

NORTHERN TRUST CORP  
Form 10-Q  
July 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 June 30, 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

**235,584,991 Shares \$1.66 2/3 Par Value**

**(Shares of Common Stock Outstanding on June 30, 2014)**

**CONSOLIDATED FINANCIAL HIGHLIGHTS****(UNAUDITED)**

<b>FOR THE PERIOD (In Millions)</b>	<b>Three Months Ended June 30,</b>			<b>Six Months Ended June 30,</b>		
	<b>2014</b>	<b>2013</b>	<b>% Change (*)</b>	<b>2014</b>	<b>2013</b>	<b>% Change (*)</b>
<b>Noninterest Income</b>						
Trust, Investment and Other Servicing Fees	\$ 706.9	\$ 657.3	8%	\$ 1,386.4	\$ 1,288.0	8%
Foreign Exchange Trading Income	52.9	71.3	(26)	103.0	130.8	(21)
Treasury Management Fees	16.6	17.1	(2)	33.4	33.9	(1)
Security Commissions and Trading Income	17.8	18.3	(3)	32.5	36.6	(11)
Other Operating Income	40.5	36.3	11	78.2	61.1	28
Investment Security Gains (Losses), net	0.4	0.1	N/M	(3.6)	0.3	N/M
<b>Total Noninterest Income</b>	<b>835.1</b>	<b>800.4</b>	<b>4</b>	<b>1,629.9</b>	<b>1,550.7</b>	<b>5</b>
<b>Net Interest Income</b>	<b>246.6</b>	<b>220.1</b>	<b>12</b>	<b>492.3</b>	<b>446.2</b>	<b>10</b>
Provision for Credit Losses		5.0	(100)	3.0	10.0	(70)
<b>Net Interest Income after Provision for Credit Losses</b>	<b>246.6</b>	<b>215.1</b>	<b>15</b>	<b>489.3</b>	<b>436.2</b>	<b>12</b>
<b>Noninterest Expense</b>						
Compensation	372.4	326.9	14	714.2	647.2	10
Employee Benefits	68.5	64.2	7	135.4	127.5	6
Outside Services	144.6	136.2	6	289.0	266.1	9
Equipment and Software	116.1	92.1	26	217.4	183.5	18
Occupancy	47.2	43.5	9	91.4	86.7	5
Other Operating Expense	62.2	66.8	(7)	131.6	147.6	(11)
<b>Total Noninterest Expense</b>	<b>811.0</b>	<b>729.7</b>	<b>11</b>	<b>1,579.0</b>	<b>1,458.6</b>	<b>8</b>
<b>Income before Income Taxes</b>	<b>270.7</b>	<b>285.8</b>	<b>(5)</b>	<b>540.2</b>	<b>528.3</b>	<b>2</b>
Provision for Income Taxes	88.8	94.7	(6)	176.9	173.2	2
<b>Net Income</b>	<b>\$ 181.9</b>	<b>\$ 191.1</b>	<b>(5)%</b>	<b>\$ 363.3</b>	<b>\$ 355.1</b>	<b>2%</b>
<b>Average Total Assets</b>	<b>\$ 103,324.1</b>	<b>\$ 92,849.6</b>	<b>11%</b>	<b>\$ 101,792.3</b>	<b>\$ 92,213.0</b>	<b>10%</b>
<b>PER COMMON SHARE</b>						
Net Income Basic	\$ 0.76	\$ 0.78	(3)%	\$ 1.51	\$ 1.46	3%
Diluted	0.75	0.78	(4)	1.50	1.45	3
Cash Dividends Declared Per Common Share	0.33	0.31	6	0.64	0.61	5
Book Value End of Period (EOP)	34.14	32.17	6	34.14	32.17	6
Market Price EOP	64.21	57.90	11	64.21	57.90	11

**FINANCIAL RATIOS**

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Return on Average Common Equity	<b>9.18%</b>	10.02%	<b>9.23%</b>	9.43%
Return on Average Assets	<b>0.71</b>	0.83	<b>0.72</b>	0.78
Dividend Payout Ratio	<b>44.00</b>	39.74	<b>42.67</b>	42.07

PERIOD END (In Millions)	June 30,	December 31,	% Change (*)
	2014	2013	
Assets	<b>\$ 105,761.2</b>	\$ 102,947.3	3%
Earning Assets	<b>96,050.9</b>	93,367.2	3
Deposits	<b>88,862.5</b>	84,098.1	6
Stockholders Equity	<b>8,042.6</b>	7,912.0	2

PERIOD END CLIENT ASSETS (In Billions)			
Assets Under Custody	<b>\$ 6,004.6</b>	\$ 5,575.7	8%
Assets Under Management	<b>924.4</b>	884.5	5

**CAPITAL RATIOS**

**Northern Trust Corporation**

	June 30, 2014		March 31,	
	Advanced Approach (a)	Standardized Approach (b)	2014 (b)	December 31, 2013 (c)
Common Equity Tier 1	<b>12.7%</b>	<b>12.7%</b>	12.8%	12.9%
Tier 1	<b>12.9</b>	<b>12.9</b>	13.0	13.4
Total	<b>14.9</b>	<b>15.4</b>	15.5	15.8
Leverage	<b>n/a</b>	<b>7.6</b>	7.8	7.9

**The Northern Trust Company**

	June 30, 2014		March 31,	
	Advanced Approach (a)	Standardized Approach (b)	2014 (b)	December 31, 2013 (c)
Common Equity Tier 1	<b>11.7%</b>	<b>11.4%</b>	11.7%	11.5%
Tier 1	<b>11.6</b>	<b>11.4</b>	11.7	11.5
Total	<b>13.7</b>	<b>14.0</b>	14.2	14.3
Leverage	<b>n/a</b>	<b>6.7</b>	6.9	6.8

- (\*) Percentage calculations are based on actual balances rather than the rounded amounts presented in the Consolidated Financial Highlights.
- (a) Effective with the second quarter of 2014, Northern Trust exited its parallel run. Accordingly, the June 30, 2014 ratios are calculated in compliance with the Basel III Advanced Approach final rules released by the Board of Governors of the Federal Reserve on July 2, 2013.
- (b) Standardized Approach capital components in 2014 are determined by Basel III phased in requirements and risk weighted assets are determined by Basel I requirements. The June 30, 2014 and March 31, 2014 ratios calculated under the Standardized Approach comply with the final rules released by the Board of Governors of the Federal Reserve on July 2, 2013.
- (c) The December 31, 2013 ratios are calculated in accordance with Basel I requirements.

---

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

**SECOND 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.

On July 23, 2014, the SEC approved rules implementing money market mutual fund reform, which, among other things, require institutional prime money market funds to maintain a floating net asset value and implement procedures that may restrict redemptions in certain circumstances. Given the uncertainty regarding the implementation of these rules, we are unable to predict with any degree of certainty what impact they will ultimately have on our business.

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 second quarter of 2014 was \$0.75 compared to \$0.78 per common share in the second quarter of 2013. Net income was \$181.9 million, down \$9.2 million, or 5%, from \$191.1 million in the prior year quarter. The performance in the current quarter produced an annualized return on average common equity of 9.2% as compared to 10.0% in the prior year quarter. The annualized return on average assets was 0.7% as compared to 0.8% in the prior year quarter.

The current quarter includes pre-tax charges and write-offs totaling \$42.3 million. Excluding these charges and write-offs, net income per diluted common share, net income, and return on average common equity were \$0.87, \$209.8 million, and 10.6%, respectively.

Revenue of \$1.08 billion was up \$61.2 million, or 6%, from \$1.02 billion in the prior year quarter. Noninterest income increased \$34.7 million, or 4%, to \$835.1 million from \$800.4 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 increased \$26.5 million, or 12%, to \$246.6 million as compared to \$220.1 million in the prior year quarter, due to higher levels of average earning assets, partially offset by a decrease in the net interest margin.

Noninterest expense totaled \$811.0 million, up \$81.3 million, or 11%, from \$729.7 million in the prior year quarter. Excluding the current quarter pre-tax charges and write-offs of \$42.3 million, noninterest expense was \$768.7 million, up \$39.0 million, or 5%, from the prior year quarter, primarily reflecting higher compensation, equipment and software and outside services expense.



**Noninterest Income**

The components of noninterest income are provided below.

Noninterest Income (\$ In Millions)	Three Months Ended June 30,			
	2014	2013	Change	
Trust, Investment and Other Servicing Fees	\$ 706.9	\$ 657.3	\$ 49.6	8%
Foreign Exchange Trading Income	52.9	71.3	(18.4)	(26)
Treasury Management Fees	16.6	17.1	(0.5)	(2)
Security Commissions and Trading Income	17.8	18.3	(0.5)	(3)
Other Operating Income	40.5	36.3	4.2	11
Investment Security Gains (Losses), net	0.4	0.1	0.3	N/M
<b>Total Noninterest Income</b>	<b>\$ 835.1</b>	<b>\$ 800.4</b>	<b>\$ 34.7</b>	<b>4%</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)	June 30,	March 31,	June 30,	Change	Change
	2014	2014	2013	Q2-14/ Q1-14	Q2-14/ Q2-13
Corporate & Institutional	\$ 5,488.0	\$ 5,249.9	\$ 4,538.9	5%	21%
Wealth Management	516.6	503.6	452.6	3	14
<b>Total Assets Under Custody</b>	<b>\$ 6,004.6</b>	<b>\$ 5,753.5</b>	<b>\$ 4,991.5</b>	<b>4%</b>	<b>20%</b>

Assets Under Management (\$ In Billions)	June 30,	March 31,	June 30,	Change	Change
	2014	2014	2013	Q2-14/ Q1-14	Q2-14/ Q2-13
Corporate & Institutional	\$ 701.5	\$ 698.2	\$ 600.5	%	17%
Wealth Management	222.9	217.2	202.5	3	10
<b>Total Assets Under Management</b>	<b>\$ 924.4</b>	<b>\$ 915.4</b>	<b>\$ 803.0</b>	<b>1%</b>	<b>15%</b>

C&IS assets under custody totaled \$5.5 trillion, up 21% from the prior year quarter, and includes \$3.5 trillion of global custody assets, 27% higher compared to the prior year quarter. C&IS assets under management include \$116.4 billion of securities lending collateral, a 19% increase from the prior year quarter.

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 22.0% and 20.3%, respectively.





**Noninterest Income (continued)**

Custodied and managed assets were invested as follows at June 30, 2014 and 2013:

Assets Under Custody	2014			2013		
	C&IS	WM	Consolidated	C&IS	WM	Consolidated
Equities	45%	56%	46%	46%	52%	46%
Fixed Income Securities	37	21	36	35	24	34
Cash and Other Assets	18	23	18	19	24	20
<b>Assets Under Management</b>						
Equities	56%	48%	54%	54%	43%	51%
Fixed Income Securities	13	28	16	14	29	18
Cash and Other Assets	31	24	30	32	28	31

Trust, investment and other servicing fees in C&IS increased \$31.2 million, or 9%, to \$395.4 million from the prior year quarter's \$364.2 million.

C&IS Trust, Investment and Other Servicing Fees (\$ In Millions)	Three Months Ended June 30,			
	2014	2013	Change	
Custody and Fund Administration	\$ 261.1	\$ 234.4	\$ 26.7	11%
Investment Management	77.7	73.9	3.8	5
Securities Lending	30.0	31.1	(1.1)	(4)
Other	26.6	24.8	1.8	8
<b>Total</b>	<b>\$ 395.4</b>	<b>\$ 364.2</b>	<b>\$ 31.2</b>	<b>9%</b>

Custody and fund administration fees, the largest component of C&IS fees, increased 11%, primarily driven by new business, as well as the favorable impact of equity markets and movements in foreign exchange rates. C&IS investment management fees increased 5%; new business and higher equity markets were partially offset by higher waived fees in money market mutual funds. Money market mutual fund fee waivers in C&IS, attributable to persistent low short-term interest rates, totaled \$14.8 million, compared to waived fees of \$9.8 million in the prior year quarter. Securities lending revenue decreased 4%, primarily reflecting lower spreads partially offset by higher volumes in the current quarter. Other fees in C&IS increased 8%, primarily reflecting new business in investment risk and analytical services.

Trust, investment and other servicing fees in Wealth Management totaled \$311.5 million, increasing \$18.4 million, or 6%, from \$293.1 million in the prior year quarter. The increased fees are primarily due to higher equity markets and new business, partially offset by higher waived fees in money market mutual funds. Money market mutual fund fee waivers in Wealth Management totaled \$15.9 million compared with \$12.9 million in the prior year quarter.

Foreign exchange trading income totaled \$52.9 million, down \$18.4 million, or 26%, compared with \$71.3 million in the prior year quarter. The decrease is attributable to lower currency market volatility and client volumes as compared to the prior year quarter.



**Noninterest Income (continued)**

Other operating income totaled \$40.5 million, up \$4.2 million, or 11%, from \$36.3 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 June 30,			
	2014	2013	Change	
Loan Service Fees	<b>\$ 16.0</b>	\$ 14.7	\$ 1.3	9%
Banking Service Fees	<b>12.6</b>	13.0	(0.4)	(2)
Other Income	<b>11.9</b>	8.6	3.3	36
<b>Total Other Operating Income</b>	<b>\$ 40.5</b>	\$ 36.3	\$ 4.2	11%

The increase in the other income component of other operating income is primarily attributable to gains from currency-related hedging activity in the current quarter.

**Net Interest Income**

Net interest income on an FTE basis totaled \$253.4 million, up \$25.4 million, or 11%, compared to \$228.0 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. Average earning assets for the quarter were \$95.5 billion, up \$12.4 billion, or 15%, from \$83.1 billion in the prior year quarter, primarily reflecting higher levels of Federal Reserve deposits and securities. The increased Federal Reserve deposits and securities as compared to the prior year quarter reflect higher levels of non-U.S. office interest-bearing deposits and demand deposits. The decline in the net interest margin to 1.06% from 1.10% in the prior year quarter 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 23.

The balance sheet line item Federal Reserve Deposits and Other Interest-Bearing averaged \$13.3 billion as compared to \$5.3 billion in the prior year quarter, an increase of \$8.0 billion.

Average securities, inclusive of Federal Reserve and Federal Home Loan Bank stock and certain community development investments which are recorded in other assets in the consolidated balance sheet, were \$34.3 billion, up \$3.6 billion, or 12%, from \$30.7 billion in the prior year quarter.

Loans and leases averaged \$30.1 billion, up \$1.5 billion, or 5%, from \$28.6 billion in the prior year quarter, primarily reflecting an increase in average private client loans and commercial and institutional loans. Private client loans averaged \$6.5 billion, up \$883.8



**Net Interest Income (continued)**

million, or 16%, from the prior year quarter's average of \$5.6 billion. Commercial and Institutional loans averaged \$7.9 billion, up \$433.1 million, or 6%, from the prior year quarter's average of \$7.5 billion.

Northern Trust utilizes a diverse mix of funding sources. Total interest-bearing deposits averaged \$65.8 billion, compared to \$55.9 billion in the prior year quarter, an increase of \$9.9 billion, or 18%. Other interest-bearing funds averaged \$7.8 billion, a decrease of \$733.4 million, or 9%, from \$8.5 billion in the prior year quarter, attributable to lower average senior notes and short-term borrowings, partially offset by increased average 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 \$3.2 billion, or 17%, to \$21.9 billion from \$18.7 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 pages 24 and 25.

**Provision for Credit Losses**

There was no provision for credit losses recorded in the current quarter. A provision of \$5.0 million was recorded in the prior year quarter. Net charge-offs were \$5.9 million, resulting from \$7.8 million of charge-offs and \$1.9 million of recoveries, compared to \$8.1 million of net charge-offs in the prior year quarter, resulting from \$15.6 million of charge-offs and \$7.5 million of recoveries. Nonperforming assets decreased 14% from the prior year quarter. Residential real estate loans accounted for 71% and 66% of total nonperforming loans and leases at June 30, 2014 and 2013, respectively. For additional discussion of the provision and allowance for credit losses, refer to the Asset Quality section beginning on page 18.

**Noninterest Expense**

The components of noninterest expense are provided below.

<b>Noninterest Expense</b> (\$ In Millions)	Three Months Ended June 30,			
	2014	2013	Change	
Compensation	<b>\$ 372.4</b>	\$ 326.9	\$ 45.5	14%
Employee Benefits	<b>68.5</b>	64.2	4.3	7
Outside Services	<b>144.6</b>	136.2	8.4	6
Equipment and Software	<b>116.1</b>	92.1	24.0	26
Occupancy	<b>47.2</b>	43.5	3.7	8
Other Operating Expense	<b>62.2</b>	66.8	(4.6)	(7)
<b>Total Noninterest Expense</b>	<b>\$ 811.0</b>	\$ 729.7	\$ 81.3	11%



**Noninterest Expense (continued)**

Compensation expense, the largest component of noninterest expense, equaled \$372.4 million, up \$45.5 million, or 14%, from \$326.9 million in the prior year quarter. The current quarter includes pre-tax severance-related charges of \$25.5 million. Excluding these charges, compensation expense increased \$20.0 million, or 6%, reflecting higher staff levels, base pay adjustments and the impact of unfavorable movements in foreign exchange rates. Staff on a full-time equivalent basis at June 30, 2014 totaled approximately 15,100, up 4% from a year ago.

Employee benefit expense equaled \$68.5 million, up \$4.3 million, or 7%, from \$64.2 million in the prior year quarter, and includes \$1.9 million of severance-related charges. Excluding these charges, employee benefit expense increased 4%, attributable to higher expense associated with employee medical benefits and payroll tax expense, partially offset by lower pension expense.

Expense associated with outside services totaled \$144.6 million, up \$8.4 million, or 6%, from \$136.2 million in the prior year quarter. Outside services expense includes \$1.1 million of severance-related charges in the current quarter. Excluding these charges, outside services expense increased \$7.3 million, or 5%, primarily reflecting volume-driven growth in global sub-custodian expense as well as increased legal services expense.

Equipment and software expense totaled \$116.1 million, up \$24.0 million, or 26%, from \$92.1 million in the prior year quarter. The current quarter includes \$9.5 million of pre-tax write-offs of replaced or eliminated software. Excluding these write-offs, equipment and software expense increased \$14.5 million, or 16%, reflecting higher software amortization and related software support costs.

Occupancy expense equaled \$47.2 million, up \$3.7 million, or 8%, from \$43.5 million in the prior year quarter. The current quarter includes pre-tax charges totaling \$4.3 million in connection with reductions in office space. Excluding these charges, occupancy expense decreased 1% from the prior year quarter.

Other operating expense totaled \$62.2 million, down 7% from \$66.8 million in the prior year quarter. The components of other operating expense are provided below.

<b>Other Operating Expense</b> (\$ In Millions)	Three Months Ended June 30,			
	2014	2013	Change	
Business Promotion	<b>\$ 19.1</b>	\$ 20.7	\$ (1.6)	(8)%
Staff Related	<b>10.1</b>	8.0	2.1	26
FDIC Insurance Premiums	<b>4.7</b>	5.1	(0.4)	(7)
Other Intangibles Amortization	<b>5.0</b>	5.1	(0.1)	(4)
Other Expenses	<b>23.3</b>	27.9	(4.6)	(17)
Total Other Operating Expense	<b>\$ 62.2</b>	\$ 66.8	\$ (4.6)	(7)%

The decrease in the other expenses component of other operating expense primarily reflects lower charges associated with account servicing activities.

## Provision for Income Taxes

Income tax expense in the current quarter was \$88.8 million, representing an effective tax rate of 32.8%, and \$94.7 million in the prior year quarter, representing an effective tax rate of 33.1%.

## BUSINESS UNIT REPORTING

The following tables reflect the earnings contributions and average assets of Northern Trust's business units for the three month periods ended June 30, 2014 and 2013. Business unit financial information, presented on an internal management-reporting basis, is determined by accounting systems that are used to allocate revenue and expense related to each segment and incorporates processes for allocating assets, liabilities, and equity, and the applicable interest income and expense.

Months Ended June 30, (Millions)	Corporate & Institutional Services		Wealth Management		Treasury and Other		Total Consolidated	
	2014	2013	2014	2013	2014	2013	2014	2013
Interest Income								
Investment and Other								
Origination Fees	\$ 395.4	\$ 364.2	\$ 311.5	\$ 293.1	\$	\$	\$ 706.9	\$ 6
Exchange Trading	50.7	69.8	2.2	1.5			52.9	
Noninterest Income	47.1	45.6	23.1	24.3	5.1	1.9	75.3	
Interest Expense	76.7	66.0	132.6	141.2	44.1	20.8	253.4	2
Provision for Credit Losses*	569.9	545.6	469.4	460.1	49.2	22.7	1,088.5	1,0
Interest Expense	2.4	1.2	(2.4)	3.8				
(loss) before Taxes*	446.4	396.0	329.4	301.8	35.2	31.9	811.0	7
Provision (Benefit) for Income Taxes*	121.1	148.4	142.4	154.5	14.0	(9.2)	277.5	2
Income	36.1	48.3	53.6	58.0	5.9	(3.7)	95.6	1
Percentage of Consolidated Net Average Assets	\$ 85.0	\$ 100.1	\$ 88.8	\$ 96.5	\$ 8.1	\$ (5.5)	\$ 181.9	\$ 1
	47%	52%	49%	51%	4%	(3)%	100%	
	\$ 59,995.2	\$ 51,976.0	\$ 22,210.8	\$ 22,803.8	\$ 21,118.1	\$ 18,069.8	\$ 103,324.1	\$ 92,8

\* Stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of \$6.8 million for 2014 and \$7.9 million for 2013.

Months Ended June 30,	Corporate & Institutional Services	Wealth Management	Treasury and Other	Total Consolidated
-----------------------	---------------------------------------	----------------------	-----------------------	-----------------------



Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

(Millions)	2014	2013	2014	2013	2014	2013	2014	2013
Interest Income								
Investment and Other								
ing Fees	\$ 774.6	\$ 712.9	\$ 611.8	\$ 575.1	\$	\$	\$ 1,386.4	\$ 1,28
n Exchange Trading								
e	98.8	128.0	4.2	2.8			103.0	13
Noninterest Income	91.5	85.8	45.8	41.5	3.2	4.6	140.5	13
Interest Income (FTE)*	150.4	130.1	267.6	289.0	89.8	42.6	507.8	46
ue*	1,115.3	1,056.8	929.4	908.4	93.0	47.2	2,137.7	2,01
ion for Credit Losses	3.6	(1.5)	(0.6)	11.5			3.0	1
Interest Expense	869.9	794.7	648.2	603.6	60.9	60.3	1,579.0	1,45
e (loss) before Income								
*	241.8	263.6	281.8	293.3	32.1	(13.1)	555.7	54
ion (Benefit) for								
e Taxes*	70.9	84.2	106.2	110.8	15.3	(6.3)	192.4	18
Income	\$ 170.9	\$ 179.4	\$ 175.6	\$ 182.5	\$ 16.8	\$ (6.8)	\$ 363.3	\$ 35
ntage of Consolidated								
ome	47%	51%	48%	51%	5%	(2)%	100%	
ge Assets	\$ 58,631.4	\$ 51,648.2	\$ 22,368.8	\$ 22,832.4	20,792.1	\$ 17,732.4	\$ 101,792.3	\$ 92,21

\* Stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of \$15.5 million for both 2014 and 2013.

## Corporate & Institutional Services

C&IS net income totaled \$85.0 million compared to \$100.1 million in the prior year quarter, a decrease of \$15.1 million, or 15%. Noninterest income was \$493.2 million, up \$13.6 million, or 3%, from \$479.6 million in the prior year quarter, primarily reflecting higher trust, investment and other servicing fees, partially offset by lower foreign exchange trading income.

C&IS Trust, Investment and Other Servicing Fees (\$ In Millions)	Three Months Ended June 30,			
	2014	2013	Change	
Custody and Fund Administration	\$ 261.1	\$ 234.4	\$ 26.7	11%
Investment Management	77.7	73.9	3.8	5
Securities Lending	30.0	31.1	(1.1)	(4)
Other	26.6	24.8	1.8	8
<b>Total</b>	<b>\$ 395.4</b>	<b>\$ 364.2</b>	<b>\$ 31.2</b>	<b>9%</b>

Custody and fund administration fees, the largest component of C&IS fees, increased 11%, primarily driven by new business, as well as the favorable impact of equity markets and movements in foreign exchange rates. C&IS investment management fees increased 5%, as new business and higher equity markets were partially offset by higher waived fees in money market mutual funds. Money market mutual fund fee waivers in C&IS, attributable to persistent low short-term interest rates, totaled \$14.8 million, compared to waived fees of \$9.8 million in the prior year quarter. Securities lending revenue decreased 4%, primarily reflecting lower spreads partially offset by higher volumes in the current quarter. Other fees in C&IS increased 8% primarily reflecting new business in investment risk and analytical services.

Foreign exchange trading income totaled \$50.7 million, a decrease of \$19.1 million, or 27%, from \$69.8 million in the prior year quarter, attributable to lower currency market volatility and trading volumes compared to the prior year quarter.

Other noninterest income in C&IS totaled \$47.1 million, up 3% from \$45.6 million in the prior year quarter, reflecting higher security commissions and trading income as compared to the prior year quarter.

Net interest income stated on an FTE basis was \$76.7 million, up \$10.7 million, or 16% from \$66.0 million in the prior year quarter. The increase in net interest income is attributable to higher levels of average earning assets, partially offset by a decrease in the net interest margin. Average earning assets totaled \$53.8 billion, an increase of \$9.7 billion, or 22%, from \$44.1 billion in the prior year quarter, and were comprised of interest-bearing deposits with banks, loans and leases and investment securities. Funding sources were primarily comprised of non-U.S. custody-related interest-bearing deposits, which averaged \$45.2 billion in the current quarter, up \$11.0 billion, or 32%, from \$34.2 billion in the prior year quarter. The net interest margin declined to 0.57% from 0.61% in the prior year quarter, reflecting lower yields on earning assets, partially offset by a lower cost of interest-related funds.

A provision for credit losses of \$2.4 million was recorded in the current quarter, primarily

---

**Corporate & Institutional Services (continued)**

reflecting higher levels of commercial and institutional loans, partially offset by continued improvement in the credit quality of the commercial and institutional loan class. The prior year quarter included a provision of \$1.2 million.

Total C&IS noninterest expense, which includes the direct expense of the business unit, indirect expense allocations from Asset Management and O&T for product and operating support, and indirect expense allocations for certain corporate support services, totaled \$446.4 million, up \$50.4 million, or 13%, from the prior year quarter's \$396.0 million. The current quarter includes \$20.9 million of pre-tax charges relating to severance activities and reductions in office space and write-offs of replaced or eliminated software. Excluding these charges and write-offs, C&IS noninterest expense increased \$29.5 million, or 7%, attributable to higher indirect expense allocations, compensation and outside services expense.

**Wealth Management**

Wealth Management net income was \$88.8 million, down \$7.7 million, or 8%, from \$96.5 million in the prior year quarter. Noninterest income was \$336.8 million, up \$17.9 million, or 6%, from \$318.9 million in the prior year quarter. Trust, investment and other servicing fees in Wealth Management totaled \$311.5 million, increasing \$18.4 million, or 6%, from \$293.1 million in the prior year quarter. The increased fees are primarily due to higher equity markets and new business, partially offset by higher waived fees in money market mutual funds. Money market mutual fund fee waivers in Wealth Management totaled \$15.9 million compared with \$12.9 million in the prior year quarter. Other noninterest income totaled \$23.1 million, down 5% from \$24.3 million in the prior year quarter, primarily reflecting lower security commissions and trading income in the current quarter.

Net interest income stated on an FTE basis was \$132.6 million, down \$8.6 million, or 6%, from \$141.2 million in the prior year quarter, primarily reflecting a decline in the net interest margin. The net interest margin decreased to 2.32% from 2.54% in the prior year quarter as a result of lower yields on earnings assets, partially offset by lower deposit rates, each reflecting the low interest rate environment. Earning assets averaged \$23.0 billion, up \$393.9 million, or 2%, from \$22.6 billion in the prior year quarter. Earning assets and funding sources were primarily comprised of loans and domestic retail interest-bearing deposits, respectively.

A negative provision for credit losses of \$2.4 million was recorded in the current quarter, reflecting improvement in the credit quality of the commercial and institutional and commercial real estate loan classes while residential real estate loans continued to reflect weakness relative to the overall portfolio. Loan balances within private client, commercial and institutional and commercial real estate loan classes increased in the current quarter, while the residential real estate loan balance decreased. A provision for credit losses of \$3.8 million was recorded in the prior year quarter.

Total noninterest expense, which includes the direct expense of the business unit, indirect expense allocations from Asset Management and O&T for product and operating support, and indirect expense allocations for certain corporate support services, totaled \$329.4

## **Wealth Management (continued)**

million compared with \$301.8 million in the prior year quarter, an increase of \$27.6 million, or 9%. Noninterest expense in the current quarter includes \$16.8 million of pre-tax charges relating to severance activities and reductions in office space and write-offs of replaced or eliminated software. Excluding these charges and write-offs noninterest expense increased \$10.8 million, or 4%, primarily reflecting higher indirect expense allocations as compared to the prior year quarter.

## **Treasury and Other**

Treasury and Other includes income and expense associated with the wholesale funding activities and the investment portfolios of the Corporation and its principal subsidiary, The Northern Trust Company (the Bank), and certain corporate-based expense, executive level compensation, and nonrecurring items not allocated to the business units.

Noninterest income totaled \$5.1 million compared to noninterest income in the prior year quarter of \$1.9 million. The increase primarily reflects current quarter gains from currency-related hedging activities.

Net interest income was \$44.1 million, compared to \$20.8 million in the prior year quarter, an increase of \$23.3 million. The increase reflects higher internal yields on funds provided to business units and increased average earning assets, up \$2.3 billion, or 14%, to \$18.7 billion in the current quarter from \$16.4 billion in the prior year quarter.

Noninterest expense totaled \$35.2 million, up 10% from \$31.9 million in the prior year quarter, and includes \$4.6 million of pre-tax severance-related charges. Excluding these charges, noninterest expense decreased 4%, primarily reflecting higher indirect expense allocations to C&IS and Wealth Management, partially offset by higher equipment and software and compensation expense as compared to the prior year quarter.

## **SIX-MONTH CONSOLIDATED RESULTS OF OPERATIONS**

### **Overview**

Net income per diluted common share was \$1.50 for the six months ended June 30, 2014 and \$1.45 in the comparable prior year period. Net income totaled \$363.3 million, up \$8.2 million, or 2%, as compared to \$355.1 million in the prior year period. The performance in the current period produced an annualized return on average common equity of 9.2%, compared to 9.4% in the prior year period. The annualized return on average assets was 0.7%, compared to 0.8% in the prior year period.

The current year period includes pre-tax charges and write-offs totaling \$42.3 million. Excluding these charges and write-offs, net income per diluted common share, net income, and return on average common equity were \$1.61, \$391.1 million, and 9.9% respectively.

Revenue for the six months ended June 30, 2014 totaled \$2.12 billion, up \$125.3 million, or 6%, from the prior year period's \$2.00 billion. Noninterest income was \$1.63 billion, up

**Overview (continued)**

\$79.2 million, or 5%, from \$1.55 billion in the prior year period. Trust, investment and other servicing fees increased \$98.4 million, or 8%, to \$1.39 billion from \$1.29 billion in the prior year period.

**Noninterest Income**

The components of noninterest income are provided below.

<b>Noninterest Income</b> (\$ In Millions)	Six Months Ended June 30,			
	2014	2013	Change	
Trust, Investment and Other Servicing Fees	<b>\$ 1,386.4</b>	\$ 1,288.0	\$ 98.4	8%
Foreign Exchange Trading Income	<b>103.0</b>	130.8	(27.8)	(21)
Treasury Management Fees	<b>33.4</b>	33.9	(0.5)	(1)
Security Commissions and Trading Income	<b>32.5</b>	36.6	(4.1)	(11)
Other Operating Income	<b>78.2</b>	61.1	17.1	28
Investment Security Gains (Losses), net	<b>(3.6)</b>	0.3	(3.9)	N/M
<b>Total Noninterest Income</b>	<b>\$ 1,629.9</b>	\$ 1,550.7	\$ 79.2	5%

Trust, investment and other servicing fees from C&IS increased \$61.7 million, or 9%, totaling \$774.6 million, compared to \$712.9 million a year ago.

<b>C&amp;IS Trust, Investment and Other Servicing Fees</b> (\$ In Millions)	Six Months Ended June 30,			
	2014	2013	Change	
Custody and Fund Administration	<b>\$ 513.3</b>	\$ 458.2	\$ 55.1	12%
Investment Management	<b>152.7</b>	149.4	3.3	2
Securities Lending	<b>52.7</b>	53.4	(0.7)	(1)
Other	<b>59.9</b>	51.9	4.0	8
<b>Total</b>	<b>\$ 774.6</b>	\$ 712.9	\$ 61.7	9%

Custody and fund administration fees, the largest component of C&IS fees, increased 12%, primarily driven by new business, as well as the favorable impact of equity markets and movements in foreign exchange rates. C&IS investment management fees increased 2%, primarily reflecting higher equity markets and new business, partially offset by higher waived fees in money market mutual funds. Money market mutual fund fee waivers in C&IS, attributable to persistent low short-term interest rates, totaled \$29.7 million, compared to waived fees of \$18.6 million in the prior year period. Securities lending revenue decreased 1%, primarily reflecting lower spreads offset by higher loan volumes in the current period. Other fees in C&IS increased 8%, primarily reflecting new business in investment risk and analytical services.

Trust, investment and other servicing fees in Wealth Management totaled \$611.8 million, increasing \$36.7 million, or 6%, from \$575.1 million in the prior year period. The increase is primarily due to higher equity markets and new business, partially offset by higher waived fees in money market mutual funds. Money market mutual fund fee

waivers in Wealth Management totaled \$33.5 million compared with \$26.3 million in the prior year period.

**Noninterest Income (continued)**

Foreign exchange trading income decreased \$27.8 million, or 21%, and totaled \$103.0 million compared with \$130.8 million in the prior year period. The decrease is attributable to lower currency market volatility and client volumes compared to the prior year period.

Other operating income increased \$17.1 million, or 28%, to \$78.2 million compared with \$61.1 million in the prior year period. The components of other operating income are provided below.

<b>Other Operating Income</b> (\$ In Millions)	Six Months Ended June 30,			
	2014	2013	Change	
Loan Service Fees	\$ 31.7	\$ 29.6	\$ 2.1	7%
Banking Service Fees	24.9	25.4	(0.5)	(2)
Other Income	21.6	6.1	15.5	N/M
Total Other Operating Income	\$ 78.2	\$ 61.1	\$ 17.1	28%

The prior year period's other income component of other operating income included a \$12.4 million write-off of certain fee receivables resulting from the correction of an accrual methodology followed in prior years. Excluding the prior year period write-off, the other income component of other operating income increased 6% in the current year period, primarily reflecting gains from currency-related hedging activity.

Net investment security losses totaled \$3.6 million, compared to net investment security gains totaling \$0.3 million in the prior year period. The current year period includes \$3.9 million of charges relating to the other-than-temporary impairment of certain Community Reinvestment Act (CRA) eligible securities.

**Net Interest Income**

Net interest income, stated on an FTE basis, totaled \$507.8 million, an increase of \$46.1 million, or 10%, from \$461.7 million reported in the prior year period. The increase is the result of higher levels of average earning assets, partially offset by a decline in the net interest margin. Average earning assets were \$93.7 billion, up \$11.1 million, or 13%, from \$82.6 billion in the prior year period, primarily attributable to higher levels of Federal Reserve deposits and securities. The increased Federal Reserve deposits and securities primarily reflect higher levels of non-U.S. interest-bearing deposits and demand deposits as compared to the prior year. The net interest margin declined to 1.09% from 1.13% in the prior year period reflecting lower yields on earning assets, partially offset by a lower cost of interest-related funds due to lower short-term interest rates.

**Provision for Credit Losses**

A provision for credit losses of \$3.0 million was recorded in the current year period. A provision of \$10.0 million was recorded in the prior year period. Net charge-offs totaled \$7.4 million resulting from \$19.3 million of charge-offs and \$11.9 million of recoveries, compared to net charge-offs of \$16.8 million in the prior year period resulting from \$28.2 million of charge-offs and \$11.4 million of recoveries. The current period provision reflects improvement in the credit quality of the commercial and institutional and commercial real





**Provision for Credit Losses (continued)**

estate loan classes while residential real estate loans continued to reflect weakness relative to the overall portfolio, accounting for 71% and 66% of total nonperforming loans and leases at June 30, 2014 and 2013, respectively. Loan balances within the commercial and institutional and commercial real estate loan classes increased in the current quarter, while the residential real estate loan balance decreased. For a fuller discussion of the consolidated allowance and provision for credit losses refer to the Asset Quality section beginning on page 18.

**Noninterest Expense**

Noninterest expense totaled \$1.58 billion for the current period, up \$120.4 million, or 8%, from the prior year period's \$1.46 billion. The components of noninterest expense are provided below.

Noninterest Expense (\$ In Millions)	Six Months Ended June 30,			
	2014	2013	Change	
Compensation	\$ 714.2	\$ 647.2	\$ 67.0	10%
Employee Benefits	135.4	127.5	7.9	6
Outside Services	289.0	266.1	22.9	9
Equipment and Software	217.4	183.5	33.9	18
Occupancy	91.4	86.7	4.7	5
Other Operating Expense	131.6	147.6	(16.0)	(11)
<b>Total Noninterest Expense</b>	<b>\$ 1,579.0</b>	<b>\$ 1,458.6</b>	<b>\$ 120.4</b>	<b>8%</b>

Compensation expense, the largest component of noninterest expense, increased \$67.0 million, or 10%, to \$714.2 million from the prior year period's \$647.2 million. The current year period includes pre-tax severance-related charges of \$25.5 million. Excluding the severance-related charges, compensation expense increased \$41.5 million, or 6%, reflecting higher staff levels, base pay adjustments and the unfavorable impact of movements in foreign exchange rates.

Employee benefit expense increased \$7.9 million, or 6% to \$135.4 million from \$127.5 million in the prior year period, and includes \$1.9 million of severance-related charges. Excluding these charges, employee benefit expense increased \$6.0 million, or 5%, primarily attributable to higher expense associated with employee medical benefits and payroll tax expense, partially offset by lower pension expense.

Outside services expense equaled \$289.0 million, up \$22.9 million, or 9%, from \$266.1 million in the prior year period. Outside services expense includes \$1.1 million of severance-related charges in the current period. Excluding these charges, outside services expense increased \$21.8 million, or 8%, primarily reflecting volume-driven growth in global sub-custodian expense as well as higher consulting and legal services expense.

Equipment and software expense totaled \$217.4 million, up \$33.9 million, or 18% from \$183.5 million in the prior year period. The current period includes \$9.5 million of pre-tax

**Noninterest Expense (continued)**

write-offs of replaced or eliminated software. Excluding these write-offs, equipment and software expense increased \$24.4 million, or 13%, reflecting higher software amortization and related software support costs.

Occupancy expense equaled \$91.4 million, up 5% from \$86.7 million in the prior year period. The current period includes pre-tax charges totaling \$4.3 million in connection with reductions in office space. Excluding these charges, occupancy expense was relatively unchanged from the prior year period.

The components of other operating expense are provided below.

Other Operating Expense (\$ In Millions)	Six Months Ended June 30,			
	2014	2013	Change	
Business Promotion	\$ 47.5	\$ 49.4	\$ (1.9)	(4)%
Staff Related	19.5	18.5	1.0	6
FDIC Insurance Premiums	10.6	11.8	(1.2)	(10)
Other Intangibles Amortization	9.9	10.3	(0.4)	(5)
Other Expenses	44.1	57.6	(13.5)	(24)
Total Other Operating Expense	\$ 131.6	\$ 147.6	\$ (16.0)	(11)%

The decrease in the other expenses component of other operating expense primarily reflects lower charges associated with account servicing activities.

**Provision for Income Taxes**

Income tax expense was \$176.9 million and \$173.2 million for the six months ended June 30, 2014 and 2013, respectively, representing an effective tax rate of 32.8% in both periods.

**BALANCE SHEET**

Total assets at June 30, 2014 were \$105.8 billion and averaged \$103.3 billion for the current quarter, compared with total assets of \$97.2 billion at June 30, 2013 and average total assets of \$92.8 billion in the prior year quarter. Average balances are considered to be a better measure of balance sheet trends, as period-end balances can be impacted on a short term basis by deposit and withdrawal activity involving large balances of short-term client funds. Loans and leases totaled \$30.7 billion at June 30, 2014 and averaged \$30.1 billion in the current quarter, up 7% and 5%, respectively, compared to \$28.8 billion at June 30, 2013 and a \$28.6 billion average in the prior year quarter. Securities, inclusive of Federal Reserve stock, Federal Home Loan Bank stock, and certain community development investments, which are classified in other assets in the consolidated balance sheet, totaled \$34.4 billion at June 30, 2014 and averaged \$34.3 billion for the current quarter, each up 12% as compared to \$30.7 billion on average and at June 30, 2013 in the prior year quarter. In aggregate, the balance sheet line item categories of federal funds sold and securities purchased under agreements to resell, interest-bearing deposits with banks, and Federal Reserve deposits and other interest-bearing totaled \$31.0 billion at June 30, 2014 and averaged \$31.1 billion in the current quarter, up 23% and 31%, respectively, from the prior year quarter balances. Interest-bearing deposits at June 30, 2014 totaled and



**BALANCE SHEET (continued)**

averaged \$65.8 billion, up 16% and 18%, respectively, compared to \$56.8 billion at June 30, 2013 and a \$55.9 billion average in the prior year quarter. Noninterest-bearing deposits at June 30, 2014 totaled \$23.0 billion and averaged \$18.8 billion, up 17% and 8%, respectively, compared to \$19.7 billion at June 30, 2013 and a \$17.5 billion average in the prior year quarter.

Total stockholders' equity at June 30, 2014 was \$8.0 billion and averaged \$7.9 billion for the current quarter, each up 4% as compared to \$7.7 billion at June 30, 2013 and \$7.6 billion on average for the prior year quarter. The increase is primarily attributable to earnings, partially offset by dividend declarations and the repurchase of common stock pursuant to the Corporation's share buyback program. During the three and six months ended June 30, 2014, the Corporation repurchased 1,235,417 shares at a cost of \$74.9 million (\$60.63 average price per share) and 3,860,132 shares at a cost of \$237.9 million (\$61.63 average price per share), respectively.

The capital ratios of Northern Trust and its principal subsidiary bank, The Northern Trust Company, remained strong at June 30, 2014, with all ratios applicable to classification as well capitalized under U.S. regulatory requirements having been exceeded.

Capital Ratios	Northern Trust Corporation	June 30, 2014			
		Advanced (a) Approach	Standardized (b) Approach	March 31, 2014	December 31, 2013 (c)
Common Equity Tier 1		12.7%	12.7%	12.8%	12.9%
Tier 1		12.9%	12.9%	13.0%	13.4%
Total		14.9%	15.4%	15.5%	15.8%
Leverage		n/a	7.6%	7.8%	7.9%

Capital Ratios	The Northern Trust Company	June 30, 2014			
		Advanced (a) Approach	Standardized (b) Approach	March 31, 2014	December 31, 2013 (c)
Common Equity Tier 1		11.7%	11.4%	11.7%	11.5%
Tier 1		11.6%	11.4%	11.7%	11.5%
Total		13.7%	14.0%	14.2%	14.3%
Leverage		n/a	6.7%	6.9%	6.8%

- (a) Effective with the second quarter of 2014, Northern Trust exited its parallel run. Accordingly, the June 30, 2014 ratios are calculated in compliance with the Basel III Advanced Approach final rules released by the Board of Governors of the Federal Reserve on July 2, 2013.
- (b) Standardized Approach capital components in 2014 are determined by Basel III phased in requirements and risk weighted assets are determined by Basel I requirements. The June 30, 2014 and March 31, 2014 ratios calculated under the Standardized Approach comply with the final rules released by the Board of Governors of the Federal Reserve on July 2, 2013.
- (c) The December 31, 2013 ratios are calculated in accordance with Basel I requirements.

**STATEMENT OF CASH FLOWS**

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

For the six months ended June 30, 2014, net cash provided by operating activities was \$1.5 billion, primarily attributable to a reduction of net collateral deposited with derivative counterparties, as well as period earnings, inclusive of the impact of non-cash charges such as the amortization of computer software, and decreased receivables. Net cash used

## STATEMENT OF CASH FLOWS (continued)

in operating activities for the six months ended June 30, 2013 was \$1.3 billion, primarily attributable to increased net collateral deposited with derivative counterparties as a result of market movements on client-related and trading derivative instruments, partially offset by period earnings, inclusive of non-cash charges.

Net cash used in investing activities of \$3.1 billion for the six months ended June 30, 2014 is primarily attributable to net purchases of securities held to maturity and available for sale, as well as increased loans and leases, partially offset by decreases within interest-bearing deposits with banks.

Net cash provided by investing activities of \$2.7 billion for the six months ended June 30, 2013 primarily reflects decreases in Federal Reserve deposits and loans and leases, as well as net changes within securities available for sale and held to maturity, and within client settlement receivables. The decrease in Federal Reserve deposits was primarily the result of lower client deposits, partially offset by higher levels of short-term other borrowings.

For the six months ended June 30, 2014, net cash provided by financing activities totaled \$2.2 billion, primarily reflecting increased total deposits, partially offset by lower levels of short-term other borrowings and senior notes. The increase in total deposits was attributable to increases in demand and other noninterest-bearing client deposits and non-U.S. office interest-bearing deposits. The decreases in short-term other borrowings and senior notes, respectively, reflect a decline in outstanding short-term other borrowings from the Federal Home Loan Bank and the maturity of \$500 million of fixed-rate senior notes during the current quarter.

For the six months ended June 30, 2013, net cash used in financing activities totaled \$436.5 million, primarily reflecting a decline in the level of U.S. demand deposits from the level at December 31, 2012, partially offset by increases in the levels of federal funds purchased and short-term other borrowings. The decrease in U.S. demand deposits was largely driven by the expiration on December 31, 2012 of the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program which had provided unlimited deposit insurance. The increases in federal funds purchased and short-term other borrowings reflect additional borrowing activity in the federal funds market and additional short-term borrowings from the Federal Home Loan Bank.

## ASSET QUALITY

### Securities Portfolio

Northern Trust maintains a high quality securities portfolio, with 85% of the combined available for sale, held to maturity, and trading account portfolios at June 30, 2014 comprised of U.S. Treasury and government sponsored agency securities and triple-A rated corporate notes, asset-backed securities, supranational, sovereign and non-U.S. agency bonds, auction rate securities and obligations of states and political subdivisions.

The remaining portfolio was comprised of corporate notes, asset-backed securities,

## ASSET QUALITY (continued)

negotiable certificates of deposit, obligations of states and political subdivisions, auction rate securities and other securities, of which as a percentage of the total securities portfolio, 6% was rated double-A, 3% was rated below double-A, and 6% was not rated by Standard and Poor's or Moody's Investors Service (primarily negotiable certificates of deposits of banks whose long term ratings are at least A).

Net unrealized gains within the investment securities portfolio totaled \$65.3 million at June 30, 2014, comprised of \$146.7 million and \$81.4 million of gross unrealized gains and losses, respectively. Of the unrealized losses on securities at June 30, 2014, the largest component, totaling \$31.2 million, related to corporate debt securities, primarily reflecting widened credit spreads and higher market rates since purchase; 44% of the corporate debt portfolio is backed by guarantees provided by U.S. and non-U.S. governmental entities. Unrealized losses of \$23.6 million related to government sponsored agency securities are primarily attributable to changes in market rates since their purchase.

For the six months ended June 30, 2014, charges of \$3.9 million were recorded relating to the other-than-temporary impairment (OTTI) of certain CRA eligible securities. There were no OTTI losses for the three months ended June 30, 2014 or for the three or six months ended June 30, 2013. Northern Trust has evaluated all securities with unrealized losses for possible OTTI in accordance with GAAP and Northern Trust's security impairment review policy.

Northern Trust participates in the repurchase agreement market as a relatively low cost alternative for short-term funding. Securities purchased under agreements to resell and securities sold under agreements to repurchase are accounted for as collateralized financings and recorded at the amounts at which the securities were acquired or sold plus accrued interest. To minimize potential credit risk associated with these transactions, the fair value of the securities purchased or sold is monitored, limits are set on exposure with counterparties, and the financial condition of counterparties is regularly assessed. It is Northern Trust's policy to take possession, either directly or via third party custodians, of securities purchased under agreements to resell. Securities sold under agreements to repurchase are held by the counterparty until their repurchase.

### Exposures in Europe

Northern Trust continues to monitor closely economic developments in Europe. Northern Trust considers Ireland, Portugal, Italy, Greece, Spain, Cyprus and Slovenia to be those European countries experiencing significant economic, fiscal and/or political strains. At June 30, 2014, Northern Trust's gross cross-border exposure to obligors in Ireland totaled approximately \$690 million, or less than 1% of Northern Trust's total consolidated assets. Of the cross-border exposure to obligors in Ireland, \$10 million was to banks and the remainder was to commercial and other borrowers, primarily funds domiciled in Ireland whose assets and investment activities are broadly diversified by investment strategy, issuer type, country of risk, and/or instrument type. Exposures to the borrowers in Ireland may be secured or unsecured, committed or uncommitted, but are typically for short periods of a year or less for foreign exchange, overdraft accommodations, and loans. As

**ASSET QUALITY (continued)**

of June 30, 2014, there was no cross-border exposure to obligors in Italy, Portugal, Greece, Spain, Cyprus or Slovenia, and there was no exposure to sovereign debt securities in any of the European countries deemed to be experiencing significant economic, fiscal and/or political strains. Exposure levels at June 30, 2014 reflect Northern Trust's risk management policies and practices, which operate to limit exposures to higher risk financial and sovereign entities.

**Nonperforming Loans and Other Real Estate Owned**

Nonperforming assets consist of nonperforming loans and Other Real Estate Owned (OREO). OREO is comprised of commercial and residential properties acquired in partial or total satisfaction of loans.

The following table provides the amounts of nonperforming loans, by segment and class, and of OREO that were outstanding at the dates shown, as well as the balance of loans that were delinquent 90 days or more and still accruing interest. The balance of loans delinquent 90 days or more and still accruing interest can fluctuate widely based on the timing of cash collections, renegotiations and renewals.

(\$ In Millions)	June 30, 2014	March 31, 2014	December 31, 2013	June 30, 2013
<b>Nonperforming Loans and Leases</b>				
<b>Commercial</b>				
Commercial and Institutional	\$ 20.8	\$ 26.1	\$ 23.1	\$ 25.0
Commercial Real Estate	45.4	51.6	49.2	61.5
<b>Total Commercial</b>	<b>66.2</b>	77.7	72.3	86.5
<b>Personal</b>				
Residential Real Estate	161.7	180.9	189.1	177.2
Private Client	1.4	1.3	1.4	3.0
<b>Total Personal</b>	<b>163.1</b>	182.2	190.5	180.2
<b>Total Nonperforming Loans and Leases</b>	<b>\$ 229.3</b>	\$ 259.9	\$ 262.8	\$ 266.7
<b>Other Real Estate Owned</b>	<b>12.6</b>	9.8	11.9	14.5
<b>Total Nonperforming Assets</b>	<b>\$ 241.9</b>	\$ 269.7	\$ 274.7	\$ 281.2
<b>90 Day Past Due Loans Still Accruing</b>	<b>\$ 13.1</b>	\$ 12.3	\$ 16.4	\$ 18.5
<b>Nonperforming Loans and Leases to Total Loans and Leases</b>	<b>0.75%</b>	0.88%	0.89%	0.93%
<b>Coverage of Loan and Lease Allowance to Nonperforming Loans and Leases</b>	<b>1.2x</b>	1.1x	1.1x	1.1x

Nonperforming assets of \$241.9 million as of June 30, 2014 remain elevated from historical levels reflecting the effect of the economic downturn in 2008 on residential property valuations and general economic conditions. Residential real estate loans have exhibited persistent weakness relative to the overall portfolio, while the credit quality of



commercial and institutional loans and commercial real estate loans have improved. In addition to the negative impact on net interest income and the risk of credit losses, nonperforming assets also increase operating costs due to the expense associated with collection efforts. Changes in credit quality, including

## ASSET QUALITY (continued)

nonperforming loan balances, impact the level of the allowance for credit losses through the resultant adjustment of the specific allowance and of the qualitative factors used in the determination of the inherent allowance levels within the allowance for credit losses.

Northern Trust focuses its lending efforts on clients who are looking to utilize a full range of financial services with Northern Trust. Northern Trust's underwriting standards do not allow for the origination of loan types generally considered to be of high risk in nature, such as option ARM loans, subprime loans, loans with initial teaser rates, and loans with excessively high loan-to-value ratios. Residential real estate loans consist of conventional home mortgages and home equity credit lines, which generally require loan to collateral values of no more than 65% to 80% at inception. Revaluations of supporting collateral are obtained upon refinancing or default or when otherwise considered warranted. Collateral revaluations for mortgages are performed by independent third parties.

The commercial real estate class consists of commercial mortgages and construction, acquisition and development loans extended primarily to highly experienced developers and/or investors well known to Northern Trust. Underwriting standards generally reflect conservative loan-to-value ratios and debt service coverage requirements. Recourse to borrowers through guarantees is also commonly required.

### Provision and Allowance for Credit Losses

The provision for credit losses is the charge to current earnings that is determined by management, through a disciplined credit review process, to be the amount needed to maintain the allowance for credit losses at an appropriate level to absorb probable credit losses that have been identified with specific borrower relationships (specific loss component) and for probable losses that are believed to be inherent in the loan and lease portfolios, undrawn commitments, and standby letters of credit (inherent loss component). Control processes and analyses employed to evaluate the appropriateness of the allowance for credit losses are reviewed on at least an annual basis and modified as considered necessary.

The amount of specific allowance is determined through an individual evaluation of loans and lending-related commitments considered impaired that is based on expected future cash flows, collateral value, and other factors that may impact the borrower's ability to pay. Changes in collateral values, delinquency ratios, portfolio volume and concentration, and other asset quality metrics, including management's subjective evaluation of economic and business conditions, result in adjustments of qualitative allowance factors that are applied in the determination of inherent allowance requirements.

There was no provision for credit losses recorded in the current quarter. A provision of \$5.0 million was recorded in the prior year quarter. Net charge-offs were \$5.9 million, resulting from \$7.8 million of charge-offs and \$1.9 million of recoveries, compared to \$8.1 million of net charge-offs in the prior year quarter, resulting from \$15.6 million of charge-offs and \$7.5 million of recoveries. The current quarter reflects improvement in the credit quality of the commercial and institutional and commercial real estate loan classes while residential real estate loans continued to reflect weakness relative to the overall portfolio,

**ASSET QUALITY (continued)**

accounting for 71% and 66% of total nonperforming loans and leases at June 30, 2014 and 2013, respectively. The residential real estate loan balance decreased in the current quarter, partially offset by higher levels of commercial and institutional loans and commercial real estate loans.

Note 6 to the consolidated financial statements includes a table that details the changes in the allowance for credit losses during the three and six months ended June 30, 2014 and 2013 due to charge-offs, recoveries, and the provision for credit losses.

The following table shows the specific portion of the allowance and the inherent portion of the allowance and its components, each by loan and lease segment and class.

(\$ In Millions)	June 30, 2014		March 31, 2014		December 31, 2013		June 30, 2013	
	Allowance Amount	Percent of Total Loans	Allowance Amount	Percent of Total Loans	Allowance Amount	Percent of Total Loans	Allowance Amount	Percent of Total Loans
Specific Allowance	\$ 23.8	%	\$ 26.3	%	\$ 24.9	%	\$ 32.9	%
Allocated Inherent Allowance								
Commercial								
Commercial and Institutional	71.4	26	70.5	26	67.5	25	73.7	25
Commercial Real Estate	69.3	10	72.2	10	71.5	10	74.6	10
Lease Financing, net	3.4	3	3.5	3	4.2	3	4.5	3
Non-U.S.	2.7	4	2.6	5	2.1	3	2.3	5
Other		2		1		2		1
<b>Total Commercial</b>	<b>146.8</b>	<b>45</b>	<b>148.8</b>	<b>45</b>	<b>145.3</b>	<b>43</b>	<b>155.1</b>	<b>44</b>
Personal								
Residential Real Estate	114.6	33	116.8	34	118.7	35	116.4	36
Private Client	18.3	22	17.5	21	19.0	22	16.3	20
Other								
<b>Total Personal</b>	<b>132.9</b>	<b>55</b>	<b>134.3</b>	<b>55</b>	<b>137.7</b>	<b>57</b>	<b>132.7</b>	<b>56</b>
<b>Total Allocated Inherent Allowance</b>	<b>\$ 279.7</b>	<b>100%</b>	<b>\$ 283.1</b>	<b>100%</b>	<b>\$ 283.0</b>	<b>100%</b>	<b>\$ 287.8</b>	<b>100%</b>
<b>Total Allowance for Credit Losses</b>	<b>303.5</b>		<b>309.4</b>		<b>307.9</b>		<b>320.7</b>	

Allowance Assigned to Loans and Leases	<b>\$ 275.2</b>	\$ 279.2	\$ 278.1	\$ 290.4
Undrawn Commitments and Standby Letters of Credit	<b>28.3</b>	30.2	29.8	30.3
Total Allowance for Credit Losses	<b>\$ 303.5</b>	\$ 309.4	\$ 307.9	\$ 320.7
Allowance Assigned to Loans and Leases to Total Loans and Leases	<b>0.90%</b>	0.94%	0.95%	1.01%

**MARKET RISK MANAGEMENT**

As described in the 2013 Annual Report to Shareholders, Northern Trust manages its interest rate risk through two primary measurement techniques: simulation of earnings and simulation of economic value of equity. Also, as part of its risk management activities, it regularly measures the risk of loss associated with foreign currency positions using a Value-at-Risk (VaR) model.

Based on this continuing evaluation process, Northern Trust's interest rate risk position, as measured by current market implied forward rates and sensitivity analyses, and the risk of loss as measured by the VaR associated with the foreign exchange trading portfolio, have not changed significantly since December 31, 2013.

**RECONCILIATION OF REPORTED NET INTEREST INCOME TO FULLY TAXABLE EQUIVALENT**

The tables below present a reconciliation of interest income and net interest income prepared in accordance with GAAP to interest income and net interest income on a fully taxable equivalent (FTE) basis, a non-GAAP financial measure. Management believes an FTE presentation facilitates the analysis of asset yields and provides a clearer indication of net interest margins for comparative purposes.

(\$ In Millions)	Three Months Ended					
	June 30, 2014			June 30, 2013		
	Reported	FTE Adj.	FTE	Reported	FTE Adj.	FTE
Interest Income	\$ 293.8	\$ 6.8	\$ 300.6	\$ 275.3	\$ 7.9	\$ 283.2
Interest Expense	47.2		47.2	55.2		55.2
Net Interest Income	\$ 246.6	\$ 6.8	\$ 253.4	\$ 220.1	\$ 7.9	\$ 228.0
Net Interest Margin	1.04%		1.06%	1.06%		1.10%

(\$ In Millions)	Six Months Ended					
	June 30, 2014			June 30, 2013		
	Reported	FTE Adj.	FTE	Reported	FTE Adj.	FTE
Interest Income	\$ 589.2	\$ 15.5	\$ 604.7	\$ 562.0	\$ 15.5	\$ 577.5
Interest Expense	96.9		96.9	115.8		115.8
Net Interest Income	\$ 492.3	\$ 15.5	\$ 507.8	\$ 446.2	\$ 15.5	\$ 461.7
Net Interest Margin	1.06%		1.09%	1.09%		1.13%

The following schedule should be read in conjunction with the Net Interest Income section of Management's Discussion and Analysis of Financial Condition and Results of Operations.

**AVERAGE CONSOLIDATED BALANCE SHEET****NORTHERN TRUST CORPORATION****WITH ANALYSIS OF NET INTEREST INCOME**

(INTEREST AND RATE ON A FULLY TAXABLE EQUIVALENT BASIS)

(\$ In Millions)	Interest	2014		Second Quarter		2013	
		Average Balance	Rate (3)	Interest	Average Balance	Rate (3)	
<b>Average Earning Assets</b>							
Federal Funds Sold and Securities Purchased under Agreements to Resell	\$ 0.7	\$ 554.1	0.47%	\$ 0.4	309.8	0.51%	
Interest-Bearing Deposits with Banks	33.6	17,294.6	0.78	34.5	18,192.6	0.76	
Federal Reserve Deposits and Other Interest-Bearing Securities	8.4	13,266.4	0.26	3.4	5,275.5	0.26	
U.S. Government	6.7	2,368.7	1.13	4.7	1,787.4	1.05	
Obligations of States and Political Subdivisions	2.8	168.4	6.76	4.6	287.0	6.39	
Government Sponsored Agency	33.3	18,359.8	0.73	25.0	17,270.4	0.58	
Other (1)	27.8	13,407.8	0.83	23.5	11,397.2	0.83	
<b>Total Securities</b>	<b>70.6</b>	<b>34,304.7</b>	<b>0.83</b>	<b>57.8</b>	<b>30,742.0</b>	<b>0.75</b>	
<b>Loans and Leases (2)</b>	<b>187.3</b>	<b>30,052.9</b>	<b>2.50</b>	<b>187.1</b>	<b>28,601.8</b>	<b>2.62</b>	
<b>Total Earning Assets</b>	<b>300.6</b>	<b>95,472.7</b>	<b>1.26</b>	<b>283.2</b>	<b>83,121.7</b>	<b>1.37</b>	
Allowance for Credit Losses Assigned to Loans and Leases		(276.8)			(290.2)		
Cash and Due from Banks		2,838.4			2,964.6		
Buildings and Equipment		450.7			461.6		
Client Security Settlement Receivables		781.0			822.2		
Goodwill		543.0			531.3		
Other Assets		3,515.1			5,238.4		
<b>Total Assets</b>	<b>\$</b>	<b>\$ 103,324.1</b>	<b>%</b>	<b>\$</b>	<b>\$ 92,849.6</b>	<b>%</b>	
<b>Average Source of Funds</b>							
<b>Deposits</b>							
Savings and Money Market	\$ 2.4	\$ 14,828.6	0.06%	\$ 2.3	\$ 14,634.7	0.06%	
Savings Certificates and Other Time	1.6	1,996.2	0.32	3.4	2,199.1	0.62	
Non-U.S. Offices Interest-Bearing	18.4	48,988.1	0.15	19.3	39,043.3	0.20	
<b>Total Interest-Bearing Deposits</b>	<b>22.4</b>	<b>65,812.9</b>	<b>0.14</b>	<b>25.0</b>	<b>55,877.1</b>	<b>0.18</b>	
Short-Term Borrowings	1.2	4,217.8	0.12	1.4	4,750.0	0.12	
Senior Notes	13.7	1,661.6	3.30	19.3	2,400.1	3.21	

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Long-Term Debt	9.4	1,642.4	2.30	8.9	1,105.2	3.24
Floating Rate Capital Debt	0.5	277.2	0.80	0.6	277.1	0.86
<b>Total Interest-Related Funds</b>	<b>47.2</b>	<b>73,611.9</b>	<b>0.26</b>	55.2	64,409.5	0.34
Interest Rate Spread			1.00			1.03
Demand and Other Noninterest-Bearing Deposits		18,832.3			17,468.1	
Other Liabilities		2,932.7			3,323.7	
Stockholders Equity		7,947.2			7,648.3	
<b>Total Liabilities and Stockholders Equity</b>	<b>\$</b>	<b>\$ 103,324.1</b>	<b>% \$</b>	<b>\$ 92,849.6</b>	<b>%</b>	
<b>Net Interest Income/Margin (FTE Adjusted)</b>	<b>\$ 253.4</b>	<b>\$</b>	<b>1.06%</b>	<b>\$ 228.0</b>	<b>\$</b>	<b>1.10%</b>
<b>Net Interest Income/Margin (Unadjusted)</b>	<b>\$ 246.6</b>	<b>\$</b>	<b>1.04%</b>	<b>\$ 220.1</b>	<b>\$</b>	<b>1.06%</b>

### ANALYSIS OF NET INTEREST INCOME CHANGES

#### DUE TO VOLUME AND RATE

(In Millions)	Three Months 2014/2013 Change Due To		
	Average Balance	Rate	Total
Earning Assets (FTE)	\$ 42.2	\$ (24.8)	\$ 17.4
Interest-Related Funds	7.8	(15.8)	(8.0)
<b>Net Interest Income (FTE)</b>	<b>\$ 34.4</b>	<b>\$ (9.0)</b>	<b>\$ 25.4</b>

- (1) Other securities include Federal Reserve and Federal Home Loan Bank stock and certain community development investments which are classified in other assets in the consolidated balance sheet as of June 30, 2014 and 2013.
- (2) Average balances include nonaccrual loans. Lease financing receivable balances are reduced by deferred income.
- (3) Rate calculations are based on actual balances rather than the rounded amounts presented in the Average Consolidated Balance Sheet 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 37.8% and 37.5% for the three months ending June 30 2014 and 2013, respectively. Total taxable equivalent interest adjustments amounted to \$6.8 million and \$7.9 million for the three months ended June 30 2014 and 2013, respectively.

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.





The following schedule should be read in conjunction with the Net Interest Income section of Management's Discussion and Analysis of Financial Condition and Results of Operations.

**AVERAGE CONSOLIDATED BALANCE SHEET  
WITH ANALYSIS OF NET INTEREST INCOME**

**NORTHERN TRUST CORPORATION**

(INTEREST AND RATE ON A FULLY  
TAXABLE  
EQUIVALENT BASIS)

Six Months

(\$ In Millions)	Interest	2014 Average Balance	Rate (3)	Interest	2013 Average Balance	Rate (3)
<b>Average Earning Assets</b>						
Federal Funds Sold and Securities Purchased under Agreements to Resell	\$ 1.3	\$ 542.3	0.49%	\$ 0.5	\$ 279.8	0.36%
Interest-Bearing Deposits with Banks	65.7	17,179.2	0.77	69.5	18,146.3	0.77
Federal Reserve Deposits and Other Interest-Bearing	16.5	12,986.0	0.26	5.9	4,577.7	0.26
<b>Securities</b>						
U.S. Government	13.1	2,341.3	1.13	9.3	1,785.1	1.05
Obligations of States and Political Subdivisions	6.3	190.6	6.65	9.7	304.0	6.36
Government Sponsored Agency	74.2	18,098.7	0.83	60.7	17,772.7	0.69
Other (1)	55.9	12,711.0	0.89	45.7	11,145.2	0.83
<b>Total Securities</b>	<b>149.5</b>	<b>33,341.6</b>	<b>0.90</b>	<b>125.4</b>	<b>31,007.0</b>	<b>0.82</b>
<b>Loans and Leases (2)</b>	<b>371.7</b>	<b>29,617.6</b>	<b>2.53</b>	<b>376.2</b>	<b>28,631.7</b>	<b>2.65</b>
<b>Total Earning Assets</b>	<b>604.7</b>	<b>93,666.7</b>	<b>1.30</b>	<b>577.5</b>	<b>82,642.5</b>	<b>1.41</b>
<b>Allowance for Credit Losses Assigned to</b>						
Loans and Leases		(277.3)			(293.2)	
Cash and Due from Banks		2,822.6			3,177.4	
Buildings and Equipment		454.2			464.5	
Client Security Settlement Receivables		842.3			807.8	
Goodwill		541.9			532.0	
Other Assets		3,741.9			4,882.0	
<b>Total Assets</b>	<b>\$</b>	<b>\$ 101,792.3</b>	<b>%</b>	<b>\$</b>	<b>\$ 92,213.0</b>	<b>%</b>
<b>Average Source of Funds</b>						
<b>Deposits</b>						
Savings and Money Market	\$ 4.7	\$ 14,771.5	0.06%	\$ 5.2	\$ 14,756.8	0.07%
Savings Certificates and Other Time	3.4	1,911.3	0.36	7.3	2,291.8	0.64
Non-U.S. Offices Interest-Bearing	34.4	47,784.0	0.15	41.6	39,132.1	0.21
<b>Total Interest-Bearing Deposits</b>	<b>42.5</b>	<b>64,466.8</b>	<b>0.13</b>	<b>54.1</b>	<b>56,180.7</b>	<b>0.19</b>

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Short-Term Borrowings	2.3	4,384.0	0.11	2.5	4,081.4	0.13
Senior Notes	31.2	1,828.2	3.44	38.5	2,402.0	3.22
Long-Term Debt	19.8	1,685.4	2.37	19.5	1,191.0	3.31
Floating Rate Capital Debt	1.1	277.2	0.81	1.2	277.1	0.87
<b>Total Interest-Related Funds</b>	<b>96.9</b>	<b>72,641.6</b>	<b>0.27</b>	115.8	64,132.2	0.36
Interest Rate Spread			<b>1.03</b>			1.05
Demand and Other Noninterest-Bearing Deposits		18,240.5			17,184.9	
Other Liabilities		2,973.4			3,299.9	
Stockholders Equity		7,936.8			7,596.0	
<b>Total Liabilities and Stockholders Equity</b>	<b>\$</b>	<b>\$ 101,792.3</b>	<b>%</b>	<b>\$</b>	<b>\$ 92,213.0</b>	<b>%</b>
<b>Net Interest Income/Margin (FTE Adjusted)</b>	<b>\$ 507.8</b>	<b>\$</b>	<b>1.09%</b>	<b>\$ 461.7</b>	<b>\$</b>	<b>1.13%</b>
<b>Net Interest Income/Margin (Unadjusted)</b>	<b>\$ 492.3</b>	<b>\$</b>	<b>1.06%</b>	<b>\$ 446.2</b>	<b>\$</b>	<b>1.09%</b>

ANALYSIS OF NET INTEREST INCOME CHANGES

DUE TO VOLUME AND RATE

(In Millions)	Six Months 2014/2013 Change Due To		
	Average Balance	Rate	Total
Earning Assets (FTE)	\$ 77.1	\$(49.9)	\$ 27.2
Interest-Related Funds	15.2	(34.1)	(18.9)
Net Interest Income (FTE)	\$ 61.9	\$(15.8)	\$ 46.1

- (1) Other securities include Federal Reserve and Federal Home Loan Bank stock and certain community development investments which are classified in other assets in the consolidated balance sheet as of June 30, 2014 and 2013.
- (2) Average balances include nonaccrual loans. Lease financing receivable balances are reduced by deferred income.
- (3) Rate calculations are based on actual balances rather than the rounded amounts presented in the Average Consolidated Balance Sheet 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 37.8 % and 37.5% for the six months ending June 30 2014 and 2013, respectively. Total taxable equivalent interest adjustments amounted to \$15.5 million and \$15.5 million for the six months ended June 30, 2014 and 2013, respectively.

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.

## FORWARD-LOOKING STATEMENTS

This report contains statements that are forward-looking, such as statements concerning Northern Trust's financial goals, capital adequacy, dividend policy, risk management policies, litigation-related matters and contingent liabilities, accounting estimates and assumptions, industry trends, strategic initiatives, credit quality including allowance levels, planned capital expenditures and technology spending, anticipated expense levels, future pension plan contributions, anticipated tax benefits and expenses, the impact of recent legislation and accounting pronouncements, and all other statements that do not relate to historical facts.

Forward-looking statements are typically identified by words or phrases such as believe, expect, anticipate, intend, estimate, project, likely, may increase, plan, goal, target, strategy, and similar expressions or future or conditional verbs such as may, will, should, would, and could. You should carefully read the risk factors described in Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2013 for a description of certain risks that could, among other things, cause our actual results to differ from these forward looking statements.

Forward-looking statements are Northern Trust's current estimates or expectations of future events or future results and involve risks and uncertainties that are difficult to predict. Actual results could differ materially from the results indicated by these statements because the realization of those results is subject to many risks and uncertainties including:

the health of the U.S. and international economies and particularly the continuing uncertainty in Europe;

the downgrade of U.S. Government issued and other securities;

the health and soundness of the financial institutions and other counterparties with which Northern Trust conducts business;

changes in financial markets, including debt and equity markets, that impact the value, liquidity, or credit ratings of financial assets in general, or financial assets in particular investment funds, client portfolios, or securities lending collateral pools, including those funds, portfolios, collateral pools, and other financial assets with respect to which Northern Trust has taken, or may in the future take, actions to provide asset value stability or additional liquidity;

the impact of stress in the financial markets, the effectiveness of governmental actions taken in response, and the effect of such governmental actions on Northern Trust, its competitors and counterparties, financial markets generally and availability of credit specifically, and the U.S. and international economies, including special deposit assessments or potentially higher FDIC premiums;

a significant downgrade of any of our debt ratings;

changes in foreign exchange trading client volumes and volatility in foreign currency exchange rates, and Northern Trust's success in assessing and mitigating the risks arising from such changes and volatility;

a decline in the value of securities held in Northern Trust's investment portfolio, particularly asset-backed securities, the liquidity and pricing of which

**FORWARD-LOOKING STATEMENTS (continued)**

may be negatively impacted by periods of economic turmoil and financial market disruptions;

uncertainties inherent in the complex and subjective judgments required to assess credit risk and establish appropriate allowances therefor;

difficulties in measuring, or determining whether there is other-than-temporary impairment in, the value of securities held in Northern Trust's investment portfolio;

our success in managing various risks inherent in its business, including credit risk, operational risk, interest rate risk, liquidity risk and strategic risk, particularly during times of economic uncertainty and volatility in the credit and financial markets;

geopolitical risks and the risks of extraordinary events such as natural disasters, terrorist events, war and the U.S. and other governments' responses to those events;

the pace and extent of continued globalization of investment activity and growth in worldwide financial assets;

regulatory and monetary policy developments;

failure to satisfy regulatory standards or to obtain regulatory approvals when required, including for the use and distribution of capital;

changes in tax laws, accounting requirements or interpretations and other legislation in the U.S. or other countries that could affect Northern Trust or its clients;

changes in the nature and activities of Northern Trust's competition, including increased consolidation within the financial services industry;

our success in maintaining existing business and continuing to generate new business in its existing markets;

the impact of equity markets on fee revenue;

our success in identifying and penetrating targeted markets;

our ability to address the complex needs of a global client base and manage compliance with legal, tax, regulatory and other requirements, especially in immature markets;

our ability to maintain a product mix that achieves acceptable margins;

our ability to continue to generate investment results that satisfy clients and to develop an array of investment products;

our success in generating revenue in our securities lending business, including for our clients, especially in periods of economic and financial market uncertainty;

our success in recruiting and retaining the necessary personnel to support business growth and expansion and maintain sufficient expertise to support increasingly complex products and services;

our success in controlling expenses and implementing revenue enhancement initiatives;

our ability, as products, methods of delivery, and client requirements change or become more complex, to continue to fund and accomplish innovation;

**FORWARD-LOOKING STATEMENTS (continued)**

our ability to improve risk management practices and controls, and address operating risks, including human errors or omissions, data security breach risks, pricing or valuation of securities, fraud, systems performance or defects, systems interruptions, and breakdowns in processes or internal controls;

uncertainties inherent in Northern Trust's assumptions concerning its pension plan, including discount rates and expected contributions, returns and payouts;

increased costs of compliance and other risks associated with changes in regulation, the current regulatory environment, and areas of increased regulatory emphasis and oversight in the U.S. and other countries such as anti-money laundering, anti-bribery, and client privacy;

risks that evolving regulations, such as Basel III and those promulgated under the Dodd-Frank Act, could affect required regulatory capital for financial institutions, including Northern Trust, potentially resulting in changes to the cost and composition of capital for Northern Trust;

the potential for substantial changes in the legal, regulatory and enforcement framework and oversight applicable to financial institutions in reaction to adverse financial market events, including changes that may affect leverage limits and risk-based capital and liquidity requirements for certain financial institutions, require financial institutions to pay higher assessments, expose financial institutions to certain liabilities of their subsidiary depository institutions, and restrict or increase the regulation of certain activities, including foreign exchange, carried on by financial institutions, including Northern Trust;

risks and uncertainties inherent in the litigation and regulatory process, including the adequacy of contingent liability, tax, and other accruals;

risks associated with being a holding company, including our dependence on dividends from our principal subsidiary;

the risk of damage to our reputation which may undermine the confidence of clients, counterparties, rating agencies, and stockholders; and

other factors identified in our Annual Report on Form 10-K, including those factors described in

Item 1A "Risk Factors", and other filings with the SEC, all of which are available on our website. Actual results may differ materially from those expressed or implied by the forward-looking statements. The information contained herein is current only as of the date of that information. All forward-looking statements included in this document are based upon information presently available, and Northern Trust assumes no obligation to update its forward-looking statements.





## CONSOLIDATED BALANCE SHEET

## NORTHERN TRUST CORPORATION

(In Millions Except Share Information)	June 30, 2014 (Unaudited)	December 31, 2013
<b>Assets</b>		
Cash and Due from Banks	\$ 3,945.2	\$ 3,162.4
Federal Funds Sold and Securities Purchased under Agreements to Resell	579.5	529.6
Interest-Bearing Deposits with Banks	17,059.8	19,397.4
Federal Reserve Deposits and Other Interest-Bearing Securities	13,338.5	12,911.5
Available for Sale	29,689.4	28,392.8
Held to Maturity (Fair value of \$4,265.4 and \$2,321.4)	4,270.6	2,325.8
Trading Account	2.7	1.7
<b>Total Securities</b>	<b>33,962.7</b>	<b>30,720.3</b>
<b>Loans and Leases</b>		
Commercial	13,991.4	12,620.0
Personal	16,706.2	16,765.5
<b>Total Loans and Leases (Net of unearned income of \$298.8 and \$286.2)</b>	<b>30,697.6</b>	<b>29,385.5</b>
Allowance for Credit Losses Assigned to Loans and Leases	(275.2)	(278.1)
Buildings and Equipment	441.9	458.8
Client Security Settlement Receivables	1,596.4	1,355.2
Goodwill	544.6	540.7
Other Assets	3,870.2	4,764.0
<b>Total Assets</b>	<b>\$ 105,761.2</b>	<b>\$ 102,947.3</b>
<b>Liabilities</b>		
<b>Deposits</b>		
Demand and Other Noninterest-Bearing	\$ 20,793.3	\$ 16,888.7
Savings and Money Market	14,394.6	14,991.5
Savings Certificates and Other Time	1,967.4	1,874.4
Non U.S. Offices Noninterest-Bearing	2,249.5	1,881.8
Interest-Bearing	49,457.7	48,461.7
<b>Total Deposits</b>	<b>88,862.5</b>	<b>84,098.1</b>
Federal Funds Purchased	968.5	965.1
Securities Sold Under Agreements to Repurchase	919.6	917.3
Other Borrowings	151.7	1,558.6
Senior Notes	1,496.8	1,996.6
Long-Term Debt	1,653.4	1,709.2
Floating Rate Capital Debt	277.2	277.1
Other Liabilities	3,388.9	3,513.3
<b>Total Liabilities</b>	<b>97,718.6</b>	<b>95,035.3</b>

**Stockholders Equity**

Common Stock, \$1.66 2/3 Par Value; Authorized 560,000,000 shares; Outstanding shares of 235,584,991 and 237,322,035	<b>408.6</b>	408.6
Additional Paid-In Capital	<b>1,039.3</b>	1,035.7
Retained Earnings	<b>7,344.1</b>	7,134.8
Accumulated Other Comprehensive Loss	<b>(205.2)</b>	(244.3)
Treasury Stock (9,586,533 and 7,849,489 shares, at cost)	<b>(544.2)</b>	(422.8)
 Total Stockholders Equity	 <b>8,042.6</b>	 7,912.0
 Total Liabilities and Stockholders Equity	 <b>\$ 105,761.2</b>	 \$ 102,947.3

*See accompanying notes to the consolidated financial statements.*

**CONSOLIDATED STATEMENT OF INCOME  
(UNAUDITED)**
**NORTHERN TRUST CORPORATION**

(In Millions Except Share Information)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<b>Noninterest Income</b>				
Trust, Investment and Other Servicing Fees	\$ 706.9	\$ 657.3	\$ 1,386.4	\$ 1,288.0
Foreign Exchange Trading Income	52.9	71.3	103.0	130.8
Treasury Management Fees	16.6	17.1	33.4	33.9
Security Commissions and Trading Income	17.8	18.3	32.5	36.6
Other Operating Income	40.5	36.3	78.2	61.1
Investment Security Gains (Losses), net (Note)	0.4	0.1	(3.6)	0.3
<b>Total Noninterest Income</b>	<b>835.1</b>	<b>800.4</b>	<b>1,629.9</b>	<b>1,550.7</b>
<b>Net Interest Income</b>				
Interest Income	293.8	275.3	589.2	562.0
Interest Expense	47.2	55.2	96.9	115.8
<b>Net Interest Income</b>	<b>246.6</b>	<b>220.1</b>	<b>492.3</b>	<b>446.2</b>
Provision for Credit Losses		5.0	3.0	10.0
<b>Net Interest Income after Provision for Credit Losses</b>	<b>246.6</b>	<b>215.1</b>	<b>489.3</b>	<b>436.2</b>
<b>Noninterest Expense</b>				
Compensation	372.4	326.9	714.2	647.2
Employee Benefits	68.5	64.2	135.4	127.5
Outside Services	144.6	136.2	289.0	266.1
Equipment and Software	116.1	92.1	217.4	183.5
Occupancy	47.2	43.5	91.4	86.7
Other Operating Expense	62.2	66.8	131.6	147.6
<b>Total Noninterest Expense</b>	<b>811.0</b>	<b>729.7</b>	<b>1,579.0</b>	<b>1,458.6</b>
<b>Income before Income Taxes</b>	<b>270.7</b>	<b>285.8</b>	<b>540.2</b>	<b>528.3</b>
Provision for Income Taxes	88.8	94.7	176.9	173.2
<b>Net Income</b>	<b>\$ 181.9</b>	<b>\$ 191.1</b>	<b>\$ 363.3</b>	<b>\$ 355.1</b>
<b>Net Income Applicable to Common Stock</b>	<b>\$ 181.9</b>	<b>\$ 191.1</b>	<b>\$ 363.3</b>	<b>\$ 355.1</b>
<b>Per Common Share</b>				
Net Income Basic	\$ 0.76	\$ 0.78	\$ 1.51	\$ 1.46
Diluted	0.75	0.78	1.50	1.45
<b>Average Number of Common Shares Outstanding</b>				
Basic	<b>236,012,703</b>	239,738,592	<b>236,607,125</b>	239,454,653
Diluted	<b>237,753,679</b>	241,040,681	<b>238,398,614</b>	240,617,300

**CONSOLIDATED STATEMENT OF COMPREHENSIVE  
INCOME**
**NORTHERN TRUST CORPORATION**

(UNAUDITED)

(In Millions)	Three Months Ended June 30, Six Months Ended June 30,			
	2014	2013	2014	2013
<b>Net Income</b>	<b>\$ 181.9</b>	<b>\$ 191.1</b>	<b>\$ 363.3</b>	<b>\$ 355.1</b>
<b>Other Comprehensive Income (Net of Tax and Reclassifications)</b>				
Net Unrealized Gains (Losses) on Securities Available for Sale	<b>33.5</b>	(81.5)	<b>38.0</b>	(80.2)
Net Unrealized Gains (Losses) on Cash Flow Hedges	<b>(0.6)</b>	2.1	<b>1.0</b>	(3.1)
Foreign Currency Translation Adjustments	<b>(5.6)</b>	5.8	<b>(6.9)</b>	1.6
Pension and Other Postretirement Benefit Adjustments	<b>3.6</b>	7.0	<b>7.0</b>	14.0
<b>Other Comprehensive Income (Loss)</b>	<b>30.9</b>	(66.6)	<b>39.1</b>	(67.7)
<b>Comprehensive Income</b>	<b>\$ 212.8</b>	<b>\$ 124.5</b>	<b>\$ 402.4</b>	<b>\$ 287.4</b>
Note: Changes in Other-Than-Temporary-Impairment (OTTI) Losses	\$	\$	\$ (4.6)	\$
Noncredit-related OTTI Losses Recorded in/(Reclassified from) OCI			<b>0.7</b>	
Other Security Gains (Losses), net	<b>0.4</b>	0.1	<b>0.3</b>	0.3
Investment Security Gains (Losses), net	<b>\$ 0.4</b>	\$ 0.1	<b>\$ (3.6)</b>	\$ 0.3

*See accompanying notes to the consolidated financial statements.*

**CONSOLIDATED STATEMENT OF CHANGES IN  
STOCKHOLDERS EQUITY  
(UNAUDITED)**
**NORTHERN TRUST CORPORATION**

(In Millions)	Six Months Ended June 30,	
	2014	2013
<b>Common Stock</b>		
Balance at January 1 and June 30	\$ 408.6	\$ 408.6
<b>Additional Paid-in Capital</b>		
Balance at January 1	1,035.7	1,012.7
Treasury Stock Transactions    Stock Options and Awards	(47.1)	(38.5)
Stock Options and Awards    Amortization	42.1	39.2
Stock Options and Awards    Tax Benefits	8.6	0.9
Balance at June 30	1,039.3	1,014.3
<b>Retained Earnings</b>		
Balance at January 1	7,134.8	6,702.7
Net Income	363.3	355.1
Dividends Declared    Common Stock	(154.0)	(148.6)
Balance at June 30	7,344.1	6,909.2
<b>Accumulated Other Comprehensive Income (Loss)</b>		
Balance at January 1	(244.3)	(283.0)
Net Unrealized Gains (Losses) on Securities Available for Sale	38.0	(80.2)
Net Unrealized Gains (Losses) on Cash Flow Hedges	1.0	(3.1)
Foreign Currency Translation Adjustments	(6.9)	1.6
Pension and Other Postretirement Benefit Adjustments	7.0	14.0
Balance at June 30	(205.2)	(350.7)
<b>Treasury Stock</b>		
Balance at January 1	(422.8)	(314.0)
Stock Options and Awards	116.5	147.0
Stock Purchased	(237.9)	(89.8)
Balance at June 30	(544.2)	(256.8)
<b>Total Stockholders Equity at June 30</b>	<b>\$ 8,042.6</b>	<b>\$ 7,724.6</b>

See accompanying notes to the consolidated financial statements.

**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**(UNAUDITED)**
**NORTHERN TRUST CORPORATION**

(In Millions)	Six Months Ended June 30,	
	2014	2013
<b>Cash Flows from Operating Activities:</b>		
Net Income	\$ 363.3	\$ 355.1
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Investment Security Losses (Gains), net	3.6	(0.3)
Amortization and Accretion of Securities and Unearned Income, net	17.2	19.5
Provision for Credit Losses	3.0	10.0
Depreciation on Buildings and Equipment	46.5	46.4
Amortization of Computer Software	113.0	99.6
Amortization of Intangibles	9.9	10.3
Computer Software Write-Offs	9.5	
Pension Plan Contributions	(13.9)	(16.4)
Change in Receivables	140.5	94.5
Change in Interest Payable	(10.2)	(12.2)
Change in Collateral With Derivative Counterparties, net	527.9	(1,818.0)
Other Operating Activities, net	329.7	(70.2)
Net Cash Provided by (Used in) Operating Activities	1,540.0	(1,281.7)
<b>Cash Flows from Investing Activities:</b>		
Net Change in Federal Funds Sold and Securities Purchased under Agreements to Resell	(49.9)	(220.4)
Change in Interest-Bearing Deposits with Banks	2,578.7	169.4
Net Change in Federal Reserve Deposits and Other Interest-Bearing Assets	(427.0)	853.8
Purchases of Securities Held to Maturity	(3,758.9)	(3,671.6)
Proceeds from Maturity and Redemption of Securities Held to Maturity	1,846.0	3,256.2
Purchases of Securities Available for Sale	(6,442.8)	(3,729.4)
Proceeds from Sale, Maturity and Redemption of Securities Available for Sale	5,185.3	4,761.3
Change in Loans and Leases	(1,318.9)	646.5
Purchases of Buildings and Equipment	(32.4)	(31.7)
Purchases and Development of Computer Software	(159.6)	(130.7)
Change in Client Security Settlement Receivables	(234.0)	561.1
Other Investing Activities, net	(271.1)	246.6
Net Cash (Used in) Provided by Investing Activities	(3,084.6)	2,711.1
<b>Cash Flows from Financing Activities:</b>		
Change in Deposits	4,468.0	(3,595.4)
Change in Federal Funds Purchased	3.4	1,503.2
Change in Securities Sold under Agreements to Repurchase	2.3	77.9
Change in Short-Term Other Borrowings	(1,644.8)	1,458.3
Repayments of Senior Notes and Long-Term Debt	(602.4)	(402.1)
Contingent Consideration Liability Payment	(55.3)	
Treasury Stock Purchased	(237.9)	(89.5)
Net Proceeds from Stock Options	69.4	108.1

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Cash Dividends Paid on Common Stock	(149.9)	(71.8)
Other Financing Activities, net	362.2	574.8
Net Cash Provided by (Used in) Financing Activities	2,215.0	(436.5)
Effect of Foreign Currency Exchange Rates on Cash	112.4	(114.7)
Increase in Cash and Due from Banks	782.8	878.2
Cash and Due from Banks at Beginning of Year	3,162.4	3,752.7
Cash and Due from Banks at End of Period	\$ 3,945.2	\$ 4,630.9
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Interest Paid	\$ 108.4	\$ 127.9
Income Taxes Paid	74.1	91.9
Transfers from Loans to OREO	8.7	14.7

*See accompanying notes to the consolidated financial statements.*



---

**Notes to Consolidated Financial Statements**

**1. Basis of Presentation** The consolidated financial statements include the accounts of Northern Trust Corporation (Corporation) and its subsidiaries (collectively, Northern Trust). Significant intercompany balances and transactions have been eliminated. The consolidated financial statements, as of and for the periods ended June 30, 2014 and 2013, have not been audited by the Corporation's independent registered public accounting firm. In the opinion of management, all accounting entries and adjustments, including normal recurring accruals, necessary for a fair presentation of the financial position and the results of operations for the interim periods have been made. Certain reclassifications have been made to the prior period consolidated financial statements to place them on a basis comparable with the current period's consolidated financial statements. Within the statement of cash flows, net changes in the fair values of derivative assets and liabilities, previously included within Change in Collateral with Derivative Counterparties, net, are included in Other Operating Activities, net. For a description of Northern Trust's significant accounting policies, refer to Note 1 of the Notes to Consolidated Financial Statements in the 2013 Annual Report to Shareholders.

**2. Recent Accounting Pronouncements** In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). The ASU is a converged standard between the FASB and the IASB that provides a single comprehensive revenue recognition model for all contracts with customers across transactions and industries. The primary objective of the ASU is revenue recognition that represents the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU is effective for interim and annual reporting periods beginning after December 15, 2016. Northern Trust is currently assessing the impact of adoption of ASU 2014-09.

In June 2014, the FASB issued ASU No. 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. This ASU requires secured borrowing accounting treatment for repurchase-to-maturity transactions and provides guidance on accounting for repurchase financing arrangements. This ASU is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of this ASU will result in additional disclosures, but is not expected to impact significantly Northern Trust's consolidated financial position or results of operations.

In June 2014, the FASB also issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could be Achieved after the Requisite Service Period. This ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition and should not be reflected in estimating the grant-date fair value of the award. This ASU is effective for interim and annual reporting periods beginning after December 15, 2015 with earlier adoption permitted. The adoption of this ASU is not expected to impact significantly Northern Trust's consolidated financial position or results of operations.

---

**Notes to Consolidated Financial Statements (continued)**

**3. Fair Value Measurements – Fair Value Hierarchy.** The following describes the hierarchy of valuation inputs (Levels 1, 2, and 3) used to measure fair value and the primary valuation methodologies used by Northern Trust for financial instruments measured at fair value on a recurring basis. Observable inputs reflect market data obtained from sources independent of the reporting entity; unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. GAAP requires an entity measuring fair value to maximize the use of observable inputs and minimize the use of unobservable inputs and establishes a fair value hierarchy of inputs. Financial instruments are categorized within the hierarchy based on the lowest level input that is significant to their valuation. Northern Trust's policy is to recognize transfers into and transfers out of fair value levels as of the end of the reporting period in which the transfer occurred. No transfers between fair value levels occurred during the six months ended June 30, 2014 or the year ended December 31, 2013.

**Level 1** Quoted, active market prices for identical assets or liabilities.

Northern Trust's Level 1 assets are comprised of available for sale investments in U.S. treasury securities.

**Level 2** Observable inputs other than Level 1 prices, such as quoted active market prices for similar assets or liabilities, quoted prices for identical or similar assets in inactive markets, and model-derived valuations in which all significant inputs are observable in active markets.

Northern Trust's Level 2 assets include available for sale and trading account securities, the fair values of which are determined predominantly by external pricing vendors. Prices received from vendors are compared to other vendor and third-party prices. If a security price obtained from a pricing vendor is determined to exceed pre-determined tolerance levels that are assigned based on an asset type's characteristics, the exception is researched and, if the price is not able to be validated, an alternate pricing vendor is utilized, consistent with Northern Trust's pricing source hierarchy. As of June 30, 2014, Northern Trust's available for sale securities portfolio included 837 Level 2 securities with an aggregate market value of \$27.2 billion. All 837 securities were valued by external pricing vendors. As of December 31, 2013, Northern Trust's available for sale securities portfolio included 831 Level 2 securities with an aggregate market value of \$26.4 billion. Of those, 829 securities, with an aggregate market value of \$26.3 billion, were valued by external pricing vendors. The remaining 2 securities, with an aggregate market value of \$57.4 million, were valued consistent with prices of similar securities as there were no vended prices available for these securities. Trading account securities, which totaled \$2.7 million and \$1.7 million as of June 30, 2014 and December 31, 2013, respectively, were all valued using external pricing vendors.

Northern Trust has established processes and procedures to assess the suitability of valuation methodologies used by external pricing vendors, including reviews of valuation techniques and assumptions used for selected securities. On a daily basis, periodic

---

**Notes to Consolidated Financial Statements (continued)**

quality control reviews of prices received from vendors are conducted which include comparisons to prices on similar security types received from multiple pricing vendors and to the previous day's reported prices for each security. Predetermined tolerance level exceptions are researched and may result in additional validation through available market information or the use of an alternate pricing vendor. Quarterly, Northern Trust reviews documentation from third-party pricing vendors regarding the valuation processes and assumptions used in their valuations and assesses whether the fair value levels assigned by Northern Trust to each security classification are appropriate. Annually, valuation inputs used within third-party pricing vendor valuations are reviewed for propriety on a sample basis through a comparison of inputs used to comparable market data, including security classifications that are less actively traded and security classifications comprising significant portions of the portfolio.

Level 2 assets and liabilities also include derivative contracts which are valued internally using widely accepted income-based models that incorporate inputs readily observable in actively quoted markets and reflect the contractual terms of the contracts. Observable inputs include foreign exchange rates and interest rates for foreign exchange contracts; credit spreads, default probabilities, and recovery rates for credit default swap contracts; interest rates for interest rate swap contracts and forward contracts; and interest rates and volatility inputs for interest rate option contracts. Northern Trust evaluates the impact of counterparty credit risk and its own credit risk on the valuation of its derivative instruments. Factors considered include the likelihood of default by Northern Trust and its counterparties, the remaining maturities of the instruments, net exposures after giving effect to master netting arrangements or similar agreements, available collateral, and other credit enhancements in determining the appropriate fair value of derivative instruments. The resulting valuation adjustments have not been considered material.

**Level 3** Valuation techniques in which one or more significant inputs are unobservable in the marketplace.

Northern Trust's Level 3 assets consist of auction rate securities purchased in 2008 from Northern Trust clients. To estimate the fair value of auction rate securities, for which trading is limited and market prices are generally unavailable, Northern Trust developed and maintains a pricing model that discounts estimated cash flows over their estimated remaining lives. Significant inputs to the model include the contractual terms of the securities, credit risk ratings, discount rates, forward interest rates, credit/liquidity spreads, and Northern Trust's own assumptions about the estimated remaining lives of the securities. The significant unobservable inputs used in the fair value measurement are Northern Trust's own assumptions about the estimated remaining lives of the securities and the applicable discount rates. Significant increases (decreases) in the estimated remaining lives or the discount rates in isolation would result in a significantly lower (higher) fair value measurement. Level 3 liabilities at December 31, 2013 consisted of acquisition-related contingent consideration liabilities, the fair value of which was determined using an income-based (discounted cash flow) model that incorporated Northern Trust's own assumptions about business growth rates and applicable discount

**Notes to Consolidated Financial Statements (continued)**

rates, which represented unobservable inputs to the model. As of March 31, 2014, the value of the acquisition-related consideration had been agreed by the parties to be \$55.3 million, removing the contingency.

Northern Trust believes its valuation methods for its assets and liabilities carried at fair value are appropriate; however, the use of different methodologies or assumptions, particularly as applied to Level 3 assets and liabilities, could have a material effect on the computation of their estimated fair values.

Management of various businesses and departments of Northern Trust (including Corporate Market Risk, Credit Policy, Corporate Financial Management, and relevant business unit personnel) determine the valuation policies and procedures for Level 3 assets and liabilities. Each business and department represents a component of Northern Trust's business units, and reports to management of their respective business units. Generally, valuation policies are reviewed by management of each business or department. Fair value measurements are performed upon acquisitions of an asset or liability. As necessary, the valuation models are reviewed by management of the appropriate business or department, and adjusted for changes in inputs. Management of each business or department reviews the inputs in order to substantiate the unobservable inputs used in each fair value measurement. When appropriate, management reviews forecasts used in the valuation process in light of other relevant financial projections to understand any variances between current and previous fair value measurements. In certain circumstances, third party information is used to support the fair value measurements. If certain third party information seems inconsistent with consensus views, a review of the information is performed by management of the respective business or department to conclude as to the appropriate fair value of the asset or liability.

The following presents the fair values of, and the valuation techniques, significant unobservable inputs, and quantitative information used to develop significant unobservable inputs for, Northern Trust's Level 3 assets as of June 30, 2014.

<b>Financial Instrument</b>	<b>Fair Value</b>	<b>Valuation Technique</b>	<b>Unobservable Inputs</b>	<b>Range of Lives and Rates</b>	
Auction Rate Securities			Remaining lives	1.9	8.6 years
	\$98.8 million	Discounted Cash Flow	Discount rates	0.2%	8.0%

## Notes to Consolidated Financial Statements (continued)

The following tables present assets and liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013, segregated by fair value hierarchy level.

(In Millions)	Level 1	Level 2	Level 3	Netting	Assets/Liabilities at Fair Value
<b>June 30, 2014</b>					
Securities					
Available for Sale					
U.S. Government	\$ 2,417.7	\$	\$	\$	\$ 2,417.7
Obligations of States and Political Subdivisions					
Government Sponsored Agency		4.6			4.6
Corporate Debt		18,168.9			18,168.9
Covered Bonds		3,670.7			3,670.7
Supranational, Sovereign and Non-U.S.					
Agency Bonds		1,988.8			1,988.8
Residential Mortgage-Backed		722.3			722.3
Other Asset-Backed		42.9			42.9
Auction Rate		2,391.0			2,391.0
Other			98.8		98.8
		183.7			183.7
<b>Total Available for Sale</b>	<b>2,417.7</b>	<b>27,172.9</b>	<b>98.8</b>		<b>29,689.4</b>
Trading Account					
		2.7			2.7
<b>Total Available for Sale and Trading Securities</b>	<b>2,417.7</b>	<b>27,175.6</b>	<b>98.8</b>		<b>29,692.1</b>
Other Assets					
Derivative Assets					
Foreign Exchange Contracts		1,796.9			1,796.9
Interest Rate Contracts		223.7			223.7
<b>Total Derivative Assets</b>		<b>2,020.6</b>		<b>(1,458.7)</b>	<b>561.9</b>
Other Liabilities					
Derivative Liabilities					
Foreign Exchange Contracts		1,830.8			1,830.8
Interest Rate Swaps		152.5			152.5
<b>Total Derivative Liabilities</b>		<b>1,983.3</b>		<b>(1,487.8)</b>	<b>495.5</b>

Note: Northern Trust has elected to net derivative assets and liabilities when legally enforceable master netting arrangements or similar agreements exist between Northern Trust and the counterparty. As of June 30, 2014,

*derivative assets and liabilities shown above also include reductions of \$552.0 million and \$581.1 million, respectively, as a result of cash collateral received from and deposited with derivative counterparties.*

## Notes to Consolidated Financial Statements (continued)

(In Millions)	Level 1	Level 2	Level 3	Netting	Assets/Liabilities at Fair Value
<b>December 31, 2013</b>					
Securities					
Available for Sale					
U.S. Government	\$ 1,917.9	\$	\$	\$	\$ 1,917.9
Obligations of States and Political Subdivisions		4.6			4.6
Government Sponsored Agency		17,528.0			17,528.0
Corporate Debt		3,524.5			3,524.5
Covered Bonds		1,943.9			1,943.9
Supranational, Sovereign and Non-U.S.					
Agency Bonds		720.6			720.6
Residential Mortgage-Backed		48.1			48.1
Other Asset-Backed		2,391.8			2,391.8
Auction Rate			98.9		98.9
Other		214.5			214.5
Total Available for Sale	1,917.9	26,376.0	98.9		28,392.8
Trading Account		1.7			1.7
Total Available for Sale and Trading Securities	1,917.9	26,377.7	98.9		28,394.5
Other Assets					
Derivative Assets					
Foreign Exchange Contracts		2,865.7			2,865.7
Interest Rate Contracts		237.9			237.9
Total Derivative Assets		3,103.6		(1,369.0)	1,734.6
Other Liabilities					
Derivative Liabilities					
Foreign Exchange Contracts		2,905.7			2,905.7
Interest Rate Swaps		195.2			195.2
Total Derivative Liabilities		3,100.9		(1,926.0)	1,174.9
Contingent Consideration	\$	\$	\$ 55.4	\$	\$ 55.4

Note: Northern Trust has elected to net derivative assets and liabilities when legally enforceable master netting arrangements or similar agreements exist between Northern Trust and the counterparty. As of December 31, 2013, derivative assets and liabilities shown above also include reductions of \$210.7 million and \$767.7 million,

*respectively, as a result of cash collateral received from and deposited with derivative counterparties.*



## Notes to Consolidated Financial Statements (continued)

The following tables present the changes in Level 3 assets and liabilities for the three and six months ended June 30, 2014 and 2013.

Level 3 Assets (In Millions)	Auction Rate Securities	
	2014	2013
<b>Three Months Ended June 30,</b>		
Fair Value at April 1	\$ 98.5	\$ 99.6
Total Gains (Losses):		
Included in Earnings		
Included in Other Comprehensive Income (2)	0.5	
Purchases, Issues, Sales, and Settlements	(0.2)	(0.5)
Fair Value at June 30	\$ 98.8	\$ 99.1
	2014	2013
<b>Six Months Ended June 30,</b>		
Fair Value at January 1	\$ 98.9	\$ 97.8
Total Gains (Losses):		
Included in Earnings (1)		0.1
Included in Other Comprehensive Income (2)	0.3	2.7
Purchases, Issues, Sales, and Settlements		
Sales	0.1	
Settlements	(0.5)	(1.5)
Fair Value at June 30	\$ 98.8	\$ 99.1

- (1) Realized gains for the six month period ended June 30, 2013 of \$0.1 million represent gains from redemptions by issuers, which are recorded in interest income within the consolidated statement of income.
- (2) Unrealized gains (losses) are included in net unrealized gains (losses) on securities available for sale within the consolidated statement of comprehensive income.

Level 3 Liabilities (In Millions)	Contingent Consideration	
	2014	2013
<b>Three Months Ended June 30,</b>		
Fair Value at April 1	\$	\$ 51.4
Total (Gains) and Losses:		
Included in Earnings (1)		1.3
Included in Other Comprehensive Income		
Purchases, Issues, Sales, and Settlements		

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Fair Value at June 30	\$	\$ 52.7
Unrealized (Gains) Losses Included in Earnings Related to Financial Instruments Held at June 30 (1)	\$	\$ 1.3
	2014	2013
<b>Six Months Ended June 30,</b>		
Fair Value at January 1	\$ 55.4	\$ 50.1
Total (Gains) Losses:		
Included in Earnings (1)	(0.1)	2.6
Included in Other Comprehensive Income Purchases, Issues, Sales, and Settlements Settlements	(55.3)	
Fair Value at June 30	\$	\$ 52.7
Unrealized (Gains) Losses Included in Earnings Related to Financial Instruments Held at June 30 (1)	\$	\$ 2.6

(1) (Gains) losses are recorded in other operating income (expense) within the consolidated statement of income.

**Notes to Consolidated Financial Statements (continued)**

During the six months ended June 30, 2014 and 2013, there were no transfers into or out of Level 3 assets or liabilities.

Carrying values of assets and liabilities that are not measured at fair value on a recurring basis may be adjusted to fair value in periods subsequent to their initial recognition, for example, to record an impairment of an asset. GAAP requires entities to disclose separately these subsequent fair value measurements and to classify them under the fair value hierarchy.

Assets measured at fair value on a nonrecurring basis at June 30, 2014 and 2013, all of which were categorized as Level 3 under the fair value hierarchy, were comprised of impaired loans whose values were based on real estate and other available collateral, and of Other Real Estate Owned (OREO) properties. Fair values of real estate loan collateral were estimated using a market approach typically supported by third party valuations and property specific fees and taxes. Other loan collateral, which typically consists of accounts receivable, inventory and equipment, is valued using a market approach adjusted for asset specific characteristics and in limited instances third party valuations are used. OREO assets are carried at the lower of cost or fair value less estimated costs to sell, with fair value typically based on third-party appraisals.

Collateral-based impaired loans and OREO assets that have been adjusted to fair value totaled \$16.9 million and \$1.4 million, respectively, at June 30, 2014, and \$45.6 million and \$2.9 million, respectively, at June 30, 2013. Assets measured at fair value on a nonrecurring basis reflect management's judgment as to realizable value.

The following table provides the fair value of, and the valuation technique, significant unobservable inputs, and quantitative information used to develop the significant unobservable inputs for, Northern Trust's Level 3 assets that were measured at fair value on a nonrecurring basis as of June 30, 2014.

<b>Financial</b>		<b>Valuation Technique</b>	<b>Unobservable Input</b>	<b>Range of Discounts Applied</b>	
<b>Instrument</b>	<b>Fair Value</b>				
Loans	\$16.9 million	Market Approach	Discount to reflect realizable value	15%	40%
OREO	\$1.4 million	Market Approach	Discount to reflect realizable value	15%	40%

---

**Notes to Consolidated Financial Statements (continued)**

**Fair Value of Financial Instruments.** GAAP requires disclosure of the estimated fair value of certain financial instruments and the methods and significant assumptions used to estimate fair value. It excludes from this requirement nonfinancial assets and liabilities, as well as a wide range of franchise, relationship, and intangible values that add value to Northern Trust. Accordingly, the required fair value disclosures provide only a partial estimate of the fair value of Northern Trust. Financial instruments recorded at fair value on Northern Trust's consolidated balance sheet are discussed above. The following methods and assumptions were used in estimating the fair values of financial instruments that are not carried at fair value.

*Held to Maturity Securities.* The fair values of held to maturity securities were modeled by external pricing vendors, or in limited cases internally, using widely accepted models which are based on an income approach that incorporates current market yield curves.

*Loans (excluding lease receivables).* The fair value of the loan portfolio was estimated using an income approach (discounted cash flow) that incorporates current market rates offered by Northern Trust as of the date of the consolidated financial statements. The fair values of all loans were adjusted to reflect current assessments of loan collectability.

*Federal Reserve and Federal Home Loan Bank Stock.* The fair values of Federal Reserve and Federal Home Loan Bank stock are equal to their carrying values which represent redemption value.

*Community Development Investments.* The fair values of these instruments were estimated using an income approach (discounted cash flow) that incorporates current market rates.

*Employee Benefit and Deferred Compensation.* These assets include U.S. treasury securities and investments in mutual and collective trust funds held to fund certain supplemental employee benefit obligations and deferred compensation plans. Fair values of U.S. treasury securities were determined using quoted, active market prices for identical securities. The fair values of investments in mutual and collective trust funds were valued at the funds' net asset values based on a market approach.

*Savings Certificates and Other Time Deposits.* The fair values of these instruments were estimated using an income approach (discounted cash flow) that incorporates market interest rates currently offered by Northern Trust for deposits with similar maturities.

*Senior Notes, Subordinated Debt, and Floating Rate Capital Debt.* Fair values were determined using a market approach based on quoted market prices, when available. If quoted market prices were not available, fair values were based on quoted market prices for comparable instruments.

*Federal Home Loan Bank Borrowings.* The fair values of these instruments were estimated using an income approach (discounted cash flow) that incorporates market interest rates available to Northern Trust.

*Loan Commitments.* The fair values of loan commitments represent the estimated costs to terminate or otherwise settle the obligations with a third party adjusted for any related allowance for credit losses.

**Notes to Consolidated Financial Statements (continued)**

*Standby Letters of Credit.* The fair values of standby letters of credit are measured as the amount of unamortized fees on these instruments, inclusive of the related allowance for credit losses. Fees are determined by applying basis points to the principal amounts of the letters of credit.

*Financial Instruments Valued at Carrying Value.* Due to their short maturity, the carrying values of certain financial instruments approximated their fair values. These financial instruments include cash and due from banks; federal funds sold and securities purchased under agreements to resell, interest-bearing deposits with banks, Federal Reserve deposits and other interest-bearing assets; client security settlement receivables; non-U.S. offices interest-bearing deposits; federal funds purchased; securities sold under agreements to repurchase; and other borrowings (includes term federal funds purchased, and other short-term borrowings). As required by GAAP, the fair values required to be disclosed for demand, noninterest-bearing, savings, and money market deposits must equal the amounts disclosed in the consolidated balance sheet, even though such deposits are typically priced at a premium in banking industry consolidations.

## Notes to Consolidated Financial Statements (continued)

The following tables summarize the fair values of all financial instruments.

(In Millions)	June 30, 2014				
	Book Value	Total Fair Value	Level 1	Fair Value Level 2      Level 3	
<b>Assets</b>					
Cash and Due from Banks	\$ 3,945.2	\$ 3,945.2	\$ 3,945.2	\$	\$
Federal Funds Sold and Resell Agreements	579.5	579.5		579.5	
Interest-Bearing Deposits with Banks	17,059.8	17,059.8		17,059.8	
Federal Reserve Deposits and Other Interest-Bearing Securities	13,338.5	13,338.5		13,338.5	
Available for Sale (1)	29,689.4	29,689.4	2,417.7	27,172.9	98.8
Held to Maturity	4,270.6	4,265.4		4,265.4	
Trading Account	2.7	2.7		2.7	
Loans (excluding Leases)					
Held for Investment	29,493.3	29,568.4			29,568.4
Held for Sale	9.5	9.5			9.5
Client Security Settlement Receivables	1,596.4	1,596.4		1,596.4	
<b>Other Assets</b>					
Federal Reserve and Federal Home Loan Bank Stock	207.5	207.5		207.5	
Community Development Investments	205.2	204.5		204.5	
Employee Benefit and Deferred Compensation	148.2	147.6	96.5	51.1	
<b>Liabilities</b>					
<b>Deposits</b>					
Demand, Noninterest-Bearing, Savings and Money Market	\$ 37,437.4	\$ 37,437.4	\$ 37,437.4	\$	\$
Savings Certificates and Other Time	1,967.4	1,969.2		1,969.2	
Non U.S. Offices Interest-Bearing	49,457.7	49,457.7		49,457.7	
Federal Funds Purchased	968.5	968.5		968.5	
Securities Sold under Agreements to Repurchase	919.6	919.6		919.6	
Other Borrowings	151.7	151.7		151.7	
Senior Notes	1,496.8	1,534.4		1,534.4	
<b>Long Term Debt (excluding Leases)</b>					
Subordinated Debt	1,583.9	1,620.6		1,620.6	
Federal Home Loan Bank Borrowings	35.0	35.3		35.3	
Floating Rate Capital Debt	277.2	240.5		240.5	
<b>Other Liabilities</b>					
Standby Letters of Credit	61.2	61.2			61.2

Loan Commitments	29.3	29.3	29.3
<b>Derivative Instruments</b>			
Asset/Liability Management			
Foreign Exchange Contracts			
Assets	\$ 12.6	\$ 12.6	\$ 12.6
Liabilities	43.7	43.7	43.7
Interest Rate Contracts			
Assets	107.9	107.9	107.9
Liabilities	41.5	41.5	41.5
Client-Related and Trading			
Foreign Exchange Contracts			
Assets	1,784.3	1,784.3	1,784.3
Liabilities	1,787.1	1,787.1	1,787.1
Interest Rate Contracts			
Assets	115.8	115.8	115.8
Liabilities	111.0	111.0	111.0

(1) Refer to the table located on page 37 for the disaggregation of available for sale securities.

## Notes to Consolidated Financial Statements (continued)

(In Millions)	December 31, 2013				
	Book Value	Total Fair Value	Level 1	Level 2	Level 3
<b>Assets</b>					
Cash and Due from Banks	\$ 3,162.4	\$ 3,162.4	\$ 3,162.4	\$	\$
Federal Funds Sold and Resell Agreements	529.6	529.6		529.6	
Interest-Bearing Deposits with Banks	19,397.4	19,397.4		19,397.4	
Federal Reserve Deposits and Other Interest-Bearing Securities	12,911.5	12,911.5		12,911.5	
Available for Sale (1)	28,392.8	28,392.8	1,917.9	26,376.0	98.9
Held to Maturity	2,325.8	2,321.4		2,321.4	
Trading Account	1.7	1.7		1.7	
Loans (excluding Leases)					
Held for Investment	28,136.5	28,147.2			28,147.2
Held for Sale					
Client Security Settlement Receivables	1,355.2	1,355.2		1,355.2	
<b>Other Assets</b>					
Federal Reserve and Federal Home Loan Bank Stock	194.7	194.7		194.7	
Community Development Investments	228.1	227.8		227.8	
Employee Benefit and Deferred Compensation	132.7	126.9	79.3	47.6	
<b>Liabilities</b>					
<b>Deposits</b>					
Demand, Noninterest-Bearing, Savings and Money Market	\$ 33,762.0	\$ 33,762.0	\$ 33,762.0	\$	\$
Savings Certificates and Other Time	1,874.4	1,877.1		1,877.1	
Non U.S. Offices Interest-Bearing	48,461.7	48,461.7		48,461.7	
Federal Funds Purchased	965.1	965.1		965.1	
Securities Sold under Agreements to Repurchase	917.3	917.3		917.3	
Other Borrowings	1,558.6	1,558.6		1,558.6	
Senior Notes	1,996.6	1,989.3		1,989.3	
Long Term Debt (excluding Leases)					
Subordinated Debt	1,537.3	1,563.5		1,563.5	
Federal Home Loan Bank Borrowings	135.0	137.2		137.2	
Floating Rate Capital Debt	277.1	230.2		230.2	
<b>Other Liabilities</b>					
Standby Letters of Credit	59.6	59.6			59.6
Contingent Consideration	55.4	55.4			55.4
Loan Commitments	35.7	35.7			35.7
<b>Derivative Instruments</b>					
Asset/Liability Management					



Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

<b>Foreign Exchange Contracts</b>				
Assets	\$ 21.0	\$ 21.0	\$ 21.0	\$
Liabilities	59.5	59.5	59.5	
<b>Interest Rate Swaps</b>				
Assets	115.1	115.1	115.1	
Liabilities	78.2	78.2	78.2	
<b>Client-Related and Trading</b>				
<b>Foreign Exchange Contracts</b>				
Assets	2,844.7	2,844.7	2,844.7	
Liabilities	2,846.2	2,846.2	2,846.2	
<b>Interest Rate Contracts</b>				
Assets	122.8	122.8	122.8	
Liabilities	117.0	117.0	117.0	

(1) Refer to the table located on page 38 for the disaggregation of available for sale securities.

## Notes to Consolidated Financial Statements (continued)

**4. Securities** The following tables provide the amortized cost and fair values of securities at June 30, 2014 and December 31, 2013.

Securities Available for Sale (In Millions)	June 30, 2014			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
U.S. Government	\$ 2,396.3	\$ 21.4	\$	\$ 2,417.7
Obligations of States and Political Subdivisions	4.5	0.1		4.6
Government Sponsored Agency	18,112.8	79.7	23.6	18,168.9
Corporate Debt	3,696.3	5.6	31.2	3,670.7
Covered Bonds	1,974.6	14.3	0.1	1,988.8
Supranational, Sovereign and Non-U.S. Agency Bonds	720.6	2.6	0.9	722.3
Residential Mortgage-Backed	44.5	0.4	2.0	42.9
Other Asset-Backed	2,388.9	2.1		2,391.0
Auction Rate	97.1	2.4	0.7	98.8
Other	183.3	0.4		183.7
<b>Total</b>	<b>\$ 29,618.9</b>	<b>\$ 129.0</b>	<b>\$ 58.5</b>	<b>\$ 29,689.4</b>

Securities Held to Maturity (In Millions)	June 30, 2014			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Obligations of States and Political Subdivisions	\$ 157.0	\$ 9.2	\$	\$ 166.2
Government Sponsored Agency	27.7	1.3		29.0
Non-U.S. Government Debt	171.7			171.7
Certificates of Deposit	1,533.0	0.2		1,533.2
Supranational, Sovereign and Non-U.S. Agency Bonds	2,317.6	6.9	9.3	2,315.2
Other	63.6	0.1	13.6	50.1
<b>Total</b>	<b>\$ 4,270.6</b>	<b>\$ 17.7</b>	<b>\$ 22.9</b>	<b>\$ 4,265.4</b>

Securities Available for Sale (In Millions)	December 31, 2013			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
U.S. Government	\$ 1,896.7	\$ 22.6	\$ 1.4	\$ 1,917.9
Obligations of States and Political Subdivisions	4.5	0.1		4.6
Government Sponsored Agency	17,495.2	80.7	47.9	17,528.0
Corporate Debt	3,615.2	10.5	101.2	3,524.5
Covered Bonds	1,898.9	50.9	5.9	1,943.9

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Supranational, Sovereign and Non-U.S. Agency Bonds	717.0	5.3	1.7	720.6
Residential Mortgage-Backed	52.4	0.1	4.4	48.1
Other Asset-Backed	2,390.8	1.4	0.4	2,391.8
Auction Rate	97.5	2.2	0.8	98.9
Other	214.1	0.4		214.5
<b>Total</b>	<b>\$ 28,382.3</b>	<b>\$ 174.2</b>	<b>\$ 163.7</b>	<b>\$ 28,392.8</b>

Securities Held to Maturity

(In Millions)	December 31, 2013			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
Obligations of States and Political Subdivisions	\$ 225.2	\$ 10.3	\$	\$ 235.5
Government Sponsored Agency	35.9	1.1		37.0
Non-U.S. Government Debt	197.3			197.3
Certificates of Deposit	698.1		0.2	697.9
Supranational, Sovereign and Non-U.S. Agency Bonds	1,109.4	0.8	4.3	1,105.9
Other	59.9	0.1	12.2	47.8
<b>Total</b>	<b>\$ 2,325.8</b>	<b>\$ 12.3</b>	<b>\$ 16.7</b>	<b>\$ 2,321.4</b>

Securities held to maturity consist of debt securities that management intends to, and Northern Trust has the ability to, hold until maturity.

**Notes to Consolidated Financial Statements (continued)**

The following table provides the remaining maturity of securities as of June 30, 2014.

(In Millions)	Amortized Cost	Fair Value
<b>Available for Sale</b>		
Due in One Year or Less	<b>\$ 8,619.5</b>	<b>\$ 8,629.4</b>
Due After One Year Through Five Years	<b>16,807.1</b>	<b>16,861.6</b>
Due After Five Years Through Ten Years	<b>3,045.0</b>	<b>3,045.5</b>
Due After Ten Years	<b>1,147.3</b>	<b>1,152.9</b>
<b>Total</b>	<b>29,618.9</b>	<b>29,689.4</b>
<b>Held to Maturity</b>		
Due in One Year or Less	<b>1,864.9</b>	<b>1,868.3</b>
Due After One Year Through Five Years	<b>2,348.2</b>	<b>2,348.6</b>
Due After Five Years Through Ten Years	<b>22.1</b>	<b>23.3</b>
Due After Ten Years	<b>35.4</b>	<b>25.2</b>
<b>Total</b>	<b>\$ 4,270.6</b>	<b>\$ 4,265.4</b>

*Note: Mortgage-backed and asset-backed securities are included in the above table taking into account anticipated future prepayments.*

**Investment Security Gains and Losses.** Net investment security gains of \$0.4 million and \$0.1 million were recognized in the three months ended June 30, 2014 and 2013, respectively, representing net realized gains from the sale of securities. Gross proceeds from the sale of securities during the three months ended June 30, 2014 of \$264.2 million resulted in gross realized gains of \$0.4 million. Gross proceeds from the sale of securities during the three months ended June 30, 2013 of \$26.0 million resulted in gross realized gains of \$0.1 million.

Net investment security losses of \$3.6 million were recognized in the six months ended June 30, 2014 and include \$3.9 million of charges related to the other-than-temporary impairment of certain Community Reinvestment Act (CRA) eligible held to maturity securities. Net investment security gains of \$0.3 million were recognized in the six months ended June 30, 2013, representing net realized gains from the sale of securities. For the six months ended June 30, 2014, proceeds of \$463.9 million were received from the sale of securities and gross realized gains and losses totaled \$0.7 million and \$0.4 million, respectively. For the six months ended June 30, 2013, proceeds of \$81.7 million were received from the sale of securities and gross realized gains of \$0.3 billion were realized.

## Notes to Consolidated Financial Statements (continued)

**Securities with Unrealized Losses.** The following tables provide information regarding securities that had been in a continuous unrealized loss position for less than 12 months and for 12 months or longer as of June 30, 2014 and December 31, 2013.

Securities with Unrealized Losses as of June 30, 2014 (In Millions)	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government Sponsored Agency	\$ 2,612.6	\$ 8.3	\$ 1,958.6	\$ 15.3	\$ 4,571.2	\$ 23.6
Corporate Debt	579.2	1.1	1,282.3	30.1	1,861.5	31.2
Covered Bonds			10.0	0.1	10.0	0.1
Supranational, Sovereign and Non-U.S. Agency Bonds	1,406.2	9.3	58.9	0.9	1,465.1	10.2
Residential Mortgage-Backed			23.1	2.0	23.1	2.0
Auction Rate	2.4	0.1	13.5	0.6	15.9	0.7
Other	22.8	7.3	33.2	6.3	56.0	13.6
<b>Total</b>	<b>\$ 4,623.2</b>	<b>\$ 26.1</b>	<b>\$ 3,379.6</b>	<b>\$ 55.3</b>	<b>\$ 8,002.8</b>	<b>\$ 81.4</b>

Securities with Unrealized Losses as of December 31, 2013 (In Millions)	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government	\$ 896.4	\$ 1.4	\$	\$	\$ 896.4	\$ 1.4
Government Sponsored Agency	4,340.8	42.6	413.7	5.3	4,754.5	47.9
Corporate Debt	1,759.5	85.4	267.0	15.8	2,026.5	101.2
Covered Bonds	278.8	5.7	9.9	0.2	288.7	5.9
Supranational, Sovereign and Non-U.S. Agency Bonds	789.4	6.0			789.4	6.0
Residential Mortgage-Backed			42.0	4.4	42.0	4.4
Other Asset-Backed	677.0	0.4			677.0	0.4
Certificates of Deposit	684.2	0.2			684.2	0.2
Auction Rate	22.1	0.1	14.0	0.7	36.1	0.8
Other	25.7	4.0	29.5	8.2	55.2	12.2
<b>Total</b>	<b>\$ 9,473.9</b>	<b>\$ 145.8</b>	<b>\$ 776.1</b>	<b>\$ 34.6</b>	<b>\$ 10,250.0</b>	<b>\$ 180.4</b>

As of June 30, 2014, 382 securities with a combined fair value of \$8.0 billion were in an unrealized loss position, with their unrealized losses totaling \$81.4 million. Unrealized losses of \$23.6 million related to government sponsored agency securities are primarily attributable to changes in market rates since their purchase. Unrealized losses of \$31.2 million within corporate debt securities primarily reflect widened credit spreads and higher market rates since purchase; 44% of the corporate debt portfolio is backed by guarantees provided by U.S. and non-U.S. governmental entities.

Unrealized losses on residential mortgage-backed securities totaling \$2.0 million reflect the impact of wider credit and liquidity spreads on the valuations of 4 residential mortgage-backed securities since purchase, with \$23.1 million having been in an unrealized loss position for more than 12 months. Residential mortgage-backed securities at June 30, 2014 had a total amortized cost and fair value of \$44.5 million and \$42.9 million, respectively. Securities classified as other asset-backed had average lives less than 5 years, and 99% were rated triple-A.

---

**Notes to Consolidated Financial Statements (continued)**

The majority of the \$13.6 million of unrealized losses in securities classified as "other" at June 30, 2014 relate to securities purchased at a premium or par by Northern Trust for compliance with CRA. Unrealized losses on these CRA related securities are attributable to yields that are below market rates for the purpose of supporting institutions and programs that benefit low to moderate income communities within Northern Trust's market area. Unrealized losses of \$0.7 million related to auction rate securities primarily reflect reduced market liquidity as a majority of auctions continue to fail preventing holders from liquidating their investments at par. The remaining unrealized losses on Northern Trust's securities portfolio as of June 30, 2014 are attributable to changes in overall market interest rates, increased credit spreads, or reduced market liquidity. As of June 30, 2014, Northern Trust does not intend to sell any investment in an unrealized loss position and it is not more likely than not that Northern Trust will be required to sell any such investment before the recovery of its amortized cost basis, which may be maturity.

Security impairment reviews are conducted quarterly to identify and evaluate securities that have indications of possible OTTI. A determination as to whether a security's decline in market value is other-than-temporary takes into consideration numerous factors and the relative significance of any single factor can vary by security. Factors Northern Trust considers in determining whether impairment is other-than-temporary include, but are not limited to, the length of time the security has been impaired; the severity of the impairment; the cause of the impairment and the financial condition and near-term prospects of the issuer; activity in the market of the issuer which may indicate adverse credit conditions; Northern Trust's intent regarding the sale of the security as of the balance sheet date; and the likelihood that it will not be required to sell the security for a period of time sufficient to allow for the recovery of the security's amortized cost basis. For each security meeting the requirements of Northern Trust's internal screening process, an extensive review is conducted to determine if OTTI has occurred.

While all securities are considered, the following describes Northern Trust's process for identifying credit impairment within non-agency residential mortgage-backed securities, the security type for which Northern Trust has previously recognized the majority of its OTTI. To determine if an unrealized loss on a non-agency residential mortgage-backed security is other-than-temporary, economic models are used to perform cash flow analyses by developing multiple scenarios in order to create reasonable forecasts of the security's future performance using available data including servicers' loan charge off patterns, prepayment speeds, annualized default rates, each security's current delinquency pipeline, the delinquency pipeline's growth rate, the roll rate from delinquency to default, loan loss severities and historical performance of like collateral, along with Northern Trust's outlook for the housing market and the overall economy. If the present value of future cash flows projected as a result of this analysis is less than the current amortized cost of the security, a credit-related OTTI loss is recorded to earnings equal to the difference between the two amounts.

## Notes to Consolidated Financial Statements (continued)

Impairments of non-agency residential mortgage-backed securities are influenced by a number of factors, including but not limited to, U.S. economic and housing market performance, security credit enhancement level, insurance coverage, year of origination, and type of collateral. The factors used in estimating losses on non-agency residential mortgage-backed securities vary by year of origination and type of collateral.

As of June 30, 2014, loss estimates for subprime, Alt-A, prime and 2nd lien collateral portfolios were developed using default roll rates, determined primarily by the stage of delinquency of the underlying instrument, that generally assumed ultimate default rates approximating 5% to 30% for current loans; 30% for loans 30 to 60 days delinquent; 80% for loans 60 to 90 days delinquent; 90% for loans delinquent greater than 90 days; and 100% for OREO properties and loans that are in foreclosure. Amortized cost, weighted average ultimate default rates, and impairment severity rates for the non-agency residential mortgage-backed securities portfolio, by security type as of June 30, 2014, are provided in the following table.

Security Type	June 30, 2014				
	Amortized Cost	Weighted Average Ultimate Default Rates	Loss Severity Rates		
			Low	High	
Prime	\$ 6.3	23.1%	32.3%	53.4%	46.1%
Alt-A	11.6	42.1	64.1	64.1	64.1
Subprime	20.1	46.3	72.7	75.4	73.3
2nd Lien	6.5	32.4	98.7	100.0	99.7
Total Non-Agency Residential Mortgage-Backed Securities	\$ 44.5	39.4%	32.3%	100.0%	70.9%

Northern Trust's processes for identifying credit impairment within auction rate securities are largely consistent with the processes utilized for non-agency residential mortgage-backed securities and include analyses of expected loss severities and default rates adjusted for the type of underlying loan and the presence of government guarantees, as applicable.

The process for identifying credit impairment within CRA eligible mortgage-backed securities incorporates an expected loss approach on the underlying collateral pools. To evaluate whether an unrealized loss on CRA mortgage-backed securities is other-than-temporary, a reasonable forecast of the security's ultimate recovery value is calculated using available data including default rates, current delinquency pipeline, loan loss severities and historical performance of like collateral, along with Northern Trust's outlook for the housing market and the overall economy. If the estimated recovery value of the collateral pools is less than the current amortized cost of the security, a credit-related OTTI loss is recorded to earnings equal to the difference between the two amounts.

Impairments of CRA mortgage-backed securities are influenced by a number of factors, including but not limited to, U.S. economic and housing market performance, pool credit enhancement level, year of origination, and estimated credit quality of the collateral. The factors used in estimating losses related to CRA mortgage-backed securities vary by vintage of loan origination and collateral quality.





**Notes to Consolidated Financial Statements (continued)**

As of June 30, 2014, impairment estimates for CRA mortgage-backed securities were developed using default and loss severity rates sourced from industry mortgage data. Ultimate recovery value of the securities was determined by applying default and severity rates against remaining collateral balances in the pools. An expected loss amount was calculated by applying loss severity rates on defaulted amounts. Book values were compared against collateral values net of expected losses in order to determine OTTI.

There were no OTTI losses recognized in the three months ended June 30, 2014 or in the three or six months ended June 30, 2013. There were \$3.9 million of OTTI losses recognized during the six months ended June 30, 2014 related to CRA eligible mortgage-backed securities.

**Credit Losses on Debt Securities.** The table below provides information regarding total other-than-temporarily impaired securities, including noncredit-related amounts recognized in other comprehensive income and net impairment losses recognized in earnings, for the three and six months ended June 30, 2014 and 2013.

(In Millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Changes in OTTI Losses*	\$	\$	\$ (4.6)	\$
Noncredit-related Losses Recorded in / (Reclassified from) OCI**			0.7	
Net Impairment Losses Recognized in Earnings	\$	\$	\$ (3.9)	\$

\* For initial other-than-temporary impairments in the respective period, the balance includes the excess of the amortized cost over the fair value of the impaired securities. For subsequent impairments of the same security, the balance includes any additional changes in fair value of the security subsequent to its most recently recorded OTTI.

\*\* For initial other-than-temporary impairments in the respective period, the balance includes the portion of the excess of amortized cost over the fair value of the impaired securities that was recorded in OCI. For subsequent impairments of the same security, the balance includes additional changes in OCI for that security subsequent to its most recently recorded OTTI.

Provided in the table below are the cumulative credit-related losses recognized in earnings on debt securities other-than-temporarily impaired.

(In Millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Cumulative Credit-Related Losses on Securities Held Beginning of Period	\$ 12.7	\$ 8.8	\$ 8.8	\$ 42.3
Plus: Losses on Newly Identified Impairments			1.8	
Additional Losses on Previously Identified Impairments			2.1	
				(33.5)

Less: Current and Prior Period Losses on Securities Sold  
During the Period

Cumulative Credit-Related Losses on Securities Held	End of				
Period		\$ 12.7	\$ 8.8	\$ 12.7	\$ 8.8

## Notes to Consolidated Financial Statements (continued)

The table below provides information regarding debt securities held as of June 30, 2014 and December 31, 2013, for which an OTTI loss has been recognized in the current period or previously.

(In Millions)	June 30, 2014	December 31, 2013
Fair Value	\$ 46.9	\$ 38.3
Amortized Cost Basis	53.2	42.8
Noncredit-related Losses Recognized in OCI	(6.3)	(4.5)
Tax Effect	2.4	1.7
Amount Recorded in OCI	\$ (3.9)	\$ (2.8)

**5. Loans and Leases** Amounts outstanding for loans and leases, by segment and class, are shown below.

(In Millions)	June 30, 2014	December 31, 2013
<b>Commercial</b>		
Commercial and Institutional	\$ 8,042.6	\$ 7,375.8
Commercial Real Estate	3,075.5	2,955.8
Lease Financing, net	926.4	975.1
Non-U.S.	1,334.0	954.7
Other	612.9	358.6
<b>Total Commercial</b>	<b>13,991.4</b>	12,620.0
<b>Personal</b>		
Residential Real Estate	9,992.6	10,271.3
Private Client	6,630.5	6,445.6
Other	83.1	48.6
<b>Total Personal</b>	<b>16,706.2</b>	16,765.5
<b>Total Loans and Leases</b>	<b>30,697.6</b>	29,385.5
Allowance for Credit Losses Assigned to Loans and Leases	(275.2)	(278.1)
<b>Net Loans and Leases</b>	<b>\$ 30,422.4</b>	\$ 29,107.4

Residential real estate loans consist of conventional home mortgages and equity credit lines that generally require a loan to collateral value of no more than 65% to 80% at inception. Northern Trust's equity credit line products generally

have draw periods of up to 10 years and a balloon payment of any outstanding balance is due at maturity. Payments are interest only with variable interest rates. Northern Trust does not offer equity credit lines that include an option to convert the outstanding balance to an amortizing payment loan.

As of June 30, 2014 and December 31, 2013, equity credit lines totaled \$1.9 billion and \$2.0 billion, respectively, and equity credit lines for which first liens were held by Northern Trust represented 87% of the total equity credit lines as of those dates.

Included within the non-U.S., commercial-other, and personal-other classes are short duration advances primarily related to the processing of custodied client investments, that totaled \$1.9 billion at June 30, 2014 and \$1.3 billion at December 31, 2013. Demand

**Notes to Consolidated Financial Statements (continued)**

deposits reclassified as loan balances totaled \$83.9 million and \$104.1 million at June 30, 2014 and December 31, 2013, respectively. Loans classified as held for sale totaled \$9.5 million at June 30, 2014. There were no loans classified as held for sale at December 31, 2013.

**Credit Quality Indicators.** Credit quality indicators are statistics, measurements or other metrics that provide information regarding the relative credit risk of loans and leases. Northern Trust utilizes a variety of credit quality indicators to assess the credit risk of loans and leases at the segment, class, and individual credit exposure levels.

As part of its credit process, Northern Trust utilizes an internal borrower risk rating system to support identification, approval, and monitoring of credit risk. Borrower risk ratings are used in credit underwriting, management reporting, and the calculation of credit loss allowances and economic capital.

Risk ratings are used for ranking the credit risk of borrowers and the probability of their default. Each borrower is rated using one of a number of ratings models, which consider both quantitative and qualitative factors. The ratings models vary among classes of loans and leases in order to capture the unique risk characteristics inherent within each particular type of credit exposure. Provided below are the more significant performance indicator attributes considered within Northern Trust's borrower rating models, by loan and lease class.

Commercial and Institutional: leverage, profit margin, liquidity, return on assets, asset size, and capital levels;

Commercial Real Estate: debt service coverage and leasing status for income-producing properties; loan-to-value and loan-to-cost ratios, leasing status, and guarantor support for loans associated with construction and development properties;

Lease Financing and Commercial-Other: leverage and profit margin levels;

Non-U.S.: entity type, liquidity, size, and leverage;

Residential Real Estate: payment history, credit bureau scores, and cash flow-to-debt and net worth ratios;

Private Client: cash flow-to-debt and net worth ratios, leverage, and profit margin levels; and

Personal-Other: cash flow-to-debt and net worth ratios.

While the criteria vary by model, the objective is for the borrower ratings to be consistent in both the measurement and ranking of risk. Each model is calibrated to a master rating scale to support this consistency. Ratings for borrowers not in default range from 1 for the strongest credits to 7 for the weakest non-defaulted credits. Ratings of 8 or 9 are used for defaulted borrowers. Borrower risk ratings are monitored and are revised when events or

circumstances indicate a change is required. Risk ratings are validated at least annually.

## Notes to Consolidated Financial Statements (continued)

Loan and lease segment and class balances as of June 30, 2014 and December 31, 2013 are provided below, segregated by borrower ratings into 1 to 3 , 4 to 5 and 6 to 9 (watch list), categories.

(In Millions)	June 30, 2014				December 31, 2013			
	1 to 3 Category	4 to 5 Category	6 to 9 Category (Watch List)	Total	1 to 3 Category	4 to 5 Category	6 to 9 Category (Watch List)	Total
Commercial								
Commercial and Institutional	\$ 4,853.8	\$ 3,072.8	\$ 116.0	\$ 8,042.6	\$ 4,432.5	\$ 2,801.5	\$ 141.8	\$ 7,375.8
Commercial Real Estate	1,203.5	1,736.3	135.7	3,075.5	1,053.7	1,748.7	153.4	2,955.8
Lease Financing, net	504.1	418.0	4.3	926.4	685.7	285.0	4.4	975.1
Non-U.S.	588.6	744.4	1.0	1,334.0	442.8	511.9		954.7
Other	520.9	92.0		612.9	157.7	200.9		358.6
<b>Total Commercial</b>	<b>7,670.9</b>	<b>6,063.5</b>	<b>257.0</b>	<b>13,991.4</b>	<b>6,772.4</b>	<b>5,548.0</b>	<b>299.6</b>	<b>12,620.0</b>
Personal								
Residential Real Estate	3,075.4	6,452.4	464.8	9,992.6	3,204.6	6,563.6	503.1	10,271.3
Private Client	4,177.9	2,447.8	4.8	6,630.5	3,957.6	2,481.2	6.8	6,445.6
Other	70.6	12.5		83.1	21.2	27.4		48.6
<b>Total Personal</b>	<b>7,323.9</b>	<b>8,912.7</b>	<b>469.6</b>	<b>16,706.2</b>	<b>7,183.4</b>	<b>9,072.2</b>	<b>509.9</b>	<b>16,765.5</b>
<b>Total Loans and Leases</b>	<b>\$ 14,994.8</b>	<b>\$ 14,976.2</b>	<b>\$ 726.6</b>	<b>\$ 30,697.6</b>	<b>\$ 13,955.8</b>	<b>\$ 14,620.2</b>	<b>\$ 809.5</b>	<b>\$ 29,385.5</b>

Loans and leases in the 1 to 3 category are expected to exhibit minimal to modest probabilities of default and are characterized by borrowers having the strongest financial qualities, including above average financial flexibility, cash flows and capital levels. Borrowers assigned these ratings are anticipated to experience very little to moderate financial pressure in adverse down cycle scenarios. As a result of these characteristics, borrowers within this category exhibit a minimal to modest likelihood of loss.

Loans and leases in the 4 to 5 category are expected to exhibit moderate to acceptable probabilities of default and are characterized by borrowers with less financial flexibility than those in the 1 to 3 category. Cash flows and capital levels are generally sufficient to allow for borrowers to meet current requirements, but have reduced cushion in adverse down cycle scenarios. As a result of these characteristics, borrowers within this category exhibit a moderate likelihood of loss.



Loans and leases in the watch list category have elevated credit risk profiles that are monitored through internal watch lists, and consist of credits with borrower ratings of 6 to 9 . These credits, which include all nonperforming credits, are expected to exhibit minimally acceptable probabilities of default, elevated risk of default, or are currently in default. Borrowers associated with these risk profiles that are not currently in default have limited financial flexibility. Cash flows and capital levels range from acceptable to potentially insufficient to meet current requirements, particularly in adverse down cycle scenarios. As a result of these characteristics, borrowers in this category exhibit an elevated to probable likelihood of loss.

---

**Notes to Consolidated Financial Statements (continued)**

**Recognition of Income.** Interest income on loans is recorded on an accrual basis unless, in the opinion of management, there is a question as to the ability of the debtor to meet the terms of the loan agreement, or interest or principal is more than 90 days contractually past due and the loan is not well-secured and in the process of collection. At the time a loan is determined to be nonperforming, interest accrued but not collected is reversed against interest income of the current period and the loan is classified as nonperforming. Interest collected on nonperforming loans is applied to principal unless, in the opinion of management, collectability of principal is not in doubt. Management's assessment of the indicators of loan and lease collectability, and its policies relative to the recognition of interest income, including the suspension and subsequent resumption of income recognition, do not meaningfully vary between loan and lease classes. Nonperforming loans are returned to performing status when factors indicating doubtful collectability no longer exist. Factors considered in returning a loan to performing status are consistent across all classes of loans and leases and, in accordance with regulatory guidance, relate primarily to expected payment performance. Loans are eligible to be returned to performing status when: (i) no principal or interest that is due is unpaid and repayment of the remaining contractual principal and interest is expected or (ii) the loan has otherwise become well-secured (possessing realizable value sufficient to discharge the debt, including accrued interest, in full) and is in the process of collection (through action reasonably expected to result in debt repayment or restoration to a current status in the near future). A loan that has not been brought fully current may be restored to performing status provided there has been a sustained period of repayment performance (generally a minimum of six months) by the borrower in accordance with the contractual terms, and Northern Trust is reasonably assured of repayment within a reasonable period of time.

Additionally, a loan that has been formally restructured so as to be reasonably assured of repayment and performance according to its modified terms may be returned to accrual status, provided there was a well-documented credit evaluation of the borrower's financial condition and prospects of repayment under the revised terms and there has been a sustained period of repayment performance (generally a minimum of six months) under the revised terms.

## Notes to Consolidated Financial Statements (continued)

Past due status is based on how long since the contractual due date a principal or interest payment has been past due. For disclosure purposes, loans that are 29 days past due or less are reported as current. The following tables provide balances and delinquency status of performing and nonperforming loans and leases by segment and class, as well as the total other real estate owned and nonperforming asset balances, as of June 30, 2014 and December 31, 2013.

June 30, 2014

(In Millions)	Current	30-59 Days		60-89 Days	90 Days or More Past Due	Total Performing	Nonperforming	Total Loans and Leases
		Past Due	Past Due					
<b>Commercial</b>								
Commercial and Institutional	\$ 7,977.8	\$ 30.3	\$ 12.4	\$ 1.3	\$ 8,021.8	\$ 20.8	\$ 8,042.6	
Commercial Real Estate	3,012.9	9.6	5.7	1.9	3,030.1	45.4	3,075.5	
Lease Financing, net	926.4				926.4		926.4	
Non-U.S.	1,334.0				1,334.0		1,334.0	
Other	612.9				612.9		612.9	
<b>Total Commercial</b>	<b>13,864.0</b>	<b>39.9</b>	<b>18.1</b>	<b>3.2</b>	<b>13,925.2</b>	<b>66.2</b>	<b>13,991.4</b>	
<b>Personal</b>								
Residential Real Estate	9,802.6	12.4	11.1	4.8	9,830.9	161.7	9,992.6	
Private Client	6,564.1	44.3	15.6	5.1	6,629.1	1.4	6,630.5	
Other	83.1				83.1		83.1	
<b>Total Personal</b>	<b>16,449.8</b>	<b>56.7</b>	<b>26.7</b>	<b>9.9</b>	<b>16,543.1</b>	<b>163.1</b>	<b>16,706.2</b>	
<b>Total Loans and Leases</b>	<b>\$ 30,313.8</b>	<b>\$ 96.6</b>	<b>\$ 44.8</b>	<b>\$ 13.1</b>	<b>\$ 30,468.3</b>	<b>\$ 229.3</b>	<b>\$ 30,697.6</b>	
						Other Real Estate Owned	12.6	
						<b>Total Nonperforming Assets</b>	<b>\$ 241.9</b>	

December 31, 2013

(In Millions)	Current	30-59 Days		60-89 Days	90 Days or More Past Due	Total Performing	Nonperforming	Total Loans and Leases
		Past Due	Past Due					
<b>Commercial</b>								
Commercial and Institutional	\$ 7,332.3	\$ 5.0	\$ 12.1	\$ 3.3	\$ 7,352.7	\$ 23.1	\$ 7,375.8	
Commercial Real Estate	2,881.1	4.1	14.6	6.8	2,906.6	49.2	2,955.8	
Lease Financing, net	975.1				975.1		975.1	

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Non-U.S.	954.7				954.7		954.7
Other	358.6				358.6		358.6
<b>Total Commercial</b>	<b>12,501.8</b>	<b>9.1</b>	<b>26.7</b>	<b>10.1</b>	<b>12,547.7</b>	<b>72.3</b>	<b>12,620.0</b>
Personal							
Residential Real Estate	9,934.4	129.3	15.6	2.9	10,082.2	189.1	10,271.3
Private Client	6,404.2	29.1	7.5	3.4	6,444.2	1.4	6,445.6
Other	48.6				48.6		48.6
<b>Total Personal</b>	<b>16,387.2</b>	<b>158.4</b>	<b>23.1</b>	<b>6.3</b>	<b>16,575.0</b>	<b>190.5</b>	<b>16,765.5</b>
<b>Total Loans and Leases</b>	<b>\$ 28,889.0</b>	<b>\$ 167.5</b>	<b>\$ 49.8</b>	<b>\$ 16.4</b>	<b>\$ 29,122.7</b>	<b>\$ 262.8</b>	<b>\$ 29,385.5</b>
						Other Real Estate Owned	11.9
						<b>Total Nonperforming Assets</b>	<b>\$ 274.7</b>

## Notes to Consolidated Financial Statements (continued)

**Impaired Loans.** A loan is considered to be impaired when, based on current information and events, management determines that it is probable that Northern Trust will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is also considered to be impaired if its terms have been modified as a concession resulting from the debtor's financial difficulties, referred to as a troubled debt restructuring (TDR) and discussed in further detail below. Impairment is measured based upon the loan's market price, the present value of expected future cash flows, discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent. If the loan valuation is less than the recorded value of the loan, based on the certainty of loss, either a specific allowance is established or a charge-off is recorded for the difference. Smaller balance (individually less than \$250,000) homogeneous loans are collectively evaluated for impairment and excluded from impaired loan disclosures as allowed under applicable accounting standards. Northern Trust's accounting policies for impaired loans is consistent across all classes of loans and leases.

Impaired loans are identified through ongoing credit management and risk rating processes, including the formal review of past due and watch list credits. Payment performance and delinquency status are critical factors in identifying impairment for all loans and leases, particularly those within the residential real estate, private client and personal-other classes. Other key factors considered in identifying impairment of loans and leases within the commercial and institutional, non-U.S., lease financing, and commercial-other classes relate to the borrower's ability to perform under the terms of the obligation as measured through the assessment of future cash flows, including consideration of collateral value, market value, and other factors.

The following tables provide information related to impaired loans by segment and class.

(In Millions)	As of June 30, 2014			As of December 31, 2013		
	Recorded Investment	Unpaid Principal Balance	Specific Allowance	Recorded Investment	Unpaid Principal Balance	Specific Allowance
<b>With No Related Specific Allowance</b>						
Commercial and Institutional	\$ 12.6	\$ 15.3	\$	\$ 12.2	\$ 18.1	\$
Commercial Real Estate	49.7	57.1		46.6	57.1	
Lease Financing, net	4.3	4.3		4.4	4.4	
Residential Real Estate	177.9	225.8		185.0	227.8	
Private Client	0.4	0.4		0.8	0.8	
<b>With a Related Specific Allowance</b>						
Commercial and Institutional	7.7	7.8	3.7	9.6	12.1	3.6
Commercial Real Estate	15.7	21.6	3.9	26.7	31.5	4.5
Residential Real Estate	1.4	1.5	0.4	8.1	8.7	2.3
Private Client	0.9	0.9	0.5			
Total						
Commercial	90.0	106.1	7.6	99.5	123.2	8.1
Personal	180.6	228.6	0.9	193.9	237.3	2.3
<b>Total</b>	<b>\$ 270.6</b>	<b>\$ 334.7</b>	<b>\$ 8.5</b>	<b>\$ 293.4</b>	<b>\$ 360.5</b>	<b>\$ 10.4</b>



## Notes to Consolidated Financial Statements (continued)

	Three Months Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
(In Millions)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With No Related Specific Allowance								
Commercial and Institutional	\$ 10.6	\$	\$ 10.8	\$ 0.1	\$ 11.0	\$	\$ 11.5	\$ 0.1
Commercial Real Estate	44.7	0.2	40.3	0.2	44.8	0.5	40.0	0.4
Lease Financing, net	4.3		4.6	0.1	4.4	0.1	4.6	0.1
Residential Real Estate	181.2	0.7	156.6	0.6	185.2	1.3	148.7	1.1
Private Client	0.7		13.3	0.2	0.7		11.4	0.3
With a Related Specific Allowance								
Commercial and Institutional	9.7		12.5		9.9		11.7	
Commercial Real Estate	22.7		33.2		24.6		31.7	
Residential Real Estate	3.8		8.3		5.4		9.0	
Private Client	0.5		1.6		0.3		1.4	
Total								
Commercial	92.0	0.2	101.4	0.4	94.7	0.6	99.5	0.6
Personal	186.2	0.7	179.8	0.8	191.6	1.3	170.5	1.4
Total	\$ 278.2	\$ 0.9	\$ 281.2	\$ 1.2	\$ 286.3	\$ 1.9	\$ 270.0	\$ 2.0

Note: Average recorded investment in impaired loans is calculated as the average of the month-end impaired loan balances for the period.

Interest income that would have been recorded for nonperforming loans in accordance with their original terms was \$2.4 million and \$2.6 million, respectively, for the three months ended June 30, 2014 and 2013, and \$4.9 million and \$5.2 million, respectively, for the six months ended June 30, 2014 and 2013.

There were \$1.5 million and \$3.4 million of aggregate undrawn loan commitments and standby letters of credit at June 30, 2014 and December 31, 2013, respectively, issued to borrowers whose loans were classified as nonperforming or impaired.

**Troubled Debt Restructurings (TDRs).** Included within impaired loans were \$62.8 million and \$72.7 million of nonperforming TDRs, and \$91.9 million and \$89.8 million of performing TDRs as of June 30, 2014 and December 31, 2013, respectively. All TDRs are reported as impaired loans in the calendar year of their restructuring. In subsequent years, a TDR may cease being reported as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months. A loan that has been modified at a below market rate will return to performing status if it satisfies the six month performance requirement; however, it will remain reported as impaired.





## Notes to Consolidated Financial Statements (continued)

The following tables provide, by segment and class, the number of loans and leases modified in TDRs during the three and six month periods ended June 30, 2014 and 2013, and the recorded investments and unpaid principal balances as of June 30, 2014 and 2013.

(\$ In Millions)	Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
	Number of Loans and Leases	Recorded Investment	Unpaid Principal Balance	Number of Loans and Leases	Recorded Investment	Unpaid Principal Balance
<b>Commercial</b>						
Commercial and Institutional	2	\$ 0.7	\$ 1.0	2	\$ 0.7	\$ 1.0
Commercial Real Estate Lease Financing, net				1	0.7	0.7
<b>Total Commercial</b>	<b>2</b>	<b>0.7</b>	<b>1.0</b>	<b>3</b>	<b>1.4</b>	<b>1.7</b>
<b>Personal</b>						
Residential Real Estate	34	4.9	5.7	68	8.4	9.4
Private Client	2	0.3	0.3	3	0.3	0.3
<b>Total Personal</b>	<b>36</b>	<b>5.2</b>	<b>6.0</b>	<b>71</b>	<b>8.7</b>	<b>9.7</b>
<b>Total Loans and Leases</b>	<b>38</b>	<b>\$ 5.9</b>	<b>\$ 7.0</b>	<b>74</b>	<b>\$ 10.1</b>	<b>\$ 11.4</b>

Note: Period end balances reflect all paydowns and charge-offs during the period.

(\$ In Millions)	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Number of Loans and Leases	Recorded Investment	Unpaid Principal Balance	Number of Loans and Leases	Recorded Investment	Unpaid Principal Balance
<b>Commercial</b>						
Commercial and Institutional		\$	\$	7	\$ 0.5	\$ 1.0
Commercial Real Estate	3	4.7	6.9	4	4.7	7.0
<b>Total Commercial</b>	<b>3</b>	<b>4.7</b>	<b>6.9</b>	<b>11</b>	<b>5.2</b>	<b>8.0</b>
<b>Personal</b>						
Residential Real Estate	36	5.3	6.9	84	45.0	48.5
Private Client	1			6	12.8	12.8

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Total Personal	37	5.3	6.9	90	57.8	61.3
Total Loans and Leases	40	\$ 10.0	\$ 13.8	101	\$ 63.0	\$ 69.3

*Note: Period end balances reflect all paydowns and charge-offs during the period.*

TDR modifications involve interest rate concessions, extensions of term, deferrals of principal, and other modifications. Other modifications typically reflect other nonstandard terms which Northern Trust would not offer in non-troubled situations.

During the three and six months ended June 30, 2014, the majority of TDR modifications of loans within the commercial real estate, residential real estate, and private client classes were extensions of term. During the three and six months ended June 30, 2013, TDR modifications of loans within the commercial and institutional, commercial real estate, and private client classes were primarily deferrals of principal; extensions of term, and other modifications, and modifications of loans within the residential real estate class were primarily deferrals of principal, interest rate concessions, extensions of term, and other modifications.

**Notes to Consolidated Financial Statements (continued)**

There were three residential real estate loans modified as TDRs in the 12 months ended March 31, 2014 which subsequently became nonperforming during the three and six months ended June 30, 2014. The total recorded investment and unpaid principal balance for these loans were \$487.4 thousand and \$862.7 thousand, respectively. There was one private client loan modified as a TDR in the 12 months ended March 31, 2014 which subsequently became nonperforming during the three and six months ended June 30, 2014. The total recorded investment and unpaid principal balance for this loan was \$5 thousand.

There were no loans or leases modified in TDRs in the 12 months ended March 31, 2013 which subsequently became nonperforming during the three or six months ended June 30, 2013.

All loans and leases modified in troubled debt restructurings are evaluated for impairment. The nature and extent of impairment of TDRs, including those that have experienced a subsequent default, is considered in the determination of an appropriate level of allowance for credit losses.

**6. Allowance for Credit Losses** The allowance for credit losses, which represents management's estimate of probable losses related to specific borrower relationships and inherent in the various loan and lease portfolios, undrawn commitments, and standby letters of credit, is determined by management through a disciplined credit review process. Northern Trust's accounting policies related to the estimation of the allowance for credit losses and the charging off of loans, leases and other extensions of credit deemed uncollectible are consistent across both loan and lease segments.

In establishing the inherent portion of the allowance for credit losses, Northern Trust's Loan Loss Allowance Committee assesses a common set of qualitative factors applicable to both the commercial and personal loan segments. The risk characteristics underlying these qualitative factors, and management's assessments as to the relative importance of a qualitative factor, can vary between loan segments and between classes within loan segments. Factors evaluated include those related to external matters, such as economic conditions and changes in collateral value, and those related to internal matters, such as changes in asset quality metrics and loan review activities. In addition to the factors noted above, risk characteristics such as portfolio delinquencies, percentage of portfolio on the watch list and on nonperforming status, and average borrower ratings are assessed in the determination of the inherent allowance.

Loan-to-value levels are considered for collateral-secured loans and leases in both the personal and commercial segments. Borrower debt service coverage is evaluated in the personal segment, and cash flow coverage is analyzed in the commercial segment.

Similar risk characteristics by type of exposure are analyzed when determining the allowance for undrawn commitments and standby letters of credit. These qualitative factors, together with historical loss rates, serve as the basis for the allowance for credit losses.

## Notes to Consolidated Financial Statements (continued)

Loans, leases and other extensions of credit deemed uncollectible are charged to the allowance for credit losses. Subsequent recoveries, if any, are credited to the allowance. Determinations as to whether an uncollectible loan is charged-off or a specific allowance is established are based on management's assessment as to the level of certainty regarding the amount of loss.

The following tables provide information regarding changes in the total allowance for credit losses by segment during the three and six months ended June 30, 2014 and 2013.

(In Millions)	Three Months Ended June 30,					
	2014			2013		
	Commercial	Personal	Total	Commercial	Personal	Total
Balance at Beginning of Period	\$ 173.1	\$ 136.3	\$ 309.4	\$ 187.1	\$ 136.7	\$ 323.8
Charge-Offs	(2.1)	(5.7)	(7.8)	(4.3)	(11.3)	(15.6)
Recoveries	0.3	1.6	1.9	4.6	2.9	7.5
Net (Charge-Offs) Recoveries	(1.8)	(4.1)	(5.9)	0.3	(8.4)	(8.1)
Provision for Credit Losses	(2.6)	2.6		(3.3)	8.3	5.0
Effect of Foreign Exchange Rates						
Balance at End of Period	\$ 168.7	\$ 134.8	\$ 303.5	\$ 184.1	\$ 136.6	\$ 320.7

(In Millions)	Six Months Ended June 30,					
	2014			2013		
	Commercial	Personal	Total	Commercial	Personal	Total
Balance at Beginning of Period	\$ 168.0	\$ 139.9	\$ 307.9	\$ 194.2	\$ 133.4	\$ 327.6
Charge-Offs	(6.3)	(13.0)	(19.3)	(5.2)	(23.0)	(28.2)
Recoveries	8.8	3.1	11.9	6.4	5.0	11.4
Net (Charge-Offs) Recoveries	2.5	(9.9)	(7.4)	1.2	(18.0)	(16.8)
Provision for Credit Losses	(1.8)	4.8	3.0	(11.2)	21.2	10.0
Effect of Foreign Exchange Rates				(0.1)		(0.1)
Balance at End of Period	\$ 168.7	\$ 134.8	\$ 303.5	\$ 184.1	\$ 136.6	\$ 320.7

The following table provides information regarding the balances of the recorded investments in loans and leases and the allowance for credit losses by segment as of June 30, 2014 and December 31, 2013.

(In Millions)	June 30, 2014			December 31, 2013		
	Commercial	Personal	Total	Commercial	Personal	Total
<b>Loans and Leases</b>	\$ 90.0	\$ 180.6	\$ 270.6	\$ 99.5	\$ 193.9	\$ 293.4

Specifically Evaluated for Impairment						
Evaluated for Inherent Impairment	<b>13,901.4</b>	<b>16,525.6</b>	<b>30,427.0</b>	<b>12,520.5</b>	16,571.6	29,092.1
Total Loans and Leases	<b>13,991.4</b>	<b>16,706.2</b>	<b>30,697.6</b>	<b>12,620.0</b>	16,765.5	29,385.5
<b>Allowance for Loans and Leases</b>						
Specifically Evaluated for Impairment	<b>7.6</b>	<b>0.9</b>	<b>8.5</b>	<b>8.1</b>	2.3	10.4
Evaluated for Inherent Impairment	<b>135.8</b>	<b>130.9</b>	<b>266.7</b>	<b>132.8</b>	134.9	267.7
Allowance Assigned to Loans and Leases	<b>143.4</b>	<b>131.8</b>	<b>275.2</b>	<b>140.9</b>	137.2	278.1
<b>Allowance for Unfunded Exposures</b>						
Commitments and Standby Letters of Credit	<b>25.3</b>	<b>3.0</b>	<b>28.3</b>	<b>27.1</b>	2.7	29.8
Total Allowance for Credit Losses	<b>\$ 168.7</b>	<b>\$ 134.8</b>	<b>\$ 303.5</b>	<b>\$ 168.0</b>	\$ 139.9	\$ 307.9

**7. Pledged Assets** Certain of Northern Trust's subsidiaries, as required or permitted by law, pledge assets to secure public and trust deposits; repurchase agreements; Federal Home Loan Bank borrowings; and for other purposes, including support for securities settlement, primarily related to client activities, and for potential Federal

**Notes to Consolidated Financial Statements (continued)**

Reserve Bank discount window borrowings. At June 30, 2014, securities and loans totaling \$32.1 billion (\$22.9 billion of government sponsored agency and other securities, \$157.3 million of obligations of states and political subdivisions, and \$9.0 billion of loans) were pledged. This compares to \$32.4 billion (\$22.6 billion of government sponsored agency and other securities, \$222.7 million of obligations of states and political subdivisions, and \$9.6 billion of loans) at December 31, 2013. Collateral required for these purposes totaled \$3.5 billion and \$5.0 billion at June 30, 2014 and December 31, 2013, respectively. Included in the total pledged assets at June 30, 2014 and December 31, 2013 were available for sale securities with a total fair value of \$922.3 million and \$915.3 million, respectively, which were pledged as collateral for agreements to repurchase securities sold transactions. The secured parties to these transactions have the right to repledge or sell these securities.

Northern Trust is not permitted, by contract or custom, to repledge or sell collateral from agreements to resell securities purchased transactions. The total fair value of accepted collateral as of June 30, 2014 and December 31, 2013 was \$500.0 million. There was no repledged or sold collateral at June 30, 2014 or December 31, 2013. Deposits maintained to meet Federal Reserve Bank reserve requirements averaged \$1.3 billion and \$1.2 billion for the three and six months ended June 30, 2014, respectively, and \$0.9 billion for both the three and six months ended June 30, 2013.

**8. Goodwill and Other Intangibles** The carrying amounts of goodwill, reflecting the effect of foreign exchange rates on non-U.S. dollar denominated balances, by business unit at June 30, 2014 and December 31, 2013 were as follows:

(In Millions)	June 30, 2014	December 31, 2013
Corporate & Institutional Services	\$ 473.0	\$ 469.2
Wealth Management	71.6	71.5
<b>Total Goodwill</b>	<b>\$ 544.6</b>	<b>\$ 540.7</b>

The gross carrying amount and accumulated amortization of other intangible assets subject to amortization as of June 30, 2014 and December 31, 2013 were as follows:

(In Millions)	June 30, 2014	December 31, 2013
Gross Carrying Amount	\$ 199.7	\$ 198.2
Less: Accumulated Amortization	126.7	115.2
<b>Net Book Value</b>	<b>\$ 73.0</b>	<b>\$ 83.0</b>

Other intangible assets consist primarily of the value of acquired client relationships and are included within other assets on the consolidated balance sheet. Amortization expense related to other intangible assets totaled \$5.0 million and \$9.9 million for the three and six months ended June 30, 2014, respectively, and \$5.1 million and \$10.3 million for the three and six months ended June 30, 2013, respectively. Amortization for the remainder of 2014 and for the years 2015, 2016, 2017, and 2018 is estimated to be \$9.9 million, \$11.9 million, \$9.3 million, \$9.2 million and \$8.6 million, respectively.



## Notes to Consolidated Financial Statements (continued)

**9. Business Units** The following tables show the earnings contributions of Northern Trust's business units for the three and six month periods ended June 30, 2014 and 2013.

**Three Months Ended**

June 30, (In Millions)	Corporate & Institutional Services		Wealth Management		Treasury and Other		Total Consolidated	
	2014	2013	2014	2013	2014	2013	2014	2013
Noninterest Income								
Trust, Investment and Other Servicing Fees	\$ 395.4	\$ 364.2	\$ 311.5	\$ 293.1	\$	\$	\$ 706.9	\$ 657.3
Foreign Exchange Trading Income	50.7	69.8	2.2	1.5			52.9	71.3
Other Noninterest Income	47.1	45.6	23.1	24.3	5.1	1.9	75.3	71.8
Total Interest Income (FTE)*	76.7	66.0	132.6	141.2	44.1	20.8	253.4	228.0
Revenue*	569.9	545.6	469.4	460.1	49.2	22.7	1,088.5	1,028.4
Provision for Credit Losses	2.4	1.2	(2.4)	3.8				5.0
Noninterest Expense	446.4	396.0	329.4	301.8	35.2	31.9	811.0	729.7
Income (loss) before Income Taxes*	121.1	148.4	142.4	154.5	14.0	(9.2)	277.5	293.7
Provision (Benefit) for Income Taxes*	36.1	48.3	53.6	58.0	5.9	(3.7)	95.6	102.6
<b>Net Income</b>	<b>\$ 85.0</b>	<b>\$ 100.1</b>	<b>\$ 88.8</b>	<b>\$ 96.5</b>	<b>\$ 8.1</b>	<b>\$ (5.5)</b>	<b>\$ 181.9</b>	<b>\$ 191.1</b>
Percentage of Consolidated Net Income	47%	52%	49%	51%	4%	-3%	100%	100%
Average Assets	\$ 59,995.2	\$ 51,976.0	\$ 22,210.8	\$ 22,803.8	\$ 21,118.1	\$ 18,069.8	\$ 103,324.1	\$ 92,849.6

\* Stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of \$6.8 million for 2014 and \$7.9 million for 2013.

**Six Months Ended**

June 30, (In Millions)	Corporate & Institutional Services		Wealth Management		Treasury and Other		Total Consolidated	
	2014	2013	2014	2013	2014	2013	2014	2013
Noninterest Income								



Trust, Investment and Other Servicing Fees	\$ 774.6	\$ 712.9	\$ 611.8	\$ 575.1	\$	\$	\$ 1,386.4	\$ 1,288.0
Foreign Exchange								
Trading Income	98.8	128.0	4.2	2.8			103.0	130.8
Other Noninterest Income	91.5	85.8	45.8	41.5	3.2	4.6	140.5	131.9
Net Interest Income (FTE)*	150.4	130.1	267.6	289.0	89.8	42.6	507.8	461.7
Revenue*	1,115.3	1,056.8	929.4	908.4	93.0	47.2	2,137.7	2,012.4
Provision for Credit Losses	3.6	(1.5)	(0.6)	11.5			3.0	10.0
Noninterest Expense	869.9	794.7	648.2	603.6	60.9	60.3	1,579.0	1,458.6
Income (loss) before Income Taxes*	241.8	263.6	281.8	293.3	32.1	(13.1)	555.7	543.8
Provision (Benefit) for Income Taxes*	70.9	84.2	106.2	110.8	15.3	(6.3)	192.4	188.7
<b>Net Income</b>	<b>\$ 170.9</b>	<b>\$ 179.4</b>	<b>\$ 175.6</b>	<b>\$ 182.5</b>	<b>\$ 16.8</b>	<b>\$ (6.8)</b>	<b>\$ 363.3</b>	<b>\$ 355.1</b>
Percentage of Consolidated Net Income	47%	51%	48%	51%	5%	-2%	100%	100%
Average Assets	\$ 58,631.4	\$ 51,648.2	\$ 22,368.8	\$ 22,832.4	20,792.1	\$ 17,732.4	\$ 101,792.3	\$ 92,213.0

\* Stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of \$15.5 million for both 2014 and 2013.

Further discussion of business unit results is provided within the Business Unit Reporting section of Management's Discussion and Analysis of Financial Condition and Results of Operations.

## Notes to Consolidated Financial Statements (continued)

**10. Accumulated Other Comprehensive Income (Loss)** The following tables summarize the components of accumulated other comprehensive income (loss) at June 30, 2014 and 2013, and changes during the three and six month periods then ended.

(In Millions)	Balance at December 31, 2013	Net Change	Balance at June 30, 2014
Net Unrealized Gains (Losses) on Securities Available for Sale	\$ 6.0	\$ 38.0	\$ 44.0
Net Unrealized Gains (Losses) on Cash Flow Hedges	2.9	1.0	3.9
Net Foreign Currency Adjustments	7.1	(6.9)	0.2
Net Pension and Other Postretirement Benefit Adjustments	(260.3)	7.0	(253.3)
<b>Total</b>	<b>\$ (244.3)</b>	<b>\$ 39.1</b>	<b>\$ (205.2)</b>

(In Millions)	Balance at December 31, 2012	Net Change	Balance at June 30, 2013
Net Unrealized Gains (Losses) on Securities Available for Sale	\$ 101.0	\$ (80.2)	\$ 20.8
Net Unrealized Gains (Losses) on Cash Flow Hedges	(1.4)	(3.1)	(4.5)
Net Foreign Currency Adjustments	10.5	1.6	12.1
Net Pension and Other Postretirement Benefit Adjustments	(393.1)	14.0	(379.1)
<b>Total</b>	<b>\$ (283.0)</b>	<b>\$ (67.7)</b>	<b>\$ (350.7)</b>

(In Millions)	Three Months Ended June 30,					
	2014			2013		
	Before Tax	Tax Effect	After Tax	Before Tax	Tax Effect	After Tax
<b>Unrealized Gains (Losses) on Securities Available for Sale</b>						
Noncredit-Related Unrealized Losses on Securities OTTI	\$ (3.3)	\$ 1.3	\$ (2.0)	\$	\$	\$
Other Unrealized Gains (Losses) on Securities Available for Sale	57.3	(21.4)	35.9	(130.7)	49.2	(81.5)
Reclassification Adjustment for (Gains) Losses Included in Net Income	(0.4)		(0.4)			

<b>Net Change</b>	<b>53.6</b>	<b>(20.1)</b>	<b>33.5</b>	<b>(130.7)</b>	<b>49.2</b>	<b>(81.5)</b>
<b>Unrealized Gains (Losses) on Cash Flow Hedges</b>						
Unrealized Gains (Losses) on Cash Flow Hedges	<b>(1.3)</b>	<b>0.6</b>	<b>(0.7)</b>	<b>(0.1)</b>	<b>0.4</b>	<b>0.3</b>
Reclassification Adjustment for (Gains) Losses Included in Net Income	<b>0.2</b>	<b>(0.1)</b>	<b>0.1</b>	<b>2.8</b>	<b>(1.0)</b>	<b>1.8</b>
<b>Net Change</b>	<b>(1.1)</b>	<b>0.5</b>	<b>(0.6)</b>	<b>2.7</b>	<b>(0.6)</b>	<b>2.1</b>
<b>Foreign Currency Adjustments</b>						
Foreign Currency Translation Adjustments	<b>13.4</b>	<b>0.1</b>	<b>13.5</b>	<b>6.7</b>	<b>1.2</b>	<b>7.9</b>
Long-Term Intra-Entity Foreign Currency Transaction Losses	<b>(1.0)</b>		<b>(1.0)</b>			
Net Investment Hedge Gains (Losses)	<b>(29.6)</b>	<b>11.5</b>	<b>(18.1)</b>	<b>(3.3)</b>	<b>1.2</b>	<b>(2.1)</b>
Reclassification Adjustment for (Gains) Losses Included in Net Income						
<b>Net Change</b>	<b>(17.2)</b>	<b>11.6</b>	<b>(5.6)</b>	<b>3.4</b>	<b>2.4</b>	<b>5.8</b>
<b>Pension and Other Postretirement Benefit Adjustments</b>						
Net Actuarial Gain (Loss)						
Reclassification Adjustment for (Gains) Losses Included in Net Income	<b>6.1</b>	<b>(2.5)</b>	<b>3.6</b>	<b>11.2</b>	<b>(4.2)</b>	<b>7.0</b>
<b>Net Change</b>	<b>\$ 6.1</b>	<b>\$ (2.5)</b>	<b>\$ 3.6</b>	<b>\$ 11.2</b>	<b>\$ (4.2)</b>	<b>\$ 7.0</b>

## Notes to Consolidated Financial Statements (continued)

(In Millions)	Six Months Ended June 30,					
	2014			2013		
	Before Tax	Tax Effect	After Tax	Before Tax	Tax Effect	After Tax
<b>Unrealized Gains (Losses) on Securities Available for Sale</b>						
Noncredit-Related Unrealized Losses on Securities OTTI	\$ (1.8)	\$ 0.7	\$ (1.1)	\$ 2.1	\$ (0.8)	\$ 1.3
Other Unrealized Gains (Losses) on Securities Available for Sale	63.0	(23.6)	39.4	(130.5)	49.1	(81.4)
Reclassification Adjustment for (Gains) Losses Included in Net Income	(0.3)		(0.3)	(0.2)	0.1	(0.1)
<b>Net Change</b>	<b>60.9</b>	<b>(22.9)</b>	<b>38.0</b>	<b>(128.6)</b>	<b>48.4</b>	<b>(80.2)</b>
<b>Unrealized Gains (Losses) on Cash Flow Hedges</b>						
Unrealized Gains (Losses) on Cash Flow Hedges	1.1	(0.3)	0.8	(9.3)	3.3	(6.0)
Reclassification Adjustment for (Gains) Losses Included in Net Income	0.4	(0.2)	0.2	4.6	(1.7)	2.9
<b>Net Change</b>	<b>1.5</b>	<b>(0.5)</b>	<b>1.0</b>	<b>(4.7)</b>	<b>1.6</b>	<b>(3.1)</b>
<b>Foreign Currency Adjustments</b>						
Foreign Currency Translation Adjustments	19.9	(0.6)	19.3	(49.7)	1.7	(48.0)
Long-Term Intra-Entity Foreign Currency Transaction Losses	(1.6)		(1.6)			
Net Investment Hedge Gains (Losses)	(40.2)	15.6	(24.6)	79.5	(29.9)	49.6
Reclassification Adjustment for (Gains) Losses Included in Net Income						
<b>Net Change</b>	<b>(21.9)</b>	<b>15.0</b>	<b>(6.9)</b>	<b>29.8</b>	<b>(28.2)</b>	<b>1.6</b>
<b>Pension and Other Postretirement Benefit Adjustments</b>						
Net Actuarial Gain (Loss)						
Reclassification Adjustment for (Gains) Losses Included in Net Income	12.5	(5.5)	7.0	22.4	(8.4)	14.0
<b>Net Change</b>	<b>\$ 12.5</b>	<b>\$ (5.5)</b>	<b>\$ 7.0</b>	<b>\$ 22.4</b>	<b>\$ (8.4)</b>	<b>\$ 14.0</b>

The following table provides the location and before-tax amounts of reclassifications out of accumulated other comprehensive income (loss) during the three and six months ended June 30, 2014.

(In Millions)	Location of Reclassification Adjustments Recognized in Income	Amount of Reclassification Adjustments Recognized	
		in Income	
		Three Months Ended June 30, 2014	Six Months Ended
<b>Securities Available for Sale</b>			
Realized (Gains) Losses on Securities Available for Sale	Investment Security Gains (Losses), net	\$ (0.4)	\$ (0.3)
<b>Realized (Gains) Losses on Cash Flow Hedges</b>			
Foreign Exchange Contracts	Other Operating Income/ Expense	0.2	0.4
<b>Pension and Other Postretirement Benefit Adjustments</b>			
Amortization of Net Actuarial (Gain) Loss	Employee Benefits	(0.4)	(0.8)
Amortization of Prior Service Cost	Employee Benefits	6.5	13.3
Gross Reclassification Adjustment		\$ 6.1	\$ 12.5

## Notes to Consolidated Financial Statements (continued)

**11. Net Income Per Common Share Computations** The computations of net income per common share are presented in the following table.

(\$ In Millions Except Per Common Share Information)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<b>Basic Net Income Per Common Share</b>				
Average Number of Common Shares Outstanding	<b>236,012,703</b>	239,738,592	<b>236,607,125</b>	239,454,653
Net Income Applicable to Common Stock	<b>\$ 181.9</b>	\$ 191.1	<b>\$ 363.3</b>	\$ 355.1
Less: Earnings Allocated to Participating Securities	<b>3.1</b>	3.2	<b>6.0</b>	5.6
<b>Earnings Allocated to Common Shares Outstanding</b>	<b>178.8</b>	187.9	<b>357.3</b>	349.5
<b>Basic Net Income Per Common Share</b>	<b>0.76</b>	0.78	<b>1.51</b>	1.46
<b>Diluted Net Income Per Common Share</b>				
Average Number of Common Shares Outstanding	<b>236,012,703</b>	239,738,592	<b>236,607,125</b>	239,454,653
Plus: Dilutive Effect of Share-based Compensation	<b>1,740,976</b>	1,302,089	<b>1,791,489</b>	1,162,647
<b>Average Common and Potential Common Shares</b>	<b>237,753,679</b>	241,040,681	<b>238,398,614</b>	240,617,300
<b>Earnings Allocated to Common and Potential Common Shares</b>	<b>\$ 178.8</b>	\$ 187.9	<b>\$ 357.3</b>	\$ 349.5
<b>Diluted Net Income Per Common Share</b>	<b>0.75</b>	0.78	<b>1.50</b>	1.45

*Note: Common stock equivalents totaling 1,981,304 and 1,980,947 for the three and six months ended June 30, 2014, respectively, and 3,432,897 and 4,008,871 for the three and six months ended June 30, 2013, respectively, were not included in the computation of diluted net income per common share because their inclusion would have been antidilutive.*

**12. Net Interest Income** The components of net interest income were as follows:

(In Millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<b>Interest Income</b>				
Loans and Leases	<b>\$ 185.8</b>	\$ 185.5	<b>\$ 368.7</b>	\$ 373.1
Securities Taxable	<b>63.5</b>	48.5	<b>132.9</b>	106.7
Non-Taxable	<b>1.8</b>	3.0	<b>4.1</b>	6.3
Interest-Bearing Deposits with Banks	<b>33.6</b>	34.5	<b>65.7</b>	69.5
Federal Reserve Deposits and Other	<b>9.1</b>	3.8	<b>17.8</b>	6.4

Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Total Interest Income	<b>293.8</b>	275.3	<b>589.2</b>	562.0
Interest Expense				
Deposits	<b>22.4</b>	25.0	<b>42.5</b>	54.1
Federal Funds Purchased	<b>0.3</b>	0.3	<b>0.6</b>	0.7
Securities Sold Under Agreements to Repurchase	<b>0.1</b>	0.1	<b>0.2</b>	0.2
Other Borrowings	<b>0.8</b>	1.0	<b>1.5</b>	1.6
Senior Notes	<b>13.7</b>	19.3	<b>31.2</b>	38.5
Long-Term Debt	<b>9.4</b>	8.9	<b>19.8</b>	19.5
Floating Rate Capital Debt	<b>0.5</b>	0.6	<b>1.1</b>	1.2
Total Interest Expense	<b>47.2</b>	55.2	<b>96.9</b>	115.8
Net Interest Income	<b>\$ 246.6</b>	\$ 220.1	<b>\$ 492.3</b>	\$ 446.2

**13. Income Taxes** Income tax expense for the three and six months ended June 30, 2014 of \$88.8 million and \$176.9 million, respectively, was recorded, representing an effective tax rate of 32.8% for both the three and six months then ended. The prior year three and six month provisions for income taxes were \$94.7 million and \$173.2 million, representing an effective tax rate of 33.1% and 32.8%, respectively.

## Notes to Consolidated Financial Statements (continued)

**14. Pension and Other Postretirement Plans** The following tables set forth the net periodic pension and postretirement benefit expense for Northern Trust's U.S. and non-U.S. pension plans, supplemental pension plan, and other postretirement plan for the three and six months ended June 30, 2014 and 2013.

## Net Periodic Pension Expense

<b>U.S. Plan</b> (In Millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Service Cost	\$ 8.2	\$ 7.6	\$ 16.4	\$ 15.2
Interest Cost	11.1	10.6	22.2	21.1
Expected Return on Plan Assets Amortization	(24.5)	(23.0)	(48.9)	(46.1)
Net Actuarial Loss	(0.1)	10.2	(0.2)	20.6
Prior Service Cost	5.3	(0.1)	10.7	(0.2)
Net Periodic Pension Expense	\$	\$ 5.3	\$ 0.2	\$ 10.6

## Net Periodic Pension Expense (Benefit)

<b>Non U.S. Plans</b> (In Millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest Cost	\$ 1.8	\$ 1.6	\$ 3.5	\$ 3.3
Expected Return on Plan Assets	(1.8)	(1.6)	(3.5)	(3.1)
Net Actuarial Loss Amortization	(0.4)	0.4	(0.8)	0.5
Net Periodic Pension Expense (Benefit)	\$ (0.4)	\$ 0.4	\$ (0.8)	\$ 0.7

## Net Periodic Pension Expense

<b>Supplemental Plan</b> (In Millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Service Cost	\$ 0.7	\$ 0.4	\$ 1.5	\$ 0.8
Interest Cost	1.2	1.1	2.4	2.2
Amortization				
Net Actuarial Loss	0.1	1.7	0.2	3.4
Prior Service Cost	1.4	0.1	2.9	0.2
Net Periodic Pension Expense	\$ 3.4	\$ 3.3	\$ 7.0	\$ 6.6



Edgar Filing: NORTHERN TRUST CORP - Form 10-Q

Net Periodic Postretirement Expense (Benefit)

<b>Other Postretirement Plan</b> (In Millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Service Cost	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.1
Interest Cost	0.3	0.3	0.7	0.6
Amortization				
Net Actuarial Gain		(0.3)		(0.6)
Prior Service Cost	(0.2)	(0.8)	(0.3)	(1.5)
Net Periodic Postretirement Expense (Benefit)	\$ 0.2	\$ (0.7)	\$ 0.5	\$ (1.4)

**Notes to Consolidated Financial Statements (continued)**

**15. Share-Based Compensation Plans** The Northern Trust Corporation 2012 Stock Plan provides for the grant of nonqualified stock options, incentive stock options, stock appreciation rights, stock awards, restricted stock units, and performance stock units.

Total compensation expense for share-based payment arrangements and the associated tax impacts were as follows for the three and six months ended June 30, 2014 and 2013.

(In Millions)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Restricted Stock Unit Awards	\$ 14.9	\$ 11.9	\$ 29.0	\$ 24.3
Stock Options	2.1	4.3	8.5	11.2
Performance Stock Units	3.2	2.1	5.8	3.3
Total Share-Based Compensation Expense	20.2	18.3	43.3	38.8
Tax Benefits Recognized	\$ 7.5	\$ 6.8	\$ 16.2	\$ 14.5

**16. Variable Interest Entities** Variable Interest Entities (VIEs) are defined within GAAP as entities that either have a total equity investment that is insufficient to permit the entity to finance its activities without additional subordinated financial support or whose equity investors lack the characteristics of a controlling financial interest. Investors that finance a VIE through debt or equity interests, or other counterparties that provide other forms of support, such as guarantees, subordinated fee arrangements, or certain types of derivative contracts, are variable interest holders in the entity. The variable interest holder, if any, that has both the power to direct the activities that most significantly impact the entity and a variable interest that could potentially be significant to the entity is deemed to be the VIE's primary beneficiary and is required to consolidate the VIE.

**Leveraged Leases.** In leveraged leasing transactions, Northern Trust acts as lessor of the underlying asset subject to the lease and typically funds 20-30% of the asset's cost via an equity ownership in a trust with the remaining 70-80% provided by third party non-recourse debt holders. In such transactions, the trusts, which are VIEs, are created to provide the lessee use of the property with substantially all of the rights and obligations of ownership. The lessee's maintenance and operation of the leased property has a direct effect on the fair value of the underlying property, and the lessee also has the ability to increase the benefits it can receive and limit the losses it can suffer by the manner in which it uses the property. As a result, Northern Trust has determined that it is not the primary beneficiary of these VIEs given it lacks the power to direct the activities that most significantly impact the economic performance of the VIEs.

Northern Trust's maximum exposure to loss as a result of its involvement with the leveraged lease trust VIEs is limited to the carrying amounts of its leveraged lease investments. As of June 30, 2014 and December 31, 2013, the carrying amounts of these investments, which are included in loans and leases in the consolidated balance sheet, were \$595.4 million and \$671.2 million, respectively. Northern Trust's funding requirements relative to the VIEs are limited to its invested capital. Northern Trust has no other liquidity arrangements or obligations to purchase assets of the VIEs that would expose Northern Trust to a loss.



---

**Notes to Consolidated Financial Statements (continued)**

**Tax Credit Structures.** Northern Trust invests in qualified affordable housing projects and community development entities (collectively, community development projects) that are designed to generate a return primarily through the realization of tax credits. These community development projects are formed as limited partnerships and LLCs in which Northern Trust invests as a limited partner/investor member through equity contributions. The economic performance of the community development projects, which are VIEs, is subject to the performance of their underlying investments and their ability to operate in compliance with the rules and regulations necessary for the qualification of tax credits generated by equity investments. Northern Trust has determined that it is not the primary beneficiary of any community development project as it lacks the power to direct the activities that most significantly impact the economic performance of the underlying investments or to affect their ability to operate in compliance with the rules and regulations necessary for the qualification of tax credits generated by equity investments. This power is held by the general partners and managing members who exercise full and exclusive control of the operations of the VIEs.

Northern Trust's maximum exposure to loss as a result of its involvement with community development projects is limited to the carrying amount of its investments, including any unfunded commitments. As of June 30, 2014 and December 31, 2013, the carrying amount of investments in community development projects that generate tax credits, included in other assets in the consolidated balance sheet, totaled \$204.2 million and \$222.3 million, respectively. As of June 30, 2014 and December 31, 2013, liabilities related to unfunded commitments on investments in tax credit community development projects, included in other liabilities in the consolidated balance sheet, totaled \$19.0 million and \$19.8 million, respectively. Northern Trust's funding requirements are limited to its invested capital and unfunded commitments for future equity contributions. Northern Trust has no exposure to loss from liquidity arrangements and no obligation to purchase assets of the community development projects.

Affordable housing tax credits and other tax benefits attributable to community development projects totaled \$13.9 million and \$28.7 million for the three and six months ended June 30, 2014.

**Trust Preferred Securities.** In 1997, Northern Trust issued Floating Rate Capital Securities, Series A and Series B, through NTC Capital I and NTC Capital II, respectively, statutory business trusts wholly-owned by the Corporation. The sole assets of the trusts are Subordinated Debentures of the Corporation that have the same interest rates and maturity dates as the corresponding distribution rates and redemption dates of the Floating Rate Capital Securities. NTC Capital I and NTC Capital II are considered VIEs; however, as the sole asset of each trust is a receivable from the Corporation and proceeds to the Corporation from the receivable exceed the Corporation's investment in the VIEs equity shares, the Corporation is not permitted to consolidate the trusts, even though the Corporation owns all of the voting equity shares of the trusts, has fully guaranteed the trusts' obligations, and has the right to redeem the preferred securities in certain circumstances. Northern Trust recognizes the subordinated debentures on its consolidated balance sheet as long-term liabilities.

---

**Notes to Consolidated Financial Statements (continued)**

**Investment Funds.** Northern Trust acts as asset manager for various funds in which clients of Northern Trust are investors. As an asset manager of funds, the Corporation earns a competitively priced fee that is based on assets managed and varies with each fund's investment objective. Based on its analysis, Northern Trust has determined that it is not the primary beneficiary of these VIEs under GAAP.

**17. Contingent Liabilities – Standby Letters of Credit and Indemnifications.** Standby letters of credit obligate Northern Trust to meet certain financial obligations of its clients, if, under the contractual terms of the agreement, the clients are unable to do so. These instruments are primarily issued to support public and private financial commitments, including commercial paper, bond financing, initial margin requirements on futures exchanges, and similar transactions. Northern Trust is obligated to meet the entire financial obligation of these agreements and in certain cases is able to recover the amounts paid through recourse against collateral received or other participants. Standby letters of credit outstanding were \$4.4 billion at June 30, 2014 and \$4.5 billion at December 31, 2013.

As part of its securities custody activities and at the direction of its clients, Northern Trust lends securities owned by clients to borrowers who are reviewed and approved by the Northern Trust Senior Credit Committee. In connection with these activities, Northern Trust has issued indemnifications to certain clients against certain losses that are a direct result of a borrower's failure to return securities when due, should the value of such securities exceed the value of the collateral required to be posted. Borrowers are required to collateralize fully securities received with cash or marketable securities. As securities are loaned, collateral is maintained at a minimum of 100% of the fair value of the securities plus accrued interest. The collateral is revalued on a daily basis. The amount of securities loaned subject to indemnification was \$94.7 billion at June 30, 2014 and \$82.7 billion at December 31, 2013. Because of the credit quality of the borrowers and the requirement to collateralize fully securities borrowed, management believes that the exposure to credit loss from this activity is not significant and no liability was recorded at June 30, 2014 or December 31, 2013 related to these indemnifications.

**Legal Proceedings.** In the normal course of business, the Corporation and its subsidiaries are routinely defendants in or parties to a number of pending and threatened legal actions, including, but not limited to, actions brought on behalf of various claimants or classes of claimants, regulatory matters, employment matters, and challenges from tax authorities regarding the amount of taxes due. In certain of these actions and proceedings, claims for substantial monetary damages or adjustments to recorded tax liabilities are asserted.

Based on current knowledge, after consultation with legal counsel and after taking into account current accruals, management does not believe that losses, if any, arising from pending litigation or threatened legal actions or regulatory matters will have a material adverse effect on the consolidated financial position or liquidity of the Corporation, although such matters could have a material adverse effect on the Corporation's operating results for a particular period.

**Notes to Consolidated Financial Statements (continued)**

Under GAAP, (i) an event is *probable* if the future event or events are likely to occur ; (ii) an event is *reasonably possible* if the chance of the future event or events occurring is more than remote but less than likely ; and (iii) an event is *remote* if the chance of the future event or events occurring is slight . Thus, references to the upper end of the range of reasonably possible loss for matters in which the Corporation is able to estimate a range of reasonably possible loss mean the upper end of the range of loss for matters for which the Corporation believes the risk of loss is more than remote but less than likely.

For the reasons set out in this paragraph, the outcome of some matters is inherently difficult to predict and/or the range of loss cannot be reasonably estimated. This may be the case in matters that (i) will be decided by a jury, (ii) are in early stages, (iii) involve uncertainty as to the likelihood of a class being certified or the ultimate size of the class, (iv) are subject to appeals or motions, (v) involve significant factual issues to be resolved, including with respect to the amount of damages, (vi) do not specify the amount of damages sought, or (vii) seek very large damages based on novel and complex damage and liability legal theories. Accordingly, the Corporation cannot reasonably estimate the eventual outcome of these pending matters, the timing of their ultimate resolution, or what the eventual loss, fines or penalties, if any, related to each pending matter will be.

In accordance with applicable accounting guidance, the Corporation records accruals for litigation and regulatory matters when those matters present loss contingencies that are both probable and reasonably estimable. When loss contingencies are not both probable and reasonably estimable, the Corporation does not record accruals. No material accruals have been recorded for pending litigation or threatened legal actions or regulatory matters.

For a limited number of the matters for which a loss is reasonably possible in future periods, whether in excess of an accrued liability or where there is no accrued liability, the Corporation is able to estimate a range of possible loss. As of June 30, 2014, the Corporation has estimated the upper end of the range of reasonably possible losses for these matters to be approximately \$130 million in the aggregate. This aggregate amount of reasonably possible loss is based upon currently available information and is subject to significant judgment and a variety of assumptions, and known and unknown uncertainties. The matters underlying the estimated range will change from time to time, and actual results will vary significantly from the current estimate.

In certain other pending matters, there may be a range of reasonably possible losses (including reasonably possible losses in excess of amounts accrued) that cannot be reasonably estimated for the reasons described above. Such matters are not included in the estimate of reasonably possible losses identified above.

As previously disclosed, a number of participants in our securities lending program, which is associated with the Corporation's asset servicing business, have commenced either individual lawsuits or purported class actions in which they claim, among other things, that we failed to exercise prudence in the investment management of the collateral received from the borrowers of the securities, resulting in losses that they seek to recover. The cases assert various contractual, statutory and common law claims, including claims for

---

**Notes to Consolidated Financial Statements (continued)**

breach of fiduciary duty under common law and under the Employee Retirement Income Security Act (ERISA). In the fourth quarter of 2013, Northern Trust recorded a \$19.2 million pre-tax charge in connection with an agreement to resolve claims related to two of these lawsuits. The settlement is not final as it requires further documentation, signed agreements and court approval. Other lawsuits related to securities lending are not part of the proposed settlement, and remain pending.

In April 2014, Northern Trust received a subpoena from the U.S. Securities and Exchange Commission (SEC) seeking documents related to Northern Trust's securities lending activities. Northern Trust is cooperating with the SEC in this investigation.

**Visa Membership.** Northern Trust, as a member of Visa U.S.A. Inc. (Visa U.S.A.) and in connection with the 2007 initial public offering of Visa Inc. (Visa), received shares of restricted stock in Visa, a portion of which was redeemed pursuant to a mandatory redemption. The proceeds of the redemption totaled \$167.9 million and were recorded as a gain in 2008. The remaining Visa shares held by Northern Trust are recorded at their original cost basis of zero and as of June 30, 2014 had restrictions as to their sale or transfer.

Northern Trust is obligated to indemnify Visa for losses resulting from certain indemnified litigation involving Visa and has been required to recognize, at its estimated fair value in accordance with GAAP, a guarantee liability arising from such litigation that has not yet settled.

During 2007, Northern Trust recorded charges and corresponding liabilities of \$150 million relating to Visa indemnified litigation. Subsequently, Visa established an escrow account to cover the settlements of, or judgments in, indemnified litigation. The fundings by Visa of its escrow account have resulted in reductions of Northern Trust's Visa related indemnification liability and of the future realization of the value of outstanding shares of Visa common stock held by Northern Trust as a member bank of Visa U.S.A. Reductions of Northern Trust's indemnification liability totaling \$23.1 million, \$33.0 million, and \$17.8 million were recorded in 2011, 2010, and 2009, respectively, which combined with a \$76.1 million reduction recorded in 2008, fully eliminated the recorded indemnification liability as of December 31, 2011.

On October 19, 2012, Visa signed a settlement agreement with plaintiff representatives for binding settlement of the indemnified litigation relating to interchange fees. On January 14, 2014, the trial court entered a final judgment order approving the settlement with the class plaintiffs, which is subject to appeal. A number of objectors have appealed from that order and more than 30 opt-out cases have been filed by merchants in various federal district courts. While the ultimate resolution of outstanding Visa related litigation and the timing for removal of selling restrictions on shares owned by Northern Trust are highly uncertain, Northern Trust anticipates that the value of its remaining shares of Visa stock will be adequate to offset any remaining indemnification obligations related to Visa litigation.

---

**Notes to Consolidated Financial Statements (continued)**

**Contingent Purchase Consideration.** In connection with an acquisition consummated in 2011, contingent consideration was recorded relating to certain performance-related purchase price adjustments. The fair value of the contingent consideration was \$55.4 million at December 31, 2013. In April 2014, Northern Trust made a payment of \$55.3 million to extinguish the contingent consideration liability at the value agreed by the parties.

**18. Derivative Financial Instruments** Northern Trust is a party to various derivative financial instruments that are used in the normal course of business to meet the needs of its clients; as part of its trading activity for its own account; and as part of its risk management activities. These instruments include foreign exchange contracts, interest rate contracts, and credit default swap contracts.

Northern Trust's primary risks associated with these instruments is the possibility that interest rates, foreign exchange rates, or credit spreads could change in an unanticipated manner, resulting in higher costs or a loss in the underlying value of the instrument. These risks are mitigated by establishing limits, monitoring the level of actual positions taken against such established limits, and monitoring the level of any interest rate sensitivity gaps created by such positions. When establishing position limits, market liquidity and volatility, as well as experience in each market, are taken into account.

Credit risk associated with derivative instruments relates to the failure of the counterparty to pay based on the contractual terms of the agreement, and is generally limited to the unrealized fair value gains or losses on these instruments, net of any cash collateral received or deposited. The amount of credit risk will increase or decrease during the lives of the instruments as interest rates, foreign exchange rates, or credit spreads fluctuate. Northern Trust's risk is controlled by limiting such activity to an approved list of counterparties and by subjecting such activity to the same credit and quality controls as are followed in lending and investment activities. Credit Support Annexes and other similar agreements are currently in place with a number of Northern Trust's counterparties which mitigate the aforementioned credit risk associated with derivative activity conducted with those counterparties by requiring that significant net unrealized fair value gains be supported by collateral placed with Northern Trust.

All derivative financial instruments, whether designated as hedges or not, are recorded in the consolidated balance sheet at fair value within other assets or other liabilities. As noted in the discussions below, the manner in which changes in the fair value of a derivative is accounted for in the consolidated statement of income depends on whether the contract has been designated as a hedge and qualifies for hedge accounting under GAAP. Northern Trust has elected to net derivative assets and liabilities when legally enforceable master netting arrangements or similar agreements exist between Northern Trust and the counterparty. Derivative assets and liabilities recorded in the consolidated balance sheet were each reduced by \$0.9 billion as of June 30, 2014 and by \$1.2 billion as of December 31, 2013, as a result of master netting arrangements and similar agreements in place. Derivative assets and liabilities recorded at June 30, 2014 also reflect reductions of \$552.0 million and \$581.1 million, respectively, as a result of cash collateral received from and deposited with derivative counterparties, respectively. This



---

**Notes to Consolidated Financial Statements (continued)**

compares with reductions of derivative assets and liabilities of \$210.7 million and \$767.7 million, respectively, at December 31, 2013. Additional cash collateral received from and deposited with derivative counterparties totaling \$102.9 million and \$2.1 million, respectively, as of June 30, 2014, and \$36.4 million and \$39.3 million, respectively, as of December 31, 2013, were not offset against derivative assets and liabilities on the consolidated balance sheet as the amounts exceeded the net derivative positions with those counterparties. Northern Trust centrally clears interest rate derivative instruments that are addressed under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Securities posted as collateral for these transactions totaled \$27.5 million and \$27.6 million at June 30, 2014 and December 31, 2013, respectively, are not offset against derivative assets and liabilities on the consolidated balance sheet, and the counterparty receiving the securities as collateral does not have the right to repledge or sell the securities.

Certain master netting arrangements Northern Trust enters into with derivative counterparties contain credit risk-related contingent features in which the counterparty has the option to declare Northern Trust in default and accelerate cash settlement of net derivative liabilities with the counterparty in the event Northern Trust's credit rating falls below specified levels. The aggregate fair value of all derivative instruments with credit risk-related contingent features that were in a liability position was \$577.6 million and \$257.3 million at June 30, 2014 and December 31, 2013, respectively. Cash collateral amounts deposited with derivative counterparties on those dates included \$554.3 million and \$197.0 million, respectively, posted against these liabilities, resulting in a net maximum amount of termination payments that could have been required at June 30, 2014 and December 31, 2013 of \$23.3 million and \$60.3 million, respectively. Accelerated settlement of these liabilities would not have a material effect on the consolidated financial position or liquidity of Northern Trust.

**Foreign exchange contracts** are agreements to exchange specific amounts of currencies at a future date, at a specified rate of exchange. Foreign exchange contracts are entered into primarily to meet the foreign exchange needs of clients. Foreign exchange contracts are also used for trading purposes and risk management. For risk management purposes, Northern Trust uses foreign exchange contracts to reduce its exposure to changes in foreign exchange rates relating to certain forecasted non-functional currency denominated revenue and expenditure transactions, foreign currency denominated assets and liabilities, and net investments in non-U.S. affiliates.

**Interest rate contracts** include swap and option contracts. Interest rate swap contracts involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal amounts. Northern Trust enters into interest rate swap contracts on behalf of its clients and also may utilize such contracts to reduce or eliminate the exposure to changes in the cash flows or fair value of hedged assets or liabilities due to changes in interest rates. Interest rate option contracts may include caps, floors, and swaptions, and provide for the transfer or reduction of interest rate risk in exchange for a fee. Northern Trust enters into option contracts primarily as a seller of interest rate protection to clients. Northern Trust receives a fee at the outset of the agreement for the assumption of the risk of an unfavorable change in interest rates. This

**Notes to Consolidated Financial Statements (continued)**

assumed interest rate risk is then mitigated by entering into an offsetting position with an outside counterparty. Northern Trust may also purchase option contracts for risk management purposes.

**Credit default swap contracts** are agreements to transfer credit default risk from one party to another in exchange for a fee. Northern Trust enters into credit default swaps with outside counterparties where the counterparty agrees to assume the underlying credit exposure of a specific Northern Trust commercial loan or loan commitment.

**Client-Related and Trading Derivative Instruments.** Approximately 97% of Northern Trust's derivatives outstanding at June 30, 2014 and December 31, 2013, measured on a notional value basis, relate to client-related and trading activities. These activities consist principally of providing foreign exchange services to clients in connection with Northern Trust's global custody business. However, in the normal course of business, Northern Trust also engages in trading of currencies for its own account.

The following table shows the notional and fair values of client-related and trading derivative financial instruments. Notional amounts of derivative financial instruments do not represent credit risk, and are not recorded in the consolidated balance sheet. They are used merely to express the volume of this activity. Northern Trust's credit-related risk of loss is limited to the positive fair value of the derivative instrument, which is significantly less than the notional amount.

(In Millions)	June 30, 2014			December 31, 2013		
	Notional Value	Fair Value		Notional Value	Fair Value	
		Asset	Liability		Asset	Liability
Foreign Exchange Contracts	\$ 260,014.8	\$ 1,784.3	\$ 1,787.1	\$ 243,135.0	\$ 2,844.7	\$ 2,846.2
Interest Rate Contracts	5,178.3	115.8	111.0	5,001.7	122.8	117.0
<b>Total</b>	<b>\$ 265,193.1</b>	<b>\$ 1,900.1</b>	<b>\$ 1,898.1</b>	<b>\$ 248,136.7</b>	<b>\$ 2,967.5</b>	<b>\$ 2,963.2</b>

Changes in the fair value of client-related and trading derivative instruments are recognized currently in income. The following table shows the location and amount of gains and losses recorded in the consolidated statement of income for the three and six months ended June 30, 2014 and 2013.

(In Millions)	Location of Derivative Gain/(Loss) Recognized in Income	Amount of Derivative Gain/(Loss) Recognized in Income			
		Three Months Ended		Six Months Ended	
		June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Foreign Exchange Contracts	Foreign Exchange Trading Income	\$ 52.9	\$ 71.3	\$ 103.0	\$ 130.8
Interest Rate Contracts	Security Commissions and Trading Income	2.1	3.8	4.0	7.0
<b>Total</b>		<b>\$ 55.0</b>	<b>\$ 75.1</b>	<b>\$ 107.0</b>	<b>\$ 137.8</b>

**Risk Management Instruments.** Northern Trust uses derivative instruments to hedge its exposure to foreign currency, interest rate, and credit risk. Certain hedging relationships are formally designated and qualify for hedge accounting under GAAP as fair value, cash flow, or net investment hedges. Other derivatives that are entered into for risk management purposes as economic hedges are not formally designated as hedges and

**Notes to Consolidated Financial Statements (continued)**

changes in fair value are recognized currently in other operating income.

In order to qualify for hedge accounting, a formal assessment is performed on a calendar quarter basis to verify that derivatives used in designated hedging transactions continue to be highly effective in offsetting the changes in fair value or cash flows of the hedged item. If a derivative ceases to be highly effective, matures, is sold, or is terminated, or if a hedged forecasted transaction is no longer probable of occurring, hedge accounting is terminated and the derivative is treated as if it were a trading instrument.

The following table identifies the types and classifications of derivative instruments formally designated as hedges under GAAP and used by Northern Trust to manage risk, their notional and fair values, and the respective risks addressed.

(In Millions)	Derivative Instrument	Risk Classification	June 30, 2014			December 31, 2013		
			Notional Value	Fair Value Asset	Fair Value Liability	Notional Value	Fair Value Asset	Fair Value Liability
<b>Fair Value Hedges</b>								
Available for Sale Investment Securities	Interest Rate Swap Contracts	Interest Rate	\$ 3,114.3	\$ 17.2	\$ 39.5	\$ 3,296.9	\$ 31.5	\$ 44.8
Senior Notes and Subordinated Debt	Interest Rate Swap Contracts	Interest Rate	1,250.0	90.7	2.0	1,250.0	83.6	33.4
<b>Cash Flow Hedges</b>								
Forecasted Foreign Currency Denominated Transactions	Foreign Exchange Contracts	Foreign Currency	333.2	9.5	3.2	314.0	10.2	5.5
Available for Sale Investment Securities	Interest Rate Swap Contracts	Interest Rate	10.0					
<b>Net Investment Hedges</b>								
Net Investments in Non-U.S. Affiliates	Foreign Exchange Contracts	Foreign Currency	1,733.9	1.6	39.9	1,684.9	9.8	52.8
<b>Total</b>			<b>\$ 6,441.4</b>	<b>\$ 119.0</b>	<b>\$ 84.6</b>	<b>\$ 6,545.8</b>	<b>\$ 135.1</b>	<b>\$ 136.5</b>

In addition to the above, Sterling denominated debt, totaling \$260.7 million and \$259.1 million at June 30, 2014 and December 31, 2013, respectively, was designated as a hedge of the foreign exchange risk associated with the net investment in certain non-U.S. affiliates.

## Notes to Consolidated Financial Statements (continued)

Derivatives are designated as fair value hedges to limit Northern Trust's exposure to changes in the fair value of assets and liabilities due to movements in interest rates. For a fair value hedge, changes in the fair value of the derivative instrument and changes in the fair value of the hedged asset or liability attributable to the hedged risk are recorded currently in income. The following table shows the location and amount of derivative gains and losses recorded in the consolidated statement of income related to fair value hedges for the three and six months ended June 30, 2014 and 2013.

(In Millions)	Derivative Instrument	Location of Derivative Gain/(Loss) Recognized in Income	Amount of Derivative Gain/(Loss) Recognized in Income			
			Three Months Ended June 30, 2014	June 30, 2013	Six Months Ended June 30, 2014	June 30, 2013
Available for Sale Investment Securities	Interest Rate Swap Contracts	Interest Income	\$ (14.9)	\$ 34.6	\$ (27.0)	\$ 38.0
Senior Notes and Long-Term Subordinated Debt	Interest Rate Swap Contracts	Interest Expense	27.7	(11.8)	60.2	(12.5)
<b>Total</b>			<b>\$ 12.8</b>	<b>\$ 22.8</b>	<b>\$ 33.2</b>	<b>\$ 25.5</b>

Northern Trust applies the shortcut method of accounting, available under GAAP, to substantially all of its fair value hedges, which assumes there is no ineffectiveness in a hedge. As a result, changes recorded in the fair value of the hedged item are equal to the offsetting gain or loss on the derivative and are reflected in the same line item as the gain or loss. For fair value hedges that do not qualify for the shortcut method of accounting, Northern Trust utilizes regression analysis, a long-haul method of accounting, in assessing whether the hedging relationships are highly effective at inception and on an ongoing basis. There was no ineffectiveness or changes in the fair value of hedged items recognized in earnings for fair value hedges during the three and six months ended June 30, 2014. There were losses of \$0.3 million and \$0.6 million recorded within the fair values of hedged items for such long-haul hedges during the three and six months ended June 30, 2013, respectively. There were losses of \$0.3 million and \$0.5 million from ineffectiveness recorded during the three and six months ended June 30, 2013, respectively, in connection with the hedging of available for sale investment securities, senior notes, and subordinated debt. Ineffectiveness resulting from fair value hedges is recorded in either interest income or interest expense.

Derivatives are also designated as cash flow hedges in order to minimize the variability in cash flows of earning assets or forecasted transactions caused by movements in interest or foreign exchange rates. The effective portion of changes in the fair value of such derivatives is recognized in AOCI, a component of stockholders' equity, and there is no change in the accounting for the hedged item. When the hedged forecasted transaction impacts earnings, balances in AOCI are reclassified to earnings. Northern Trust applies the shortcut method of accounting for cash flow hedges of available for sale investment securities. For cash flow hedges of forecasted foreign currency denominated revenue and expenditure transactions, Northern Trust closely matches all terms of the hedged item and the hedging derivative at inception and on an ongoing basis.

**Notes to Consolidated Financial Statements (continued)**

which limits hedge ineffectiveness. To the extent all terms are not perfectly matched, effectiveness is assessed using the dollar-offset method and any ineffectiveness is measured using the hypothetical derivative method. There was no ineffectiveness recognized in earnings for cash flow hedges during the three and six months ended June 30, 2014 and 2013. As of June 30, 2014, 23 months is the maximum length of time over which the exposure to variability in future cash flows of forecasted foreign currency denominated transactions is being hedged.

The following tables provide cash flow hedge derivative gains and losses recognized in AOCI and the amounts reclassified to earnings during the three and six months ended June 30, 2014 and 2013.

(In Millions)	Foreign Exchange Contracts (Before Tax)	
	2014	2013
<b>Three Months Ended June 30,</b>		
Net Gain/(Loss) Recognized in AOCI	\$ (1.3)	\$ (0.1)
Net Gain/(Loss) Reclassified from AOCI to Earnings		
Other Operating Income	1.9	(1.0)
Interest Income		
Other Operating Expense		(1.8)
Total	\$ 1.9	\$ (2.8)

(In Millions)	Foreign Exchange Contracts (Before Tax)	
	2014	2013
<b>Six Months Ended June 30,</b>		
Net Gain/(Loss) Recognized in AOCI	\$ 1.1	\$ (9.3)
Net Gain/(Loss) Reclassified from AOCI to Earnings		
Other Operating Income	2.7	(1.7)
Interest Income		
Other Operating Expense	(0.2)	(2.9)
Total	\$ 2.5	\$ (4.6)

During the three and six months ended June 30, 2014 and 2013, there were no transactions discontinued due to the original forecasted transactions no longer being probable of occurring. It is estimated that a net gain of \$5.3 million will be reclassified into earnings within the next twelve months relating to cash flow hedges.

Certain foreign exchange contracts and qualifying nonderivative instruments are designated as net investment hedges to minimize Northern Trust's exposure to variability in the foreign currency translation of net investments in non-U.S. branches and subsidiaries. The effective portion of changes in the fair value of the hedging instrument is recognized in AOCI consistent with the related translation gains and losses of the hedged net investment. For net investment hedges, all critical terms of the hedged item and the hedging instrument are matched at inception and on an ongoing basis to

minimize the risk of hedge ineffectiveness. To the extent all terms are not perfectly matched, any ineffectiveness is measured using the hypothetical derivative method. Ineffectiveness resulting from net investment hedges is recorded in other operating income. There was



## Notes to Consolidated Financial Statements (continued)

no ineffectiveness recorded during the three and six months ended June 30, 2014 and 2013. Amounts recorded in AOCI are reclassified to earnings only upon the sale or liquidation of an investment in a non-U.S. branch or subsidiary.

The following table provides net investment hedge gains and losses recognized in AOCI during the three and six months ended June 30, 2014 and 2013.

(In Millions)	Hedging Gain/(Loss) Recognized in OCI (Before Tax)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Foreign Exchange Contracts	\$ (22.9)	\$ (2.0)	\$ (31.9)	\$ 64.3
Sterling Denominated Subordinated Debt	(6.7)	(1.3)	(8.3)	15.2
<b>Total</b>	<b>\$ (29.6)</b>	<b>\$ (3.3)</b>	<b>\$ (40.2)</b>	<b>\$ 79.5</b>

Derivatives that are not formally designated as hedges under GAAP are entered into for risk management purposes. Foreign exchange contracts are entered into to manage the foreign currency risk of non-U.S. dollar denominated assets and liabilities, the net investment in certain non-U.S. affiliates, commercial loans, and forecasted foreign currency denominated transactions. Credit default swaps are entered into to manage the credit risk associated with certain loans and loan commitments. The following table identifies the types of risk management derivative instruments not formally designated as hedges and their notional amounts and fair values.

(In Millions)	June 30, 2014			December 31, 2013		
	Notional Value	Fair Value		Notional Value	Fair Value	
		Asset	Liability		Asset	Liability
Foreign Exchange Contracts	\$ 183.9	\$ 1.5	\$ 0.6	\$ 168.8	\$ 1.0	\$ 1.2

Changes in the fair value of derivative instruments not formally designated as hedges are recognized currently in income. The following table provides the location and amount of gains and losses recorded in the consolidated statement of income for the three and six months ended June 30, 2014 and 2013.

(In Millions)	Location of Derivative Gain/ (Loss) Recognized in Income	Amount of Derivative Gain/(Loss) Recognized in Income			
		Three Months Ended		Six Months Ended	
		June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Credit Default Swap Contracts	Other Operating Income	\$	\$	\$	\$ (0.1)
Foreign Exchange Contracts	Other Operating Income	1.5	(1.6)	0.8	(4.5)
<b>Total</b>		<b>\$ 1.5</b>	<b>\$ (1.6)</b>	<b>\$ 0.8</b>	<b>\$ (4.6)</b>



## Notes to Consolidated Financial Statements (continued)

## 19. Offsetting of Assets and Liabilities

The following tables provide information regarding the offsetting of derivative assets and securities purchased under agreements to resell within the consolidated balance sheet as of June 30, 2014 and December 31, 2013.

June 30, 2014

(In Millions)	Gross Recognized Assets	Gross Amounts Offset	Net Amounts Presented	Gross Amounts Not Offset	Net Amount (3)
<b>Derivative Assets (1)</b>					
Foreign Exchange Contracts Over the Counter (OTC)	\$ 1,513.4	\$ 790.2	\$ 723.2	\$	\$ 723.2
Interest Rate Swaps OTC	205.1	38.6	166.5		166.5
Interest Rate Swaps Exchange Cleared	18.6	9.1	9.5		9.5
Cross Product Netting Adjustment		68.8			
Cross Product Collateral Adjustment		552.0			
<b>Total Derivatives Subject to a Master Netting Arrangement</b>	<b>1,737.1</b>	<b>1,458.7</b>	<b>278.4</b>		<b>278.4</b>
<b>Total Derivatives Not Subject to a Master Netting Arrangement</b>	<b>283.5</b>		<b>283.5</b>		<b>283.5</b>
<b>Total Derivatives</b>	<b>2,020.6</b>	<b>1,458.7</b>	<b>561.9</b>		<b>561.9</b>
Securities Purchased under Agreements to Resell (2)	\$ 500.0	\$	\$ 500.0	\$ 500.0	\$

December 31, 2013

(In Millions)	Gross Recognized Assets	Gross Amounts Offset	Net Amounts Presented	Gross Amounts Not Offset	Net Amount (3)
<b>Derivative Assets (1)</b>					
Foreign Exchange Contracts OTC	\$ 2,612.5	\$ 1,073.3	\$ 1,539.2	\$	\$ 1,539.2
Interest Rate Swaps OTC	228.8	47.5	181.3		181.3
Interest Rate Swaps Exchange Cleared	9.1	9.1			
Cross Product Netting Adjustment		28.4			
Cross Product Collateral Adjustment		210.7			
<b>Total Derivatives Subject to a Master Netting Arrangement</b>	<b>2,850.4</b>	<b>1,369.0</b>	<b>1,481.4</b>		<b>1,481.4</b>
	253.2		253.2		253.2

## Total Derivatives Not Subject to a Master Netting Arrangement

Total Derivatives	3,103.6	1,369.0	1,734.6	1,734.6
Securities Purchased under Agreements to Resell (2)	\$ 500.0	\$	\$ 500.0	\$ 500.0

- (1) *Derivative assets are reported in other assets in the consolidated balance sheet. Other assets (excluding derivative assets) totaled \$3,308.3 million and \$3,029.4 million as of June 30, 2014 and December 31, 2013, respectively.*
- (2) *Securities purchased under agreements to resell are reported in federal funds sold and securities purchased under agreements to resell in the consolidated balance sheet. Federal funds sold totaled \$79.5 million and \$29.6 million as of June 30, 2014 and December 31, 2013, respectively.*
- (3) *Northern Trust did not possess any cash collateral that was not offset in the consolidated balance sheet that could have been used to offset the net amounts presented in the consolidated balance sheet as of June 30, 2014 and December 31, 2013.*

## Notes to Consolidated Financial Statements (continued)

The following tables provide information regarding the offsetting of derivative liabilities and securities sold under agreements to repurchase within the consolidated balance sheet as of June 30, 2014 and December 31, 2013.

June 30, 2014

(In Millions)	Gross Recognized Liabilities	Gross Amounts Offset	Net Amounts Presented	Gross Amounts Not Offset	Net Amount (2)
<b>Derivative Liabilities (1)</b>					
Foreign Exchange Contracts OTC	\$ 1,493.0	\$ 790.2	\$ 702.8	\$	\$ 702.8
Interest Rate Swaps OTC	143.4	38.6	104.8		104.8
Interest Rate Swaps Exchange Cleared	9.1	9.1			
Cross Product Netting Adjustment		68.8			
Cross Product Collateral Adjustment		581.1			
<b>Total Derivatives Subject to a Master Netting Arrangement</b>	<b>1,645.5</b>	<b>1,487.8</b>	<b>157.7</b>		<b>157.7</b>
<b>Total Derivatives Not Subject to a Master Netting Arrangement</b>	<b>337.8</b>		<b>337.8</b>		<b>337.8</b>
<b>Total Derivatives</b>	<b>1,983.3</b>	<b>1,487.8</b>	<b>495.5</b>		<b>495.5</b>
<b>Securities Sold under Agreements to Repurchase</b>	<b>\$ 919.6</b>	<b>\$</b>	<b>\$ 919.6</b>	<b>\$ 919.6</b>	<b>\$</b>

December 31, 2013

(In Millions)	Gross Recognized Liabilities	Gross Amounts Offset	Net Amounts Presented	Gross Amounts Not Offset	Net Amount (2)
<b>Derivative Liabilities (1)</b>					
Foreign Exchange Contracts OTC	\$ 2,039.0	\$ 1,073.3	\$ 965.7	\$	\$ 965.7
Interest Rate Swaps OTC	163.7	47.5	116.2		116.2
Interest Rate Swaps Exchange Cleared	31.5	9.1	22.4		22.4
Cross Product Netting Adjustment		28.4			
Cross Product Collateral Adjustment		767.7			
<b>Total Derivatives Subject to a Master Netting Arrangement</b>	<b>2,234.2</b>	<b>1,926.0</b>	<b>308.2</b>		<b>308.2</b>
<b>Total Derivatives Not Subject to a Master Netting Arrangement</b>	<b>866.7</b>		<b>866.7</b>		<b>866.7</b>
<b>Total Derivatives</b>	<b>3,100.9</b>	<b>1,926.0</b>	<b>1,174.9</b>		<b>1,174.9</b>

Securities Sold under Agreements to Repurchase	\$	917.3	\$	\$	917.3	\$	917.3	\$
--	----	-------	----	----	-------	----	-------	----

- (1) *Derivative liabilities are reported in other liabilities in the consolidated balance sheet. Other liabilities (excluding derivative liabilities) totaled \$2,893.4 million and \$2,338.4 million as of June 30, 2014 and December 31, 2013, respectively.*
- (2) *Northern Trust did not place any cash collateral with counterparties that was not offset in the consolidated balance sheet that could have been used to offset the net amounts presented in the consolidated balance sheet as of June 30, 2014 and December 31, 2013.*

All of Northern Trust's securities sold under agreements to repurchase (repurchase agreements) and securities purchased under agreements to resell (reverse repurchase agreements) involve the transfer of financial assets in exchange for cash subject to a right and obligation to repurchase those assets for an agreed upon amount. In the event of a repurchase failure, the cash or financial assets are available for offset. All of Northern Trust's repurchase agreements and reverse repurchase agreements are subject to a master netting arrangement, which sets forth the rights and obligations for repurchase and offset. Under the master netting arrangement, Northern Trust is entitled to set off receivables from and collateral placed with a single counterparty against obligations owed to that counterparty. In addition, collateral held by Northern Trust can be offset against receivables from that counterparty.

**Notes to Consolidated Financial Statements (continued)**

Derivative asset and liability positions with a single counterparty can be offset against each other in cases where legally enforceable master netting arrangements or similar agreements exist. Derivative assets and liabilities can be further offset by cash collateral received from, and deposited with, the transacting counterparty. The basis for this view is that, upon termination of transactions subject to a master netting arrangement or similar agreement, the individual derivative receivables do not represent resources to which general creditors have rights and individual derivative payables do not represent claims that are equivalent to the claims of general creditors. Northern Trust centrally clears those interest rate derivative instruments addressed under Title VII of the Dodd-Frank Act. These transactions are subject to an agreement similar to a master netting arrangement which has the same rights of offset as described above.

**Item 1. Financial Statements**

The information called for by this item is incorporated herein by reference to the Financial Statements section within this Form 10-Q.

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

The information called for by this item is incorporated herein by reference to the Management's Discussion and Analysis of Financial Condition and Results of Operations section within this Form 10-Q.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The information called for by this item is incorporated herein by reference to the Management's Discussion and Analysis of Financial Condition and Results of Operations-Market Risk Management section within this Form 10-Q.

**Item 4. Controls and Procedures**

The Corporation's management, with the participation of the Corporation's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of Northern Trust's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of June 30, 2014. Based on such evaluation, such officers have concluded that, as of June 30, 2014, the Corporation's disclosure controls and procedures are effective in bringing to their attention on a timely basis information required to be disclosed by the Corporation in the reports it files or submits under the Exchange Act.

During the quarter ended June 30, 2014, there have been no changes in the Corporation's internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

The information presented in Note 17 titled Contingent Liabilities within this Form 10-Q is incorporated herein by reference.



**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(c) The following table shows certain information relating to the Corporation's purchases of common stock for the three months ended June 30, 2014.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan (2)	Maximum Number of Shares that May Yet be Purchased Under the Plan
April 1-30, 2014	229,508	\$ 60.13	229,508	11,770,492
May 1-31, 2014	775,880	60.31	775,880	10,994,612
June 1-30, 2014	230,029	62.19	230,029	10,764,583
Total (Second Quarter)	1,235,417	\$ 60.63	1,235,417	10,764,583

- (1) Includes shares purchased from employees in connection with equity plan transactions such as the surrender of shares to pay an option exercise price or tax withholding.
- (2) Includes shares repurchased under the authorization announced by the Corporation on April 16, 2013. This program was terminated on April 15, 2014, as on that date the Corporation's board of directors authorized the Corporation to repurchase up to 12.0 million shares of the Corporation's common stock. Shares purchased after April 15, 2014 were made pursuant to the new program, which has no expiration date.

**Item 6. Exhibits**

A list of exhibits to this Form 10-Q is set forth on the Exhibit Index immediately preceding such exhibits and is incorporated herein by reference.

**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.

NORTHERN TRUST CORPORATION  
(Registrant)

Date: July 28, 2014

By: /s/ Michael G. O Grady  
Michael G. O Grady  
Executive Vice President and Chief Financial Officer

Date: July 28, 2014

By: /s/ Jane Karpinski  
Jane Karpinski  
Senior Vice President and Controller  
  
(Principal Accounting Officer)

---

**EXHIBIT INDEX**

Exhibit Number	Description
10.1	Northern Trust Corporation 1997 Deferred Compensation Plan For Non-Employee Directors As Amended and Restated.
31.1	Rule 13a-14(a)/15d-14(a) Certification of CEO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Rule 13a-14(a)/15d-14(a) Certification of CFO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of CEO and CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Includes the following financial and related information from Northern Trust's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 formatted in Extensible Business Reporting Language (XBRL): (1) the Consolidated Balance Sheet (2) the Consolidated Statement of Income, (3) the Consolidated Statement of Comprehensive Income (4) the Consolidated Statement of Changes in Stockholders' Equity, (5) the Consolidated Statement of Cash Flows, and (6) Notes to Consolidated Financial Statements.