

NORTHERN TRUST CORP
Form 10-Q
October 29, 2018
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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 September 30, 2018

OR

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

For the transition period from _____ to _____

Commission File No. 001-36609

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 every Interactive Data File required to be submitted 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 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.

Large accelerated filer Accelerated filer

Non-accelerated filer 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.

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

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221,395,358 Shares – \$1.66 2/3 Par Value
(Shares of Common Stock Outstanding on September 30, 2018)

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NORTHERN TRUST CORPORATION
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FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018
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(UNAUDITED)

CONDENSED INCOME STATEMENTS (In Millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	% Change ⁽¹⁾	2018	2017	% Change ⁽¹⁾
Noninterest Income	\$1,066.1	\$991.0	8 %	\$3,250.9	\$2,901.6	12 %
Net Interest Income	408.2	354.2	15	1,205.5	1,049.2	15
Provision for Credit Losses	(9.0)	(7.0)	29	(10.5)	(15.0)	(30)
Noninterest Expense	1,002.3	935.6	7	2,995.0	2,767.5	8
Income before Income Taxes	481.0	416.6	15	1,471.9	1,198.3	23
Provision for Income Taxes	106.5	118.2	(10)	325.4	355.9	(9)
Net Income	\$374.5	\$298.4	26 %	\$1,146.5	\$842.4	36 %
PER COMMON SHARE						
Net Income — Basic	\$ 1.59	\$ 1.21	31 %	\$ 4.87	\$ 3.43	42 %
— Diluted	1.58	1.20	32	4.84	3.41	42
Cash Dividends Declared Per Common Share	0.55	0.42	31	1.39	1.18	18
Book Value — End of Period (EOP)	42.83	40.82	5	42.83	40.82	5
Market Price — EOP	102.13	91.93	11	102.13	91.93	11

SELECTED BALANCE SHEET DATA (In Millions)

End of Period:	September 30, 2018		December 31, 2017		% Change ⁽¹⁾	
	2018	2017	2018	2017		
Assets	\$132,378.5	\$138,590.5	(4)	%		
Earning Assets	122,348.9	129,656.6	(6)			
Deposits	104,891.3	112,390.8	(7)			
Stockholders' Equity	10,364.5	10,216.2	1			
	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	% Change ⁽¹⁾	2018	2017	% Change ⁽¹⁾
Average Balances:						
Assets	\$122,155.6	\$121,159.4	1 %	\$123,496.7	\$118,696.0	4 %
Earning Assets	112,694.8	112,485.0	—	114,254.3	110,460.7	3
Deposits	93,501.8	97,112.0	(4)	95,759.5	96,269.6	(1)
Stockholders' Equity	10,274.6	10,040.2	2	10,205.3	9,936.8	3

CLIENT ASSETS (In Billions)	September 30, 2018	December 31, 2017	% Change ⁽¹⁾
Assets Under Custody/Administration ⁽²⁾	\$10,829.8	\$10,722.6	1 %
Assets Under Custody	8,188.9	8,084.6	1
Assets Under Management	1,171.5	1,161.0	1

(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 September 30, 2018		September 30, 2017		Nine Months Ended September 30, 2018		September 30, 2017	
	Advanced Approach	Standardized Approach	Advanced Approach	Standardized Approach	Advanced Approach	Standardized Approach	Advanced Approach	Standardized Approach
Financial Ratios:								
Return on Average Common Equity	15.1%	12.2%	15.9%	11.8%				
Return on Average Assets	1.22	0.98	1.24	0.95				
Dividend Payout Ratio	34.8	35.0	28.7	34.6				
Net Interest Margin ⁽¹⁾	1.47	1.29	1.44	1.31				
Capital Ratios:								
Northern Trust Corporation								
Common Equity Tier 1	13.4%	12.9%	13.5%	12.6%				
Tier 1	14.8	14.2	14.8	13.8				
Total	16.7	16.2	16.7	15.8				
Tier 1 Leverage	7.8	7.8	7.8	7.8				
Supplementary Leverage	6.9	N/A	6.8	N/A				
The Northern Trust Company								
Common Equity Tier 1	14.1%	13.2%	13.7%	12.6%				
Tier 1	14.1	13.2	13.7	12.6				
Total	15.8	14.9	15.4	14.3				
Tier 1 Leverage	7.2	7.2	7.0	7.0				
Supplementary Leverage	6.4	N/A	6.1	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.

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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

THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS

General

Northern Trust Corporation (the Corporation) is a financial holding company that is a leading provider of wealth management, asset servicing, asset management and banking solutions to corporations, institutions, families and individuals. 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 terms “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 \$1.58 in the current quarter, up from \$1.20 in the third quarter of 2017. Net income was \$374.5 million in the current quarter as compared to \$298.4 million in the prior-year quarter. Annualized return on average common equity was 15.1% in the current quarter and 12.2% in the prior-year quarter. The annualized return on average assets was 1.22% in the current quarter as compared to 0.98% in the prior-year quarter.

Revenue of \$1.47 billion in the current quarter was up \$129.1 million, or 10%, from \$1.35 billion in the prior-year quarter.

Noninterest income increased \$75.1 million, or 8%, to \$1.07 billion from \$991.0 million in the prior-year quarter, reflecting higher trust, investment and other servicing fees and foreign exchange trading income, partially offset by lower other operating income.

Net interest income increased \$54.0 million, or 15%, to \$408.2 million in the current quarter as compared to \$354.2 million in the prior-year quarter, primarily resulting from a higher net interest margin.

The provision for credit losses was a credit of \$9.0 million in the current quarter, as compared to a provision credit of \$7.0 million in the prior-year quarter.

Noninterest expense totaled \$1.00 billion in the current quarter, up \$66.7 million, or 7%, from \$935.6 million in the prior-year quarter, primarily attributable to higher compensation, outside services, equipment and software expense, and employee benefits.

The provision for income taxes in the current quarter totaled \$106.5 million, representing an effective tax rate of 22.1%. The provision for income taxes in the prior-year quarter totaled \$118.2 million, representing an effective tax rate of 28.4%.

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THIRD 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 September 30,				
	2018	2017	Change		
Trust, Investment and Other Servicing Fees	\$939.2	\$867.9	\$71.3	8	%
Foreign Exchange Trading Income	71.7	49.1	22.6	46	
Treasury Management Fees	12.5	13.2	(0.7)	(5)	
Security Commissions and Trading Income	21.9	21.2	0.7	3	
Other Operating Income	20.9	40.0	(19.1)	(48)	
Investment Security (Losses) Gains, net	(0.1)	(0.4)	0.3	(68)	
Total Noninterest Income	\$1,066.1	\$991.0	\$75.1	8	%

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 calculations on which fees are based are performed on a monthly or quarterly basis in arrears. For a further discussion of trust, investment and other servicing fees and how they are derived, refer to the "Reporting Segments" section.

When considering the impact of markets on the Corporation's results, the following tables present selected market indices and the percentage changes year over year.

Table 2: Equity Market Indices

	Daily Averages			Period-End		
	Three Months Ended September 30,			As of September 30,		
	2018	2017	Change	2018	2017	Change
S&P 500	2,848	2,466	15 %	2,914	2,519	16 %
MSCI EAFE (U.S. dollars)	1,964	1,934	2	1,974	1,974	—
MSCI EAFE (local currency)	1,141	1,106	3	1,152	1,126	2

Table 3: Fixed Income Market Indices

	As of September 30,		
	2018	2017	Change
Barclays Capital U.S. Aggregate Bond Index	2,014	2,038	(1)%
Barclays Capital Global Aggregate Bond Index	473	480	(1)

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 4: Assets Under Custody / Administration

Assets Under Custody / Administration (\$ In Billions)	September 30, 2018	June 30, 2018	September 30, 2017	Change Q3-18/Q2-18	Change Q3-18/Q3-17
Corporate & Institutional	\$10,153.9	\$10,051.9	\$9,062.8	1 %	12 %
Wealth Management	675.9	660.6	633.2	2	7
Total Assets Under Custody / Administration	\$10,829.8	\$10,712.5	\$9,696.0	1 %	12 %

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THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

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

Table 5: Assets Under Custody

Assets Under Custody (\$ In Billions)	September 30, 2018	June 30, 2018	September 30, 2017	Change Q3-18/Q2-18	Change Q3-18/Q3-17
Corporate & Institutional	\$ 7,523.1	\$ 7,451.1	\$ 7,130.9	1 %	6 %
Wealth Management	665.8	650.8	622.9	2	7
Total Assets Under Custody	\$ 8,188.9	\$ 8,101.9	\$ 7,753.8	1 %	6 %

The 6% increase in consolidated assets under custody from \$7.75 trillion as of September 30, 2017 to \$8.19 trillion as of September 30, 2018 primarily reflects favorable markets and net inflows, partially offset by unfavorable movements in foreign exchange rates.

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

Table 6: Allocation of Assets Under Custody

Assets Under Custody	September 30, 2018		June 30, 2018		September 30, 2017	
	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total
Equities	46%	58%	47%	45%	58%	46%
Fixed Income	37	18	35	38	18	36
Cash and Other Assets	15	24	16	15	24	16
Securities Lending Collateral	2	—	2	2	—	2

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

Table 7: Assets Under Management

Assets Under Management (\$ In Billions)	September 30, 2018	June 30, 2018	September 30, 2017	Change Q3-18/Q2-18	Change Q3-18/Q3-17
Corporate & Institutional	\$ 876.0	\$ 862.1	\$ 840.7	2 %	4 %
Wealth Management	295.5	286.8	284.4	3	4
Total Assets Under Management	\$ 1,171.5	\$ 1,148.9	\$ 1,125.1	2 %	4 %

The 4% increase in consolidated assets under management from \$1.13 trillion at September 30, 2017 to \$1.17 trillion as of September 30, 2018 was primarily due to favorable markets, partially offset by net outflows and the unfavorable impact of foreign exchange rates.

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

Table 8: Assets Under Management by Investment Type

(\$ In Billions)	September 30, 2018	June 30, 2018	September 30, 2017
Equities	\$ 610.2	\$ 587.8	\$ 572.5
Fixed Income	180.3	177.4	178.3
Cash and Other Assets	214.4	209.9	212.3
Securities Lending Collateral	166.6	173.8	162.0
Total Assets Under Management	\$ 1,171.5	\$ 1,148.9	\$ 1,125.1

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THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

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

Table 9: Allocation of Assets Under Management

	September 30, 2018		June 30, 2018		September 30, 2017	
	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total
Assets Under Management	52%	52%	51%	52%	51%	51%
Equities	52%	52%	51%	52%	51%	51%
Fixed Income	12	24	12	25	13	25
Cash and Other Assets	17	24	17	23	17	24
Securities Lending Collateral	19	—	14	20	—	14

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

Table 10: Activity in Consolidated Assets Under Management by Investment Type

(\$ In Billions)	Three Months Ended				
	September 30, 2018	June 30, 2018	March 31, 2018	December 31, 2017	September 30, 2017
Beginning Balance of AUM	\$1,148.9	\$1,165.7	\$1,161.0	\$1,125.1	\$1,028.8
Inflows by Investment Type					
Equity	42.3	44.7	44.2	63.0	51.2
Fixed Income	15.1	17.5	17.4	23.0	19.8
Cash & Other Assets	109.3	124.2	114.4	116.3	101.6
Securities Lending Collateral	23.3	22.4	68.1	32.4	45.5
Total Inflows	190.0	208.8	244.1	234.7	218.1
Outflows by Investment Type					
Equity	(43.9)	(42.4)	(47.8)	(67.7)	(41.0)
Fixed Income	(12.8)	(20.4)	(24.0)	(20.7)	(13.0)
Cash & Other Assets	(103.8)	(130.6)	(117.4)	(111.8)	(83.0)
Securities Lending Collateral	(30.5)	(36.1)	(48.3)	(26.8)	(14.4)
Total Outflows	(191.0)	(229.5)	(237.5)	(227.0)	(151.4)
Net Inflows / (Outflows)	(1.0)	(20.7)	6.6	7.7	66.7
Market Performance, Currency & Other					
Market Performance & Other	24.6	11.5	(4.6)	(27.9)	26.6
Currency	(1.0)	(7.6)	2.7	0.3	3.0
Total Market Performance, Currency & Other	23.6	3.9	(1.9)	(28.2)	29.6
Ending Balance of AUM	\$1,171.5	\$1,148.9	\$1,165.7	\$1,161.0	\$1,125.1

Foreign exchange trading income totaled \$71.7 million in the current quarter, up \$22.6 million, or 46%, compared to \$49.1 million in the prior-year quarter. The increase was primarily due to increased foreign exchange swap activity in Treasury and higher client volumes as compared to the prior-year quarter.

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THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

Other operating income totaled \$20.9 million in the current quarter, down \$19.1 million, or 48%, compared to \$40.0 million in the prior-year quarter, primarily due to \$8.1 million of impairment recognized related to a community development equity investment previously held at cost, expenses related to existing swap agreements related to Visa Inc. Class B common shares, lower income on hedging activity, and lower banking and credit-related service fees recorded in other income in the current quarter. The components of other operating income are provided below.

Table 11: Other Operating Income

Other Operating Income	Three Months Ended September 30,		
(\$ In Millions)	2018	2017	Change
Loan Service Fees	\$11.6	\$12.7	\$(1.1) (9)%
Banking Service Fees	11.1	12.6	(1.5) (12)
Other Income	(1.8)	14.7	(16.5) (112)
Total Other Operating Income	\$20.9	\$40.0	\$(19.1) (48)%

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THIRD 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 12: Average Consolidated Balance Sheets with Analysis of Net Interest Income

(Interest and Rate on a Fully Taxable Equivalent Basis) (\$ In Millions)	NORTHERN TRUST CORPORATION THIRD QUARTER					
	2018			2017		
	Interest	Average Balance	Rate ⁽⁵⁾	Interest	Average Balance	Rate ⁽⁵⁾
Average Earning Assets						
Federal Reserve and Other Central Bank Deposits	\$50.0	\$22,889.6	0.87 %	\$44.9	\$25,182.9	0.71 %
Interest-Bearing Due from and Deposits with Banks ⁽¹⁾	15.6	5,410.3	1.15	16.0	7,145.8	0.88
Federal Funds Sold and Securities Purchased under Agreements to Resell	10.2	1,775.2	2.27	7.8	1,945.8	1.58
Securities						
U.S. Government	28.0	5,726.6	1.94	22.1	6,002.2	1.46
Obligations of States and Political Subdivisions	3.7	730.7	2.05	3.0	845.3	1.41
Government Sponsored Agency						