

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2015

OR

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

For the transition period from _____ to _____

Commission File No. 0-5965

NORTHERN TRUST CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

36-2723087
(I.R.S. Employer
Identification No.)

50 South LaSalle Street

60603

Chicago, Illinois

(Address of principal executive offices)

(Zip Code)

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

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

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

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

PER COMMON SHARE

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

SELECTED BALANCE SHEET DATA (In Millions)

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

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

CLIENT ASSETS (In Billions)

% Change (*)

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

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Table of Contents**SELECTED RATIOS AND METRICS**

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

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

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

(**) Net interest margin is presented on a fully taxable equivalent (FTE) basis, a non-generally-accepted-accounting-principle (GAAP) financial measure that facilitates the analysis of asset yields. The net interest margin on a GAAP basis and a reconciliation of net interest income on a GAAP basis to net interest income on an FTE basis are presented on page 27.

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

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

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PART I FINANCIAL INFORMATION

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

SECOND QUARTER CONSOLIDATED RESULTS OF OPERATIONS

General

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

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

Overview

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

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

The prior-year quarter included pre-tax charges of \$32.8 million for severance and related costs and for the realignment of the Corporation's real estate portfolio and \$9.5 million of software write-offs. Excluding these charges and write-offs, net income per diluted common share, net income, and return on average common equity were \$0.87, \$209.8 million, and 10.6%, respectively.

Revenue of \$1.26 billion was up \$174.2 million, or 16%, from \$1.08 billion in the prior-year quarter. Noninterest income increased \$169.6 million, or 20%, to \$1.00 billion from \$835.1 million in the prior-year quarter, primarily reflecting the \$99.9 million net gain on the sale of Visa Inc. Class B common shares, higher trust, investment and other servicing fees and foreign exchange trading income.

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

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

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

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

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

Noninterest Income

The components of noninterest income are provided below.

Table 1: Noninterest Income

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

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

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

Table 2: Assets Under Custody

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

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

Table 3: Allocations of Assets Under Custody

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

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

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

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

Table 4: Assets Under Management

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

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

Table 5: Assets Under Management by Investment Type

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

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

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

Table 6: Allocations of Assets Under Management

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

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

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

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

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

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

Table 7: Other Operating Income

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

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

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

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

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

WITH ANALYSIS OF NET INTEREST INCOME

(INTEREST AND RATE ON A FULLY TAXABLE EQUIVALENT BASIS)

Second Quarter

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

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

Deposits

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

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

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

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

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

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

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

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

Notes: Net Interest Income (FTE Adjusted) includes adjustments to a fully taxable equivalent basis for loans and securities. Such adjustments are based on a blended federal and state tax rate of 37.7% and 37.8% for the three months ended June 30, 2015 and 2014, respectively. Total taxable equivalent interest adjustments amounted to \$6.4 million and \$6.8 million for the three months ended June 30, 2015 and 2014, respectively.

Interest revenue on cash collateral positions is reported above within interest-bearing deposits with banks and within loans and leases. Interest expense on cash collateral positions is reported above within non-U.S. offices interest-bearing deposits. Related cash collateral received from and deposited with derivative counterparties is recorded net of the associated derivative contract within other assets and other liabilities, respectively.

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

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

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

When adjusted to an FTE basis, yields on taxable, nontaxable, and partially taxable assets are comparable; however, the adjustment to an FTE basis has no impact on net income. A reconciliation of net interest income on a GAAP basis to net interest income on an FTE basis (a non-GAAP financial measure) is provided on page 27.

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

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

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

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

Northern Trust utilizes a diverse mix of funding sources. Total interest-bearing deposits averaged \$66.8 billion, compared to \$65.8 billion in the prior-year quarter, an increase of \$963.8 million, or 1%. Other interest-bearing funds averaged \$7.6 billion, a decrease of \$239.6 million, from \$7.8 billion in the prior-year quarter, attributable to decreased long-term debt and senior notes, partially offset by increased short-term borrowings. The balances within short-term borrowing classifications vary based on funding requirements and strategies, interest rate levels, changes in the volume of lower-cost deposit sources, and the availability of collateral to secure these borrowings. Average net noninterest-related funds utilized to fund earning assets increased \$7.6 billion, or 35%, to \$29.5 billion from \$21.9 billion in the prior-year quarter, primarily resulting from higher levels of demand and other noninterest-bearing deposits.

Provision for Credit Losses

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

Noninterest Expense

The components of noninterest expense are provided below.

Table 9: Noninterest Expense

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

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

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

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

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

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

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

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

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

Table 10: Other Operating Expense

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

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

Provision for Income Taxes

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

REPORTING SEGMENTS

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

Table of Contents**REPORTING SEGMENTS (continued)**

The following tables reflect the earnings contributions and average assets of Northern Trust's reporting segments for the three- and six-month periods ended June 30, 2015, and 2014. 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 11: Results of Reporting Segments

Months Ended June 30, (Millions)	Corporate & Institutional Services		Wealth Management		Treasury and Other		Total Consolidated	
	2015	2014	2015	2014	2015	2014	2015	2014
Interest Income								
Investment and Other Fees	\$ 432.0	\$ 395.4	\$ 324.8	\$ 311.5	\$	\$	\$ 756.8	\$
Exchange Trading	71.8	50.7	3.0	2.2			74.8	
Noninterest Income	43.2	47.1	26.8	23.1	103.1	5.1	173.1	
Interest Income (FTE)*	92.7	76.7	141.0	132.6	23.9	44.1	257.6	
Expense*	639.7	569.9	495.6	469.4	127.0	49.2	1,262.3	1,0
Provision for Credit Losses	2.0	2.4	(12.0)	(2.4)			(10.0)	
Interest Expense	488.2	446.4	322.7	329.4	43.6	35.2	854.5	8
Income before Income Taxes*	149.5	121.1	184.9	142.4	83.4	14.0	417.8	2
Provision for Income Taxes*	45.3	36.1	69.6	53.6	33.7	5.9	148.6	
Income	\$ 104.2	\$ 85.0	\$ 115.3	\$ 88.8	\$ 49.7	\$ 8.1	\$ 269.2	\$ 1
Percentage of Consolidated Net Average Assets	39%	47%	43%	49%	18%	4%	100%	
Assets	\$ 43,299.8	\$ 59,995.2	\$ 24,826.5	\$ 22,210.8	\$ 43,564.8	\$ 21,118.1	\$ 111,691.1	\$ 103,3

* Stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of \$6.4 million for 2015 and \$6.8 million for 2014.

Months Ended June 30, (Millions)	Corporate & Institutional Services		Wealth Management		Treasury and Other		Total Consolidated	
	2015	2014	2015	2014	2015	2014	2015	2014
Interest Income	\$ 839.3	\$ 774.6	\$ 645.0	\$ 611.8	\$	\$	\$ 1,484.3	\$ 1,38

Investment and Other									
ing Fees									
n Exchange Trading									
e	139.3	98.8	7.1	4.2			146.4	10	
Noninterest Income	85.1	91.5	55.6	45.8	107.2	3.2	247.9	14	
Interest Income (FTE)*	188.7	150.4	279.3	267.6	56.4	89.8	524.4	50	
ue*	1,252.4	1,115.3	987.0	929.4	163.6	93.0	2,403.0	2,13	
ion for Credit Losses	(0.2)	3.6	(14.3)	(0.6)			(14.5)		
Interest Expense	923.1	869.9	644.6	648.2	75.8	60.9	1,643.5	1,57	
e before Income									
*	329.5	241.8	356.7	281.8	87.8	32.1	774.0	55	
ion for Income Taxes*	102.6	70.9	134.2	106.2	37.3	15.3	274.1	19	
Income	\$ 226.9	\$ 170.9	\$ 222.5	\$ 175.6	\$ 50.5	\$ 16.8	\$ 499.9	\$ 36	
Percentage of Consolidated									
Income	45%	47%	45%	48%	10%	5%	100%		
ge Assets	\$ 41,540.9	\$ 58,631.4	\$ 24,569.1	\$ 22,368.8	43,503.7	20,792.1	\$ 109,613.7	\$ 101,79	

* Stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of \$12.6 million for 2015 and \$15.5 million for 2014.

Table of Contents**REPORTING SEGMENTS (continued)****Corporate & Institutional Services**

C&IS net income totaled \$104.2 million in the current quarter compared to \$85.0 million in the prior-year quarter, an increase of \$19.2 million, or 23%. Noninterest income was \$547.0 million in the current quarter, up \$53.8 million, or 11%, from \$493.2 million in the prior-year quarter, reflecting higher trust, investment and other servicing fees and foreign exchange trading income. The following table provides a summary of C&IS trust, investment and other servicing fees.

Table 12: C&IS Trust, Investment and Other Servicing Fees

(\$ In Millions)	Three Months Ended June 30,		Change	
	2015	2014		
Custody and Fund Administration	\$ 293.6	\$ 261.1	\$ 32.5	12%
Investment Management	80.6	77.7	2.9	4
Securities Lending	26.8	30.0	(3.2)	(11)
Other	31.0	26.6	4.4	17
Total C&IS Trust, Investment and Other Servicing Fees	\$ 432.0	\$ 395.4	\$ 36.6	9%

Custody and fund administration fees, the largest component of C&IS fees, are driven primarily by values of client assets under custody, 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, which are based generally on client assets under management, are based primarily on market values throughout a period.

Custody and fund administration fees increased 12%, driven by new business and higher equity markets, partially offset by the unfavorable impact of movements in foreign exchange rates. Investment management fees increased 4% due to new business, lower money market mutual fund fee waivers and higher equity markets. Money market mutual fund fee waivers in C&IS totaled \$13.6 million in the current quarter compared to \$14.8 million in the prior-year quarter. Securities lending decreased 11% due to changes in fee arrangements.

Foreign exchange trading income totaled \$71.8 million in the current quarter, an increase of \$21.1 million, or 42%, from \$50.7 million in the prior-year quarter. The increase was primarily attributable to higher currency volatility and client volumes as compared to the prior-year quarter.

Other noninterest income in C&IS totaled \$43.2 million in the current quarter, down 8%, from \$47.1 million in the prior-year quarter, primarily reflecting decreases within various miscellaneous categories of other operating income, partially offset by higher security commissions and trading income.

Net interest income stated on an FTE basis was \$92.7 million in the current quarter, up \$16.0 million, or 21% from \$76.7 million in the prior-year quarter. The increase in net interest income was attributable to an increase in the net interest margin, partially offset by lower levels of average earning assets and a \$17.8 million impairment of the residual value of certain aircraft under leveraged lease agreements. The changes to both the net interest margin and average earning assets versus prior-year period were partially due to a change in presentation, as certain assets were transferred to the Treasury and Other segment in the prior quarter and the related internal funds pricing method was updated. As a result, the net interest margin increased to 0.99% from 0.57% in the prior-year quarter while average earning assets totaled \$37.4 billion, a decrease of \$16.4 billion, or 30%, from \$53.8 billion in the prior-year quarter. The earning assets that remain consist primarily of intercompany assets and loans and leases. Funding sources were primarily comprised of non-U.S. custody-related interest-bearing deposits, which averaged \$45.6 billion in the current quarter, relatively unchanged from the prior-year quarter.

Table of Contents**REPORTING SEGMENTS (continued)****Corporate & Institutional Services (continued)**

The provision for credit losses totaled \$2.0 million in the current quarter, reflecting an increase in the level of commercial and institutional loans, partially offset by continued improvement in credit quality. The prior-year quarter included a provision of \$2.4 million.

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 \$488.2 million in the current quarter, up \$41.8 million, or 9%, from \$446.4 million in the prior-year quarter. The increase was primarily attributable to \$36.6 million of the charge related to voluntary cash contributions to certain constant dollar NAV funds noted above allocated to C&IS.

Wealth Management

Wealth Management net income was \$115.3 million in the current quarter, up \$26.5 million, or 30%, from \$88.8 million in the prior-year quarter. Noninterest income was \$354.6 million, up \$17.8 million, or 5%, from \$336.8 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 \$324.8 million in the current quarter, up \$13.3 million, or 4%, from \$311.5 million in the prior-year quarter. The following table provides a summary of Wealth Management trust, investment and other servicing fees.

Table 13: Wealth Management Trust, Investment and Other Servicing Fees

(\$ In Millions)	Three Months Ended June 30,		Change	
	2015	2014		
Central	\$ 128.2	\$ 126.2	\$ 2.0	2%
East	85.9	83.0	2.9	3
West	68.5	65.0	3.5	5
Global Family Office	42.2	37.3	4.9	13
Total Wealth Management Trust, Investment and Other Servicing Fees	\$ 324.8	\$ 311.5	\$ 13.3	4%

Wealth Management fee income is calculated primarily based on market values. The increased Wealth Management fees across regions and Global Family Office were primarily attributable to higher equity markets and new business. Money market mutual fund fee waivers in Wealth Management totaled \$14.6 million in the current quarter compared to \$15.9 million in the prior-year quarter.

Other noninterest income totaled \$26.8 million in the current quarter, up \$3.7 million, or 16%, from \$23.1 million in the prior-year quarter, primarily reflecting increases within various miscellaneous categories of other operating income.

Net interest income stated on an FTE basis was \$141.0 million in the current quarter, up \$8.4 million, or 6%, from \$132.6 million in the prior-year quarter, reflecting higher levels of average earning assets, partially offset by a decline in the net interest margin. The net interest margin decreased to 2.30% in the current quarter from 2.32% in the prior-year quarter due to lower yields on earning assets, partially offset by a lower cost of interest-related funds. Earning assets averaged \$24.5 billion, up \$1.5 billion, or 7%, from \$23.0 billion in the prior-year quarter. Earning assets and funding sources were primarily comprised of loans and domestic retail interest-bearing deposits, respectively.

The provision for credit losses was a credit of \$12.0 million in the current quarter, reflecting improvement in the credit quality of commercial real estate and private client loans, and a decrease in the level of residential real estate loans, partially offset by an increase in the level of private client and commercial real estate loans. The provision for credit losses was a credit of \$2.4 million in the prior-year quarter.

Table of Contents**REPORTING SEGMENTS (continued)****Wealth Management (continued)**

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 \$322.7 million in the current quarter, compared to \$329.4 million in the prior-year quarter, a decrease of \$6.7 million, or 2%. The decrease was primarily attributable to lower compensation and outside services expense, partially offset by higher indirect allocations, primarily attributable to \$9.2 million of the charge related to voluntary cash contributions to certain constant dollar NAV funds allocated to Wealth Management.

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 totaled \$103.1 million in the current quarter, compared to \$5.1 million in the prior-year quarter. The increase reflects the \$99.9 million net gain on the sale of 1.0 million of Visa Inc. Class B common shares recognized by the Corporation during the quarter. As of June 30, 2015, the Corporation continued to hold approximately 5.2 million Visa Inc. Class B common shares.

Net interest income decreased \$20.2 million, or 46%, to \$23.9 million in the current quarter, compared to \$44.1 million in the prior-year quarter. The decrease reflects a decline in the net interest margin, partially offset by higher levels of earning assets. The changes to both the net interest margin and average earning assets versus prior year are partially due to a change in presentation, as certain assets were transferred to Treasury and Other from C&IS and the related internal funds pricing method was updated in the prior quarter. Average earning assets increased \$23.1 billion to \$41.8 billion from the prior-year quarter's \$18.7 billion.

Noninterest expense totaled \$43.6 million in the current quarter, up \$8.4 million, or 24%, from \$35.2 million in the prior-year quarter, primarily reflecting higher general overhead costs, partially offset by higher indirect expense allocations to C&IS and Wealth Management as compared to the prior-year quarter.

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

Net income per diluted common share was \$2.04 for the six months ended June 30, 2015 and \$1.50 in the comparable prior-year period. Net income totaled \$499.9 million, up \$136.6 million, or 38%, as compared to \$363.3 million in the prior-year period. The performance in the current period produced an annualized return on average common equity of 12.1%, compared to 9.2% in the prior-year period. The annualized return on average assets was 0.9%, compared to 0.7% in the prior-year period.

The current period includes a net pre-tax gain on the sale of 1.0 million Visa Inc. Class B common shares totaling \$99.9 million; voluntary cash contributions to certain constant dollar NAV funds of \$45.8 million; and the impairment of the residual value of certain aircraft under leveraged lease agreements of \$17.8 million. Excluding the gain and

charges, net income per diluted common share, net income, and return on average common equity were \$1.95, \$477.4 million and 11.5%, respectively.

The prior-year period included pre-tax charges of \$32.8 million for severance and related costs and for the realignment of the Corporation's real estate portfolio and \$9.5 million of software write-offs. Excluding these charges and write-offs, net income per diluted common share, net income, and return on average common equity were \$1.61, \$391.1 million, and 9.9% respectively.

Table of Contents**SIX-MONTH CONSOLIDATED RESULTS OF OPERATIONS (continued)****Overview (continued)**

Revenue for the six months ended June 30, 2015 totaled \$2.39 billion, up \$268.2 million, or 13%, as compared to \$2.12 billion in the prior-year period. Noninterest income was \$1.88 billion, up \$248.7 million, or 15%, from \$1.63 billion in the prior-year period. Trust, investment and other servicing fees increased \$97.9 million, or 7%, to \$1.48 billion from \$1.39 billion in the prior-year period.

Noninterest Income

The components of noninterest income are provided below.

Table 14: Six Months Ended June 30 Noninterest Income

Noninterest Income (\$ In Millions)	Six Months Ended June 30,		Change	
	2015	2014		
Trust, Investment and Other Servicing Fees	\$ 1,484.3	\$ 1,386.4	\$ 97.9	7%
Foreign Exchange Trading Income	146.4	103.0	43.4	42
Treasury Management Fees	32.4	33.4	(1.0)	(3)
Security Commissions and Trading Income	39.8	32.5	7.3	22
Other Operating Income	176.0	78.2	97.8	125
Investment Security Gains (Losses), net	(0.3)	(3.6)	3.3	(92)
Total Noninterest Income	\$ 1,878.6	\$ 1,629.9	\$ 248.7	15%

As illustrated in the following table, trust, investment and other servicing fees from C&IS increased \$64.7 million, or 8%, totaling \$839.3 million, compared to \$774.6 million a year ago.

Table 15: Six Months Ended June 30 C&IS Trust, Investment and Other Servicing Fees

C&IS Trust, Investment and Other Servicing Fees (\$ In Millions)	Six Months Ended June 30,		Change	
	2015	2014		
Custody and Fund Administration	\$ 570.7	\$ 513.3	\$ 57.4	11%
Investment Management	157.0	152.7	4.3	3
Securities Lending	48.4	52.7	(4.3)	(8)
Other	63.2	55.9	7.3	13
Total	\$ 839.3	\$ 774.6	\$ 64.7	8%

Custody and fund administration fees, the largest component of C&IS fees, increased 11%, primarily driven by new business and higher equity markets, partially offset by the unfavorable impact of movements in foreign exchange rates. C&IS investment management fees increased 3%, primarily reflecting new business, lower money market mutual fund fee waivers and higher equity markets. Money market mutual fund fee waivers in C&IS totaled \$28.8 million, compared to waived fees of \$29.7 million in the prior-year period. Securities lending revenue decreased 8%, reflecting changes in fee arrangements and lower spreads, partially offset by higher loan volumes in the current period. Other fees in C&IS increased 13%, primarily reflecting increased sub-advisory fees.

Table of Contents**SIX-MONTH CONSOLIDATED RESULTS OF OPERATIONS (continued)****Noninterest Income (continued)**

As illustrated in the following table, trust, investment and other servicing fees from Wealth Management increased \$33.2 million, or 5%, totaling \$645.0 million, compared to \$611.8 million a year ago.

Table 16: Six Months Ended June 30 Wealth Management Trust, Investment and Other Servicing Fees

(\$ In Millions)	Six Months Ended June 30,		Change	
	2015	2014		
Wealth Management Trust, Investment and Other Servicing Fees				
Central	\$ 259.0	\$ 250.3	\$ 8.7	3%
East	168.3	159.7	8.6	5
West	135.3	127.4	7.9	6
Global Family Office	82.4	74.4	8.0	11
Total	\$ 645.0	\$ 611.8	\$ 33.2	5%

The increase is primarily due to higher equity markets and new business. Money market mutual fund fee waivers in Wealth Management totaled \$32.3 million compared with \$33.5 million in the prior-year period.

Foreign exchange trading income increased \$43.4 million, or 42%, and totaled \$146.4 million compared with \$103.0 million in the prior-year period. The increase was attributable to higher currency volatility and client volumes compared to the prior-year period.

Other operating income increased \$97.8 million to \$176.0 million compared with \$78.2 million in the prior-year period. The components of other operating income are provided below.

Table 17: Six Months Ended June 30 Other Operating Income

Other Operating Income (\$ In Millions)	Six Months Ended June 30,		Change	
	2015	2014		
Loan Service Fees	\$ 29.5	\$ 31.7	\$ (2.2)	(7)%
Banking Service Fees	23.7	24.9	(1.2)	(5)
Other Income	122.8	21.6	101.2	N/M
Total Other Operating Income	\$ 176.0			