

NORTHERN TRUST CORP
Form 10-Q
July 29, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2015

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

60603

Chicago, Illinois
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (312) 630-6000

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

232,852,813 Shares \$1.66 2/3 Par Value

(Shares of Common Stock Outstanding on June 30, 2015)

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NORTHERN TRUST CORPORATION
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FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2015
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CONDENSED INCOME STATEMENT (In Millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014	% Change (*)	2015	2014	% Change (*)
Noninterest Income	\$ 1,004.7	\$ 835.1	20%	1,878.6	1,629.9	15
Net Interest Income	251.2	246.6	2	511.8	492.3	4
Provision for Credit Losses	(10.0)		N/M	(14.5)	3.0	N/M
Noninterest Expense	854.5	811.0	5	1,643.5	1,579.0	4
Income before Income Taxes	411.4	270.7	52	761.4	540.2	41
Provision for Income Taxes	142.2	88.8	60	261.5	176.9	48
Net Income	\$ 269.2	\$ 181.9	48%	\$ 499.9	\$ 363.3	38%

PER COMMON SHARE

Net Income Basic	\$ 1.11	\$ 0.76	46%	\$ 2.06	\$ 1.51	36%
Diluted	1.10	0.75	47	2.04	1.50	36
Cash Dividends Declared Per Common Share	0.36	0.33	9	0.69	0.64	8
Book Value End of Period (EOP)	35.91	34.14	5	35.91	34.14	5
Market Price EOP	76.46	64.21	19	76.46	64.21	19

SELECTED BALANCE SHEET DATA (In Millions)

	June 30, 2015	December 31, 2014	% Change (*)
<i>End of Period:</i>			
Assets	\$ 119,942.9	\$ 109,946.5	9%
Earning Assets	109,565.3	100,889.8	9
Deposits	100,687.9	90,757.0	11
Stockholders Equity	8,749.3	8,448.9	4

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014	% Change (*)	2015	2014	% Change (*)
<i>Average Balances:</i>						
Assets	\$ 111,691.1	\$ 103,324.1	8%	\$ 109,613.7	\$ 101,792.3	8
Earning Assets	103,806.0	95,472.7	9	101,263.7	93,666.7	8
Deposits	92,335.1	84,645.2	9	89,446.7	82,707.3	8
Stockholders Equity	8,607.9	7,947.2	8	8,540.7	7,936.8	8

CLIENT ASSETS (In Billions)

% Change (*)

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	June 30, 2015	December 31, 2014	
Assets Under Custody	\$ 6,177.0	\$ 5,968.8	3%
Assets Under Management	945.6	934.1	1

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Table of Contents**SELECTED RATIOS AND METRICS**

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014	% Change (*)	2015	2014	% Change (*)
<i>Financial Ratios:</i>						
Return on Average Common Equity	12.85%	9.18%	40%	12.08%	9.23%	31
Return on Average Assets	0.97	0.71	36	0.92	0.72	28
Dividend Payout Ratio	32.7	44.0	(26)	33.8	42.7	(21)
Net Interest Margin (**)	1.00	1.06	(6)	1.04	1.09	(5)

	June 30, 2015		December 31, 2014	
	Advanced Approach	Standardized Approach (a)	Advanced Approach	Standardized Approach (a)
<i>Capital Ratios:</i>				
Northern Trust Corporation				
Common Equity Tier 1	12.0%	10.7%	12.4%	12.5%
Tier 1	12.6	11.2	13.2	13.3
Total	14.4	13.2	15.0	15.5
Tier 1 Leverage	7.6	7.6	n/a	7.8
Supplementary Leverage (b)	6.3	n/a	n/a	n/a
The Northern Trust Company				
Common Equity Tier 1	11.6%	10.1%	12.0%	11.8%
Tier 1	11.6	10.1	12.0	11.8
Total	13.2	11.9	13.8	14.0
Tier 1 Leverage	6.8	6.8	n/a	6.9
Supplementary Leverage (b)	5.6	n/a	n/a	n/a

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

(**) 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 27.

(a) In 2014, Standardized Approach risk-weighted assets were determined by Basel I requirements. Effective with the first quarter of 2015, risk-weighted assets are calculated in accordance with the Basel III Standardized Approach final rules.

(b) Beginning with the first quarter of 2015, advanced approaches banking organizations must calculate and report their supplementary leverage ratio. Effective January 1, 2018, advanced approaches institutions, such as the Corporation, will be subject to a minimum supplementary leverage ratio of 3 percent.

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PART I FINANCIAL INFORMATION

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

SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS

General

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

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

Overview

Net income per diluted common share in the current quarter was \$1.10, up from \$0.75 in the second quarter of 2014. Net income was \$269.2 million in the current quarter as compared to \$181.9 million in the prior-year quarter. Annualized return on average common equity in the quarter was 12.8% as compared to 9.2% in the prior-year quarter. The annualized return on average assets was 1.0% as compared to 0.7% in the prior-year quarter.

The current quarter includes a net pre-tax gain on the sale of 1.0 million Visa Inc. Class B common shares totaling \$99.9 million; voluntary cash contributions to certain constant dollar net-asset-value (NAV) funds of \$45.8 million; and the impairment of the residual value of certain aircraft under leveraged lease agreements of \$17.8 million. Excluding these items, net income per diluted common share, net income, and return on average common equity were \$1.01, \$246.7 million and 11.8%, respectively.

The prior-year quarter included pre-tax charges of \$32.8 million for severance and related costs and for the realignment of the Corporation's real estate portfolio and \$9.5 million of software write-offs. 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 \$1.26 billion was up \$174.2 million, or 16%, from \$1.08 billion in the prior-year quarter. Noninterest income increased \$169.6 million, or 20%, to \$1.00 billion from \$835.1 million in the prior-year quarter, primarily reflecting the \$99.9 million net gain on the sale of Visa Inc. Class B common shares, higher trust, investment and other servicing fees and foreign exchange trading income.

Net interest income increased 2% to \$251.2 million in the current quarter as compared to \$246.6 million in the prior-year quarter, due to growth in earning assets, offset by the \$17.8 million impairment of the residual value of certain aircraft under leveraged lease agreements and a lower net interest margin.

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The provision for credit losses was a credit of \$10.0 million in the current quarter, reflecting improved credit quality. There was no provision for credit losses recorded in the prior-year quarter.

Noninterest expense totaled \$854.5 million, up \$43.5 million, or 5%, from \$811.0 million in the prior-year quarter. The current quarter includes the \$45.8 million charge related to voluntary cash contributions to certain

Table of Contents**SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)****Overview (continued)**

constant dollar NAV funds. The prior-year quarter includes the \$32.8 million charge for severance and related costs and realignment of the Corporation's real estate portfolio and \$9.5 million of software write-offs. Excluding the current- and prior-year quarter charges and write-offs, noninterest expense increased \$40.0 million, or 5%, primarily attributable to higher compensation, equipment and software, other operating and employee benefits expense.

Noninterest Income

The components of noninterest income are provided below.

Table 1: Noninterest Income

Noninterest Income (\$ In Millions)	Three Months Ended June 30,		Change	
	2015	2014		
Trust, Investment and Other Servicing Fees	\$ 756.8	\$ 706.9	\$ 49.9	7%
Foreign Exchange Trading Income	74.8	52.9	21.9	41
Treasury Management Fees	16.1	16.6	(0.5)	(3)
Security Commissions and Trading Income	20.0	17.8	2.2	12
Other Operating Income	137.4	40.5	96.9	N/M
Investment Security Gains (Losses), net	(0.4)	0.4	(0.8)	N/M
Total Noninterest Income	\$ 1,004.7	\$ 835.1	\$ 169.6	20%

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 table presents Northern Trust's assets under custody by reporting segment.

Table 2: Assets Under Custody

Assets Under Custody (\$ In Billions)	June 30,	March 31,	June 30,	Change	Change
	2015	2015	2014	Q2-15/ Q1-15	Q2-15/ Q2-14
Corporate & Institutional	\$ 5,652.6	\$ 5,566.2	\$ 5,488.0	2%	3%
Wealth Management	524.4	524.6	516.6		2

Total Assets Under Custody	\$ 6,177.0	\$ 6,090.8	\$ 6,004.6	1%	3%
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The following table presents the allocation of Northern Trust's custodied assets by reporting segment.

Table 3: Allocations of Assets Under Custody

Assets Under Custody	June 30, 2015			March 31, 2015			June 30, 2014		
	C&IS	WM	Total	C&IS	WM	Total	C&IS	WM	Total
Equities	45%	55%	46%	45%	55%	46%	45%	56%	46%
Fixed Income Securities	37	23	35	37	23	35	37	21	36
Cash and Other Assets	18	22	19	18	22	19	18	23	18

Table of Contents**SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)****Noninterest Income (continued)**

The 3% increase in consolidated assets under custody from \$6.09 trillion at June 30, 2014, to \$6.18 trillion as of June 30, 2015, primarily reflected increased net new business driven by institutional clients in global funds services, primarily in equities.

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

Table 4: Assets Under Management

Assets Under Management				Change	Change
(\$ In Billions)	June 30, 2015	March 31, 2015	June 30, 2014	Q2-15/ Q1-15	Q2-15/ Q2-14
Corporate & Institutional	\$ 713.6	\$ 727.0	\$ 701.5	(2)%	2%
Wealth Management	232.0	233.1	222.9		4
Total Assets Under Management	\$ 945.6	\$ 960.1	\$ 924.4	(2)%	2%

The following table presents consolidated assets under management as of June 30, 2015, and June 30, 2014, by investment type.

Table 5: Assets Under Management by Investment Type

(\$ In Billions)	June 30, 2015	June 30, 2014
Equities	\$ 487.7	\$ 495.7
Fixed Income Securities	167.7	153.2
Cash and Other Assets	169.9	159.0
Securities Lending Collateral	120.3	116.5
Total Assets Under Management	\$ 945.6	\$ 924.4

The 2% increase in consolidated assets under management from \$924.4 billion at June 30, 2014, to \$945.6 billion as of June 30, 2015, primarily reflected higher fixed income securities, cash and securities lending collateral, partially offset by lower equity assets, driven in part by a stronger U.S. dollar.

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

Table 6: Allocations of Assets Under Management

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Assets Under Management	June 30, 2015			March 31, 2015			June 30, 2014		
	C&IS	WM	Total	C&IS	WM	Total	C&IS	WM	Total
Equities	53%	47%	51%	53%	46%	52%	56%	48%	54%
Fixed Income Securities	14	28	18	14	28	17	13	28	16
Securities Lending Collateral	17		13	17		13	16		13
Cash and Other Assets	16	25	18	16	26	18	15	24	17

Changes in assets under custody and under management are in comparison to the twelve month increase in the S&P 500[®] index of 5.2% and decline in the MSCI EAFE[®] index (USD) of 6.6%.

Foreign exchange trading income totaled \$74.8 million in the current quarter, up \$21.9 million, or 41%, compared to \$52.9 million in the prior-year quarter. The increase was primarily attributable to higher currency volatility and client volumes as compared to the prior-year quarter.

Security commissions and trading income totaled \$20.0 million, up 12%, compared with \$17.8 million in the prior-year quarter. The increase was attributable to higher referral fees and higher income from interest rate protection products sold to clients.

Table of Contents**SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)****Noninterest Income (continued)**

Other operating income totaled \$137.4 million, up \$96.9 million, compared to \$40.5 million in the prior-year quarter. The components of other operating income are provided below.

Table 7: Other Operating Income

Other Operating Income (\$ In Millions)	Three Months Ended June 30,		Change	
	2015	2014		
Loan Service Fees	\$ 14.6	\$ 16.0	\$ (1.4)	(9)%
Banking Service Fees	11.8	12.6	(0.8)	(7)
Other Income	111.0	11.9	99.1	N/M
Total Other Operating Income	\$ 137.4	\$ 40.5	\$ 96.9	N/M%

Other income in the current quarter includes the \$99.9 million net gain on the sale of 1.0 million Visa Inc. Class B common shares. Excluding the gain, other operating income totaled \$37.5 million, down 7%, from the prior-year quarter, reflecting decreases in loan and banking services fees and various miscellaneous income categories.

Table of Contents**SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)****Net Interest Income**

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

Table 8: AVERAGE CONSOLIDATED BALANCE SHEET **NORTHERN TRUST CORPORATION**

WITH ANALYSIS OF NET INTEREST INCOME

(INTEREST AND RATE ON A FULLY TAXABLE EQUIVALENT BASIS)

Second Quarter

(\$ In Millions)	Interest	2015 Average Balance	Rate (4)	Interest	2014 Average Balance	Rate (4)
Average Earning Assets						
Federal Funds Sold and Securities Purchased under						
Agreements to Resell	\$ 1.2	\$ 1,041.9	0.46%	\$ 0.7	\$ 554.1	0.47%
Interest-Bearing Due from and Deposits with Banks (1)	28.7	16,920.6	0.68	33.6	17,294.6	0.78
Federal Reserve Deposits	9.5	14,992.1	0.25	8.4	13,266.4	0.26
Securities						
U.S. Government	13.4	4,789.1	1.12	6.7	2,368.7	1.13
Obligations of States and Political Subdivisions	1.9	112.2	6.75	2.8	168.4	6.76
Government Sponsored Agency	34.2	16,821.7	0.82	33.3	18,359.8	0.73
Other (2)	33.8	16,207.0	0.84	27.8	13,407.8	0.83
Total Securities	83.3	37,930.0	0.88	70.6	34,304.7	0.83
Loans and Leases (3)	172.5	32,921.4	2.10	187.3	30,052.9	2.50
Total Earning Assets	295.2	103,806.0	1.14	300.6	95,472.7	1.26
Allowance for Credit Losses						
Assigned to Loans and Leases		(260.0)			(276.8)	
Cash and Due from Banks		2,142.9			2,838.4	
Buildings and Equipment		446.5			450.7	
Client Security Settlement						
Receivables		945.0			781.0	
Goodwill		531.1			543.0	
Other Assets		4,079.6			3,515.1	

Total Assets	\$	\$ 111,691.1	%	\$	\$ 103,324.1	%
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Average Source of Funds

Deposits

Savings and Money Market	\$ 2.4	\$ 15,705.4	0.06%	\$ 2.4	\$ 14,828.6	0.06%
Savings Certificates and Other Time	2.1	1,779.5	0.48	1.6	1,996.2	0.32
Non-U.S. Offices Interest-Bearing	13.9	49,291.8	0.11	18.4	48,988.1	0.15
Total Interest-Bearing Deposits	18.4	66,776.7	0.11	22.4	65,812.9	0.14
Short-Term Borrowings	1.3	4,404.8	0.12	1.2	4,217.8	0.12
Senior Notes	11.9	1,497.1	3.14	13.7	1,661.6	3.30
Long-Term Debt	5.5	1,380.2	1.59	9.4	1,642.4	2.30
Floating Rate Capital Debt	0.5	277.3	0.84	0.5	277.2	0.80

Total Interest-Related Funds	37.6	74,336.1	0.20	47.2	73,611.9	0.26
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Interest Rate Spread			0.94			1.00
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Demand and Other

Noninterest-Bearing Deposits		25,558.4			18,832.3	
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Other Liabilities		3,188.7			2,932.7	
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Stockholders Equity		8,607.9			7,947.2	
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Total Liabilities and Stockholders

Equity	\$	\$ 111,691.1	%	\$	\$ 103,324.1	%
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Net Interest Income/Margin (FTE Adjusted)

\$ 257.6	\$	1.00%	\$ 253.4	\$	1.06%
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Net Interest Income/Margin (Unadjusted)

\$ 251.2	\$	0.97%	\$ 246.6	\$	1.04%
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Table of Contents**SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)****Net Interest Income (continued)****ANALYSIS OF NET INTEREST INCOME CHANGES****DUE TO VOLUME AND RATE**

(In Millions)	Three Months Ended June 30, 2015/2014		
	Change Due To		
	Average Balance	Rate	Total
Earning Assets (FTE)	\$ 26.2	\$ (31.6)	\$ (5.4)
Interest-Related Funds	0.5	(10.1)	(9.6)
Net Interest Income (FTE)	\$ 25.7	\$ (21.5)	\$ 4.2

- (1) Interest-Bearing Due from and Deposits with Banks includes the interest-bearing component of Cash and Due from Banks and Interest-Bearing Deposits with Banks as presented on the consolidated balance sheet in our periodic filings with the U.S. Securities and Exchange Commission.
- (2) Other securities include certain community development investments and Federal Home Loan Bank and Federal Reserve stock of \$193.9 million, \$131.1 million and \$54.0 million, which are classified in other assets in the consolidated balance sheet as of June 30, 2015 and 2014.
- (3) Average balances include nonaccrual loans. Lease financing receivable balances are reduced by deferred income.
- (4) Rate calculations are based on actual balances rather than the rounded amounts presented in the Average Consolidated Balance 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 37.7% and 37.8% for the three months ended June 30, 2015 and 2014, respectively. Total taxable equivalent interest adjustments amounted to \$6.4 million and \$6.8 million for the three months ended June 30, 2015 and 2014, 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.

Net interest income is defined as the total of interest income and amortized fees on earning assets, less interest expense on deposits and borrowed funds, adjusted for the impact of interest-related hedging activity.

Net interest income on a fully taxable equivalent (FTE) basis totaled \$257.6 million, up 2%, compared to \$253.4 million in the prior-year quarter. The increase was primarily the result of growth in earning assets, partially offset by the \$17.8 million impairment of the residual value of certain aircraft under leveraged lease agreements and a lower net interest margin. Earning assets for the current quarter averaged \$103.8 billion, up \$8.3 billion, or 9%, from \$95.5 billion in the prior-year quarter, primarily resulting from higher levels of securities, reflecting demand deposit growth, combined with increased loan volume.

The net interest margin on an FTE basis, declined to 1.00% in the current quarter from 1.06% in the prior-year quarter. Excluding the impairment noted above, the net interest margin was 1.06%, unchanged from the prior-year quarter, as higher securities yields and lower cost of interest-related funds were offset by lower loan and short-term interest-bearing deposit 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 (a non-GAAP financial measure) is provided on page 27.

Earning assets for the quarter averaged \$103.8 billion, up \$8.3 billion, or 9%, from \$95.5 billion in the prior-year quarter. Federal Reserve deposits averaged \$15.0 billion, up \$1.7 billion, or 13%, from \$13.3 billion in the prior-year quarter. Average securities were \$37.9 billion, up \$3.6 billion, or 11%, from \$34.3 billion in the prior-year quarter and include certain community development investments and Federal Home Loan Bank and Federal Reserve stock of \$193.9 million, \$131.1 million and \$54.0 million, respectively, which are recorded in other assets in the consolidated balance sheets.

Loans and leases averaged \$32.9 billion, up \$2.9 billion, or 10%, from \$30.1 billion in the prior-year quarter, primarily reflecting higher levels of private client loans, commercial and institutional loans, and commercial real

Table of Contents**SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)****Net Interest Income (continued)**

estate loans. Private client loans averaged \$8.0 billion, up \$1.5 billion, or 23%, from \$6.5 billion for the prior-year quarter. Commercial and institutional loans averaged \$9.0 billion, up \$1.1 billion, or 14%, from \$7.9 billion for the prior-year quarter. Commercial real estate loans averaged \$3.6 billion, up \$487.6 million, or 16%, from \$3.1 billion for the prior-year quarter.

Northern Trust utilizes a diverse mix of funding sources. Total interest-bearing deposits averaged \$66.8 billion, compared to \$65.8 billion in the prior-year quarter, an increase of \$963.8 million, or 1%. Other interest-bearing funds averaged \$7.6 billion, a decrease of \$239.6 million, from \$7.8 billion in the prior-year quarter, attributable to decreased long-term debt and senior notes, partially offset by increased short-term borrowings. 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 \$7.6 billion, or 35%, to \$29.5 billion from \$21.9 billion in the prior-year quarter, primarily resulting from higher levels of demand and other noninterest-bearing deposits.

Provision for Credit Losses

The provision for credit losses was a credit of \$10.0 million in the current quarter, reflecting improved credit quality. No provision for credit losses was recorded in the prior-year quarter. Net charge-offs in the current quarter were \$2.6 million, resulting from charge-offs of \$6.1 million and recoveries of \$3.5 million. The prior-year quarter included \$5.9 million of net charge-offs, resulting from \$7.8 million of charge-offs and \$1.9 million of recoveries. Nonperforming assets decreased 10% from the prior-year quarter. Residential real estate loans and commercial real estate loans accounted for 76% and 12%, respectively, of total nonperforming loans and leases at June 30, 2015. For additional discussion of the provision and allowance for credit losses, refer to the [Asset Quality](#) section beginning on page 22.

Noninterest Expense

The components of noninterest expense are provided below.

Table 9: Noninterest Expense

Noninterest Expense (\$ In Millions)	Three Months Ended June 30,		Change	
	2015	2014		
Compensation	\$ 361.9	\$ 372.4	\$ (10.5)	(3)%
Employee Benefits	73.2	68.5	4.7	7
Outside Services	147.2	144.6	2.6	2
Equipment and Software	114.4	116.1	(1.7)	(2)
Occupancy	43.0	47.2	(4.2)	(9)

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Other Operating Expense	114.8	62.2	52.6	85
Total Noninterest Expense	\$ 854.5	\$ 811.0	\$ 43.5	5%

Compensation expense, the largest component of noninterest expense, totaled \$361.9 million in the current quarter, down \$10.5 million, or 3%, from \$372.4 million in the prior-year quarter. The prior-year quarter included severance-related charges of \$25.5 million. Excluding the severance-related charges, compensation expense increased \$15.0 million, or 4%, reflecting higher performance-based compensation, staff levels and base pay adjustments, partially offset by the favorable impact in foreign exchange rates. Staff on a full-time equivalent basis at June 30, 2015, totaled approximately 15,800, up 4% from June 30, 2014.

Table of Contents**SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)****Noninterest Expense (continued)**

Employee benefit expense totaled \$73.2 million in the current quarter, up 7%, from \$68.5 million in the prior-year quarter. The prior-year quarter included \$1.9 million of severance-related charges. Excluding these charges, employee benefit expense increased \$6.6 million, or 10%, attributable to higher pension and employee medical expense.

Expense associated with outside services totaled \$147.2 million in the current quarter, up 2%, from \$144.6 million in the prior-year quarter. The prior-year quarter included \$1.1 million of severance-related charges. Excluding these charges, outside services expense increased 3%, reflecting higher technical services.

Equipment and software expense totaled \$114.4 million in the current quarter, down 2%, from \$116.1 million in the prior-year quarter. The prior-year quarter included \$9.5 million of write-offs of replaced or eliminated software. Excluding these write-offs, equipment and software expense increased \$7.8 million, or 7%, reflecting higher software amortization.

Occupancy expense totaled \$43.0 million, down 9%, from \$47.2 million in the prior-year quarter. The prior-year quarter included charges totaling \$4.3 million in connection with reductions in office space. Excluding these charges, occupancy expense was relatively unchanged from the prior-year quarter.

Other operating expense totaled \$114.8 million in the current quarter, up \$52.6 million, or 85%, from \$62.2 million in the prior-year quarter. The components of other operating expense are provided below.

Table 10: Other Operating Expense

Other Operating Expense (\$ In Millions)	Three Months Ended June 30,		Change	
	2015	2014		
Business Promotion	\$ 20.8	\$ 19.1	\$ 1.7	9%
Staff Related	9.3	10.1	(0.8)	(8)
FDIC Insurance Premiums	5.8	4.7	1.1	22
Other Intangibles Amortization	2.1	5.0	(2.9)	(57)
Other Expenses	76.8	23.3	53.5	N/M
Total Other Operating Expense	\$ 114.8	\$ 62.2	\$ 52.6	85%

In the current quarter, other expenses includes a charge related to voluntary cash contributions to certain constant dollar NAV funds totaling \$45.8 million, to bring the NAVs of these funds to \$1.00. Excluding the current-quarter charge, other operating expense increased \$6.8 million, or 11%, reflecting higher charitable contributions and charges associated with account servicing activities.

Provision for Income Taxes

Income tax expense was \$142.2 million in the current quarter, representing an effective tax rate of 34.6%, compared to \$88.8 million in the prior-year quarter, representing an effective tax rate of 32.8%.

REPORTING SEGMENTS

Northern Trust is organized around its two client-focused reporting segments: 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. The revenue and expenses of Asset Management and certain other support functions are allocated fully to C&IS and Wealth Management. Income and expense associated with the wholesale funding activities and investment portfolios of the Corporation and its principal subsidiary, The Northern Trust Company (the Bank), as well as certain corporate-based expense, executive level compensation and nonrecurring i