



March 24, 2017

Mr. Frederick H. Waddell  
Chairman & Chief Executive Officer  
Northern Trust Corporation  
50 South LaSalle Street  
Chicago, Illinois 60603-1008

Dear Mr. Waddell:

The Board of Governors of the Federal Reserve System (Board) and the Federal Deposit Insurance Corporation (FDIC) (together, the Agencies) have reviewed the annual resolution plan submission (2015 Plan) that Northern Trust Corporation (NTC) submitted in December 2015, as required by section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), 12 U.S.C. § 5365(d), and the jointly issued implementing regulation, 12 CFR Part 243 (Board) and 12 CFR Part 381 (FDIC) (the Resolution Plan Rule).

The Agencies have reviewed NTC's 2015 Plan in accordance with section 165(d) of the Dodd-Frank Act and the Resolution Plan Rule. In doing so, the Agencies considered the 2015 Plan; section 165(d) of the Dodd-Frank Act; the Resolution Plan Rule; and feedback provided in July 2015 to NTC for the development of the 2015 Plan. In reviewing NTC's 2015 Plan, the Agencies have identified a number of shortcomings.

The Agencies require that the annual plan NTC submits by December 31, 2017 (2017 Plan), address in a satisfactory manner all the shortcomings of the 2015 Plan identified in this letter. If the Agencies jointly decide that these matters are not satisfactorily addressed in the 2017 Plan, the Agencies may determine jointly that the 2017 Plan is not credible or would not facilitate an orderly resolution under the U.S. Bankruptcy Code. The 2017 Plan should provide a

detailed update on efforts to remedy each shortcoming and timelines for completion. For any project that cannot be completed by December 31, 2017, the 2017 Plan should reflect demonstrable progress toward project completion.

The following sections set out (i) the shortcomings of NTC's 2015 Plan and the additional information the 2017 Plan should provide and (ii) additional feedback NTC should address in its 2017 Plan. Previously provided guidance continues to be applicable except to the extent that it is superseded or supplemented by the provisions of this letter.<sup>1</sup>

## **I. Shortcomings**

NTC operates through an insured depository institution that has a United Kingdom (U.K.) based bank subsidiary and several foreign branches. The firm's multiple point-of-entry (MPOE) based resolution strategy envisions the reorganization, liquidation, or other resolution of its material entities, core business lines, and critical operations under various resolution regimes across multiple jurisdictions. The Agencies identified three areas where a weakness or gap in the 2015 Plan rose to the level of a shortcoming because it raised questions about the feasibility of NTC's resolution strategy.

*Resolution Liquidity:* Because of NTC's international footprint and its MPOE-based strategy, in August 2015, the Agencies informed NTC that "[t]he 2015 Plan must explain how [adverse ring fencing actions by foreign authorities] would affect the capital and liquidity of material entities and how material entities will maintain sufficient capital and liquidity to continue to meet their operational needs." The 2015 Plan, however, does not describe the intraday funding flows between material entities in resolution, including non-U.S. domiciled

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<sup>1</sup> The 2017 Plan should incorporate elements of the 2015 Plan that do not require any change or clarification by reference as outlined in section \_\_.4(j) of the Resolution Plan Rule, with reference to relevant chapter and page(s) of the 2015 Plan. To the extent detailed project plans already have been provided, they may be incorporated by reference and updated to reflect current implementation status.

branches. The 2015 Plan also does not fully address risks associated with cross-border funding flows. Moreover, the 2015 Plan did not provide financial projections for four of NTC's material entities and the projections provided for the other four did not provide a clear understanding of the liquidity needs of these entities or the sources from which these needs would be satisfied. For example, it was unclear from the information contained in the 2015 Plan the extent to which assets held by NTC material entities were encumbered and therefore not readily available as a source of liquidity in resolution. The insufficiently detailed and incomplete funding information contained in the 2015 Plan calls into question whether NTC has the capability to reliably calculate the liquidity it needs to execute its preferred resolution strategy, and whether NTC has fully considered the potential obstacles to funding flows among its domestic and international material entities.

To address this shortcoming, the 2017 Plan should clearly demonstrate the firm's ability to measure the standalone liquidity position of each material entity, including any non-U.S. branch that is a material entity, such as the London branch, and that the funding needed to continue critical operations would be readily available to execute the preferred resolution strategy. This analysis should estimate the minimum operating liquidity and peak funding needs at each material entity in resolution, which should capture material entity intraday liquidity requirements, operating expenses, working capital needs, and inter-affiliate funding frictions. The 2017 Plan should also discuss the extent to which the continuity of critical operations is dependent on cross-border funding flows and how the firm is mitigating risk to the continuity of critical operations should such funding become trapped during the runway period.

*Transfer of Uninsured and Foreign Deposits to Bridge Bank:* The transfer of uninsured deposits of NTC's London Branch to an FDIC-organized bridge depository institution is critical

to the successful execution of NTC's bridge bank strategy. The 2015 Plan does not provide sufficient support for NTC's assertion that the transfer to an FDIC bridge bank of these deposits, which are not dually payable in the United Kingdom and United States, would be consistent with least-cost and other applicable requirements of an FDIC receivership.<sup>2</sup>

As an initial matter, the London Branch deposits should have been treated as claims of unsecured general creditors and not as deposits. As such, the London Branch depositors would be *pari passu* with other unsecured general creditors, such as litigation and debt holder claimants, which are assumed to remain in the receivership, and therefore would be subject to potential loss. The FDIC has authority to transfer unsecured creditor claims to the bridge bank if it can be demonstrated that the transfer of these claims, because they preserve or add value for the bridge bank, would be consistent with least-cost resolution and other applicable laws concerning treatment of creditors. Northern Trust did not provide an adequate analysis of these considerations. The treatment as unsecured general creditors and the resulting loss potential faced by the London Branch depositors could, in turn, motivate U.K. authorities to take adverse ring-fencing actions to protect these depositors. Such actions could potentially hinder the successful execution of NTC's bridge bank strategy.

To address this shortcoming, to the extent the 2017 Plan continues to rely upon a bridge bank strategy and the transfer of uninsured and foreign deposits to the bridge bank, the 2017 Plan should treat non-dually payable foreign deposits as unsecured general creditor claims and should explain, with detailed supporting information, how the transfer of these claims would be consistent with least cost resolution and other applicable laws concerning treatment of creditors. The analysis may include, for example, demonstration that the transfer of specific liabilities, such

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<sup>2</sup> See, e.g., 12 U.S.C. § 1821 (n)(1)(B) (authorities of bridge depository institution).

as non-dually payable foreign deposits, to the bridge bank in addition to insured deposits would result in an increase in the franchise value over the expected loss that the uninsured depositors and foreign depositors would bear had no such transfer occurred. Support for the analysis may include reference to historical pricing, benchmarks, or recognized models; additional recovery value on foreign assets that would be recovered in the absence of adverse ring-fencing; evidence supporting client attrition rates; and other relevant information, taking into account the severely adverse stress scenario and realistic disposition time frames.

*Shared and Outsourced Services:* As noted, NTC operates in multiple jurisdictions, and the 2015 Plan reflected that NTC relies on both affiliates and third-party vendors to provide necessary corporate and front and back office services to entities across jurisdictions to support, and ensure the continuity of, its core business lines and critical operations throughout resolution. The 2015 Plan and clarifying explanations from NTC staff, however, revealed that key service contracts with affiliates and third-party vendors contain provisions that would allow counterparties to terminate services, or prevent the relevant NTC entity from assigning contractual rights to services, in the event of resolution. Moreover, the 2015 Plan noted that NTC is party to various service contracts with third-party vendors that are, in turn, relied on by NTC affiliates; yet no formal agreements or contracts are in place to document the services being relied on by NTC affiliates.

The existence and exercise of termination and anti-assignment provisions in key service contracts and the lack of documentation of service relationships between and among affiliates could potentially disrupt the provision of services needed to ensure continuity in resolution of the firm's core business lines and critical operations. The 2015 Plan asserted that the termination of shared services agreements would be highly unlikely, that the FDIC has the authority under the

Federal Deposit Insurance Act to override termination and anti-assignment clauses in vendor contracts held by the bank, and that access to contracts held by NTC could be obtained through the bankruptcy court. Relying on regulatory cooperation and the FDIC's authority, however, may not be sufficient to timely prevent the disruption to the provision of key services, particularly given the potential need for the FDIC to assert its rights and claims as receiver in the context of more complex cross-border arrangements.

To address this shortcoming, NTC should identify potential mitigants to these contract issues and should develop and implement a project plan(s) to remediate these concerns. The 2017 Plan must include a status report on projects relevant to this shortcoming, including statements on the scope of each project, the current status of each project, and completion timelines (as appropriate).

## **II. Additional Feedback**

In addition to addressing the aforementioned shortcomings, the 2017 Plan should also address and/or incorporate the items listed below.

*Shared and Outsourced Services:* The 2017 Plan should demonstrate continued progress towards (A) identifying all shared and outsourced services that support critical operations; (B) maintaining a mapping of how and where these services support core business lines and critical operations; and (C) mitigating any identified continuity risks beyond the contractual issues noted above.

*Transfer of Custodial Assets to the Bridge Bank:* Given NTC's custodial operations, which are substantially conducted through its insured bank subsidiary, the 2017 Plan should provide a detailed analysis of the legal and operational issues associated with the transfer of custodial assets to the bridge bank, including any impediments to such transfer. Ensuring

smooth transfer of custodial assets, including those held overseas, is fundamental to maintaining critical operations in resolution and operationalizing NTC's resolution strategy. This analysis should include a detailed discussion of all applicable domestic and non-U.S. jurisdictional requirements (e.g., change of control issues, required consents, conditions on transfer) associated with the transfer of custodial assets to the bridge bank. NTC should provide a project plan with specific timelines to remediate any impediments identified as a result of this analysis.

*Stress Scenario:* The 2017 Plan should assume the DFAST severely adverse scenario for the first quarter of 2017 is the domestic and international economic environment at the time of NTC's failure and throughout the resolution process.<sup>3</sup> The 2017 Plan should also discuss any changes to the resolution strategy under the adverse and baseline scenarios to the extent that these scenarios reflect obstacles to a rapid and orderly resolution that are not captured under the severely adverse scenario.

*Financial Statements and Projections:* The 2017 Plan should include pro forma financial statements for each material entity at key junctures in the execution of the resolution strategy, beginning at December 31, 2016. Key junctures should include the beginning and end of the runway period. The pro forma financial statements should clearly evidence the losses or other event(s) leading to the bankruptcy filing and any other key assumptions underlying the plan. If the 2017 Plan follows a reorganization strategy, the pro forma financial statements should reflect any recapitalization or reorganization actions to implement the strategy.

*Key Personnel Identification and Retention:* NTC has started development of a HR Staff Retention Playbook. The 2017 Plan should describe the progress to date in developing the

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<sup>3</sup> <https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20170203a5.pdf>.

playbook, including actions the firm has taken or plans to take, if any, to address the risk that key employees may depart during its resolution.

*Financial Market Utilities (FMUs)/Subcustodians/Correspondents:* NTC should continue to develop its playbooks related to continued access to payment, clearing, and settlement activities in a manner that would support an orderly resolution under its bridge bank strategy. The firm should identify each FMU and third-party agent that is key to the continuity of the firm's critical operations. If the 2017 Plan continues to use a bridge bank strategy, it should provide additional information that addresses the potential discontinuity in FMU memberships.

*Public Section:* The 2017 Plan must be divided into a confidential section and a public section. The public section should be submitted as a separate document and should contain an executive summary of the resolution plan that describes the business of the covered company and includes, to the extent material to an understanding of the covered company, the eleven informational elements required by subsection \_\_.8(c) of the Resolution Plan Rule. Additionally, either the public section or the confidential section must detail compliance with subsection \_\_.3(e) of the Resolution Plan Rule.

**III. Conclusion**

If you have any questions about the information communicated in this letter, please contact Alfonso Ventoso, Manager, Federal Reserve Board, at 202-475-6366 or [alfonso.r.ventoso@frb.gov](mailto:alfonso.r.ventoso@frb.gov), or Robert Connors, Associate Director, FDIC, at 202-898-3834 or [rconnors@fdic.gov](mailto:rconnors@fdic.gov).

Sincerely,

*Michael Gibson (Signed)*

Michael Gibson  
Director  
Division of Supervision & Regulation  
Board of Governors  
of the Federal Reserve System

Sincerely,

*Doreen Eberley (Signed)*

Doreen Eberley  
Director  
Division of Risk Management Supervision  
Federal Deposit Insurance Corporation