ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC
Form 10-Q
November 12, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

OR

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

Commission File Number 1-10367

Advanced Environmental Recycling Technologies, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	71-0675758 (I.R.S. Employer Identification No.)
914 N. Jefferson Street Springdale, Arkansas (Address of principal executive offices)	72764 (Zip Code)

(479) 756-7400
(Registrant's telephone number, including area code)

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: þ 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller 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 þ

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of November 11, 2010, the number of shares outstanding of the Registrant's Class A common stock, which is the class registered under the Securities Exchange Act of 1934, was 48,777,896 and the number of shares outstanding of the Registrant's Class B Common Stock was 1,465,530.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS
(in thousands, except share and per share data)

Assets	December 31, 2009	September 30, 2010 (unaudited)
Current assets:		
Cash and cash equivalents	$ 243	$ 807
Restricted cash and cash equivalents	-	893
Trade accounts receivable, net of allowance of $7 at December 31, 2009 and $408 at September 30, 2010	5,163	1,372
Inventories	6,795	10,776
Prepaid expenses	707	954
Total current assets	12,908	14,802
Land, buildings and equipment:		
Land	1,989	1,989
Buildings and leasehold improvements	8,903	17,876
Machinery and equipment	45,296	53,860
Transportation equipment	830	799
Office equipment	2,396	2,402
Construction in progress	16,006	387
Total land, buildings and equipment	75,420	77,313
Less accumulated depreciation	36,240	40,110
Net land, buildings and equipment	39,180	37,203
Other assets:		
Debt issuance costs, net of accumulated amortization of $1,538 at December 31, 2009 and $1,695 at September 30, 2010	2,941	2,783
Debt service reserve fund	222	52
Other assets, net of accumulated amortization of $478 at December 31, 2009 and $486 at September 30, 2010	1,087	1,184
Total other assets	4,250	4,019
Total assets	$ 56,338	$ 56,024

The accompanying notes are an integral part of these financial statements.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

BALANCE SHEETS
(in thousands, except share and per share data)

Liabilities and Stockholders' Deficit	December 31, 2009	September 30, 2010 (unaudited)
Current liabilities:		
Accounts payable – trade	$9,078	$12,304
Accounts payable – related parties	636	1,193
Current maturities of long-term debt	2,878	3,494
Current maturities of capital lease obligations	244	209
Accruals related to expected settlement of class action lawsuit	7,245	5,460
Other accrued liabilities	6,578	6,217
Working capital line of credit	7,829	7,829
Notes payable	1,238	378
Total current liabilities	35,726	37,084
Long-term debt, less current maturities	28,260	27,070
Capital lease obligations, less current maturities	401	251
	28,661	27,321
Accrued dividends on convertible preferred stock	948	1,541
Commitments and contingencies (see Note 10)		
Stockholders' deficit:		
Preferred stock, $.01 par value; 5,000,000 shares authorized, 748,772 shares issued and outstanding at December 31, 2009 and September 30, 2010; aggregate liquidation preference of $19,768 at December 31, 2009 and September 30, 2010	7	7
Class A common stock, $.01 par value; 125,000,000 shares authorized; 48,105,554 shares issued and outstanding at December 31, 2009 and 48,277,896 at September 30, 2010	481	483
Class B convertible common stock, $.01 par value; 7,500,000 shares authorized; 1,465,530 shares issued and outstanding at December 31, 2009 and September 30, 2010	15	15
Warrants outstanding; 3,787,880 at December 31, 2009 and September 30, 2010	1,533	1,533
Additional paid-in capital	52,711	52,970
Accumulated deficit	(63,744)	(64,930)
Total stockholders' deficit	(8,997)	(9,922)
Total liabilities and stockholders' deficit	$56,338	$56,024

The accompanying notes are an integral part of these financial statements.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF OPERATIONS
(unaudited)
(in thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Net sales	$19,099	$16,165	$57,833	$55,786
Cost of goods sold	14,046	13,958	44,971	44,425
Estimated liability for claims from class action settlement	5,100	-	5,100	-
Gross margin	(47)	2,207	7,762	11,361
Selling and administrative costs	3,027	2,900	9,227	9,009
Operating income (loss)	(3,074)	(693)	(1,465)	2,352
Other income (expenses):				
Gain from fixed asset disposition	-	-	54	6
Late registration fees	-	-	273	-
Net interest expense	(799)	(1,172)	(2,613)	(2,951)
Loss before dividends	(3,873)	(1,865)	(3,751)	(593)
Dividends on preferred stock	(198)	(198)	(607)	(593)
Net loss applicable to common stock	$(4,071)	$(2,063)	$(4,358)	$(1,186)
Loss per share of common stock (basic and diluted)	$(0.08)	$(0.04)	$(0.09)	$(0.02)
Weighted average common shares outstanding (basic and diluted)	49,542,846	49,743,426	49,221,015	49,643,495

The accompanying notes are an integral part of these financial statements.

ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES, INC.

STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net loss applicable to common stock	$ (4,358)	$ (1,186)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	4,330	4,722
Dividends on preferred stock	607	593
Increase in accounts receivable allowance	-	401
Gain from fixed asset disposition	(54)	(6)
Increase in cash restricted for interest costs	(705)	(413)
Decrease in other assets	690	65
Changes in current assets and current liabilities	3,755	1,843
Net cash provided by operating activities	4,265	6,019
Cash flows from investing activities:		
Purchases of land, buildings and equipment	(8,516)	(2,311)
Proceeds from disposition of equipment	54	6
Net cash used in investing activities	(8,462)	(2,305)
Cash flows from financing activities:		
Net payments on line of credit	(1,700)	-
Payments on notes	(1,033)	(2,485)
Payments on capital lease obligations	(160)	(185)
(Increase) decrease in cash restricted for payment of debt and construction costs	7,577	(480)
Net cash provided by (used in) financing activities	4,684	(3,150)
Increase in cash and cash equivalents	487	564
Cash and cash equivalents, beginning of period	1,238	243
Cash and cash equivalents, end of period	$ 1,725	$ 807

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

Note 1: Unaudited Information

Advanced Environmental Recycling Technologies, Inc. (the Company or AERT) has prepared the financial statements included herein without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). However, all adjustments have been made to the accompanying financial statements which are, in the opinion of the Company's management, of a normal recurring nature and necessary for a fair presentation of the Company's operating results. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented herein not misleading. It is recommended that these financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest annual report on Form 10-K.

Note 2: Description of the Company

AERT, founded in 1988, recycles polyethylene plastic and develops, manufactures, and markets composite building materials that are used in place of traditional wood or plastic products for exterior applications in building and remodeling homes and for certain other industrial or commercial building purposes. The Company's products are made primarily from approximately equal amounts of waste wood fiber, which has been cleaned, sized and reprocessed, and recycled polyethylene plastics, which have been cleaned, processed, and reformulated utilizing our patented and proprietary technologies. The products have been extensively tested, and are sold by leading national companies such as BlueLinx Corporation (BlueLinx), Lowe's Companies, Inc. (Lowe's) and Therma-Tru Corporation. The Company's products are primarily used in renovation and remodeling by consumers, homebuilders, and contractors as an exterior green (environmentally responsible) building alternative for decking, railing, and trim products.

On May 13, 2010, the Company changed its distributor for ChoiceDek® products from Weyerhaeuser Company, previously its largest customer, to BlueLinx. The change comes primarily as a result of Weyerhaeuser's decision to transition away from non-lumber products. All ChoiceDek® products are sold by the distributor exclusively to Lowe's.

The Company currently manufactures all of its composite products at extrusion facilities in Springdale, Arkansas. The Company operates a plastic recycling, blending and storage facility in Lowell, Arkansas, where it also leases warehouses and land for inventory storage. In February 2010, the Company commenced operations at its Watts, Oklahoma recycling facility, which currently recycles polyethylene plastic scrap in order to reduce the Company's costs of recycled plastics. The Company expects to also use the Watts facility to recycle plastic for sales to third parties in the future.

Note 3: Future Operations

The financial statements of the Company have been prepared on the basis of accounting principles applicable to a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. At September 30, 2010, the Company had a working capital deficit of $22.3 million and a stockholders' deficit of $9.9 million. It incurred losses from operations of $1.1 million and $19.8 million for the years ended December 31, 2009 and 2008, respectively. The Company has limited additional financial resources available to support its operations and has relied over the last two years on extensions of certain of its financings by its lenders and the additional support of its vendors and major shareholder. The Company has received approval for additional financial assistance from the states of Arkansas and Oklahoma in the total amount of $3.3 million to expand its operations and increase sales (see Note 9: Financing). However, the Company will require additional financial resources in order to fund maturities of debt and other obligations as they become due, or will need to work with its lenders to restructure its debt or receive forbearance on certain debt payments. These factors, among others, raised doubt about the ability of the Company to continue as a going concern. The ability of the Company to continue as a going concern is dependent upon the ongoing support of its creditors, investors and customers, and its ability to successfully mass produce and market its products at economically feasible levels. The financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

The Company plans to resolve its current liquidity issue and structure its operations to grow its business, improve its margins and generate net income in order to maximize shareholder value. The Company's immediate liquidity issue is being addressed by:

1) Increasing sales volumes: The Company expects to increase its sales by introducing new products to the marketplace.

2) Implementing additional cost reductions: A substantial amount of cost has already been eliminated from the Company's

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operations and additional cost reductions are being identified and implemented.

3) Streamlining operations to increase efficiencies: The Company expects to make changes to certain operational processes in order to increase production.

4) Seeking additional sources of revenue through increased market share: The Company is pursuing additional distribution of its current product line and is introducing new products in order to increase its sales. BlueLinx and other distributors partner with the Company in aggressively marketing the Company's products.

5) Pursuing additional funding to provide liquidity while restructuring the business: The Company is investigating potential sources of financing, including less traditional debt and equity financing opportunities.

6) Restructuring existing debt to improve short-term liquidity: The Company's mortgage loan with Liberty Bank was extended from April 15, 2010 to April 15, 2012, and its line of credit was extended from July 15, 2010 to October 15, 2010. The Company is currently working to restructure its line of credit as part of a larger financing.

7) Completing the second phase of its Watts recycling facility: The Company expects its Watts recycling facility to reduce raw material costs and generate additional sales of recycled materials once the second phase of the facility is completed, which will allow for the production of recycled plastic pellets for sales to third parties.

Note 4: Statements of Cash Flows

In order to determine net cash provided by operating activities, net loss has been adjusted by, among other things, changes in current assets and current liabilities, excluding changes in cash, current maturities of long-term debt and current notes payable. Those changes, shown as an (increase) decrease in current assets and an increase (decrease) in current liabilities, are as follows for the nine months ended September 30 (in thousands):

	2009 (unaudited)	2010 (unaudited)
Receivables	$ (1,591)	$ 3,391
Inventories	4,311	(3,982)
Prepaid expenses and other	1,541	748
Accounts payable – trade and related parties	(4,303)	3,832
Accrued liabilities	3,797	(2,146)
	$ 3,755	$ 1,843
Cash paid for interest, net of amounts capitalized of $811 in 2009 and $260 in 2010	$ 1,276	$ 1,622

Supplemental Disclosures of Non-Cash Investing and Financing Activities (in thousands):

	2009 (unaudited)	2010 (unaudited)
Notes payable for financing insurance policies	1,025	995
Note payable for equipment		56
Class A common stock issued in payment of accounts payable		50
Investment tax credit related to construction of fixed assets	754	
Amortized discount on Allstate note payable	193	

Note 5: Significant Accounting Policies

Revenue Recognition Policy

The Company recognizes revenue when the title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the sales price is determinable and collectability is reasonably assured. The Company typically recognizes revenue at the time product is shipped or when segregated and billed under a bill and hold arrangement. Sales are recorded net of discounts, rebates and returns, which were $0.3 million and $0.7 million for the quarters ended September 30, 2009 and 2010, respectively, and $1.0 million and $3.0 million for the nine months ended September 30, 2009 and

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2010, respectively. The increase for the nine months ended September 30, 2010 was due to the replacement of our discontinued style of handrail with an updated handrail product line for Lowe's.

Estimates of expected sales discounts are calculated by applying the appropriate sales discount rate to all unpaid invoices that are eligible for the discount. The Company's sales prices are determinable given that its sales discount rates are fixed and given the predictability with which customers take sales discounts.

Shipping and Handling

The Company records shipping fees billed to customers in net sales and records the related expenses in cost of goods sold.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market. Material, labor, and factory overhead necessary to produce the inventories are included in their cost. Inventories consisted of the following (in thousands):

	December 31, 2009	September 30, 2010 (unaudited)
Parts and supplies	$ 1,470	$ 1,294
Raw materials	2,416	4,070
Work in process	1,041	2,396
Finished goods	1,868	3,016
	$ 6,795	$ 10,776

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Concentration Risk

The Company's revenues are derived principally from national and regional building products distributors and BlueLinx, the Company's primary decking customer. The ChoiceDek® brand of decking products sold to BlueLinx are in turn sold exclusively to Lowe's. BlueLinx is also one of the Company's MoistureShield® decking customers. The Company extends unsecured credit to its customers. The Company's concentration in the building materials industry has the potential to impact its exposure to credit risk because changes in economic or other conditions in the construction industry may similarly affect the Company's customers. The Company derived most of its revenue prior to May 2010 from Weyerhaeuser, its distributor of ChoiceDek® products prior to the change to BlueLinx. Since the change, the Company has derived most of its revenue from BlueLinx.

Disclosure about Fair Value of Financial Instruments

The fair value of the Company's long-term debt has been estimated by the Company based upon each obligation's characteristics, including remaining maturities, interest rate, credit rating, and collateral and amortization schedule. The carrying amount approximates fair value.

Research and Development

Expenditures relating to the development of new products and processes, including significant improvements to existing products, are expensed as incurred.

Share-Based Payments

The Company measures the cost of employee and director services received in exchange for an award of equity instruments based on the grant-date fair value of the award and recognizes that cost in the financial statements. Compensation cost is recognized as the awards vest. Since 2005, the Company has used restricted stock awards as its exclusive form of stock-based compensation.

Note 6: Related Party Transaction

In September 2010, the Company purchased plastic equipment from Joe Brooks, the Company's chairman and chief executive officer. The total purchase price of the equipment was $0.2 million and was included in accounts payable – related parties at September 30, 2010.

Note 7: Income Taxes

As of September 30, 2010, the Company had net operating loss carryforwards that are available to reduce future taxable income and will expire in 2010 through 2029 if not utilized. As there has been insufficient certainty that the Company will be able to generate adequate future taxable income to enable it to realize its net operating loss carryforwards prior to expiration, the Company carries a valuation allowance to recognize its deferred tax assets only to the extent of its deferred tax liabilities. As a result, no income tax provision has been recorded for the quarter and nine months ended September 30, 2009 and 2010.

Based upon a review of its income tax filing positions, the Company believes that its positions would be sustained upon an audit and does not anticipate any adjustments that would result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded. The Company recognizes interest related to income taxes as interest expense and penalties as operating expenses.

The Company is no longer subject to income tax examinations by tax authorities for years before 2006, except in the State of Texas, for which the 2005 tax year is still subject to examination. The Company is not currently the subject of any income tax examinations by any tax authorities.

Note 8: Earnings Per Share

When applicable, the Company provides dual presentation of basic and diluted earnings per shares (EPS) on the face of the statements of operations, and provides a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

In computing diluted EPS, only potential common shares that are dilutive — those that reduce earnings per share or increase loss per share — are included. The exercise of options and warrants or conversion of convertible securities is not assumed if the result would be antidilutive, such as when a loss from continuing operations is reported. As a result, if there is a loss from continuing operations, diluted EPS would be computed in the same manner as basic EPS is computed, even if an entity has net income after adjusting for discontinued operations, an extraordinary item or the cumulative effect of an accounting change. The Company incurred losses from continuing operations for the three and nine months ended September 30, 2009 and 2010. Therefore, basic EPS and diluted EPS were computed in the same manner for those periods.

Although not included in a diluted EPS calculation due to being antidilutive, the Company had potentially dilutive securities outstanding at September 30, 2009 and 2010. The following schedule presents antidilutive securities for the quarters and nine months ended September 30, 2009 and 2010:

	Three Months Ended September 30,	Nine Months Ended September 30,

	2009	2010	2009	2010
Options	1,174,000	1,049,000	1,174,000	1,049,000
Warrants	3,787,880	3,787,880	3,787,880	3,787,880
Restricted common stock	1,503,270	2,030,000	1,503,270	2,030,000
Series D preferred stock	7,487,720	7,487,720	7,487,720	7,487,720

Although these financial instruments were not included due to being antidilutive, such financial instruments may become dilutive and would then need to be included in future calculations of diluted EPS.

Note 9: Financing

Line of Credit

The maturity date of the Company's line of credit agreement with Liberty Bank of Arkansas was extended from July 15, 2010 to October 15, 2010. The Company is currently working to restructure and extend the line. The line is secured by inventory, accounts receivable, chattel paper, general intangibles and other current assets, as well as by fixtures and equipment, and bears an interest rate of 9%. The maximum amount that may be drawn on the line at one time is the lesser of $7.8 million and the borrowing base. At September 30, 2010, the borrowing base was overdrawn, leaving no funds available to borrow. The borrowing base is equal to the sum of approximately 85% of our qualifying accounts receivable, 75% of finished goods inventory and 50% of all other inventory, excluding parts and supplies. The full amount of the line is guaranteed as to payment by our largest stockholder, Marjorie Brooks, and by Joe Brooks, the Company's chairman and chief executive officer, and Steve Brooks, the Company's chief operating officer. In addition to her personal guarantee, Ms. Brooks has pledged real estate collateral. In conjunction with restructuring the line of credit, the Company will be renegotiating the fees it pays to Ms. Brooks as compensation for her guarantees.

The credit facility includes a debt service coverage ratio, current ratio, and accounts payable and accounts receivable aging covenants, and customary restrictions on dividends and the incurrence of additional debt or liens, among other matters. The Company was not in compliance with the debt service coverage, current ratio, and accounts payable covenants as of September 30, 2010. Liberty Bank has not waived the covenants, and as such could enforce all remedies available to it under the loan agreement. However, as previously discussed, Liberty Bank has continued to work with the Company and has extended the line of credit twelve times.

Allstate Debt

The Company did not make the October 2010 principal payment in the amount of $0.2 million on its Allstate bridge loan that had a balance of $5.4 million at September 30, 2010. Failure to make a principal payment when due is an event of default under the bridge loan agreement. Additionally, the Company did not make the October 2010 bond principal fund and bond interest fund payments totaling $0.3 million on its Allstate bonds that had a balance of $23.2 million at September 30, 2010. The Company is working with Allstate to restructure its debts to Allstate.

Oklahoma Energy Program Loan

On July 14, 2010, we entered into a loan agreement with the Oklahoma Department of Commerce (ODOC) whereby ODOC agreed to a 15-year, $3.0 million loan to AERT at a fixed interest rate of 3%. The loan is being made pursuant to the American Recovery and Reinvestment Act (ARRA) State Energy Program for the State of Oklahoma, and will fund the second phase of AERT's new recycling facility in Watts, Oklahoma. Payments on the loan are scheduled to commence on the earlier of project completion or July 1, 2011.

Arkansas Economic Infrastructure Funding

On March 30, 2010, the Company entered into a grant agreement with the City of Springdale and the Arkansas Economic Development Commission (AEDC) in the amount of $170,000. Part of the grant funds have been used to pay for a new packaging line in the Springdale North plant. On June 4, 2010, the Company accepted an offer of additional grant funding in the amount of $150,000 that would be combined with and become a part of the initial grant provided by AEDC, bringing the total amount of that grant to $320,000. The Company expects to sign final grant agreements shortly. The new grant funding and the remainder of the initial grant will be used to relocate equipment, including an idle extrusion line from AERT's plant at Junction, Texas to the Springdale South plant. AERT expects to create 84 jobs in its operations in Arkansas as a result of the grant funding from AEDC.

Note 10: Commitments and Contingencies

Advanced Environmental Recycling Technologies, Inc. v. Fort Mason Master, L.P. and Fort Mason Partners, L.P.

On August 19, 2009, AERT filed a complaint for declaratory and injunctive relief in the Court of Chancery of the State of Delaware (the Court) against Fort Mason Master, L.P. and Fort Mason Partners, L.P. (the Funds), requesting that the Court enter an order that AERT has no obligation to redeem its Series D preferred stock held by the Funds and that the Funds be required to comply with the terms of the preferred stock agreements. Prior to AERT filing a complaint, the Funds indicated to the Company their belief that they were entitled to have their stock redeemed (representing $4.0 million of initial investment) because of the Company's accruing but not paying cumulative dividends, allegedly misrepresenting their redemption rights, and/or failing to pay late registration penalties. The Company denied and disputed these allegations. AERT also sought a ruling to clarify its obligation with respect to late registration penalties attributable to delays in getting its S-3 resale registration statement for the preferred stock effective as a result of circumstances beyond its control. At September 30, 2010, the Company had $0.4 million accrued relating to these late registration penalties.

On January 15, 2010, the Funds filed with the Court an answer to the Company's complaint and a counterclaim against AERT. The Funds denied any allegations made by AERT and claimed that AERT had breached certain terms of the Series D preferred stock agreements, including that AERT failed to pay required dividends, AERT falsely represented that it was not prohibited from redeeming the preferred stock, and AERT failed to timely make effective a registration statement and failed to pay the related late registration penalties. The Funds sought damages and attorneys' fees from AERT for the alleged breaches of contract. Additionally, the Funds requested that the Court require AERT to redeem the preferred stock, claiming that the alleged breaches of contract gave the Funds the right to require redemption under the preferred stock agreements.

AERT responded to the counterclaims on February 4, 2010. In its response, AERT denied the allegations of the Funds and requested that the Court enter an order dismissing the counterclaims, declaring that AERT had no current obligation to redeem the preferred stock, requiring the Funds to comply with the rights and obligations in connection with the Series D preferred stock under Delaware law, and awarding AERT its attorneys' fees and expenses related to this lawsuit.

On April 27, 2010, the Funds filed a motion for summary judgment on their counterclaims. AERT filed its answering brief with the Court on June 16, 2010 and the Funds filed their reply brief on July 2, 2010. On August 6, 2010, AERT and the Funds agreed to dismiss, without prejudice, the pending lawsuit and the claims and counterclaims therein in conjunction with a sale by the Funds of their Series D preferred stock and warrants to a third party.

Class Action Lawsuits

The U.S. District Court, Western District of Washington (Seattle Division) approved a class action settlement in January 2009 related to a purported class action lawsuit seeking to recover on behalf of purchasers of ChoiceDek® composite decking for damages allegedly caused by mold and mildew stains on their decks. The settlement includes decking material purchased from January 1, 2004 through December 31, 2007, along with decking material purchased after December 31, 2007 that was manufactured before October 1, 2006, the date a mold inhibitor was introduced in the manufacturing process.

At September 30, 2010, AERT had a total remaining balance in accrued expenses of $5.5 million associated with the settlement of the class action lawsuit. The estimate included $4.9 million remaining for the claims resolution process and $0.6 million remaining to be paid for plaintiffs' attorney fees. In 2008, the Company accrued an estimated $2.9 million for resolving claims. In the third quarter of 2009, the Company increased its estimate of costs to be incurred in resolving claims under the settlement by $5.1 million. The estimate was revised due to events that occurred and information that became available after the second quarter of 2009 concerning primarily the number of claims received. The deadline for submitting new claims has now passed. The claim resolution process will have an annual net cost limitation to AERT of $2.0 million until the claim resolution process is completed.

Other Matters

AERT is involved from time to time in litigation arising from the normal course of business that is not disclosed in its filings with the SEC. In management's opinion, this litigation is not expected to materially impact the Company's results of operations or financial condition.

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

Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2010

The following table sets forth selected information from our statements of operations (in thousands).

	Three Months Ended September 30,					
	2009		2010		% Change	
Net sales	$19,099		$16,165		-15.4	%
Cost of goods sold	14,046		13,958		-0.6	%
% of net sales	73.5	%	86.3	%		
Estimated liability for claims from class action settlement	5,100		-		-100.0	%
% of net sales	26.7	%	0.0	%		
Gross margin	(47	)	2,207		*	
% of net sales	-0.2	%	13.7	%		
Selling and administrative costs	3,027		2,900		-4.2	%
% of net sales	15.8	%	17.9	%		
Operating loss	(3,074	)	(693	)	-77.5	%
% of net sales	-16.1	%	-4.3	%	&#7	

(1) Other securities include Federal Reserve and Federal Home Loan Bank stock and certain community development investments which are classified in other assets in the consolidated balance sheet as of March 31, 2014 and 2013.

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

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

Notes: Net Interest Income (FTE Adjusted) includes adjustments to a fully taxable equivalent basis for loans and securities. Such adjustments are based on a blended federal and state tax rate of 37.5%. Total taxable equivalent interest adjustments amounted to $8.7 million and $7.6 million for the three months ended March 31 2014 and 2013, respectively.

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

FORWARD-LOOKING STATEMENTS

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

Forward-looking statements are typically identified by words or phrases such as believe , expect , anticipate , intend , estimate , project , likely , may increase , plan , goal , target , strategy , and similar expressions or future or c verbs such as may , will , should , would , and could.

Forward-looking statements are Northern Trust s current estimates or expectations of future events or future results and involve risks and uncertainties that are difficult to predict. These statements are based on assumptions about many important factors, including:

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

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

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

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

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

a significant downgrade of any of our debt ratings;

changes in foreign exchange trading client volumes, fluctuations and volatility in foreign currency exchange rates;

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;

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

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FORWARD-LOOKING STATEMENTS (continued)

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

our ability to manage risks inherent in our business, including credit risk, operational risk, interest rate risk, liquidity risk, and strategic risk;

natural disasters, pandemics, terrorist events, and global conflicts;

the pace and extent of continued globalization of investment activity and growth in worldwide financial assets; regulatory and monetary policy developments;

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

changes in tax laws, accounting requirements or interpretations and other legislation in the U.S. or other countries that could affect Northern Trust or its clients, including changes in accounting rules for fair value measurements and recognizing impairments;

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

our ability to maintain existing business, continue to generate new business in our existing markets, and identify and penetrate targeted markets;

the impact of equity markets on fee revenue;

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

our ability to maintain a product mix that achieves acceptable margins and to continue to generate investment results that satisfy clients and to develop an array of investment products;

our success in generating revenue in our securities lending business, including for our clients;

our success in recruiting and retaining employees and maintaining sufficient expertise;

our success in controlling expenses and implementing revenue enhancement initiatives;

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

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

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

FORWARD-LOOKING STATEMENTS (continued)

- risks that evolving regulations, such as Basel III and those promulgated under the Dodd-Frank Act, could affect required regulatory capital for financial institutions, including Northern Trust, potentially resulting in changes to the cost and composition of capital for Northern Trust;
- changes in the legal, regulatory and enforcement framework and oversight applicable to financial institutions, including changes that may affect leverage limits and risk-based capital and liquidity requirements for certain financial institutions, require financial institutions to pay higher assessments, expose financial institutions to certain liabilities of their subsidiary depository institutions, and restrict or increase the regulation of certain activities, including foreign exchange, carried on by financial institutions, including Northern Trust;
- risks and uncertainties inherent in the litigation and regulatory process, including the adequacy of contingent liability, tax, and other accruals;
- the risk of damage to our reputation which may undermine the confidence of clients, counterparties, rating agencies, and stockholders;
- risks associated with being a holding company, including our dependence on dividends from our principal subsidiary; and
- other factors identified elsewhere in this report and other filings with the U.S. Securities and Exchange Commission, including those factors described in Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2013, all of which are available on our website.

Actual results may differ materially from those expressed or implied by the forward-looking statements. Northern Trust assumes no obligation to update its forward-looking statements.

CONSOLIDATED BALANCE SHEET **NORTHERN TRUST CORPORATION**

(In Millions Except Share Information)	March 31, 2014 (Unaudited)	December 31, 2013
Assets		
Cash and Due from Banks	**$ 3,676.3**	$ 3,162.4
Federal Funds Sold and Securities Purchased under Agreements to Resell	**510.0**	529.6
Interest-Bearing Deposits with Banks	**17,155.8**	19,397.4
Federal Reserve Deposits and Other Interest-Bearing	**12,211.0**	12,911.5
Securities		
Available for Sale	**29,540.6**	28,392.8
Held to Maturity (Fair value of $4,209.2 and $2,321.4)	**4,211.7**	2,325.8
Trading Account	**1.5**	1.7
Total Securities	**33,753.8**	30,720.3
Loans and Leases		
Commercial	**13,280.7**	12,620.0
Personal	**16,380.1**	16,765.5
Total Loans and Leases (Net of unearned income of $300.4 and $286.2)	**29,660.8**	29,385.5
Allowance for Credit Losses Assigned to Loans and Leases	**(279.2)**	(278.1)
Buildings and Equipment	**449.4**	458.8
Client Security Settlement Receivables	**1,845.2**	1,355.2
Goodwill	**541.6**	540.7
Other Assets	**4,307.9**	4,764.0
Total Assets	**$ 103,832.6**	$ 102,947.3
Liabilities		
Deposits		
Demand and Other Noninterest-Bearing	**$ 19,102.4**	$ 16,888.7
Savings and Money Market	**15,506.0**	14,991.5
Savings Certificates and Other Time	**2,034.5**	1,874.4
Non U.S. Offices Noninterest-Bearing	**2,060.4**	1,881.8
Interest-Bearing	**47,564.4**	48,461.7
Total Deposits	**86,267.7**	84,098.1
Federal Funds Purchased	**1,013.9**	965.1
Securities Sold Under Agreements to Repurchase	**736.6**	917.3
Other Borrowings	**652.4**	1,558.6
Senior Notes	**1,996.7**	1,996.6
Long-Term Debt	**1,731.3**	1,709.2
Floating Rate Capital Debt	**277.2**	277.1
Other Liabilities	**3,208.5**	3,513.3
Total Liabilities	**95,884.3**	95,035.3

Stockholders Equity		
Common Stock, $1.66 2/3 Par Value; Authorized 560,000,000 shares; Outstanding shares of 236,481,078 and 237,322,035	**408.6**	408.6
Additional Paid-In Capital	**1,022.9**	1,035.7
Retained Earnings	**7,241.4**	7,134.8
Accumulated Other Comprehensive Loss	**(236.1)**	(244.3)
Treasury Stock (8,690,446 and 7,849,489 shares, at cost)	**(488.5)**	(422.8)
Total Stockholders Equity	**7,948.3**	7,912.0
Total Liabilities and Stockholders Equity	**$ 103,832.6**	$ 102,947.3

See accompanying notes to the consolidated financial statements.

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

(In Millions Except Share Information)		Three Months Ended March 31, 2014	2013
Noninterest Income			
Trust, Investment and Other Servicing Fees		**$ 679.5**	$ 630.7
Foreign Exchange Trading Income		**50.1**	59.5
Treasury Management Fees		**16.8**	16.8
Security Commissions and Trading Income		**14.7**	18.3
Other Operating Income		**37.7**	24.8
Investment Security Gains (Losses), net (Note)		**(4.0)**	0.2
Total Noninterest Income		**794.8**	750.3
Net Interest Income			
Interest Income		**295.4**	286.7
Interest Expense		**49.7**	60.6
Net Interest Income		**245.7**	226.1
Provision for Credit Losses		**3.0**	5.0
Net Interest Income after Provision for Credit Losses		**242.7**	221.1
Noninterest Expense			
Compensation		**341.8**	320.3
Employee Benefits		**66.9**	63.3
Outside Services		**144.4**	129.9
Equipment and Software		**101.3**	91.4
Occupancy		**44.2**	43.2
Other Operating Expense		**69.4**	80.8
Total Noninterest Expense		**768.0**	728.9
Income before Income Taxes		**269.5**	242.5
Provision for Income Taxes		**88.1**	78.5
Net Income		**$ 181.4**	$ 164.0
Net Income Applicable to Common Stock		**$ 181.4**	$ 164.0
Per Common Share			
Net Income Basic		**$ 0.75**	$ 0.68
Diluted		**0.75**	0.67
Average Number of Common Shares Outstanding	Basic	**237,208,151**	239,167,559
	Diluted	**239,050,714**	240,189,215

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

(UNAUDITED)

		Three Months Ended March 31,		
(In Millions)		2014		2013
Net Income	**$**	**181.4**	$	164.0
Other Comprehensive Income (Net of Tax and Reclassifications)				
Net Unrealized Gains (Losses) on Securities Available for Sale		**4.5**		1.3
Net Unrealized Gains (Losses) on Cash Flow Hedges		**1.6**		(5.2)
Foreign Currency Translation Adjustments		**(1.3)**		(4.2)
Pension and Other Postretirement Benefit Adjustments		**3.4**		7.0
Other Comprehensive Income (Loss)		**8.2**		(1.1)
Comprehensive Income	**$**	**189.6**	$	162.9

Note:	Changes in Other-Than-Temporary-Impairment (OTTI) Losses	**$**	**(4.6)**	$	
	Noncredit-related OTTI Losses Recorded in/(Reclassified from) OCI		**0.7**		
	Other Security Gains (Losses), net		**(0.1)**		0.2
	Investment Security Gains (Losses), net	**$**	**(4.0)**	$	0.2

See accompanying notes to the consolidated financial statements.

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CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

NORTHERN TRUST CORPORATION

(In Millions)	Three Months Ended March 31, 2014	2013
Common Stock		
Balance at January 1 and March 31	**$ 408.6**	$ 408.6
Additional Paid-in Capital		
Balance at January 1	**1,035.7**	1,012.7
Treasury Stock Transactions Stock Options and Awards	**(43.2)**	(35.6)
Stock Options and Awards Amortization	**23.3**	20.8
Stock Options and Awards Tax Benefits	**7.1**	(2.7)
Balance at March 31	**1,022.9**	995.2
Retained Earnings		
Balance at January 1	**7,134.8**	6,702.7
Net Income	**181.4**	164.0
Dividends Declared Common Stock	**(74.8)**	(72.9)
Balance at March 31	**7,241.4**	6,793.8
Accumulated Other Comprehensive Income (Loss)		
Balance at January 1	**(244.3)**	(283.0)
Net Unrealized Gains (Losses) on Securities Available for Sale	**4.5**	1.3
Net Unrealized Gains (Losses) on Cash Flow Hedges	**1.6**	(5.2)
Foreign Currency Translation Adjustments	**(1.3)**	(4.2)
Pension and Other Postretirement Benefit Adjustments	**3.4**	7.0
Balance at March 31	**(236.1)**	(284.1)
Treasury Stock		
Balance at January 1	**(422.8)**	(314.0)
Stock Options and Awards	**97.3**	87.1
Stock Purchased	**(163.0)**	(74.5)
Balance at March 31	**(488.5)**	(301.4)
Total Stockholders Equity at March 31	**$ 7,948.3**	$ 7,612.1

See accompanying notes to the consolidated financial statements.

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

(In Millions)	Three Months Ended March 31, 2014	2013
Cash Flows from Operating Activities:		
Net Income	**$ 181.4**	$ 164.0
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Investment Security (Gains) Losses, net	**4.0**	(0.2)
Amortization and Accretion of Securities and Unearned Income, net	**3.0**	1.5
Provision for Credit Losses	**3.0**	5.0
Depreciation on Buildings and Equipment	**23.0**	22.4
Amortization of Computer Software	**55.6**	48.7
Amortization of Intangibles	**4.9**	5.2
Pension Plan Contributions	**(13.9)**	(16.4)
Change in Receivables	**(254.9)**	(32.3)
Change in Interest Payable	**(0.1)**	(18.8)
Change in Collateral With Derivative Counterparties, net	**505.7**	52.3
Other Operating Activities, net	**26.8**	81.1
Net Cash Provided by Operating Activities	**538.5**	312.5
Cash Flows from Investing Activities:		
Net Change in Federal Funds Sold and Securities Purchased under Agreements to Resell	**19.6**	(190.7)
Change in Interest-Bearing Deposits with Banks	**2,329.1**	108.7
Net Change in Federal Reserve Deposits and Other Interest-Bearing Assets	**700.2**	1,791.0
Purchases of Securities Held to Maturity	**(2,467.4)**	(2,182.6)
Proceeds from Maturity and Redemption of Securities Held to Maturity	**597.6**	1,633.6
Purchases of Securities Available for Sale	**(3,939.1)**	(2,276.8)
Proceeds from Sale, Maturity and Redemption of Securities Available for Sale	**2,803.7**	3,728.9
Change in Loans and Leases	**(274.9)**	637.4
Purchases of Buildings and Equipment	**(13.5)**	(11.9)
Purchases and Development of Computer Software	**(74.9)**	(60.4)
Change in Client Security Settlement Receivables	**(485.6)**	1,232.6
Other Investing Activities, net	**(16.9)**	29.1
Net Cash Provided by (Used in) Investing Activities	**(822.1)**	4,438.9
Cash Flows from Financing Activities:		
Change in Deposits	**2,082.4**	(5,778.3)
Change in Federal Funds Purchased	**48.8**	540.3
Change in Securities Sold under Agreements to Repurchase	**(180.7)**	(209.6)
Change in Short-Term Other Borrowings	**(1,004.4)**	1,057.3
Repayments of Senior Notes and Long-Term Debt	**(1.1)**	(201.0)
Treasury Stock Purchased	**(163.0)**	(74.2)
Net Proceeds from Stock Options	**54.0**	51.1
Cash Dividends Paid on Common Stock	**(75.0)**	(1.1)
Other Financing Activities, net	**27.1**	(52.1)

Net Cash Provided by (Used in) Financing Activities	**788.1**	(4,667.6)
Effect of Foreign Currency Exchange Rates on Cash	**9.4**	(63.0)
Increase in Cash and Due from Banks	**513.9**	20.8
Cash and Due from Banks at Beginning of Year	**3,162.4**	3,752.7
Cash and Due from Banks at End of Period	**$ 3,676.3**	$ 3,773.5
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	**$ 50.4**	$ 79.4
Income Taxes Paid	**15.1**	14.5
Transfers from Loans to OREO	**1.9**	4.4

See accompanying notes to the consolidated financial statements.

Notes to Consolidated Financial Statements

1. Basis of Presentation The consolidated financial statements include the accounts of Northern Trust Corporation (Corporation) and its subsidiaries (collectively, Northern Trust). Significant intercompany balances and transactions have been eliminated. The consolidated financial statements, as of and for the periods ended March 31, 2014 and 2013, have not been audited by the Corporation s independent registered public accounting firm. In the opinion of management, all accounting entries and adjustments, including normal recurring accruals, necessary for a fair presentation of the financial position and the results of operations for the interim periods have been made. Certain reclassifications have been made to the prior period consolidated financial statements to place them on a basis comparable with the current period s consolidated financial statements. Within the statement of cash flows, net changes in the fair values of derivative assets and liabilities, previously included within Net Changes in Derivative Fair Value, Including Required Collateral, are included in Other Operating Activities, net. For a description of Northern Trust s significant accounting policies, refer to Note 1 of the Notes to Consolidated Financial Statements in the 2013 Annual Report to Shareholders.

2. Recent Accounting Pronouncements As of January 1, 2014, Northern Trust adopted Accounting Standards Update (ASU) No. 2014-01, Investments Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force) , and has elected to account for investments in qualified affordable housing projects using the proportional amortization method when the conditions to apply are met. Northern Trust recognized the cumulative effect of the adoption in the current period, resulting in a $1.1 million increase in the provision for income taxes and a $0.2 million increase in income before income taxes, and the adoption of the ASU will not have a material impact on Northern Trust s consolidated financial position or results of operations going forward.

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 three months ended March 31, 2014 or the year ended December 31, 2013.

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

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

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

Notes to Consolidated Financial Statements (continued)

Northern Trust s Level 2 assets include available for sale and trading account securities, the fair values of which are determined predominantly by external pricing vendors. Prices received from vendors are compared to other vendor and third-party prices. If a security price obtained from a pricing vendor is determined to exceed pre-determined tolerance levels that are assigned based on an asset type s characteristics, the exception is researched and, if the price is not able to be validated, an alternate pricing vendor is utilized, consistent with Northern Trust s pricing source hierarchy. As of March 31, 2014, Northern Trust s available for sale securities portfolio included 891 Level 2 securities with an aggregate market value of $27.0 billion. All 891 securities were valued by external pricing vendors. As of December 31, 2013, Northern Trust s available for sale securities portfolio included 831 Level 2 securities with an aggregate market value of $26.4 billion. Of those, 829 securities, with an aggregate market value of $26.3 billion, were valued by external pricing vendors. The remaining 2 securities, with an aggregate market value of $57.4 million, were valued consistent with prices of similar securities as there were no vended prices available for these securities. Trading account securities, which totaled $1.5 million and $1.7 million as of March 31, 2014 and December 31, 2013, respectively, were all valued using external pricing vendors.

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

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

Notes to Consolidated Financial Statements (continued)

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

Northern Trust s Level 3 assets consist of auction rate securities purchased in 2008 from Northern Trust clients. To estimate the fair value of auction rate securities, for which trading is limited and market prices are generally unavailable, Northern Trust developed and maintains a pricing model that discounts estimated cash flows over their estimated remaining lives. Significant inputs to the model include the contractual terms of the securities, credit risk ratings, discount rates, forward interest rates, credit/liquidity spreads, and Northern Trust s own assumptions about the estimated remaining lives of the securities. The significant unobservable inputs used in the fair value measurement are Northern Trust s own assumptions about the estimated remaining lives of the securities and the applicable discount rates. Significant increases (decreases) in the estimated remaining lives or the discount rates in isolation would result in a significantly lower (higher) fair value measurement. Level 3 liabilities at December 31, 2013 consisted of acquisition-related contingent consideration liabilities, the fair value of which was determined using an income-based (discounted cash flow) model that incorporated Northern Trust s own assumptions about business growth rates and applicable discount rates, which represented unobservable inputs to the model. As of March 31, 2014, the value of the acquisition-related consideration had been agreed by the parties to be $55.3 million, removing the contingency.

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

Management of various businesses and departments of Northern Trust (including Corporate Market Risk, Credit Policy, Corporate Financial Management, and relevant business unit personnel) determine the valuation policies and procedures for Level 3 assets and liabilities. Each business and department represents a component of Northern Trust s business units, and reports to management of their respective business units. Generally, valuation policies are reviewed by management of each business or department. Fair value measurements are performed upon acquisitions of an asset or liability. As necessary, the valuation models are reviewed by management of the appropriate business or department, and adjusted for changes in inputs. Management of each business or department reviews the inputs in order to substantiate the unobservable

Notes to Consolidated Financial Statements (continued)

inputs used in each fair value measurement. When appropriate, management reviews forecasts used in the valuation process in light of other relevant financial projections to understand any variances between current and previous fair value measurements. In certain circumstances, third party information is used to support the fair value measurements. If certain third party information seems inconsistent with consensus views, a review of the information is performed by management of the respective business or department to conclude as to the appropriate fair value of the asset or liability.

The following presents the fair values of, and the valuation techniques, significant unobservable inputs, and quantitative information used to develop significant unobservable inputs for, Northern Trust s Level 3 assets as of March 31, 2014.

Financial Instrument	Fair Value	Valuation Technique	Unobservable Input	Range of Lives and Rates
Auction Rate Securities	$98.5 million	Discounted Cash Flow	Remaining lives	2.2 8.6 years
			Discount rates	0.2% 7.8%

Notes to Consolidated Financial Statements (continued)

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

(In Millions)	Level 1	Level 2	Level 3	Netting	Assets/Liabilities at Fair Value
March 31, 2014					
Securities					
Available for Sale					
U.S. Government	$ 2,414.7	$	$	$	$ 2,414.7
Obligations of States and Political Subdivisions		4.6			4.6
Government Sponsored Agency		18,150.8			18,150.8
Corporate Debt		3,626.0			3,626.0
Covered Bonds		1,978.5			1,978.5
Supranational, Sovereign and Non-U.S. Agency Bonds		720.5			720.5
Residential Mortgage-Backed		45.7			45.7
Other Asset-Backed		2,304.7			2,304.7
Auction Rate			98.5		98.5
Other		196.6			196.6
Total Available for Sale	2,414.7	27,027.4	98.5		29,540.6
Trading Account		1.5			1.5
Total Available for Sale and Trading Securities	2,414.7	27,028.9	98.5		29,542.1
Other Assets					
Derivative Assets					
Foreign Exchange Contracts		1,866.1			1,866.1
Interest Rate Contracts		228.4			228.4
Total Derivative Assets		2,094.5		(1,393.7)	700.8
Other Liabilities					
Derivative Liabilities					
Foreign Exchange Contracts		1,890.4			1,890.4
Interest Rate Contracts		154.8			154.8
Credit Default Swaps					
Total Derivative Liabilities		2,045.2		(1,445.0)	600.2

Note: Northern Trust has elected to net derivative assets and liabilities when legally enforceable master netting arrangements or similar agreements exist between Northern Trust and the counterparty. As of March 31, 2014, derivative assets and liabilities shown above also include reductions of $313.6 million and $364.9 million, respectively, as a result of cash collateral received from and deposited with derivative counterparties.

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Notes to Consolidated Financial Statements (continued)

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

Note: Northern Trust has elected to net derivative assets and liabilities when legally enforceable master netting arrangements or similar agreements exist between Northern Trust and the counterparty. As of December 31, 2013, derivative assets and liabilities shown above also include reductions of $210.7 million and $767.7 million, respectively, as a result of cash collateral received from and deposited with derivative counterparties.

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Notes to Consolidated Financial Statements (continued)

The following tables present the changes in Level 3 assets and liabilities for the three months ended March 31, 2014 and 2013.

Level 3 Assets (In Millions)	Auction Rate Securities	
Three Months Ended March 31,	2014	2013
Fair Value at January 1	**$ 98.9**	$ 97.8
Total Gains (Losses):		
Included in Earnings (1)		0.1
Included in Other Comprehensive Income (2)	**(0.2)**	2.7
Purchases, Issues, Sales, and Settlements		
Sales	**0.1**	
Settlements	**(0.3)**	(1.0)
Fair Value at March 31	**$ 98.5**	$ 99.6

(1) Realized gains for the three month period ended March 31, 2013 of $0.1 million represent gains from redemptions by issuers, which are recorded in interest income within the consolidated statement of income.
(2) Unrealized gains (losses) related to auction rate securities are included in net unrealized gains (losses) on securities available for sale within the consolidated statement of comprehensive income.

Level 3 Liabilities (In Millions)	Contingent Consideration	
Three Months Ended March 31,	2014	2013
Fair Value at January 1	**$ 55.4**	$ 50.1
Total (Gains) and Losses:		
Included in Earnings (1)	**(0.1)**	1.3
Included in Other Comprehensive Income		
Purchases, Issues, Sales, and Settlements		
Purchases		
Settlements	**(55.3)**	
Fair Value at March 31	**$**	$ 51.4
Unrealized (Gains) Losses Included in Earnings Related to Financial Instruments Held at March 31 (1)	**$**	$ 1.3

(1) Gains (losses) are recorded in other operating income (expense) within the consolidated statement of income.
During the three months ended March 31, 2014 and 2013, there were no transfers into or out of Level 3 assets or liabilities.

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

Notes to Consolidated Financial Statements (continued)

Assets measured at fair value on a nonrecurring basis at March 31, 2014 and 2013, all of which were categorized as Level 3 under the fair value hierarchy, were comprised of impaired loans whose values were based on real estate and other available collateral, and of Other Real Estate Owned (OREO) properties. Fair values of real estate loan collateral were estimated using a market approach typically supported by third party valuations and property specific fees and taxes. Other loan collateral, which typically consists of accounts receivable, inventory and equipment, is valued using a market approach adjusted for asset specific characteristics and in limited instances third party valuations are used. OREO assets are carried at the lower of cost or fair value less estimated costs to sell, with fair value typically based on third-party appraisals.

Collateral-based impaired loans and OREO assets that have been adjusted to fair value totaled $33.3 million and $1.5 million, respectively, at March 31, 2014, and $32.4 million and $1.5 million, respectively, at March 31, 2013. Assets measured at fair value on a nonrecurring basis reflect management s judgment as to realizable value.

The following table provides the fair value of, and the valuation technique, significant unobservable inputs, and quantitative information used to develop the significant unobservable inputs for, Northern Trust s Level 3 assets that were measured at fair value on a nonrecurring basis as of March 31, 2014.

Financial Instrument	Fair Value	Valuation Technique	Unobservable Input	Range of Discounts Applied
Loans	$33.3 million	Market Approach	Discount to reflect realizable value	15% 40%
OREO	$1.5 million	Market Approach	Discount to reflect realizable value	15% 40%

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

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

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

Notes to Consolidated Financial Statements (continued)

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

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

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

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

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

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

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

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

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

Notes to Consolidated Financial Statements (continued)

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

(In Millions)	March 31, 2014				
	Book Value	Total Fair Value	Fair Value Level 1	Level 2	Level 3
Assets					
Cash and Due from Banks	**$ 3,676.3**	**$ 3,676.3**	**$ 3,676.3**	**$**	**$**
Federal Funds Sold and Resell Agreements	**510.0**	**510.0**		**510.0**	
Interest-Bearing Deposits with Banks	**17,155.8**	**17,155.8**		**17,155.8**	
Federal Reserve Deposits and Other Interest-Bearing	**12,211.0**	**12,211.0**		**12,211.0**	
Securities					
Available for Sale [(1)]	**29,540.6**	**29,540.6**	**2,414.7**	**27,027.4**	**98.5**
Held to Maturity	**4,211.7**	**4,209.2**		**4,209.2**	
Trading Account	**1.5**	**1.5**		**1.5**	
Loans (excluding Leases)					
Held for Investment	**28,492.5**	**28,533.1**			**28,533.1**
Held for Sale					
Client Security Settlement Receivables	**1,845.2**	**1,845.2**		**1,845.2**	
Other Assets					
Federal Reserve and Federal Home Loan Bank Stock	**194.7**	**194.7**		**194.7**	
Community Development Investments	**216.3**	**219.9**		**219.9**	
Employee Benefit and Deferred Compensation	**149.3**	**145.6**	**93.9**	**51.7**	
Liabilities					
Deposits					
Demand, Noninterest-Bearing, Savings and Money Market	**$ 36,668.8**	**$ 36,668.8**	**$ 36,668.8**	**$**	**$**
Savings Certificates and Other Time	**2,034.5**	**2,036.6**		**2,036.6**	
Non U.S. Offices Interest-Bearing	**47,564.4**	**47,564.4**		**47,564.4**	
Federal Funds Purchased	**1,013.9**	**1,013.9**		**1,013.9**	
Securities Sold under Agreements to Repurchase	**736.6**	**736.6**		**736.6**	
Other Borrowings	**652.4**	**652.4**		**652.4**	
Senior Notes	**1,996.7**	**2,020.1**		**2,020.1**	
Long Term Debt (excluding Leases)					
Subordinated Debt	**1,560.4**	**1,587.1**		**1,587.1**	
Federal Home Loan Bank Borrowings	**135.0**	**135.7**		**135.7**	
Floating Rate Capital Debt	**277.2**	**238.9**		**238.9**	
Other Liabilities					
Standby Letters of Credit	**57.6**	**57.6**			**57.6**
Loan Commitments	**33.0**	**33.0**			**33.0**

Derivative Instruments					
Asset/Liability Management					
Foreign Exchange Contracts					
Assets	$ **11.9**	$ **11.9**	$	$ **11.9**	$
Liabilities	**23.7**	**23.7**		**23.7**	
Interest Rate Contracts					
Assets	**111.7**	**111.7**		**111.7**	
Liabilities	**43.5**	**43.5**		**43.5**	
Client-Related and Trading					
Foreign Exchange Contracts					
Assets	**1,854.2**	**1,854.2**		**1,854.2**	
Liabilities	**1,866.7**	**1,866.7**		**1,866.7**	
Interest Rate Contracts					
Assets	**116.7**	**116.7**		**116.7**	
Liabilities	**111.3**	**111.3**		**111.3**	

(1) Refer to the table located on page 33 for the disaggregation of available for sale securities.

Notes to Consolidated Financial Statements (continued)

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

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

(1) Refer to the table located on page 34 for the disaggregation of available for sale securities.

Notes to Consolidated Financial Statements (continued)

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

Securities Available for Sale	March 31, 2014			
	Amortized	Gross Unrealized		Fair
(In Millions)	Cost	Gains	Losses	Value
U.S. Government	**$ 2,396.0**	**$ 20.5**	**$ 1.8**	**$ 2,414.7**
Obligations of States and Political Subdivisions	**4.5**	**0.1**		**4.6**
Government Sponsored Agency	**18,131.4**	**65.1**	**45.7**	**18,150.8**
Corporate Debt	**3,661.9**	**5.3**	**41.2**	**3,626.0**
Covered Bonds	**1,965.2**	**13.7**	**0.4**	**1,978.5**
Supranational, Sovereign and Non-U.S. Agency Bonds	**719.9**	**2.0**	**1.4**	**720.5**
Residential Mortgage-Backed	**48.6**	**0.1**	**3.0**	**45.7**
Other Asset-Backed	**2,302.8**	**2.0**	**0.1**	**2,304.7**
Auction Rate	**97.3**	**2.1**	**0.9**	**98.5**
Other	**196.1**	**0.5**		**196.6**
Total	**$ 29,523.7**	**$ 111.4**	**$ 94.5**	**$ 29,540.6**

Securities Held to Maturity	March 31, 2014			
		Gross		
	Amortized	Unrealized		Fair
(In Millions)	Cost	Gains	Losses	Value
Obligations of States and Political Subdivisions	**$ 196.2**	**$ 9.7**	**$**	**$ 205.9**
Government Sponsored Agency	**32.1**	**1.1**		**33.2**
Non-U.S. Government Debt	**176.1**		**0.1**	**176.0**
Certificates of Deposit	**1,531.8**	**0.1**	**0.1**	**1,531.8**
Supranational, Sovereign and Non-U.S. Agency Bonds	**2,217.5**	**3.8**	**6.3**	**2,215.0**
Other	**58.0**	**0.1**	**10.8**	**47.3**
Total	**$ 4,211.7**	**$ 14.8**	**$ 17.3**	**$ 4,209.2**

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

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

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

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

Notes to Consolidated Financial Statements (continued)

The following table provides the remaining maturity of securities as of March 31, 2014.

(In Millions)	Amortized Cost	Fair Value
Available for Sale		
Due in One Year or Less	**$ 9,112.9**	**$ 9,117.7**
Due After One Year Through Five Years	**15,997.9**	**16,023.6**
Due After Five Years Through Ten Years	**2,946.9**	**2,937.8**
Due After Ten Years	**1,466.0**	**1,461.5**
Total	**29,523.7**	**29,540.6**
Held to Maturity		
Due in One Year or Less	**1,897.9**	**1,900.9**
Due After One Year Through Five Years	**2,256.4**	**2,257.5**
Due After Five Years Through Ten Years	**25.3**	**25.9**
Due After Ten Years	**32.1**	**24.9**
Total	**$ 4,211.7**	**$ 4,209.2**

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

Investment Security Gains and Losses. Net investment security losses of $4.0 million were recognized in the three months ended March 31, 2014, and include $3.9 million of charges related to the other-than-temporary impairment of certain Community Reinvestment Act (CRA) eligible held to maturity securities. Gross proceeds from the sale of securities during the three months ended March 31, 2014 of $199.7 million resulted in gross realized gains of $0.3 million and gross realized losses of $0.4 million. Gross proceeds from the sale of securities during the three months ended March 31, 2013 of $55.7 million resulted in gross realized gains of $0.2 million.

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

as of March 31, 2014	Less than 12 Months		12 Months or Longer		Total	
(In Millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government	**$ 1,195.6**	**$ 1.8**	**$**	**$**	**$ 1,195.6**	**$ 1.8**
Government Sponsored Agency	**6,055.6**	**33.6**	**913.1**	**12.1**	**6,968.7**	**45.7**
Corporate Debt	**1,323.6**	**20.8**	**497.0**	**20.4**	**1,820.6**	**41.2**

Covered Bonds	**190.1**	**0.2**	**9.9**	**0.2**	**200.0**	**0.4**
Supranational, Sovereign and Non-U.S. Agency Bonds	**1,260.4**	**7.7**			**1,260.4**	**7.7**
Residential Mortgage-Backed			**41.0**	**3.0**	**41.0**	**3.0**
Other Asset-Backed	**187.4**	**0.1**			**187.4**	**0.1**
Auction Rate	**23.2**	**0.2**	**13.7**	**0.7**	**36.9**	**0.9**
Non-U.S. Government Debt	**148.9**	**0.1**			**148.9**	**0.1**
Certificates of Deposit	**473.5**	**0.1**			**473.5**	**0.1**
Other	**41.3**	**3.5**	**29.0**	**7.3**	**70.3**	**10.8**
Total	**$ 10,899.6**	**$ 68.1**	**$ 1,503.7**	**$ 43.7**	**$ 12,403.3**	**$ 111.8**

Notes to Consolidated Financial Statements (continued)

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

As of March 31, 2014, 509 securities with a combined fair value of $12.4 billion were in an unrealized loss position, with their unrealized losses totaling $111.8 million. Unrealized losses of $45.7 million related to government sponsored agency securities are primarily attributable to changes in market rates since their purchase. Unrealized losses of $41.2 million within corporate debt securities primarily reflect widened credit spreads and higher market rates since purchase; 46% of the corporate debt portfolio is backed by guarantees provided by U.S. and non-U.S. governmental entities.

Unrealized losses on residential mortgage-backed securities totaling $3.0 million reflect the impact of wider credit and liquidity spreads on the valuations of 5 residential mortgage-backed securities since purchase, with $41.0 million having been in an unrealized loss position for more than 12 months. Residential mortgage-backed securities at March 31, 2014 had a total amortized cost and fair value of $48.6 million and $45.7 million, respectively. Securities classified as other asset-backed had average lives less than 5 years, and 99% were rated triple-A.

The majority of the $10.8 million of unrealized losses in securities classified as other at March 31, 2014 relate to securities which Northern Trust purchases for compliance with CRA. Unrealized losses on these CRA related securities are attributable to their purchase at below market rates for the purpose of supporting institutions and programs that benefit low to moderate income communities within Northern Trust s market area. Unrealized losses of $0.9 million related to auction rate securities primarily reflect reduced market liquidity as a majority of auctions continue to fail preventing holders from liquidating their investments at par. The remaining unrealized losses on Northern Trust s securities portfolio as of March 31, 2014 are attributable to changes in overall market interest rates, increased credit spreads, or reduced market liquidity. As of March 31, 2014, Northern Trust does not intend to sell any investment in an unrealized loss position and it is not more likely than not that Northern Trust will be required to sell any such investment before the recovery of its amortized cost basis, which may be maturity.

Notes to Consolidated Financial Statements (continued)

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

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

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

As of March 31, 2014, loss estimates for subprime, Alt-A, prime and 2nd lien collateral portfolios were developed using default roll rates, determined primarily by the stage of delinquency of the underlying instrument, that generally assumed ultimate default rates approximating 5% to 30% for current loans; 30% for loans 30 to 60 days delinquent; 80% for loans 60 to 90 days delinquent; 90% for loans delinquent greater than 90 days; and 100% for OREO properties and loans that are in foreclosure. March 31, 2014 amortized cost, weighted average ultimate default rates, and impairment severity rates for the non-agency residential mortgage-backed securities portfolio, by security type, are provided in the following table.

Notes to Consolidated Financial Statements (continued)

($ In Millions)	March 31, 2014				
			Loss Severity Rates		
Security Type	Amortized Cost	Weighted Average Ultimate Default Rates	Low	High	Weighted Average
Prime	**$ 7.2**	**19.7%**	**32.5%**	**53.4%**	**47.0%**
Alt-A	**11.8**	**40.1**	**64.7**	**64.7**	**64.7**
Subprime	**21.6**	**47.1**	**74.0**	**77.1**	**74.7**
2nd Lien	**8.0**	**32.3**	**98.9**	**99.0**	**99.0**
Total Non-Agency Residential Mortgage-Backed Securities	**$ 48.6**	**38.5%**	**32.5%**	**99.0%**	**72.1%**

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

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

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

As of March 31, 2014, impairment estimates for CRA mortgage-backed securities were developed using default and loss severity rates sourced from industry mortgage data. Ultimate recovery value of the securities was determined by applying default and severity rates against remaining collateral balances in the pools. An expected loss amount was calculated by applying loss severity rates on defaulted amounts. Lastly, book values were compared against collateral values net of expected losses in order to determine OTTI.

There was $3.9 million of OTTI losses recognized during the three months ended March 31, 2014 related to CRA eligible mortgage-backed securities. There were no OTTI losses recognized during the three months ended March 31, 2013.

Notes to Consolidated Financial Statements (continued)

Credit Losses on Debt Securities. The table below provides information regarding total other-than-temporarily impaired securities, including noncredit-related amounts recognized in other comprehensive income and net impairment losses recognized in earnings, for the three months ended March 31, 2014 and 2013.

	Three Months Ended March 31,	
(In Millions)	2014	2013
Changes in OTTI Losses*	**$ (4.6)**	$
Noncredit-related Losses Recorded in / (Reclassified from) OCI**	**0.7**	
Net Impairment Losses Recognized in Earnings	**$ (3.9)**	$

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

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

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

	Three Months Ended March 31,	
(In Millions)	2014	2013
Cumulative Credit-Related Losses on Securities Held Beginning of Period	**$ 8.8**	$ 42.3
Plus: Losses on Newly Identified Impairments	**1.8**	
Additional Losses on Previously Identified Impairments	**2.1**	
Less: Current and Prior Period Losses on Securities Sold During the Period		(33.5)
Cumulative Credit-Related Losses on Securities Held End of Period	**$ 12.7**	$ 8.8

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

(In Millions)	March 31, 2014	December 31, 2013
Fair Value	**$ 52.4**	$ 38.3
Amortized Cost Basis	**55.4**	42.8
Noncredit-related Losses Recognized in OCI	**(3.0)**	(4.5)
Tax Effect	**1.1**	1.7
Amount Recorded in OCI	**$ (1.9)**	$ (2.8)

Notes to Consolidated Financial Statements (continued)

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

(In Millions)	March 31, 2014	December 31, 2013
Commercial		
Commercial and Institutional	**$ 7,738.2**	$ 7,375.8
Commercial Real Estate	**3,018.9**	2,955.8
Lease Financing, net	**892.6**	975.1
Non-U.S.	**1,349.7**	954.7
Other	**281.3**	358.6
Total Commercial	**13,280.7**	12,620.0
Personal		
Residential Real Estate	**10,093.9**	10,271.3
Private Client	**6,247.8**	6,445.6
Other	**38.4**	48.6
Total Personal	**16,380.1**	16,765.5
Total Loans and Leases	**29,660.8**	29,385.5
Allowance for Credit Losses Assigned to Loans and Leases	**(279.2)**	(278.1)
Net Loans and Leases	**$ 29,381.6**	$ 29,107.4

Residential real estate loans consist of conventional home mortgages and equity credit lines that generally require a loan to collateral value of no more than 65% to 80% at inception. Northern Trust s equity credit line products generally have draw periods of up to 10 years and a balloon payment of any outstanding balance is due at maturity. Payments are interest only with variable interest rates. Northern Trust does not offer equity credit lines that include an option to convert the outstanding balance to an amortizing payment loan.

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

Included within the non-U.S., commercial-other, and personal-other classes are short duration advances primarily related to the processing of custodied client investments, that totaled $1.5 billion at March 31, 2014 and $1.3 billion at December 31, 2013. Demand deposits reclassified as loan balances totaled $117.5 million and $104.1 million at March 31, 2014 and December 31, 2013, respectively. There were no loans classified as held for sale at March 31, 2014 or December 31, 2013.

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

As part of its credit process, Northern Trust utilizes an internal borrower risk rating system to support identification, approval, and monitoring of credit risk. Borrower risk ratings are

Notes to Consolidated Financial Statements (continued)

used in credit underwriting, management reporting, and the calculation of credit loss allowances and economic capital.

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

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

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

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

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

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

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

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

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

Notes to Consolidated Financial Statements (continued)

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

	March 31, 2014				December 31, 2013			
(In Millions)	1 to 3 Category	4 to 5 Category	6 to 9 Category (Watch List)	Total	1 to 3 Category	4 to 5 Category	6 to 9 Category (Watch List)	Total
Commercial								
Commercial and Institutional	**$ 4,730.7**	**$ 2,860.4**	**$ 147.1**	**$ 7,738.2**	$ 4,432.5	$ 2,801.5	$ 141.8	$ 7,375.8
Commercial Real Estate	**1,150.6**	**1,709.7**	**158.6**	**3,018.9**	1,053.7	1,748.7	153.4	2,955.8
Lease Financing, net	**458.9**	**429.3**	**4.4**	**892.6**	685.7	285.0	4.4	975.1
Non-U.S.	**523.2**	**825.6**	**0.9**	**1,349.7**	442.8	511.9		954.7
Other	**172.7**	**108.6**		**281.3**	157.7	200.9		358.6
Total Commercial	**7,036.1**	**5,933.6**	**311.0**	**13,280.7**	6,772.4	5,548.0	299.6	12,620.0
Personal								
Residential Real Estate	**3,124.3**	**6,473.6**	**496.0**	**10,093.9**	3,204.6	6,563.6	503.1	10,271.3
Private Client	**3,932.5**	**2,308.3**	**7.0**	**6,247.8**	3,957.6	2,481.2	6.8	6,445.6
Other	**23.4**	**15.0**		**38.4**	21.2	27.4		48.6
Total Personal	**7,080.2**	**8,796.9**	**503.0**	**16,380.1**	7,183.4	9,072.2	509.9	16,765.5
Total Loans and Leases	**$ 14,116.3**	**$ 14,730.5**	**$ 814.0**	**$ 29,660.8**	$ 13,955.8	$ 14,620.2	$ 809.5	$ 29,385.5

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

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

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

Notes to Consolidated Financial Statements (continued)

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

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

Notes to Consolidated Financial Statements (continued)

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

March 31, 2014

(In Millions)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Performing	Nonperforming	Total Loans and Leases
Commercial							
Commercial and Institutional	**$ 7,700.8**	**$ 5.5**	**$ 4.2**	**$ 1.6**	**$ 7,712.1**	**$ 26.1**	**$ 7,738.2**
Commercial Real Estate	**2,934.0**	**22.5**	**3.8**	**7.0**	**2,967.3**	**51.6**	**3,018.9**
Lease Financing, net	**892.6**				**892.6**		**892.6**
Non-U.S.	**1,349.7**				**1,349.7**		**1,349.7**
Other	**281.3**				**281.3**		**281.3**
Total Commercial	**13,158.4**	**28.0**	**8.0**	**8.6**	**13,203.0**	**77.7**	**13,280.7**
Personal							
Residential Real Estate	**9,841.0**	**65.7**	**3.2**	**3.1**	**9,913.0**	**180.9**	**10,093.9**
Private Client	**6,206.8**	**30.9**	**8.2**	**0.6**	**6,246.5**	**1.3**	**6,247.8**
Other	**38.4**				**38.4**		**38.4**
Total Personal	**16,086.2**	**96.6**	**11.4**	**3.7**	**16,197.9**	**182.2**	**16,380.1**
Total Loans and Leases	**$ 29,244.6**	**$ 124.6**	**$ 19.4**	**$ 12.3**	**$ 29,400.9**	**$ 259.9**	**$ 29,660.8**
					Other Real Estate Owned	**9.8**	
					Total Nonperforming Assets	**$ 269.7**	

December 31, 2013

(In Millions)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Performing	Nonperforming	Total Loans and Leases
Commercial							
Commercial and Institutional	$ 7,332.3	$ 5.0	$ 12.1	$ 3.3	$ 7,352.7	$ 23.1	$ 7,375.8
Commercial Real Estate	2,881.1	4.1	14.6	6.8	2,906.6	49.2	2,955.8
Lease Financing, net	975.1				975.1		975.1
Non-U.S.	954.7				954.7		954.7

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

Notes to Consolidated Financial Statements (continued)

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

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

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

	As of March 31, 2014			As of December 31, 2013		
(In Millions)	Recorded Investment	Unpaid Principal Balance	Specific Allowance	Recorded Investment	Unpaid Principal Balance	Specific Allowance
With No Related Specific Allowance						
Commercial and Institutional	**$ 12.2**	**$ 15.4**	**$**	$ 12.2	$ 18.1	$
Commercial Real Estate	**49.8**	**58.1**		46.6	57.1	
Lease Financing, net	**4.4**	**4.4**		4.4	4.4	
Residential Real Estate	**190.7**	**237.3**		185.0	227.8	
Private Client	**0.5**	**0.5**		0.8	0.8	
With a Related Specific Allowance						
Commercial and Institutional	**12.3**	**13.0**	**3.7**	9.6	12.1	3.6
Commercial Real Estate	**27.0**	**33.0**	**6.0**	26.7	31.5	4.5
Residential Real Estate	**5.1**	**5.3**	**1.7**	8.1	8.7	2.3
Private Client	**0.4**	**0.4**	**0.4**			
Total						
Commercial	**105.7**	**123.9**	**9.7**	99.5	123.2	8.1
Personal	**196.7**	**243.5**	**2.1**	193.9	237.3	2.3
Total	**$ 302.4**	**$ 367.4**	**$ 11.8**	$ 293.4	$ 360.5	$ 10.4

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Notes to Consolidated Financial Statements (continued)

	Three Months Ended March 31,			
	2014		2013	
(In Millions)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With No Related Specific Allowance				
Commercial and Institutional	**$ 11.4**	**$**	$ 12.2	$
Commercial Real Estate	**44.8**	**0.3**	39.6	0.2
Lease Financing, net	**4.4**	**0.1**	4.6	
Residential Real Estate	**189.2**	**0.6**	141.0	0.5
Private Client	**0.7**		9.4	0.1
With a Related Specific Allowance				
Commercial and Institutional	**10.0**		11.0	
Commercial Real Estate	**26.4**		30.4	
Residential Real Estate	**7.1**		9.8	
Private Client	**0.1**		1.1	
Total				
Commercial	**97.0**	**0.4**	97.8	0.2
Personal	**197.1**	**0.6**	161.3	0.6
Total	**$ 294.1**	**$ 1.0**	$ 259.1	$ 0.8

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

Interest income that would have been recorded for nonperforming loans in accordance with their original terms was $2.5 million and $2.6 million, respectively, for the three months ended March 31, 2014 and 2013.

There were $2.9 million and $3.4 million of aggregate undrawn loan commitments and standby letters of credit at March 31, 2014 and December 31, 2013, respectively, issued to borrowers whose loans were classified as nonperforming or impaired.

Troubled Debt Restructurings (TDRs). Included within impaired loans were $61.9 million and $72.7 million of nonperforming TDRs, and $95.9 million and $89.8 million of performing TDRs as of March 31, 2014 and December 31, 2013, respectively. All TDRs are reported as impaired loans in the calendar year of their restructuring. In subsequent years, a TDR may cease being reported as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months. A loan that has been modified at a below market rate will return to performing status if it satisfies the six month performance requirement; however, it will remain reported as impaired.

Notes to Consolidated Financial Statements (continued)

The following tables provide, by segment and class, the number of loans and leases modified in TDRs during the three month period ended March 31, 2014 and 2013, and the recorded investments and unpaid principal balances as of March 31, 2014 and 2013.

($ In Millions)	Three Months Ended March 31, 2014		
	Number of Loans and Leases	Recorded Investment	Unpaid Principal Balance
Commercial			
Commercial Real Estate	**1**	**$ 0.7**	**$ 0.7**
Total Commercial	**1**	**0.7**	**0.7**
Personal			
Residential Real Estate	**34**	**3.5**	**3.8**
Private Client	**1**		
Total Personal	**35**	**3.5**	**3.8**
Total Loans and Leases	**36**	**$ 4.2**	**$ 4.5**

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

($ In Millions)	Three Months Ended March 31, 2013		
	Number of Loans and Leases	Recorded Investment	Unpaid Principal Balance
Commercial			
Commercial and Institutional	7	$ 2.5	$ 3.1
Commercial Real Estate	1	0.1	0.1
Total Commercial	8	2.6	3.2
Personal			
Residential Real Estate	48	41.7	43.1
Private Client	5	12.8	12.8
Total Personal	53	54.5	55.9
Total Loans and Leases	61	$ 57.1	$ 59.1

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

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

During the three months ended March 31, 2014, the majority of TDR modifications of loans within the commercial real estate, residential real estate, and private client classes were extensions of term. During the three months ended March 31, 2013, TDR modifications of loans within the commercial and institutional, commercial real estate, and private client classes were primarily deferrals of principal; extensions of term, and other modifications, and modifications of loans within the residential real estate class were primarily deferrals of principal, interest rate concessions, extensions of term, and other modifications.

There were no loans or leases modified in TDRs in the 12 months ended December 31, 2013 or 2012 which subsequently became nonperforming during the three months ended March 31, 2014 or 2013, respectively.

Notes to Consolidated Financial Statements (continued)

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

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

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

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

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

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

Notes to Consolidated Financial Statements (continued)

The following tables provide information regarding changes in the total allowance for credit losses by segment during the three months ended March 31, 2014 and 2013.

	Three Months Ended March 31,					
	2014			2013		
(In Millions)	Commercial	Personal	Total	Commercial	Personal	Total
Balance at Beginning of Period	**$ 168.0**	**$ 139.9**	**$ 307.9**	$ 194.2	$ 133.4	$ 327.6
Charge-Offs	**(4.2)**	**(7.3)**	**(11.5)**	(0.9)	(11.7)	(12.6)
Recoveries	**8.5**	**1.5**	**10.0**	1.8	2.1	3.9
Net (Charge-Offs) Recoveries	**4.3**	**(5.8)**	**(1.5)**	0.9	(9.6)	(8.7)
Provision for Credit Losses	**0.8**	**2.2**	**3.0**	(7.9)	12.9	5.0
Effect of Foreign Exchange Rates				(0.1)		(0.1)
Balance at End of Period	**$ 173.1**	**$ 136.3**	**$ 309.4**	$ 187.1	$ 136.7	$ 323.8

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

	March 31, 2014			December 31, 2013		
(In Millions)	Commercial	Personal	Total	Commercial	Personal	Total
Loans and Leases						
Specifically Evaluated for Impairment	**$ 105.7**	**$ 196.7**	**$ 302.4**	$ 99.5	$ 193.9	$ 293.4
Evaluated for Inherent Impairment	**13,175.0**	**16,183.4**	**29,358.4**	12,520.5	16,571.6	29,092.1
Total Loans and Leases	**13,280.7**	**16,380.1**	**29,660.8**	12,620.0	16,765.5	29,385.5
Allowance for Loans and Leases						
Specifically Evaluated for Impairment	**9.7**	**2.1**	**11.8**	8.1	2.3	10.4
Evaluated for Inherent Impairment	**136.4**	**131.0**	**267.4**	132.8	134.9	267.7
Allowance Assigned to Loans and Leases	**146.1**	**133.1**	**279.2**	140.9	137.2	278.1
Allowance for Unfunded Exposures						
	27.0	**3.2**	**30.2**	27.1	2.7	29.8

Commitments and Standby Letters of Credit												
Total Allowance for Credit Losses	**$**	**173.1**	**$**	**136.3**	**$**	**309.4**	$	168.0	$	139.9	$	307.9

7. Pledged Assets Certain of Northern Trust s subsidiaries, as required or permitted by law, pledge assets to secure public and trust deposits; repurchase agreements; Federal Home Loan Bank borrowings; and for other purposes, including support for securities settlement, primarily related to client activities, and for potential Federal Reserve Bank discount window borrowings. At March 31, 2014, securities and loans totaling $30.3 billion ($20.7 billion of government sponsored agency and other securities, $173.3 million of obligations of states and political subdivisions, and $9.4 billion of loans) were pledged. This compares to $32.4 billion ($22.6 billion of government sponsored agency and other securities, $222.7 million of obligations of states and political subdivisions, and $9.6 billion of loans) at December 31, 2013. Collateral required for these purposes totaled $3.2 billion and $5.0 billion at March 31, 2014 and December 31, 2013, respectively. Included in the total pledged assets at March 31, 2014 and December 31, 2013 were available for sale securities with a total fair value of $735.5 million and $915.3 million, respectively, which were pledged as collateral for agreements to repurchase securities sold transactions. The secured parties to these transactions have the right to repledge or sell these securities.

Notes to Consolidated Financial Statements (continued)

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

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

(In Millions)	March 31, 2014	December 31, 2013
Corporate & Institutional Services	**$ 470.1**	$ 469.2
Wealth Management	**71.5**	71.5
Total Goodwill	**$ 541.6**	$ 540.7

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

(In Millions)	March 31, 2014	December 31, 2013
Gross Carrying Amount	**$ 198.7**	$ 198.2
Less: Accumulated Amortization	**120.5**	115.2
Net Book Value	**$ 78.2**	$ 83.0

Other intangible assets consist primarily of the value of acquired client relationships and are included within other assets on the consolidated balance sheet. Amortization expense related to other intangible assets totaled $4.9 million and $5.2 million for the three months ended March 31, 2014 and 2013, respectively. Amortization for the remainder of 2014 and for the years 2015, 2016, 2017, and 2018 is estimated to be $14.8 million, $11.9 million, $9.3 million, $9.3 million and $8.6 million, respectively.

Notes to Consolidated Financial Statements (continued)

9. Business Units The following tables show the earnings contributions of Northern Trust s business units for the three month periods ended March 31, 2014 and 2013.

hree Months Ended larch 31, In Millions)	Corporate & Institutional Services 2014	2013	Wealth Management 2014	2013	Treasury and Other 2014	2013	Total Consolidated 2014	2013
oninterest Income								
rust, Investment and ther Servicing Fees	**$ 379.2**	$ 348.7	**$ 300.3**	$ 282.0	**$**	$	**$ 679.5**	$ 630.7
oreign Exchange rading Income	**48.1**	58.2	**2.0**	1.3			**50.1**	59.5
ther Noninterest come	**44.4**	40.2	**22.7**	17.2	**(1.9)**	2.7	**65.2**	60.1
et Interest Income TE)*	**73.7**	64.1	**135.0**	147.8	**45.7**	21.8	**254.4**	233.7
evenue*	**545.4**	511.2	**460.0**	448.3	**43.8**	24.5	**1,049.2**	984.0
rovision for Credit osses	**1.2**	(2.7)	**1.8**	7.7			**3.0**	5.0
oninterest Expense	**423.5**	398.7	**318.8**	301.8	**25.7**	28.4	**768.0**	728.9
come (Loss) before come Taxes*	**120.7**	115.2	**139.4**	138.8	**18.1**	(3.9)	**278.2**	250.1
rovision (Benefit) for come Taxes*	**34.8**	35.9	**52.6**	52.8	**9.4**	(2.6)	**96.8**	86.1
et Income	**$ 85.9**	$ 79.3	**$ 86.8**	$ 86.0	**$ 8.7**	$ (1.3)	**$ 181.4**	$ 164.0
ercentage of onsolidated Net come	**47%**	48%	**48%**	52%	**5%**	N/M	**100%**	100%
verage Assets	**$ 57,252.4**	$ 51,316.8	**$ 22,528.7**	$ 22,861.4	**$ 20,462.4**	$ 17,391.1	**$ 100,243.5**	$ 91,569.3

* Stated on a fully taxable equivalent basis (FTE). Total consolidated includes FTE adjustments of $8.7 million for 2014 and $7.6 million for 2013.

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

10. Accumulated Other Comprehensive Income (Loss) The following tables summarize the components of accumulated other comprehensive income (loss) at March 31, 2014 and 2013, and changes during the three month periods then ended.

(In Millions)	Balance at December 31, 2013	Net Change	Balance at March 31, 2014
Net Unrealized Gains (Losses) on Securities Available for Sale	**$ 6.0**	**$ 4.5**	**$ 10.5**
Net Unrealized Gains (Losses) on Cash Flow Hedges	**2.9**	**1.6**	**4.5**
Net Foreign Currency Adjustments	**7.1**	**(1.3)**	**5.8**
Net Pension and Other Postretirement Benefit Adjustments	**(260.3)**	**3.4**	**(256.9)**
Total	**$ (244.3)**	**$ 8.2**	**$ (236.1)**

(In Millions)	Balance at December 31, 2012	Net Change	Balance at March 31, 2013
Net Unrealized Gains (Losses) on Securities Available for Sale	$ 101.0	$ 1.3	$ 102.3
Net Unrealized Gains (Losses) on Cash Flow Hedges	(1.4)	(5.2)	(6.6)
Net Foreign Currency Adjustments	10.5	(4.2)	6.3
Net Pension and Other Postretirement Benefit Adjustments	(393.1)	7.0	(386.1)
Total	$ (283.0)	$ (1.1)	$ (284.1)

Notes to Consolidated Financial Statements (continued)

	Three Months Ended March 31,					
	2014			2013		
(In Millions)	Before Tax	Tax Effect	After Tax	Before Tax	Tax Effect	After Tax
Unrealized Gains (Losses) on Securities Available for Sale						
Noncredit-Related Unrealized Losses on Securities OTTI	**$ 1.5**	**$ (0.6)**	**$ 0.9**	$ 2.1	$ (0.8)	$ 1.3
Other Unrealized Gains (Losses) on Securities Available for Sale	**5.7**	**(2.2)**	**3.5**	0.2	(0.1)	0.1
Reclassification Adjustment for (Gains) Losses Included in Net Income	**0.1**		**0.1**	(0.2)	0.1	(0.1)
Net Change	**7.3**	**(2.8)**	**4.5**	2.1	(0.8)	1.3
Unrealized Gains (Losses) on Cash Flow Hedges						
Unrealized Gains (Losses) on Cash Flow Hedges	**2.4**	**(0.9)**	**1.5**	(9.2)	2.9	(6.3)
Reclassification Adjustment for (Gains) Losses Included in Net Income	**0.2**	**(0.1)**	**0.1**	1.8	(0.7)	1.1
Net Change	**2.6**	**(1.0)**	**1.6**	(7.4)	2.2	(5.2)
Foreign Currency Adjustments						
Foreign Currency Translation Adjustments	**6.5**	**(0.7)**	**5.8**	(56.4)	0.5	(55.9)
Long-Term Intra-Entity Foreign Currency Transaction Losses	**(0.6)**		**(0.6)**			
Net Investment Hedge Gains (Losses)	**(10.6)**	**4.1**	**(6.5)**	82.8	(31.1)	51.7
Reclassification Adjustment for (Gains) Losses Included in Net Income						
Net Change	**(4.7)**	**3.4**	**(1.3)**	26.4	(30.6)	(4.2)
Pension and Other Postretirement Benefit Adjustments						
Net Actuarial Gain (Loss)						
Reclassification Adjustment for (Gains) Losses Included in Net Income	**6.4**	**(3.0)**	**3.4**	11.2	(4.2)	7.0
Net Change	**$ 6.4**	**$ (3.0)**	**$ 3.4**	$ 11.2	$ (4.2)	$ 7.0

The following table provides the location and before-tax amounts of reclassifications out of accumulated other comprehensive income (loss) during the three months ended March 31, 2014.

(In Millions)	Location of Reclassification Adjustments Recognized in Income	Amount of Reclassification Adjustments Recognized in Income for the Three Months Ended March 31, 2014	
Securities Available for Sale			
Realized (Gains) Losses on Securities Available for Sale	Investment Security Gains (Losses), net	**$**	**0.1**
Realized (Gains) Losses on Cash Flow Hedges			
Foreign Exchange Contracts	Other Operating Income/ Expense		**0.2**
Pension and Other Postretirement Benefit Adjustments			
Amortization of Net Actuarial (Gain) Loss	Employee Benefits		**(0.4)**
Amortization of Prior Service Cost	Employee Benefits		**6.8**
Gross Reclassification Adjustment		**$**	**6.4**

Notes to Consolidated Financial Statements (continued)

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

($ In Millions Except Per Common Share Information)	Three Months Ended March 31, 2014	2013
Basic Net Income Per Common Share		
Average Number of Common Shares Outstanding	**237,208,151**	239,167,559
Net Income Applicable to Common Stock	**$ 181.4**	$ 164.0
Less: Earnings Allocated to Participating Securities	**2.9**	2.5
Earnings Allocated to Common Shares Outstanding	**178.5**	161.5
Basic Net Income Per Common Share	**0.75**	0.68
Diluted Net Income Per Common Share		
Average Number of Common Shares Outstanding	**237,208,151**	239,167,559
Plus: Dilutive Effect of Share-based Compensation	**1,842,563**	1,021,656
Average Common and Potential Common Shares	**239,050,714**	240,189,215
Earnings Allocated to Common and Potential Common Shares	**$ 178.5**	$ 161.5
Diluted Net Income Per Common Share	**0.75**	0.67

Note: Common stock equivalents totaling 1,997,337 and 4,603,526 for the three months ended March 31, 2014 and 2013, respectively, were not included in the computation of diluted net income per common share because their inclusion would have been antidilutive.

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

(In Millions)	Three Months Ended March 31, 2014	2013
Interest Income		
Loans and Leases	**$ 182.9**	$ 187.6
Securities Taxable	**69.5**	58.2
Non-Taxable	**2.2**	3.3
Interest-Bearing Deposits with Banks	**32.1**	35.0
Federal Reserve Deposits and Other	**8.7**	2.6

Total Interest Income	**295.4**	286.7
Interest Expense		
Deposits	**20.1**	