

LPL Financial Holdings Inc.  
Form 10-Q  
October 29, 2015

---

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

Form 10-Q  
(Mark One)

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

For the quarterly period ended September 30, 2015

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 001-34963

LPL Financial Holdings Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

20-3717839

(I.R.S. Employer  
Identification No.)

75 State Street, Boston, MA 02109

(Address of Principal Executive Offices) (Zip Code)

(617) 423-3644

(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  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  Smaller reporting company   
(Do not check if a smaller reporting company)

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

The number of shares of Common Stock, par value \$0.001 per share, outstanding as of October 26, 2015 was 94,994,871.

---

---

TABLE OF CONTENTS

Item Number	Page
<u>PART I — FINANCIAL INFORMATION</u>	
<u>1. Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Statements of Income (unaudited)</u>	<u>1</u>
<u>Condensed Consolidated Statements of Comprehensive Income (unaudited)</u>	<u>2</u>
<u>Condensed Consolidated Statements of Financial Condition (unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Stockholders' Equity (unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows (unaudited)</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	<u>7</u>
<u>2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
<u>3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>40</u>
<u>4. Controls and Procedures</u>	<u>44</u>
<u>PART II — OTHER INFORMATION</u>	
<u>1. Legal Proceedings</u>	<u>46</u>
<u>1A. Risk Factors</u>	<u>46</u>
<u>2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>46</u>
<u>3. Defaults Upon Senior Securities</u>	<u>47</u>
<u>4. Mine Safety Disclosures</u>	<u>47</u>
<u>5. Other Information</u>	<u>47</u>
<u>6. Exhibits</u>	<u>48</u>
<u>SIGNATURES</u>	<u>49</u>



## WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly, and current reports, proxy statements, and other information required by the Securities Exchange Act of 1934, as amended (“Exchange Act”), with the Securities and Exchange Commission (“SEC”). You may read and copy any document we file with the SEC at the SEC’s public reference room located at 100 F Street, N.E., Washington, D.C. 20549, U.S.A. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public from the SEC’s internet site at <http://www.sec.gov>. On our internet site, <http://www.lpl.com>, we post the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: our annual reports on Form 10-K, our proxy statements, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act. Hard copies of all such filings are available free of charge by request via email ([investor.relations@lpl.com](mailto:investor.relations@lpl.com)), telephone (617) 897-4574, or mail (LPL Financial Investor Relations at 75 State Street, 24th Floor, Boston, MA 02109). The information contained or incorporated on our website is not a part of this Quarterly Report on Form 10-Q.

When we use the terms “LPLFH,” “we,” “us,” “our” and the “Company,” we mean LPL Financial Holdings Inc., a Delaware corporation, and its consolidated subsidiaries, taken as a whole, unless the context otherwise indicates.

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Statements in Item 2 - “Management's Discussion and Analysis of Financial Condition and Results of Operations” and other sections of this Quarterly Report on Form 10-Q regarding the Company's future financial and operating results, growth, business strategies and plans, liquidity, future indebtedness, future share repurchases, and future dividends, including statements regarding future resolution of regulatory matters and related costs, income projections based on changes in interest rates, and projected savings and anticipated improvements to the Company's operating model, services, and technology as a result of its initiatives and programs, as well as any other statements that are not related to present facts or current conditions or that are not purely historical, constitute forward-looking statements. These forward-looking statements are based on the Company's historical performance and its plans, estimates, and expectations as of October 29, 2015. The words “anticipates,” “believes,” “expects,” “may,” “plans,” “predicts,” “will,” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Forward-looking statements are not guarantees that the future results, plans, intentions, or expectations expressed or implied by the Company will be achieved. Matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, legislative, regulatory, competitive, and other factors, which may cause actual financial or operating results, levels of activity, or the timing of events, to be materially different than those expressed or implied by forward-looking statements. Important factors that could cause or contribute to such differences include: changes in general economic and financial market conditions, including retail investor sentiment; fluctuations in the value of brokerage and advisory assets; fluctuations in levels of net new advisory assets and the related impact on fee revenue; effects of competition in the financial services industry; changes in the number of the Company's financial advisors and institutions, and their ability to market effectively financial products and services; changes in interest rates and fees payable by banks participating in the Company's cash sweep program, including the Company's success in negotiating agreements with current or additional counterparties; changes in the growth of the Company's fee-based business; the effect of current, pending, and future legislation, regulation, and regulatory actions, including the fiduciary rule proposed by the U.S. Department of Labor and disciplinary actions imposed by federal and state securities regulators and self-regulatory organizations; the costs of settling and remediating issues related to pending or future regulatory matters; execution of the Company's capital management plans, including its ability to increase its level of indebtedness, refinance a portion of its existing debt and amend certain restrictive covenants, each of which is subject to conditions in the debt capital markets and the Company's success in renegotiating certain terms of its existing credit agreement; the price, availability of shares and trading volumes of the Company's common stock, which will affect the timing and size of future share repurchases by the Company; execution of the Company's plans and its success in realizing the expense savings and service improvements and efficiencies expected to result from its initiatives and programs, particularly its expense plans and technological initiatives; the Company's success in negotiating and developing commercial arrangements with third-party services providers; the performance of third-party service providers on which the Company relies; the Company's ability to

control operating risks, information technology systems risks, cybersecurity risks, and sourcing risks; and the other factors set forth in Part I, “Item 1A. Risk Factors” in the Company's 2014 Annual Report on Form 10-K, as may be amended or updated in the Company's Quarterly Reports on Form 10-Q. Except as required by law, the Company specifically disclaims any obligation to update any forward-looking statements as a result of deve

developments occurring after the date of this quarterly report, even if its estimates change, and you should not rely on statements contained herein as representing the Company's views as of any date subsequent to the date of this quarterly report.

ii

---

## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements (unaudited)

## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Income

(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
<b>REVENUES:</b>				
Commission	\$480,271	\$520,388	\$1,513,359	\$1,590,139
Advisory	341,217	340,369	1,028,213	998,016
Asset-based	123,921	121,283	369,625	354,494
Transaction and fee	105,593	94,674	305,099	276,284
Interest income, net of interest expense	5,221	4,727	14,976	14,279
Other	(1,478)	) 7,793	23,436	36,182
Total net revenues	1,054,745	1,089,234	3,254,708	3,269,394
<b>EXPENSES:</b>				
Commission and advisory	701,585	746,001	2,179,686	2,242,206
Compensation and benefits	110,494	106,290	335,111	317,459
Promotional	42,040	36,669	104,416	93,581
Depreciation and amortization	26,766	24,519	79,564	70,618
Occupancy and equipment	19,760	19,043	61,957	62,922
Professional services	15,341	38,174	43,914	82,736
Brokerage, clearing and exchange	13,403	12,090	39,680	36,594
Communications and data processing	11,253	11,476	33,974	32,598
Restructuring charges	3,071	9,928	11,487	26,473
Other	28,852	16,694	86,796	51,395
Total operating expenses	972,565	1,020,884	2,976,585	3,016,582
Non-operating interest expense	13,493	12,897	40,671	38,651
Total expenses	986,058	1,033,781	3,017,256	3,055,233
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	68,687	55,453	237,452	214,161
<b>PROVISION FOR INCOME TAXES</b>	27,635	22,181	95,480	84,663
<b>NET INCOME</b>	\$41,052	\$33,272	\$141,972	\$129,498
<b>EARNINGS PER SHARE (NOTE 12)</b>				
Earnings per share, basic	\$0.43	\$0.33	\$1.48	\$1.29
Earnings per share, diluted	\$0.43	\$0.33	\$1.46	\$1.26
Weighted-average shares outstanding, basic	94,972	100,052	95,744	100,519
Weighted-average shares outstanding, diluted	96,472	101,834	97,303	102,384

See notes to unaudited condensed consolidated financial statements.

## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
NET INCOME	\$41,052	\$33,272	\$141,972	\$129,498
Other comprehensive (loss) income, net of tax:				
Unrealized (loss) gain on cash flow hedges, net of tax expense of (\$98), (\$63), \$96, and \$863 for the three and nine months ended September 30, 2015 and 2014, respectively	(156	) (101	) 121	1,361
Reclassification adjustment for realized gain on cash flow hedges included in net income, net of tax expense of \$62, \$85, \$290, and \$113 for the three and nine months ended September 30, 2015 and 2014, respectively	(100	) (135	) (463	) (180
Total other comprehensive (loss) income, net of tax	(256	) (236	) (342	) 1,181
TOTAL COMPREHENSIVE INCOME	\$40,796	\$33,036	\$141,630	\$130,679

See notes to unaudited condensed consolidated financial statements.



## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Financial Condition

(Unaudited)

(Dollars in thousands, except par value)

	September 30, 2015	December 31, 2014
<b>ASSETS</b>		
Cash and cash equivalents	\$410,036	\$412,332
Cash and securities segregated under federal and other regulations	470,721	568,930
Restricted cash	22,462	1,109
Receivables from:		
Clients, net of allowance of \$1,337 at September 30, 2015 and \$1,245 at December 31, 2014	344,351	365,390
Product sponsors, broker-dealers, and clearing organizations	154,306	177,470
Others, net of allowance of \$11,340 at September 30, 2015 and \$8,379 at December 31, 2014	323,238	291,449
Securities owned:		
Trading — at fair value	16,611	13,466
Held-to-maturity — at amortized cost	10,847	8,594
Securities borrowed	6,488	5,035
Income taxes receivable	17,370	84
Fixed assets, net of accumulated depreciation and amortization of \$320,897 at September 30, 2015 and \$288,834 at December 31, 2014	256,998	214,154
Debt issuance costs, net of accumulated amortization of \$13,922 at September 30, 2015 and \$11,724 at December 31, 2014	11,042	13,241
Goodwill	1,365,838	1,365,838
Intangible assets, net of accumulated amortization of \$333,207 at September 30, 2015 and \$305,154 at December 31, 2014	401,563	430,704
Other assets	167,487	183,197
<b>Total assets</b>	<b>\$3,979,358</b>	<b>\$4,050,993</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Drafts payable	\$144,307	\$180,099
Payables to clients	558,540	652,714
Payables to broker-dealers and clearing organizations	43,531	45,427
Accrued commission and advisory expenses payable	132,682	146,504
Accounts payable and accrued liabilities	308,884	289,426
Unearned revenue	71,847	64,482
Securities sold, but not yet purchased — at fair value	226	302
Senior secured credit facilities	1,666,129	1,634,258
Leasehold financing obligation	43,182	—
Deferred income taxes, net	64,633	66,181
<b>Total liabilities</b>	<b>3,033,961</b>	<b>3,079,393</b>
Commitments and contingencies		
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock, \$.001 par value; 600,000,000 shares authorized; 119,238,650 shares issued at September 30, 2015 and 118,234,552 shares issued at December 31, 2014	119	118
Additional paid-in capital	1,401,441	1,355,085
	(922,817	) (780,661

Edgar Filing: LPL Financial Holdings Inc. - Form 10-Q

Treasury stock, at cost — 24,435,356 shares at September 30, 2015 and 21,089,882 shares at December 31, 2014

Accumulated other comprehensive income	595	937
Retained earnings	466,059	396,121
Total stockholders' equity	945,397	971,600
Total liabilities and stockholders' equity	\$3,979,358	\$4,050,993

See notes to unaudited condensed consolidated financial statements.

3

---

## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Stockholders' Equity

(Unaudited)

(In thousands)

	Common Stock		Additional Paid-In	Treasury Stock		Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
	Shares	Amount	Capital	Shares	Amount			
BALANCE — December 31, 2013	117,112	\$ 117	\$ 1,292,374	15,216	\$(506,205)	\$ 115	\$ 313,570	\$ 1,099,971
Net income and other comprehensive income, net of tax expense						1,181	129,498	130,679
Issuance of common stock to settle restricted stock units, net	40	1		13	(674 )			(673 )
Treasury stock purchases				2,990	(150,021 )			(150,021 )
Cash dividends on common stock							(72,104 )	(72,104 )
Stock option exercises and other	972		24,141	(31 )	1,078		115	25,334
Share-based compensation			22,649					22,649
Excess tax benefits from share-based compensation			7,537					7,537
BALANCE — September 30, 2014	118,124	\$ 118	\$ 1,346,701	18,188	\$(655,822)	\$ 1,296	\$ 371,079	\$ 1,063,372
BALANCE — December 31, 2014	118,235	\$ 118	\$ 1,355,085	21,090	\$(780,661)	\$ 937	\$ 396,121	\$ 971,600
Net income and other comprehensive income (loss), net of tax expense						(342 )	141,972	141,630
Issuance of common stock to settle restricted stock units, net	172	1		64	(2,868 )			(2,867 )
Treasury stock purchases				3,325	(140,835 )			(140,835 )
Cash dividends on common stock							(72,056 )	(72,056 )
Stock option exercises and other	832		22,331	(44 )	1,547		22	23,900
Share-based compensation			22,577					22,577

Edgar Filing: LPL Financial Holdings Inc. - Form 10-Q

Excess tax benefits from share-based compensation									
			1,448						1,448
BALANCE — September 30, 2015	119,239	\$ 119	\$ 1,401,441	24,435	\$(922,817)	\$ 595	\$ 466,059	\$ 945,397	

See notes to unaudited condensed consolidated financial statements.

4

---

## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows  
(Unaudited)  
(In thousands)

	Nine Months Ended September 30,	
	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 141,972	\$ 129,498
Adjustments to reconcile net income to net cash provided by operating activities:		
Noncash items:		
Depreciation and amortization	79,564	70,618
Amortization of debt issuance costs	2,198	3,241
Share-based compensation	22,577	22,649
Excess tax benefits related to share-based compensation	(2,420)	(7,666)
Provision for bad debts	1,632	2,124
Deferred income tax provision	(1,354)	585
Loan forgiveness	27,469	20,326
Other	13,308	3,339
Changes in operating assets and liabilities:		
Cash and securities segregated under federal and other regulations	98,208	93,844
Receivables from clients	20,948	30,723
Receivables from product sponsors, broker-dealers, and clearing organizations	23,164	(4,369)
Receivables from others	(61,523)	(31,195)
Securities owned	(3,763)	(3,999)
Securities borrowed	(1,453)	(1,225)
Other assets	3,457	(8,534)
Drafts payable	(35,792)	(59,876)
Payables to clients	(94,174)	17
Payables to broker-dealers and clearing organizations	(1,896)	(4,842)
Accrued commission and advisory expenses payable	(13,822)	7,875
Accounts payable and accrued liabilities	19,706	(11,580)
Income taxes receivable/payable	(14,866)	(22,187)
Unearned revenue	7,365	(4,922)
Securities sold, but not yet purchased	(76)	(193)
Net cash provided by operating activities	\$ 230,429	\$ 224,251

Continued on following page



## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows - Continued

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2015	2014
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	\$(51,553	) \$(69,830 )
Purchase of intangible assets	—	(9,000 )
Proceeds from disposal of fixed assets	—	7,123
Purchase of securities classified as held-to-maturity	(4,602	) (6,749 )
Proceeds from maturity of securities classified as held-to-maturity	2,350	4,250
Deposits of restricted cash	(22,462	) (6,049 )
Release of restricted cash	1,109	141
Net cash used in investing activities	(75,158	) (80,114 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net proceeds from revolving credit facility	40,000	—
Repayment of senior secured credit facilities	(8,129	) (8,129 )
Payment of contingent consideration	—	(3,300 )
Tax payments related to settlement of restricted stock units	(2,867	) (673 )
Repurchase of common stock	(140,835	) (150,021 )
Dividends on common stock	(72,056	) (72,104 )
Excess tax benefits related to share-based compensation	2,420	7,666
Proceeds from stock option exercises and other	23,900	25,334
Net cash used in financing activities	(157,567	) (201,227 )
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(2,296</b>	<b>) (57,090 )</b>
<b>CASH AND CASH EQUIVALENTS — Beginning of period</b>	<b>412,332</b>	<b>516,584</b>
<b>CASH AND CASH EQUIVALENTS — End of period</b>	<b>\$410,036</b>	<b>\$459,494</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Interest paid	\$38,509	\$38,877
Income taxes paid	\$112,899	\$109,805
<b>NONCASH DISCLOSURES:</b>		
Capital expenditures included in accounts payable and accrued liabilities	\$7,843	\$6,462
Fixed assets acquired under build-to-suit lease	\$—	\$8,114
Finance obligation related to real estate projects	\$43,182	\$—
See notes to unaudited condensed consolidated financial statements.		

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Organization and Description of the Company

LPL Financial Holdings Inc. (“LPLFH”), a Delaware holding corporation, together with its consolidated subsidiaries (collectively, the “Company”) provides an integrated platform of brokerage and investment advisory services to independent financial advisors and financial advisors at financial institutions (collectively “advisors”) in the United States of America. Through its custody and clearing platform, using both proprietary and third-party technology, the Company provides access to diversified financial products and services enabling its advisors to offer independent financial advice and brokerage services to retail investors (their “clients”).

2. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). These unaudited condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. These adjustments are of a normal recurring nature. The Company’s results for any interim period are not necessarily indicative of results for a full year or any other interim period.

The unaudited condensed consolidated financial statements do not include all information and notes necessary for a complete presentation of results of income, comprehensive income, financial position, and cash flows in conformity with generally accepted accounting principles in the United States of America (“GAAP”). Accordingly, these financial statements should be read in conjunction with the Company’s audited consolidated financial statements and the related notes for the year ended December 31, 2014, contained in the Company’s Annual Report on Form 10-K as filed with the SEC.

The Company’s significant accounting policies are included in Note 2. Summary of Significant Accounting Policies, in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. There have been no significant changes to these accounting policies during the first nine months of 2015.

Consolidation

These unaudited condensed consolidated financial statements include the accounts of LPLFH and its subsidiaries. Intercompany transactions and balances have been eliminated. Equity investments in which the Company exercises significant influence but does not exercise control and is not the primary beneficiary are accounted for using the equity method.

Use of Estimates

The preparation of the unaudited condensed consolidated financial statements in conformity with GAAP requires the Company to make estimates and judgments that affect the reported amounts of assets and liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. These estimates are based on the information that is currently available and on various other assumptions that the Company believes to be reasonable under the circumstances. Actual results could vary from these estimates.

Reportable Segment

The Company's internal reporting is organized into two service channels: Independent Advisor Services and Institution Services. These service channels are aggregated and viewed as one operating segment, and therefore, one reportable segment due to their similar economic characteristics, products and services, production and distribution processes, and regulatory environment.

Restricted Cash

Restricted cash primarily represents cash restricted for use by the Company’s captive insurance subsidiary.



## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements (Unaudited)

## Fair Value of Financial Instruments

The Company's financial assets and liabilities are carried at fair value or at amounts that, because of their short-term nature, approximate current fair value, with the exception of its held-to-maturity securities and indebtedness. The Company carries its held-to-maturity securities and indebtedness at amortized cost. The Company measures the implied fair value of its debt instruments using trading levels obtained from a third-party service provider.

Accordingly, the debt instruments qualify as Level 2 fair value measurements. See Note 4. Fair Value Measurements, for additional detail regarding the Company's fair value measurements. As of September 30, 2015, the carrying amount and fair value of the Company's indebtedness was approximately \$1,666.1 million and \$1,658.1 million, respectively. As of December 31, 2014, the carrying amount and fair value was approximately \$1,634.3 million and \$1,620.8 million, respectively.

## Leasehold Financing Obligation

The Company is involved with the construction of a building for use as office space in Fort Mill, South Carolina and has determined that it has substantially all of the risks of ownership during construction of the leased property.

Accordingly, from an accounting perspective, the Company is deemed to be the owner of the construction project. As such, the Company records an asset for the amount of the total project costs and an amount related to the value attributed to the building under construction in fixed assets and the related financing obligation in leasehold financing obligations on the unaudited condensed consolidated statement of financial condition. Once construction is complete, the Company will determine if the asset qualifies for sale-leaseback accounting treatment.

## Recently Issued Accounting Pronouncements

There are no recently issued accounting pronouncements that would materially impact the Company's condensed consolidated statements of income, comprehensive income, financial condition, or cash flows.

## 3. Restructuring

In February 2013, the Company committed to an expansion of its Service Value Commitment initiative (the "Program"), an ongoing effort to position the Company's people, processes, and technology for sustainable long-term growth while improving the service experience of its advisors and delivering efficiencies in its operating model. The Program is expected to be completed in 2015.

The following table summarizes the balance of accrued expenses and the changes in the accrued amounts for the Program as of and for the nine months ended September 30, 2015 (in thousands):

	Accrued Balance at December 31, 2014	Costs Incurred	Payments	Accrued Balance at September 30, 2015	Cumulative Costs Incurred to Date	Total Expected Restructuring Costs
Outsourcing and other related costs	\$—	\$1,198	\$(1,198 )	\$—	\$22,686	\$23,500
Technology transformation costs	4,458	377	(4,424 )	411	30,295	30,300
Employee severance obligations and other related costs	1,999	2,265	(3,358 )	906	11,151	13,400
Asset impairments	—	—	—	—	842	842
Total	\$6,457	\$3,840	\$(8,980 )	\$1,317	\$64,974	\$68,042

In February 2015, the Company committed to a course of action to restructure the business of its subsidiary, Fortigent Holdings Company, Inc. (together with its subsidiaries, "Fortigent"). The Company acquired Fortigent, which provides outsourced wealth management solutions, in April 2012. The intention of the restructuring plan is to migrate Fortigent's operations from Rockville, Maryland to the Company's office in Charlotte, North Carolina, simplify and improve the efficiency of Fortigent's existing service offerings, and position Fortigent to capitalize on the Company's future technology investments and service offerings for financial institutions and advisors focused on high-net-worth clients. This restructuring is expected to be completed in 2016.



LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements (Unaudited)

The following table summarizes the balance of accrued expenses and the changes in the accrued amounts for the Fortigent restructuring as of and for the nine months ended September 30, 2015 (in thousands):

	Costs Incurred	Payments	Non-cash	Accrued Balance at September 30, 2015	Cumulative Costs Incurred to Date	Total Expected Restructuring Costs
Employee severance obligations and other related costs	\$2,838	\$(1,816 )	\$—	\$1,022	\$2,838	\$2,900
Relocation and related costs	2,409	(1,816 )	—	593	2,409	3,600
Lease restructuring charges	793	(170 )	—	623	793	1,300
Asset impairments	821	—	(821 )	—	821	1,200
Total	\$6,861	\$(3,802 )	\$(821 )	\$2,238	\$6,861	\$9,000

#### 4. Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Inputs used to measure fair value are prioritized within a three-level fair value hierarchy. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

There have been no transfers of assets or liabilities between these fair value measurement classifications during the nine months ended September 30, 2015.

The Company's fair value measurements are evaluated within the fair value hierarchy, based on the nature of inputs used to determine the fair value at the measurement date. At September 30, 2015, the Company had the following financial assets and liabilities that are measured at fair value on a recurring basis:

Cash Equivalents — The Company's cash equivalents include money market funds, which are short term in nature with readily determinable values derived from active markets.

Securities Owned and Securities Sold, But Not Yet Purchased — The Company's trading securities consist of house account model portfolios established and managed for the purpose of benchmarking the performance of its fee-based advisory platforms and temporary positions resulting from the processing of client transactions. Examples of these securities include money market funds, U.S. treasury obligations, mutual funds, certificates of deposit, and traded equity and debt securities.

The Company uses prices obtained from independent third-party pricing services to measure the fair value of its trading securities. Prices received from the pricing services are validated using various methods including comparison to prices received from additional pricing services, comparison to available quoted market prices, and review of other relevant market data including implied yields of major categories of securities. In general, these quoted prices are derived from active markets for identical assets or liabilities. When quoted prices in active markets for identical assets and liabilities are not available, the quoted prices are based on similar assets and liabilities or inputs other than the quoted prices that are observable, either directly or indirectly. For certificates of deposit and treasury securities, the Company utilizes market-based inputs, including observable market interest rates that correspond to the remaining maturities or the next interest reset dates. At September 30, 2015, the Company did not adjust prices received from the

independent third-party pricing services.

Other Assets — The Company's other assets include: (1) deferred compensation plan assets that are invested in money market and other mutual funds, which are actively traded and valued based on quoted market prices; (2) certain non-traded real estate investment trusts and auction rate notes, which are valued

9

---

## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements (Unaudited)

using quoted prices for identical or similar securities and other inputs that are observable or can be corroborated by observable market data; and (3) cash flow hedges, which are measured using quoted prices for similar cash flow hedges, taking into account counterparty credit risk and the Company's own non-performance risk.

Accounts Payable and Accrued Liabilities — The Company's accounts payable and accrued liabilities include contingent consideration liabilities that are measured using Level 3 inputs.

The following table summarizes the Company's financial assets and financial liabilities measured at fair value on a recurring basis at September 30, 2015 (in thousands):

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash equivalents	\$8,858	\$—	\$—	\$8,858
Securities owned — trading:				
Money market funds	269	—	—	269
Mutual funds	6,686	—	—	6,686
Equity securities	80	—	—	80
Debt securities	—	5,266	—	5,266
U.S. treasury obligations	4,310	—	—	4,310
Total securities owned — trading	11,345	5,266	—	16,611
Other assets	94,096	3,847	—	97,943
Total assets at fair value	\$114,299	\$9,113	\$—	\$123,412
<b>Liabilities</b>				
Securities sold, but not yet purchased:				
Equity securities	\$193	\$—	\$—	\$193
Debt securities	—	31	—	31
Certificates of deposit	—	2	—	2
Total securities sold, but not yet purchased	193	33	—	226
Accounts payable and accrued liabilities	—	—	527	527
Total liabilities at fair value	\$193	\$33	\$527	\$753

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements (Unaudited)

The following table summarizes the Company's financial assets and financial liabilities measured at fair value on a recurring basis at December 31, 2014 (in thousands):

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash equivalents	\$22,592	\$—	\$—	\$22,592
Securities owned — trading:				
Money market funds	293	—	—	293
Mutual funds	7,570	—	—	7,570
Equity securities	224	—	—	224
Debt securities	—	1,379	—	1,379
U.S. treasury obligations	4,000	—	—	4,000
Total securities owned — trading	12,087	1,379	—	13,466
Other assets	75,540	5,058	—	80,598
Total assets at fair value	\$110,219	\$6,437	\$—	\$116,656
<b>Liabilities</b>				
Securities sold, but not yet purchased:				
Mutual funds	\$13	\$—	\$—	\$13
Equity securities	279	—	—	279
Debt securities	—	10	—	10
Total securities sold, but not yet purchased	292	10	—	302
Accounts payable and accrued liabilities	—	—	527	527
Total liabilities at fair value	\$292	\$10	\$527	\$829

Level 3 Recurring Fair Value Measurements

The Company determines the fair value for its contingent consideration obligations using an income approach whereby the Company assesses the probability and timing of the achievement of the applicable milestones, which are based on contractually negotiated financial or operating targets that vary by acquisition transaction, such as revenues. The contingent payments are estimated using a probability weighted, multi-scenario analysis of expected future performance of the acquired businesses. The Company then discounts these expected payment amounts to calculate the fair value as of the valuation date. The Company's management evaluates the underlying projections and other related factors used in determining fair value each period and makes updates when there have been significant changes in management's expectations.

5. Held-to-Maturity Securities

The Company holds certain investments in securities, primarily U.S. government notes, which are recorded at amortized cost because the Company has both the intent and the ability to hold these investments to maturity. Interest income is accrued as earned. Premiums and discounts are amortized using a method that approximates the effective yield method over the term of the security and are recorded as an adjustment to the investment yield.

The amortized cost, gross unrealized gain or loss, and fair value of securities held-to-maturity were as follows (in thousands):

	September 30, 2015	December 31, 2014
Amortized cost	\$10,847	\$8,594
Gross unrealized gain (loss)	20	(14)
Fair value	\$10,867	\$8,580

## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements (Unaudited)

At September 30, 2015, the securities held-to-maturity were scheduled to mature as follows (in thousands):

	Within one year	After one but within five years	After five but within ten years	Total
U.S. government notes — at amortized cost	\$5,000	\$5,347	\$500	\$10,847
U.S. government notes — at fair value	\$5,005	\$5,355	\$507	\$10,867

## 6. Derivative Financial Instruments

In May 2013, in conjunction with its Service Value Commitment initiative, the Company entered into a long-term contractual obligation (the “Agreement”) with a third-party provider to enhance the quality, speed, and cost of processes by outsourcing certain functions. The Agreement enables the third-party provider to use the services of its affiliates in India to provide services to the Company and provides for the Company to settle the cost of its contractual obligation to the third-party provider in U.S. dollars each month. However, the Agreement provides that on each annual anniversary date of the signing of the Agreement, the price for services (denominated in U.S. dollars) is to be adjusted for the then-current exchange rate between the U.S. dollar (“USD”) and the Indian rupee (“INR”). The Agreement provides that, once an annual adjustment is calculated, there are no further modifications to the amounts paid by the Company to the third-party provider for fluctuations in the exchange rate between the USD and the INR until the reset on the next anniversary date of the signing of the Agreement.

The third-party provider bore the risk of currency movement from the date of signing the Agreement until the reset on the first anniversary of its signing, and bears such risk during each period until the next annual reset date. The Company bears the risk of currency movement at each of the annual reset dates following the first anniversary. To mitigate foreign currency risk arising from these annual reset events, the Company entered into four non-deliverable foreign currency contracts, all of which have been designated as cash flow hedges. The first cash flow hedge, with a notional amount of 560.4 million INR, or \$8.5 million, settled in June 2014. The Company received a settlement of \$1.0 million, which was reclassified out of accumulated other comprehensive income and recognized in net income ratably over the 12-month period ending May 31, 2015 to match the timing of the underlying hedged item. The second cash flow hedge, with a notional amount of 560.4 million INR, or \$8.1 million, settled in June 2015. The Company received a settlement of \$0.7 million, which will be reclassified out of accumulated other comprehensive income and recognized in net income ratably over a 12-month period ending May 31, 2016 to match the timing of the underlying hedged item.

The details related to the remaining non-deliverable foreign currency contracts at September 30, 2015 are as follows (in millions, except foreign exchange rate):

	Settlement Date	Hedged Notional Amount (INR)	Contractual INR/USD Foreign Exchange Rate	Hedged Notional Amount (USD)
Cash flow hedge #3	6/2/2016	560.4	72.21	7.8
Cash flow hedge #4	6/2/2017	560.4	74.20	7.5
Total hedged amount				\$15.3

The fair value of the derivative instruments, included in other assets in the unaudited condensed consolidated statements of financial condition, were as follows (in thousands):

	September 30, 2015	December 31, 2014
Cash flow hedges	\$638	\$1,179

## 7. Goodwill and Other Intangible Assets

The balances in goodwill and intangible assets were a result of various acquisitions. See Note 8. Goodwill and Other Intangible Assets, in the Company's 2014 Annual Report on Form 10-K for a discussion of the components of goodwill and additional information regarding intangible assets.





## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements (Unaudited)

## 8. Debt

Senior Secured Credit Facilities — In October 2014, the Company entered into the Second Amendment, Extension and Incremental Assumption Agreement (“Credit Agreement”) with its wholly owned subsidiary, LPL Holdings, Inc., and the other parties thereto. The Credit Agreement includes a term loan A (“Term Loan A”), a term loan B (“Term Loan B”), and a revolving credit facility (“Revolving Credit Facility”), which has a borrowing capacity of \$400.0 million.

The Company’s outstanding borrowings as of the dates below were as follows (dollars in thousands):

	Maturity	September 30, 2015		December 31, 2014	
		Balance	Interest Rate	Balance	Interest Rate
Senior Secured Credit Facilities					
Revolving Credit Facility	9/30/2019	\$ 150,000	3.73 %	\$ 110,000	4.75 %
Senior secured term loans:					
Term Loan A	9/30/2019	459,375	2.69 %	459,375	2.67 %
Term Loan B	3/29/2019	1,056,754	3.25 %	1,064,883	3.25 %
Total borrowings		1,666,129		1,634,258	
Less current portion		160,839		120,839	
Long-term borrowings — net of current portion		\$ 1,505,290		\$ 1,513,419	

As of September 30, 2015, the Company also had \$18.0 million of irrevocable letters of credit, with an applicable interest rate margin of 2.50%, which were supported by the Revolving Credit Facility.

The Credit Agreement subjects the Company to certain financial and non-financial covenants. As of September 30, 2015, the Company was in compliance with such covenants.

Bank Loans Payable — The Company maintains three uncommitted lines of credit. Two of the lines have unspecified limits, which are primarily dependent on the Company’s ability to provide sufficient collateral. The third line has a \$200 million limit, and allows for both collateralized and uncollateralized borrowings. One line was utilized for one day during the three months ended September 30, 2015 with an average balance outstanding of \$0.6 million at a weighted-average interest rate of 1.50%. The lines were not otherwise utilized in 2015 and were not utilized in 2014. There were no balances outstanding at September 30, 2015 or December 31, 2014.

## 9. Commitments and Contingencies

## Leases

The Company leases office space and equipment under various operating leases. These leases are generally subject to scheduled base rent and maintenance cost increases, which are recognized on a straight-line basis over the period of the leases. Total rental expense for all operating leases was approximately \$6.2 million and \$6.5 million for the three months ended September 30, 2015 and 2014, respectively, and \$19.4 million and \$23.5 million for the nine months ended September 30, 2015 and 2014, respectively.

## Service and Development Contracts

The Company is party to certain long-term contracts for systems and services that enable back office trade processing and clearing for its product and service offerings.

## Guarantees

The Company occasionally enters into certain types of contracts that contingently require it to indemnify certain parties against third-party claims. The terms of these obligations vary and, because a maximum obligation is not explicitly stated, the Company has determined that it is not possible to make an estimate of the amount that it could be obligated to pay under such contracts.

The Company’s subsidiary, LPL Financial, provides guarantees to securities clearing houses and exchanges under their standard membership agreements, which require a member to guarantee the performance of other members. Under these agreements, if a member becomes unable to satisfy its obligations to the clearing houses



LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

and exchanges, all other members would be required to meet any shortfall. The Company's liability under these arrangements is not quantifiable and may exceed the cash and securities it has posted as collateral. However, the potential requirement for the Company to make payments under these agreements is remote. Accordingly, no liability has been recognized for these transactions.

Loan Commitments

From time to time, LPL Financial makes loans to its advisors, primarily to newly recruited advisors to assist in the transition process, which may be forgivable. Due to timing differences, LPL Financial may make commitments to issue such loans prior to actually funding them. These unfunded commitments are generally contingent upon certain events occurring, including but not limited to the advisor joining LPL Financial. LPL Financial had no such significant unfunded commitments at September 30, 2015.

Legal & Regulatory Matters

Assessing the probability of a loss occurring and the amount of any loss related to a legal proceeding or regulatory matter is inherently difficult. The Company exercises significant and complex judgments to make certain estimates presented in its consolidated financial statements, and there are particular uncertainties and complexities involved when assessing the potential outcomes of legal proceedings and regulatory matters. The Company's assessment process considers a variety of factors and assumptions, which may include the procedural status of the matter and any recent developments; prior experience and the experience of others in similar matters; the size and nature of potential exposures; available defenses; the progress of fact discovery; the opinions of counsel and experts; potential opportunities for settlement and the status of any settlement discussions; as well as the potential for insurance coverage and indemnification, if available. The Company monitors these factors and assumptions for new developments and re-assesses the likelihood that a loss will occur and the estimated range or amount of loss, if those amounts can be reasonably determined. The Company has established an accrual for those legal proceedings and regulatory matters for which a loss is both probable and the amount can be reasonably estimated. The Company's accruals at September 30, 2015 include estimated costs for regulatory matters generally relating to the adequacy of the Company's compliance and supervisory systems and procedures and other controls, for which the Company believes losses are both probable and reasonably estimable. When it is not probable but at least reasonably possible that a loss has been incurred, a disclosure of fact is made when the underlying loss or range of losses can also be reasonably estimated. The Company estimates that, as of September 30, 2015, exposure to those losses could range from \$0 to \$6 million in excess of the accrued liability, if any, related to those matters. Due to the inherent unpredictability of such matters, the Company may have exposure to losses that are not yet predictable or cannot yet be reasonably estimated in addition to those amounts that have been accrued or disclosed.

Third-Party Insurance

The Company maintains third-party insurance coverage for certain legal proceedings, including those involving client claims. With respect to client claims, the estimated losses on many of the pending matters are less than the applicable deductibles of the insurance policies. The Company is also subject to extensive regulation and supervision by U.S. federal and state agencies and various self-regulatory organizations. The Company and its advisors periodically engage with such agencies and organizations, in the context of examinations or otherwise, to respond to inquiries, informational requests, and investigations. From time to time, such engagements result in regulatory complaints or other matters, the resolution of which can include fines and other remediation.

Self-Insurance Liabilities

The Company has self-insurance for certain potential liabilities, including various errors and omissions liabilities, through a wholly-owned captive insurance subsidiary. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated by considering, in part, historical claims experience, severity factors, and other actuarial assumptions. The estimated accruals for these potential liabilities could be significantly affected if future occurrences and claims differ from such assumptions and historical trends. As of September 30, 2015, these self-insurance liabilities are included in accounts payable and accrued liabilities in the unaudited condensed

consolidated balance sheet. Self-insurance related charges are included in other expenses in the unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2015.

## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements (Unaudited)

## Other Commitments

As of September 30, 2015, the Company had received collateral primarily in connection with client margin loans with a market value of approximately \$344.6 million, which it can re-pledge, loan, or sell. Of these securities, approximately \$29.4 million were client-owned securities pledged to the Options Clearing Corporation as collateral to secure client obligations related to options positions. As of September 30, 2015 there were no restrictions that materially limited the Company's ability to re-pledge, loan, or sell the remaining \$315.2 million of client collateral. Trading securities on the unaudited condensed consolidated statements of financial condition includes \$4.3 million and \$4.0 million pledged to clearing organizations at September 30, 2015 and December 31, 2014, respectively. The Company is involved in a build-to-suit lease arrangement in Fort Mill, South Carolina, under which it serves as the construction agent on behalf of the landlord. Under such arrangement, the Company has obligations to fund cost over-runs in its capacity as the construction agent, and accordingly has determined that under lease accounting standards it bears substantially all of the risks and rewards of ownership as measured under GAAP. The Company is therefore required to report the landlord's costs of construction on its balance sheet as a fixed asset during the construction period as if the Company owned such asset. As of September 30, 2015, the Company has recorded \$43.2 million in fixed assets in connection with this arrangement and an equal and off-setting leasehold financing obligation on the unaudited condensed consolidated statement of financial condition.

## 10. Stockholders' Equity

## Dividends

The payment, timing, and amount of any dividends are subject to approval by the Board of Directors as well as certain limits under the Company's credit facilities. Cash dividends per share of common stock and total cash dividends paid on a quarterly basis were as follows for the periods indicated (in millions, except per share data):

	2015		2014	
	Dividend per Share	Total Cash Dividend	Dividend per Share	Total Cash Dividend
First quarter	\$0.25	\$24.2	\$0.24	\$24.1
Second quarter	\$0.25	\$24.1	\$0.24	\$24.0
Third quarter	\$0.25	\$23.8	\$0.24	\$24.0

## Share Repurchases

The Board of Directors has approved several share repurchase programs pursuant to which the Company may repurchase its issued and outstanding shares of common stock from time to time. Repurchased shares are included in treasury stock on the unaudited condensed consolidated statements of financial condition. Purchases may be effected in open market or privately negotiated transactions, including transactions with affiliates, with the timing of purchases and the amount of stock purchased generally determined at the discretion of the Company's management within the constraints of the Credit Agreement and general liquidity needs.

For the three months ended September 30, 2015 and 2014, the Company had the following activity under its approved share repurchase programs (in millions, except share and per share data):

Approval Date	Amount		Three Months Ended September 30,					
	Authorized Repurchase at Amount	Remaining September 30, 2015	2015	2014	2015	2014	2015	2014
			Shares Purchased	Weighted-Average Price Paid Per Share	Total Cost(1)	Shares Purchased	Weighted-Average Price Paid Per Share	Total Cost(1)
February 10, 2014	\$ 150.0	\$—	—	\$ —	\$—	531,426	\$ 47.06	\$25.0
April 28, 2015	\$ 200.0	\$ 152.2	593,868	\$ 42.12	\$25.0	—	\$ —	\$—

Edgar Filing: LPL Financial Holdings Inc. - Form 10-Q

\$152.2	593,868	\$ 42.12	\$25.0	531,426	\$ 47.06	\$25.0
---------	---------	----------	--------	---------	----------	--------

---

(1) Included in the total cost of shares purchased is a commission fee of \$0.02 per share.

15

---

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2015 and 2014, the Company had the following activity under its approved share repurchase programs (in millions, except share and per share data):

Approval Date	Authorized Repurchase Amount	Amount Remaining at September 30, 2015	Nine Months Ended September 30,					
			2015			2014		
			Shares Purchased	Weighted Average Price Paid Per Share	Total Cost(1)	Shares Purchased	Weighted Average Price Paid Per Share	Total Cost(1)
May 28, 2013	\$ 200.0	\$—	—	\$—	\$—	1,306,288	\$52.00	\$67.9
February 10, 2014	\$ 150.0	\$—	—	\$—	\$—	1,683,424	\$48.77	\$82.1
October 1, 2014	\$ 150.0	\$—	2,193,262	\$42.39	\$93.0	—	\$—	\$—
April 28, 2015	\$ 200.0	\$ 152.2	1,131,790	\$42.29	\$47.8	—	\$—	\$—
		\$ 152.2	3,325,052	\$42.36	\$ 140.8	2,989,712	\$50.18	\$ 150.0

(1)Included in the total cost of shares purchased is a commission fee of \$0.02 per share.

See Note 14. Related Party Transactions, for details regarding the repurchase of shares from related parties in 2014.

#### 11. Share-Based Compensation

Certain employees, advisors, institutions, officers, and directors of the Company participate in various long-term incentive plans, which provide for granting stock options, warrants, restricted stock awards, and restricted stock units. Stock options and warrants generally vest in equal increments over a three- to five-year period and expire on the tenth anniversary following the date of grant. Restricted stock awards and restricted stock units generally vest over a two- to four-year period.

In November 2010, the Company adopted a 2010 Omnibus Equity Incentive Plan (as amended and restated in May 2015, the “2010 Plan”), which provides for the granting of stock options, warrants, restricted stock awards, restricted stock units, and other equity-based compensation. The 2010 Plan serves as the successor to the 2005 Stock Option Plan for Incentive Stock Options, the 2005 Stock Option Plan for Non-qualified Stock Options, the 2008 Advisor and Institution Incentive Plan, the 2008 Stock Option Plan, and the Director Restricted Stock Plan (collectively, the “Predecessor Plans”). Upon adoption of the 2010 Plan, awards were no longer made under the Predecessor Plans; however, awards previously granted under the Predecessor Plans remain outstanding until exercised or forfeited. There were 20,055,945 shares authorized for grant under the 2010 Plan after the amendment and restatement of the plan in May 2015. There were 5,214,409 shares reserved for issuance upon exercise or conversion of outstanding awards granted, and 12,995,726 shares remaining available for future issuance, under the 2010 Plan as of September 30, 2015.

#### Stock Options and Warrants

The following table presents the weighted-average assumptions used in the Black-Scholes valuation model by the Company in calculating the fair value of its employee and officer stock options that have been granted during the nine months ended September 30, 2015:

Expected life (in years)	5.30	
Expected stock price volatility	25.78	%
Expected dividend yield	2.30	%
Risk-free interest rate	1.58	%
Fair value of options	\$8.83	

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

The fair value of each stock option or warrant awarded to advisors and financial institutions is estimated on the date of the grant and revalued at each reporting period using the Black-Scholes valuation model with the following weighted-average assumptions used during the nine months ended September 30, 2015:

Expected life (in years)	5.99	
Expected stock price volatility	25.92	%
Expected dividend yield	2.33	%
Risk-free interest rate	1.51	%
Fair value of options	\$11.11	

The following table summarizes the Company's stock option and warrant activity for the nine months ended September 30, 2015:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding — December 31, 2014	6,287,410	\$31.59		
Granted	1,141,309	\$45.51		
Exercised	(799,783 )	\$27.92		
Forfeited	(523,680 )	\$39.26		
Outstanding — September 30, 2015	6,105,256	\$34.02	6.29	\$35,117
Exercisable — September 30, 2015	3,523,282	\$29.55	5.03	\$36,018

The following table summarizes information about outstanding stock options and warrants at September 30, 2015:

Range of Exercise Prices	Outstanding		Exercisable		
	Total Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)	Number of Shares	Weighted-Average Exercise Price
\$18.04 - \$23.02	1,082,705	\$21.39	3.69	1,082,705	\$21.39
\$23.41 - \$30.00	1,316,612	\$28.21	5.12	875,567	\$27.94
\$31.60 - \$32.33	1,133,954	\$31.88	6.91	610,283	\$31.91
\$34.01 - \$39.60	972,627	\$34.59	5.43	744,954	\$34.53
\$43.74 - \$54.81	1,599,358	\$48.50	9.11	209,773	\$53.73
	6,105,256	\$34.02	6.29	3,523,282	\$29.55

The Company recognizes share-based compensation for stock options awarded to employees, officers, and directors based on the grant date fair value over the requisite service period of the award, which generally equals the vesting period. The Company recognized share-based compensation related to the vesting of these awards of \$4.1 million and \$3.8 million during the three months ended September 30, 2015 and 2014, respectively, and \$12.4 million and \$11.4 million during the nine months ended September 30, 2015 and 2014, respectively, which is included in compensation and benefits expense on the unaudited condensed consolidated statements of income. As of September 30, 2015, total unrecognized compensation cost related to non-vested stock options granted to employees, officers, and directors was \$13.0 million, which is expected to be recognized over a weighted-average period of 1.76 years.

The Company recognizes share-based compensation for stock options and warrants awarded to its advisors and to financial institutions based on the fair value of the awards at each reporting period. The Company recognized share-based compensation of \$0.1 million and \$1.1 million during the three months ended September 30, 2015 and





## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements (Unaudited)

2014, respectively, and \$1.8 million and \$5.9 million for during the nine months ended September 30, 2015 and 2014, respectively, related to the vesting of stock options and warrants awarded to its advisors and financial institutions, which is classified within commission and advisory expense on the unaudited condensed consolidated statements of income. As of September 30, 2015, total unrecognized compensation cost related to non-vested stock options and warrants granted to advisors and financial institutions was \$3.7 million, which is expected to be recognized over a weighted-average period of 1.76 years.

## Restricted Stock

The following summarizes the Company's activity in its restricted stock awards and restricted stock units for the nine months ended September 30, 2015:

	Restricted Stock Awards		Restricted Stock Units	
	Number of Shares	Weighted-Average Grant-Date Fair Value	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2014	33,634	\$ 42.78	546,725	\$ 43.34
Granted	31,847	\$ 41.42	352,643	\$ 41.82
Vested	(18,832)	) \$ 37.66	(172,468)	) \$ 39.53
Forfeited	—	\$ —	(82,371)	) \$ 44.44
Nonvested at September 30, 2015	46,649	\$ 43.92	644,529	\$ 43.39

The Company recognizes share-based compensation for restricted stock awards and restricted stock units granted to its employees, officers, and directors based on the grant date fair value over the requisite service period of the award, which generally equals the vesting period. The Company recognized \$2.0 million and \$1.7 million of share-based compensation related to the vesting of these restricted stock awards and restricted stock units during the three months ended September 30, 2015 and 2014, respectively, and \$6.4 million and \$4.4 million during the nine months ended September 30, 2015 and 2014, respectively, which is included in compensation and benefits expense on the unaudited condensed consolidated statements of income. As of September 30, 2015, total unrecognized compensation cost for restricted stock awards and restricted stock units granted to employees, officers, and directors was \$12.6 million, which is expected to be recognized over a weighted-average remaining period of 1.99 years.

The Company recognizes share-based compensation for restricted stock units granted to its advisors and to financial institutions based on the fair value of the awards at each reporting period. The Company recognized share-based compensation of \$0.4 million and \$0.4 million related to the vesting of these restricted stock units during the three months ended September 30, 2015 and 2014, respectively, and \$1.5 million and \$0.6 million during the nine months ended September 30, 2015 and 2014, respectively, which is classified within commission and advisory expense on the unaudited condensed consolidated statements of income. As of September 30, 2015, total unrecognized compensation cost for restricted stock units granted to advisors and financial institutions was \$6.2 million, which is expected to be recognized over a weighted-average remaining period of 2.25 years.

## LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements (Unaudited)

## 12. Earnings Per Share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the period. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the denominator is increased to include the number of additional shares of common stock that would have been outstanding if dilutive potential shares of common stock had been issued. The calculation of basic and diluted earnings per share is as follows (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income	\$41,052	\$33,272	\$141,972	\$129,498
Basic weighted-average number of shares outstanding	94,972	100,052	95,744	100,519
Dilutive common share equivalents	1,500	1,782	1,559	1,865
Diluted weighted-average number of shares outstanding	96,472	101,834	97,303	102,384
Basic earnings per share	\$0.43	\$0.33	\$1.48	\$1.29
Diluted earnings per share	\$0.43	\$0.33	\$1.46	\$1.26

The computation of diluted earnings per share excludes stock options, warrants, and restricted stock units that are anti-dilutive. For the three months ended September 30, 2015 and 2014, stock options, warrants, and restricted stock units representing common share equivalents of 2,068,568 shares and 1,478,016 shares, respectively, were anti-dilutive. For the nine months ended September 30, 2015 and 2014, stock options, warrants, and restricted stock units representing common share equivalents of 1,975,454 shares and 1,344,782 shares, respectively, were anti-dilutive.

## 13. Income Taxes

The Company's effective income tax rate differs from the federal corporate tax rate of 35.0%, primarily as a result of state taxes, settlement contingencies, and expenses that are not deductible for tax purposes. These items resulted in effective tax rates of 40.2% and 40.0% for the three months ended September 30, 2015 and 2014. The change between periods is due to various factors including the release of accruals for uncertain tax positions in 2014 due to completion of state tax audits.

The effective tax rates for the nine months ended September 30, 2015 and 2014 were 40.2% and 39.5%, respectively. The change between periods is due to the release of accruals for uncertain tax positions in 2014 due to completion of state tax audits and a decrease in the number of incentive stock options exercised in 2015 compared to the same period in 2014.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

## 14. Related Party Transactions

The Company has related party transactions with certain portfolio companies of TPG, one of the Company's significant stockholders, and the LPL Financial Foundation. During the nine months ended September 30, 2015 and 2014, the Company recognized revenue for services provided to these related parties of \$0.6 million and \$0.7 million, respectively. The Company incurred expenses for services provided by certain of the TPG portfolio companies and the LPL Financial Foundation of \$4.2 million and \$0.9 million, during the nine months ended September 30, 2015 and 2014, respectively. As of September 30, 2015 and 2014, receivables from related parties were \$0 and \$0.1 million, respectively, and payables to related parties were \$0.2 million and less than \$0.1 million, respectively.

In February 2014, the Company entered into a share repurchase agreement with an investment fund associated with TPG, pursuant to which the Company repurchased 1.9 million shares of its common stock at a price of \$52.00 per

share, for total consideration of \$100.0 million.

19

---

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

15. Net Capital and Regulatory Requirements

The Company operates in a highly regulated industry. Applicable laws and regulations restrict permissible activities and investments and require compliance with various financial and customer-related regulations. The consequences of noncompliance can include substantial monetary and non-monetary sanctions. In addition, the Company is also subject to comprehensive examinations and supervision by various governmental and self-regulatory agencies. These regulatory agencies generally have broad discretion to prescribe greater limitations on the operations of a regulated entity for the protection of investors or public interest. Furthermore, where the agencies determine that such operations are unsafe or unsound, fail to comply with applicable law, or are otherwise inconsistent with the laws and regulations or with the supervisory policies, greater restrictions may be imposed.

The Company's registered broker-dealer, LPL Financial, is subject to the SEC's Uniform Net Capital Rule (Rule 15c3-1 under the Exchange Act), which requires the maintenance of minimum net capital, as defined. Net capital and the related net capital requirement may fluctuate on a daily basis. LPL Financial is a clearing broker-dealer and had net capital of \$153.1 million with a minimum net capital requirement of \$6.5 million as of September 30, 2015.

The Company's subsidiary, The Private Trust Company N.A. ("PTC"), operates in a highly regulated industry and is subject to various regulatory capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have substantial monetary and non-monetary impacts to PTC's operations.

As of September 30, 2015 and December 31, 2014, LPL Financial and PTC met all capital adequacy requirements to which they were subject.

16. Financial Instruments with Off-Balance-Sheet Credit Risk and Concentrations of Credit Risk

LPL Financial's client securities activities are transacted on either a cash or margin basis. In margin transactions, LPL Financial extends credit to the advisor's client, subject to various regulatory and internal margin requirements, collateralized by cash or securities in the client's account. As clients write options contracts or sell securities short, LPL Financial may incur losses if the clients do not fulfill their obligations and the collateral in the clients' accounts is not sufficient to fully cover losses that clients may incur from these strategies. To control this risk, LPL Financial monitors margin levels daily and clients are required to deposit additional collateral, or reduce positions, when necessary.

LPL Financial is obligated to settle transactions with brokers and other financial institutions even if its advisors' clients fail to meet their obligation to LPL Financial. Clients are required to complete their transactions on the settlement date, generally three business days after the trade date. If clients do not fulfill their contractual obligations, LPL Financial may incur losses. In addition, the Company occasionally enters into certain types of contracts to fulfill its sale of when, as, and if issued securities. When, as, and if issued securities have been authorized but are contingent upon the actual issuance of the security. LPL Financial has established procedures to reduce this risk by generally requiring that clients deposit cash or securities into their account prior to placing an order.

LPL Financial may at times hold equity securities that are recorded on the unaudited condensed consolidated statements of financial condition at market value. While long inventory positions represent LPL Financial's ownership of securities, short inventory positions represent obligations of LPL Financial to deliver specified securities at a contracted price, which may differ from market prices prevailing at the time of completion of the transaction. Accordingly, both long and short inventory positions may result in losses or gains to LPL Financial as market values of securities fluctuate. To mitigate the risk of losses, long and short positions are marked-to-market daily and are continuously monitored by LPL Financial.

17. Subsequent Events

On October 25, 2015, the Board of Directors declared a cash dividend of \$0.25 per share on the Company's outstanding common stock to be paid on November 24, 2015 to stockholders of record on November 12, 2015.

On October 25, 2015, the Company's Board of Directors approved an increase in the Company's share repurchase plan by \$347.8 million to a total of \$500.0 million.

20

---

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

### Business Overview

We are the nation's largest independent broker-dealer, a top custodian for registered investment advisors ("RIAs"), and a leading independent consultant to retirement plans. We provide an integrated platform of brokerage and investment advisory services to more than 14,000 independent financial advisors, including financial advisors at more than 700 financial institutions (our "advisors") across the country, enabling them to provide their retail investors ("clients") with objective financial advice through a lower conflict model. We also support approximately 4,300 financial advisors who are affiliated and licensed with insurance companies that use our customized clearing, advisory platforms, and technology solutions.

Through our advisors, we are one of the largest distributors of financial products and services in the United States, and we believe we have the fifth-largest overall advisor base in the United States.

We believe that objective financial guidance is a fundamental need for everyone. We enable our advisors to focus on what they do best—create the personal, long-term relationships that are the foundation for turning life's aspirations into financial realities. We do that through a singular focus on providing our advisors with the front-, middle-, and back-office support they need to serve the large and growing market for independent investment advice. We believe that LPL Financial is the only company that offers advisors the unique combination of an integrated technology platform, comprehensive self-clearing services, and open architecture access to leading financial products, all delivered in an environment unencumbered by conflicts from product manufacturing, underwriting, or market-making.

### Executive Summary

#### Asset Growth Trends

We experienced strong asset growth as net new advisory assets were \$4.2 billion and \$13.7 billion for the three and nine months ended September 30, 2015, compared to \$4.8 billion and \$13.5 billion in the same periods in 2014. However, reductions in market-sensitive asset valuations offset these strong asset flows, and brokerage and advisory assets served as of September 30, 2015 declined to \$461.8 billion from the September 30, 2014 balance of \$464.8 billion.

As of September 30, 2015, our advisory assets had grown to \$179.7 billion from \$169.5 billion as of September 30, 2014 and represented 39% of advisory and brokerage assets served. Assets on our platform that serves independent RIAs that conduct their advisory business through separate entities ("Hybrid RIAs") operating pursuant to the Investment Advisers Act of 1940 or through their respective states' investment advisory licensing rules, rather than through LPL Financial, had grown to \$110.0 billion as of September 30, 2015 compared to \$87.4 billion as of September 30, 2014, and represented 24% of total advisory and brokerage assets served.

#### Gross Profit Growth

Third quarter gross profit grew to \$339.8 million, up from \$331.1 million in the comparable period in 2014. Key contributors to third quarter gross profit growth included:

- \$17.8 billion increase in net new advisory assets since September 30, 2014.
- 163 net new advisors added since September 30, 2014.
- \$3.7 billion increase in client cash sweep assets since September 30, 2014.

#### Progress on a number of regulatory matters

Regulatory-related charges decreased \$14.4 million and \$5.4 million for the three and nine months ended September 30, 2015 compared to the comparable periods in 2014, as we reached agreements to resolve several significant regulatory matters on which we had been working.

#### Capital Management Activity

We returned \$49.0 million of capital to shareholders in the third quarter, including \$24.0 million of dividends and \$25.0 million of share buy backs. We purchased approximately 600,000 shares during the period at a weighted average price of \$42.12 per share.

The Company's Board of Directors ("Board") declared a cash dividend of \$0.25 per share on our outstanding common stock to be paid on November 24, 2015 to stockholders of record on November 12, 2015.

Our Sources of Revenue

Our revenues are derived primarily from fees and commissions from products and advisory services offered by our advisors to their clients, a substantial portion of which we pay out to our advisors, as well as fees we receive from our advisors for the use of our technology, custody, clearing, trust, and reporting platforms. We also generate asset-based revenues through our platform of over 26,000 financial products from a broad range of product manufacturers. Under our self-clearing platform, we custody the majority of client assets invested in these financial products, for which we provide statements, transaction processing, and ongoing account management. In return for these services, mutual funds, insurance companies, banks, and other financial product manufacturers pay us fees based on asset levels or number of accounts managed. We also earn interest from margin loans made to our advisors' clients.

We track recurring revenue, a characterization of net revenue and a statistical measure, which we define to include our revenues from asset-based fees, advisory fees, trailing commissions, cash sweep programs, and certain other fees that are based upon accounts and advisors. Because certain recurring revenues are associated with asset balances, they will fluctuate depending on the market values and current interest rates. These asset balances, specifically related to advisory and asset-based revenues, have a correlation of approximately 60% to the fluctuations of the overall market, as measured by the S&P 500 index. Accordingly, our recurring revenue can be negatively impacted by adverse external market conditions. However, recurring revenue is meaningful to us despite these fluctuations because it is not dependent upon transaction volumes or other activity-based revenues, which are more difficult to predict, particularly in declining or volatile markets.

The table below summarizes the sources of our revenue, the primary drivers of each revenue source, and the percentage of each revenue source that represents recurring revenue:

	Sources of Revenue	Primary Drivers	Nine Months Ended September 30, 2015		
			Total (millions)	% of Total Net Revenue	% Recurring
Advisor-driven revenue with ~85%-90% payout ratio	Commission	- Transactions - Brokerage asset levels	\$1,513	47%	48%
	Advisory	- Advisory asset levels - Cash balances	\$1,028	32%	99%
	Asset-Based - Cash Sweep Fees - Sponsorship Fees - Record Keeping	- Interest rates - Client asset levels - Number of accounts	\$370	11%	98%
Attachment revenue retained by us	Transaction and Fee - Transactions - Client (Investor) Accounts - Advisor Seat and Technology	- Client activity - Number of clients - Number of advisors - Number of accounts - Number of premium technology subscribers - Margin account balances	\$305	9%	62%
	Other	- Alternative investment transactions	\$39	1%	46%
	Total Net Revenue		\$3,255	100%	
	Total Recurring Revenue		\$2,313	71%	



Edgar Filing: LPL Financial Holdings Inc. - Form 10-Q

How We Evaluate Our Business

We focus on several business and key financial metrics in evaluating the success of our business relationships and our resulting financial position and operating performance. Our business and key financial metrics are as follows:

	September 30,		% Change	
	2015	2014		
<b>Business Metrics</b>				
Advisors(1)	14,073	13,910	1.2	%
Advisory and brokerage assets (in billions)(2)	\$461.8	\$464.8	(0.6	)%
Advisory assets under custody (in billions)(2)(3)	\$179.7	\$169.5	6.0	%
Net new advisory assets (in billions)(4)	\$13.7	\$13.5	1.5	%
Insured cash account balances (in billions)(2)	\$19.5	\$16.9	15.4	%
Money market account balances (in billions)(2)	\$8.2	\$7.1	15.5	%
	Three Months Ended		Nine Months Ended	
	September 30,		September	
	2015	2014	2015	2014
<b>Financial Metrics</b>				
Revenue (decrease) increase from prior period	(3.2	)% 3.4	% (0.4	)% 7.3
Recurring revenue as a % of net revenue	72.4	% 70.2	% 71.1	% 68.1
Net income (in millions)	\$41.1	\$33.3	\$142.0	\$129.5
Earnings per share (diluted)	\$0.43	\$0.33	\$1.46	\$1.26
<b>Non-GAAP Measures:</b>				
Gross profit (in millions)(5)	\$339.8	\$331.1	\$1,035.3	\$990.6
Gross profit growth from prior period	2.6	% 4.5	% 4.5	% 6.8
Gross profit as a % of net revenue	32.2	% 30.4	% 31.8	% 30.3
Adjusted EBITDA (in millions)	\$118.4	\$108.9	\$388.8	\$378.6
Adjusted EBITDA as a % of net revenue	11.2	% 10.0	% 11.9	% 11.6
Adjusted EBITDA as a % of gross profit	34.8	% 32.9	% 37.6	% 38.2
Adjusted Earnings (in millions)	\$52.8	\$48.8	\$179.2	\$181.6
Adjusted Earnings per share (diluted)	\$0.55	\$0.48	\$1.84	\$1.77

(1) Advisors are defined as those independent financial advisors and financial advisors at financial institutions who are licensed to do business with our broker-dealer subsidiary.

Advisory and brokerage assets are comprised of assets that are custodied, networked, and non-networked and reflect market movement in addition to new assets, inclusive of new business development and net of attrition.

(2) Insured cash account and money market account balances are also included in advisory and brokerage assets. Set forth below are other client assets at September 30, 2015 and 2014, including retirement plan assets and certain trust and high-net-worth assets, that are custodied with third-party providers and therefore excluded from advisory and brokerage assets (in billions):

	September 30,	
	2015	2014
Retirement plan assets(a)	\$80.8	\$76.2
Trust assets	\$1.0	\$3.0
High-net-worth assets	\$94.4	\$83.9

(a) Retirement plan assets are held in retirement plans that are supported by advisors licensed with LPL Financial. At September 30, 2015 and 2014, our retirement plan assets represent assets that are custodied with various third-party providers of retirement plan administrative services who provide reporting feeds. We estimate the total assets in retirement plans supported to be between \$115.0 billion and \$125.0 billion at September 30, 2015 and between \$110.0 billion and \$120.0 billion at September 30, 2014. If we receive reporting feeds in the future from providers for whom we do not



currently receive feeds, we intend to include and identify such additional assets in this metric. Such additional feeds since September 30, 2014, accounted for \$3.6 billion of the \$4.6 billion increase in retirement plan assets.

Advisory assets under custody are comprised of advisory assets under management in our corporate RIA platform (3) and Hybrid RIA assets in advisory accounts custodied by us. See “Results of Operations” for a tabular presentation of advisory assets under custody.

Represents net new advisory assets for the nine months ended September 30, 2015 and 2014 consisting of funds (4) from new accounts and additional funds deposited into existing advisory accounts that are custodied in our fee-based advisory platforms.

Gross profit is calculated as net revenues less production expenses. Because our gross profit amounts do not (5) include any depreciation and amortization expense, we consider our gross profit amounts to be non-GAAP measures that may not be comparable to those of others in our industry.

#### Adjusted EBITDA

Adjusted EBITDA is defined as EBITDA (net income plus interest expense, income tax expense, depreciation, and amortization), further adjusted to exclude certain non-cash charges and other adjustments set forth below. We present Adjusted EBITDA because we consider it an important measure of our performance. Adjusted EBITDA is a useful financial metric in assessing our operating performance from period to period by excluding certain items that we believe are not representative of our core business, such as certain material non-cash items and other adjustments. We believe that Adjusted EBITDA, viewed in addition to, and not in lieu of, our reported financial results under GAAP, provides useful information to investors regarding our performance and overall results of operations for the following reasons:

because non-cash equity grants made to employees, officers, and directors at a certain price and point in time do not necessarily reflect how our business is performing at any particular time, share-based compensation expense is not a key measure of our operating performance; and

because costs associated with acquisitions and the resulting integrations, debt refinancing, and restructuring and conversions costs can vary from period to period and transaction to transaction, expenses associated with these activities are not considered a key measure of our operating performance.

We use Adjusted EBITDA:

- as a measure of operating performance;
- for planning purposes, including the preparation of budgets and forecasts;
- to allocate resources to enhance the financial performance of our business;
- to evaluate the effectiveness of our business strategies;
- in communications with our Board concerning our financial performance; and
- as a factor in determining employee and executive bonuses.

Adjusted EBITDA is a non-GAAP measure and does not purport to be an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Adjusted EBITDA is not a measure of net income, operating income, or any other performance measure derived in accordance with GAAP.

Adjusted EBITDA has limitations as an analytical tool and should not be considered in isolation or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are:

Adjusted EBITDA does not reflect all cash expenditures, future requirements for capital expenditures or contractual commitments;

Adjusted EBITDA does not reflect changes in, or cash requirements for, working capital needs;

Adjusted EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt; and

Adjusted EBITDA can differ significantly from company to company depending on long-term strategic decisions regarding capital structure, the tax jurisdictions in which companies operate and capital investments, limiting its usefulness as a comparative measure.

Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in our business. We compensate for these limitations by relying primarily on the GAAP results and using Adjusted EBITDA as supplemental information.

Set forth below is a reconciliation from our net income to Adjusted EBITDA, a non-GAAP measure, for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income	\$41,052	\$33,272	\$141,972	\$129,498
Non-operating interest expense	13,493	12,897	40,671	38,651
Provision for income taxes	27,635	22,181	95,480	84,663
Amortization of intangible assets	9,534	9,634	28,707	29,046
Depreciation and amortization of fixed assets	17,231	14,885	50,856	41,572
EBITDA	108,945	92,869	357,686	323,430
EBITDA Adjustments:				
Employee share-based compensation expense(1)	6,250	5,550	19,213	16,087
Acquisition and integration related expenses(2)	(8	) (328	) 58	764
Restructuring and conversion costs(3)	3,080	9,958	11,487	26,606
Other(4)	85	829	402	11,667
Total EBITDA Adjustments	9,407	16,009	31,160	55,124
Adjusted EBITDA	\$118,352	\$108,878	\$388,846	\$378,554

Represents share-based compensation for equity awards granted to employees, officers, and directors. Such awards (1) are measured based on the grant-date fair value and recognized over the requisite service period of the individual awards, which generally equals the vesting period.

Represents acquisition and integration costs resulting from various acquisitions, including changes in the estimated (2) fair value of future payments, or contingent consideration, required to be made to former shareholders of certain acquired entities.

Represents organizational restructuring charges, conversion, and other related costs primarily resulting from the (3) expansion of our Service Value Commitment initiative. Results for the three and nine months ended September 30, 2015 also include charges related to the restructuring of the business of our subsidiary, Fortigent Holdings Company, Inc. (together with its subsidiaries, "Fortigent").

Results for the three and nine months ended September 30, 2014 include approximately \$0.6 million and \$9.8 (4) million, respectively, in parallel rent, property tax, fixed asset disposals, and common area maintenance expenses incurred in connection with our relocation to our San Diego office building.

Adjusted Earnings and Adjusted Earnings per share

Adjusted Earnings represents net income before: (a) employee share-based compensation expense, (b) amortization of intangible assets, (c) acquisition and integration related expenses, (d) restructuring and conversion costs, (e) debt extinguishment costs, and (f) other. Reconciling items are tax effected using the income tax rates in effect for the applicable period, adjusted for any potentially non-deductible amounts.

Adjusted Earnings per share represents Adjusted Earnings divided by weighted-average outstanding shares on a fully diluted basis.

We prepared Adjusted Earnings and Adjusted Earnings per share to eliminate the effects of items that we do not consider indicative of our core operating performance.

We believe that Adjusted Earnings and Adjusted Earnings per share, viewed in addition to, and not in lieu of, our reported financial results under GAAP, provide useful information to investors regarding our performance and overall results of operations for the following reasons:



because non-cash equity grants made to employees, officers, and directors at a certain price and point in time do not necessarily reflect how our business is performing, the related share-based compensation expense is not a key measure of our current operating performance;

because costs associated with acquisitions and related integrations, debt refinancing, and restructuring and conversions can vary from period to period and transaction to transaction, expenses associated with these activities are not considered a key measure of our operating performance; and

because amortization expenses can vary substantially from company to company and from period to period depending upon each company's financing and accounting methods, the fair value and average expected life of acquired intangible assets and the method by which assets were acquired, the amortization of intangible assets obtained in acquisitions is not considered a key measure in comparing our operating performance.

We use Adjusted Earnings for internal management reporting and evaluation purposes. We also believe Adjusted Earnings and Adjusted Earnings per share are useful to investors in evaluating our operating performance because securities analysts use them as supplemental measures to evaluate the overall performance of companies, and our investor and analyst presentations, which are generally available to investors through our website, include references to Adjusted Earnings and Adjusted Earnings per share.

Adjusted Earnings and Adjusted Earnings per share are not measures of our financial performance under GAAP and should not be considered as an alternative to net income or earnings per share or any other performance measure derived in accordance with GAAP, or as an alternative to cash flows from operating activities as a measure of our profitability or liquidity.

Although Adjusted Earnings and Adjusted Earnings per share are frequently used by securities analysts and others in their evaluation of companies, they have limitations as analytical tools, and you should not consider Adjusted Earnings and Adjusted Earnings per share in isolation, or as substitutes for an analysis of our results as reported under GAAP. In particular you should consider:

- Adjusted Earnings and Adjusted Earnings per share do not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;

- Adjusted Earnings and Adjusted Earnings per share do not reflect changes in, or cash requirements for, our working capital needs; and

- other companies in our industry may calculate Adjusted Earnings and Adjusted Earnings per share differently than we do, limiting their usefulness as comparative measures.

Management compensates for the inherent limitations associated with using Adjusted Earnings and Adjusted Earnings per share through disclosure of such limitations, presentation of our financial statements in accordance with GAAP, and reconciliation of Adjusted Earnings to the most directly comparable GAAP measure, net income.

The following table sets forth a reconciliation of net income to the non-GAAP measures Adjusted Earnings and Adjusted Earnings per share for the three and nine months ended September 30, 2015 and 2014 (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2015	2014	2015	2014	
Net income	\$41,052	\$33,272	\$141,972	\$129,498	
After-Tax:					
EBITDA Adjustments					
Employee share-based compensation expense(1)	3,928	3,666	12,256	10,778	
Acquisition and integration related expenses	(5	) (703	) 36	(33	)
Restructuring and conversion costs	1,891	6,114	7,053	16,336	
Other	52	509	247	7,164	
Total EBITDA Adjustments	5,866	9,586	19,592	34,245	
Amortization of intangible assets	5,854	5,915	17,626	17,834	
Adjusted Earnings	\$52,772	\$48,773	\$179,190	\$181,577	
Adjusted Earnings per share(2)	\$0.55	\$0.48	\$1.84	\$1.77	
Weighted-average shares outstanding — diluted	96,472	101,834	97,303	102,384	



- (1) Generally, EBITDA Adjustments and amortization of intangible assets have been tax effected using a federal rate of 35.0% and the applicable effective state rate, which was 3.6%, net of the federal tax benefit, for the periods ended September 30, 2015 and 2014, respectively, except for the impact of incentive stock options granted to employees that qualify for preferential tax treatment and conversely for which we do not receive a tax deduction.
- (2) Represents Adjusted Earnings, a non-GAAP measure, divided by weighted-average number of shares outstanding on a fully diluted basis. Set forth below is a reconciliation of earnings per share on a fully diluted basis, as calculated in accordance with GAAP, to Adjusted Earnings per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Earnings per share — diluted	\$0.43	\$0.33	\$1.46	\$1.26
After-Tax:				
EBITDA Adjustments per share	0.06	0.09	0.20	0.33
Amortization of intangible assets per share	0.06	0.06	0.18	0.18
Adjusted Earnings per share	\$0.55	\$0.48	\$1.84	\$1.77

#### Regulatory Matters

As a regulated entity, we are subject to regulatory oversight and inquiries related to, among other items, our compliance and supervisory systems and procedures and other controls, as well as our disclosures, supervision and reporting. The ongoing environment of additional regulation, increased regulatory compliance obligations, and enhanced regulatory enforcement has resulted in additional operational and compliance costs, as well as increased costs in the form of fines, restitution, and remediation related to regulatory matters. In the ordinary course of business, we periodically identify or become aware of purported inadequacies, deficiencies, and other issues. It is our policy to evaluate these matters for potential securities law or regulatory violations, and other potential compliance issues. It is also our policy to self-report known violations and issues as required by applicable law and regulation. When deemed probable that matters may result in financial losses, we accrue for those losses based on an estimate of possible fines, customer restitution, and losses related to the repurchase of sold securities and other losses, as applicable. Our ability to estimate such costs may vary based on the current stage of evaluation and status of discussion with regulators, as applicable.

Our accruals at September 30, 2015 include estimated costs for significant regulatory matters, generally relating to the adequacy of our compliance and supervisory systems and procedures and other controls, for which we believe losses are both probable and reasonably estimable. One of the matters relates to sales of certain securities over several years, and our accrual at September 30, 2015 includes an estimate for the loss we expect to incur in resolving this matter including if we were to repurchase certain affected securities at their original sales prices.

The outcome of regulatory matters could result in legal liability, regulatory fines, or monetary penalties in excess of our accruals, which could have a material adverse effect on our business, results of operations, cash flows, or financial condition. For more information on management's loss contingency policies, see Note 9. Commitments and Contingencies, within the notes to the unaudited condensed consolidated financial statements.

#### Our Service Value Commitment Initiative

##### The Program

Our Service Value Commitment initiative (the "Program") is a multi-year effort to position us for sustainable long-term growth by improving the service experience of our advisors and delivering efficiencies in our operating model. We have assessed our information technology delivery, governance, organization and strategy, and committed to undertake a course of action to reposition our labor force and invest in technology, human capital, marketing, and other key areas to enable future growth.

As of September 30, 2015, we have incurred \$65.0 million of costs related to outsourcing and other related costs, technology transformation costs, employee severance obligations, and other related costs, as well as non-cash charges for impairment of certain fixed assets related to internally developed software. The Program is expected to be completed in 2015, and we estimate total charges to be approximately \$68.0 million. See Note 3. Restructuring, within the notes to the unaudited condensed consolidated financial statements for additional information regarding the Program.





### Derivative Financial Instruments

In conjunction with the Program, we entered into a long-term contractual obligation (the "Agreement") with a third-party provider to enhance the quality and speed and reduce the cost of our processes by outsourcing certain functions. The Agreement enables the third-party provider to use the services of its affiliates in India to provide services to us. The Agreement provides that we settle the cost of our contractual obligation to the third-party provider each month in US dollars. However, the Agreement provides that on each annual anniversary date of the signing of the Agreement, the price for services (as denominated in US dollars) is to be adjusted for the then-current exchange rate between the US dollar and the Indian rupee. The Agreement provides that, once an annual adjustment is calculated, there are no further modifications to the amounts paid by us to the third-party provider for fluctuations in the exchange rate until the reset on the next anniversary date. The third-party provider bears the risk of currency movement from the date of signing the Agreement until the reset on the first anniversary of its signing, and during each period until the next annual reset. We bear the risk of currency movement at each annual reset date following the first anniversary.

We use derivative financial instruments consisting solely of non-deliverable foreign currency contracts, all of which have been designated as cash flow hedges. Through these instruments, we believe we have mitigated foreign currency risk arising from a substantial portion of our contract obligation with the third-party provider arising from annual anniversary adjustments. We will continue to assess the effectiveness of our use of cash flow hedges to mitigate risk from foreign currency contracts.

See Note 6. Derivative Financial Instruments, within the notes to the unaudited condensed consolidated financial statements for additional information regarding our derivative financial instruments.

### Acquisitions, Integrations, and Divestitures

From time to time we undertake acquisitions or divestitures outside the ordinary course of business based on opportunities in the competitive landscape. These activities are part of our overall growth strategy, but can distort comparability when reviewing revenue and expense trends for periods presented. There have been no material acquisitions, integrations, or divestitures during the nine months ended September 30, 2015. See our 2014 Annual Report on Form 10-K for 2014 activity.

### Economic Overview and Impact of Financial Market Events

Our business is directly and indirectly sensitive to several macroeconomic factors and the state of financial markets, particularly in the United States. In the U.S., economic growth has remained steady despite headwinds from slowing growth in manufacturing, largely attributable to decreasing capital expenditures on energy projects; a strong dollar, which has weighed on exports; and concern in international markets, especially heavy commodity exporters and China. On the positive side, the job market has continued to heal, which has supported consumer spending; services sector growth remained strong; and housing markets have shown signs of strength. According to the most recent estimates by the Bureau of Economic Analysis, real gross domestic product ("GDP") in the U.S. grew at an annual rate of 3.9% in the second quarter of 2015, following 0.6% growth in the first quarter slowed by unusually harsh winter weather and West Coast port strikes. Based on preliminary third quarter data reviewed, the economy continued to expand at a moderate pace in the third quarter.

While U.S. growth has been steady, concerns about international growth and low commodity prices, as well as uncertainty about the timetable for Federal Reserve interest rate hikes, have caused increased uncertainty in some financial markets. The S&P 500 failed to produce a positive quarter for the first time since 2011, posting a negative total return of 6.4%. The quarter began on a positive note as second quarter earnings showed profit growth in the non-energy sectors of the economy, particularly financials and retail. However, August proved to be a particularly volatile month as investor sentiment turned more negative on concerns over a weakening Chinese economy and declining commodity prices. Weakness in stocks pushed benchmark Treasury rates lower during the quarter and flattened the yield curve, supporting performance by longer-duration quality bonds. More economically sensitive sectors, such as high-yield, were hurt by global growth concerns and underperformed the broad fixed income market. Despite quality bonds benefiting from increased investor risk aversion during the quarter, low rates and the prospect of future Federal Reserve interest rate hikes have continued to have an impact on demand for fixed and variable annuity products.

Our business is also sensitive to current and expected short-term interest rates, which are largely driven by Federal Reserve policy. Low short-term rates can weigh on the profitability of our cash sweep program, due to the fee compression needed to keep our rates competitive. Expectations of the timing of the Federal Reserve's first rate hike of the current cycle were pushed back by weaker than expected jobs growth in September, still low inflation pressured by commodity prices and dollar strength, and the most recent policy guidance from the Federal

Reserve's policy arm, the Federal Open Market Committee ("FOMC"), following its October 27-28, 2015 meeting. The policy statement released at the conclusion of the FOMC's meeting included an affirmation of its view that the current 0 to 1/4 percent target range for the federal funds rate remains appropriate. In determining whether it will be appropriate to raise the target range at its next meeting, the FOMC indicated that it will assess its progress - both realized and expected - toward its objectives of maximum employment and 2 percent inflation. The FOMC stated that its assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. The FOMC also stated that it anticipates that raising the target range for the federal funds rate would be appropriate when it has determined that the labor market is further improved and is reasonably confident that inflation will move back to 2 percent over the medium term.

## Results of Operations

The following table and discussion below presents an analysis of our results of operations for the three and nine months ended September 30, 2015 and 2014. Where appropriate, we have identified specific events and changes that affect comparability or identification or monitoring of trends, and where possible and practical, have quantified the impact of such items.

	Three Months Ended September 30,			Nine Months Ended September 30,			% Change	
	2015	2014	% Change	2015	2014	% Change		
	(In thousands)							
<b>Revenues</b>								
Commission	\$480,271	\$520,388	(7.7)	)%	\$1,513,359	\$1,590,139	(4.8)	)%
Advisory	341,217	340,369	0.2	%	1,028,213	998,016	3.0	%
Asset-based	123,921	121,283	2.2	%	369,625	354,494	4.3	%
Transaction and fee	105,593	94,674	11.5	%	305,099	276,284	10.4	%
Other	3,743	12,520	(70.1)	)%	38,412	50,461	(23.9)	)%
Net revenues	1,054,745	1,089,234	(3.2)	)%	3,254,708	3,269,394	(0.4)	)%
<b>Expenses</b>								
Production	714,988	758,091	(5.7)	)%	2,219,366	2,278,800	(2.6)	)%
Compensation and benefits	110,494	106,290	4.0	%	335,111	317,459	5.6	%
General and administrative	117,246	122,056	(3.9)	)%	331,057	323,232	2.4	%
Depreciation and amortization	26,766	24,519	9.2	%	79,564	70,618	12.7	%
Restructuring charges	3,071	9,928	(69.1)	)%	11,487	26,473	(56.6)	)%
Total operating expenses	972,565	1,020,884	(4.7)	)%	2,976,585	3,016,582	(1.3)	)%
Non-operating interest expense	13,493	12,897	4.6	%	40,671	38,651	5.2	%
Total expenses	986,058	1,033,781	(4.6)	)%	3,017,256	3,055,233	(1.2)	)%
Income before provision for income taxes	68,687	55,453	23.9	%	237,452	214,161	10.9	%
Provision for income taxes	27,635	22,181	24.6	%	95,480	84,663	12.8	%
Net income	\$41,052	\$33,272	23.4	%	\$141,972	\$129,498	9.6	%

## Revenues

## Commission Revenues

We generate two types of commission revenues: transaction-based sales commissions and trailing commissions. Transaction-based sales commission revenues, which occur whenever clients trade securities or purchase various types of investment products, primarily represent gross commissions generated by our advisors. The levels of transaction-based sales commission revenues can vary from period to period based on the overall economic environment, number of trading days in the reporting period, and investment activity of our advisors' clients. We earn trailing commission revenues (a commission that is paid over time, such as 12(b)-1 fees) primarily on mutual funds and variable annuities held by clients of our advisors. Trailing commission revenues are recurring in nature and are earned based on the market value of investment holdings in trail-eligible assets.

The following table sets forth our commission revenue, by product category, included in our unaudited condensed consolidated statements of income for the three months ended September 30, 2015 and 2014 (in thousands):

	Three Months Ended		\$ Change	% Change	
	September 30,				
	2015	2014			
Variable annuities	\$189,623	\$206,382	\$(16,759)	(8.1)	)%
Mutual funds	144,441	153,875	(9,434)	(6.1)	)%
Alternative investments	26,113	41,911	(15,798)	(37.7)	)%
Fixed annuities	42,417	36,631	5,786	15.8	%
Equities	24,875	26,624	(1,749)	(6.6)	)%
Fixed income	21,778	21,165	613	2.9	%
Insurance	19,105	20,293	(1,188)	(5.9)	)%
Group annuities	11,777	13,350	(1,573)	(11.8)	)%
Other	142	157	(15)	(9.6)	)%
Total commission revenue	\$480,271	\$520,388	\$(40,117)	(7.7)	)%

The following table sets forth our commission revenue, by sales-based and trailing commission revenue, for the three months ended September 30, 2015 and 2014 (in thousands):

	Three Months Ended		\$ Change	% Change	
	September 30,				
	2015	2014			
Sales-based	\$244,041	\$278,375	\$(34,334)	(12.3)	)%
Trailing	236,230	242,013	(5,783)	(2.4)	)%
Total commission revenue	\$480,271	\$520,388	\$(40,117)	(7.7)	)%

The decrease in commission revenue for the three months ended September 30, 2015 compared with the same period in 2014, was primarily due to a decrease in sales-based activity for alternative investments, variable annuities, and mutual funds. Significant market volatility and investor uncertainty in the low interest rate environment led to a decline in demand for variable annuities and mutual funds. Alternative investment sales commissions were challenged by a mature real estate market.

Edgar Filing: LPL Financial Holdings Inc. - Form 10-Q

The following table sets forth our commission revenue, by product category, included in our unaudited condensed consolidated statements of income for the nine months ended September 30, 2015 and 2014 (dollars in thousands):

	Nine Months Ended September 30,			
	2015	2014	\$ Change	% Change
Variable annuities	\$585,354	\$611,286	\$(25,932)	(4.2)%
Mutual funds	453,658	456,839	(3,181)	(0.7)%
Alternative investments	116,793	148,285	(31,492)	(21.2)%
Fixed annuities	113,616	126,187	(12,571)	(10.0)%
Equities	75,684	82,245	(6,561)	(8.0)%
Fixed income	69,836	65,591	4,245	6.5%
Insurance	60,817	57,615	3,202	5.6%
Group annuities	37,160	41,571	(4,411)	(10.6)%
Other	441	520	(79)	(15.2)%
Total commission revenue	\$1,513,359	\$1,590,139	\$(76,780)	(4.8)%

The following table sets forth our commission revenue, by sales-based and trailing commission revenue, for the nine months ended September 30, 2015 and 2014 (dollars in thousands):

	Nine Months Ended September 30,			
	2015	2014	\$ Change	% Change
Sales-based	\$790,300	\$893,628	\$(103,328)	(11.6)%
Trailing	723,059	696,511	26,548	3.8%
Total commission revenue	\$1,513,359	\$1,590,139	\$(76,780)	(4.8)%

The decrease in commission revenue for the nine months ended September 30, 2015 compared with the same period in 2014, was primarily due to a decrease in sales-based activity for alternative investments, fixed and variable annuities, and mutual funds. Alternative investment sales commissions were challenged by a mature real estate market. Significant market volatility and investor uncertainty in the low interest rate environment led to a decline in demand for fixed and variable annuities and mutual funds.

Increases in trailing revenues primarily for mutual funds and variable annuities reflect improved investor engagement and stronger market conditions in the nine months ended September 30, 2015, resulting in the increase in the value of the underlying assets.

#### Advisory Revenues

Advisory revenues primarily represent fees charged on our corporate RIA platform provided through LPL Financial LLC ("LPL Financial") to clients of our advisors based on the value of advisory assets. Advisory fees are typically billed to clients quarterly, in advance, and are recognized as revenue ratably during the quarter. The value of the assets in an advisory account on the billing date determines the amount billed, and accordingly, the revenues earned in the following three month period. The majority of our accounts are billed in advance using values as of the last business day of each calendar quarter. Advisory revenues collected on our corporate RIA platform generally average 1.1% of the underlying assets, and can range anywhere from 0.5% to 3.0%.

In addition, we support Hybrid RIAs, which engage us for technology, clearing, compliance-related, and custody services, as well as access to certain of our investment platforms. Most financial advisors associated with Hybrid RIAs carry their brokerage license with LPL Financial and access our fully-integrated brokerage platform under standard terms, although some financial advisors associated with Hybrid RIAs do not carry a brokerage license with us. The assets held under a Hybrid RIA's investment advisory accounts custodied with LPL Financial are included in our advisory and brokerage assets, net new advisory assets, and advisory assets under custody metrics. However, the advisory revenue generated by a Hybrid RIA is earned by the Hybrid RIA, and accordingly is not included in our advisory revenue. We charge administrative fees to Hybrid RIAs for technology, clearing, compliance-related, and custody services based on the value of assets within these advisory accounts. The administrative fees collected on our Hybrid RIA platform vary and can reach a maximum of 0.6% of the underlying assets.





Furthermore, we support certain financial advisors at broker-dealers affiliated with insurance companies through our customized advisory platforms and charge fees to these advisors based on the value of assets within these advisory accounts.

The following table summarizes the activity within our advisory assets under custody for the three and nine months ended September 30, 2015 and 2014 (in billions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Balance - Beginning of period	\$ 186.8	\$ 167.3	\$ 175.8	\$ 151.6
Net new advisory assets	4.2	4.8	13.7	13.5
Market impact and other	(11.3 )	(2.6 )	(9.8 )	4.4
Balance - End of period	\$ 179.7	\$ 169.5	\$ 179.7	\$ 169.5

Net new advisory assets for the three and nine months ended September 30, 2015 and 2014 had a limited impact on advisory fee revenue for those respective periods. Rather, net new advisory assets are a primary driver of future advisory fee revenue and have resulted from recruiting of new Hybrid RIAs and the continued shift by our existing advisors from brokerage towards more advisory business. Advisory revenue for a particular quarter is predominately driven by the prior quarter-end advisory assets under management. The growth in advisory revenue for the three and nine months ended September 30, 2015 compared with the same period in 2014 is due to net new advisory assets resulting from our recruiting efforts and strong advisor productivity, as well as market gains as represented by higher levels of the S&P 500 index, particularly in the first half of 2015.

Adoption of our Hybrid RIA platform has continued to grow rapidly as advisors seek the freedom to run their businesses in a manner that they believe best enables them to meet their clients' needs. This continued shift of advisors to the Hybrid RIA platform (for which we custody assets but do not earn advisory revenues for managing those assets) has caused the rate of revenue growth of advisory assets under management to lag behind the rate of growth of advisory assets under custody. Our advisory revenues include administrative fees collected on our Hybrid RIA platform, but do not include fees for advisory services charged by Hybrid RIA advisors to their clients.

The following table summarizes the composition of our advisory assets under custody as of September 30, 2015 and 2014 (in billions):

	September 30,		\$ Change	% Change
	2015	2014		
Advisory assets under management	\$ 119.1	\$ 123.1	\$(4.0 )	(3.2 )%
Hybrid RIA assets in advisory accounts custodied by LPL Financial	60.6	46.4	14.2	30.6 %
Total advisory assets under custody	\$ 179.7	\$ 169.5	\$ 10.2	6.0 %

Asset-Based Revenues  
Asset-based revenues are comprised of fees from cash sweep programs, our sponsorship programs with financial product manufacturers, and omnibus processing and networking services. Pursuant to contractual arrangements, uninvested cash balances in our advisors' client accounts are swept into either insured deposit accounts at various banks or third-party money market funds, for which we receive fees, including administrative and recordkeeping fees based on account type and the invested balances. We receive fees from certain financial product manufacturers in connection with sponsorship programs that support our marketing and sales-force education and training efforts. Our omnibus processing and networking revenues represent fees paid to us in exchange for administrative and record-keeping services that we provide to clients of our advisors. Omnibus processing revenues are paid to us by mutual fund product sponsors and are based on the value of custodied assets in advisory accounts and the number of brokerage accounts in which the related mutual fund positions are held. Networking revenues on brokerage assets are correlated to the number of positions we administer and are paid to us by mutual fund and annuity product manufacturers.

Revenues from product sponsors and for record-keeping services, which are largely based on the underlying asset values, increased in the three months ended September 30, 2015 compared with the same period in 2014 due to the impact of the higher average market indices on the value of those underlying assets and net new sales of eligible

assets. Asset-based revenues also include revenues from our cash sweep programs, which decreased by

33

---

\$1.2 million, or 4.8%, to \$24.0 million for the three months ended September 30, 2015 from \$25.2 million for the three months ended September 30, 2014. The decrease is due to fee reduction that resulted from the repricing of certain contracts that underlie our cash sweep programs.

Revenues for product sponsors and record-keeping services increased in the nine months ended September 30, 2015 compared to the same period in 2014 due to the impact of the higher average market indices on the value of such underlying assets and net new sales of eligible assets. Asset-based revenues also include revenues from our cash sweep programs, which decreased by \$5.8 million, or 7.8%, to \$68.1 million for the nine months ended September 30, 2015 from \$73.9 million for the nine months ended September 30, 2014. The decrease is due to fee reduction that resulted from the repricing of certain contracts that underlie our cash sweep programs.

#### Transaction and Fee Revenues

Revenues earned from transactions and fees primarily consist of transaction fees and ticket charges, subscription fees, Individual Retirement Account (“IRA”) custodian fees, contract and license fees, conference fees, and other client account fees. We charge fees to our advisors and their clients for executing certain transactions in brokerage and fee-based advisory accounts. We earn subscription fees for various services provided to our advisors and on IRA custodial services that we provide for their client accounts. We charge administrative fees to our advisors and fees to advisors who subscribe to our reporting services. We charge fees to financial product manufacturers for participating in our training and marketing conferences. In addition, we host certain advisor conferences that serve as training, sales, and marketing events, for which we charge a fee for attendance.

Transaction and fee revenues increased for the three and nine months ended September 30, 2015 compared with the same periods in 2014, primarily due to higher trade volumes in certain advisory accounts that generate transaction based revenue. An additional contributing factor was the increase in our average number of advisors of 1.7% and 2.3% for the three and nine months ended September 30, 2015, respectively.

#### Other Revenues

Other revenues include marketing allowances received from certain financial product manufacturers, primarily those who offer alternative investments, such as non-traded real estate investment trusts and business development companies, mark-to-market gains and losses on assets held by us for the advisor non-qualified deferred compensation plan and our model research portfolios, revenues from our Retirement Partners program, interest income from client margin accounts and cash equivalents, net of operating interest expense, and other items.

Other revenues decreased for the three and nine months ended September 30, 2015 compared to the same periods in 2014 primarily due to mark-to-market losses on assets related to the advisor non-qualified deferred compensation plan and our model research portfolios.

#### Expenses

##### Production Expenses

Production expenses are comprised of the following: base payout amounts that are earned by and paid out to advisors based on commission and advisory revenues earned on each client's account (collectively, commission and advisory revenues earned by LPL Financial are referred to as gross dealer concessions, or “GDC”); production bonuses earned by advisors based on the levels of commission and advisory revenues they produce; the recognition of share-based compensation expense from equity awards granted to advisors and financial institutions based on the fair value of the awards at each reporting period; a mark-to-market gain or loss on amounts designated by advisors as deferred commissions in a non-qualified deferred compensation plan at each reporting period; and brokerage, clearing, and exchange fees. Our production payout ratio is calculated as production expenses, excluding brokerage, clearing, and exchange fees, divided by GDC.

We characterize components of production payout, which consists of all production expenses except brokerage, clearing, and exchange fees, as either GDC sensitive or non-GDC sensitive. Base payout amounts and production based bonuses earned by and paid to advisors are characterized as GDC sensitive because they are variable and highly correlated to the level of our commission and advisory revenues in a particular reporting period. Payout characterized as non-GDC sensitive includes share-based compensation expense from equity awards granted to advisors and financial institutions based on the fair value of the awards at each reporting period, and mark-to-market gains or losses on amounts designated by advisors as deferred commissions in a non-qualified deferred compensation plan. Non-GDC sensitive payout is correlated either to market movement or to the value of



our stock. We believe that discussion of production payout, viewed in addition to, and not in lieu of, our production expenses, provides useful information to investors regarding our payouts to advisors.

The following table shows our production payout ratio for the three and nine months ended September 30, 2015 and 2014:

	Three Months Ended			Nine Months Ended		
	September 30,		Change	September 30,		Change
	2015	2014		2015	2014	
Base payout rate	83.17	% 83.50	% (33 bps)	83.35	% 83.86	% (51 bps)
Production based bonuses	3.12	% 3.18	% (6 bps)	2.49	% 2.41	% 8 bps
GDC sensitive payout	86.29	% 86.68	% (39 bps)	85.84	% 86.27	% (43 bps)
Non-GDC sensitive payout	(0.89)	)% (0.01)	)% (88 bps)	(0.08)	)% 0.41	% (49 bps)
Total Payout Ratio	85.40	% 86.67	% (127 bps)	85.76	% 86.68	% (92 bps)

Production expenses for the three months ended September 30, 2015 compared with the same period in 2014 decreased, which correlates with the changes in our commission and advisory revenues during the same period. The change in non-GDC sensitive payout is attributable to decreased advisor share-based compensation, which is correlated to market movement in our stock as measured at the end of each quarter in the periods presented and the advisor non-qualified deferred compensation plan.

Production expenses for the nine months ended September 30, 2015 compared with the same period in 2014 decreased, which correlates with the changes in our commission and advisory revenues during the same period. The change in non-GDC sensitive payout ratio is attributable to decreased advisor share-based compensation correlating to market movement in our stock as measured at the end of each quarter in the periods presented and the advisor non-qualified deferred compensation plan.

#### Compensation and Benefits Expense

Compensation and benefits expense includes salaries and wages and related employee benefits and taxes for our employees (including share-based compensation), as well as compensation for temporary employees and consultants. The increase in compensation and benefits expense for the three months ended September 30, 2015 compared with the same period in 2014 was primarily driven by increases in salary that reflect our annual merit pay increase cycle and health care costs. The average number of full-time employees was consistent, at 3,394 for the three months ended September 30, 2015 compared to 3,386 for the three months ended September 30, 2014.

The increase in compensation and benefits expense for the nine months ended September 30, 2015 compared with the same period in 2014 was primarily driven by increases in salary that reflect our annual merit pay increase cycle, increases in health care costs, and a 1.5% increase in our average number of full-time employees from 3,320 for the nine months ended September 30, 2014 to 3,369 for the nine months ended September 30, 2015.

#### General and Administrative Expenses

General and administrative expenses include promotional, occupancy and equipment, professional services, communications and data processing, and other expenses. Promotional expenses include costs related to our hosting of certain advisor conferences that serve as training, sales, and marketing events, as well as recruiting costs such as transition assistance and amortization related to forgivable loans issued to advisors. Included in other expenses are the estimated costs of the investigation, settlement, and resolution of regulatory matters.

The decrease in general and administrative expenses for the three months ended September 30, 2015 compared with the same period in 2014 was primarily driven by decreases in charges related to estimated costs for the investigation, settlement, and resolution of regulatory matters.

The increase in general and administrative expenses for the nine months ended September 30, 2015 compared with the same period in 2014 was primarily driven by promotional expenses, offset by a decrease in charges related to estimated costs for the investigation, settlement, and resolution of regulatory matters.

#### Depreciation and Amortization Expense

Depreciation and amortization expense represents the benefits received for using long-lived assets. Those assets consist of intangible assets established through our acquisitions, as well as fixed assets, which include internally developed software, hardware, leasehold improvements, and other equipment.

The increase in depreciation and amortization for the three and nine months ended September 30, 2015 compared with the same periods in 2014 was due to the increased levels of capital expenditures in 2014 related to the relocation of our San Diego office building and the continuing development of capitalized software.

#### Restructuring Charges

Restructuring charges primarily represent expenses incurred as a result of our expansion of our Service Value Commitment initiative. These charges relate primarily to consulting fees paid to support our technology transformation as well as employee severance obligations and other related costs and non-cash charges for impairment. Also included in the restructuring charges are expenses incurred as part of our Fortigent restructuring. See Note 3. Restructuring, within the notes to the unaudited condensed consolidated financial statements for further detail.

#### Interest Expense

Interest expense represents non-operating interest expense for our senior secured credit facilities. Period over period variances correspond to changes in the level of outstanding indebtedness relating to these facilities.

#### Provision for Income Taxes

We estimate our full-year effective income tax rate at the end of each reporting period. This estimate is used in providing for income taxes on a year-to-date basis and may change in subsequent interim periods. The tax rate in any quarter can be affected positively and negatively by adjustments that are required to be reported in the quarter in which resolution of the item occurs. The effective income tax rates reflect the impact of state taxes, settlement contingencies, and expenses that are not deductible for tax purposes.

Our effective tax rate was 40.2% and 40.0% for the three months ended September 30, 2015 and 2014, respectively. The change between periods is due to the release of accruals for uncertain tax positions in 2014 due to the completion of state tax audits.

Our effective tax rate was 40.2% and 39.5% for the nine months ended September 30, 2015 and 2014, respectively. The change between periods is due to the release of accruals for uncertain tax positions in 2014 due to the completion of state tax audits and a decrease in the number of incentive stock options exercised in 2015 compared to the same period in 2014.

#### Liquidity and Capital Resources

Senior management establishes our liquidity and capital policies. These policies include senior management's review of short- and long-term cash flow forecasts, review of monthly capital expenditures, and daily monitoring of liquidity for our subsidiaries. Decisions on the allocation of capital are based upon, among other things, projected profitability and cash flow, risks of the business, regulatory capital requirements, and future liquidity needs for strategic activities. Our Treasury Department assists in evaluating, monitoring, and controlling the business activities that impact our financial condition, liquidity and capital structure and maintains relationships with various lenders. The objectives of these policies are to support the executive business strategies while ensuring ongoing and sufficient liquidity. On October 29, 2015, we announced planned changes in our capital management strategies related to our overall level of indebtedness and share repurchases, which are expected to affect our liquidity and capital resources beginning in the fourth quarter of 2015.

A summary of changes in our cash flow is provided as follows (in thousands):

	Nine Months Ended September 30,	
	2015	2014
Net cash flows provided by (used in):		
Operating activities	\$230,429	\$224,251
Investing activities	(75,158	) (80,114
Financing activities	(157,567	) (201,227
Net decrease in cash and cash equivalents	(2,296	) (57,090
Cash and cash equivalents — beginning of period	412,332	516,584
Cash and cash equivalents — end of period	\$410,036	\$459,494

Cash requirements and liquidity needs are primarily funded through our cash flow from operations and our capacity for additional borrowing.

Net cash provided by operating activities includes changes in operating asset and liability balances related to settlement and funding of client transactions, receivables from product sponsors, and accrued commission and advisory expenses due to our advisors. Operating assets and liabilities that arise from the settlement and funding of transactions by our advisors' clients are the principal drivers of changes to our net cash from operating activities and can fluctuate significantly from day to day and period to period depending on overall trends and clients' behaviors. The change in cash flows provided by operating activities for the nine months ended September 30, 2015 compared to the same period in 2014 was primarily due to increases in accounts payable and accrued liabilities relating to advisor deferred compensation and self-insurance, and increases in unearned revenues and deferred commissions, partially offset by uses of cash in receivables from others associated with advisor loans.

Changes in cash flows used in investing activities for the nine months ended September 30, 2015 as compared to the same period in 2014 were due primarily to the deposits of restricted cash relating to our captive insurance subsidiary, which was not established until the first quarter of 2015.

Changes in the cash flows used in financing activities for the nine months ended September 30, 2015 compared to the same period in 2014 were due to an increase in proceeds from our revolving credit facility.

We believe that based on current levels of operations and anticipated growth, cash flow from operations, together with other available sources of funds, which include three uncommitted lines of credit available and the revolving credit facility established through our amended credit agreement, will be adequate to satisfy our working capital needs, the payment of all of our obligations, and the funding of anticipated capital expenditures for the foreseeable future. In addition, we have certain capital adequacy requirements related to our registered broker-dealer entity and bank trust subsidiaries and have met all such requirements and expect to continue to do so for the foreseeable future. We regularly evaluate our existing indebtedness, including refinancing thereof, based on a number of factors, including our capital requirements, future prospects and business opportunities, contractual restrictions, the availability of refinancing on attractive terms, and general market conditions. On October 29, 2015, we announced an intention to increase our level of indebtedness and refinance a portion of our existing debt, which we expect to occur in the fourth quarter of 2015 subject to conditions in the debt capital markets and our ability to renegotiate certain terms of our existing credit agreement. See the Risks Related to our Debt section within Part I, "Item 1A. Risk Factors" in our 2014 Annual Report on Form 10-K for more information about the risks associated with our debt obligations and their potential effect on our liquidity.

#### Share Repurchases

The Board of Directors has historically approved several share repurchase programs pursuant to which we may repurchase issued and outstanding shares of our common stock. On October 29, 2015, we announced that the Board of Directors had authorized an increase to our current share repurchase program, which enables us to repurchase up to \$500 million of our shares from time to time. We also announced our intention to effectuate these purchases as quickly as practicable consistent with best execution, our general operating needs and applicable constraints under our credit agreement. These purchases may be effected in open market or privately negotiated transactions, which may include accelerated share repurchase programs or transactions with our affiliates, with the timing of purchases and the amount of stock purchased generally determined at our discretion. See Note 10.





Stockholders' Equity, within the the notes to the unaudited condensed consolidated financial statements for additional information regarding our share repurchases.

#### Dividends

The payment, timing, and amount of any dividends are subject to approval by our Board as well as certain limits under our credit facilities. See Note 10. Stockholders' Equity, within the notes to the unaudited condensed consolidated financial statements for additional information regarding our dividends. On October 25, 2015, the Board of Directors declared a cash dividend of \$0.25 per share on the Company's outstanding common stock to be paid on November 24, 2015 to stockholders of record on November 12, 2015.

#### Operating Capital Requirements

Our primary requirement for working capital relates to funds we loan to our advisors' clients for trading conducted on margin and funds we are required to maintain at clearing organizations to support these clients' trading activities. We have several sources of funds that enable us to meet increases in working capital requirements that relate to increases in client margin activities and balances. These sources include cash and cash equivalents on hand, cash and securities segregated under federal and other regulations, and proceeds from re-pledging or selling client securities in margin accounts. When a client purchases securities on margin or uses securities as collateral to borrow from us on margin, we are permitted, pursuant to the applicable securities industry regulations, to repledge, loan, or sell securities that collateralize those margin accounts. As of September 30, 2015, we had received collateral primarily in connection with client margin loans with a fair value of approximately \$344.6 million, which we can re-pledge, loan, or sell. Of these securities, approximately \$29.4 million were client-owned securities pledged to the Options Clearing Corporation as collateral to secure client obligations related to options positions. As of September 30, 2015 there were no restrictions that materially limited our ability to re-pledge, loan, or sell the remaining \$315.2 million of client collateral.

Our other working capital needs are primarily related to regulatory capital requirements at our broker-dealer and bank trust subsidiaries and software development, which we have satisfied in the past from internally generated cash flows. Notwithstanding the self-funding nature of our operations, we may sometimes be required to fund timing differences arising from the delayed receipt of client funds associated with the settlement of client transactions in securities markets. These timing differences are funded either with internally generated cash flow or, if needed, with funds drawn on our uncommitted lines of credit at our broker-dealer subsidiary LPL Financial, or under our revolving credit facility.

Our registered broker-dealer, LPL Financial, is subject to the SEC's Uniform Net Capital Rule, which requires the maintenance of minimum net capital. LPL Financial computes net capital requirements under the alternative method, which requires firms to maintain minimum net capital, as defined, equal to the greater of \$250,000 or 2.0% of aggregate debit balances arising from client transactions. At September 30, 2015, LPL Financial's excess net capital was \$146.6 million.

LPL Financial's ability to pay dividends greater than 10% of its excess net capital during any 35 day rolling period is subject to prior approval from FINRA. In addition, payment of dividends is restricted if LPL Financial's net capital would be less than 5.0% of aggregate customer debit balances.

LPL Financial also acts as an introducing broker for commodities and futures. Accordingly, its trading activities are subject to the National Futures Association's ("NFA") financial requirements and it is required to maintain net capital that is in excess of or equal to the greatest of NFA's minimum financial requirements. The NFA was designated by the Commodity Futures Trading Commission as LPL Financial's primary regulator for such activities. Currently, the highest NFA requirement is the minimum net capital calculated and required pursuant to the SEC's Uniform Net Capital Rule.

Our subsidiary, The Private Trust Company, N.A. ("PTC"), is also subject to various regulatory capital requirements. Failure to meet the respective minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have substantial monetary and non-monetary impacts on PTC's operations.

### Debt and Related Covenants

We are party to a debt agreement with our wholly-owned subsidiary, LPL Holdings, Inc., and other parties thereto (the "Credit Agreement"). See Note 8. Debt, within the notes to the unaudited condensed consolidated financial statements for further detail.

The Credit Agreement contains a number of covenants that, among other things, restrict, subject to certain exceptions, our ability to:

- incur additional indebtedness;
- create liens;
- enter into sale and leaseback transactions;
- engage in mergers or consolidations;
- sell or transfer assets;
- pay dividends and distributions or repurchase our capital stock;
- make investments, loans or advances;
- prepay certain subordinated indebtedness;
- engage in certain transactions with affiliates;
- amend material agreements governing certain subordinated indebtedness; and
- change our lines of business.

Our Credit Agreement prohibits us from paying dividends and distributions or repurchasing our capital stock except for limited purposes. In addition, our financial covenant requirements include a total leverage ratio test and an interest coverage ratio test. Under our total leverage ratio test, we covenant not to allow the ratio of our consolidated total debt (as defined) to an adjusted EBITDA reflecting financial covenants in our Credit Agreement to exceed certain prescribed levels set forth in the Credit Agreement. Under our interest coverage ratio test, we covenant not to allow the ratio of our Credit Agreement Adjusted EBITDA to our consolidated interest expense (as defined in the Credit Agreement) to be less than certain prescribed levels set forth in the Credit Agreement. Each of our financial ratios is measured at the end of each fiscal quarter.

As of September 30, 2015 we were in compliance with all of our covenant requirements. Our covenant requirements and actual ratios were as follows:

Financial Ratio	September 30, 2015	
	Covenant Requirement	Actual Ratio
Leverage Test (Maximum)	4.00	2.70
Interest Coverage (Minimum)	3.00	10.50

On October 29, 2015, we announced our intention to amend the Credit Agreement to provide for incremental upsizing of our credit facilities by up to \$700 million, extension of the maturity of certain or all currently outstanding term B loans (from March 2019 to March 2021), and modification of restrictive covenants to enable additional levels of indebtedness and execution of the full amount of the increased share repurchase authorization that was concurrently announced. We also announced an intention to maintain a leverage to net debt ratio of approximately four times adjusted EBITDA.

### Off-Balance Sheet Arrangements

We enter into various off-balance-sheet arrangements in the ordinary course of business, primarily to meet the needs of our advisors' clients. These arrangements include firm commitments to extend credit. For information on these arrangements, see Note 9. Commitments and Contingencies and Note 16. Financial Instruments with Off-Balance-Sheet Credit Risk and Concentrations of Credit Risk, within the notes to the unaudited condensed consolidated financial statements.

### Contractual Obligations

We are involved in a build-to-suit lease arrangement in Fort Mill, South Carolina, under which we serve as the construction agent on behalf of the landlord. Under such arrangement, we have obligations to fund cost over-runs in our capacity as the construction agent, and accordingly have determined that under lease accounting standards we bear substantially all of the risks and rewards of ownership as measured under GAAP. We are therefore required to report the landlord's costs of construction on our balance sheet as a fixed asset during the construction period as if we owned such asset. As of September 30, 2015, we have recorded \$43.2 million in fixed assets in connection with this arrangement and an equal and off-setting leasehold financing obligation on the unaudited condensed consolidated statement of financial condition. See Note 2. Summary of Significant Accounting Policies within the notes to the unaudited condensed consolidated financial statements for further detail as well as Risks Related to Our Business Generally section within Part I, "Item 1A. Risk Factors" in our 2014 Annual Report on Form 10-K for more information about the risks associated with this real estate development project.

In the three months ended September 30, 2015 there have been no material changes in our contractual obligations, other than in the ordinary course of business or as noted above, from those disclosed in our 2014 Annual Report on Form 10-K. See Note 8. Debt and Note 9. Commitments and Contingencies, within the notes to the unaudited condensed consolidated financial statements, as well as the Contractual Obligations section within Part II, "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our 2014 Annual Report on Form 10-K, for further detail on operating lease obligations and obligations under noncancelable service contracts.

### Fair Value of Financial Instruments

We use fair value measurements to record certain financial assets and liabilities at fair value and to determine fair value disclosures.

We use prices obtained from an independent third-party pricing service to measure the fair value of our trading securities. We validate prices received from the pricing service using various methods including, comparison to prices received from additional pricing services, comparison to available market prices and review of other relevant market data including implied yields of major categories of securities.

At September 30, 2015, we did not adjust prices received from the independent third-party pricing service. For certificates of deposit and treasury securities, we utilize market-based inputs including observable market interest rates that correspond to the remaining maturities or next interest reset dates.

### Critical Accounting Policies and Estimates

In the notes to our consolidated financial statements and in "Item 7-Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our 2014 Annual Report on Form 10-K, we have disclosed those accounting policies that we consider to be significant in determining our results of operations and financial condition. There have been no material changes to those policies that we consider to be significant since the filing of our 2014 Annual Report on Form 10-K. The accounting principles used in preparing our unaudited condensed consolidated financial statements conform in all material respects to GAAP.

### Recently Issued Accounting Pronouncements

Refer to Note 2. Summary of Significant Accounting Policies, within the notes to the condensed consolidated financial statements for a discussion of recent accounting pronouncements or changes in accounting pronouncements that are of significance, or potential significance, to us.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

#### Market Risk

We maintain trading securities owned and securities sold, but not yet purchased in order to facilitate client transactions, to meet a portion of our clearing deposit requirements at various clearing organizations, and to track the performance of our research models. These securities could include mutual funds, debt securities issued by the U.S. government, money market funds, corporate debt securities, certificates of deposit, and equity securities. Changes in the value of our trading inventory may result from fluctuations in interest rates, credit ratings of the issuer, equity prices, and the correlation among these factors. We manage our trading inventory by product type. Our activities to facilitate client transactions generally involve mutual fund activities, including dividend reinvestments. The balances are based upon pending client activities, which are monitored by our Service, Trading,



and Operations (formerly known as Client Support Services) department. Because these positions arise from pending client transactions, there are no specific trading or position limits. Positions held to meet clearing deposit requirements consist of U.S. government securities. The amount of securities deposited depends upon the requirements of the clearing organization. The level of securities deposited is monitored by the settlement area within our Service, Trading, and Operations department. Our research department develops model portfolios that are used by advisors in developing client portfolios. We currently maintain approximately 194 accounts based on model portfolios. At the time a portfolio is developed, we purchase securities in the same weighting as we would for a client account. Account minimums vary by product and can range from \$5,000 to \$250,000 per model. We utilize these positions to track the performance of the research department. The limits on this activity are based at the inception of each new model. At September 30, 2015, the fair value of our trading securities owned were \$16.6 million. Securities sold, but not yet purchased were immaterial at September 30, 2015. The fair value of securities included within other assets were \$97.9 million at September 30, 2015. See Note 4. Fair Value Measurements, within the notes to the unaudited condensed consolidated financial statements for information regarding the fair value of trading securities owned, securities sold, but not yet purchased, and other assets associated with our client facilitation activities. See Note 5. Held-to-Maturity Securities, within the notes to the unaudited condensed consolidated financial statements for information regarding the fair value of securities held to maturity.

We do not enter into contracts involving derivatives or other similar financial instruments for proprietary trading purposes.

We also have market risk on the fees we earn that are based on the market value of advisory and brokerage assets, assets on which trailing commissions are paid, and assets eligible for sponsor payments.

#### Interest Rate Risk

We are exposed to risk associated with changes in interest rates. As of September 30, 2015, all of the outstanding debt under our Credit Agreement, \$1.7 billion, was subject to floating interest rate risk. While our senior secured term loans are subject to increases in interest rates, we do not believe that a short-term change in interest rates would have a material impact on our income before taxes given assets owned, which are subject to the same, but off-setting interest rate risk.

The following table summarizes the impact of increasing interest rates on our interest expense from the variable portion of our debt outstanding at September 30, 2015 (in thousands):

	Outstanding at Variable Interest Rates	Annual Impact of an Interest Rate Increase of 10 Basis Points	25 Basis Points	50 Basis Points	100 Basis Points
Senior Secured Credit Facilities					
Term Loan A	\$459,375	\$459	\$1,148	\$2,297	\$4,594
Term Loan B	1,056,754	—	174	2,534	7,797
Revolving Credit Facility	150,000	150	375	750	1,500
Variable Rate Debt Outstanding	\$1,666,129	\$609	\$1,697	\$5,581	\$13,891

See Note 8. Debt, within the notes to the unaudited condensed consolidated financial statements for additional information.

We offer our advisors and their clients two primary cash sweep programs that are interest rate sensitive: our insured cash programs and money market sweep vehicles involving multiple money market fund providers. Our insured cash programs use multiple non-affiliated banks to provide up to \$1.5 million (\$3.0 million in joint accounts) of FDIC insurance for client deposits custodied at the banks. While clients earn interest for balances on deposit in the insured cash programs, we earn a fee. Our fees from the insured cash programs are based on prevailing interest rates in the current interest rate environment. Changes in interest rates and fees for the insured cash programs are monitored by our fee and rate setting committee (the "FRS committee"), which governs and approves any changes to our fees. By meeting promptly after interest rates change, or for other market or non-market reasons, the FRS committee balances financial risk of the insured cash programs with products that offer competitive client yields. However, as short-term interest rates hit lower levels, the FRS committee may be compelled to lower fees.

The average Federal Reserve effective federal funds rate (“FFER”) for the three months ended September 30, 2015 was 0.14%. The following table reflects the approximate annual impact to asset-based revenues on our insured cash programs (assuming that client balances at September 30, 2015 remain unchanged) of an upward or downward change in short-term interest rates of one basis point (dollars in thousands):

Federal Reserve Effective Federal Funds Rate	Annualized Increase or Decrease in Asset-Based Revenues per One Basis Point Change	
0.00% - 0.25%		\$1,900
0.26% - 1.25%		\$1,000
1.26% - 2.80%		\$900

The actual impact to asset-based revenues, including a change in the FFER of greater than 2.8%, may vary depending on the FRS committee's strategy in response to a change in interest rate levels, the significance of a change, and actual balances at the time of such change.

#### Credit Risk

Credit risk is the risk of loss due to adverse changes in a borrower's, issuer's, or counterparty's ability to meet its financial obligations under contractual or agreed upon terms. Credit risk includes the risk that collateral posted with LPL Financial by clients of our advisors to support margin lending or derivative trading is insufficient to meet such client's contractual obligations to LPL Financial. We bear credit risk on the activities of our advisors' clients, including the execution, settlement and financing of various transactions on behalf of these clients.

These activities are transacted on either a cash or margin basis. Our credit exposure in these transactions consists primarily of margin accounts, through which we extend credit to advisors' clients collateralized by cash (for purposes of margin lending, cash is not used as collateral) and securities in the client's account. Under many of these agreements, we are permitted to sell, re-pledge or loan these securities held as collateral and use these securities to enter into securities lending arrangements or to deliver to counterparties to cover short positions.

As our advisors execute margin transactions on behalf of their clients, we may incur losses if clients do not fulfill their obligations, the collateral in clients' accounts is insufficient to fully cover losses from such investments, and our advisors fail to reimburse us for such losses. Our losses on margin accounts were immaterial and did not exceed \$0.1 million during the nine months ended September 30, 2015 and 2014. We monitor exposure to industry sectors and individual securities and perform analyses on a regular basis in connection with our margin lending activities. We adjust our margin requirements if we believe our risk exposure is not appropriate based on market conditions.

We are subject to concentration risk if we extend large loans to or have large commitments with a single counterparty, borrower, or group of similar counterparties or borrowers (e.g. in the same industry), or if we accept a concentrated position as collateral for a margin loan. Receivables from and payables to clients and stock borrowing and lending activities are conducted with a large number of clients and counterparties and potential concentration is carefully monitored. We seek to limit this risk through careful review of the underlying business and the use of limits established by senior management, taking into consideration factors including the financial strength of the counterparty, the size of the position or commitment, the expected duration of the position or commitment and other positions or commitments outstanding.

#### Operational Risk

Operational risk is defined as the risk of loss resulting from failed or inadequate processes or systems, actions by people, or external events. We operate in diverse markets and are reliant on the ability of our employees and systems, as well as third-party service providers and their systems, to process a large number of transactions effectively. These risks are less direct and quantifiable than credit and market risk, but managing them is critical, particularly in a rapidly changing environment with increasing transaction volumes and in light of increasing reliance on third-party service providers. In the event of a breakdown or improper operation of systems or improper action by employees, advisors or third-party service providers, we could suffer financial loss, data loss, regulatory sanctions, and damage to our reputation. Business continuity plans exist for critical systems, and redundancies are built into the systems as deemed appropriate. In order to assist in the mitigation and control of operational risk, we have an Operational Risk Management department and framework that enables assessment and reporting on operational risk across the firm. This framework helps ensure policies and procedures are in place and appropriately designed to identify and manage operational risk at appropriate levels throughout our organization and within various departments. These control

mechanisms attempt to ensure that operational policies and procedures are being

42

---

followed and that our employees and advisors operate within established corporate policies and limits. Notwithstanding the foregoing, please consult the Risks Related to our Technology section within Part I, “Item 1A. Risk Factors” in our 2014 Annual Report on Form 10-K for more information about the risks associated with our technology, including risks related to security, and the potential related effects on our operations.

#### Regulatory and Legal Risk

The regulatory environment in which we operate is discussed in detail within Part I, “Item 1, Business Section” in our 2014 Annual Report on Form 10-K. In recent years, and during the period presented in this Quarterly Report on Form 10-Q, we have observed regulators broaden the scope, frequency, and depth of their examinations to include greater emphasis on the quality and consistency of the industry’s execution of policies and procedures. Please consult the Risks Related to Our Regulatory Environment section within Part I, “Item 1A. Risk Factors” in our 2014 Annual Report on Form 10-K for more information about the risks associated with operating within our regulatory environment, and the potential related effects on our operations.

#### Risk Management

We employ an enterprise risk management framework (“ERM”) that is intended to address key risks and responsibilities, enable us to execute our business strategy, and protect our Company and its franchise. Our framework is designed to promote clear lines of risk management accountability and a structured escalation process for key risk information and events.

Our risk management governance approach includes the Board and certain of its committees; the Management Committee and business line management of our broker-dealer subsidiary LPL Financial; the Risk Oversight Committee (the “ROC”) of LPL Financial and its subcommittees; the Internal Audit Department of LPL Financial; and the Governance, Risk, and Compliance (“GRC”) Department of LPL Financial. We regularly reevaluate and, when necessary, modify our processes to improve the identification and escalation of risks and events.

#### Audit Committee of the Board

In addition to its other responsibilities, the Audit Committee of the Board (the “Audit Committee”) reviews our policies with respect to risk assessment and risk management, as well as our major financial risk exposures and the steps management has undertaken to control them. The Audit Committee provides reports to the Board at each of the Board’s regularly scheduled quarterly meetings.

#### Compensation and Human Resources Committee of the Board

In addition to its other responsibilities, the Compensation and Human Resources Committee of the Board assesses whether our compensation arrangements encourage inappropriate risk-taking, and whether risks arising from our compensation arrangements are reasonably likely to have a material adverse effect on the Company.

#### Risk Oversight Committee of LPL Financial

The Audit Committee has mandated that the ROC oversee our risk management activities, including those of our subsidiaries. The Chief Risk Officer of LPL Financial serves as chair, and our Executive Vice President, Deputy General Counsel, Regulatory Counseling, serves as vice chair, of the ROC, which generally meets on a monthly basis with ad hoc meetings as necessary. Each member of the Management Committee of LPL Financial and all other Managing Directors serve on the ROC. Additional members of the Company’s senior management team are also included as ex-officio members, representing the key control areas of the Company. These individuals include, but are not limited to, the Chief Compliance Officer, Brokerage; the Chief Compliance Officer, Advisory; the Chief Information Security Officer; and the Chief Privacy Officer of LPL Financial. Participation in the ROC by senior officers is intended to ensure that the ROC covers the key risk areas of the Company, including its subsidiaries, and that the ROC thoroughly reviews significant matters relating to risk priorities, policies, control procedures and related exceptions, certain new and complex products and business arrangements, transactions with significant risk elements, and identified emerging risks.

The chair of the ROC provides reports to the Audit Committee at each of the Audit Committee’s regularly scheduled quarterly meetings and, as necessary or requested, to the Board. The reports generally cover topics addressed by the ROC at its meetings since the immediately preceding report. If warranted, matters of material risk are escalated to the Audit Committee or Board more frequently.





#### Subcommittees of the Risk Oversight Committee

The ROC has established multiple subcommittees that cover key areas of risk. The subcommittees meet regularly and are responsible for keeping the ROC informed and escalating issues in accordance with the Company's escalation policies. The responsibilities of such subcommittees include, for example, oversight of the approval of new and complex investment products offered to advisors' clients; oversight of the Company's investment advisory business; issues and trends related to advisor compliance and examination findings; whistle-blower hotline allegations; and oversight of disclosures related to our financial reporting.

#### Internal Audit Department

The Internal Audit Department provides independent verification of the effectiveness of the Company's internal controls by conducting risk assessments and audits designed to identify and cover important risk categories. The Internal Audit Department provides regular reports to the ROC and reports to the Audit Committee at least as often as quarterly.

#### Control Groups

The GRC Department provides compliance oversight and guidance, and conducts various risk and other assessments to address regulatory and Company-specific risks and requirements. The GRC Department reports to the Chief Risk Officer, who reviews the results of the Company's risk management process with the ROC, the Audit Committee, and the Board as necessary. We also consider the Internal Audit Department to be a control group.

#### Business Line Management

Each business line is responsible for managing its risk, and business line management is responsible for keeping senior management, including the members of the ROC, informed of operational risk and escalating risk matters (as defined by the Company's escalation policies). We have conducted Company-wide escalation training for our employees. Certain business lines, including Service, Trading, and Operations and Business Technology Services, have dedicated personnel with responsibilities for monitoring and managing risk-related matters. Business lines are subject to oversight by the control groups, and the Finance, Legal, Business Technology Services, and Human Capital Departments also execute certain control functions and report matters to the ROC, Audit Committee, and Board as appropriate.

#### Policy Committee and Advisor Policies

In addition to the ERM framework, the Management Committee of LPL Financial has established a Policy Committee to provide a centralized decision-making process for material policy issues that may arise on an ad hoc basis. The membership of the Policy Committee consists of a subset of the Management Committee and currently includes: the President, who serves as chair of the Policy Committee; the Managing Director, Legal & Government Relations; the Managing Director, Chief Risk Officer; and the Managing Director, Investment and Planning Solutions. Among other issues, the Policy Committee addresses policy conflicts and potential conflicts that may arise from time to time from legal and regulatory requirements, business proposals, and practices throughout the Company as they relate to advisor-facing or public-facing issues. The Policy Committee is responsible for analyzing such issues, and either facilitating the policy decision or conflict resolution, or making the policy decision. The Policy Committee reports the results of its decisions or other resolutions to the Management Committee on an ad hoc basis.

We also have written policies and procedures that govern the conduct of business by our advisors, employees, and the terms and conditions of our relationships with product manufacturers. Our client and advisor policies address the extension of credit for client accounts, data and physical security, compliance with industry regulation, and codes of ethics to govern employee and advisor conduct, among other matters.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Our Disclosure Committee, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective.



**Change in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the third quarter ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

45

---

## PART II — OTHER INFORMATION

## Item 1. Legal Proceedings

We are involved from time to time in routine legal proceedings occurring in the ordinary course of business. In the opinion of management, there are no matters outstanding that would have a material adverse impact on our operations or financial condition. For a discussion of legal proceedings, see Note 9. Commitments and Contingencies, within the notes to the unaudited condensed consolidated financial statements for disclosure of matters related to regulatory matters.

## Item 1A. Risk Factors

There have been no material changes in the information regarding the Company's risks, as set forth under Part I, "Item 1A. Risk Factors" in the Company's 2014 Annual Report on Form 10-K.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The table below sets forth information regarding repurchases on a monthly basis during the three months ended September 30, 2015:

Period	Total Number of Shares Purchased	Weighted Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs(1)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Programs
July 1, 2015 through July 31, 2015	—	\$—	—	\$177,158,921
August 1, 2015 through August 31, 2015	593,868	\$42.12	593,868	\$152,158,982
September 1, 2015 through September 30, 2015	—	\$—	—	\$152,158,982
July 1, 2015 through September 30, 2015	593,868		593,868	\$152,158,982

(1) See Note 10. Stockholders' Equity, within the notes to the unaudited condensed consolidated financial statements for additional information.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

- 3.1 Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.1 to the registration statement on Form S-1 (File Number 333-167325) on July 9, 2010, and incorporated herein by reference)
- 3.2 Certificate of Ownership and Merger (previously filed as Exhibit 3.1 to the Current Report on Form 8-K (File Number 001-34963) on June 19, 2012, and incorporated herein by reference)
- 3.3 Certificate of Amendment to the Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.1 to the Current Report on Form 8-K (File Number 001-34963) on May 9, 2014, and incorporated herein by reference)
- 3.4 Fifth Amended and Restated Bylaws (previously filed as Exhibit 3.1 to the Current Report on Form 8-K (File Number 001-34963) on March 12, 2014 and incorporated herein by reference)
- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)\*
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)\*
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Taxonomy Extension Calculation
- 101.LAB XBRL Taxonomy Extension Label
- 101.PRE XBRL Taxonomy Extension Presentation
- 101.DEF XBRL Taxonomy Extension Definition

---

\* Filed herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LPL Financial Holdings Inc.

Date: October 29, 2015

By: /s/ MARK S. CASADY  
Mark S. Casady  
Chairman and Chief Executive Officer

Date: October 29, 2015

By: /s/ MATTHEW J. AUDETTE  
Matthew J. Audette  
Chief Financial Officer