

NORTHERN TRUST CORP
Form 10-Q
April 29, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2019

OR

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

For the transition period from _____ to _____

Commission File No. 001-36609

NORTHERN TRUST CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 36-2723087

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

50 South LaSalle Street

60603

Chicago, Illinois

(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

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

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217,676,589 Shares – \$1.66 2/3 Par Value

(Shares of Common Stock Outstanding on March 31, 2019)

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NORTHERN TRUST CORPORATION
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FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2019
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(UNAUDITED)

CONDENSED INCOME STATEMENTS (In Millions)	Three Months Ended March 31,		
	2019	2018	% Change ⁽¹⁾
Noninterest Income	\$1,058.9	\$1,092.0	(3)%
Net Interest Income	422.0	384.0	10
Provision for Credit Losses	—	(3.0)	N/M
Noninterest Expense	1,028.7	995.3	3
Income before Income Taxes	452.2	483.7	(7)
Provision for Income Taxes	105.1	102.1	3
Net Income	\$347.1	\$381.6	(9)%
PER COMMON SHARE			
Net Income — Basic	\$1.49	\$1.59	(6)%
— Diluted	1.48	1.58	(6)
Cash Dividends Declared Per Common Share	0.60	0.42	43
Book Value — End of Period (EOP)	44.72	41.66	7
Market Price — EOP	90.41	103.13	(12)

SELECTED BALANCE SHEET DATA (In Millions)

End of Period:	March 31,	December	% Change ⁽¹⁾
	2019	31, 2018	
Assets	\$121,869.4	\$132,212.5	(8)%
Earning Assets	111,120.5	122,847.3	(10)
Deposits	95,844.2	104,496.8	(8)
Stockholders' Equity	10,616.2	10,508.3	1

	Three Months Ended March 31,		
	2019	2018	% Change ⁽¹⁾
Average Balances:			
Assets	\$119,416.7	\$124,493.3	(4)%
Earning Assets	110,672.2	115,686.3	(4)
Deposits	91,369.8	98,197.5	(7)
Stockholders' Equity	10,428.8	10,137.7	3

CLIENT ASSETS (In Billions)	March 31,	December	% Change ⁽¹⁾
	2019	31, 2018	
Assets Under Custody/Administration ⁽²⁾	\$10,927.4	\$10,125.3	8 %
Assets Under Custody	8,199.7	7,593.9	8
Assets Under Management	1,162.1	1,069.4	9

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

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

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SELECTED RATIOS AND METRICS

	Three Months Ended March 31, 2019		2018	
Financial Ratios:				
Return on Average Common Equity	14.0%		16.0%	
Return on Average Assets	1.18		1.24	
Dividend Payout Ratio	40.5		26.6	
Net Interest Margin ⁽¹⁾	1.58		1.38	
	March 31, 2019		December 31, 2018	
	Advanced	Standardized	Advanced	Standardized
	Approach	Approach	Approach	Approach
Capital Ratios:				
Northern Trust Corporation				
Common Equity Tier 1	13.5%	13.0	%	13.7%
Tier 1	14.8	14.3		15.0
Total	16.6	16.3		16.9
Tier 1 Leverage	8.2	8.2		8.0
Supplementary Leverage	7.2	N/A		7.0
				N/A
The Northern Trust Company				
Common Equity Tier 1	13.9%	13.2	%	14.1%
Tier 1	13.9	13.2		14.1
Total	15.5	14.9		15.8
Tier 1 Leverage	7.4	7.4		7.3
Supplementary Leverage	6.6	N/A		6.4
				N/A

(1) Net interest margin is presented on a fully taxable equivalent (FTE) basis, a non-generally accepted accounting principle (GAAP) financial measure that facilitates the analysis of asset yields. The net interest margin on a GAAP basis and a reconciliation of net interest income on a GAAP basis to net interest income on an FTE basis are presented on page 21.

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PART I – FINANCIAL INFORMATION

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

FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS

General

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

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

Overview

Net income per diluted common share was \$1.48 in the current quarter, down from \$1.58 in the first quarter of 2018. Net income was \$347.1 million in the current quarter as compared to \$381.6 million in the prior-year quarter. Annualized return on average common equity was 14.0% in the current quarter and 16.0% in the prior-year quarter. The annualized return on average assets was 1.18% in the current quarter as compared to 1.24% in the prior-year quarter.

Revenue was relatively unchanged compared to the prior-year quarter, totaling \$1.48 billion.

Noninterest income decreased \$33.1 million, or 3%, to \$1.06 billion from \$1.09 billion in the prior-year quarter, primarily reflecting lower foreign exchange trading income, trust, investment and other servicing fees, other operating income, and securities commissions and trading income.

Net interest income increased \$38.0 million, or 10%, to \$422.0 million in the current quarter as compared to \$384.0 million in the prior-year quarter, primarily resulting from a higher net interest margin, partially offset by a decrease in earning assets.

There was no provision for credit losses in the current quarter, as compared to a provision credit of \$3.0 million in the prior-year quarter.

Noninterest expense totaled \$1.03 billion in the current quarter, up \$33.4 million, or 3%, from \$995.3 million in the prior-year quarter, primarily attributable to higher outside services, compensation, and equipment and software expense, partially offset by lower employee benefits expense.

The provision for income taxes in the current quarter totaled \$105.1 million, representing an effective tax rate of 23.2%. The provision for income taxes in the prior-year quarter totaled \$102.1 million, representing an effective tax rate of 21.1%.

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income

The components of noninterest income are provided below.

Table 1: Noninterest Income

Noninterest Income (\$ In Millions)	Three Months Ended March 31,		
	2019	2018	Change
Trust, Investment and Other Servicing Fees	\$928.9	\$937.7	\$(8.8) (1)%
Foreign Exchange Trading Income	66.2	78.5	(12.3) (16)
Treasury Management Fees	11.7	14.0	(2.3) (17)
Security Commissions and Trading Income	23.3	27.2	(3.9) (14)
Other Operating Income	29.0	34.8	(5.8) (16)
Investment Security (Losses) Gains, net	(0.2)	(0.2)	— 30
Total Noninterest Income	\$1,058.9	\$1,092.0	\$(33.1) (3)%

Trust, investment and other servicing fees are based primarily on the market value of assets held in custody, managed or serviced; the volume of transactions; securities lending volume and spreads; and fees for other services rendered. Certain market value calculations on which fees are based are performed on a monthly or quarterly basis in arrears. For a further discussion of trust, investment and other servicing fees and how they are derived, refer to the “Reporting Segments” section.

The following tables present selected market indices and the percentage changes year over year to provide context regarding equity and fixed income market impacts on the Corporation’s results.

Table 2: Equity Market Indices

	Daily Averages			Period-End		
	Three Months Ended March 31,			As of March 31,		
	2019	2018	Change	2019	2018	Change
S&P 500	2,718	2,733	(1)%	2,834	2,641	7 %
MSCI EAFE (U.S. dollars)	1,833	2,072	(12)	1,875	2,002	(6)
MSCI EAFE (local currency)	1,074	1,147	(6)	1,105	1,105	—

Table 3: Fixed Income Market Indices

	As of March 31,		
	2019	2018	Change
Barclays Capital U.S. Aggregate Bond Index	2,107	2,016	4 %
Barclays Capital Global Aggregate Bond Index	489	491	—

Assets under custody/administration (AUC/A) and assets under management form the primary drivers of our trust, investment and other servicing fees. For the purposes of disclosing AUC/A, to the extent that both custody and administration services are provided, the value of the assets is included only once. The following table presents AUC/A by reporting segment.

Table 4: Assets Under Custody / Administration

Assets Under Custody / Administration (\$ In Billions)	March 31, December		March 31, Change		Change	
	2019	31, 2018	2018	Q1-19/Q4-18	Q1-19/Q1-18	
Corporate & Institutional	\$10,238.9	\$9,490.5	\$10,131.7	8 %	1 %	
Wealth Management	688.5	634.8	654.0	8	5	
Total Assets Under Custody / Administration	\$10,927.4	\$10,125.3	\$10,785.7	8 %	1 %	

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

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

Table 5: Assets Under Custody

Assets Under Custody (\$ In Billions)	March 31, 2019	December 31, 2018	March 31, 2018	Change Q1-19/Q4-18	Change Q1-19/Q1-18
Corporate & Institutional	\$7,529.1	\$6,971.0	\$7,466.5	8 %	1 %
Wealth Management	670.6	622.9	645.2	8	4
Total Assets Under Custody	\$8,199.7	\$7,593.9	\$8,111.7	8 %	1 %

The 1% increase in consolidated assets under custody from \$8.11 trillion as of March 31, 2018 to \$8.20 trillion as of March 31, 2019 primarily reflects favorable markets, partially offset by the impact of unfavorable movements in foreign exchange rates and net outflows.

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

Table 6: Allocation of Assets Under Custody

Assets Under Custody	March 31, 2019		December 31, 2018		March 31, 2018	
	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total
Equities	45 %	57 %	46 %	44 %	54 %	45 %
Fixed Income	38	19	36	39	20	37
Cash and Other Assets	15	24	16	15	26	16
Securities Lending Collateral	2	—	2	2	—	2

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

Table 7: Assets Under Management

Assets Under Management (\$ In Billions)	March 31, 2019	December 31, 2018	March 31, 2018	Change Q1-19/Q4-18	Change Q1-19/Q1-18
Corporate & Institutional	\$867.9	\$790.8	\$878.3	10 %	(1) %
Wealth Management	294.2	278.6	287.4	6	2
Total Assets Under Management	\$1,162.1	\$1,069.4	\$1,165.7	9 %	— %

Consolidated assets under management were relatively unchanged compared to the prior-year quarter, totaling \$1.17 trillion at March 31, 2018 and \$1.16 trillion as of March 31, 2019, as net outflows and the unfavorable impact of movements in foreign exchange rates were partially offset by favorable markets.

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

Table 8: Assets Under Management by Investment Type

(\$ In Billions)	March 31, 2019	December 31, 2018	March 31, 2018
Equities	\$591.8	\$534.2	\$583.7
Fixed Income	185.1	178.3	177.7
Cash and Other Assets	220.1	207.0	216.8
Securities Lending Collateral	165.1	149.9	187.5
Total Assets Under Management	\$1,162.1	\$1,069.4	\$1,165.7

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

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

Table 9: Allocation of Assets Under Management

	March 31, 2019		December 31, 2018		March 31, 2018	
	C&ISWM	Total	C&ISWM	Total	C&ISWM	Total
Assets Under Management	51%	50%	51%	47%	50%	50%
Equities	13	25	13	26	12	25
Fixed Income	17	25	17	27	17	23
Cash and Other Assets	19	—	14	—	14	—
Securities Lending Collateral	19	—	14	—	21	—

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

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

(\$ In Billions)	Three Months Ended				
	March 31, 2019	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018
Beginning Balance of AUM	\$ 1,069.4	\$ 1,171.5	\$ 1,148.9	\$ 1,165.7	\$ 1,161.0
Inflows by Investment Type					
Equity	49.8	43.5	42.3	44.7	44.2
Fixed Income	14.5	13.7	15.1	17.5	17.4
Cash & Other Assets	133.2	136.4	109.3	124.2	114.4
Securities Lending Collateral	74.3	51.8	23.3	22.4	68.1
Total Inflows	271.8	245.4	190.0	208.8	244.1
Outflows by Investment Type					
Equity	(48.8)	(45.1)	(43.9)	(42.4)	(47.8)
Fixed Income	(14.5)	(15.3)	(12.8)	(20.4)	(24.0)
Cash & Other Assets	(127.1)	(135.6)	(103.8)	(130.6)	(117.4)
Securities Lending Collateral	(59.1)	(68.4)	(30.5)	(36.1)	(48.3)
Total Outflows	(249.5)	(264.4)	(191.0)	(229.5)	(237.5)
Net Inflows / (Outflows)	22.3	(19.0)	(1.0)	(20.7)	6.6
Market Performance, Currency & Other					
Market Performance & Other	70.9	(80.8)	24.6	11.5	(4.6)
Currency	(0.5)	(2.3)	(1.0)	(7.6)	2.7
Total Market Performance, Currency & Other	70.4	(83.1)	23.6	3.9	(1.9)
Ending Balance of AUM	\$ 1,162.1	\$ 1,069.4	\$ 1,171.5	\$ 1,148.9	\$ 1,165.7

Foreign exchange trading income totaled \$66.2 million in the current quarter, down \$12.3 million, or 16%, compared to \$78.5 million in the prior-year quarter. The decrease was primarily due to lower market volatility and decreased foreign exchange swap activity in Treasury as compared to the prior-year quarter.

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Noninterest Income (continued)

Security commissions and trading income totaled \$23.3 million in the current quarter, down \$3.9 million, or 14%, compared to \$27.2 million in the prior-year quarter, primarily due to lower core brokerage revenue.

Other operating income totaled \$29.0 million in the current quarter, down \$5.8 million, or 16%, compared to \$34.8 million in the prior-year quarter, primarily due to higher expenses associated with existing swap agreements related to Visa Inc. Class B common shares and lower income from miscellaneous other operating income categories. The components of other operating income are provided below.

Table 11: Other Operating Income

Other Operating Income	Three		
	Months		
	Ended		
	March 31,		
(\$ In Millions)	2019	2018	Change
Loan Service Fees	\$12.1	\$12.5	\$(0.4) (3)%
Banking Service Fees	11.2	12.5	(1.3) (11)%
Other Income	5.7	9.8	(4.1) (40)
Total Other Operating Income	\$29.0	\$34.8	\$(5.8) (16)%

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FIRST QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

Net Interest Income

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

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

(Interest and Rate on a Fully Taxable Equivalent Basis) (\$ In Millions)	NORTHERN TRUST CORPORATION					
	FIRST QUARTER			2018		
	2019	Average Balance	Rate ⁽⁶⁾	2018	Average Balance	Rate ⁽⁶⁾
Average Earning Assets						
Federal Reserve and Other Central Bank Deposits and Other ⁽¹⁾	\$61.3	\$20,163.2	1.23 %	\$47.4	\$26,495.1	0.72 %
Interest-Bearing Due from and Deposits with Banks ⁽²⁾	17.9	6,452.2	1.13	19.9	6,920.4	1.17
Federal Funds Sold and Securities Purchased under Agreements to Resell Securities	6.8	978.1	2.84	6.8	1,467.1	1.89
U.S. Government	28.7	5,238.9	2.22	23.8	5,735.4	1.68
Obligations of States and Political Subdivisions	5.0	770.5	2.57	2.4	678.2	1.42
Government Sponsored Agency	148.5	22,439.0	2.69	81.4	18,848.3	1.75
Other ⁽³⁾	102.2	23,440.9	1.77	79.2	23,073.8	1.39
Total Securities	284.4	51,889.3	2.22	186.8	48,335.7	1.57
Loans and Leases ⁽⁴⁾	300.2	31,189.4	3.90	253.7	32,468.0	3.17
Total Earning Assets	670.6	110,672.2	2.46	514.6	115,686.3	1.80
Allowance for Credit Losses Assigned to Loans and Leases	—	(114.0)	—	—	(131.0)	—
Cash and Due from Banks and Other Central Bank Deposits ⁽⁵⁾	—	1,940.7	—	—	2,593.2	—
Buildings and Equipment	—	424.4	—	—	457.0	—
Client Security Settlement Receivables	—	981.5	—	—	1,012.0	—
Goodwill	—	675.5	—	—	611.0	—
Other Assets	—	4,836.4	—	—	4,264.8	—
Total Assets	\$—	\$119,416.7	— %	\$—		