

NORTHERN TRUST CORP  
Form 10-Q  
October 29, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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

For the Quarterly Period Ended September 30, 2018

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 001-36609

NORTHERN TRUST CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 36-2723087

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

50 South LaSalle Street 60603  
Chicago, Illinois

(Address of principal executive offices) (Zip Code)

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

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

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

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

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

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QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018  
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(UNAUDITED)

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

## SELECTED BALANCE SHEET DATA (In Millions)

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

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

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

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



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## SELECTED RATIOS AND METRICS

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Financial Ratios:				
Return on Average Common Equity	15.1%	12.2%	15.9%	11.8%
Return on Average Assets	1.22	0.98	1.24	0.95
Dividend Payout Ratio	34.8	35.0	28.7	34.6
Net Interest Margin <sup>(1)</sup>	1.47	1.29	1.44	1.31
	September 30, 2018		December 31, 2017	
	Advanced Approach	Standardized Approach	Advanced Approach	Standardized Approach
Capital Ratios:				
Northern Trust Corporation				
Common Equity Tier 1	13.4%	12.9%	13.5%	12.6%
Tier 1	14.8	14.2	14.8	13.8
Total	16.7	16.2	16.7	15.8
Tier 1 Leverage	7.8	7.8	7.8	7.8
Supplementary Leverage	6.9	N/A	6.8	N/A
The Northern Trust Company				
Common Equity Tier 1	14.1%	13.2%	13.7%	12.6%
Tier 1	14.1	13.2	13.7	12.6
Total	15.8	14.9	15.4	14.3
Tier 1 Leverage	7.2	7.2	7.0	7.0
Supplementary Leverage	6.4	N/A	6.1	N/A

Net interest margin is presented on a fully taxable equivalent (FTE) basis, a non-generally accepted accounting principle (GAAP) financial measure that facilitates the analysis of asset yields. The net interest margin on a GAAP basis and a reconciliation of net interest income on a GAAP basis to net interest income on an FTE basis are presented on page 28.

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PART I – FINANCIAL INFORMATION

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

THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS

General

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

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

Overview

Net income per diluted common share was \$1.58 in the current quarter, up from \$1.20 in the third quarter of 2017. Net income was \$374.5 million in the current quarter as compared to \$298.4 million in the prior-year quarter. Annualized return on average common equity was 15.1% in the current quarter and 12.2% in the prior-year quarter. The annualized return on average assets was 1.22% in the current quarter as compared to 0.98% in the prior-year quarter.

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

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

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

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

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

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

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## THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Noninterest Income

The components of noninterest income are provided below.

Table 1: Noninterest Income

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

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

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

Table 2: Equity Market Indices

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

Table 3: Fixed Income Market Indices

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

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

Table 4: Assets Under Custody / Administration

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





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## THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Noninterest Income (continued)

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

Table 5: Assets Under Custody

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

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

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

Table 6: Allocation of Assets Under Custody

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

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

Table 7: Assets Under Management

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

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

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

Table 8: Assets Under Management by Investment Type

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

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## THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Noninterest Income (continued)

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

Table 9: Allocation of Assets Under Management

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

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

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

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

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



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## THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Noninterest Income (continued)

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

Table 11: Other Operating Income

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

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## THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Net Interest Income

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

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

NORTHERN TRUST CORPORATION						
THIRD QUARTER						
(Interest and Rate on a Fully Taxable Equivalent Basis)	2018		2017			
(\$ In Millions)	Interest	Average Balance	Rate <sup>(5)</sup>	Interest	Average Balance	Rate <sup>(5)</sup>
Average Earning Assets						
Federal Reserve and Other Central Bank Deposits	\$50.0	\$22,889.6	0.87 %	\$44.9	\$25,182.9	0.71 %
Interest-Bearing Due from and Deposits with Banks <sup>(1)</sup>	15.6	5,410.3	1.15	16.0	7,145.8	0.88
Federal Funds Sold and Securities Purchased under Agreements to Resell Securities	10.2	1,775.2	2.27	7.8	1,945.8	1.58
U.S. Government Obligations of States and Political Subdivisions	28.0	5,726.6	1.94	22.1	6,002.2	1.46
Government Sponsored Agency Other <sup>(2)</sup>	3.7	730.7	2.05	3.0	845.3	1.41
Total Securities	125.3	21,589.9	2.30	65.4	17,974.7	1.45
Loans and Leases <sup>(3)</sup>	91.8	22,773.6	1.60	64.2	19,920.1	1.28
Total Earning Assets	248.8	50,820.8	1.94	154.7	44,742.3	1.37
Allowance for Credit Losses Assigned to Loans and Leases	284.9	31,798.9	3.55	242.4	33,468.2	2.87
Cash and Due from Banks and Other Central Bank Deposits <sup>(4)</sup>	609.5	112,694.8	2.15	465.8	112,485.0	1.64
Buildings and Equipment	—	(127.6 )	—	—	(155.1 )	—
Client Security Settlement Receivables	—	2,702.9	—	—	2,666.8	—
Goodwill	—	426.8	—	—	467.3	—
Other Assets	—	968.1	—	—	917.0	—
Total Assets	—	672.4	—	—	523.9	—
Average Source of Funds	—	4,818.2	—	—	4,254.5	—
Deposits	\$—	\$122,155.6	— %	\$—	\$121,159.4	— %
Savings, Money Market and Other Savings Certificates and Other Time	\$22.1	\$14,787.6	0.59 %	\$7.3	\$15,617.1	0.19 %
Non-U.S. Offices — Interest-Bearing	1.9	810.5	0.93	2.4	1,255.1	0.75
Total Interest-Bearing Deposits	81.4	58,473.2	0.55	45.4	58,503.4	0.31
Short-Term Borrowings	105.4	74,071.3	0.56	55.1	75,375.6	0.29
Senior Notes	57.7	11,380.7	2.01	20.3	7,264.5	1.11
Long-Term Debt	14.6	1,818.0	3.21	11.5	1,497.0	3.11
Floating Rate Capital Debt	11.3	1,254.4	3.57	11.3	1,672.5	2.68
Total Interest-Related Funds	2.0	277.6	2.89	1.4	277.5	1.87
Interest Rate Spread	191.0	88,802.0	0.85	99.6	86,087.1	0.46
Demand and Other Noninterest-Bearing Deposits	—	—	1.30	—	—	1.18
Other Liabilities	—	19,430.5	—	—	21,736.4	—
Stockholders' Equity	—	3,648.5	—	—	3,295.7	—
Total Liabilities and Stockholders' Equity	—	10,274.6	—	—	10,040.2	—
Net Interest Income/Margin (FTE Adjusted)	\$—	\$122,155.6	— %	\$—	\$121,159.4	— %
	\$418.5	\$—	1.47 %	\$366.2	\$—	1.29 %

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Net Interest Income/Margin (Unadjusted)	\$408.2 \$—	1.44 %	\$354.2 \$—	1.25 %
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## THIRD 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		
	September 30, 2018/2017		
	Change Due To		
	Average Balance	Rate	Total
Earning Assets (FTE)	\$12.0	\$131.7	\$143.7
Interest-Related Funds	15.7	75.7	91.4
Net Interest Income (FTE)	\$(3.7)	\$56.0	\$52.3

- (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 sheets. Other securities include certain community development investments and Federal Home Loan Bank and Federal Reserve stock, which are classified in other assets in the consolidated balance sheets as of September 30, 2018 and 2017.
- (2) Average balances include nonaccrual loans. Lease financing receivable balances are reduced by deferred income.
- (3) Cash and Due from Banks and Other Central Bank Deposits includes the noninterest-bearing component of Federal Reserve and Other Central Bank Deposits as presented on the consolidated balance sheets.
- (4) Rate calculations are based on actual balances rather than the rounded amounts presented in the Average Consolidated Balance Sheets with Analysis of Net Interest Income.
- (5) Consolidated Balance Sheets with Analysis of Net Interest Income.

Net Interest Income (FTE Adjusted), a non-generally accepted accounting principle (GAAP) financial measure, 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 24.8% and 38.1% for the three months ended September 30, 2018 and Notes:2017, respectively. Total taxable equivalent interest adjustments amounted to \$10.3 million and \$12.0 million for the three months ended September 30, 2018 and 2017, respectively. A reconciliation of net interest income and net interest margin on a GAAP basis to net interest income and net interest margin on an FTE basis (each of which is a non-GAAP financial measure) is provided on page 28.

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 \$418.5 million in the current quarter, up \$52.3 million, or 14%, compared to \$366.2 million in the prior-year quarter. The increase was primarily the result of a higher net interest margin. Average earning assets for the current quarter were \$112.7 billion, up slightly from \$112.5 billion in the prior-year quarter, primarily resulting from higher levels of securities, partially offset by lower levels of short-term interest-bearing deposits with banks and reductions in loans and leases. Earning asset growth was funded primarily by higher levels of borrowed funds, partially offset by lower levels of client demand and other noninterest-bearing deposits and client interest-bearing deposits.

The net interest margin on an FTE basis increased to 1.47% in the current quarter from 1.29% in the prior-year quarter, primarily due to higher short-term interest rates and lower premium amortization, partially offset by a balance sheet mix shift.



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 and net interest margin on a GAAP basis to net interest income and net interest margin on an FTE basis (each of which is a non-GAAP financial measure) is provided on page 28.

Federal Reserve and other central bank deposits averaged \$22.9 billion, down \$2.3 billion, or 9%, from \$25.2 billion in the prior-year quarter. Average securities were \$50.8 billion, up \$6.1 billion, or 14%, from \$44.7 billion in the prior-year quarter and include certain community development investments, Federal Home Loan Bank stock, and Federal Reserve stock of \$489.5 million, \$236.6 million and \$53.8 million, respectively, which are recorded in other assets in the consolidated balance sheets.

Loans and leases averaged \$31.8 billion, down \$1.7 billion, or 5%, from \$33.5 billion in the prior-year quarter, primarily reflecting lower levels of residential real estate, commercial real estate, and commercial and institutional loans. Residential real estate loans averaged \$6.9 billion, down \$650.1 million, or 9%, from \$7.6 billion for the prior-year quarter. Commercial and institutional loans averaged \$9.3 billion, down \$533.0 million, or 5%, from \$9.8 billion for the prior-year quarter. Commercial real estate loans averaged \$3.4 billion, down \$235.9 million, or 6%, from \$3.6 billion for the prior-year quarter. Private client loans averaged \$10.6 billion in both the current and prior-year quarters.

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## THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Net Interest Income (continued)

Northern Trust utilizes a diverse mix of funding sources. Total interest-bearing deposits averaged \$74.1 billion in the current quarter, compared to \$75.4 billion in the prior-year quarter, a decrease of \$1.3 billion. Other interest-bearing funds averaged \$14.7 billion in the current quarter, compared to \$10.7 billion in the prior-year quarter. 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 decreased \$2.5 billion, or 9%, to \$23.9 billion in the current quarter from \$26.4 billion in the prior-year quarter, primarily resulting from lower levels of client demand and other noninterest-bearing deposits.

## Provision for Credit Losses

The provision credit for credit losses was a credit of \$9.0 million in the current quarter, as compared to a credit of \$7.0 million in the prior-year quarter. The provision credit in the current quarter was primarily driven by reductions in outstanding loans and undrawn loan commitments attributable to the commercial and institutional and residential real estate portfolios as well as improved credit quality across all major portfolios. Net recoveries in the current quarter were \$0.3 million, resulting from charge-offs of \$2.8 million and recoveries of \$3.1 million. The prior-year quarter included \$1.6 million of net recoveries, reflecting \$3.5 million of charge-offs and \$5.1 million of recoveries. Nonperforming assets of \$124.9 million decreased 14% from \$145.5 million at the end of the prior-year quarter. Residential real estate, commercial and institutional, and commercial real estate loans accounted for 86%, 8%, and 6%, respectively, of total nonperforming loans and leases at September 30, 2018. For additional discussion of the provision and allowance for credit losses, refer to the “Asset Quality” section beginning on page 23.

## Noninterest Expense

The components of noninterest expense are provided below.

Table 13: Noninterest Expense

Noninterest Expense (\$ In Millions)	Three Months Ended September 30,			Change
	2018	2017		
Compensation	\$436.1	\$418.3	\$17.8	4 %
Employee Benefits	85.5	74.8	10.7	14
Outside Services	186.9	172.7	14.2	8
Equipment and Software	145.7	130.5	15.2	12
Occupancy	51.0	47.3	3.7	8
Other Operating Expense	97.1	92.0	5.1	5
Total Noninterest Expense	\$1,002.3	\$935.6	\$66.7	7 %

Compensation expense, the largest component of noninterest expense, totaled \$436.1 million in the current quarter, up \$17.8 million, or 4%, compared to \$418.3 million in the prior-year quarter, primarily reflecting higher salary expense and higher cash-based incentive accruals. Compensation expense in the prior-year quarter included a charge of \$6.0 million from severance-related and restructuring charges. The increase in salary expense was driven by base pay adjustments and the acquisition of UBS Asset Management’s fund administration units in Luxembourg and Switzerland (the UBS acquisition).

Employee benefits expense totaled \$85.5 million in the current quarter, up \$10.7 million, or 14%, compared to \$74.8 million in the prior-year quarter, primarily due to higher medical costs and retirement plan expenses.

Outside services expense totaled \$186.9 million in the current quarter, up \$14.2 million, or 8%, compared to \$172.7 million in the prior-year quarter, primarily reflecting a change in presentation of third-party advisor costs resulting from the adoption of the new revenue recognition accounting standard as of January 1, 2018, increased costs associated with the UBS acquisition, and higher technical services costs, partially offset by lower consulting services and sub-advisor costs. There is a corresponding increase to trust, investment and other servicing fees as a result of the

adoption of the new revenue recognition accounting standard.

Equipment and software expense totaled \$145.7 million in the current quarter, up \$15.2 million, or 12%, compared to \$130.5 million in the prior-year quarter, primarily reflecting higher software amortization and disposition charges.

Other operating expense totaled \$97.1 million in the current quarter, up \$5.1 million, or 5%, from \$92.0 million in the prior-year quarter, primarily driven by increased costs associated with the UBS acquisition.

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## THIRD QUARTER CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Noninterest Expense (continued)

The components of other operating expense are provided below.

Table 14: Other Operating Expense

Other Operating Expense	Three Months Ended September 30,			
	2018	2017	Change	
(\$ In Millions)				
Business Promotion	\$38.3	\$36.5	\$1.8	5 %
Staff Related	10.1	10.2	(0.1)	—
FDIC Insurance Premiums	8.2	9.1	(0.9)	(11)
Other Intangibles Amortization	4.3	2.3	2.0	83
Other Expenses	36.2	33.9	2.3	7
Total Other Operating Expense	\$97.1	\$92.0	\$5.1	5 %

## Provision for Income Taxes

Income tax expense for the three months ended September 30, 2018 was \$106.5 million, representing an effective tax rate of 22.1%, compared to \$118.2 million in the prior-year quarter, representing an effective tax rate of 28.4%.

The decrease in the provision for income taxes was primarily attributable to the reduction in the U.S. corporate income tax rate from 35% to 21% as a result of the Tax Cuts and Jobs Act (“TCJA”) enacted in the fourth quarter of 2017 as well as adjustments of \$5.5 million recorded in the current quarter associated with the re-establishment of a deferred tax asset based on the issuance of guidance by the Internal Revenue Service (IRS) related to the implementation of the TCJA. Decreases to the provision for income taxes were partially offset by an increase in income before income taxes, Federal and State research tax credits of \$17.6 million recognized in the prior-year quarter due to the completion of a study of the Corporation’s technology spend between 2013 and 2016, and tax accounting changes in 2018 brought about by the TCJA including the tax accounting associated with non-U.S. branches and subsidiaries. The initial estimated impact of the TCJA may continue to be refined in future periods as further information becomes available.

During the current quarter, the IRS issued proposed regulations with respect to the TCJA’s Global Intangible Low-Taxed Income (“GILTI”) provisions. Based on the Corporation’s analysis of these proposed regulations, they are not expected to impact the Corporation materially if adopted as proposed.

## 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 items, are not allocated to C&IS and Wealth Management, and are reported in Northern Trust’s third reporting segment, Treasury and Other, in the following pages.

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## REPORTING SEGMENTS (continued)

The following tables reflect the earnings contributions and average assets of Northern Trust's reporting segments for the three- and nine- month periods ended September 30, 2018 and 2017. Reporting segment 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, equity and the applicable interest income and expense.

Table 15: Results of Reporting Segments

Three Months Ended September 30, (\$ In Millions)	Corporate & Institutional Services		Wealth Management		Treasury and Other		Total Consolidated	
	2018	2017	2018	2017	2018	2017	2018	2017
Noninterest Income Trust, Investment and Other Servicing Fees	\$541.0	\$501.1	\$398.2	\$366.8	\$—	\$—	\$939.2	\$867.9
Foreign Exchange Trading Income	51.4	47.2	0.9	0.7	19.4	1.2	71.7	49.1
Other Noninterest Income	42.0	43.8	25.5	25.2	(12.3 )	5.0	55.2	74.0
Net Interest Income*	253.0	194.0	202.9	186.6	(37.4 )	(14.4 )	418.5	366.2
Revenue*	887.4	786.1	627.5	579.3	(30.3 )	(8.2 )	1,484.6	1,357.2
Provision for Credit Losses	(2.8 )	0.8	(6.2 )	(7.8 )	—	—	(9.0 )	(7.0 )
Noninterest Expense	601.0	542.1	362.0	348.8	39.3	44.7	1,002.3	935.6
Income before Income Taxes*	289.2	243.2	271.7	238.3	(69.6 )	(52.9 )	491.3	428.6
Provision for Income Taxes*	66.1	78.4	67.2	90.3	(16.5 )	(38.5 )	116.8	130.2
Net Income	\$223.1	\$164.8	\$204.5	\$148.0	\$(53.1 )	\$(14.4 )	\$374.5	\$298.4
Percentage of Consolidated Net Income	59	% 55	% 55	% 50	% (14 )	% (5 )	% 100	% 100
Average Assets	\$83,360.6	\$82,250.9	\$26,110.5	\$26,463.0	\$12,684.5	\$12,445.5	\$122,155.6	\$121,159.4

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\* Non-GAAP financial measures stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of \$10.3 million for 2018 and \$12.0 million for 2017. A reconciliation of total consolidated revenue, net interest income and net interest margin on a GAAP basis to revenue, net interest income and net interest margin on an FTE basis (each of which is a non-GAAP financial measure) is provided on page 28.

Nine Months

Ended September 30, (\$ In Millions)	Corporate & Institutional Services		Wealth Management		Treasury and Other		Total Consolidated	
	2018	2017	2018	2017	2018	2017	2018	2017
Noninterest Income Trust, Investment and Other Servicing Fees	\$1,637.5	\$1,451.1	\$1,182.3	\$1,073.2	\$—	\$—	\$2,819.8	\$2,524.3
Foreign Exchange Trading Income	173.9	146.9	3.1	2.4	52.1	(2.2 )	229.1	147.1
Other Noninterest Income	133.6	132.4	77.9	77.4	(9.5 )	20.4	202.0	230.2
Net Interest Income*	730.3	536.5	611.3	545.4	(107.8 )	(2.9 )	1,233.8	1,079.0
Revenue*	2,675.3	2,266.9	1,874.6	1,698.4	(65.2 )	15.3	4,484.7	3,980.6
Provision for Credit Losses	(3.7 )	(1.6 )	(6.8 )	(13.4 )	—	—	(10.5 )	(15.0 )
Noninterest Expense	1,785.9	1,598.5	1,097.2	1,046.0	111.9	123.0	2,995.0	2,767.5
Income before Income Taxes*	893.1	670.0	784.2	665.8	(177.1 )	(107.7 )	1,500.2	1,228.1
Provision for Income Taxes*	195.9	213.0	193.7	251.4	(35.9 )	(78.7 )	353.7	385.7
Net Income	\$697.2	\$457.0	\$590.5	\$414.4	\$(141.2 )	\$(29.0 )	\$1,146.5	\$842.4
Percentage of Consolidated Net Income	61	% 54	% 51	% 49	% (12 )	% (3 )	% 100	% 100
Average Assets	\$83,049.5	\$80,229.1	\$26,101.6	\$26,648.7	\$14,345.6	\$11,818.2	\$123,496.7	\$118,696.0

\* Non-GAAP financial measures stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of \$28.3 million for 2018 and \$29.8 million for 2017. A reconciliation of total consolidated revenue, net interest income and net interest margin on a GAAP basis to revenue, net interest income and net interest margin on an FTE basis (each of which is a non-GAAP financial measure) is provided on page 28.



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## REPORTING SEGMENTS (continued)

## Corporate &amp; Institutional Services

C&IS net income totaled \$223.1 million in the current quarter compared to \$164.8 million in the prior-year quarter, an increase of \$58.3 million, or 35%. Noninterest income was \$634.4 million in the current quarter, up \$42.3 million, or 7%, from \$592.1 million in the prior-year quarter, primarily reflecting higher trust, investment and other servicing fees and foreign exchange trading income.

Table 16: C&amp;IS Trust, Investment and Other Servicing Fees

(\$ In Millions)	Three Months Ended			
	September 30,			
	2018	2017	Change	
Custody and Fund Administration	\$374.7	\$338.1	\$36.6	11 %
Investment Management	108.7	104.3	4.4	4
Securities Lending	24.1	22.8	1.3	6
Other	33.5	35.9	(2.4)	(7)
Total C&IS Trust, Investment and Other Servicing Fees	\$541.0	\$501.1	\$39.9	8 %

Custody and fund administration fees, the largest component of C&IS fees, are driven primarily by values of client AUC/A, transaction volumes and number of accounts. The asset values used to calculate these fees vary depending on the individual fee arrangements negotiated with each client. Custody fees related to asset values are client specific and are priced based on quarter-end or month-end values, values at the beginning of each quarter or average values for a month or quarter. The fund administration fees that are asset-value-related are priced using month-end, quarter-end, or average daily balances. Investment management fees are based generally on market values of client assets under management throughout the period.

Custody and fund administration fees increased \$36.6 million, or 11%, from the prior-year quarter, primarily due to revenue associated with the UBS acquisition, new business, and favorable markets. Investment management fees increased \$4.4 million, or 4%, primarily due to favorable markets and a change in presentation of certain fees resulting from the adoption of the new revenue recognition standard. Securities lending fees increased 6%, primarily due to increased loan volumes, partially offset by lower spreads. Other fees decreased 7%, primarily due to lower sub-advisor fees. The income associated with sub-advisor fees has an associated expense in outside services.

Foreign exchange trading income totaled \$51.4 million in the current quarter, an increase of \$4.2 million, or 9%, from \$47.2 million in the prior-year quarter. The increase was driven primarily by higher client volumes.

Other noninterest income in C&IS totaled \$42.0 million in the current quarter, down 4%, from \$43.8 million in the prior-year quarter, primarily due to lower banking and credit-related service fees, partially offset by an increase in securities commissions and trading income.

Net interest income stated on an FTE basis was \$253.0 million in the current quarter, up \$59.0 million, or 30%, from \$194.0 million in the prior-year quarter. The increase in net interest income was primarily attributable to an increase in the net interest margin and higher levels of earning assets. The net interest margin increased to 1.30% from 1.01% in the prior-year quarter, primarily due to higher short-term interest rates. Average earning assets totaled \$77.2 billion, up from \$76.4 billion in the prior-year quarter. The earning assets in C&IS consisted primarily of intercompany assets and loans and leases. Funding sources were primarily comprised of non-U.S. custody-related interest-bearing deposits, which averaged \$54.4 billion in the current quarter, up from \$54.1 billion in the prior-year quarter.

The provision for credit losses was a credit of \$2.8 million in the current quarter, compared with a provision of \$0.8 million in the prior-year quarter. The current quarter provision credit reflected reductions in outstanding loans and undrawn loan commitments, as well as improved credit quality, that resulted in a reduction in the inherent allowance. The prior-year quarter provision reflected an increase in the inherent reserve requirement.

Total C&IS noninterest expense, which includes the direct expense of the reporting segment, indirect expense allocations for product and operating support and indirect expense allocations for certain corporate support services, totaled \$601.0 million in the current quarter, up \$58.9 million, or 11%, from \$542.1 million in the prior-year quarter, primarily reflecting higher compensation expense, indirect expense allocations, employee benefit expense, other



operating expense, and outside services expense.

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## REPORTING SEGMENTS (continued)

## Corporate &amp; Institutional Services (continued)

The provision for income taxes was \$66.1 million in the current quarter compared to \$78.4 million in the prior-year quarter, primarily attributable to the reduction in the U.S. federal corporate income tax rate from 35% to 21% as a result of the TCJA, partially offset by an increase in income before income taxes.

## Wealth Management

Wealth Management net income was \$204.5 million in the current quarter, up \$56.5 million, or 38%, from \$148.0 million in the prior-year quarter. Noninterest income was \$424.6 million, up \$31.9 million, or 8%, from \$392.7 million in the prior-year quarter, primarily reflecting higher trust, investment and other servicing fees. Trust, investment and other servicing fees in Wealth Management totaled \$398.2 million in the current quarter, increasing \$31.4 million, or 9%, from \$366.8 million in the prior-year quarter. The following table provides a summary of Wealth Management trust, investment and other servicing fees.

Table 17: Wealth Management Trust, Investment and Other Servicing Fees

(\$ In Millions)	Three Months Ended			
	September 30,		Change	
	2018	2017		
Central	\$152.2	\$145.4	\$6.8	5 %
East	102.7	90.2	12.5	14
West	80.7	73.7	7.0	9
Global Family Office	62.6	57.5	5.1	9
Total Wealth Management Trust, Investment and Other Servicing Fees	\$398.2	\$366.8	\$31.4	9 %

Wealth Management fee income is calculated primarily based on market values. The increase in Wealth Management fees across all regions was primarily attributable to favorable markets, a change in presentation of certain fees resulting from the adoption of the new revenue recognition standard, and new business. The 9% increase in Global Family Office fees was primarily attributable to new business and favorable markets.

Other noninterest income was \$25.5 million in the current quarter, up 1% from \$25.2 million in the prior-year quarter, primarily reflecting an increase in securities commissions and trading income.

Net interest income stated on an FTE basis was \$202.9 million in the current quarter, up \$16.3 million, or 9%, from \$186.6 million in the prior-year quarter, primarily reflecting an increase in the net interest margin, partially offset by lower levels of earning assets. The net interest margin increased to 3.12% from 2.82% in the prior-year quarter, reflecting higher yields on earning assets. Average earning assets decreased \$372.7 million to \$25.8 billion from the prior-year quarter's \$26.2 billion. Earning assets and funding sources were primarily comprised of loans and domestic interest-bearing deposits, respectively.

The provision for credit losses was a provision credit of \$6.2 million in the current quarter, compared with a provision credit of \$7.8 million in the prior-year quarter. The current-quarter provision credit reflected reductions in outstanding loans and undrawn loan commitments and improved credit quality that resulted in a reduction in the inherent allowance, as well as a reduction in the specific reserve attributable to the residential real estate portfolio. The prior-year quarter provision reflected reductions in undrawn loan commitments and standby letters of credit as well as improved credit quality resulting in a reduction in the inherent allowance.

Total noninterest expense, which includes the direct expense of the reporting segment, indirect expense allocations for product and operating support and indirect expense allocations for certain corporate support services, totaled \$362.0 million in the current quarter, compared to \$348.8 million in the prior-year quarter, an increase of \$13.2 million, or 4%, primarily reflecting higher indirect expense allocations and employee benefits expense.

The provision for income taxes was \$67.2 million in the current quarter compared to \$90.3 million in the prior-year quarter, primarily attributable to the reduction in the U.S. federal corporate income tax rate from 35% to 21% as a result of the TCJA, partially offset by an increase in income before income taxes.



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## REPORTING SEGMENTS (continued)

## Treasury and Other

Treasury and Other includes income and expense associated with the wholesale funding activities and the investment portfolios of the Corporation and the Bank, and certain corporate-based expenses, executive-level compensation and nonrecurring items not allocated to C&IS and Wealth Management.

Treasury and Other noninterest income increased from \$6.2 million in the prior-year quarter to \$7.1 million in the current quarter. The increase in noninterest income in Treasury and Other was driven by higher foreign exchange trading income due to increased foreign exchange swap activity in Treasury, partially offset by an impairment charge of \$8.1 million related to a community development equity investment and higher expenses related to existing swap agreements related to Visa Inc. Class B common shares.

Net interest income decreased \$23.0 million from net interest expense of \$14.4 million in the prior-year quarter to net interest expense of \$37.4 million in the current quarter. The reduction in net interest income in Treasury and Other was driven by higher net funds transfer pricing credits in the C&IS segment, partially offset by higher yields on earning assets and higher net funds transfer pricing charges in the Wealth Management segment. Average earning assets decreased \$187.6 million to \$9.7 billion from \$9.9 billion in the prior-year quarter.

Noninterest expense totaled \$39.3 million in the current quarter, down \$5.4 million, or 12%, from \$44.7 million in the prior-year quarter, primarily reflecting higher indirect expense allocations to C&IS and Wealth Management as compared to the prior-year quarter and lower compensation expense, partially offset by higher equipment and software expense, outside services expense, other operating expense, occupancy expense, and employee benefit expense.

The provision for income taxes was a benefit of \$16.5 million in the current quarter compared to a \$38.5 million benefit in the prior-year quarter. The prior-year quarter tax provision included Federal and State research tax credits of \$17.6 million due to the completion of a study of the Corporation's technology spend between 2013 and 2016. The current-quarter tax provision was impacted by the reduction in the U.S. federal corporate income tax rate from 35% to 21% as a result of the TCJA and adjustments of \$5.5 million associated with the re-establishment of a deferred tax asset based on the issuance of guidance by the IRS related to the implementation of the TCJA, partially offset by a decrease in income before income taxes.

## NINE-MONTH CONSOLIDATED RESULTS OF OPERATIONS

## Overview

Net income per diluted common share was \$4.84 for the nine months ended September 30, 2018, and \$3.41 in the comparable prior-year period. Net income totaled \$1.15 billion, up \$304.1 million, or 36%, compared to \$842.4 million in the prior-year period. The performance in the current period produced an annualized return on average common equity of 15.9%, compared to 11.8% in the prior-year period. The annualized return on average assets was 1.24% in the current period compared to 0.95% in the prior-year period.

Revenue for the nine months ended September 30, 2018 totaled \$4.46 billion, up \$505.5 million, or 13%, as compared to \$3.95 billion in the prior-year period.

Noninterest income was \$3.25 billion, up \$349.3 million, or 12%, from \$2.90 billion in the prior-year period, primarily driven by increased trust, investment, and other servicing fees and foreign exchange trading income, partially offset by lower other operating income.

Net interest income totaled \$1.21 billion, up \$156.3 million, or 15%, as compared to \$1.05 billion in the prior-year period, due to a higher net interest margin and an increase in earning assets.

The provision for credit losses was a provision credit of \$10.5 million in the current period, as compared to a provision credit of \$15.0 million in the prior-year period.

Noninterest expense totaled \$3.00 billion in the current period, up \$227.5 million, or 8%, from \$2.77 billion in the prior-year period, primarily attributable to higher compensation, outside services, equipment and software, employee benefits, and occupancy expense.



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## NINE-MONTH CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Noninterest Income

The components of noninterest income are provided below.

Table 18: Nine Months Ended September 30 Noninterest Income

Noninterest Income (\$ In Millions)	Nine Months Ended September 30,			
	2018	2017	Change	
Trust, Investment and Other Servicing Fees	\$2,819.8	\$2,524.3	\$295.5	12 %
Foreign Exchange Trading Income	229.1	147.1	82.0	56
Treasury Management Fees	40.0	42.8	(2.8 )	(7 )
Security Commissions and Trading Income	75.2	65.8	9.4	14
Other Operating Income	87.1	122.7	(35.6 )	(29)
Investment Security Losses, net	(0.3 )	(1.1 )	0.8	(72)
Total Noninterest Income	\$3,250.9	\$2,901.6	\$349.3	12 %

As illustrated in the following table, trust, investment and other servicing fees from C&IS increased \$186.4 million, or 13%, totaling \$1.64 billion, compared to \$1.45 billion a year ago.

Table 19: Nine Months Ended September 30 C&amp;IS Trust, Investment and Other Servicing Fees

C&IS Trust, Investment and Other Servicing Fees (\$ In Millions)	Nine Months Ended September 30,			
	2018	2017	Change	
Custody and Fund Administration	\$1,125.3	\$973.1	\$152.2	16 %
Investment Management	331.5	297.1	34.4	12
Securities Lending	80.3	71.2	9.1	13
Other	100.4	109.7	(9.3 )	(8 )
Total	\$1,637.5	\$1,451.1	\$186.4	13 %

Custody and fund administration fees, the largest component of C&IS fees, increased 16%, primarily driven by revenue associated with the UBS acquisition, new business, the favorable impact of movements in foreign exchange rates, and favorable markets. C&IS investment management fees increased 12%, primarily due to favorable markets, a change in presentation of certain fees resulting from the adoption of the new revenue recognition standard, and new business. Securities lending fees increased 13%, primarily driven by increased loan volumes, partially offset by lower spreads. Other fees in C&IS decreased 8%, primarily due to lower sub-advisor fees, partially offset by new business. The decrease associated with sub-advisor fees has an associated decrease in outside services expense.

As illustrated in the following table, trust, investment and other servicing fees from Wealth Management totaled \$1.18 billion, up \$109.1 million, or 10%, from \$1.07 billion a year ago.

Table 20: Nine Months Ended September 30 Wealth Management Trust, Investment and Other Servicing Fees

(\$ In Millions)	Nine Months Ended September 30,			
	2018	2017	Change	
Wealth Management Trust, Investment and Other Servicing Fees				
Central	\$456.8	\$425.9	\$30.9	7 %
East	298.6	263.7	34.9	13
West	239.7	216.7	23.0	11
Global Family Office	187.2	166.9	20.3	12
Total	\$1,182.3	\$1,073.2	\$109.1	10 %

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## NINE-MONTH CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Noninterest Income (continued)

The increase in Wealth Management fees across the regions was primarily attributable to favorable markets, a change in presentation of certain fees resulting from the adoption of the new revenue recognition standard, and new business. The 12% increase in Global Family Office fees was primarily attributable to new business and favorable markets. Foreign exchange trading income increased \$82.0 million, or 56%, and totaled \$229.1 million compared with \$147.1 million in the prior-year period. The increase was primarily attributable to increased foreign exchange swap activity in Treasury, increased market volatility and higher spreads.

Security commissions and trading income increased \$9.4 million, or 14%, and totaled \$75.2 million compared with \$65.8 million in the prior-year period. The increase was attributable to higher core brokerage and transition management revenue.

Other operating income decreased \$35.6 million, or 29%, to \$87.1 million compared with \$122.7 million in the prior-year period. The decrease was due to expenses related to existing swap agreements related to Visa Inc. Class B common shares recorded in other income in the current period, \$8.1 million of impairment recognized related to a community development equity investment previously held at cost, non-recurring net gains on hedging activity recognized in the prior-year period, and lower banking and credit-related service fees. The components of other operating income are provided below.

Table 21: Nine Months Ended September 30 Other Operating Income

Other Operating Income	Nine Months		
	Ended		
	September		
	30,		
(\$ In Millions)	2018	2017	Change
Loan Service Fees	\$36.8	\$38.4	\$(1.6 ) (4 )%
Banking Service Fees	35.3	37.5	(2.2 ) (6 )
Other Income	15.0	46.8	(31.8 ) (68)
Total Other Operating Income	\$87.1	\$122.7	\$(35.6) (29)%

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## NINE-MONTH 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 22: Nine Months Ended September 30 Average Consolidated Balance Sheets with Analysis of Net Interest Income

(Interest and Rate on a Fully Taxable Equivalent Basis) (\$ In Millions)	NORTHERN TRUST CORPORATION					
	Nine Months Ended September 30, 2018			2017		
	Interest	Average Balance	Rate <sup>(5)</sup>	Interest	Average Balance	Rate <sup>(5)</sup>
<b>Average Earning Assets</b>						
Federal Reserve and Other Central Bank Deposits	\$ 146.1	\$24,619.3	0.79 %	\$ 108.4	\$23,198.9	0.62 %
Interest-Bearing Due from and Deposits with Banks <sup>(1)</sup>	53.8	6,290.3	1.14	45.0	7,163.0	0.84
Federal Funds Sold and Securities Purchased under Agreements to Resell	25.2	1,554.3	2.17	21.7	2,005.4	1.45
<b>Securities</b>						
U.S. Government	78.5	5,726.7	1.83	67.1	6,542.2	1.37
Obligations of States and Political Subdivisions	9.8	731.6	1.76	10.0	920.8	1.45
Government Sponsored Agency	315.9	20,227.8	2.09	196.0	17,887.4	1.47
Other <sup>(2)</sup>	259.6	22,939.2	1.51	178.0	19,066.8	1.25
Total Securities	663.8	49,625.4	1.79	451.1	44,417.2	1.36
Loans and Leases <sup>(3)</sup>	812.2	32,165.0	3.38	684.9	33,676.2	2.72
Total Earning Assets	1,701.1	114,254.3	1.99	1,311.1	110,460.7	1.59
Allowance for Credit Losses Assigned to Loans and Leases	—	(128.3 )	—	—	(159.4 )	—
Cash and Due from Banks and Other Central Bank Deposits <sup>(4)</sup>	—	2,579.3	—	—	2,496.9	—
Buildings and Equipment	—	441.2	—	—	466.1	—
Client Security Settlement Receivables	—	973.9	—	—	858.9	—
Goodwill	—	633.3	—	—	521.7	—
Other Assets	—	4,743.0	—	—	4,051.1	—
Total Assets	\$—	\$123,496.7	— %	\$—	\$118,696.0	— %
<b>Average Source of Funds</b>						
<b>Deposits</b>						
Savings, Money Market and Other	\$ 51.9	\$15,418.9	0.45 %	\$ 15.2	\$15,433.9	0.13 %
Savings Certificates and Other Time	6.0	921.0	0.87	7.0	1,301.8	0.72
Non-U.S. Offices — Interest-Bearing	187.9	58,449.7	0.43	101.5	55,892.8	0.24
Total Interest-Bearing Deposits	245.8	74,789.6	0.44	123.7	72,628.5	0.23
Short-Term Borrowings	143.6	10,714.6	1.79	41.5	6,117.7	0.91
Senior Notes	38.1	1,605.5	3.18	35.0	1,496.9	3.14
Long-Term Debt	34.3	1,363.3	3.36	28.3	1,512.4	2.50
Floating Rate Capital Debt	5.5	277.5	2.64	3.6	277.4	1.71
Total Interest-Related Funds	467.3	88,750.5	0.70	232.1	82,032.9	0.38
Interest Rate Spread	—	—	1.29	—	—	1.21
Demand and Other Noninterest-Bearing Deposits	—	20,969.9	—	—	23,641.1	—
Other Liabilities	—	3,571.0	—	—	3,085.2	—
Stockholders' Equity	—	10,205.3	—	—	9,936.8	—
Total Liabilities and Stockholders' Equity	\$—	\$123,496.7	— %	\$—	\$118,696.0	— %



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Net Interest Income/Margin (FTE Adjusted)	\$1,233.8 \$—	1.44 %	\$1,079.0 \$—	1.31 %
Net Interest Income/Margin (Unadjusted)	\$1,205.5 \$—	1.41 %	\$1,049.2 \$—	1.27 %

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## NINE-MONTH CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Net Interest Income (continued)

ANALYSIS OF NET INTEREST INCOME CHANGES  
DUE TO VOLUME AND RATE

(In Millions)	Nine Months Ended		
	September 30, 2018/2017		
	Change Due To		
	Average Balance	Rate	Total
Earning Assets (FTE)	\$58.6	\$331.4	\$390.0
Interest-Related Funds	42.9	192.3	235.2
Net Interest Income (FTE)	\$15.7	\$139.1	\$154.8

(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 sheets.

(2) Reserve stock, which are classified in other assets in the consolidated balance sheets as of September 30, 2018 and 2017.

(3) Average balances include nonaccrual loans. Lease financing receivable balances are reduced by deferred income.

(4) Cash and Due from Banks and Other Central Bank Deposits includes the non-interest-bearing component of Federal Reserve and Other Central Bank Deposits as presented on the consolidated balance sheets.

(5) Rate calculations are based on actual balances rather than the rounded amounts presented in the Average Consolidated Balance Sheets with Analysis of Net Interest Income.

Net Interest Income (FTE Adjusted), a non-generally accepted accounting principle (GAAP) financial measure, 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 24.8% and 38.1% for the nine months ended September 30, 2018 and Notes: 2017, respectively. Total taxable equivalent interest adjustments amounted to \$28.3 million and \$29.8 million for the nine months ended September 30, 2018 and 2017, respectively. A reconciliation of net interest income and net interest margin on a GAAP basis to net interest income and net interest margin on an FTE basis (each of which is a non-GAAP financial measure) is provided on page 28.

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, stated on an FTE basis, totaled \$1.23 billion, an increase of \$154.8 million, or 14%, from \$1.08 billion reported in the prior-year period. The increase is the result of higher net interest margin and an increase in earning assets. Average earning assets were \$114.3 billion, up \$3.8 billion, or 3%, from \$110.5 billion in the prior-year period, primarily attributable to higher levels of securities, partially offset by a reduction in loans and leases. The net interest margin, on an FTE basis, increased to 1.44% from 1.31% in the prior-year period.

**Provision for Credit Losses**

The provision for credit losses was a provision credit of \$10.5 million in the current-year period, compared to a provision credit of \$15.0 million in the prior-year period. The credit provision in the current-year period was primarily driven by reductions in outstanding loans that resulted in a reduction in the inherent allowance ascribed to the residential real estate, commercial real estate, and commercial and institutional portfolios as well as the reduction in the specific reserve attributable to the residential real estate portfolio. Net charge-offs in the current-year period totaled \$2.8 million resulting from \$9.3 million of charge-offs and \$6.5 million of recoveries, compared to net charge-offs of \$3.6 million in the prior-year period resulting from \$13.2 million of charge-offs and \$9.6 million of

recoveries. Residential real estate loans continued to reflect weakness relative to the overall portfolio, accounting for 86% and 88% of total nonperforming loans and leases at September 30, 2018 and 2017, respectively. Loan balances within the residential real estate, commercial and institutional, and commercial real estate portfolios decreased in the current period, while loan balances in the private client portfolio increased slightly. For additional discussion of the consolidated allowance and provision for credit losses refer to the “Asset Quality” section beginning on page 23.

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## NINE-MONTH CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Noninterest Expense

Noninterest expense totaled \$3.00 billion for the current period, up \$227.5 million, or 8%, compared to \$2.77 billion in the prior-year period. The components of noninterest expense are provided below.

Table 23: Nine Months Ended September 30 Noninterest Expense

Noninterest Expense (\$ In Millions)	Nine Months Ended September 30,			
	2018	2017	Change	
Compensation	\$1,362.5	\$1,276.6	\$85.9	7 %
Employee Benefits	266.0	228.2	37.8	17
Outside Services	543.9	492.8	51.1	10
Equipment and Software	429.9	391.5	38.4	10
Occupancy	151.3	139.0	12.3	9
Other Operating Expense	241.4	239.4	2.0	1
Total Noninterest Expense	\$2,995.0	\$2,767.5	\$227.5	8 %

Compensation expense, the largest component of noninterest expense, totaled \$1.36 billion, up \$85.9 million, or 7%, from \$1.28 billion in the prior-year period, reflecting increases due to higher salary expense driven by base pay adjustments and the UBS acquisition and higher cash-based incentive accruals, partially offset by lower severance-related and restructuring charges of \$9.9 million in the current period compared to \$25.5 million in the prior-year period.

Employee benefits expense of \$266.0 million was up \$37.8 million, or 17%, from \$228.2 million in the prior-year period, reflecting higher retirement plan expenses, medical expenses, and payroll taxes, partially offset by \$3.1 million of severance-related and restructuring charges recorded in the prior-year period.

Outside services expense equaled \$543.9 million, up \$51.1 million, or 10%, from \$492.8 million in the prior-year period, primarily reflecting a change in presentation of third-party advisor costs resulting from the adoption of the new revenue recognition accounting standard, increased costs associated with the UBS acquisition, higher sub-custodian expenses, higher technical services costs, and higher severance-related and restructuring charges of \$8.0 million in the current period compared to \$1.2 million in the prior-year period, partially offset by lower sub-advisor costs and consulting services. There is a corresponding increase to trust, investment and other servicing fees as a result of the adoption of the new revenue recognition accounting standard.

Equipment and software expense totaled \$429.9 million, up \$38.4 million, or 10%, from \$391.5 million in the prior-year period, reflecting increased software amortization, costs associated with the UBS acquisition, and disposition charges.

Occupancy expense equaled \$151.3 million, up \$12.3 million, or 9%, from \$139.0 million in the prior-year period, primarily reflecting accelerated depreciation expense related to a previously announced facility exit.

Other operating expense totaled \$241.4 million, up \$2.0 million, or 1%, from \$239.4 million in the prior-year period, primarily reflecting higher costs associated with the UBS acquisition, partially offset by lower charges associated with account servicing activities and lower staff-related expenses. The components of other operating expense are provided below.

Table 24: Nine Months Ended September 30 Other Operating Expense

Other Operating Expense (\$ In Millions)	Nine Months Ended September 30,			Change	
	2018	2017			
Business Promotion	\$76.2	\$72.5	\$3.7	5	%
Staff Related	25.8	31.6	(5.8 )	(18)	
FDIC Insurance Premiums	24.6	26.1	(1.5 )	(6 )	

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Other Intangibles Amortization	13.2	7.0	6.2	87
Other Expenses	101.6	102.2	(0.6)	(1)
Total Other Operating Expense	\$241.4	\$239.4	\$2.0	1%

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## NINE-MONTH CONSOLIDATED RESULTS OF OPERATIONS (continued)

## Provision for Income Taxes

Income tax expense for the nine months ended September 30, 2018 was \$325.4 million, representing an effective tax rate of 22.1%, compared to \$355.9 million for the nine months ended September 30, 2017, representing an effective tax rate of 29.7%.

The decrease in the provision for income taxes compared to the prior-year period was primarily attributable to the reduction in the U.S. corporate income tax rate from 35% to 21% as a result of the TCJA enacted in the fourth quarter of 2017 and a \$22.6 million benefit resulting from a change in accounting method regarding the timing of tax deductions for software development-related expenses. Decreases to the provision for income taxes were partially offset by an increase in income before income taxes, tax accounting changes in 2018 brought about by the TCJA including the tax accounting associated with non-U.S. branches and subsidiaries, Federal and State research tax credits of \$17.6 million recognized in the prior-year period due to the completion of a study of the Corporation's technology spend between 2013 and 2016, a reduction in the income tax benefit derived from the vesting of restricted stock units and stock option exercises compared to the prior-year period, and a \$10.3 million net provision representing adjustments to the initial estimated impact of the TCJA recorded in the fourth quarter of 2017. The initial estimated impact of the TCJA may continue to be refined in future periods as further information becomes available.

## CONSOLIDATED BALANCE SHEETS

Total assets were \$132.4 billion and \$138.6 billion at September 30, 2018 and December 31, 2017, respectively, and averaged \$122.2 billion in the current quarter compared with \$121.2 billion in the quarter ended September 30, 2017. Average balances are considered to be a better measure of balance sheet trends, as period-end balances can be impacted by the timing of deposit and withdrawal activity involving large client balances. Loans and leases totaled \$31.4 billion and \$32.6 billion at September 30, 2018 and December 31, 2017, respectively, and averaged \$31.8 billion in the current quarter, down 5% from \$33.5 billion in the quarter ended September 30, 2017. 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 sheets, totaled \$51.7 billion and \$47.4 billion at September 30, 2018 and December 31, 2017, respectively, and averaged \$50.8 billion for the current quarter, up 14% from \$44.7 billion in the quarter ended September 30, 2017. In aggregate, the categories of federal funds sold and securities purchased under agreements to resell, interest-bearing due from and deposits with banks, and Federal Reserve and other central bank deposits totaled \$39.3 billion and \$49.6 billion at September 30, 2018 and December 31, 2017, respectively, and averaged \$30.1 billion in the current quarter, down 12% from \$34.3 billion in the quarter ended September 30, 2017, primarily reflecting decreased Federal Reserve and other central bank deposits and lower interest-bearing due from and deposits with banks. Interest-bearing client deposits at September 30, 2018 and December 31, 2017, totaled \$80.9 billion and \$83.8 billion, respectively, and averaged \$74.1 billion in the current quarter compared to \$75.4 billion in the quarter ended September 30, 2017. Noninterest-bearing client deposits at September 30, 2018 and December 31, 2017 totaled \$24.0 billion and \$28.6 billion, respectively, and averaged \$19.4 billion in the current quarter, down 11% from \$21.7 billion in the quarter ended September 30, 2017.

Total stockholders' equity was \$10.4 billion at September 30, 2018 and \$10.2 billion at December 31, 2017, and averaged \$10.3 billion for the current quarter, up 2% from \$10.0 billion for the quarter ended September 30, 2017.

The increase in stockholders' equity was primarily attributable to earnings, partially offset by the repurchase of common stock pursuant to the Corporation's share repurchase program and dividend declarations.

During the three and nine months ended September 30, 2018, the Corporation declared cash dividends totaling \$123.4 million and \$315.6 million to common stockholders, and cash dividends totaling \$17.3 million and \$40.5 million to preferred stockholders, respectively. During the three and nine months ended September 30, 2018, the Corporation repurchased 2,171,699 shares of common stock, including 54,672 shares withheld related to share-based compensation, at a total cost of \$235.9 million (\$108.62 average price per share) and 6,477,409 shares of common stock, including 439,781 shares withheld related to share-based compensation, at a total cost of \$689.7 million (\$106.48 average price per share), respectively.



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## CAPITAL RATIOS

The capital ratios of Northern Trust and its principal subsidiary, The Northern Trust Company, remained strong at September 30, 2018, exceeding the minimum requirements for classification as “well-capitalized” under applicable U.S. regulatory requirements.

The table below provides capital ratios for Northern Trust Corporation and The Northern Trust Company determined by Basel III phased in requirements.

Table 25: Regulatory Capital Ratios

Capital Ratios — Northern Trust Corporation	September 30, 2018			June 30, 2018			September 30, 2017		
	Advanced	Standardized		Advanced	Standardized		Advanced	Standardized	
	Approach	Approach		Approach	Approach		Approach	Approach	
Common Equity Tier 1	13.4%	12.9	%	13.3%	12.4	%	13.3%	12.3	%
Tier 1	14.8%	14.2	%	14.6%	13.6	%	14.6%	13.4	%
Total	16.7%	16.2	%	16.5%	15.6	%	16.4%	15.4	%
Tier 1 Leverage	7.8	% 7.8	%	7.7	% 7.7	%	8.0	% 8.0	%
Supplementary Leverage	6.9	% N/A		6.8	% N/A		6.9	% N/A	

Capital Ratios — The Northern Trust Company	September 30, 2018			June 30, 2018			September 30, 2017		
	Advanced	Standardized		Advanced	Standardized		Advanced	Standardized	
	Approach	Approach		Approach	Approach		Approach	Approach	
Common Equity Tier 1	14.1%	13.2	%	13.8%	12.6	%	13.5%	12.2	%
Tier 1	14.1%	13.2	%	13.8%	12.6	%	13.5%	12.2	%
Total	15.8%	14.9	%	15.4%	14.3	%	15.1%	13.9	%
Tier 1 Leverage	7.2	% 7.2	%	7.1	% 7.1	%	7.2	% 7.2	%
Supplementary Leverage	6.4	% N/A		6.2	% N/A		6.2	% N/A	

## STATEMENTS OF CASH FLOWS

Net cash provided by operating activities of \$1.3 billion for the nine months ended September 30, 2018 was primarily attributable to period earnings and the impact of non-cash charges such as amortization of computer software, partially offset by higher net collateral deposited with derivative counterparties and an increase in receivables. For the nine months ended September 30, 2017, net cash provided by operating activities of \$869.7 million was primarily attributable to period earnings, net collateral deposited with derivative counterparties, and the impact of non-cash charges such as amortization of computer software, partially offset by net changes in other operating activities primarily due to a decrease in accounts payable.

Net cash provided by investing activities of \$5.3 billion for the nine months ended September 30, 2018 was primarily attributable to decreased levels of Federal Reserve and other central bank deposits, lower interest-bearing deposits with banks, and lower levels of loans and leases, partially offset by net purchases of debt securities available for sale and held to maturity and net change in other investing activities. For the nine months ended September 30, 2017, net cash used in investing activities of \$6.0 billion was primarily attributable to increased levels of Federal Reserve and other central bank deposits and interest-bearing deposits with banks, offset by lower levels of loans and leases as well as net proceeds from sale, maturity and redemption of securities available for sale.

Net cash used in financing activities of \$5.9 billion for the nine months ended September 30, 2018 was primarily attributable to decreased levels of total deposits, lower securities sold under agreements to repurchase, and the repurchase of common stock pursuant to the Corporation’s share repurchase program, partially offset by higher short-term other borrowings and the proceeds from the issuance of senior notes. The decrease in total deposits was primarily attributable to lower levels of interest-bearing and non-interest bearing domestic and non-U.S. office client deposits. For the nine months ended September 30, 2017, net cash provided by financing activities of \$4.8 billion was primarily attributable to increased levels of total deposits, federal funds purchased, short-term other borrowings, and the proceeds from the issuance of fixed-to-floating rate subordinated notes, partially offset by the repurchase of common stock pursuant to the Corporation’s share repurchase program, and cash dividends paid to common and



preferred stockholders. The increase in total deposits was attributable to higher levels of interest-bearing and non-interest bearing non-U.S. office client deposits.

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## ASSET QUALITY

## Securities Portfolio

Northern Trust maintains a high quality debt securities portfolio, with 80% of the combined available for sale, held to maturity, and trading account portfolios at September 30, 2018, composed of U.S. Treasury and government sponsored agency securities and triple-A rated corporate notes, asset-backed securities, covered bonds, sub-sovereign, supranational, sovereign and non-U.S. agency bonds, commercial mortgage-backed securities and obligations of states and political subdivisions. The remaining portfolio was comprised of corporate notes, asset-backed securities, 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, 8% was rated double-A, 2% was rated below double-A, and 10% was not rated by Moody's Investors Service or Standard and Poor's (primarily negotiable certificates of deposits of banks and non-U.S. sovereign securities whose long term ratings are at least A).

Net unrealized losses within the investment securities portfolio totaled \$356.2 million at September 30, 2018, compared to net unrealized losses of \$160.8 million as of December 31, 2017. Net unrealized losses as of September 30, 2018 were comprised of \$74.3 million and \$430.5 million of gross unrealized gains and losses, respectively. Unrealized losses as of September 30, 2018 of \$199.6 million and \$58.8 million related to government sponsored agency and U.S. government securities, respectively, are primarily attributable to changes in market rates since purchase. \$57.1 million of unrealized losses in securities classified as "other" related to securities primarily purchased at a premium or par by Northern Trust to fulfill its obligation under the Community Reinvestment Act (CRA). Unrealized losses on these CRA-related securities were attributable to yields that were below market rates for the purpose of supporting institutions and programs that benefit low- to moderate-income communities within Northern Trust's market area. Also, \$27.7 million of the unrealized losses related to corporate debt securities, primarily reflecting widened credit spreads and higher market rates since purchase. As of September 30, 2018, 38% of the corporate debt portfolio was backed by guarantees provided by U.S. and non-U.S. governmental entities.

For the nine months ended September 30, 2018, charges of \$0.3 million were recorded relating to the other-than-temporary impairment (OTTI) of certain CRA-eligible securities. There were \$0.1 million OTTI losses for the nine months ended September 30, 2017. 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.

## Nonperforming Loans and Leases and Other Real Estate Owned

Nonperforming assets consist of nonperforming loans and leases and other real estate owned (OREO). OREO is comprised of commercial and residential properties acquired in partial or total satisfaction of loans.

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## ASSET QUALITY (continued)

## Nonperforming Loans and Leases and Other Real Estate Owned (continued)

The following table provides the amounts of nonperforming loans and leases, by loan and lease segment and class, and of OREO that were outstanding at the dates shown, as well as the balance of loans that was 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.

Table 26: Nonperforming Assets

(\$ In Millions)	September 30, 2018	June 30, 2018	September 30, 2017
Nonperforming Loans and Leases			
Commercial			
Commercial and Institutional	\$ 9.3	\$ 14.1	\$ 8.8
Commercial Real Estate	6.6	6.7	8.3
Total Commercial	15.9	20.8	17.1
Personal			
Residential Real Estate	\$ 97.3	\$ 107.6	\$ 120.1
Private Client	0.4	—	0.1
Total Personal	97.7	107.6	120.2
Total Nonperforming Loans and Leases	113.6	128.4	137.3
Other Real Estate Owned	11.3	3.8	8.2
Total Nonperforming Assets	\$ 124.9	\$ 132.2	\$ 145.5
90 Day Past Due Loans Still Accruing	\$ 27.5	\$ 5.2	\$ 8.7
Nonperforming Loans and Leases to Total Loans and Leases	0.36	% 0.40	% 0.41
Coverage of Loan and Lease Allowance to Nonperforming Loans and Leases	1.1	x 1.0	x 1.1

Nonperforming assets of \$124.9 million as of September 30, 2018 primarily reflected decreases within the residential real estate portfolio as a result of payments and charge-offs, partially offset by new nonperforming assets. 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 the level of nonperforming assets may be indicative of changes in the credit quality of one or more loan classes. Changes in credit quality impact 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's underwriting standards do not allow for the origination of loan types generally considered to be high risk in nature, such as option adjustable rate mortgages, subprime loans, loans with initial "teaser" rates and loans with excessively high loan-to-value ratios. Residential real estate loans consist of first lien mortgages and 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 to experienced 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 period 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

necessary.

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## ASSET QUALITY (continued)

## Provision and Allowance for Credit Losses (continued)

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. The inherent component of the allowance addresses exposure relating to probable but unidentified credit-related losses. The inherent component of the allowance also covers the credit exposure associated with undrawn loan commitments and standby letters of credit. To estimate the allowance for credit losses on these instruments, management uses conversion rates to determine the estimated amount that will be drawn and assigns an allowance factor determined in accordance with the methodology utilized for outstanding loans. The provision credit for credit losses was a provision credit of \$9.0 million in the current quarter, compared to a provision credit of \$7.0 million in the prior-year quarter. Net recoveries were \$0.3 million, resulting from \$2.8 million of charge-offs and \$3.1 million of recoveries, compared to \$1.6 million of net recoveries in the prior-year quarter, resulting from \$3.5 million of charge-offs and \$5.1 million of recoveries. Residential real estate loans accounted for 86% and 88% of total nonperforming loans and leases at September 30, 2018 and 2017, respectively.

Note 7 to the consolidated financial statements includes a table that details the changes in the allowance for credit losses during the three and nine months ended September 30, 2018 and 2017 due to charge-offs, recoveries and provisions for credit losses.

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

Table 27: Allocation of the Allowance for Credit Losses

(\$ In Millions)	September 30, 2018		June 30, 2018		September 30, 2017	
	Allowance Amount	Percent of Loans to Total Loans	Allowance Amount	Percent of Loans to Total Loans	Allowance Amount	Percent of Loans to Total Loans
Specific Allowance	\$4.4	— %	\$6.1	— %	\$8.6	— %
Allocated Inherent Allowance						
Commercial						
Commercial and Institutional	31.8	28	33.5	27	33.4	28
Commercial Real Estate	41.0	11	41.8	11	53.6	11
Lease Financing, net	0.2	1	0.2	—	0.3	1
Non-U.S.	—	4	—	6	—	5
Other	1.6	1	2.1	2	1.1	1
Total Commercial	74.6	45	77.6	46	88.4	46
Personal						
Residential Real Estate	51.3	21	54.4	21	64.2	22
Private Client	8.7	34	9.5	33	9.9	32
Other	1.5	—	1.6	—	2.3	—
Total Personal	61.5	55	65.5	54	76.4	54
Total Allocated Inherent Allowance	\$136.1	100 %	\$143.1	100 %	\$164.8	100 %
Total Allowance for Credit Losses	\$140.5		\$149.2		\$173.4	
Allowance Assigned to						
Loans and Leases	\$119.6		\$127.2		\$150.3	
Undrawn Commitments and Standby Letters of Credit	20.9		22.0		23.1	
Total Allowance for Credit Losses	\$140.5		\$149.2		\$173.4	
Allowance Assigned to Loans and Leases to Total Loans and Leases	0.38 %		0.39 %		0.45 %	



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## MARKET RISK MANAGEMENT

There are two types of market risk, interest rate risk and trading risk. Interest rate risk is the potential for movements in interest rates to cause changes in net interest income and the market value of equity. Trading risk is the potential for movements in market variables such as foreign exchange and interest rates to cause changes in the value of trading positions.

Northern Trust uses two primary measurement techniques to manage interest rate risk: Net Interest Income (NII) sensitivity and Market Value of Equity (MVE) sensitivity. NII sensitivity provides management with a short-term view of the impact of interest rate changes on NII. MVE sensitivity provides management with a long-term view of interest rate changes on MVE as of the period-end balance sheet. Both simulation models use the same initial market interest rates and product balances.

As part of its risk management activities, Northern Trust also measures daily the risk of loss associated with all non-U.S. currency positions using a Value-at-Risk (VaR) model and applying the historical simulation methodology. The following information about Northern Trust's management of market risk should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2017.

**NII Sensitivity** — The modeling of NII sensitivity incorporates on-balance-sheet positions, as well as derivative financial instruments (principally interest rate swaps) that are used to manage interest rate risk. Northern Trust uses market implied forward interest rates as the base case and measures the sensitivity (i.e., change) of a static balance sheet to changes in interest rates. Stress testing of interest rates is performed to include such scenarios as immediate parallel shocks to rates, nonparallel (i.e., twist) changes to yield curves that result in their becoming steeper or flatter, and changes to the relationship among the yield curves (i.e., basis risk).

The NII sensitivity analysis incorporates certain critical assumptions such as interest rates and client behaviors under changing rate environments. These assumptions are based on a combination of historical analysis and future expected pricing behavior. The simulation cannot precisely estimate NII sensitivity given uncertainty in the assumptions. The following key assumptions are incorporated into the simulation:

- the balance sheet size and mix remains constant over the simulation horizon with maturing assets and liabilities replaced with instruments with similar terms as those that are maturing, with the exception of certain non-maturity deposits that are considered short-term in nature and therefore receive a more conservative interest-bearing treatment;
- prepayments on mortgage loans and securities collateralized by mortgages are projected under each rate scenario using a third-party mortgage analytics system that incorporates market prepayment assumptions;
- cash flows for structured securities are estimated using a third-party vendor in conjunction with the prepayments provided by the third-party mortgage analytics vendor;
- nonmaturity deposit pricing and lives are projected based on Northern Trust's actual historical patterns and management judgment, depending upon the availability of historical data and current pricing strategies/or judgment;
- and
- new business rates are based on current spreads to market indices.

The following table shows the estimated NII impact over the next twelve months of 100 and 200 basis point upward and 50 basis point downward movements in interest rates relative to forward rates. Each rate movement is assumed to occur gradually over a one-year period.

Table 28: Net Interest Income Sensitivity as of September 30, 2018

(\$ In Millions)	Increase/(Decrease) Estimated Impact on Next Twelve Months of Net Interest Income
Increase in Interest Rates Above Market Implied Forward Rates	
100 Basis Points	\$ (1 )
200 Basis Points	(2 )
Decrease in Interest Rates Below Market Implied Forward Rates	

50 Basis Points

(51 )

The NII sensitivity analysis does not incorporate any management actions that may be used to mitigate adverse effects of actual interest rate movement. For that reason and others, the estimated impacts do not reflect the likely actual results but serve as estimates of interest rate risk. NII sensitivity is not comparable to actual results disclosed elsewhere or directly predictive of future values of other measures provided. Further, the estimated impacts presented above are not directly comparable to those presented in

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## MARKET RISK MANAGEMENT (continued)

documents filed with or furnished to the U.S. Securities and Exchange Commission by the Corporation prior to its Annual Report on Form 10-K for the year ended December 31, 2017 due to changes to client deposit pricing assumptions and the implementation of interest rate risk model enhancements.

**MVE Sensitivity** — MVE is defined as the present value of assets minus the present value of liabilities, net of the value of instruments that are used to manage the interest rate risk of balance sheet items. The potential effect of interest rate changes on MVE is derived from the impact of such changes on projected future cash flows and the present value of these cash flows and is then compared to the established limit. Northern Trust uses current market rates (and the future rates implied by these market rates) as the base case and measures MVE sensitivity under various rate scenarios. Stress testing of interest rates is performed to include such scenarios as immediate parallel shocks to rates, nonparallel (i.e., twist) changes to yield curves that result in their becoming steeper or flatter, and changes to the relationship among the yield curves (i.e., basis risk).

The MVE sensitivity analysis incorporates certain critical assumptions such as interest rates and client behaviors under changing rate environments. These assumptions are based on a combination of historical analysis and future expected pricing behavior. The simulation cannot precisely estimate MVE sensitivity given uncertainty in the assumptions. Many of the assumptions that apply to NII sensitivity also apply to MVE sensitivity simulations, with the following separate key assumptions incorporated into the MVE simulation:

the present value of nonmaturity deposits are estimated using remaining lives, which are based on a combination of Northern Trust's actual historical runoff patterns and management judgment — some balances are assumed to be core and have long lives while other balances are assumed to be temporary and have comparatively shorter lives; and the present values of most noninterest-related balances (such as receivables, equipment, and payables) are the same as their book values.

The following table shows the estimated impact on MVE of 100 and 200 basis point shocks up and a 50 basis point shock down from current market implied forward rates.

Table 29: Market Value of Equity Sensitivity as of September 30, 2018

(\$ In Millions)	Increase/(Decrease) Estimated Impact on Market Value of Equity
Increase in Interest Rates Above Market Implied Forward Rates	
100 Basis Points	\$ 76
200 Basis Points	(225 )
Decrease in Interest Rates Below Market Implied Forward Rates	
50 Basis Points	(243 )

The MVE simulations do not incorporate any management actions that may be used to mitigate adverse effects of actual interest rate movements. For that reason and others, the estimated impacts do not reflect the likely actual results but serve as estimates of interest rate risk. MVE sensitivity is not comparable to actual results disclosed elsewhere or directly predictive of future values of other measures provided. Further, the estimated impacts presented above are not directly comparable to those presented in documents filed with or furnished to the U.S. Securities and Exchange Commission by the Corporation prior to its Annual Report on Form 10-K for the year ended December 31, 2017 due to changes to client deposit pricing assumptions and the implementation of interest rate risk model enhancements. During the period ended September 30, 2018, Northern Trust did not exceed its NII sensitivity limits or its MVE sensitivity limits.

**Foreign Currency Value-At-Risk (VaR)** — Northern Trust measures daily the risk of loss associated with all non-U.S. currency positions using a VaR model and applying the historical simulation methodology. This statistical model provides estimates, based on a variety of high confidence levels, of the potential loss in value that might be incurred if an adverse shift in non-U.S. currency exchange rates were to occur over a small number of days. The model incorporates foreign currency and interest rate volatilities and correlations in price movements among the currencies.

VaR is computed for each trading desk and for the global portfolio.

Northern Trust monitors several variations of the foreign exchange VaR measures to meet specific regulatory and internal management needs. Variations include different methodologies (historical, variance-covariance and Monte Carlo), equally weighted and exponentially weighted volatilities, horizons of one day and ten days, confidence levels ranging from 95% to 99.95% and look

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## MARKET RISK MANAGEMENT (continued)

back periods of one year and four years. Those alternative measures provide management an array of corroborating metrics and alternative perspectives on Northern Trust's market risks.

The table below presents the levels of total regulatory VaR and its subcomponents for global foreign currency in the years indicated below, based on the historical simulation methodology, a 99% confidence level, a one-day horizon and equally weighted volatility. The total VaR for foreign currency is typically less than the sum of its two components due to diversification benefits derived from the two subcomponents.

Table 30: Foreign Currency Value-At-Risk

(\$ In Millions)	Total VaR (Spot and Forward)		Foreign Exchange Spot VaR		Foreign Exchange Forward VaR	
	September 30, 2018	June 30, 2018	September 30, 2018	June 30, 2018	September 30, 2018	June 30, 2018
High	\$ 0.2	\$ 0.2	\$ 0.2	\$ 0.2	\$0.1	\$ 0.2
Low	0.1	0.1	—	—	—	—
Average	0.1	0.1	0.1	0.1	0.1	0.1
Quarter-End	0.1	0.1	0.1	0.1	0.1	0.1

## RECONCILIATION OF CERTAIN REPORTED ITEMS TO FULLY TAXABLE EQUIVALENTS

The following table presents a reconciliation of interest income, net interest income, net interest margin, and revenue prepared in accordance with GAAP to such measures on an FTE basis, which are non-GAAP financial measures. Management believes this presentation provides a clearer indication of these financial measures for comparative purposes. 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.

Table 31: Reconciliation of Reported Revenue and Net Interest Income to Fully Taxable Equivalent

(\$ In Millions)	Three Months Ended							
	September 30, 2018			September 30, 2017				
	Reported	FTE Adj.	FTE	Reported	FTE Adj.	FTE		
Interest Income	\$599.2	\$ 10.3	\$609.5	\$453.8	\$ 12.0	\$465.8		
Interest Expense	191.0	—	191.0	99.6	—	99.6		
Net Interest Income	\$408.2	\$ 10.3	\$418.5	\$354.2	\$ 12.0	\$366.2		
Net Interest Margin	1.44	%	1.47	%	1.25	%	1.29	%
Revenue	\$1,474.3	\$ 10.3	\$1,484.6	\$1,345.2	\$ 12.0	\$1,357.2		
(\$ In Millions)	Nine Months Ended							
	September 30, 2018			September 30, 2017				
	Reported	FTE Adj.	FTE	Reported	FTE Adj.	FTE		
Interest Income	\$1,672.8	\$ 28.3	\$1,701.1	\$1,281.3	\$ 29.8	\$1,311.1		
Interest Expense	467.3	—	467.3	232.1	—	232.1		
Net Interest Income	\$1,205.5	\$ 28.3	\$1,233.8	\$1,049.2	\$ 29.8	\$1,079.0		
Net Interest Margin	1.41	%	1.44	%	1.27	%	1.31	%
Revenue	\$4,456.4	\$ 28.3	\$4,484.7	\$3,950.8	\$ 29.8	\$3,980.6		

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RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (ASU 2016-02). ASU 2016-02 introduces a lessee model that brings most leases on the balance sheet, with certain specified scope exceptions. Specifically within the lessee model under ASU 2016-02, a lessee is required to recognize on the balance sheet a liability to make future lease payments, known as the lease liability, and a right-of-use asset (ROU asset) representing its right to use the underlying asset over the lease term. Northern Trust has established a complete inventory of leases and is formalizing the future operating model for lease accounting and related internal controls. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018, with certain practical expedients available. Northern Trust expects to adopt ASU 2016-02 on January 1, 2019, the date of initial application, and in doing so does not expect to restate comparative periods for the effects of applying ASU 2016-02. Upon adoption, Northern Trust expects to elect the package of practical expedients available under ASU 2016-02, which allows Northern Trust to forego a reassessment of (1) whether any expired or existing contracts are or contain leases, (2) the lease classification for any expired or existing leases, and (3) the initial direct costs for any existing leases. ASU 2016-02 is expected to have a significant impact on Northern Trust’s consolidated financial condition, with the most significant changes related to the recognition of ROU assets and lease liabilities for real estate operating leases. ASU 2016-02 is not expected to impact significantly Northern Trust’s consolidated results of operations.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (ASU 2016-13). ASU 2016-13 significantly changes the way impairment of financial instruments is recognized by requiring immediate recognition of estimated credit losses expected to occur over the remaining life of financial instruments. The main provisions of ASU 2016-13 include (1) replacing the “incurred loss” approach under current GAAP with an “expected loss” model for instruments measured at amortized cost, (2) requiring entities to record an allowance for available-for-sale debt securities rather than reduce the carrying amount of the investments, as is required by the other-than-temporary-impairment model under current GAAP, and (3) a simplified accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019, although early adoption is permitted.

Northern Trust has established a working group across various functions, an overall governance structure, and has finalized a detailed project plan for its implementation efforts. Further, Northern Trust assessed its current inventory of underlying credit models along with the suitability of these models for the overall expected loss impairment model under ASU 2016-13 and is in the process of completing its development activities for these models. In addition, Northern Trust assessed the new disclosure requirements and evaluated the availability of required new data elements. Northern Trust continues to evaluate specific application issues and the overall impact of the adoption of ASU 2016-13.

In August 2018, the FASB issued ASU No. 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement” (ASU 2018-13). The primary objective of ASU 2018-13 is to improve the effectiveness of disclosures in the notes to financial statements. ASU 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019, although early adoption is permitted. The adoption of ASU 2018-13 will not impact significantly Northern Trust’s consolidated financial condition or results of operations.

In August 2018, the FASB issued ASU No. 2018-14, “Compensation-Retirement Benefits-Defined Benefit Plans-General (Topic 715-20): Disclosure Framework-Changes to the Disclosure Requirements for Defined Benefit Plans” (ASU 2018-14). The primary objective of ASU 2018-14 is to improve the effectiveness of disclosures in the notes to financial statements. As a result of this ASU, Northern Trust plans to remove, modify and add certain disclosures related to defined benefit pension and other postretirement plans. ASU 2018-14 is effective for interim and annual report reporting periods beginning after December 15, 2020, although early adoption is permitted. The

adoption of ASU 2018-14 will not impact significantly Northern Trust's consolidated financial condition or results of operations.

In August 2018, the FASB issued ASU No. 2018-15, "Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force)" (ASU 2018-15). ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). ASU 2018-15 is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, although early adoption is permitted. ASU 2018-15 is not expected to impact significantly Northern Trust's consolidated financial condition or results of operations.

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## FORWARD-LOOKING STATEMENTS

This report may include statements which constitute “forward-looking statements” within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are identified typically by words or phrases such as “believe,” “expect,” “anticipate,” “intend,” “estimate,” “project,” “likely,” “plan,” “goal,” “strategy,” and similar expressions or future or conditional verbs such as “may,” “will,” “should,” “would,” and “could.” Forward-looking statements include statements, other than those related to historical facts, that relate to Northern Trust’s financial results and outlook; capital adequacy; dividend policy and share repurchase program; accounting estimates and assumptions; credit quality including allowance levels; future pension plan contributions; effective tax rate; anticipated expense levels; contingent liabilities; acquisitions; strategies; industry trends; and expectations regarding the impact of accounting pronouncements and legislation. These statements are based on Northern Trust’s current beliefs and expectations of future events or future results, and involve risks and uncertainties that are difficult to predict and subject to change. These statements are also based on assumptions about many important factors, including:

- financial market disruptions or economic recession, whether in the United States, Europe, the Middle East, Asia or other regions;
- volatility or 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 held in particular investment funds or client portfolios, including those funds, portfolios, 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 equity markets on fee revenue;
- the downgrade of U.S. government-issued and other securities;
- changes in foreign exchange trading client volumes and volatility in foreign currency exchange rates, changes in the valuation of the U.S. dollar relative to other currencies in which Northern Trust records revenue or accrues expenses, and Northern Trust’s success in assessing and mitigating the risks arising from all 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 may be negatively impacted by periods of economic turmoil and financial market disruptions;
- Northern Trust’s ability to address operating risks, including those related to cyber-security, data security, human errors or omissions, pricing or valuation of securities, fraud, systems performance or defects, systems interruptions, and breakdowns in processes or internal controls;
- Northern Trust’s success in responding to and investing in changes and advancements in technology;
- a significant downgrade of any of Northern Trust’s debt ratings;
- the health and soundness of the financial institutions and other counterparties with which Northern Trust conducts business;
- uncertainties inherent in the complex and subjective judgments required to assess credit risk and establish appropriate allowances therefor;
- the pace and extent of continued globalization of investment activity and growth in worldwide financial assets;
- changes in interest rates or in the monetary or other policies of various regulatory authorities or central banks;
- changes in the legal, regulatory and enforcement framework and oversight applicable to financial institutions, including Northern Trust;
- 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 United States and other countries, such as anti-money laundering, anti-bribery, and client privacy;
- failure to address in the Corporation’s resolution plan submitted in December 2017 the “shortcomings” jointly identified by the Federal Reserve Board and FDIC in the resolution plan submitted by the Corporation in December 2015;
- 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 United States or other countries that could affect Northern Trust or its clients including with respect to the adoption of the Tax Cuts and Jobs Act;

geopolitical risks and the risks of extraordinary events such as natural disasters, terrorist events and war, and the responses of the United States and other countries to those events;

the pending departure of the United Kingdom from the European Union, commonly referred to as “Brexit,” and any negative effects thereof on global economic conditions, global financial markets, and our business and results of operations;

changes in the nature and activities of Northern Trust’s competition;

Northern Trust’s success in maintaining existing business and continuing to generate new business in existing and targeted markets and its ability to deploy deposits in a profitable manner consistent with its liquidity requirements;

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FORWARD-LOOKING STATEMENTS (continued)

• Northern Trust’s ability to address the complex needs of a global client base and manage compliance with legal, tax, regulatory and other requirements;

• Northern Trust’s ability to maintain a product mix that achieves acceptable margins;

• Northern Trust’s ability to continue to generate investment results that satisfy clients and to develop an array of investment products;

• Northern Trust’s 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;

• Northern Trust’s success in implementing its expense management initiatives, including its “Value for Spend” initiative;

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

• Northern Trust’s success in continuing to enhance its risk management practices and controls and managing risks inherent in its businesses, including credit risk, operational risk, market and liquidity risk, fiduciary risk, compliance risk and strategic risk;

• risks and uncertainties inherent in the litigation and regulatory process, including the possibility that losses may be in excess of Northern Trust’s recorded liability and estimated range of possible loss for litigation exposures;

• risks associated with being a holding company, including Northern Trust’s dependence on dividends from its principal subsidiary;

• the risk of damage to Northern Trust’s reputation which may undermine the confidence of clients, counterparties, rating agencies, and stockholders; and

• other factors identified elsewhere in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2017, including those factors described in Item 1A, “Risk Factors,” and other filings with the SEC, all of which are available on Northern Trust’s website.

Actual results may differ materially from those expressed or implied by 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.



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## Item 1. Consolidated Financial Statements (unaudited)

## CONSOLIDATED BALANCE SHEETS NORTHERN TRUST CORPORATION

(In Millions Except Share Information)	September 30, 2018 (Unaudited)	December 31, 2017
<b>Assets</b>		
Cash and Due from Banks	\$5,073.4	\$4,518.1
Federal Reserve and Other Central Bank Deposits	32,831.8	40,479.1
Interest-Bearing Deposits with Banks	2,776.0	5,611.9
Federal Funds Sold and Securities Purchased under Agreements to Resell	1,501.5	1,324.3
<b>Debt Securities</b>		
Available for Sale	36,131.1	33,742.1
Held to Maturity (Fair value of \$14,355.1 and \$13,010.9)	14,445.4	13,049.0
Trading Account	1.1	0.5
Total Debt Securities	50,577.6	46,791.6
<b>Loans and Leases</b>		
Commercial	13,874.1	14,558.0
Personal	17,479.9	18,034.2
Total Loans and Leases (Net of unearned income of \$19.7 and \$35.5)	31,354.0	32,592.2
Allowance for Credit Losses Assigned to Loans and Leases	(119.6)	(131.2)
Buildings and Equipment	417.2	464.6
Client Security Settlement Receivables	1,541.4	1,647.0
Goodwill	672.7	605.6
Other Assets	5,752.5	4,687.3
Total Assets	\$132,378.5	\$138,590.5
<b>Liabilities</b>		
<b>Deposits</b>		
Demand and Other Noninterest-Bearing	\$16,022.0	\$18,712.2
Savings, Money Market and Other Interest-Bearing	15,739.7	16,975.3
Savings Certificates and Other Time	755.5	1,152.3
Non U.S. Offices — Noninterest-Bearing	8,000.6	9,878.8
— Interest-Bearing	64,373.5	65,672.2
Total Deposits	104,891.3	112,390.8
Federal Funds Purchased	2,563.9	2,286.1
Securities Sold Under Agreements to Repurchase	46.9	834.0
Other Borrowings	7,725.2	6,051.1
Senior Notes	1,996.2	1,497.3
Long-Term Debt	1,096.5	1,449.5
Floating Rate Capital Debt	277.6	277.5
Other Liabilities	3,416.4	3,588.0
Total Liabilities	122,014.0	128,374.3
<b>Stockholders' Equity</b>		
Preferred Stock, No Par Value; Authorized 10,000,000 shares:		
Series C, outstanding shares of 16,000	388.5	388.5
Series D, outstanding shares of 5,000	493.5	493.5
Common Stock, \$1.66 2/3 Par Value; Authorized 560,000,000 shares;		
Outstanding shares of 221,395,358 and 226,126,674	408.6	408.6
Additional Paid-In Capital	1,055.3	1,047.2

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Retained Earnings	10,496.3	9,685.1
Accumulated Other Comprehensive Loss	(526.9 )	(414.3 )
Treasury Stock (23,776,166 and 19,044,850 shares, at cost)	(1,950.8 )	(1,392.4 )
Total Stockholders' Equity	10,364.5	10,216.2
Total Liabilities and Stockholders' Equity	\$ 132,378.5	\$ 138,590.5

See accompanying notes to the consolidated financial statements.

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(UNAUDITED)

## NORTHERN TRUST CORPORATION

(In Millions Except Share Information)	Three Months Ended		Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
Noninterest Income				
Trust, Investment and Other Servicing Fees	\$939.2	\$ 867.9	\$2,819.8	\$ 2,524.3
Foreign Exchange Trading Income	71.7	49.1	229.1	147.1
Treasury Management Fees	12.5	13.2	40.0	42.8
Security Commissions and Trading Income	21.9	21.2	75.2	65.8
Other Operating Income	20.9	40.0	87.1	122.7
Investment Security Gains (Losses), net (Note)	(0.1 )	(0.4 )	(0.3 )	(1.1 )
Total Noninterest Income	1,066.1	991.0	3,250.9	2,901.6
Net Interest Income				
Interest Income	599.2	453.8	1,672.8	1,281.3
Interest Expense	191.0	99.6	467.3	232.1
Net Interest Income	408.2	354.2	1,205.5	1,049.2
Provision for Credit Losses	(9.0 )	(7.0 )	(10.5 )	(15.0 )
Net Interest Income after Provision for Credit Losses	417.2	361.2	1,216.0	1,064.2
Noninterest Expense				
Compensation	436.1	418.3	1,362.5	1,276.6
Employee Benefits	85.5	74.8	266.0	228.2
Outside Services	186.9	172.7	543.9	492.8
Equipment and Software	145.7	130.5	429.9	391.5
Occupancy	51.0	47.3	151.3	139.0
Other Operating Expense	97.1	92.0	241.4	239.4
Total Noninterest Expense	1,002.3	935.6	2,995.0	2,767.5
Income before Income Taxes	481.0	416.6	1,471.9	1,198.3
Provision for Income Taxes	106.5	118.2	325.4	355.9
Net Income	\$374.5	\$ 298.4	\$1,146.5	\$ 842.4
Preferred Stock Dividends	17.3	17.3	40.5	43.9
Net Income Applicable to Common Stock	\$357.2	\$ 281.1	\$1,106.0	\$ 798.5
Per Common Share				
Net Income — Basic	\$1.59	\$ 1.21	\$4.87	\$ 3.43
— Diluted	1.58	1.20	4.84	3.41
Average Number of Common Shares Outstanding				
— Basic	222,442,727	228,010,866	224,098,656	228,751,804
— Diluted	223,860,029	229,313,645	225,494,633	230,189,289
Note: Changes in Other-Than-Temporary-Impairment (OTTI) Losses	\$(0.1 )	\$ —	\$(0.3 )	\$(0.1 )
Other Security Gains (Losses), net	—	(0.4 )	—	(1.0 )
Investment Security Gains (Losses), net	\$(0.1 )	\$(0.4 )	\$(0.3 )	\$(1.1 )

CONSOLIDATED STATEMENTS OF  
COMPREHENSIVE INCOME (UNAUDITED)NORTHERN TRUST  
CORPORATION

Three Months	Nine Months
Ended	Ended September

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(In Millions)	September 30,		30,	
	2018	2017	2018	2017
Net Income	\$374.5	\$298.4	\$1,146.5	\$842.4
Other Comprehensive Income (Loss) (Net of Tax and Reclassifications)				
Net Unrealized (Losses) Gains on Debt Securities Available for Sale	(32.1 )	(2.2 )	(107.0 )	18.7
Net Unrealized (Losses) Gains on Cash Flow Hedges	(4.2 )	(1.9 )	(11.4 )	(4.9 )
Foreign Currency Translation Adjustments	10.6	3.6	11.1	10.5
Pension and Other Postretirement Benefit Adjustments	6.9	4.3	20.0	10.6
Other Comprehensive Income	(18.8 )	3.8	(87.3 )	34.9
Comprehensive Income	\$355.7	\$302.2	\$1,059.2	\$877.3
See accompanying notes to the consolidated financial statements.				

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CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)	NORTHERN TRUST CORPORATION	
(In Millions)	Nine Months Ended September 30,	
	2018	2017
Preferred Stock		
Series C, Balance at January 1 and September 30	\$388.5	\$388.5
Series D, Balance at January 1 and September 30	493.5	493.5
Balance at January 1 and September 30	882.0	882.0
Common Stock		
Balance at January 1 and September 30	408.6	408.6
Additional Paid-in Capital		
Balance at January 1	1,047.3	1,035.8
Treasury Stock Transactions — Stock Options and Awards	(101.4	) (104.8
Stock Options and Awards — Amortization	109.4	106.5
Balance at September 30	1,055.3	1,037.5
Retained Earnings		
Balance at January 1	9,685.1	8,908.4
Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	25.3	—
Change in Accounting Principle	(4.5	) —
Net Income	1,146.5	842.4
Dividends Declared — Common Stock	(315.6	) (275.7
Dividends Declared — Preferred Stock	(40.5	) (43.9
Balance at September 30	10,496.3	9,431.2
Accumulated Other Comprehensive Income (Loss)		
Balance at January 1	(414.3	) (370.0
Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	(25.3	) —
Net Unrealized (Losses) Gains on Debt Securities Available for Sale	(107.0	) 18.7
Net Unrealized Losses on Cash Flow Hedges	(11.4	) (4.9
Foreign Currency Translation Adjustments	11.1	10.5
Pension and Other Postretirement Benefit Adjustments	20.0	10.6
Balance at September 30	(526.9	) (335.1
Treasury Stock		
Balance at January 1	(1,392.4	) (1,094.4
Stock Options and Awards	131.3	187.9
Stock Purchased	(689.7	) (352.5
Balance at September 30	(1,950.8	) (1,259.0
Total Stockholders' Equity at September 30	\$10,364.5	\$10,165.2

See accompanying notes to the consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) NORTHERN TRUST CORPORATION

	Nine Months Ended September 30,	
(In Millions)	2018	2017
Cash Flows from Operating Activities:		
Net Income	\$1,146.5	\$842.4
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Investment Security Losses, net	0.3	1.1
Amortization and Accretion of Securities and Unearned Income, net	79.8	88.6
Provision for Credit Losses	(10.5 )	(15.0 )
Depreciation on Buildings and Equipment	81.9	73.8
Amortization of Computer Software	251.8	230.4
Amortization of Intangibles	13.2	7.0
Pension Plan Contributions	(71.9 )	(11.5 )
Change in Receivables	(241.0 )	(135.1 )
Change in Interest Payable	26.1	16.5
Change in Collateral With Derivative Counterparties, net	(262.0 )	534.8
Other Operating Activities, net	294.2	(763.3 )
Net Cash Provided by Operating Activities	1,308.4	869.7
Cash Flows from Investing Activities:		
Net Change in Federal Funds Sold and Securities Purchased under Agreements to Resell	(211.9 )	336.3
Change in Interest-Bearing Deposits with Banks	2,648.9	(535.6 )
Net Change in Federal Reserve and Other Central Bank Deposits	7,234.1	(6,472.3 )
Purchases of Debt Securities — Held to Maturity	(15,907.1)	(7,346.3 )
Proceeds from Maturity and Redemption of Debt Securities — Held to Maturity	14,334.1	7,180.1
Purchases of Debt Securities — Available for Sale	(9,128.6 )	(6,937.6 )
Proceeds from Sale, Maturity and Redemption of Debt Securities — Available for Sale	6,160.7	7,607.7
Change in Loans and Leases	1,210.8	710.7
Purchases of Buildings and Equipment	(39.0 )	(63.7 )
Purchases and Development of Computer Software	(289.1 )	(288.2 )
Change in Client Security Settlement Receivables	56.5	(220.4 )
Acquisition of a Business, Net of Cash Received	(70.0 )	—
Other Investing Activities, net	(651.2 )	63.6
Net Cash Provided by (Used in) Investing Activities	5,348.2	(5,965.7 )
Cash Flows from Financing Activities:		
Change in Deposits	(6,296.5 )	2,082.4
Change in Federal Funds Purchased	277.9	1,937.3
Change in Securities Sold under Agreements to Repurchase	(786.6 )	50.4
Change in Short-Term Other Borrowings	1,689.1	966.4
Proceeds from Senior Notes and Long-Term Debt	497.9	350.0
Repayments of Senior Notes and Long-Term Debt	(305.4 )	(7.0 )
Treasury Stock Purchased	(689.7 )	(352.5 )
Net Proceeds from Stock Options	29.9	83.1
Cash Dividends Paid on Common Stock	(283.6 )	(261.2 )
Cash Dividends Paid on Preferred Stock	(29.1 )	(32.4 )
Other Financing Activities, net	0.1	0.1

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Net Cash (Used in) Provided by Financing Activities	(5,896.0 )	4,816.6
Effect of Foreign Currency Exchange Rates on Cash	(205.3 )	210.3
Change in Cash and Due from Banks	555.3	(69.1 )
Cash and Due from Banks at Beginning of Year	4,518.1	5,332.0
Cash and Due from Banks at End of Period	\$5,073.4	\$5,262.9
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	\$441.4	\$215.2
Income Taxes Paid	352.2	348.9
Transfers from Loans to OREO	11.3	7.2
See accompanying notes to the consolidated financial statements.		

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Notes to Consolidated Financial Statements (unaudited)

Note 1 – Basis of Presentation

The consolidated financial statements include the accounts of Northern Trust Corporation (the Corporation) and its wholly-owned subsidiary, The Northern Trust Company (the Bank), and various other wholly-owned subsidiaries of the Corporation and the Bank. Throughout the notes to the consolidated financial statements, the term “Northern Trust” refers to the Corporation and its subsidiaries. Intercompany balances and transactions have been eliminated in consolidation. The consolidated financial statements, as of and for the periods ended September 30, 2018 and 2017, 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. The accounting and financial reporting policies of Northern Trust conform to U.S. generally accepted accounting principles (GAAP) and reporting practices prescribed by the banking industry. The consolidated statements of income include results of acquired subsidiaries from the dates of acquisition. Certain amounts in prior periods have been reclassified to conform with the current year’s presentation. For a description of Northern Trust’s significant accounting policies, refer to Note 1 of the Notes to Consolidated Financial Statements in the Annual Report on Form 10-K for the year ended December 31, 2017.

Note 2 – Recent Accounting Pronouncements

On January 1, 2018, Northern Trust adopted ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (ASU 2014-09). The primary objective of ASU 2014-09 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. Northern Trust adopted ASU 2014-09 using the modified retrospective method applied to contracts not yet completed as of the date of adoption. Results for reporting periods beginning January 1, 2018 are presented under ASU 2014-09, including certain changes to gross versus net presentation, whereas prior period amounts are not adjusted. The impact of adopting ASU 2014-09 resulted in a \$4.0 million reduction in retained earnings. Please refer to Note 14 – “Revenue from Contracts with Clients” for further information.

On January 1, 2018, Northern Trust adopted ASU No. 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” (ASU 2016-01). ASU 2016-01 requires equity investments (except those accounted for under the equity method or those that result in consolidation) to be measured at fair value with changes in fair value recognized in net income unless a policy election is made for investments without readily determinable fair values. Additionally, ASU 2016-01 requires public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet. Furthermore, it requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or in the accompanying notes to the financial statements. The impact of adopting ASU 2016-01 resulted in a \$0.5 million reduction in retained earnings.

On January 1, 2018, Northern Trust adopted ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments” (ASU 2016-15). ASU 2016-15 provides guidance on eight specific cash flow issues, thereby reducing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. Upon adoption of ASU 2016-15, there was no significant impact to Northern Trust’s consolidated statement of cash flows.

On January 1, 2018, Northern Trust adopted ASU No. 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory” (ASU 2016-16). ASU 2016-16 requires an entity to recognize the income tax



consequences of intra-entity transfers of assets (excluding inventory) in the period in which the transfer occurs. Upon adoption of ASU 2016-16, there was no significant impact to Northern Trust's consolidated financial condition or results of operations.

On January 1, 2018, Northern Trust adopted ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)" (ASU 2016-18). ASU 2016-18 requires an entity to include amounts generally described as restricted cash and cash equivalents with cash and cash equivalents when reconciling beginning and end of period total cash balances in the statement of cash flows and as a result, transfers between cash and cash equivalents, and restricted cash and cash equivalents, will not be presented in the statement of cash flows as cash flow activities. Additionally, if the balance sheet includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash and cash equivalents, an entity is required to disclose a reconciliation between the balance sheet and the statement of cash flows. Furthermore, if restricted cash and cash equivalents are material, an entity must disclose information about the nature of restrictions. Upon adoption of ASU 2016-18, there was no significant impact to Northern Trust's consolidated statement of cash flows.

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Notes to Consolidated Financial Statements (unaudited) (continued)

On January 1, 2018, Northern Trust adopted ASU No. 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business” (ASU 2017-01). ASU 2017-01 clarifies the definition of a business with the objective of adding guidance to assist companies with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in ASU 2017-01 provide a more robust framework to use in determining when a set of assets and activities is a business. Upon adoption of ASU 2017-01, there was no significant impact to Northern Trust’s consolidated financial condition or results of operations.

On January 1, 2018, Northern Trust adopted ASU No. 2017-05, “Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets” (ASU 2017-05). ASU 2017-05 clarifies that an in substance nonfinancial asset is an asset or group of assets for which substantially all of the fair value consists of nonfinancial assets and the group or subsidiary is not a business. Transfers of nonfinancial assets to another entity in exchange for a noncontrolling ownership interest in that entity will be accounted for under Accounting Standards Codification 610-20 - Gains and Losses from the Derecognition of Nonfinancial Assets. ASU 2017-05 also impacts the accounting for partial sales of nonfinancial assets, and provides that when an entity transfers its controlling financial interest in a nonfinancial asset, but retains a noncontrolling ownership interest, the entity will measure the retained interest at fair value. This will result in full gain or loss recognition upon the sale of a controlling interest in a nonfinancial asset. Upon adoption of ASU 2017-05, there was no significant impact to Northern Trust’s consolidated financial condition or results of operations.

On January 1, 2018, Northern Trust adopted ASU No. 2017-07, “Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost” (ASU 2017-07). Under previous GAAP, net benefit cost on pension and postretirement benefit plans included multiple components, including current-period employee service cost, interest cost on the obligation, expected return on plan assets, and amortization of various amounts deferred from previous periods. ASU 2017-07 requires the bifurcation of the net benefit cost by presenting separately the service cost component from the other components of net benefit cost. Northern Trust provides a detailed breakdown of its net periodic pension costs components including a reference to the respective income statement line in the footnotes and therefore there were no changes to the presentation of net periodic pension costs in the results of operations upon adoption of ASU 2017-07.

On January 1, 2018, Northern Trust adopted ASU No. 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting” (ASU 2017-09). ASU 2017-09 clarifies which types of changes to share-based payment awards are in scope of modification accounting. ASU 2017-09 also provides clarification related to the fair value assessment with respect to determining whether a fair value calculation is required and the appropriate unit of account to apply. Upon adoption of ASU 2017-09, there was no impact to Northern Trust’s consolidated financial condition or results of operations.

On January 1, 2018, Northern Trust adopted ASU No. 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income” (ASU 2018-02). The amendments in ASU 2018-02 allow an entity to elect to reclassify from accumulated other comprehensive income to retained earnings the stranded tax effects resulting from the Tax Cuts and Jobs Act. ASU 2018-02 is effective for interim and annual reporting periods beginning after December 15, 2018, however early adoption is permitted. The amendments in ASU 2018-02 may be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. Upon adoption of ASU 2018-02, Northern Trust elected to reclassify \$25.3 million of income tax effects from the Tax Cuts and Jobs Act from accumulated other comprehensive income to retained earnings. In the normal course, it is Northern Trust’s policy to release income tax effects from accumulated other comprehensive income on an aggregate portfolio basis. Please refer to Note 12 – “Accumulated Other

Comprehensive Income (Loss)” for further information.

On April 1, 2018, Northern Trust adopted ASU No. 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities” (ASU 2017-12). The main provisions of ASU 2017-12 are intended to align better an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships. ASU 2017-12 eliminates the requirement to measure and report hedge ineffectiveness separately and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. Further, ASU 2017-12 eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. Northern Trust currently applies the “shortcut” method of accounting available under US GAAP for substantially all fair value hedges and other aspects of Northern Trust’s current hedge accounting program and therefore upon adoption of ASU 2017-12, there was no significant impact to Northern Trust’s consolidated financial condition or results of operations.

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## Notes to Consolidated Financial Statements (unaudited) (continued)

## Note 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 nine months ended September 30, 2018 or the year ended December 31, 2017.

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 debt 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 September 30, 2018, Northern Trust's available for sale debt securities portfolio included 1,483 Level 2 debt securities with an aggregate market value of \$30.5 billion. All 1,483 debt securities were valued by external pricing vendors. As of December 31, 2017, Northern Trust's available for sale debt securities portfolio included 1,436 Level 2 debt securities with an aggregate market value of \$28.0 billion. All 1,436 debt securities were valued by external pricing vendors. Trading account debt securities, which totaled \$1.1 million and \$0.5 million as of September 30, 2018 and December 31, 2017, respectively, were all valued using external pricing vendors.

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; 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, Northern Trust uses external pricing vendors that incorporate transaction details and market-based inputs such as past auction results, trades and bids. The significant unobservable inputs used in the fair value measurement are the prices of the securities supported by little market activity and for which trading is limited.

Northern Trust's Level 3 liabilities consist of swaps that Northern Trust entered into with the purchaser of 1.1 million and 1.0 million shares of Visa Inc. Class B common stock (Visa Class B common shares) previously held by Northern Trust and sold in June 2016 and 2015, respectively. Pursuant to the swaps, Northern Trust retains the risks associated with the ultimate conversion of the Visa Class B common shares into shares of Visa Inc. Class A common stock (Visa Class A common shares), such that the counterparty will be compensated for any dilutive adjustments to the conversion ratio and Northern Trust will be compensated for any anti-dilutive adjustments to the ratio. The swaps also

require periodic payments from Northern Trust to the counterparty calculated by reference to the market price of Visa Class A common shares and a fixed rate of interest. The fair value of the swaps is determined using a discounted cash flow methodology. The significant unobservable inputs used in the fair value measurement are Northern Trust's own assumptions about estimated changes in the conversion rate of the Visa Class B common shares into

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## Notes to Consolidated Financial Statements (unaudited) (continued)

Visa Class A common shares, the date on which such conversion is expected to occur and the estimated growth rate of the Visa Class A common share price. See “Visa Class B Common Shares” under Note 20 – “Contingent Liabilities” for further information.

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.

The following table presents the fair values of Northern Trust’s Level 3 assets and liabilities as of September 30, 2018 and December 31, 2017, as well as the valuation techniques, significant unobservable inputs, and quantitative information used to develop significant unobservable inputs for such assets and liabilities as of such dates.

Table 32: Level 3 Significant Unobservable Inputs

Financial Instrument	September 30, 2018		Unobservable Inputs	Range of Inputs
	Fair Value	Valuation Technique		
Auction Rate Securities	\$2.9 million	Comparables	Price	\$93 -100
Swaps Related to Sale of Certain Visa Class B Common Shares	\$36.6 million	Discounted Cash Flow	Visa Class A Appreciation	7.0 %-11.0%
			Conversion Rate	1.62x -1.64x
			Expected Duration	1.5 $\frac{4.0}{\text{years}}$
Financial Instrument	December 31, 2017		Unobservable Inputs	Range of Inputs
	Fair Value	Valuation Technique		
Auction Rate Securities	\$4.3 million	Comparables	Price	\$92 -100
Swap Related to Sale of Certain Visa Class B Common Shares	\$29.7 million	Discounted Cash Flow	Visa Class A Appreciation	7.0 %-11.0%
			Conversion Rate	1.63 x -1.65x
			Expected Duration	1.5 $\frac{4.0}{\text{years}}$

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Notes to Consolidated Financial Statements (unaudited) (continued)

The following tables present assets and liabilities measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017, segregated by fair value hierarchy level.

Table 33: Recurring Basis Hierarchy Leveling

(In Millions)	Level 1	Level 2	Level 3	Netting	Assets/Liabilities at Fair Value
September 30, 2018					
Debt Securities					
Available for Sale					
U.S. Government	\$5,624.8	\$ —	—	—	—\$ 5,624.8
Obligations of States and Political Subdivisions	—	712.3	—	—	712.3
Government Sponsored Agency	&#82				