

NORTHERN TRUST CORP
Form 10-Q
July 27, 2017
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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 June 30, 2017

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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

228,485,957 Shares – \$1.66 2/3 Par Value

(Shares of Common Stock Outstanding on June 30, 2017)

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NORTHERN TRUST CORPORATION
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2017
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(UNAUDITED)

CONDENSED INCOME STATEMENTS (In Millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2017	2016 ^	% Change ⁽¹⁾	2017	2016 ^	% Change ⁽¹⁾
Noninterest Income	\$979.7	\$1,017.0	(4)%	\$1,910.6	\$1,899.2	1 %
Net Interest Income	341.5	299.7	14	695.0	607.5	14
Provision for Credit Losses	(7.0)	(3.0)	133	(8.0)	(1.0)	N/M
Noninterest Expense	937.4	925.0	1	1,831.9	1,753.8	4
Income before Income Taxes	390.8	394.7	(1)	781.7	753.9	4
Provision for Income Taxes	122.9	131.7	(7)	237.7	245.5	(3)
Net Income	\$267.9	\$263.0	2 %	\$544.0	\$508.4	7 %
PER COMMON SHARE						
Net Income — Basic	\$1.12	\$1.11	1 %	\$2.22	\$2.14	4 %
— Diluted	1.12	1.10	2	2.21	2.13	4
Cash Dividends Declared Per Common Share	0.38	0.36	6	0.76	0.72	6
Book Value — End of Period (EOP)	40.20	37.79	6	40.20	37.79	6
Market Price — EOP	97.21	66.26	47	97.21	66.26	47

SELECTED BALANCE SHEET DATA (In Millions)

End of Period:	June 30,		% Change ⁽¹⁾
	2017	December 31, 2016	
Assets	\$125,605.7	\$123,926.9	1 %
Earning Assets	116,324.6	115,446.4	1
Deposits	104,312.1	101,651.7	3
Stockholders' Equity	10,067.9	9,770.4	3
	Three Months Ended June 30,		Six Months Ended June 30,
	% Change		% Change
	2017	2016	2017
			2016
			% Change ⁽¹⁾
Average Balances:			
Assets	\$118,400.7	\$114,913.8	3 %
Earning Assets	109,906.5	106,613.5	3
Deposits	96,739.2	93,608.1	3
Stockholders' Equity	9,976.0	8,792.7	13

CLIENT ASSETS (In Billions)	June 30,		% Change ⁽¹⁾
	2017	December 31, 2016	
Assets Under Custody/Administration ⁽²⁾	\$9,294.2	\$8,541.3	9 %
Assets Under Custody	7,379.6	6,720.5	10
Assets Under Management	1,028.8	942.4	9

⁽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.

⁽³⁾ The three and six months ended June 30, 2016 results have been adjusted to reflect the adoption of ASU No 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" (ASU No. 2016-09). Please refer to Note 1, "Basis of Presentation," of the Notes to Consolidated

Financial Statements for further discussion on the impact to the Corporation's previously reported quarterly results.

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SELECTED RATIOS AND METRICS

	Three Months		Six Months	
	Ended June		Ended June	
	30,	30,	30,	30,
	2017	2016	2017	2016
Financial Ratios:				
Return on Average Common Equity	11.6%	12.3%	11.6%	12.0%
Return on Average Assets	0.91	0.92	0.93	0.90
Dividend Payout Ratio	33.9	33.0	34.4	34.3
Net Interest Margin ⁽¹⁾	1.28	1.16	1.31	1.18
	June 30, 2017		December 31, 2016	
	Advanced	Standardized	Advanced	Standardized
	Approach	Approach	Approach	Approach
Capital Ratios:				
Northern Trust Corporation				
Common Equity Tier 1	13.2%	12.3%	12.4%	11.8%
Tier 1	14.5	13.5	13.7	12.9
Total	16.5	15.6	15.1	14.5
Tier 1 Leverage	8.1	8.1	8.0	8.0
Supplementary Leverage	7.0	N/A	6.8	N/A
The Northern Trust Company				
Common Equity Tier 1	13.3%	12.1%	12.4%	11.5%
Tier 1	13.3	12.1	12.4	11.5
Total	14.9	13.9	14.0	13.3
Tier 1 Leverage	7.2	7.2	7.0	7.0
Supplementary Leverage	6.2	N/A	6.0	N/A

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 28.

⁽¹⁾ The three and six months ended June 30, 2016 results have been adjusted to reflect the adoption of ASU No 2016-09. Please refer to Note 1, "Basis of Presentation," of the Notes to Consolidated Financial Statements for further discussion on the impact to the Corporation's previously reported quarterly results.

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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

SECOND 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 \$1.12 in the current quarter, up from \$1.10 in the second quarter of 2016. Net income was \$267.9 million in the current quarter as compared to \$263.0 million in the prior-year quarter. Annualized return on average common equity was 11.6% in the current quarter and 12.3% in the prior-year quarter. The annualized return on average assets was 0.91% in the current quarter as compared to 0.92% in the prior-year quarter.

The current quarter included expense charges of \$22.8 million (\$14.9 million after tax, or \$0.06 per diluted common share) associated with severance and related activities.

The prior-year quarter included the pre-tax gain on the sale of 1.1 million Visa Inc. Class B common shares, net of the valuation adjustment to existing swap agreements, totaling \$118.2 million (\$73.1 million after tax, or \$0.31 per diluted common share); a pre-tax charge in connection with an agreement to settle certain securities lending litigation of \$46.5 million (\$28.9 million after tax, or \$0.12 per diluted common share); charges related to contractual modifications associated with existing C&IS clients of \$18.6 million (\$11.6 million after tax, or \$0.05 per diluted common share); severance, other personnel and related charges of \$17.5 million (\$11.2 million after tax, or \$0.05 per diluted common share); impairment charges and the loss on sale related to the decision to exit a portion of a non-strategic loan and lease portfolio of \$14.1 million (\$8.8 million after tax, or \$0.04 per diluted common share); and impairment charges related to the residual value of certain aircraft and rail cars of \$7.5 million (\$4.6 million after tax, or \$0.02 per diluted common share).

Revenue was \$1.32 billion in both the current and prior-year quarters. The prior-year quarter included the sale of 1.1 million Visa Inc. Class B common shares, net of the valuation adjustment to existing swap agreements, totaling \$118.2 million, partially offset by impairment charges and the loss on sale related to the decision to exit a portion of a non-strategic loan and lease portfolio of \$14.1 million and impairment charges related to the residual value of certain aircraft and rail cars of \$7.5 million. Excluding these items, revenue increased \$101.1 million, or 8%, primarily reflecting higher trust, investment and other servicing fees and net interest income, partially offset by lower foreign exchange trading income.

Net interest income increased 14% to \$341.5 million in the current quarter as compared to \$299.7 million in the prior-year quarter, primarily due to a higher net interest margin and growth in earning assets. Additionally, the prior-year quarter included a pre-tax charge of \$2.7 million related to the residual value of certain aircraft and rail

cars.

The provision for credit losses was a credit of \$7.0 million in the current quarter, as compared to a credit of \$3.0 million in the prior-year quarter.

Noninterest expense totaled \$937.4 million in the current quarter, up \$12.4 million, or 1%, from \$925.0 million in the prior-year quarter. The current quarter included expense charges of \$22.8 million associated with severance and related activities. The prior-year quarter included a pre-tax charge in connection with an agreement to settle certain securities lending litigation of \$46.5 million, charges related to contractual modifications associated with existing C&IS clients of \$18.6 million, and severance, other personnel and related charges of \$17.5 million. Excluding these items, noninterest expense increased \$72.2 million, or 9%, primarily attributable to higher compensation, equipment and software, other operating, and outside expenses.

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SECOND 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 June 30,		
	2017	2016	Change
Trust, Investment and Other Servicing Fees	\$848.2	\$777.2	\$71.0 9 %
Foreign Exchange Trading Income	49.9	64.4	(14.5) (22)
Treasury Management Fees	14.9	16.0	(1.1) (7)
Security Commissions and Trading Income	24.1	20.6	3.5 17
Other Operating Income	43.0	141.2	(98.2) (70)
Investment Security Gains (Losses), net	(0.4)	(2.4)	2.0 (81)
Total Noninterest Income	\$979.7	\$1,017.0	\$(37.3) (4)%

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. The following table presents AUC/A by reporting segment.

Table 2: Assets Under Custody / Administration

Assets Under Custody / Administration (\$ In Billions)	June 30, 2017	March 31, 2017	June 30, 2016	Change Q2-17/Q1-17	Change Q2-17/Q2-16
Corporate & Institutional	\$8,690.8	\$8,338.2	\$7,590.8	4 %	14 %
Wealth Management	603.4	586.5	525.1	3	15
Total Assets Under Custody / Administration	\$9,294.2	\$8,924.7	\$8,115.9	4 %	15 %

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

Table 3: Assets Under Custody

Assets Under Custody (\$ In Billions)	June 30, 2017	March 31, 2017	June 30, 2016	Change Q2-17/Q1-17	Change Q2-17/Q2-16
Corporate & Institutional	\$6,786.3	\$6,533.3	\$5,838.6	4 %	16 %
Wealth Management	593.3	574.4	514.2	3	15
Total Assets Under Custody	\$7,379.6	\$7,107.7	\$6,352.8	4 %	16 %

The 16% increase in consolidated assets under custody from \$6.35 trillion as of June 30, 2016 to \$7.38 trillion as of June 30, 2017 primarily reflected the impact of favorable markets and new business.

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SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

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

Table 4: Allocations of Assets Under Custody

Assets Under Custody	June 30, 2017			March 31, 2017			June 30, 2016		
	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total	
Equities	45%	56%	46%	45%	56%	46%	42%	54%	43%
Fixed Income	38	20	37	37	21	36	40	24	39
Cash and Other Assets	17	24	17	18	23	18	18	22	18

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

Table 5: Assets Under Management

Assets Under Management	June 30, 2017	March 31, 2017	June 30, 2016	Change Q2-17/Q1-17	Change Q2-17/Q2-16
(\$ In Billions)					
Corporate & Institutional	\$762.7	\$741.1	\$672.3	3%	13%
Wealth Management	266.1	260.2	233.9	2%	14%
Total Assets Under Management	\$1,028.8	\$1,001.3	\$906.2	3%	14%

The 14% increase in consolidated assets under management from \$906.2 billion at June 30, 2016 to \$1.03 trillion as of June 30, 2017 was primarily due to favorable global equity markets and net inflows in securities lending collateral, fixed income products, and cash.

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

Table 6: Assets Under Management by Investment Type

(\$ In Billions)	June 30, 2017	March 31, 2017	June 30, 2016
Equities	\$531.3	\$516.8	\$456.4
Fixed Income	169.5	165.8	156.3
Cash and Other Assets	197.0	195.1	185.2
Securities Lending Collateral	131.0	123.6	108.3
Total Assets Under Management	\$1,028.8	\$1,001.3	\$906.2

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

Table 7: Allocations of Assets Under Management

Assets Under Management	June 30, 2017			March 31, 2017			June 30, 2016		
	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total	
Equities	52%	49%	52%	52%	49%	52%	52%	46%	50%
Fixed Income	13	26	16	13	27	17	13	29	17
Cash and Other Assets	18	25	19	18	24	19	19	25	21
Securities Lending Collateral	17	—	13	17	—	12	16	—	12

For the twelve months ended June 30, 2017, the S&P 500 index increased 15.5%, the MSCI EAFE index (USD) increased 17.1%, and the MSCI EAFE index (local currency) increased 18.9%.

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SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

The following table presents activity in consolidated assets under management by investment type.

Table 8: Activity in Consolidated Assets Under Management by Investment Type

(\$ In Billions)	Three Months Ended				
	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Beginning Balance of AUM	\$1,001.3	\$942.4	\$ 945.8	\$ 906.2	\$900.0
Inflows by Investment Type					
Equity	36.3	41.6	44.5	27.2	34.9
Fixed Income	11.6	13.7	16.2	13.1	18.6
Cash & Other Assets	98.2	91.8	95.7	109.5	83.6
Securities Lending Collateral	24.9	29.6	24.8	27.1	21.5
Total Inflows	171.0	176.7	181.2	176.9	158.6
Outflows by Investment Type					
Equity	(38.6)	(38.4)	(50.0)	(26.6)	(31.4)
Fixed Income	(10.5)	(13.0)	(14.1)	(8.8)	(14.9)
Cash & Other Assets	(99.5)	(89.7)	(98.4)	(100.2)	(84.7)
Securities Lending Collateral	(17.5)	(18.0)	(26.8)	(21.4)	(19.3)
Total Outflows	(166.1)	(159.1)	(189.3)	(157.0)	(150.3)
Net Inflows / (Outflows)	4.9	17.6	(8.1)	19.9	8.3
Market Performance, Currency & Other					
Market Performance & Other	18.2	38.9	—	—	—
Currency	4.4	2.4	—	—	—
Total Market Performance, Currency & Other	22.6	41.3	4.7	19.7	(2.1)
Ending Balance of AUM	\$1,028.8	\$1,001.3	\$ 942.4	\$ 945.8	\$906.2

Foreign exchange trading income totaled \$49.9 million in the current quarter, down \$14.5 million, or 22%, compared to \$64.4 million in the prior-year quarter. The decrease generally reflected lower currency volatility as compared to the prior-year quarter.

Other operating income in the prior-year quarter included the pre-tax gain on the sale of 1.1 million Visa Inc. Class B common shares, net of the valuation adjustment to existing swap agreements, totaling \$118.2 million, partially offset by impairment charges and the loss on sale related to the decision to exit a portion of a non-strategic loan and lease portfolio as well as impairment charges related to the residual value of certain aircraft and rail cars of \$18.9 million. Excluding these items, other operating income totaled \$43.0 million, up 3%, compared to \$41.9 million in the prior-year quarter primarily due to net gains on hedging activity. The components of other operating income are provided below.

Table 9: Other Operating Income

Other Operating Income

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	Three Months Ended June 30,		
(\$ In Millions)	2017	2016	Change
Loan Service Fees	\$13.3	\$14.8	\$(1.5) (11)%
Banking Service Fees	12.6	12.8	(0.2) (2)
Other Income	17.1	113.6	(96.5) (85)
Total Other Operating Income	\$43.0	\$141.2	\$(98.2) (70)%

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SECOND 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 10: Average Consolidated Balance Sheets with Analysis of Net Interest Income

(Interest and Rate on a Fully Taxable Equivalent Basis) (\$ In Millions)	NORTHERN TRUST CORPORATION SECOND QUARTER					
	2017			2016		
	Interest	Average Balance	Rate ⁽⁵⁾	Interest	Average Balance	Rate ⁽⁵⁾
Average Earning Assets						
Federal Reserve and Other Central Bank Deposits	\$33.8	\$22,570.0	0.60 %	\$23.6	\$19,657.8	0.48 %
Interest-Bearing Due from and Deposits with Banks ⁽¹⁾	14.1	7,653.9	0.74	16.5	9,827.9	0.68
Federal Funds Sold and Securities Purchased under Agreements to Resell Securities	7.4	2,059.4	1.45	4.8	1,915.2	1.00
U.S. Government	22.0	6,423.8	1.37	20.9	6,875.1	1.22
Obligations of States and Political Subdivisions	3.4	928.8	1.46	2.5	470.2	2.09
Government Sponsored Agency	61.5	17,888.7	1.38	37.0	17,347.0	0.86
Other ⁽²⁾	56.9	18,490.5	1.23	42.9	16,064.2	1.07
Total Securities	143.8	43,731.8	1.32	103.3	40,756.5	1.02
Loans and Leases ⁽³⁾	227.0	33,891.4	2.69	203.4	34,456.1	2.38
Total Earning Assets	426.1	109,906.5	1.56	351.6	106,613.5	1.33
Allowance for Credit Losses Assigned to Loans and Leases	—	(162.3)	—	—	(195.4)	—
Cash and Due from Banks and Other Central Bank Deposits ⁽⁴⁾	—	2,701.1	—	—	2,093.9	—
Buildings and Equipment	—	465.2	—	—	—	—