

NORTHERN TRUST CORP
Form 10-Q
April 28, 2016
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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, 2016

OR

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

For the transition period from _____ to _____

Commission File No. 001-36609

NORTHERN TRUST CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 36-2723087

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

50 South LaSalle Street 60603

Chicago, Illinois

(Address of principal executive offices) (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 (Do not check if a smaller reporting company) 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

228,163,712 Shares – \$1.66 2/3 Par Value

(Shares of Common Stock Outstanding on March 31, 2016)

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FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2016
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(UNAUDITED)

	Three Months Ended March 31,			
CONDENSED INCOME STATEMENTS (In Millions)	2016	2015	% Change ⁽¹⁾	
Noninterest Income	\$882.2	\$873.9	1	%
Net Interest Income	307.8	260.6	18	
Provision for Credit Losses	2.0	(4.5)		N/M
Noninterest Expense	828.8	789.0	5	
Income before Income Taxes	359.2	350.0	3	
Provision for Income Taxes	117.4	119.3	(2))
Net Income	\$241.8	\$230.7	5	%
PER COMMON SHARE				
Net Income — Basic	\$1.01	\$0.95	6	%
— Diluted	1.01	0.94	7	
Cash Dividends Declared Per Common Share	0.36	0.33	9	
Book Value — End of Period (EOP)	37.01	35.22	5	
Market Price — EOP	65.17	69.65	(6)	
SELECTED BALANCE SHEET DATA (In Millions)				
	March 31,	December	% Change ⁽¹⁾	
	2016	31, 2015		
End of Period:				
Assets	\$117,798.8	\$116,749.6	1	%
Earning Assets	107,589.2	106,848.9	1	
Deposits	97,659.6	96,868.9	1	
Stockholders' Equity	8,832.8	8,705.9	1	
Average Balances:				
	Three Months Ended March 31,			
			%	
	2016	2015	Change	(1)
Assets	\$113,417.1	\$107,513.2	5	%
Earning Assets	104,625.6	98,693.1	6	
Deposits	92,476.3	86,526.1	7	
Stockholders' Equity	8,691.2	8,472.7	3	
CLIENT ASSETS (In Billions)				
	March	December	% Change ⁽¹⁾	
	31, 2016	31, 2015		
Assets Under Custody/Administration ⁽²⁾	\$7,926.4	\$7,797.0	2	%
Assets Under Custody	6,211.4	\$6,072.1	2	
Assets Under Management	900.0	875.3	3	

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

(2) For the purposes of disclosing Assets Under Custody/Administration, to the extent that both custody and administration services are provided, the value of the assets is included only once.

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SELECTED RATIOS AND METRICS

	Three Months Ended March			
	31,		% Change ⁽¹⁾	
	2016	2015		
Financial Ratios:				
Return on Average Common Equity	11.43%	11.28%	1	%
Return on Average Assets	0.86	0.87	(1)
Dividend Payout Ratio	35.7	35.1	2	
Net Interest Margin ⁽²⁾	1.21	1.10	10	
	March 31, 2016		December 31, 2015	
	Advanced	Standardized	Advanced	Standardized
	Approach	Approach	Approach	Approach
Capital Ratios:				
Northern Trust Corporation				
Common Equity Tier 1	11.6%	10.6	%	11.9% 10.8
Tier 1	12.1	11.1		12.5 11.4
Total	13.6	12.8		14.2 13.2
Tier 1 Leverage	7.4	7.4		7.5 7.5
Supplementary Leverage ⁽³⁾	6.1	N/A		6.2 N/A
The Northern Trust Company				
Common Equity Tier 1	11.5%	10.4	%	11.6% 10.4
Tier 1	11.5	10.4		11.6 10.4
Total	13.2	12.2		13.1 12.0
Tier 1 Leverage	6.9	6.9		6.7 6.7
Supplementary Leverage ⁽³⁾	6.0	N/A		5.6 N/A

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

(2) Net interest margin is presented on a fully taxable equivalent (FTE) basis, a non-generally accepted accounting principle (GAAP) financial measure that facilitates the analysis of asset yields. The net interest margin on a GAAP basis and a reconciliation of net interest income on a GAAP basis to net interest income on an FTE basis are presented on page 19.

(3) Effective January 1, 2018, Northern Trust will be subject to a minimum supplementary leverage ratio of 3 percent.

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PART I – FINANCIAL INFORMATION

Items 2. and 3. Management’s Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures about Market Risk

FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS

General

Northern Trust Corporation (the Corporation) is a financial holding company that is a leading provider of asset servicing, fund administration, asset management, fiduciary and banking solutions for corporations, institutions, families and individuals worldwide. The Corporation focuses on managing and servicing client assets through its two client-focused reporting segments: Corporate & Institutional Services (C&IS) and Wealth Management. Asset management and related services are provided to C&IS and Wealth Management clients primarily by the Asset Management business. Except where the context requires otherwise, the term “Northern Trust,” “we,” “us,” “our” or similar terms mean the 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 also should read the section entitled “Forward-Looking Statements.”

Overview

Net income per diluted common share was \$1.01 in the current quarter, up from \$0.94 in the first quarter of 2015. Net income was \$241.8 million in the current quarter as compared to \$230.7 million in the prior-year quarter. Annualized return on average common equity in the current quarter was 11.4%, up from 11.3% in the prior-year quarter. The annualized return on average assets was 0.9% in both the current and prior-year quarters.

Revenue of \$1.19 billion was up \$55.5 million, or 5%, from \$1.13 billion in the prior-year quarter, primarily reflecting higher net interest income and trust, investment and other servicing fees, partially offset by lower foreign exchange trading income. Noninterest income increased \$8.3 million, or 1%, to \$882.2 million from \$873.9 million in the prior-year quarter.

Net interest income increased 18% to \$307.8 million in the current quarter as compared to \$260.6 million in the prior-year quarter, due to growth in earning assets and a higher net interest margin.

The provision for credit losses was \$2.0 million in the current quarter, as compared to a provision credit of \$4.5 million in the prior-year quarter.

Noninterest expense totaled \$828.8 million, up \$39.8 million, or 5%, from \$789.0 million in the prior-year quarter, attributable to higher compensation and outside services expenses.

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income

The components of noninterest income are provided below.

Table 1: Noninterest Income

Noninterest Income (\$ In Millions)	Three Months Ended March 31,				
	2016	2015	Change		
Trust, Investment and Other Servicing Fees	\$748.2	\$727.5	\$20.7	3	%
Foreign Exchange Trading Income	60.5	71.6	(11.1)	(15))
Treasury Management Fees	16.2	16.3	(0.1)	(1))
Security Commissions and Trading Income	18.9	19.8	(0.9)	(4))
Other Operating Income	38.1	38.6	(0.5)	(1))
Investment Security Gains, net	0.3	0.1	0.2	134	
Total Noninterest Income	\$882.2	\$873.9	\$8.3	1	%

Trust, investment and other servicing fees are based primarily on: the market value of assets held in custody, managed or serviced; the volume of transactions; securities lending volume and spreads; and fees for other services rendered. Certain market-value-based fees are calculated on asset values that are a month or quarter in arrears. For a further discussion of trust, investment and other servicing fees and how they are derived, refer to the "Reporting Segments" section.

Assets under custody/administration (AUC/A), and assets under management form the primary drivers of our trust, investment and other servicing fees. For the purposes of disclosing AUC/A, to the extent that both custody and administration services are provided, the value of the assets is included only once. At March 31, 2016, AUC/A were \$7.93 trillion, up \$129.4 billion, or 2%, from \$7.80 trillion at December 31, 2015.

The following table presents Northern Trust's assets under custody, a component of AUC/A, by reporting segment.

Table 2: Assets Under Custody

Assets Under Custody (\$ In Billions)	March 31, 2016	December 31, 2015	March 31, 2015	Change Q1-16/Q4-15	Change Q1-16/Q1-15
Corporate & Institutional	\$5,700.3	\$5,565.8	\$5,566.2	2	%
Wealth Management	511.1	506.3	524.6	1	(3)
Total Assets Under Custody	\$6,211.4	\$6,072.1	\$6,090.8	2	%

The following table presents the allocation of Northern Trust's custodied assets by reporting segment.

Table 3: Allocations of Assets Under Custody

Assets Under Custody	March 31, 2016		December 31, 2015		March 31, 2015	
	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total
Equities	43%	54%	43%	44%	54%	44%
Fixed Income	39	23	38	38	24	37
Cash and Other Assets	18	23	19	18	22	19

The \$120.6 billion increase in consolidated assets under custody from \$6.09 trillion at March 31, 2015, to \$6.21 trillion as of March 31, 2016, primarily reflected new business, partially offset by the unfavorable impact of equity markets and lower securities lending collateral.

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

The following table presents Northern Trust's assets under management by reporting segment.

Table 4: Assets Under Management

Assets Under Management (\$ In Billions)	March 31, 2016	December 31, 2015	March 31, 2015	Change Q1-16/Q4-15	Change Q1-16/Q1-15
Corporate & Institutional	\$669.9	\$ 648.0	\$727.0	3 %	(8)%
Wealth Management	230.1	227.3	233.1	1	(1)
Total Assets Under Management	\$900.0	\$ 875.3	\$960.1	3 %	(6)%

The following table presents Northern Trust's assets under management by investment type.

Table 5: Assets Under Management by Investment Type

(\$ In Billions)	March 31, 2016	December 31, 2015	March 31, 2015
Equities	\$453.5	\$ 446.6	\$495.8
Fixed Income	148.5	147.1	168.0
Cash and Other Assets	192.0	177.7	173.1
Securities Lending Collateral	106.0	103.9	123.2
Total Assets Under Management	\$900.0	\$ 875.3	\$960.1

The following table presents the allocation of Northern Trust's assets under management by reporting segment.

Table 6: Allocations of Assets Under Management

Assets Under Management	March 31, 2016		December 31, 2015		March 31, 2015				
	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total			
Equities	52%	46%	50%	53%	46%	51%	53%	46%	52%
Fixed Income	12	29	17	13	28	17	14	28	17
Securities Lending Collateral	16	—	12	16	—	12	17	—	13
Cash and Other Assets	20	25	21	18	26	20	16	26	18

The 6% decrease in consolidated assets under management from \$960.1 billion at March 31, 2015, to \$900.0 billion as of March 31, 2016, primarily reflected lower equity assets due to outflows from certain sovereign wealth fund clients and unfavorable global equity markets, as well as lower fixed income assets due to the loss of one passive mandate from a non-U.S. institutional client.

Changes in assets under custody and under management are in comparison to the twelve-month decrease in the S&P 500 index of 0.4% and in the MSCI EAFE index (USD) of 10.7%.

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

The following table presents activity in consolidated assets under management by investment type during the three months ended March 31, 2016.

Table 7: Activity in Consolidated Assets Under Management by Investment Type
(\$ In Billions)

Balance as of December 31, 2015 \$875.3

Inflows by Investment Type

Equity 29.4
Fixed Income 11.4
Cash & Other Assets 94.6
Securities Lending Collateral 20.4

Total Inflows 155.8

Outflows by Investment Type

Equity (28.1)
Fixed Income (10.2)
Cash & Other Assets (80.3)
Securities Lending Collateral (18.2)

Total Outflows (136.8)

Net Inflows 19.0

Market Performance,
Currency & Other 5.7

Balance as of March 31, 2016 \$900.0

Foreign exchange trading income totaled \$60.5 million in the current quarter, down \$11.1 million, or 15%, compared to \$71.6 million in the prior-year quarter. The decrease generally reflected lower client volumes as compared to the prior-year quarter.

Security commissions and trading income totaled \$18.9 million, down 4% compared with \$19.8 million in the prior-year quarter. The decrease was primarily attributable to lower income from transition management, interest rate protection products and core brokerage revenue, partially offset by increased referral fees.

Other operating income totaled \$38.1 million, down 1% compared to \$38.6 million in the prior-year quarter, reflecting a decrease in loan service fees, partially offset by an increase in bank service fees and other income. Included in current quarter other income is a \$2.3 million net gain in the current quarter related to the decision to exit a portion of a non-strategic loan and lease portfolio. The components of other operating income are provided below.

Table 8: Other Operating Income

Other Operating Income	Three Months Ended March 31,		
	2016	2015	Change
(\$ In Millions)			
Loan Service Fees	\$13.4	\$14.9	\$(1.5) (11)%

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Banking Service Fees	12.4	11.9	0.5	5
Other Income	12.3	11.8	0.5	5
Total Other Operating Income	\$38.1	\$38.6	\$(0.5)	(1)%

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Net Interest Income

The following table presents an analysis of average balances and interest rate changes affecting net interest income.

Table 9: Average Consolidated Balance Sheets with Analysis of Net Interest Income

(\$ In Millions)	NORTHERN TRUST CORPORATION					
	First Quarter			2015		
	2016			2015		
(Interest and Rate on a Fully Taxable Equivalent Basis)	Interest	Average Balance	Rate (4)	Interest	Average Balance	Rate (4)
Average Earning Assets						
Federal Funds Sold and Securities Purchased under						
Agreements to Resell	\$3.2	\$1,593.7	0.82 %	\$1.2	\$1,033.7	0.45 %
Interest-Bearing Due from and Deposits with Banks (1)	23.7	14,545.0	0.66	26.6	15,263.1	0.71
Federal Reserve Deposits	19.8	15,690.2	0.51	9.2	14,504.0	0.26
Securities						
U.S. Government	19.3	6,500.5	1.19	12.7	4,580.0	1.13
Obligations of States and Political Subdivisions	1.8	189.1	3.77	2.1	121.6	6.75
Government Sponsored Agency	48.8	16,764.2	1.17	37.4	16,511.9	0.92
Other (2)	38.9	15,349.5	1.02	30.4	14,579.0	0.85
Total Securities	108.8	38,803.3	1.13	82.6	35,792.5	0.94
Loans and Leases (3)	202.7	33,993.4	2.40	185.4	32,099.8	2.34
Total Earning Assets	358.2	104,625.6	1.38	305.0	98,693.1	1.25
Allowance for Credit Losses Assigned to Loans and Leases	—	(193.5)	—	—	(265.9)	—
Cash and Due from Banks	—	2,184.2	—	—	1,573.4	—
Buildings and Equipment	—	445.9	—	—	446.9	—
Client Security Settlement Receivables	—	1,190.5	—	—	959.7	—
Goodwill	—	523.1	—	—	529.7	—
Other Assets	—	4,641.3	—	—	5,576.3	—
Total Assets	\$—	\$113,417.1	— %	\$—	\$107,513.2	— %
Average Source of Funds						
Deposits						
Savings and Money Market	\$2.9	\$15,367.3	0.07 %	\$2.4	\$15,361.0	0.06 %
Savings Certificates and Other Time	2.0	1,459.6	0.54	1.2	1,741.7	0.28
Non-U.S. Offices — Interest-Bearing	17.3	49,434.9	0.14	13.1	47,399.8	0.11
Total Interest-Bearing Deposits	22.2	66,261.8	0.13	16.7	64,502.5	0.10
Short-Term Borrowings	3.4	5,584.1	0.25	1.5	5,187.4	0.12
Senior Notes	11.7	1,497.4	3.15	11.6	1,497.0	3.17
Long-Term Debt	6.1	1,399.3	1.75	7.8	1,571.9	2.02
Floating Rate Capital Debt	0.8	277.3	1.15	0.6	277.2	0.82
Total Interest-Related Funds	44.2	75,019.9	0.24	38.2	73,036.0	0.21
Interest Rate Spread	—	—	1.14	—	—	1.04
Demand and Other Noninterest-Bearing Deposits	—	26,214.5	—	—	22,023.6	—
Other Liabilities	—	3,491.5	—	—	3,980.9	—
Stockholders' Equity	—	8,691.2	—	—	8,472.7	—
Total Liabilities and Stockholders' Equity	\$—	\$113,417.1	— %	\$—	\$107,513.2	— %
Net Interest Income/Margin (FTE Adjusted)	\$314.0	\$—	1.21 %	\$266.8	\$—	1.10 %
Net Interest Income/Margin (Unadjusted)	\$307.8	\$—	1.18 %	\$260.6	\$—	1.07 %

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Net Interest Income (continued)

ANALYSIS OF NET INTEREST INCOME CHANGES
DUE TO VOLUME AND RATE

(In Millions)	Three Months Ended March 31, 2016/2015		
	Change Due To		
	Average Balance	Rate	Total
Earning Assets (FTE)	\$ 19.5	\$ 33.7	\$ 53.2
Interest-Related Funds	0.9	5.1	6.0
Net Interest Income (FTE)	\$ 18.6	\$ 28.6	\$ 47.2

(1) Interest-Bearing Due from and Deposits with Banks includes the interest-bearing component of Cash and Due from Banks and Interest-Bearing Deposits with Banks as presented on the consolidated balance sheets.

Other securities include certain community development investments and Federal Home Loan Bank and Federal Reserve stock, which are classified in other assets in the consolidated balance sheets as of March 31, 2016 and 2015.

(3) Average balances include nonaccrual loans. Lease financing receivable balances are reduced by deferred income.

(4) Rate calculations are based on actual balances rather than the rounded amounts presented in the Average

Consolidated Balance Sheets with Analysis of Net Interest Income.

Notes: Net Interest Income (FTE Adjusted) includes adjustments to a fully taxable equivalent basis for loans and securities. Such adjustments are based on a blended federal and state tax rate of 37.7% and 37.4% for the three months ended March 31, 2016 and 2015, respectively. Total taxable equivalent interest adjustments amounted to \$6.2 million for the three months ended March 31, 2016 and 2015.

Interest revenue on cash collateral positions is reported above within interest-bearing deposits with banks and within loans and leases. Interest expense on cash collateral positions is reported above within non-U.S. offices interest-bearing deposits. Related cash collateral received from and deposited with derivative counterparties is recorded net of the associated derivative contract within other assets and other liabilities, respectively.

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 on a fully taxable equivalent (FTE) basis totaled \$314.0 million, up \$47.2 million, or 18%, compared to \$266.8 million in the prior-year quarter. The increase was primarily the result of growth in average earning assets and a higher net interest margin. Average earning assets for the current quarter averaged \$104.6 billion, up \$5.9 billion, or 6%, from \$98.7 billion in the prior-year quarter, primarily resulting from higher levels of securities and loans.

The net interest margin on an FTE basis increased to 1.21% in the current quarter from 1.10% in the prior-year quarter, primarily reflecting higher yields on earning assets.

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 (a non-GAAP financial measure) is provided on page 19.

Federal Reserve deposits averaged \$15.7 billion, up \$1.2 billion, or 8%, from \$14.5 billion in the prior-year quarter.

Average securities were \$38.8 billion, up \$3.0 billion, or 8%, from \$35.8 billion in the prior-year quarter and include Federal Home Loan Bank, certain community development investments and Federal Reserve stock of \$200.0 million, \$168.4 million and \$53.1 million, respectively, which are recorded in other assets in the consolidated balance sheets. Loans and leases averaged \$34.0 billion, up \$1.9 billion, or 6%, from \$32.1 billion in the prior-year quarter, primarily reflecting higher levels of private client loan