

NORTHERN TRUST CORP  
Form 10-Q  
April 28, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the Quarterly Period Ended March 31, 2014**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 0-5965**

**NORTHERN TRUST CORPORATION**  
**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of  
incorporation or organization)**

**36-2723087**  
**(I.R.S. Employer  
Identification No.)**

**50 South LaSalle Street**  
**Chicago, Illinois**  
**(Address of principal executive offices)**

**60603**  
**(Zip Code)**

**Registrant's telephone number, including area code: (312) 630-6000**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

**236,481,078 Shares - \$1.66 2/3 Par Value**

**(Shares of Common Stock Outstanding on March 31, 2014)**

**CONSOLIDATED FINANCIAL HIGHLIGHTS  
(UNAUDITED)**

<b>FOR THE PERIOD (In Millions)</b>	2014	Three Months Ended March 31, 2013	% Change (*)
<b>Noninterest Income</b>			
Trust, Investment and Other Servicing Fees	\$ 679.5	\$ 630.7	8%
Foreign Exchange Trading Income	50.1	59.5	(16)
Treasury Management Fees	16.8	16.8	
Security Commissions and Trading Income	14.7	18.3	(20)
Other Operating Income	37.7	24.8	53
Investment Security Gains (Losses), net	(4.0)	0.2	N/M
<b>Total Noninterest Income</b>	<b>794.8</b>	<b>750.3</b>	<b>6</b>
<b>Net Interest Income</b>	<b>245.7</b>	<b>226.1</b>	<b>9</b>
Provision for Credit Losses	3.0	5.0	(40)
<b>Net Interest Income after Provision for Credit Losses</b>	<b>242.7</b>	<b>221.1</b>	<b>10</b>
<b>Noninterest Expense</b>			
Compensation	341.8	320.3	7
Employee Benefits	66.9	63.3	6
Outside Services	144.4	129.9	11
Equipment and Software	101.3	91.4	11
Occupancy	44.2	43.2	2
Other Operating Expense	69.4	80.8	(14)
<b>Total Noninterest Expense</b>	<b>768.0</b>	<b>728.9</b>	<b>5</b>
<b>Income before Income Taxes</b>	<b>269.5</b>	<b>242.5</b>	<b>11</b>
Provision for Income Taxes	88.1	78.5	12
<b>Net Income</b>	<b>\$ 181.4</b>	<b>\$ 164.0</b>	<b>11%</b>
<b>Average Total Assets</b>	<b>\$ 100,243.5</b>	<b>\$ 91,569.3</b>	<b>9%</b>

**PER COMMON SHARE**

Net Income Basic	\$ 0.75	\$ 0.68	10%
Diluted	0.75	0.67	12
Cash Dividends Declared Per Common Share	0.31	0.30	3
Book Value End of Period (EOP)	33.61	31.82	6
Market Price EOP	65.56	54.56	20

**RATIOS**

Return on Average Common Equity	9.28%	8.82%
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Return on Average Assets	<b>0.73</b>	0.73
Dividend Payout Ratio	<b>41.3</b>	44.8
Average Stockholders Equity to Average Assets	<b>7.9</b>	8.2

<b>PERIOD END (In Millions)</b>	March 31, 2014	December 31, 2013	% Change (*)
Assets	<b>\$ 103,832.6</b>	\$ 102,947.3	1%
Earning Assets	<b>93,702.4</b>	93,367.2	
Deposits	<b>86,267.7</b>	84,098.1	3
Stockholders Equity	<b>7,948.3</b>	7,912.0	

**PERIOD END CLIENT ASSETS (In Billions)**

Assets Under Custody	<b>\$ 5,753.5</b>	\$ 5,575.7	3%
Assets Under Management	<b>915.4</b>	884.5	3

**RATIOS**

Tier 1 Capital to Risk-Weighted Assets EOP	<b>13.0%</b>	13.4%
Total Capital to Risk-Weighted Assets EOP	<b>15.5</b>	15.8
Common Equity Tier 1 Capital to Risk-Weighted Assets - EOP (**)	<b>12.8</b>	
Tier 1 Leverage Ratio	<b>7.8</b>	7.9

(\*) Percentage calculations are based on actual balances rather than the rounded amounts presented in the Consolidated Financial Highlights.

(\*\*) Beginning January 1, 2014, common equity tier 1 capital is calculated in accordance with the Basel III risk-based capital guidelines.

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

**FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS**

**General**

Northern Trust Corporation (the Corporation), together with its subsidiaries, is a leading provider of asset servicing, fund administration, asset management, fiduciary and banking solutions for corporations, institutions, families, and individuals worldwide. Northern Trust focuses on servicing and managing client assets through its two primary business units, Wealth Management (WM) and Corporate & Institutional Services (C&IS). Asset management and related services are provided to Wealth Management and C&IS clients primarily by a third business unit, Asset Management. Northern Trust emphasizes a high level of client service complemented by the effective use of technology, delivered by a fourth business unit, Operations & Technology (O&T). Except where the context otherwise requires, the term Northern Trust refers to Northern Trust Corporation and its subsidiaries on a consolidated basis.

The following should be read in conjunction with the consolidated financial statements and related footnotes included in this report. Investors should also read the section entitled Forward-Looking Statements.

**Overview**

Net income per diluted common share in the first quarter of 2014 was \$0.75 compared to \$0.67 per common share in the first quarter of 2013. Net income for the current quarter was \$181.4 million, up \$17.4 million, or 11%, from \$164.0 million in the prior year quarter. The performance in the current quarter produced an annualized return on average common equity of 9.3% as compared to 8.8% in the prior year quarter. The annualized return on average assets was 0.73% in both the current and prior year quarter.

The prior year quarter included a \$12.4 million pre-tax write-off of certain fee receivables resulting from the correction of an accrual methodology followed in prior years, as well as restructuring and integration related charges of \$1.8 million. These prior year quarter items totaled \$14.2 million (\$8.9 million after tax, or \$0.04 per common share).

Revenue of \$1.04 billion in the current quarter was up \$64.1 million, or 7%, from \$976.4 million in the prior year quarter. Noninterest income, which represented 76% of revenue, increased \$44.5 million, or 6%, to \$794.8 million from the prior year quarter's \$750.3 million, primarily reflecting higher trust, investment and other servicing fees, partially offset by lower foreign exchange trading income as compared to the prior year quarter.

Net interest income for the current quarter increased \$19.6 million, or 9%, to \$245.7 million as compared to \$226.1 million in the prior year quarter, due to higher levels of average earning assets, partially offset by a decrease in the net interest margin.

Net investment security losses totaled \$4.0 million in the current quarter, reflecting \$3.9 million of charges relating to the other-than-temporary impairment of certain Community Reinvestment Act (CRA) eligible securities.

**Overview (continued)**

Noninterest expense totaled \$768.0 million in the current quarter, up \$39.1 million, or 5%, from \$728.9 million in the prior year quarter, reflecting higher compensation, outside services, and equipment and software expense, partially offset by lower other operating expense.

**Noninterest Income**

The components of noninterest income are provided below.

Noninterest Income (\$ In Millions)	Three Months Ended March 31,			
	2014	2013	Change	
Trust, Investment and Other Servicing Fees	\$ 679.5	\$ 630.7	\$ 48.8	8%
Foreign Exchange Trading Income	50.1	59.5	(9.4)	(16)
Treasury Management Fees	16.8	16.8		
Security Commissions and Trading Income	14.7	18.3	(3.6)	(20)
Other Operating Income	37.7	24.8	12.9	53
Investment Security Gains (Losses), net	(4.0)	0.2	(4.2)	N/M
<b>Total Noninterest Income</b>	<b>\$ 794.8</b>	<b>\$ 750.3</b>	<b>\$ 44.5</b>	<b>6%</b>

Trust, investment and other servicing fees are based generally on the market value of assets held in custody, managed and serviced; the volume of transactions; securities lending volume and spreads; and fees for other services rendered. Certain market value calculations on which fees are based are performed on a monthly or quarterly basis and can be based on the beginning, ending or daily average value of the client portfolio.

The following tables present Northern Trust's assets under custody and assets under management by business segment.

Assets Under Custody (\$ In Billions)	March 31,	December 31,	March 31,	Change	Change
	2014	2013	2013	Q1-14/ Q4-13	Q1-14/ Q1-13
Corporate & Institutional	\$ 5,249.9	\$ 5,079.7	\$ 4,569.1	3%	15%
Wealth Management	503.6	496.0	455.3	2	11
<b>Total Assets Under Custody</b>	<b>\$ 5,753.5</b>	<b>\$ 5,575.7</b>	<b>\$ 5,024.4</b>	<b>3%</b>	<b>15%</b>

Assets Under Management (\$ In Billions)	March 31,	December 31,	March 31,	Change	Change
	2014	2013	2013	Q1-14/ Q4-13	Q1-14/ Q1-13
Corporate & Institutional	\$ 698.2	\$ 662.7	\$ 604.2	5%	16%
Wealth Management	217.2	221.8	206.0	(2)	5

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Total Assets Under Management	\$ 915.4	\$ 884.5	\$ 810.2	3%	13%
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C&IS assets under custody totaled \$5.2 trillion, up 15% from the prior year quarter, and include \$3.3 trillion of global custody assets, 19% higher compared to the prior year quarter. C&IS assets under management include \$116.4 billion of securities lending collateral, a 15% increase from the prior year quarter.

**Noninterest Income (continued)**

Changes in assets under custody and under management are in comparison to the twelve month increase in the S&P 500® index and MSCI EAFE® index (USD) of 19.3% and 14.4%, respectively.

Custodied and managed assets were invested as follows at March 31:

Assets Under Custody	2014			2013		
	C&IS	WM	Consolidated	C&IS	WM	Consolidated
Equities	45%	55%	46%	46%	50%	46%
Fixed Income Securities	37	22	35	36	24	35
Cash and Other Assets	18	23	19	18	26	19
<b>Assets Under Management</b>						
Equities	55%	46%	53%	53%	41%	50%
Fixed Income Securities	13	28	16	14	29	18
Cash and Other Assets	32	26	31	33	30	32

Trust, investment and other servicing fees in C&IS increased \$30.5 million, or 9%, to \$379.2 million in the current quarter from the prior year quarter's \$348.7 million.

C&IS Trust, Investment and Other Servicing Fees (\$ In Millions)	Three Months Ended March 31,			
	2014	2013	Change	
Custody and Fund Administration	\$ 252.2	\$ 223.8	\$ 28.4	13%
Investment Management	75.0	75.5	(0.5)	(1)
Securities Lending	22.7	22.3	0.4	2
Other	29.3	27.1	2.2	8
<b>Total</b>	<b>\$ 379.2</b>	<b>\$ 348.7</b>	<b>\$ 30.5</b>	<b>9%</b>

Custody and fund administration fees, the largest component of C&IS fees, increased 13%, primarily driven by new business and the favorable impact of equity markets. C&IS investment management fees decreased 1%, primarily reflecting higher waived fees in money market mutual funds, partially offset by higher equity markets and new business. Money market mutual fund fee waivers in C&IS, attributable to persistent low short-term interest rates, totaled \$14.9 million in the current quarter, compared to waived fees of \$8.8 million in the prior year quarter. Securities lending revenue increased 2%, primarily reflecting higher volumes in the current quarter.

Trust, investment and other servicing fees in Wealth Management totaled \$300.3 million in the current quarter, increasing \$18.3 million, or 6%, from \$282.0 million in the prior year quarter. The increased fees in the current quarter are primarily due to higher equity markets and new business, partially offset by higher waived fees in money market mutual funds and the impact of fee reductions in certain mutual funds. Money market mutual fund fee waivers in Wealth Management totaled \$17.6 million in the current quarter compared with \$13.4 million in the prior year quarter.





**Noninterest Income (continued)**

Foreign exchange trading income totaled \$50.1 million, down \$9.4 million, or 16%, compared with \$59.5 million in the prior year quarter. The decrease is attributable to lower currency market volatility as compared to the prior year quarter.

Other operating income totaled \$37.7 million in the current quarter, up \$12.9 million, or 53%, from \$24.8 million in the prior year quarter. The components of other operating income are provided below.

<b>Other Operating Income</b> (\$ In Millions)	Three Months Ended March 31,			
	2014	2013	Change	
Loan Service Fees	\$ 15.7	\$ 14.9	\$ 0.8	5%
Banking Service Fees	12.3	12.4	(0.1)	(1)
Other Income	9.7	(2.5)	12.2	N/M
Total Other Operating Income	\$ 37.7	\$ 24.8	\$ 12.9	53%

The other income component of other operating income in the prior year quarter included the \$12.4 million write-off of certain fee receivables.

Net investment security losses totaled \$4.0 million in the current quarter, reflecting \$3.9 million of charges relating to the other-than-temporary impairment of certain CRA eligible securities.

**Net Interest Income**

Net interest income for the quarter on an FTE basis totaled \$254.4 million, up \$20.7 million, or 9%, compared to \$233.7 million in the prior year quarter. The increase is the result of higher levels of average earning assets, partially offset by a decline in the net interest margin to 1.12% from 1.15% in the prior year quarter. Average earning assets for the quarter were \$91.8 billion, up \$9.6 billion, or 12%, from \$82.2 billion in the prior year quarter, primarily reflecting higher levels of Federal Reserve deposits. The increase in Federal Reserve deposits as compared to the prior year quarter is due to higher levels of non-U.S. office client interest-bearing deposits and other short-term borrowings.

The decline in the net interest margin reflects lower yields on earning assets, partially offset by a lower cost of interest-related funds. Net interest income is defined as the total of interest income and amortized fees on earning assets, less interest expense on deposits and borrowed funds, adjusted for the impact of interest-related hedging activity. Net interest income stated on an FTE basis is a non-generally accepted accounting principle (GAAP) financial measure that facilitates the analysis of asset yields. When adjusted to an FTE basis, yields on taxable, nontaxable, and partially taxable assets are comparable; however, the adjustment to an FTE basis has no impact on net income. A reconciliation of net interest income on a GAAP basis to net interest income on an FTE basis is provided on page 20.

### **Net Interest Income (continued)**

The balance sheet line item Federal Reserve Deposits and Other Interest-Bearing averaged \$12.7 billion in the current quarter as compared to \$3.9 billion in the prior year quarter, an increase of \$8.8 billion.

Average securities, inclusive of Federal Reserve and Federal Home Loan Bank stock and certain community development investments, which are classified in other assets in the consolidated balance sheet, were \$32.4 billion, up \$1.1 billion, or 3%, from \$31.3 billion in the prior year quarter.

Loans and leases averaged \$29.2 billion in the current quarter, up \$515.5 million, or 2%, from \$28.7 billion in the prior year quarter, primarily reflecting an increase in average private client loans and commercial real estate loans. Private client loans averaged \$6.2 billion in the current quarter, up \$338.3 million, or 6%, from the prior year quarter's average of \$5.9 billion. Commercial real estate loans averaged \$3.0 billion in the current quarter, up \$57.1 million, or 2%, from the prior year quarter's average of \$2.9 billion.

Northern Trust utilizes a diverse mix of funding sources. Total interest-bearing deposits averaged \$63.1 billion in the current quarter, compared to \$56.5 billion in the prior year quarter, an increase of \$6.6 billion, or 12%. Other interest-bearing funds averaged \$8.6 billion in the current quarter, an increase of \$1.2 billion, or 16%, from \$7.4 billion in the prior year quarter, attributable to higher average short-term borrowings and long-term debt. The balances within short-term borrowing classifications vary based on funding requirements and strategies, interest rate levels, changes in the volume of lower-cost deposit sources, and the availability of collateral to secure these borrowings. Average net noninterest-related funds utilized to fund earning assets increased \$1.9 billion, or 10%, to \$20.2 billion from \$18.3 billion in the prior year quarter, primarily resulting from higher levels of demand and other noninterest-bearing deposits.

For additional quantitative analysis of average balances and interest rate changes affecting net interest income, refer to the Average Consolidated Balance Sheet with Analysis of Net Interest Income and the Analysis of Net Interest Income Changes Due To Volume and Rate on page 21.

### **Provision for Credit Losses**

The provision for credit losses was \$3.0 million in the current quarter compared to \$5.0 million in the prior year quarter. Net charge-offs were \$1.5 million in the current quarter resulting from \$11.5 million of charge-offs and \$10.0 million of recoveries, compared to \$8.7 million of net charge-offs in the prior year quarter resulting from \$12.6 million of charge-offs and \$3.9 million of recoveries. Nonperforming assets increased 3% from the prior year quarter. Residential real estate loans accounted for 70% and 69% of total nonperforming loans and leases at March 31, 2014 and 2013, respectively. For additional discussion of the provision and allowance for credit losses, refer to the Asset Quality section beginning on page 15.

**Noninterest Expense**

The components of noninterest expense are prov