuance	273,804	
Balance, end of period	69,660,108	67,655,941
Treasury shares		
Balance, beginning of period	2,895,021	2,124,669
Balance, end of period	2,895,021	2,124,669
Common stock		
Balance, beginning of period	$ 685	$ 672
Exercise of stock options	12	5
Balance, end of period	697	677
Surplus		
Balance, beginning of period	334,929	286,265
Share-based awards and exercise of stock options	31,326	15,314
Tax benefit from exercise of stock options	6,518	2,361
Transfer of deferred compensation to surplus		(311)
Amortization of deferred compensation		104
Balance, end of period	372,773	303,733
Deferred compensation		
Balance, beginning of period		(311)
Transfer of deferred compensation to surplus		311
Balance, end of period		
Retained earnings		
Balance, beginning of period	720,433	572,549
Net income	40,501	37,403
Cash dividend, $0.0250 and $0.0225 per share in the three-month periods ended March 31, 2007 and 2006, respectively	(1,650)	(1,469)
Balance, end of period	759,284	608,483
Accumulated other comprehensive (loss) income, net		
Balance, beginning of period	(14,514)	(13,369)
Net unrealized investment gain (loss)	11,329	(9,197)
Net unrealized derivative instrument (loss) gain	(2,436)	3,164
Amortization of terminated interest rate swap agreements	(141)	(473)
Cumulative translation adjustment	62	129
Balance, end of period	(5,700)	(19,746)
Treasury stock		
Balance, beginning of period	(102,795)	(72,948)
Balance, end of period	(102,795)	(72,948)
Total Stockholders Equity	$ 1,024,259	$ 820,199

See Notes to Unaudited Consolidated Financial Statements.

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Investors Financial Services Corp.
Unaudited Consolidated Statements of Cash Flows
Three Months Ended March 31, 2007 and 2006 (Dollars in thousands)

	March 31, 2007	March 31, 2006
Cash Flows From Operating Activities:		
Net income	$40,501	$37,403
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed loss of unconsolidated subsidiary	7	7
Depreciation and amortization	9,691	7,806
Share-based compensation	2,096	1,155
Amortization of premiums on securities, net of accretion of discounts	12,119	10,267
Excess tax benefit related to share-based compensation	(7,826)	(1,633)
Changes in assets and liabilities:		
Accrued interest and fees receivable	(7,358)	(4,187)
Other assets	31,591	5,509
Accrued taxes and other expenses	(1,754)	16,271
Other liabilities	5,518	29,895
Net cash provided by operating activities	84,585	102,493
Cash Flows From Investing Activities:		
Proceeds from maturities and paydowns of securities available for sale	638,958	251,050
Proceeds from maturities and paydowns of securities held to maturity	273,459	302,247
Proceeds from the redemption of non-marketable equity securities	1,092	
Purchases of securities available for sale	(871,332)	(392,764)
Purchases of securities held to maturity	(970)	(48,363)
Purchases of non-marketable equity securities		(750)
Net decrease in due to brokers for open trades payable	(26,359)	(9,344)
Net increase in Federal funds sold and securities purchased under resale agreements	(2,650,000)	(525,000)
Net decrease (increase) in other short-term investments	837	(6,089)
Net decrease in loans	11,738	94,449
Purchases of equipment, software and leasehold improvements	(28,165)	(17,704)
Net cash used for investing activities	(2,650,742)	(352,268)
Cash Flows From Financing Activities:		
Net increase in demand deposits	657,323	107,326
Net increase in time and savings deposits	1,680,765	324,775
Net increase (decrease) in securities sold under repurchase agreements	696,273	(5,857)
Net decrease in short-term and other borrowings	(454,554)	(169,446)
Proceeds from exercise of stock options	29,461	14,164
Excess tax benefit related to share-based compensation	7,826	1,633
Dividends paid to stockholders	(1,650)	(1,469)
Net cash provided by financing activities	2,615,444	271,126
Effect of exchange rates on cash	35	450
Net Increase in Cash and Due From Banks	49,322	21,801
Cash and Due From Banks, Beginning of Period	113,994	79,637
Cash and Due From Banks, End of Period	$163,316	$101,438

See Notes to Unaudited Consolidated Financial Statements.

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Investors Financial Services Corp.
Notes to Unaudited Consolidated Financial Statements

1. Description of Business

Investors Financial Services Corp. (IFSC) provides asset administration services for the financial services industry through its wholly-owned subsidiary, Investors Bank & Trust Company (the Bank). As used herein, the defined term the Company shall mean IFSC together with the Bank and its domestic and foreign subsidiaries. The Company provides core services and value-added services to a variety of financial asset managers, including mutual fund complexes, investment advisors, family offices, hedge funds, banks and insurance companies. Core services include global custody, multicurrency accounting, fund administration and middle office outsourcing. Value-added services include foreign exchange, cash management, securities lending, investment advisory, performance measurement, institutional transfer agency, lines of credit and brokerage and transition management services. The Company is subject to regulation by the Federal Reserve Board of Governors (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Commissioner of Banks of the Commonwealth of Massachusetts (Commissioner), the Securities and Exchange Commission (SEC), the National Association of Securities Dealers, Inc. (NASD), the State of Vermont Department of Banking, Insurance, Securities & Health Care Administration (BISHCA), the Office of the Superintendent of Financial Institutions in Canada (OSFI), the Irish Financial Services Regulatory Authority (IFSRA), the Cayman Islands Monetary Authority (CIMA), the Financial Services Authority in the United Kingdom (FSA) and the Commission de Surveillance du Secteur Financier in Luxembourg (CSSF).

On February 4, 2007, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with State Street Corporation (State Street). At the closing of the transaction contemplated by the Merger Agreement, the Company will merge into State Street and the Company s shareholders will receive 0.906 shares of State Street common stock for each share of the Company s common stock. Each company s Board of Directors has approved the Merger Agreement. The Company expects to complete the transaction in the third quarter of 2007, subject to customary closing conditions, including regulatory and shareholder approval.

2. Interim Financial Statements

The unaudited consolidated interim financial statements of the Company as of March 31, 2007 and December 31, 2006, and for the three-month periods ended March 31, 2007 and 2006 have been prepared by the Company pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted as permitted by such rules and regulations. All adjustments, consisting of normal recurring adjustments, necessary for their fair presentation in conformity with GAAP are included. All significant intercompany accounts and transactions have been eliminated. The Company s management believes that the disclosures are adequate to present fairly the financial position, results of operations and cash flows at the dates and for the periods presented. The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates. It is suggested that these interim financial statements be read in conjunction with the financial statements and the notes thereto included in the Company s latest annual report on Form 10-K. Results for interim periods are not necessarily indicative of those to be expected for the full fiscal year. Certain amounts in prior years financial statements have been reclassified to conform to the current years presentation.

Cash and Cash Equivalents For purposes of reporting cash flows and amounts on the consolidated balance sheets, the Company defines cash and cash equivalents to include cash, due from banks, and interest-bearing deposits with other banks that have original maturities of 90 days or less.

Securities The Company classifies all equity securities that have readily determinable fair values and all investments in debt securities into one of three categories. Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held to maturity and carried at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and carried at fair value, with unrealized gains and losses included in earnings. All other debt and equity securities not classified as either held to maturity or trading are classified as available for sale and carried at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Non-marketable securities primarily consist of stock of the Federal Home Loan Bank of Boston (FHLBB) and stock of the Federal Reserve Bank of Boston (FRBB). The FHLBB stock is carried at cost and redeemable at par value. The Company is required to hold this stock under its borrowing arrangement with the FHLBB. The Company was required to purchase stock of the FRBB in connection with its membership with the FRBB.

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An investment is considered impaired if the fair value of the investment is less than its cost. The Company recognizes an impairment charge if, based on the facts and circumstances, management determines the impairment to be other than temporary. For example, the Company will record an other than temporary impairment charge on a debt security if it is determined that it is probable that the Company will be unable to recover all amounts due under the contractual obligations of the security.

Amortization and accretion of debt securities purchased at a premium or discount are amortized or accreted into income using a method which approximates the constant effective yield method. The Company applies Statement of Financial Accounting Standards No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (SFAS 91) for the amortization of premiums and accretion of discounts. In calculating the effective yield for securities that represent holdings of large numbers of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, prepayments are anticipated using the Company s actual three-month prepayment experience.

The amount of amortization or accretion to recognize in income is driven by the calculation of the constant effective yield. When calculating this yield, the Company assumes that prepayments will continue from the analysis date to the date of the security s expected maturity at its most recent three-month prepayment rate. The prepayment rate is updated monthly based on the Company s previous three-month actual prepayment experience.

The Company utilizes three-month prepayment rates to anticipate prepayments because such rates are based on its own actual prepayment experience and because the Company believes three-month rates are a better estimate of future experience than either one-month or six-month or longer rates. In the opinion of management, a one-month rate does not capture enough experience to predict future prepayment behavior and may create undue volatility in interest income due to one-time fluctuations in prepayment activity. Conversely, in the opinion of management, a six-month or longer rate would not capture enough volatility to predict future prepayment behavior.

If a difference arises between the Company s estimated prepayments and its actual prepayments received, the constant effective yield is recalculated based on the Company s actual payments to date and anticipated future payments. This monthly recalculation results in the carrying value of the security being adjusted to the amount that would have existed had the new effective yield been applied since the purchase date, and a corresponding charge or credit is recognized to interest income.

For securities that do not represent holdings of large numbers of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, the associated premiums and discounts are amortized or accreted over their contractual term using the constant effective yield. Actual prepayment experience for such securities is reviewed monthly and a proportionate amount of premium or discount is recognized in income at that time such that the effective yield on the remaining portion of the securities continues unchanged.

As of and for the periods ended March 31, 2007 and 2006, the Company anticipated prepayments on its residential mortgage-backed securities. All other securities do not meet the SFAS 91 criteria for anticipating prepayments. Accordingly, no prepayments were anticipated for these securities.

Income Taxes Income tax expense is based on estimated taxes payable or refundable on a tax return basis for the current year and the changes in deferred tax assets and liabilities during the year. Deferred tax assets and liabilities are established for temporary differences between the accounting bases and the tax bases of the Company s assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. If the Company determines that it is more likely than not that some portion or all of a deferred tax asset will not be realized, the Company records a valuation allowance in accordance with the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109).

The Company presents taxes collected from customers and remitted to government authorities (such as sales and value added taxes) on a net basis in the consolidated statement of income and comprehensive income.

In accordance with Accounting Principles Board Opinion No. 23, *Accounting for Income Taxes Special Areas* (APB 23), the Company presumes the undistributed earnings of its foreign subsidiaries will be distributed to its parent company unless the Company adopts the indefinite reversal provisions of APB 23, which would require the Company to provide sufficient evidence to support that the subsidiary has invested or will invest the undistributed earnings indefinitely. The Company recognizes the indefinite reversal provision of APB 23 for its Irish and Cayman Islands subsidiaries due to the projected capital needs necessary to support the continued growth of these entities. As such, the Company does not record U.S. income taxes on the undistributed earnings of its Irish and Cayman Island subsidiaries.

On January 1, 2007, the Company adopted Statement of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 establishes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Pursuant to FIN 48, the effects of a tax position are recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination by the taxing authority. Conversely, previously recognized tax positions are derecognized when it is no longer more likely than not that the tax position would be sustained upon examination. FIN 48 also requires certain disclosures regarding unrecognized tax benefits and the amounts and classification of the related interest and penalties. There was no material impact to the financial condition or results of operations of the Company upon adoption of FIN 48.

As of January 1, 2007, the Company s unrecognized tax benefit totaled $2.1 million. The amount of unrecognized tax benefit which, if recognized, would affect the effective tax rate was $1.4 million, of which $0.4 million related to interest and penalties. The Company does not anticipate recognizing any unrecognized tax benefits during the next twelve months. In accordance with the Company s policy, any tax-related interest and/or penalties are classified as a component of income taxes in the consolidated statement of financial position. The tax years ended December 31, 2003, 2004 and 2005 remain subject to examination by various state jurisdictions.

Share-Based Compensation On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R requires that compensation cost relating to share-based payment transactions be recognized in the financial statements, with measurement based upon the fair value of the equity or liability instruments issued. The Company adopted SFAS 123R using the modified prospective application method. Under that method, compensation cost for equity awards granted after January 1, 2006 is recognized over the service period based on the grant date fair value. In addition, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of January 1, 2006 is recognized prospectively as the requisite service is rendered. The compensation cost for that portion of awards is based on the grant date fair value of those awards as calculated under the pro forma disclosures of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-based Compensation* (SFAS 123). In accordance with the modified prospective application method, the financial statements of interim periods prior to the adoption of SFAS 123R have not been restated.

The following table sets forth share-based compensation cost and the related tax benefit recognized in the income statement for all of the Company s share-based compensation plans (Dollars in thousands):

	For the Three Months Ended March 31,			
	2007		**2006**	
Share-based compensation cost	$	2,096	$	1,155
Income tax benefit	$	660	$	230

Certain of the Company s share-based awards contain terms that provide for a graded vesting schedule whereby portions of the awards vest in increments over the requisite service period. As provided for under SFAS 123R, the Company has elected to recognize compensation cost for awards granted on or after January 1, 2006 with graded vesting schedules on a straight-line basis over the requisite service period for the entire award.

The fair value of each option grant under the Director Plan, the Stock Plan, and the 2005 Plan (as described further in Note 8) was estimated on the date of grant using the Black-Scholes valuation model with the following weighted-average assumptions for the three months ended March 31, 2007 and 2006, respectively: an average assumed risk-free interest rate of 4.67% and 4.52%, an average expected term of seven years and five years, an expected volatility of 50.42% and 42.82%, and an average dividend yield of 0.20% and 0.21%.

The Company bases its estimate of expected term on the historical exercise and post-vesting employment termination behavior for similar grants. The Company s volatility assumption is based on the historical volatility of the Company s stock over a period equating to the expected term of the employee share option, using weekly price observations and looking backward from the date of grant.

The fair value of the option feature of grants under the 1997 Employee Stock Purchase Plan (ESPP) (as described further in Note 8) was estimated on the grant date using the Black-Scholes valuation model with the following weighted-average assumptions for the three months ended March 31, 2007 and 2006, respectively: an average assumed risk-free rate of 4.95% and 4.40%, an expected term of 0.5 years, an expected volatility of 28.84% and 36.96%, and an average dividend yield of 0.21% and 0.25%.

The expected term for the ESPP is equal to the six-month payment period. The Company estimates expected volatility for the ESPP in the same manner as for employee stock options, except that daily volatility is used instead of weekly volatility. The Company uses daily volatility for the ESPP because weekly volatility over six months does not result in a statistically significant number of data points upon which to base the volatility calculation.

Earnings Per Share Basic earnings per share (EPS) is computed by dividing net income by the weighted-average number of common shares outstanding during the quarter. Diluted EPS reflects the potential dilution that could occur if contracts to issue common stock were exercised into common stock that then shared in the earnings of the Company. The reconciliation from Basic EPS to Diluted EPS is as follows (Dollars in thousands, except per share data):

	For the Three Months Ended March 31, 2007	**2006**
Income available to common stockholders	$ 40,501	$ 37,403
Basic weighted-average shares outstanding	66,068,993	65,313,068
Dilutive effect of stock options	1,951,443	1,911,009
Diluted weighted-average shares outstanding	68,020,436	67,224,077
Earnings per share:		
Basic	$ 0.61	$ 0.57
Diluted	$ 0.60	$ 0.56

There were 843,717 and 91,737 options which were not considered dilutive for purposes of EPS calculations for the three-month periods ended March 31, 2007 and 2006, respectively.

Recently Issued Accounting Pronouncements In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands upon existing disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements. Rather, the guidance contained in SFAS 157 applies to assets, liabilities, and certain equity instruments that are already measured at fair value under existing accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We do not anticipate any material impact to our financial condition or results of operations as a result of the adoption of SFAS 157.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to elect to measure certain financial instruments and other items at fair value through earnings. The fair value option may be applied on an instrument by instrument basis, is irrevocable and is applied only to entire instruments. SFAS 159 requires additional financial statement presentation and disclosure requirements for those entities that elect to adopt the standard and is effective for fiscal years beginning after November 15, 2007. We do not anticipate any material impact to our financial condition or results of operations as a result of the adoption of SFAS 159.

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3. Securities

Amortized cost amounts and fair values of securities are summarized as follows as of March 31, 2007 (Dollars in thousands):

Held to Maturity	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Fair Value
Mortgage-backed securities	$ 3,611,327	$ 9,784	$ (20,895)	$ 3,600,216
Federal agency securities	1,542,336	1,551	(19,971)	1,523,916
State and political subdivisions	94,817	3,972	(56)	98,733
Total	$ 5,248,480	$ 15,307	$ (40,922)	$ 5,222,865

Available for Sale	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Fair Value
Mortgage-backed securities	$ 4,137,289	$ 11,880	$ (21,522)	$ 4,127,647
Federal agency securities	398,954	42	(46)	398,950
State and political subdivisions	343,905	2,539	(453)	345,991
Corporate debt	168,404	127	(818)	167,713
Foreign government securities	10,556		(21)	10,535
Total	$ 5,059,108	$ 14,588	$ (22,860)	$ 5,050,836

Amortized cost amounts and fair values of securities are summarized as follows as of December 31, 2006 (Dollars in thousands):

Held to Maturity	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Fair Value
Mortgage-backed securities	$ 3,753,497	$ 7,271	$ (25,584)	$ 3,735,184
Federal agency securities	1,680,458	2,956	(12,328)	1,671,086
State and political subdivisions	98,375	4,206	(63)	102,518
Total	$ 5,532,330	$ 14,433	$ (37,975)	$ 5,508,788

Available for Sale	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Fair Value
Mortgage-backed securities	$ 4,302,932	$ 7,400	$ (35,281)	$ 4,275,051
State and political subdivisions	343,204	2,090	(990)	344,304
Corporate debt	170,797	226	(1,173)	169,850
Foreign government securities	10,559		(24)	10,535
Total	$ 4,827,492	$ 9,716	$ (37,468)	$ 4,799,740

Excluded from the above tables are nonmarketable equity securities, which consisted primarily of stock of the FRBB and FHLBB at March 31, 2007 and December 31, 2006. The Company s capital stock investment in the FHLBB totaled $28.4 million as of March 31, 2007, which represents a $1.0 million decrease from December 31, 2006. The $28.4 million capital stock investment includes both a $25.0 million membership component and a $3.4 million activity-based component. The membership component of the FHLBB capital stock investment requires a five-year advance notice of withdrawal. The Company s $28.4 million capital stock investment in the FHLBB provides an overnight borrowing capacity of up to $114.5 million. There was no outstanding balance under this arrangement as of March 31, 2007. The Company currently has the ability to purchase up to $25.0 million of activity-based capital, which would provide a total overnight borrowing capacity of $833.3 million.

The Company had no sales of securities during the three-month periods ended March 31, 2007 and March 31, 2006.

The carrying value of securities pledged amounted to approximately $7.9 billion and $7.2 billion at March 31, 2007 and December 31, 2006, respectively. Securities are pledged primarily to secure clearings with other depository institutions, to secure repurchase agreements and to secure outstanding FHLBB and Federal Reserve Discount Window borrowings.

On a quarterly basis the Company reviews its investment portfolio on a security by security basis for any investment that may be other than temporarily impaired. In its evaluation, the Company considers the length of time the security has been impaired, the severity of the impairment, the financial condition and future prospects of the issuer and the Company s ability and intent to hold the security to maturity or until it recovers in value. At March 31, 2007, no securities were considered to be other-than-temporarily impaired.

4. Loans

Loans consist of demand loans to custody clients of the Company, including individuals, not-for-profit institutions and mutual fund clients. The loans to mutual funds and other pooled product clients include lines of credit and advances pursuant to the terms of the custody agreements between the Company and those clients to facilitate securities transactions and redemptions. Almost all of the Company s commitments to fund loans are at variable rates. The credit risk associated with these loans is considered low since the loans are, or may be, in the event of default, collateralized with marketable securities held by the Company as custodian. However, management recognizes some credit risk inherent in the portfolio, and therefore the Company has recorded an allowance for loan losses of $0.1 million at March 31, 2007, a level which has remained consistent for the past five years. This allowance is not allocated to any particular loan, but is intended to absorb any risk of loss inherent in the loan portfolio at the balance sheet date that is not captured in the Company s historical loss rates. Management actively monitors the loan portfolio and the underlying collateral and regularly assesses the adequacy of the allowance for loan losses. There were no impaired loans, nonperforming loans or loans on nonaccrual status at March 31, 2007 or December 31, 2006. In addition, there were no loan charge-offs or recoveries during the three months ended March 31, 2007 or 2006. Loans are summarized as follows (Dollars in thousands):

	March 31, 2007	**December 31, 2006**
Loans to mutual funds	$ 110,218	$ 152,491
Loans to individuals	94,312	64,118
Commercial and industrial	5,618	6,634
Other	48,907	47,550
	259,055	270,793
Less allowance for loan losses	(100)	(100)
Total	$ 258,955	$ 270,693

5. Deposits

The following is a summary of deposit balances by type (Dollars in thousands):

	March 31, 2007	**December 31, 2006**
Interest-bearing deposits:		
Demand	$ 121,218	$ 110,647
Savings	6,453,385	4,854,711
Time	255,260	224,386
Total interest-bearing deposits	6,829,863	5,189,744
Noninterest-bearing deposits:		
Demand	1,231,926	585,174
Savings	46,241	70,024
Time	375,000	300,000
Total noninterest-bearing deposits	1,653,167	955,198
Total	$ 8,483,030	$ 6,144,942

Time deposits with balances greater than $100,000 totaled $630.3 million and $524.4 million at March 31, 2007 and December 31, 2006, respectively. All time deposits had a maturity of less than three months at March 31, 2007 and December 31, 2006. The aggregate amounts of overdraft deposits that have been reclassified as loan balances were $131.3 million and $86.2 million at March 31, 2007 and December 31, 2006, respectively.

6. Securities Sold Under Repurchase Agreements

The components of securities sold under repurchase agreements are as follows (Dollars in thousands):

	March 31, 2007	December 31, 2006
Repurchase agreements - short term	$ 4,424,073	$ 3,627,800
Repurchase agreements - long term		100,000
Total	$ 4,424,073	$ 3,727,800

Approximately $4.6 billion and $3.9 billion of securities were pledged to collateralize repurchase agreements as of March 31, 2007 and December 31, 2006, respectively.

7. Short-term and Other Borrowings

The components of short-term and other borrowings are as follows (Dollars in thousands):

	March 31, 2007	December 31, 2006
Federal funds purchased	$ 62,497	$ 391,967
FHLBB overnight advances		125,000
Treasury, Tax and Loan account		84
Total	$ 62,497	$ 517,051

The Company has borrowing arrangements with the Federal Reserve Discount Window and the FHLBB, which have been utilized on an overnight and short-term basis to satisfy funding requirements. A summary of the borrowing arrangements are as follows (Dollars in thousands):

	March 31, 2007	December 31, 2006
Federal Reserve Discount Window:		
Borrowing capacity	$ 1,997,442	$ 1,984,499
Borrowing utilized		
Maturity range		
Securities pledged	2,086,828	2,077,291
Federal Home Loan Bank of Boston:		
Borrowing capacity	$ 114,523	$ 146,430
Borrowing utilized		125,000
Maturity range		Overnight
Securities pledged	932,399	925,286

8. Stockholders Equity

As of March 31, 2007, the Company s capital stock consisted of 1,000,000 authorized shares of preferred stock, of which no shares were issued, and 175,000,000 authorized shares of common stock, of which 69,660,108 shares were issued. All shares have a par value of $0.01 per share.

The Company has four equity incentive plans: the Amended and Restated 1995 Stock Plan (Stock Plan), the Amended and Restated 1995 Non-Employee Director Stock Option Plan (Director Plan), the 1997 Employee Stock Purchase Plan (ESPP) and the 2005 Equity Incentive Plan (the 2005 Plan). The 2005 Plan supersedes both the Stock Plan and the Director Plan, both of which continue in effect only with regard to options outstanding under those plans. Options awarded under the Stock Plan, the Director Plan and the 2005 Plan generally vest over zero to nine years of continuous service and generally have ten-year contractual terms. The exercise prices of these awards are generally equal to the fair market value of the Company s common stock on the date the awards are granted. There were no amendments to any plans during the three months ended March 31, 2007.

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Cash received from options exercised under all share-based payment arrangements for the three months ended March 31, 2007 was $29.5 million. The actual tax benefit realized for the tax deductions related to these exercises amounted to $6.6 million for the three months ended March 31, 2007.

In June 2006, the Company announced that its Board of Directors authorized a repurchase plan of up to $150.0 million of the Company s common stock over the twelve months following the announcement. As of March 31, 2007, the Company has repurchased $29.3 million of its common stock. The plan expires in June 2007.

The Stock Plan, the Director Plan, and the 2005 Plan

Effective with the start of the 2005 Plan, 45,703 shares of the Director Plan and 3,439,197 shares of the Stock Plan were transferred to the 2005 Plan. On April 14, 2005, the shareholders authorized an additional 2,000,000 shares of common stock for issuance under the 2005 Plan.

A summary of option activity under the Stock Plan, the Director Plan and the 2005 Plan for the three months ended March 31, 2007 is as follows:

Options	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2007	5,707,273	$ 31		
Granted	828,057	47		
Exercised	(873,349)	34		
Forfeited or expired	(14,223)	43		
Outstanding at March 31, 2007	5,647,758	33	5.9 years	$ 140,937
Exercisable at March 31, 2007	4,717,320	$ 31	5.2 years	$ 129,150

The weighted-average grant-date fair values per option of options granted during the three months ended March 31, 2007 and 2006 were $26.37 and $19.24, respectively. The total intrinsic values of options exercised during the three months ended March 31, 2007 and 2006 were $22.1 million and $7.1 million, respectively.

As of March 31, 2007, there was $21.5 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Stock Plan, the Director Plan and the 2005 Plan. That cost is expected to be recognized over a weighted-average period of 4.2 years.

A summary of the status of the Company s nonvested shares for the three months ended March 31, 2007 is presented below:

Nonvested Shares	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2007	4,000	$ 34
Granted	278,225	47
Vested		
Forfeited	(4,421)	47
Nonvested at March 31, 2007	277,804	$ 47

As of March 31, 2007, there was $12.7 million of total unrecognized compensation cost related to nonvested shares granted under the Stock Plan, the Director Plan and the 2005 Plan. That cost is expected to be recognized over a weighted-average period of 4.6 years.

ESPP

Under the terms of the ESPP, the Company may issue up to 1,620,000 shares of common stock pursuant to the exercise of nontransferable options granted to participating employees. The ESPP permits eligible employees to purchase up to 8,000 shares of common stock per payment period, subject to limitations provided by Section 423(b) of the Internal Revenue Code, through accumulated payroll deductions. The purchases are made twice a year at a price equal to the lesser of (i) 90% of the market value of the Company s common stock on the first business day of the payment period or (ii) 90% of the market value of the Company s common stock on the last business day of the payment period. The payment periods consist of two six-month periods, January 1 through June 30 and July 1 through December 31. The NASDAQ Stock Market became a registered national securities exchange with the SEC in August 2006. In accordance with the terms of the plan, because the Company is now traded on a national securities exchange, the Company will calculate the market value on a measurement day to be the average of the high and low prices of the Company s common stock on that day. This calculation method applies to all purchases made during and after the six-month period ended December 31, 2006.

A summary of activity under the ESPP is as follows:

	For the Three Months Ended March 31, 2007	**For the Year Ended December 31, 2006**
Total shares available under the plan, beginning of period	387,255	521,563
Issued at June 30		(68,506)
Issued at December 31		(65,802)
Total shares available under the plan, end of period	387,255	387,255

For the first payment period in the year ended December 31, 2006, the purchase price of the stock was $33.52, or 90% of the market value of the Company s common stock on the first business day of the payment period ending June 30, 2006. For the second payment period in the year ended December 31, 2006, the purchase price of the stock was $38.45, or 90% of the market value of the average of the high and low price of the Company s common stock on the last business day of the payment period ending December 31, 2006.

Prior to the adoption of SFAS 123R, the ESPP was considered a non-compensatory plan and, therefore, no compensation cost was recognized. However, pursuant to SFAS 123R, the ESPP is considered a compensatory plan, effective January 1, 2006. Accordingly, compensation cost is computed as the sum of: (a) 10% of the fair market value of the Company s common stock on the first day of the purchase period and (b) the fair value of the option features, calculated using the Black-Scholes valuation model. Compensation cost is recognized ratably over the payment period based on the components of fair value in the preceding sentence and the number of shares that could be purchased at grant date based on the estimated total withholdings and the discounted market price of the stock on grant date. The weighted-average grant-date fair value of awards granted under the ESPP was $8.17 per share for the three months ended March 31, 2007.

Compensation cost related to the ESPP was $0.3 million and $0.2 million for the three months ended March 31, 2007 and 2006, respectively. As of March 31, 2007, there was $0.3 million of total unrecognized compensation cost related to the nonvested awards granted under the ESPP.

9. Employee Benefit Plans

Pension Plan The Company has a trusteed, noncontributory, qualified defined benefit pension plan (Pension Plan) covering substantially all of its employees who were hired before January 1, 1997. The benefits are based on years of service and the employee s compensation during employment. Generally, the Company s funding policy is to contribute annually the maximum amount that can be deducted for federal income tax purposes. Contributions are intended to provide not only for benefits attributed to service to date, but also for benefits expected to be earned in the future. The plan document was amended in December 2001 and December 2004 to freeze benefit accruals for certain highly compensated participants. Effective December 31, 2005, all Pension Plan participant s accounts were frozen and effective January 1, 2006, no further Pension Plan benefit will accrue on behalf of any Pension Plan participant. The Company uses a December 31 measurement date for this plan.

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Net periodic pension benefit for the Company s Pension Plan included the following components (Dollars in thousands):

	For the Three Months Ended March 31, 2007	March 31, 2006
Interest cost on projected benefit obligations	$ 252	$ 235
Expected return on plan assets	(378)	(349)
Amortization of net transition (asset) obligation		(7)
Amortization of net loss	6	25
Net periodic pension benefit	$ (120)	$ (96)

The Company does not expect to contribute to its Pension Plan during 2007, and no contributions were made during the three-month period ended March 31, 2007.

Supplemental Retirement Plan The Company also has a nonqualified, unfunded, supplemental retirement plan (SERP) which was established in 1994 and covers certain employees and pays benefits that supplement any benefits paid under the Pension Plan. Benefits under the SERP are generally based on compensation not includable in the calculation of benefits to be paid under the Pension Plan. The plan document was amended in April 2000 to eliminate the compensation cap and include bonuses and commissions of certain employees. The Company uses a December 31 measurement date for this plan.

Net periodic pension cost for the Company s SERP included the following components (Dollars in thousands):

	For the Three Months Ended March 31, 2007	March 31, 2006
Service cost-benefits earned / benefit obligations	$ 424	$ 462
Interest cost on projected benefit obligations	440	396
Amortization of net transition (asset) obligation	1	1
Amortization of prior service cost	36	36
Amortization of net loss	160	202
Net periodic pension cost	$ 1,061	$ 1,097

During the three-month period ended, March 31, 2007, the Company contributed $0.03 million to the SERP, and the SERP distributed $0.03 million to its plan participants. The Company does not anticipate making any contributions during the remainder of 2007.

Effective December 31, 2006, the Company adopted the provisions of FASB Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). SFAS 158 changes current practice by requiring employers to recognize the overfunded or underfunded positions of defined benefit postretirement plans, including pension plans, on the balance sheet. The funded status is defined as the difference between the projected benefit obligation and the fair value of plan assets. SFAS 158 also requires employers to recognize the change in funded status in other comprehensive income (a component of shareholders equity). Upon adopting SFAS 158, the Company recognized the funded status of its SERP and pension plans on its consolidated balance sheet.

10. Off-Balance Sheet Financial Instruments

Lines of Credit At March 31, 2007, the Company had commitments to mutual funds, individuals and others under collateralized open lines of credit totaling $1.3 billion, against which $127.7 million in loans were drawn. The credit risk involved in issuing lines of credit is essentially the same as that involved in extending demand loans. The Company does not anticipate any loss as a result of these lines of credit.

Securities Lending On behalf of its clients, the Company lends securities to creditworthy broker-dealers. In certain circumstances, the Company may indemnify its clients for the fair market value of those securities against a failure of the borrower to return such securities. The Company requires the borrowers to provide collateral in an amount equal to, or in excess of, 102% of the fair market value of U.S. dollar-denominated securities borrowed and 105% of the fair market value of non-U.S. dollar-denominated securities borrowed. The borrowed securities are revalued daily to determine whether additional collateral is necessary. As guarantor, the Company is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The Company measures the fair value of its indemnification obligation by marking its securities lending portfolio to market on a daily basis and comparing the value of the portfolio to the collateral holdings position. The fair value of the indemnification obligation to be recorded would be the deficiency of collateral as compared to the value of the securities out on loan.

With respect to the indemnified securities lending portfolio, the cash and U.S. government securities held by the Company as collateral at March 31, 2007 totaled $11.8 billion, while the fair value of the indemnified securities lending portfolio totaled approximately $11.3 billion. Given that the collateral held was in excess of the value of the securities that the Company would be required to replace if the borrower defaulted and failed to return such securities, the Company s indemnification obligation was zero and no liability was recorded.

All securities loans are categorized as overnight loans. The maximum potential amount of future payments that the Company could be required to make would be equal to the market value of the securities borrowed. Since the securities loans are over collateralized by 2% (for U.S. dollar-denominated securities) to 5% (for non-U.S. dollar-denominated securities) of the fair market value of the loan made, the collateral held by the Company would be used to satisfy the obligation. In addition, each borrowing agreement includes set-off language that allows the Company to use any excess collateral on other loans to that borrower to cover any collateral shortfall of that borrower. However, there is a potential risk that the collateral would not be sufficient to cover such an obligation if the security on loan increased in value between the time the borrower defaulted and the time the security is bought-in . In those instances, the Company would buy-in the security using all available collateral and a loss would result from the difference between the value of the security bought-in and the value of the collateral held. The Company has never experienced a broker default.

11. Derivative Financial Instruments

Interest Rate Contracts Interest rate contracts involve an agreement with a counterparty to exchange cash flows based on an underlying interest rate index. A swap agreement involves the exchange of a series of interest payments, either at a fixed or variable-rate, based upon the notional amount without the exchange of the underlying principal amount. The Company s exposure from these interest rate contracts results from the possibility that one party may default on its contractual obligation when the contracts are in a gain position. The Company has experienced no terminations by counterparties of interest rate swaps. Credit risk is limited to the positive fair value of the derivative financial instrument, which is significantly less than the notional value. The positive fair values related to the Company s interest rate contracts was approximately $9.0 million and $13.8 million at March 31, 2007 and December 31, 2006, respectively, which are included in other assets on the Company s consolidated balance sheet.

The Company enters into pay-fixed/receive-floating interest rate swap agreements. These instruments have been designated as cash flow hedges of variable-rate liabilities and a forecasted series of fixed-rate overnight liabilities incurred at different daily fixed rates (thereby resulting in a variable interest expense pattern). The contractual or notional amounts of the interest rate swap agreements held by the Company were approximately $1.3 billion at March 31, 2007 and $1.6 billion at December 31, 2006, respectively. These contracts had net fair values of approximately $8.9 million and $13.8 million at March 31, 2007 and December 31, 2006, respectively. These fair values are included in the respective other assets and other liabilities categories on the Company s consolidated balance sheets.

For the three months ended March 31, 2007, the Company recognized net pre-tax losses of $0.7 million, which represented the total ineffectiveness for all cash flow hedges. Hedge ineffectiveness did not have a material impact on earnings for the three months ended March 31, 2006.

As of March 31, 2007, the Company expects that approximately $3.4 million of deferred net after-tax gains on derivative contracts included in other comprehensive income will be reclassified to net interest income within the next twelve months. This expectation is based on the net discounted cash flows from existing cash flow hedging derivatives, as well as the amortization of gains from the terminated cash flow hedging derivatives.

Foreign Exchange Contracts Foreign exchange contracts involve an agreement to exchange the currency of one country for the currency of another country at an agreed-upon rate and settlement date. Foreign exchange contracts consist of spot, forward and swap contracts. Spot contracts call for the exchange of one currency for another and usually settle in two business days. Forward contracts call for the exchange of one currency for another at a date beyond spot. In a currency swap, the holder of a currency transacts simultaneously both a spot and a forward transaction in that currency for an equivalent amount of another currency to get temporary liquidity in the currency owned. The Company s risk from foreign exchange contracts results from the possibility that one party may default on its contractual obligation or from movements in exchange rates. Credit risk is limited to the positive market value of the derivative financial instrument, which is significantly less than the notional value. The notional value of the Company s foreign exchange contracts at March 31, 2007 and December 31, 2006 was $17.0 billion and $13.5 billion, respectively. Unrealized gains or losses resulting from purchases and sales of foreign exchange contracts are included within the respective other assets and other liabilities categories on the Company s consolidated balance sheets. Unrealized gains in other assets were $24.8 million and $27.5 million at March 31, 2007 and December 31, 2006, respectively. Unrealized losses in other liabilities were $23.2 million and $27.0 million at March 31, 2007 and December 31, 2006, respectively. Foreign exchange contracts with the same counterparty are netted in the Company s consolidated balance sheets when a master netting agreement exists. These contracts have not been designated as hedging instruments; therefore, all changes in fair value are included in asset servicing fees.

Other The Company also enters into fixed price purchase contracts that are designed to hedge the variability of the consideration to be paid for the purchase of investment securities. By entering into these contracts, the Company is fixing the price to be paid at a future date for certain investment securities. Changes in fair value of these cash flow hedges are included as a component of other comprehensive income. The Company had no fixed price purchase contracts outstanding to purchase investment securities at March 31, 2007 and December 31, 2006.

12. Commitments and Contingencies

Restrictions on Cash Balances The Company is required to maintain certain average cash reserve balances. The average required reserve balance with the FRBB for the two-week period including March 31, 2007 was approximately $55.4 million. In addition, the Company s consolidated balance sheet includes deposits totaling $32.8 million, which were pledged to secure clearings with depository institutions as of March 31, 2007.

Contingencies Assets held by the Company in a fiduciary capacity are not included in the consolidated balance sheets since these items are not assets of the Company. Management conducts regular reviews of its fiduciary responsibilities and considers the results in preparing its consolidated financial statements. In the opinion of management, there were no contingent liabilities related to its fiduciary capacity at March 31, 2007 that were material to the consolidated financial position or consolidated results of operations of the Company.

13. Regulatory Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company s and the Bank s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company s and the Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of March 31, 2007, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of March 31, 2007, the most recent notification from the Federal Deposit Insurance Corporation categorized the Company and the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Company and the Bank must maintain minimum Total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Company s or the Bank s category.

The following table presents the capital ratios for the Company and the Bank (Dollars in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of March 31, 2007:						
Total Capital (to Risk-Weighted Assets-the Company)	$ 977,070	17.95 %	$ 435,496	8.00 %	N/A	N/A
Total Capital (to Risk-Weighted Assets-the Bank)	$ 905,151	16.63 %	$ 435,355	8.00 %	$ 544,194	10.00 %
Tier 1 Capital (to Risk-Weighted Assets-the Company)	$ 976,970	17.95 %	$ 217,748	4.00 %	N/A	N/A
Tier 1 Capital (to Risk-Weighted Assets-the Bank)	$ 905,051	16.63 %	$ 217,677	4.00 %	$ 326,516	6.00 %
Tier 1 Capital (to Average Assets-the Company)	$ 976,970	7.66 %	$ 510,029	4.00 %	N/A	N/A
Tier 1 Capital (to Average Assets-the Bank)	$ 905,051	7.10 %	$ 509,821	4.00 %	$ 637,276	5.00 %
As of December 31, 2006:						
Total Capital (to Risk-Weighted Assets-the Company)	$ 900,299	19.04 %	$ 378,305	8.00 %	N/A	N/A
Total Capital (to Risk-Weighted Assets-the Bank)	$ 863,841	18.28 %	$ 378,048	8.00 %	$ 472,560	10.00 %
Tier 1 Capital (to Risk-Weighted Assets-the Company)	$ 900,199	19.04 %	$ 189,152	4.00 %	N/A	N/A
Tier 1 Capital (to Risk-Weighted Assets-the Bank)	$ 863,741	18.28 %	$ 189,024	4.00 %	$ 283,536	6.00 %
Tier 1 Capital (to Average Assets-the Company)	$ 900,199	7.63 %	$ 472,082	4.00 %	N/A	N/A
Tier 1 Capital (to Average Assets-the Bank)	$ 863,741	7.32 %	$ 471,715	4.00 %	$ 589,643	5.00 %

Under Massachusetts law, trust companies such as the Bank, like national banks, may pay dividends no more often than quarterly and only out of net profits and to the extent that such payments will not impair the Bank s capital stock and surplus account. Moreover, prior Commissioner approval is required if the total dividends for a calendar year would exceed net profits for that year combined with retained net profits for the previous two years. These restrictions on the ability of the Bank to pay dividends to the Company may restrict the ability of the Company to pay dividends to its stockholders.

The operations of the Company s securities broker affiliate, Investors Securities Services, LLC (ISS), are subject to federal and state securities laws, as well as the rules of both the SEC and the NASD. Management believes, as of March 31, 2007, that ISS is in material compliance with all of the foregoing requirements to which it is subject.

The operations of the Company s captive insurance affiliate, Investors Vermont Insurance Company (IVIC), are subject to the laws and regulations of the BISHCA. Management believes, as of March 31, 2007, that IVIC is in material compliance with all of the foregoing requirements to which it is subject.

The operations of the Company s affiliated international subsidiaries are subject to laws and regulations of various regulators, including the OSFI, the IFSRA, the CIMA, the FSA and the CSSF. Management believes, as of March 31, 2007, that its affiliated international subsidiaries are all in compliance with all of the foregoing requirements to which each is subject.

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In June 2004, the Basel Committee on Banking Supervision (Basel Committee) released the document International Convergence of Capital Measurement and Capital Standards: A Revised Framework. The Framework, also referred to as Basel II, is designed to secure international convergence on regulations and standards governing the capital adequacy of internationally active banking organizations. In September 2006, the U.S. banking and thrift supervisory agencies issued a notice of Proposed Rulemaking setting forth a proposed framework for the timing and qualification process for U.S. banks that are either required (core banks) or choose (opt-in banks) to be subject to Basel II. As currently proposed, the new rules as applied in the U.S. are expected to become effective on January 1, 2009, subject to transitional parallel testing beginning on January 1, 2008. Although the Bank is not required to be compliant with the new rules, the Bank is in the process of developing and implementing a program to achieve Basel II compliance. Ultimately, U.S. implementation of Basel II will depend on, and will be subject to, final regulations and related policies promulgated by the U.S. supervisory agencies. The Bank cannot predict the final form of the rules, nor their impact on its risk-based capital.

14. Geographic Reporting and Service Lines

The Company does not utilize segment information for internal reporting, as management views the Company as one segment. The following represents net operating revenue and long-lived assets (including goodwill) by geographic area (Dollars in thousands):

	Net Operating Revenue Three Months Ended March 31,		**Long-Lived Assets**	
Geographic Information	**March 31, 2007**	**2006**	**March 31, 2007**	**December 31, 2006**
United States	$ 204,304	$ 180,758	$ 196,984	$ 182,276
Ireland	14,063	10,411	13,128	9,269
Canada	1,689	1,508	125	116
Luxembourg	127		83	75
United Kingdom	81	70	1,417	1,520
Cayman Islands	34	41		
Total	$ 220,298	$ 192,788	$ 211,737	$ 193,256

Barclays Global Investors, N.A. (BGI) accounted for approximately 18% of the Company s consolidated net operating revenues for the three-month periods ended March 31, 2007 and 2006. No client other than BGI accounted for more than 10% of the Company s consolidated net operating revenues for the three-month periods ended March 31, 2007 and 2006.

The following represents the Company s asset servicing fees by service lines (Dollars in thousands):

	For the Three Months Ended March 31,	
	2007	2006
Core service fees:		
Custody, accounting and administration	$ 129,026	$ 107,759
Value-added service fees:		
Foreign exchange	17,594	20,334
Cash management	14,343	11,312
Securities lending	6,060	6,162
Investment advisory	1,839	1,936
Other service fees	791	800
Total value-added service fees	40,627	40,544
Total asset servicing fees	$ 169,653	$ 148,303

15. Net Interest Income

The components of interest income and interest expense are as follows (Dollars in thousands):

	For the Three Months Ended March 31, 2007	2006
Interest income:		
Federal funds sold and securities purchased under resale agreements, interest-bearing deposits with other banksand other short-term investments	$ 20,762	$ 478
Investment securities:		
Mortgage-backed securities	102,838	96,777
Federal agency securities	20,964	24,663
State and political subdivisions (exempt from federal tax)	4,600	5,503
Other securities	2,665	2,807
Loans	6,156	4,209
Total interest income	157,985	134,437
Interest expense:		
Deposits	62,444	33,687
Securities sold under repurchase agreements	43,993	40,954
Short-term and other borrowings	1,777	15,870
Junior subordinated debentures	605	605
Total interest expense	108,819	91,116
Net interest income	$ 49,166	$ 43,321

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Investors Financial Services Corp.

We have reviewed the accompanying consolidated balance sheet of Investors Financial Services Corp. and subsidiaries (the Company) as of March 31, 2007, and the related consolidated statements of income and comprehensive income, stockholders equity and cash flows for the three-month periods ended March 31, 2007 and 2006. These interim financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Investors Financial Services Corp. and subsidiaries as of December 31, 2006, and the related consolidated statements of income and comprehensive income, stockholders equity, and cash flows for the year then ended (not presented herein); and in our report dated February 26, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

DELOITTE & TOUCHE LLP

Boston, Massachusetts
May 2, 2007

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion together with our Unaudited Consolidated Financial Statements and related Notes to Unaudited Consolidated Financial Statements, which are included elsewhere in this Report. The following discussion contains forward-looking statements that reflect plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. See Certain Factors That May Affect Future Results.

Unless otherwise indicated or unless the context requires otherwise, all references in this Report to Investors Financial, we, us, our, or similar references mean Investors Financial Services Corp., together with our subsidiaries. Investors Bank or the Bank means our subsidiary, Investors Bank & Trust Company, alone.

Overview

We provide asset administration services for the financial services industry through our wholly-owned subsidiary, Investors Bank & Trust Company. We provide core services and value-added services to a variety of financial asset managers, including mutual fund complexes, investment advisors, family offices, hedge funds, banks and insurance companies. Core services include global custody, multicurrency accounting, fund administration and middle office outsourcing. Value-added services include foreign exchange, cash management, securities lending, investment advisory, performance measurement, institutional transfer agency, lines of credit and brokerage and transition management services. We have offices located in the United States, Ireland, Canada, the Cayman Islands, the United Kingdom and Luxembourg with a vast global subcustodian network established to accommodate the international needs of our clients. At March 31, 2007, we provided services for approximately $2.3 trillion in net assets, including approximately $0.5 trillion in foreign net assets.

We grow our business by selling our services to new clients and by further penetrating our existing clients. We believe that we service approximately 10% of the assets managed by our existing clients, and we have traditionally achieved significant success in growing client relationships. Our ability to service new clients and expand our relationships with existing clients depends on our provision of superior client service. Our growth is also affected by conditions in the global securities markets, the interest rate environment, the regulatory environment for us and our clients and the success of our clients in marketing their products.

We derive our asset servicing revenue from providing core and value-added services. We derive our net interest income by investing the cash balances our clients leave on deposit with us. Since we price our service offerings on a bundled basis, our share of earnings from these investments is viewed as part of the total compensation that our clients pay us for servicing their assets. In establishing a fee structure for a specific client, we analyze all expected revenue and expenses. We believe net operating revenue (net interest income plus noninterest income) and net income are the most meaningful measures of our financial results.

As an asset administration services company, the amount of net operating revenue that we generate is impacted by overall market conditions, client activity and the prevailing interest rate environment. A significant portion of our core services revenue is based upon the amount of assets we process. As market values of underlying assets fluctuate, so will our revenue. We have managed this volatility by offering a tiered pricing structure for our asset-based fees. As asset values increase, the basis point fee is reduced for the incremental assets. When asset values decrease, revenue is only impacted at the then marginal rate. Many of our value-added services are transactional based, and we receive a fee for each transaction processed. The higher net interest margin experienced during the first three months of 2007 as compared to the same period in 2006 is primarily a result of higher levels of client based funding relative to external borrowings. The yield curve has remained inverted throughout the first quarter of 2007, impacting reinvestment and purchase spreads on investments. The majority of our liability base reprices to overnight or short-term rates, which have remained stable during the first quarter 2007. The market implied forward yield curve, which is used as a basis in our net interest income forecasting, incorporates a modest steepening during the second half of 2007 which would positively impact our forecasted net interest income.

On February 4, 2007, we entered into an Agreement and Plan of Merger (the Merger Agreement) with State Street Corporation (State Street). At the closing of the transaction contemplated by the Merger Agreement, we will merge into State Street and our shareholders will receive 0.906 shares of State Street common stock for each share of our common stock. Each company s Board of Directors has approved the Merger Agreement. We expect to complete the transaction in the third quarter of 2007, subject to customary closing conditions, including regulatory and shareholder approval.

Certain Factors That May Affect Future Results

From time to time, information provided by us, statements made by our employees, or information included in our filings with the Securities Exchange Commission (SEC) (including this Form 10-Q) may contain statements which are not historical facts, so-called forward-looking statements, which are made under Section 21E of the Securities Exchange Act of 1934 and which involve risks and uncertainties. These statements relate to future events or our future financial performance and are identified by words such as may, could, should, expect, plan, intend, seek, anticipate, believe, estimate, potential, or continue or other comparable terms or the negative of those terms. Forward-loo statements in this Form 10-Q include certain statements regarding the anticipated closing of our acquisition by State Street Corporation, recognition of tax benefits, liquidity, capital resources, growth rate, annual dividend payments, interest rate conditions, the shape of the yield curve, interest rate sensitivity, compliance with capital adequacy guidelines, loss exposure on lines of credit, foreign exchange revenue, cash management revenue, securities lending revenue, net interest income, operating margin, operating expenses, including investments in technology, investments in Federal Home Loan Bank of Boston (FHLBB) capital stock, the effect on earnings of changes in equity values or fixed income values, the effects of increased prepayments and reduced investment opportunities for our net interest income, the effect of any anticipated activity under our stock repurchase plan, contributions to our supplemental retirement plan, the effect of new accounting pronouncements, the effect of amortization and the effect of certain legal claims against us. Our actual future results may differ significantly from those stated in any forward-looking statements. Factors that may cause such differences include, but are not limited to, the factors discussed in Item 1A of this Form 10-Q and our Form 10-K filed on February 27, 2007.

Statements of Income

Comparison of Operating Results for the Three Months Ended March 31, 2007 and 2006

Net income for the three months ended March 31, 2007 increased 8% to $40.5 million from the same period in 2006. The increase primarily resulted from increased net interest income and asset servicing fees, which reflect our ability to sell to new and existing clients, combined with market appreciation and strong client fund flows.

Fees and Other Revenue

The components of fees and other revenue are as follows (Dollars in thousands):

	For the Three Months Ended March 31, 2007	2006	Change
Total asset servicing fees	$ 169,653	$ 148,303	14 %
Other operating income	1,479	1,164	27 %
Total fees and other revenue	$ 171,132	$ 149,467	14 %

The largest components of asset servicing fees are custody, accounting and administration fees, which increased 20% to $129.0 million for the three-month period ended March 31, 2007 from $107.8 million for the same period in 2006. Custody, multicurrency accounting and fund administration fees are based in part on the value of assets processed. Assets processed is the total dollar value of financial assets on the reported date for which we provide one or more of the following services: global custody, multicurrency accounting, fund administration, middle office outsourcing, foreign exchange, cash management, securities lending, investment advisory, performance measurement, institutional transfer agency, lines of credit and brokerage and transition management services.

The change in net assets processed includes the following components (Dollars in billions):

	For the Three Months Ended March 31, 2007	
Net assets processed, beginning of period	$	2,212
Change in net assets processed:		
Sales to new clients	1	
Further penetration of existing clients	12	
Lost clients		
Fund flows and market gain	51	
Total change in net assets processed	64	
Net assets processed, end of period	$	2,276

The majority of the increase in assets processed for the three months ended March 31, 2007 was due to client fund flows and market movements. As indicated in the Overview section, our core services fees are primarily generated by charging a fee based upon the value of assets processed. As market values or clients asset levels fluctuate, so will our revenue. Our tiered pricing structure, coupled with minimum and flat fees, allow us to manage this volatility to a certain extent. As asset values increase, the basis point fee typically lowers. When asset values decrease, revenue is only impacted by the asset decline at the then marginal rate.

If the value of equity or fixed income assets held by our clients were to increase or decrease by 10% for a sustained period of time, we estimate currently that this market movement, by itself, would cause a corresponding change of less than 5% in our earnings per share. Earnings per share do not track precisely to the value of the equity and fixed-income markets because conditions present in a market increase or decrease may generate offsetting increases or decreases in other revenue and expense items that are influenced by the value of the assets we administer. For example, increased market volatility often results in higher transaction fee revenue. Also, market value declines may result in increased interest income and sweep fee income as clients move larger amounts of assets into the cash management vehicles that we offer. In addition, our tiered pricing structure reduces the impact of volatility in asset values to a certain extent. However, there can be no assurance that any of these offsetting revenue and expense movements will occur during any future upturn or downturn in the equity or fixed-income markets, or that our tiered pricing structure will reduce the impact on us of a sustained change in asset values.

Transaction-driven income includes our value-added services, such as foreign exchange, cash management, securities lending and investment advisory services.

- Foreign exchange fees were $17.6 million for the three-month period ended March 31, 2007, down 13% from the same period in 2006. The decrease in foreign exchange fees is attributable to decreased volatility in currency markets. Future foreign exchange income is dependent on the volume of new and existing client activity and overall volatility in the currencies traded.

- Cash management fees, which consist of sweep fees, were $14.3 million for the three-month period ended March 31, 2007, up 27% from the same period in 2006. The increase is primarily due to higher balances placed by our clients in the cash management products we offer. Cash management fees will continue to depend on the level of client balances and interest rate volatility. If our clients investment products continue to maintain higher cash balances than they did in comparable periods, we expect our cash management revenue to be positively impacted.

- Securities lending fees were $6.1 million for the three-month period ended March 31, 2007, down 2% from the same period in 2006, primarily due to lower transaction spreads in the first three months of 2007. Securities lending transaction volume and spreads are positively affected by the market value of securities on loan, merger and acquisition activity, increased IPO activity, the seasonality of international dividend arbitrage and a steeper short-end of the yield curve. If the capital markets experience any of the aforementioned activity, it is likely that our securities lending revenue will be positively impacted. If we experience any of the following: 1) a reduction in our securities lending portfolio volume, 2) lower market values or 3) compression of the spreads earned on securities lending activity, our securities lending revenue will likely be negatively impacted.

- Investment advisory fees were $1.8 million for the three-month period ended March 31, 2007, down 5% for the same period in 2006 due to lower asset values in our proprietary Merrimac money market funds. Future investment advisory fee income is dependent upon asset levels within the Merrimac money market funds, which are driven by overall market conditions, client activity and transaction volumes.

- Other service fees were $0.8 million for the three-month period ended March 31, 2007, down 1% from the same period in 2006. Other service fees include income earned on compliance advisory, brokerage and transition management services. The decrease in other service fees is primarily due to a decrease in transition management service fees.

- Other operating income for the three-month period ended March 31, 2007 was $1.5 million, up 27% from the same period in 2006, primarily due to an increase in interest earned on clearing agency deposits.

Net Interest Income

The following table presents the components of net interest income (Dollars in thousands):

	For the Three Months Ended March 31, 2007	2006	Change
Interest income	$ 157,985	$ 134,437	18 %
Interest expense	108,819	91,116	19 %
Net interest income	$ 49,166	$ 43,321	13 %

Net interest income is affected by the volume and mix of assets and liabilities and the movement and level of interest rates. The increase in our net interest income for the three-month period ended March 31, 2007 was primarily due to strong client funding. Average investment security balances were down $0.8 billion for the three-month period ended March 31, 2007 compared to the same period in 2006, primarily due to lower reinvestment.

The table below presents the changes in net interest income resulting from changes in the volume of interest-earning assets or interest-bearing liabilities and changes in interest rates for the three months ended March 31, 2007 compared to the same period in 2006. Changes attributed to both volume and rate have been allocated based on the proportion of change in each category (Dollars in thousands):

	For the Three Months Ended March 31, 2007 Change Due to Volume	Change Due to Rate	Net
Interest-earning assets:			
	$ 20,187	$ 97	$ 20,284

Federal funds sold and securitiespurchased under resale agreements, interest-bearing deposits with other banks and short-term investments			
Investment securities	(9,807)	11,124	1,317
Loans	109	1,838	1,947
Total interest-earning assets	10,489	13,059	23,548
Interest-bearing liabilities:			
Deposits	18,656	10,101	28,757
Borrowings	(21,809)	10,755	(11,054)
Total interest-bearing liabilities	(3,153)	20,856	17,703
Change in net interest income	$ 13,642	$ (7,797)	$ 5,845

In addition to investing in both variable and fixed-rate securities, we use derivative instruments to manage our exposure to interest rate risk. See the Market Risk section for more detailed information.

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The following tables present average balances, interest income and expense, and yields earned or paid on the major categories of assets and liabilities for the periods indicated (Dollars in thousands):

	Three Months Ended March 31, 2007			Three Months Ended March 31, 2006		
	Average Balance	**Interest**	**Average Yield/Cost**	**Average Balance**	**Interest**	**Average Yield/Cost**
Interest-earning assets:						
Federal funds sold and securities purchased under resale agreements, interest-bearing deposits with other banks and other short-term investments	$ 1,584,121	$ 20,762	5.24 %	$ 42,784	$ 478	4.47 %
Investment securities(1)						
Mortgage-backed securities	7,924,358	102,838	5.19 %	8,160,279	96,777	4.74 %
Federal agency securities	1,717,695	20,964	4.88 %	2,210,833	24,663	4.46 %
State and political subdivisions	438,942	4,600	4.19 %	505,096	5,503	4.36 %
Other securities	180,016	2,665	5.92 %	212,146	2,807	5.29 %
Total investment securities	10,261,011	131,067	5.11 %	11,088,354	129,750	4.68 %
Loans	324,997	6,156	7.58 %	316,996	4,209	5.31 %
Total interest-earning assets	12,170,129	157,985	5.19 %	11,448,134	134,437	4.70 %
Allowance for loan losses	(100)			(100)		
Noninterest-earning assets	639,557			641,002		
Total assets	$ 12,809,586			$ 12,089,036		
Interest-bearing liabilities:						
Deposits:						
Demand	$ 136,494	$ 1,565	4.65 %	$ 95,778	$ 919	3.84 %
Savings	5,821,103	57,035	3.97 %	4,078,497	31,922	3.13 %
Time	294,892	3,844	5.21 %	75,974	846	4.45 %
Securities sold under repurchaseagreements	4,491,610	43,993	3.92 %	4,826,124	40,954	3.39 %
Junior subordinated debentures	24,774	605	9.77 %	24,774	605	9.77 %
Other borrowings	104,651	1,777	6.79 %	1,401,077	15,870	4.53 %
Total interest-bearing liabilities	10,873,524	108,819	4.00 %	10,502,224	91,116	3.47 %
Noninterest-bearing liabilities:						
Demand deposits	412,091			342,368		
Savings	95,162			56,212		
Time deposits	306,111			215,000		
Other liabilities	143,616			174,591		
Total liabilities	11,830,504			11,290,395		
Equity	979,082			798,641		
Total liabilities and equity	$ 12,809,586			$ 12,089,036		
Net interest income		$ 49,166			$ 43,321	
Net interest margin (2)			1.62 %			1.51 %
Average interest rate spread (3)			1.19 %			1.23 %
Ratio of interest-earning assets to interest-bearing liabilities			111.92 %			109.01 %

(1) Average yield/cost on available for sale securities is based on amortized cost.

(2) Annualized net interest income divided by total interest-earning assets.

(3) Yield on interest-earning assets less rate paid on interest-bearing liabilities.

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Operating Expenses

Total operating expenses were $159.4 million for the three months ended March 31, 2007, up 17% from the same period in 2006. The increase in total operating expenses for the three-month period ended March 31, 2007 was primarily due to increased compensation and benefits, transaction processing services, occupancy and depreciation and amortization, as detailed below. The components of operating expenses were as follows (Dollars in thousands):

	For the Three Months Ended March 31, 2007	2006	Change
Compensation and benefits	$ 97,420	$ 76,998	27 %
Technology and telecommunications	18,535	17,338	7 %
Transaction processing services	15,341	13,672	12 %
Occupancy	10,018	7,551	33 %
Depreciation and amortization	9,691	7,806	24 %
Professional fees	2,273	3,461	(34 %)
Travel and sales promotion	2,126	1,931	10 %
Insurance	980	973	1 %
Other operating expenses	3,010	5,954	(49 %)
Total operating expenses	$ 159,394	$ 135,684	17 %

Compensation and benefits expense was $97.4 million for the three months ended March 31, 2007, up 27% from the same period last year due to higher headcount in our Boston and European offices. Annual salary increases and option expense also contributed to the growth in the compensation and benefits expense.

Technology and telecommunications expense was $18.5 million for the three months ended March 31, 2007, up 7% from the same period last year. The increase is primarily due to our investment in enhancing our global integrated technology platform, which we view as a significant competitive advantage and growth in new business and existing customer volumes. Generally, we expect technology reinvestment to equal approximately 18-20% of net operating revenue each year, including related compensation costs.

Transaction processing services expense was $15.3 million for the three months ended March 31, 2007, up 12% from the same period last year due to increases in transaction volumes, higher market values and new business. Future transaction processing services expense will be dependent upon asset levels and the volume of client transaction activity.

Occupancy expense was $10.0 million for the three months ended March 31, 2007, up 33% from the same period last year due to the addition of our new office space worldwide.

Depreciation and amortization expense was $9.7 million for the three months ended March 31, 2007, up 24% from the same period last year due to new computer equipment and to the increased amortization of leasehold improvements from our office space build-outs in 2006.

Professional fees expense was $2.3 million for the three months ended March 31, 2007, down 34% from the same period last year. The decrease is primarily attributed to lower legal fees.

Travel and sales promotion expense was $2.1 million for the three months ended March 31, 2007, up 10% from the same period last year. Travel and sales promotion expense consists of expenses incurred by the sales force, client management staff and other employees in connection with sales calls on potential clients, traveling to existing client sites and our foreign offices, and attendance at industry conferences.

Other operating expense was $3.0 million for the three months ended March 31, 2007, down 49% from the same period last year as a result of lower temporary staffing expenses and the partial reversal of a previously accrued loss contingency.

Income Taxes

Income taxes were $20.4 million for the three-month period ended March 31, 2007, up 4% from the same period in 2006. This increase in income taxes is primarily related to an increase in pretax earnings, partially offset by a 1% decrease in the 2007 effective tax rate resulting from a change in the recognition threshold of a tax position, which occurred in the second quarter of 2006.

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Financial Condition

At March 31, 2007, our total assets were $14.2 billion, up 23% from $11.6 billion at December 31, 2006, primarily due to an increase in Federal funds sold and securities purchased under resale agreements. Average interest-earning assets increased $0.7 billion, or 6%, for the three-month period ended March 31, 2007 as compared to the same period in 2006. Our asset growth, particularly in Federal funds sold, was primarily driven by strong client funding during the first three months of 2007.

Investment Portfolio

The income we derive from our investment portfolio is generated primarily by investing client cash balances and is a component of our asset processing business. In addition, we use our investment portfolio to secure open positions at securities clearing institutions in connection with our custody services. The following table summarizes our investment portfolio as of the dates indicated (Dollars in thousands):

	March 31, 2007	December 31, 2006
Securities held to maturity:		
Mortgage-backed securities	$ 3,611,327	$ 3,753,497
Federal agency securities	1,542,336	1,680,458
State and political subdivisions	94,817	98,375
Total securities held to maturity	$ 5,248,480	$ 5,532,330
Securities available for sale:		
Mortgage-backed securities	$ 4,127,647	$ 4,275,051
Federal agency securities	398,950	
State and political subdivisions	345,991	344,304
Corporate debt	167,713	169,850
Foreign government securities	10,535	10,535
Total securities available for sale	$ 5,050,836	$ 4,799,740

Our held to maturity securities portfolio decreased $0.3 billion, or 5%, from December 31, 2006 to March 31, 2007. The decrease was primarily due to paydowns and slower reinvestment. Our held to maturity portfolio securities are purchased with the intent and ability to hold them to maturity.

Our available for sale securities portfolio increased $0.3 billion, or 5%, from December 31, 2006 to March 31, 2007. The increase was mainly due to purchases of new Federal agency securities, offset by maturities and prepayments. Our investment security purchases included mortgage-backed securities and municipal securities. We believe that purchasing these securities allows us to take advantage of attractive yields and limited extension risk which aligns with our asset and liability strategy. Refer to the gap analysis under the Market Risk section for additional details regarding the matching of our interest-earning assets and interest-bearing liabilities.

The average balance of our investment securities for the three-month period ended March 31, 2007 was $10.3 billion, with an average yield of 5.11%, compared to an average balance of $11.1 billion with an average yield of 4.68% during the same period in 2006. The increased portfolio yield is primarily due to higher rates on our variable-rate securities. Anticipating prepayments in calculating the constant effective yield for mortgage-backed securities may result in more monthly earnings volatility due to the impact of changing interest rates and the resulting adjustments to the amount of amortization. We do not expect changes to the amount of amortization resulting from anticipating prepayments to have a material effect on our future reported financial results or financial condition.

Prepayment cash flow levels on our investment portfolio decreased in the first three months of 2007, which we believe is primarily due to decreased refinancing opportunities.

We invest in mortgage-backed securities and Federal agency securities to increase the total return of the investment portfolio. Mortgage-backed securities and Federal agency securities generally have a higher yield than U.S. Treasury securities due to credit and prepayment risk. Credit risk results from the possibility that a loss may occur if a counterparty, such as the Federal agency issuing the securities, is unable to meet the terms of the contract. Credit risk related to mortgage-backed securities and Federal agency securities is substantially reduced by payment guarantees and credit enhancements. Prepayment risk results from the possibility that changes in interest rates and other economic factors will result in investment securities being paid off earlier than the scheduled maturity date. Refer to the Market Risk section for additional details regarding our

net interest income simulation model, which includes the impact of changes in interest rates, and therefore prepayment risk, on our net interest income.

We invest in AAA rated, insured municipal securities to generate stable, tax-advantaged income. Municipal securities generally have lower stated yields than Federal agency and U.S. Treasury securities, but their after-tax yields are comparable. Municipal securities are subject to call risk. Call risk is similar to prepayment risk and results from the possibility that fluctuating interest rates and other factors may result in the exercise of the call option by the issuing municipality prior to the maturity date of the security.

Loan Portfolio

The balance in our loan portfolio was $259.0 million, down 4% from December 31, 2006. The decrease was primarily due to repayments of lines of credit, partially offset by new loan originations.

We make loans to individually managed account customers and to mutual funds and other pooled product clients. We offer overdraft protection and lines of credit to our clients for the purpose of funding redemptions, covering overnight cash shortfalls, leveraging portfolios and meeting other client borrowing needs. The majority of loans to individually managed account customers are written on a demand basis, bear variable interest rates tied to the Prime rate or the Federal funds rate and are fully secured by liquid collateral, primarily freely tradable securities held in custody by us for the borrower. We monitor the value of collateral daily to ensure the amount of collateral held by us exceeds the loan balance by a certain threshold. Loans to mutual funds and other pooled product clients include unsecured lines of credit that may, in the event of default, be collateralized at our option by securities held in custody by us for those clients. Loans to individually managed account customers, mutual funds and other pooled product clients also include advances that we make to certain clients pursuant to the terms of our custody agreements with those clients to facilitate securities transactions and redemptions.

At March 31, 2007, our only lending concentrations that exceeded 10% of total loan balances were the lines of credit to mutual fund clients discussed above. These loans were made in the ordinary course of business on substantially similar terms and conditions prevailing at the time for comparable transactions.

Our loan portfolio credit performance has been excellent. There have been no loan charge-offs in the history of our Company. It is our policy to place a loan on nonaccrual status when either principal or interest becomes 90 days past due and the loan s collateral is not sufficient to cover both principal and accrued interest. As of March 31, 2007, there were no loans on nonaccrual status and no troubled debt restructurings. Although virtually all of our loans are fully collateralized with freely tradable securities, management recognizes some credit risk inherent in the loan portfolio, and therefore we have recorded an allowance for loan losses of $0.1 million at March 31, 2007, a level which has remained consistent for the past five years. This allowance is not allocated to any particular loan, but is intended to absorb any risk of loss inherent in the loan portfolio at the balance sheet date that is not captured in our historical loss rate. Management actively monitors the loan portfolio and the underlying collateral and regularly assesses the adequacy of the allowance for loan losses.

Deposits

Total deposits were $8.5 billion at March 31, 2007, up 38% from December 31, 2006. The increase in our deposit balances is a result of new business and our clients holding larger cash positions in their portfolios.

Time deposits with balances greater than $100,000 totaled $630.3 million and $524.4 million at March 31, 2007 and December 31, 2006, respectively. All time deposits had a maturity of less than three months at March 31, 2007 and December 31, 2006.

Repurchase Agreements and Short-Term and Other Borrowings

Repurchase agreements increased $0.7 billion, or 19%, from December 31, 2006 to March 31, 2007. The majority of our repurchase agreements are with clients who prefer a more collateralized form of deposit. Repurchase agreements provide for the sale of securities for cash coupled with the obligation to repurchase those securities on a set date or on demand. We use repurchase agreements, including client repurchase agreements, because they provide a lower cost source of funding than other short-term borrowings and allow our clients the extra benefit of collateralization of their deposits. The average balance of securities sold under repurchase agreements for the three months ended March 31, 2007 was $4.5 billion with an average cost of approximately 3.92%, compared to an average balance of $4.8 billion and an average cost of approximately 3.39% for the same period in 2006. The increase in the average cost of repurchase agreements was due to higher short-term interest rates in the first three months of 2007 compared to the same period in 2006.

Short-term and other borrowings decreased $0.5 billion, or 88%, from December 31, 2006 to March 31, 2007, primarily due to increased client funding. We use short-term and other borrowings to offset the variability of deposit flow. The average balance of short-term and other borrowings for the three months ended March 31, 2007 was $0.1 billion with an average cost of approximately 6.79%, compared to an average balance of $1.4 billion and an average cost of approximately 4.53% for the same period in 2006. The increase in the average cost of short-term and other borrowings was due to higher short-term interest rates in the first three months of 2007 compared to the same period in 2006.

Market Risk

Our clients, in the course of their financial asset management, maintain cash balances, which they can deposit with us on a short-term basis in interest-bearing accounts or client repurchase agreements. We either directly invest these cash balances to earn interest income, or place these deposits in third-party vehicles and remit a portion of the earnings on these investments to our clients after deducting a fee as our compensation for investing clients funds in these investment vehicles. In the conduct of these activities, we are subject to market risk.

Market risk is the risk of an adverse financial impact from changes in market prices. The level of risk we assume is a function of our overall strategic objectives and liquidity needs, client requirements and market volatility. The active management of market risk is integral to our operations.

Our balance sheet is primarily subject to interest rate risk, which is the risk of loss due to movements in interest rates. Prepayment risk, which is the risk that changes in interest rates and other economic factors will result in investment securities being paid off earlier than the scheduled maturity date, is inherent in our investment securities, mainly our mortgage-backed securities and variable-rate Federal agency securities. Prepayment levels for mortgage-backed securities are primarily driven by changes in interest rates. Prepayment levels for Federal agency securities are driven by a number of factors, including expiration of prepayment penalty provisions, the economic condition of the borrower, borrower refinancing alternatives and interest rates. The objective of interest rate sensitivity management is to provide sustainable net interest income under various economic conditions.

Our Board of Directors has set asset and liability management policies that define the overall framework for managing interest rate sensitivity, including accountabilities and controls over investment activities. These policies delineate investment limits and strategies that are appropriate, given our liquidity and regulatory requirements. For example, we have established a policy limit stating that projected net interest income will not be impacted by more than 10% given a change in interest rates of up to 200 basis points (+ or -) over a twelve-month period. Each quarter, our Board of Directors reviews our asset and liability positions, including simulations of the effect of various interest rate scenarios on our net interest income.

The day-to-day responsibility for oversight of the Asset and Liability Management function has been delegated by our Board of Directors to our Asset and Liability Committee (ALCO). ALCO is a senior management committee consisting of the Chief Executive Officer, the President, the Chief Financial Officer, the Chief Risk Officer and members of the Treasury function. ALCO meets twice monthly. Our primary tool in managing interest rate sensitivity is an income simulation model. Key assumptions in the simulation model include the timing of cash flows, which include forecasted prepayment speeds that are based on market and industry data, maturities and repricing of financial instruments, changes in market conditions, capital planning and deposit sensitivity. The model assumes that the composition of our interest-sensitive assets and liabilities will change over the period being measured. The model also assumes that the change in interest rates is a parallel shift of the yield curve across all maturities. These assumptions are inherently uncertain, and as a result, the model cannot precisely predict the effect of changes in interest rates on our net interest income. Actual results may differ from simulated results due to the timing, magnitude and frequency of interest rate changes, and changes in market conditions and management strategies.

The results of the income simulation model as of March 31, 2007 and 2006 indicated that an upward shift of interest rates by 200 basis points over a twelve-month period would result in a reduction in projected net interest income of approximately 4.6% and 6.9%, respectively, which are both within our 10% policy limit. We also simulate a 200 basis point rate reduction over a twelve-month period. This simulation would result in an increase in projected net interest income of approximately 1.5% and 3.3% as of March 31, 2007 and 2006, respectively, both within our 10% policy limit.

We also use gap analysis as a secondary tool to manage our interest rate sensitivity. Gap analysis involves measurement of the difference in asset and liability repricing on a cumulative basis within a specified time frame. A positive gap indicates that more interest-earning assets than interest-bearing liabilities reprice/mature in a time frame, and a negative gap indicates the opposite. As shown in the cumulative gap position in the table presented on the following page, at March 31, 2007, interest-bearing liabilities repriced faster than interest-earning assets in the short term. This implies that a rising rate environment would negatively impact forecasted net interest income; however, the gap analysis does not quantify the impact. Other important determinants of net interest income are the shape of the yield curve, general rate levels, reinvestment spreads, balance sheet growth and mix, and interest rate spreads. We continue to run a closely matched balance sheet by investing the majority of our assets in short duration, variable-rate securities and executing interest rate swaps against client liabilities, including client repurchase agreements.

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We manage the structure of interest-earning assets and interest-bearing liabilities by adjusting their mix, yield, maturity and/or repricing characteristics based on market conditions. Client deposits and repurchase agreements, which are predominantly short term, are our primary sources of funds. We also use term borrowings and interest rate swap agreements to augment our management of interest rate exposure. The effect of the swap agreements is to lengthen both a forecasted series of fixed-rate overnight liabilities incurred at different daily fixed rates and short-term variable-rate liabilities into longer-term fixed-rate liabilities. The weighted-average fixed-payment rates on our swap agreements were 3.88% and 3.66% at March 31, 2007 and 2006, respectively. Variable-interest payments received are currently indexed to the overnight Federal funds rate. At March 31, 2007 and 2006, the weighted-average rates of variable market-indexed interest payment obligations to us were 5.26% and 4.44%, respectively. The remaining terms of swaps at March 31, 2007 range from 1 to 20 months. These contracts had net fair values of approximately $8.9 million and $29.5 million at March 31, 2007 and 2006, respectively.

The following table presents the repricing schedule of our interest-earning assets and interest-bearing liabilities at March 31, 2007 (Dollars in thousands):

	Within Three Months	Three to Six Months	Six to Twelve Months	One Year to Five Years	Over Five Years	Total
Interest-earning assets: (1)						
Investment securities (2, 3)	$ 6,179,381	$ 476,668	$ 799,927	$ 2,121,526	$ 730,087	$ 10,307,589
Federal funds sold and securities purchased and under resale agreements, interest bearing deposits with other banks and short-term investments	2,972,002					2,972,002
Loans - variable rate	227,654	31,388				259,042
Loans - fixed rate				13		13
Total interest-earning assets	$ 9,379,037	$ 508,056	$ 799,927	$ 2,121,539	$ 730,087	$ 13,538,646
Interest-bearing liabilities:						
Demand deposits	$ 121,218	$	$	$	$	$ 121,218
Savings accounts	6,453,385					6,453,385
Time deposits	255,260					255,260
Interest rate contracts	(1,070,000)	250,000	340,000	480,000		
Securities sold under repurchase agreements	4,124,073	150,000	150,000			4,424,073
Short-term and other borrowings	62,497					62,497
Junior subordinated debentures	24,774					24,774
Total interest-bearing liabilities	$ 9,971,207	$ 400,000	$ 490,000	$ 480,000	$	$ 11,341,207
Net interest-sensitivity gap during the period	$ (592,170)	$ 108,056	$ 309,927	$ 1,641,539	$ 730,087	$ 2,197,439
Cumulative gap	$ (592,170)	$ (484,114)	$ (174,187)	$ 1,467,352	$ 2,197,439	
Interest-earning assets as a percent of interest-bearing liabilities (cumulative)	94.06 %	95.33 %	98.40 %	112.94 %	119.38 %	
Interest-earning assets as a percent of total assets (cumulative)	66.02 %	69.60 %	73.23 %	90.17 %	95.31 %	
Net interest-sensitivity gap as a percent of total assets	(4.17 %)	0.76 %	2.18 %	11.56 %	5.14 %	
Cumulative gap as a percent of total assets	(3.17 %)	(3.41 %)	(1.23 %)	10.33 %	15.47 %	

(1) Adjustable rate assets are included in the period in which interest rates are next scheduled to adjust rather than in the period in which they are due. Fixed-rate loans are included in the period in which they are scheduled to be repaid.

(2) Mortgage-backed securities are included in the pricing category that corresponds with the earlier of their first repricing date or principal paydown schedule generated from industry sourced prepayment projections.

(3) Excludes $8.3 million of net unrealized losses as of March 31, 2007.

Liquidity

Liquidity represents the ability of an institution to meet present and future financial obligations through either runoff due to prepayments, asset sales, maturity of existing assets or the acquisition of additional funds through liability management. These obligations arise from the withdrawals of deposits, the payment of operating expenses, and the inclusion of capital expenditures for fixed assets and leasehold improvements.

Our primary sources of liquidity include cash and cash equivalents, Federal funds sold, new deposits, short-term borrowings, interest and principal payments on securities held to maturity and available for sale, fees collected from asset administration clients, FHLBB borrowings and the Federal Reserve Discount Window. As a result of our management of liquid assets and our ability to generate liquidity through liability funds, management believes that we maintain overall liquidity sufficient to meet our depositors needs, to satisfy our operating requirements and to fund the payment of an anticipated annual cash dividend of $0.10 per share for 2007 (approximately $6.7 million based upon 66,765,087 shares outstanding as of March 31, 2007).

Our ability to pay dividends on common stock may depend on the receipt of dividends from the Bank. Any dividend payments by the Bank are subject to certain restrictions imposed by the Massachusetts Commissioner of Banks. During all periods presented in this report, the Company did not require dividends from the Bank in order to fund the Company s own dividends. In addition, we may not pay dividends on our common stock if we are in default under certain agreements entered into in connection with the sale of our Capital Securities. The Capital Securities were issued in 1997 by Investors Capital Trust I, a Delaware statutory business trust sponsored by us, and qualify as Tier 1 capital under the capital guidelines of the Federal Reserve Board of Governors (FRB).

In June 2006, we announced that our Board of Directors had authorized a new repurchase plan of up to $150.0 million of our common stock over the twelve months following the announcement. We do not expect our stock repurchase program to have a material impact on our capital resources, such as maintaining risk-based capital ratios in excess of capital adequacy guidelines and our ability to pay dividends on our common stock. We did not repurchase any shares during the three months ended March 31, 2007. As of March 31, 2007, we have repurchased $29.3 million of our common stock under this plan.

We have informal borrowing arrangements with various counterparties. Each counterparty has agreed to make funds available to us at the Federal funds overnight rate. Each counterparty may terminate its arrangement at any time and is under no contractual obligation to provide us with requested funding. Our borrowings under these arrangements are typically on a short-term basis. We cannot be certain, however, that such funding will be available. Lack of availability of liquid funds could have a material adverse impact on our operations.

We also have Master Repurchase Agreements in place with various counterparties. Each counterparty has agreed on an uncommitted basis to make funds available to us at various rates in exchange for collateral consisting of marketable securities.

Our capital stock investment in the FHLBB totaled $28.4 million as of March 31, 2007, which represents a $1.0 million decrease from December 31, 2006. The $28.4 million capital stock investment includes both a $25.0 million membership component and a $3.4 million activity-based component. The membership component of the FHLBB capital stock investment requires a five-year advance notice of withdrawal. Our $28.4 million capital stock investment in the FHLBB provides an overnight borrowing capacity of up to $114.5 million. There was no outstanding balance under this arrangement as of March 31, 2007. Additional borrowing is available to us based on prescribed collateral levels and increased investment in FHLBB capital stock. We currently have the ability to purchase up to $25.0 million of activity-based capital, which would provide a total overnight borrowing capacity of $833.3 million.

In October 2006, we became a member of the Federal Reserve Bank of Boston (FRBB). In connection with our membership, we were required to subscribe to purchase stock of the FRBB totaling 6% of the Bank s capital and surplus. We fulfilled our obligation to purchase 50% of the subscribed amount by purchasing $7.4 million of FRBB stock. The remaining subscription amount is subject to purchase upon the request of the FRBB. The Bank s capital stock investment in the FRBB is $7.4 million at March 31, 2007.

Capital Resources

Historically, we have financed our operations principally through internally generated cash flows. We incur capital expenditures for furniture, fixtures, capitalized software and miscellaneous equipment needs. We lease office space and computing equipment through operating leases. Capital expenditures have been incurred and leases entered into on an as-required basis, primarily to meet our growing operating needs. As a result, our capital expenditures were $28.2 million and $17.7 million for the three months ended March 31, 2007 and 2006, respectively. For the three months ended March 31, 2007, capital expenditures were comprised of $6.9 million in leasehold improvements, $11.2 million in capitalized software and projects in process and $10.1 million in fixed assets. For the three months ended March 31, 2006, capital expenditures were comprised of $7.3 million in leasehold improvements, $6.0 million in capitalized software and projects in process and $4.4 million in fixed assets.

Stockholders equity at March 31, 2007 was $1.0 billion, up 9% from December 31, 2006, primarily due to net income earned and the exercise of stock options. The ratio of average stockholders equity to average assets was approximately 8% for March 31, 2007, compared to 7% for December 31, 2006.

The FRB has adopted capital adequacy guidelines applicable to United States banking organizations. The FRB s capital adequacy guidelines generally require bank holding companies (BHCs) to maintain total capital equal to 8% of total risk-adjusted assets and off-balance sheet items (the Total Risk-Based Capital Ratio), with at least 50% of that amount consisting of Tier 1, or core capital, and the remaining amount consisting of Tier 2, or supplementary capital. Tier 1 capital for BHCs generally consists of the sum of common stockholders equity and perpetual preferred stock (subject to certain limitations), less goodwill and other nonqualifying intangible assets. Tier 2 capital generally consists of hybrid capital instruments, perpetual debt and mandatory convertible debt securities; perpetual preferred stock, not included as Tier 1 capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan and lease losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics.

In addition to the risk-based capital requirements, the FRB requires BHCs to maintain a minimum leverage capital ratio of Tier 1 capital to its average total consolidated assets (the Leverage Ratio) of 3%. Total average consolidated assets for this purpose does not include goodwill and any other intangible assets and investments that the FRB determines should be deducted from Tier 1 capital. The FRB has announced that the 3% Leverage Ratio requirement is the minimum for the top-rated BHCs. All other BHCs are required to maintain a minimum Leverage Ratio of 4%. BHCs with supervisory, financial, operational or managerial weaknesses, as well as BHCs that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above the minimum levels. Because we anticipate significant future growth, we will be required to maintain a Leverage Ratio of 4% or higher.

We are currently in compliance with both the Total Risk-Based Capital Ratio and the Leverage Ratio requirements, and management expects these ratios to remain in compliance with the FRB s capital adequacy guidelines. At March 31, 2007, our Total Risk-Based Capital Ratio and Leverage Ratio were 17.95% and 7.66%, respectively.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The information required by this item is contained in the Market Risk section in the Management s Discussion and Analysis of Financial Condition and Results of Operations, as part of this Report.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as of March 31, 2007, the end of the quarter covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures. In designing and evaluating the Company s disclosure controls and procedures, the Company and its management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and the Company s management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure, and is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms. There was no change in the Company s internal control over financial reporting that occurred during the quarter ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting. The Company reviews, on an ongoing basis, its disclosure controls and procedures, which may include its internal controls over financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Company s systems evolve with its business.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We and certain of our officers were named as defendants in three purported class action complaints that were filed on or about August 4, 2005, August 15, 2005, and September 30, 2005 in the United States District Court for the District of Massachusetts, Boston, Massachusetts. The U.S. District Court has consolidated those cases and appointed lead plaintiffs, who filed a consolidated complaint against us and seven of our current and former officers on February 3, 2006. Among other things, the consolidated complaint asserts that the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 during the period April 10, 2001 until July 15, 2005. The allegations in the consolidated complaint predominantly relate to: (1) our October 2004 restatement of our financial results, and (2) our July 2005 revision of public guidance regarding our future financial performance. The consolidated complaint seeks unspecified damages, interest, fees, and costs. On May 14, 2006, we filed a motion to dismiss all claims asserted in the consolidated complaint. That motion is currently pending before the Court. We strongly believe that the lawsuit lacks merit and we intend to defend against the claims vigorously. However, we cannot predict the outcome of the lawsuit at this time, and we can give no assurance that it will not materially adversely affect our financial condition or results of operations.

We and nine of our officers and directors are named as defendants in two shareholder derivative complaints that were filed on or about September 22, 2005 and October 17, 2005 in the United States District Court for the District of Massachusetts, Boston, Massachusetts. Among other things, the complaints assert that the defendants are liable for breach of fiduciary duty, unjust enrichment, abuse of control, mismanagement, misappropriation of information, insider trading, and violation of Section 14(a) of the Securities Exchange Act of 1934. The complaint filed on September 22, 2005 also seeks reimbursement under the Sarbanes-Oxley Act of 2002. The allegations in the complaints predominantly relate to: (1) our October 2004 restatement of our financial results, and (2) our July 2005 revision of public guidance regarding our future financial performance. The complaints seek unspecified damages, attorneys fees, accountant and expert fees, and costs. We are also named as a nominal defendant in these complaints, although the actions are derivative in nature and purportedly asserted on behalf of us. We are in the process of evaluating these claims. However, we cannot predict the outcome of the lawsuits at this time, and we can give no assurance that they will not materially adversely affect our financial condition or results of operations.

Item 1A. Risk Factors

Our operating results are subject to fluctuations in interest rates and the securities markets.

A significant portion of our fees is based on the market value of the assets we process. Accordingly, our operating results are subject to fluctuations in interest rates and securities markets as these fluctuations affect the market value of assets processed. Our net interest income is primarily driven by the spread between earnings on our investments and loan portfolios relative to our cost of funds. The relationship between short-term and long-term interest rates, referred to as the shape of the yield curve, affects the market value of, and the earnings produced by, our investment and loan portfolios, and thus could impact our net interest income. In addition, narrower investment portfolio reinvestment and purchase spreads have impacted, and could potentially continue to impact, our net interest income.

Volatility in the equity markets can have a material effect on our asset-based fees. While reductions in asset servicing fees may be offset by increases in other sources of revenue, a sustained downward movement of the broad equity markets will likely have an adverse impact on our earnings.

Our growth depends in part on the ability of our clients to generate fund flows by selling their investment products to new and existing investors. Fluctuations in interest rates or the securities markets can lead to investors seeking alternatives to the investment offerings of our clients, which could result in a lesser amount of assets processed and correspondingly lower fees. For example, if the value of equity or fixed income assets held by our clients were to increase or decrease by 10% for a sustained period of time, we estimate currently that this market movement, by itself, would cause a corresponding change of less than 5% in our earnings per share.

We may not consummate our merger with State Street Corporation.

Consummation of the transaction contemplated by the Merger Agreement is subject to customary closing conditions, including stockholder and regulatory approval. Failure to complete the merger could have a material adverse impact on our ability to sell our services to new clients.

A material portion of our revenue is derived from our relationship with Barclays Global Investors, N.A. (BGI) and related entities.

As a result of our ongoing relationship with BGI s iShares and Master Investment Portfolios, our assumption of the operations of the U.S. asset administration unit of BGI in 2001 and our servicing assets for Barclays Global Investors Canada, Ltd., BGI accounted for approximately 18% of our net operating revenue for both the three months ended March 31, 2007 and the three months ended March 31, 2006. We recently renewed our U.S. asset administration outsourcing agreement and our iShares and Master Investment Portfolio custody and fund accounting agreements with BGI, and we expect that BGI will continue to account for a significant portion of our net operating revenue. We provide services to BGI under long-term contracts that may be terminated before the expiration of the contracts under certain circumstances. Further information regarding the terms of certain BGI contracts, including early termination provisions, was disclosed in Item 8.01 on our Form 8-K filed on January 25, 2006.

We may incur losses due to operational errors.

The services that we provide require complex processes and interaction with numerous third parties. While we maintain sophisticated computer systems and a comprehensive system of internal controls, and our operational history has been excellent, from time to time we may make operational errors for which we are responsible to our clients. In addition, even though we maintain appropriate errors and omissions and other insurance policies, an operational error could result in a significant liability to us and may have a material adverse effect on our results of operations.

We face significant competition from other financial services companies, which could negatively affect our operating results.

We are part of an extremely competitive asset servicing industry. Many of our current and potential competitors have longer operating histories, greater name recognition and substantially greater financial, marketing and other resources than we do. These greater resources could, for example, allow our competitors to develop technology superior to our own. In addition, we face the risk that large mutual fund complexes may build in-house asset servicing capabilities and no longer outsource these services to us. As a result, we may not be able to compete effectively with current or future competitors, which could result in a loss of existing clients or difficulty in gaining new clients.

We may incur significant costs defending legal claims.

We have been named in lawsuits in U.S. District Court in Massachusetts alleging, among other things, violations of securities laws. While we believe these claims are without merit, we cannot be sure that we will prevail in the defense of these claims. We are also party to other litigation and we may become subject to other legal claims in the future. Litigation is costly and could divert the attention of management. For a more detailed discussion of our ongoing lawsuits, please see Item 1, Legal Proceedings, in Part II of this report and Item 3, Legal Proceedings, in Part 1 of our Annual Report on Form 10-K for the year ended December 31, 2006.

The failure to properly manage our growth could adversely affect the quality of our services and result in the loss of clients.

We have experienced a period of rapid growth that has required the dedication of significant management and other resources. Continued growth could place a strain on our management and other resources. To manage future growth effectively, we must continue to invest in our operational, financial and other internal systems, and our human resources, which could affect our profitability.

We must hire and retain skilled personnel in order to succeed.

Qualified personnel, in particular managers and other senior personnel, are in great demand throughout the financial services industry. As a result, we could find it increasingly difficult to continue to attract and retain sufficient numbers of these highly skilled employees, which could affect our ability to attract and retain clients. In addition, uncertainty regarding integration in our merger with State Street Corporation could cause key employees to seek employment elsewhere.

We may not reap all or any of the expected benefits of our recent increased spending.

To position us for future growth, we accelerated some disciplined investments during 2006 and the first three months of 2007. We believe our investments in personnel, technology and office space are necessary to support our future growth in areas such as Europe, technology, alternative investments, middle office outsourcing and fund services. While these investments have and will continue to decrease our short-term operating margins, we believe they are necessary to build the foundation for future growth. However, we may not reap any or all of the expected benefits of our recent investments.

We may not be able to protect our proprietary technology.

Our proprietary technology is important to our business. We rely on trade secret, copyright and trademark laws and confidentiality agreements with employees and third parties to protect our proprietary technology, all of which offer only limited protection. These intellectual property rights may be invalidated or our competitors may develop similar technology independently. Legal proceedings to enforce our intellectual property rights may be unsuccessful and could also be expensive and divert management s attention.

Our quarterly and annual operating results may fluctuate.

Our quarterly and annual operating results are difficult to predict and may fluctuate from quarter to quarter and annually for several reasons, including:

- The timing of commencement or termination of client engagements;
- Changes in interest rates, the relationship between different interest rates or equity values;
- The rate of net inflows and outflows of investor funds in the investment vehicles offered by our clients; and
- The timing and magnitude of share repurchases under our share repurchase plan.

Most of our expenses, such as employee compensation and rent, are relatively fixed. As a result, any shortfall in revenue relative to our expectations could significantly affect our operating results.

We are subject to extensive federal, state and international regulations that impose complex restraints on our business.

Federal and state laws and regulations applicable to financial institutions and their parent companies apply to us. Our primary regulators are the Federal Reserve Board of Governors (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Commissioner of Banks of the Commonwealth of Massachusetts, the Securities and Exchange Commission, the National Association of Securities Dealers, Inc. (NASD), the State of Vermont Department of Banking, Insurance, Securities, Health Care Administration (BISHCA), the Office of the Superintendent of Financial Institutions in Canada (OSFI), the Irish Financial Services Regulatory Authority (IFSRA), the Cayman Islands Monetary Authority (CIMA), the Financial Services Authority in the United Kingdom (FSA) and the Commission de Surveillance du Secteur Financier in Luxembourg (CSSF). Virtually all aspects of our operations are subject to specific requirements or restrictions and general regulatory oversight including the following:

- The FRB and the FDIC maintain capital requirements that we must meet. Failure to meet those requirements could lead to severe regulatory action or even receivership. We are currently considered to be well-capitalized ;
- Under Massachusetts law, the Bank may be restricted in its ability to pay dividends to Investors Financial Services Corp., which may in turn restrict our ability to pay dividends to our stockholders;
- The FRB and the FDIC are empowered to assess monetary penalties against, and to order termination of activities by, companies or individuals who violate the law;

- The NASD maintains certain regulatory requirements that our securities broker affiliate, Investors Securities Services, LLC, must meet. Failure to meet those requirements could lead to severe regulatory action;

- BISHCA maintains certain regulatory requirements that our insurance captive affiliate, Investors Vermont Insurance Company, must meet. Failure to meet those requirements could lead to regulatory action; and

- Our international operations are subject to regulatory oversight by regulators in the jurisdictions in which we operate, including the OSFI, the IFSRA, the CIMA, the FSA and the CSSF. Failure to comply with applicable international regulatory requirements, including capital requirements that we must meet, could result in regulatory action and impact our ability to provide services in those jurisdictions.

Banking law restricts our ability to own the stock of certain companies and also makes it more difficult for us to be acquired. Also, we have not elected financial holding company status under the federal Gramm-Leach-Bliley Act of 1999. This may place us at a competitive disadvantage with respect to other organizations.

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Item 6. Exhibits

(a) Exhibits

Exhibit No.	**Description**
15	Letter of awareness from Deloitte & Touche LLP.
31.1	Certification of Kevin J. Sheehan, Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
31.2	Certification of John N. Spinney, Jr., Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
32.1	Certification of Kevin J. Sheehan, Chief Executive Officer, and John N. Spinney, Jr., Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INVESTORS FINANCIAL SERVICES CORP.

Date: May 2, 2007

By: /s/ Kevin J. Sheehan
Kevin J. Sheehan
Chairman and Chief Executive Officer

By: /s/ John N. Spinney, Jr.
John N. Spinney, Jr.
Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)