LPL Financial Holdings Inc.
Form 10-Q
October 30, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2014

or

o 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	20-3717839
(State or other jurisdiction of incorporation or organization)	(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. x Yes o 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). x Yes o 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 x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of Common Stock, par value $0.001 per share, outstanding as of October 27, 2014 was 98,808,921.

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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), 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, plans, liquidity, future share repurchases, and future dividends, including statements regarding projected savings, projected expenses, and anticipated improvements to the Company's operating model, services, and technology as a result of the Service Value Commitment, 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 30, 2014. The words “anticipates,” “believes,” “expects,” “may,” “plans,” “predicts,” “will” and sim 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 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; the Company's success in integrating the operations of acquired businesses; execution of the Company's plans related to the Service Value Commitment, including the Company's ability to successfully transform and transition business processes to third party service providers; the Company's success in negotiating and developing commercial arrangements with third party service providers that will enable the Company to realize the service improvements and efficiencies expected to result from the Service Value Commitment; the performance of third party service providers to which business processes are transitioned from the Company; 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 2013 Annual Report on Form 10-K, as may be amended or updated in our 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 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.

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,	
	2014	2013	2014	2013
REVENUES:				
Commission	$520,388	$527,419	$1,590,139	$1,521,390
Advisory	340,369	299,101	998,016	878,421
Asset-based	121,283	107,447	354,494	318,718
Transaction and fee	94,674	93,799	276,284	271,808
Interest income, net of interest expense	4,727	4,509	14,279	13,343
Other	7,793	20,937	36,182	43,248
Total net revenues	1,089,234	1,053,212	3,269,394	3,046,928
EXPENSES:				
Commission and advisory	746,001	724,835	2,242,206	2,086,075
Compensation and benefits	106,290	102,310	317,459	299,317
Promotional	36,669	36,807	93,581	85,276
Depreciation and amortization	24,519	21,432	70,618	61,451
Occupancy and equipment	19,043	16,568	62,922	49,649
Professional services	38,174	18,955	82,736	47,588
Brokerage, clearing and exchange	12,090	11,360	36,594	32,958
Communications and data processing	11,476	11,017	32,598	31,401
Regulatory fees and other	8,476	8,234	25,437	23,339
Restructuring charges	9,928	6,482	26,473	19,851
Other	8,218	20,547	25,958	37,116
Total operating expenses	1,020,884	978,547	3,016,582	2,774,021
Non-operating interest expense	12,897	13,363	38,651	38,190
Loss on extinguishment of debt	—	—	—	7,962
Total expenses	1,033,781	991,910	3,055,233	2,820,173
INCOME BEFORE PROVISION FOR INCOME TAXES	55,453	61,302	214,161	226,755
PROVISION FOR INCOME TAXES	22,181	23,671	84,663	89,316
NET INCOME	$33,272	$37,631	$129,498	$137,439
EARNINGS PER SHARE (NOTE 12)				
Earnings per share, basic	$0.33	$0.36	$1.29	$1.30
Earnings per share, diluted	$0.33	$0.36	$1.26	$1.29
Weighted-average shares outstanding, basic	100,052	104,271	100,519	105,670
Weighted-average shares outstanding, diluted	101,834	105,705	102,384	106,934

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,	
	2014	2013	2014	2013
NET INCOME	$33,272	$37,631	$129,498	$137,439
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on cash flow hedges, net of tax expense (benefit) of ($63), ($155), $863, and ($155) for the three and nine months ended September 30, 2014 and 2013, respectively	(101)	(250)	1,361	(250)
Reclassification adjustment for realized gain on cash flow hedges included in net income, net of tax expense of $85, $0, $113, and $0 for the three and nine months ended September 30, 2014 and 2013, respectively	(135)	—	(180)	—
Total other comprehensive income (loss), net of tax	(236)	(250)	1,181	(250)
TOTAL COMPREHENSIVE INCOME	$33,036	$37,381	$130,679	$137,189

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, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$459,494	$516,584
Cash and securities segregated under federal and other regulations	418,507	512,351
Receivables from:		
Clients, net of allowance of $1,237 at September 30, 2014 and $588 at December 31, 2013	342,304	373,675
Product sponsors, broker-dealers and clearing organizations	178,439	174,070
Others, net of allowance of $9,383 at September 30, 2014 and $7,091 at December 31, 2013	281,411	272,018
Securities owned:		
Trading — at fair value	12,926	8,964
Held-to-maturity	9,345	6,853
Securities borrowed	8,327	7,102
Income taxes receivable	25,404	—
Fixed assets, net of accumulated depreciation and amortization of $300,823 at September 30, 2014 and $263,321 at December 31, 2013	207,413	189,059
Debt issuance costs, net of accumulated amortization of $10,991 at September 30, 2014 and $7,751 at December 31, 2013	13,040	16,281
Goodwill	1,365,838	1,361,361
Intangible assets, net of accumulated amortization of $295,332 at September 30, 2014 and $266,285 at December 31, 2013	440,526	464,522
Other assets	155,193	139,991
Total assets	$3,918,167	$4,042,831
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Drafts payable	$135,095	$194,971
Payables to clients	565,221	565,204
Payables to broker-dealers and clearing organizations	38,315	43,157
Accrued commission and advisory expenses payable	143,024	135,149
Accounts payable and accrued liabilities	287,219	301,644
Income taxes payable	—	4,320
Unearned revenue	68,817	73,739
Securities sold, but not yet purchased — at fair value	18	211
Senior secured credit facilities	1,526,967	1,535,096
Deferred income taxes, net	90,119	89,369
Total liabilities	2,854,795	2,942,860
Commitments and contingencies		
STOCKHOLDERS' EQUITY:		
Common stock, $.001 par value; 600,000,000 shares authorized; 118,124,141 shares issued at September 30, 2014 and 117,112,465 shares issued at December 31, 2013	118	117
Additional paid-in capital	1,346,701	1,292,374
	(655,822)	(506,205)

Treasury stock, at cost — 18,187,765 shares at September 30, 2014 and 15,216,301 shares at December 31, 2013		
Accumulated other comprehensive income	1,296	115
Retained earnings	371,079	313,570
Total stockholders’ equity	1,063,372	1,099,971
Total liabilities and stockholders’ equity	$3,918,167	$4,042,831

See notes to unaudited condensed consolidated financial statements.

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders’ Equity
(Unaudited)
(In thousands)

	Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount		Shares	Amount			
BALANCE — December 31, 2012	115,714	$116	$1,228,075	9,422	$(287,998)	$ —	$199,827	$1,140,020
Net income and other comprehensive loss, net of tax expense						(250)	137,439	137,189
Treasury stock purchases				4,910	(184,318)			(184,318)
Cash dividends on common stock							(48,672)	(48,672)
Stock option exercises and other	1,140	1	27,623	(19)	663		(98)	28,189
Share-based compensation			17,330					17,330
Excess tax benefits from share-based compensation			1,919					1,919
BALANCE — September 30, 2013	116,854	$117	$1,274,947	14,313	$(471,653)	$ (250)	$288,496	$1,091,657
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			7,537					7,537

compensation								
BALANCE — September 30, 2014	118,124	$118	$1,346,701	18,188	$(655,822)	$1,296	$371,079	$1,063,372

See notes to unaudited condensed consolidated financial statements.

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LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

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

	Nine Months Ended September 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$129,498	$137,439
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Noncash items:		
Depreciation and amortization	70,618	61,451
Amortization of debt issuance costs	3,241	3,285
Share-based compensation	22,649	17,330
Loss on disposal of fixed assets	1,282	154
Excess tax benefits related to share-based compensation	(7,666)	(1,919)
Provision for bad debts	2,124	1,911
Deferred income tax provision	585	(9,850)
Loss on extinguishment of debt	—	7,962
Net changes in estimated fair value of contingent consideration obligations	—	4,131
Loan forgiveness	20,326	1,001
Closure of NestWise	—	9,294
Other	2,057	731
Changes in operating assets and liabilities:		
Cash and securities segregated under federal and other regulations	93,844	149,390
Receivables from clients	30,723	28,447
Receivables from product sponsors, broker-dealers and clearing organizations	(4,369)	368
Receivables from others	(31,195)	(14,472)
Securities owned	(3,999)	(1,373)
Securities borrowed	(1,225)	(1,168)
Other assets	(8,534)	625
Drafts payable	(59,876)	(24,981)
Payables to clients	17	(211,422)
Payables to broker-dealers and clearing organizations	(4,842)	(29,988)
Accrued commission and advisory expenses payable	7,875	142
Accounts payable and accrued liabilities	(11,580)	13,697
Income taxes receivable/payable	(22,187)	(1,896)
Unearned revenue	(4,922)	1,666
Securities sold, but not yet purchased	(193)	(48)
Net cash provided by operating activities	$224,251	$141,907

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LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

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

	Nine Months Ended September 30, 2014	2013
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	$(69,830)	$(40,787)
Purchase of intangible assets	(9,000)	—
Proceeds from disposal of fixed assets	7,123	—
Purchase of securities classified as held-to-maturity	(6,749)	(2,495)
Proceeds from maturity of securities classified as held-to-maturity	4,250	5,900
Deposits of restricted cash	(6,049)	(1,500)
Release of restricted cash	141	613
Purchases of minority interest investments	—	(2,500)
Net cash used in investing activities	(80,114)	(40,769)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of senior secured credit facilities	(8,129)	(863,869)
Proceeds from senior secured credit facilities	—	1,078,957
Payment of debt issuance costs	—	(2,461)
Payment of contingent consideration	(3,300)	—
Tax payments related to settlement of restricted stock units	(673)	—
Repurchase of common stock	(150,021)	(175,722)
Dividends on common stock	(72,104)	(48,672)
Excess tax benefits related to share-based compensation	7,666	1,919
Proceeds from stock option exercises and other	25,334	28,189
Net cash (used in) provided by financing activities	(201,227)	18,341
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(57,090)	119,479
CASH AND CASH EQUIVALENTS — Beginning of period	516,584	466,261
CASH AND CASH EQUIVALENTS — End of period	$459,494	$585,740
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid	$38,877	$38,433
Income taxes paid	$109,805	$100,999
NONCASH DISCLOSURES:		
Fixed assets acquired under build-to-suit lease	$8,114	$9,088
Discount on proceeds from senior secured credit facilities recorded as debt issuance costs	$—	$4,893
Pending settlement of treasury stock purchases	$—	$8,596

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, 2013, 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, 2013. There have been no significant changes to these accounting policies during the first nine months of 2014.

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 qualify as individual operating segments and are aggregated and viewed as one reportable segment due to their similar economic characteristics, products and services, production and distribution processes, and regulatory environment.

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, 2014, the carrying amount and fair value of the Company's indebtedness was approximately $1,527.0 million and $1,513.1 million, respectively. As of December 31, 2013, the carrying amount and fair value was approximately $1,535.1 million and $1,533.3 million, respectively.

Recently Issued Accounting Pronouncements

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

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

3. Restructuring

In February 2013, the Company committed to an expansion of its Service Value Commitment (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 Company estimates total charges in connection with the Program will approach $65.0 million. These expenditures are comprised of 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 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, 2014 (in thousands):

	Accrued Balance at December 31, 2013	Costs Incurred	Payments	Accrued Balance at September 30, 2014	Cumulative Costs Incurred to Date	Total Expected Restructuring Costs
Outsourcing and other related costs	$1,424	$5,045	$(6,106)	$363	$20,326	$26,000
Technology transformation costs	1,753	15,954	(14,252)	3,455	25,223	27,000
Employee severance obligations and other related costs	820	4,363	(1,595)	3,588	6,821	11,000
Asset impairments	—	—	—	—	842	1,000
Total	$3,997	$25,362	$(21,953)	$7,406	$53,212	$65,000

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, 2014.

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, 2014, 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, 2014, 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 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, 2014 (in thousands):

	Level 1	Level 2	Level 3	Total
At September 30, 2014:				
Assets				
Cash equivalents	$109,742	$—	$—	$109,742
Securities owned — trading:				
Money market funds	310	—	—	310
Mutual funds	7,497	—	—	7,497
Equity securities	250	—	—	250
Debt securities	—	69	—	69
U.S. treasury obligations	4,800	—	—	4,800
Total securities owned — trading	12,857	69	—	12,926
Other assets	71,145	4,709	—	75,854
Total assets at fair value	$193,744	$4,778	$—	$198,522
Liabilities				
Securities sold, but not yet purchased:				
Equity securities	$8	$—	$—	$8
Debt securities	—	10	—	10
Total securities sold, but not yet purchased	8	10	—	18
Accounts payable and accrued liabilities	—	—	527	527
Total liabilities at fair value	$8	$10	$527	$545

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, 2013 (in thousands):

	Level 1	Level 2	Level 3	Total
At December 31, 2013:				
Assets				
Cash equivalents	$254,032	$—	$—	$254,032
Securities owned — trading:				
Money market funds	170	—	—	170
Mutual funds	7,291	—	—	7,291
Equity securities	103	—	—	103
U.S. treasury obligations	1,400	—	—	1,400
Total securities owned — trading	8,964	—	—	8,964
Other assets	47,539	3,072	—	50,611
Total assets at fair value	$310,535	$3,072	$—	$313,607
Liabilities				
Securities sold, but not yet purchased:				
Mutual funds	$63	$—	$—	$63
Equity securities	127	—	—	127
Debt securities	—	10	—	10
Certificates of deposit	—	11	—	11
Total securities sold, but not yet purchased	190	21	—	211
Accounts payable and accrued liabilities	—	—	39,293	39,293
Total liabilities at fair value	$190	$21	$39,293	$39,504

Changes in Level 3 Recurring Fair Value Measurements

As of December 31, 2013, the Company had a contingent consideration obligation related to the acquisition of National Retirement Partners, Inc. (“NRP”). This obligation was based on the achievement of certain revenue-based targets for the twelve-month period ended November 30, 2013, in aggregate for those advisors joining LPL Financial LLC (“LPL Financial”) subsequent to the NRP acquisition for whom retirement plans comprise a significant part of their business. As of December 31, 2013, the Company had finalized the determination of the amount of contingent consideration to be paid to the former shareholders of NRP, resulting in a total payment of $39.3 million, which was made on February 19, 2014.

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, gross margin, EBITDA, and assets under custody. 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.

The principal significant unobservable input used in the valuations of the Company's contingent consideration obligations is a risk-adjusted discount rate. Whereas management's underlying projections adjust for market penetration and adoption rates, the discount rate is risk-adjusted for key factors such as advisor attrition, advisor recruitment, expenses and overhead costs, average client assets, revenue generation of client assets, and credit risk. An increase in the discount rate will result in a decrease in the fair value of contingent consideration. Conversely, a decrease in the discount rate will result in an increase in the fair value of contingent consideration.

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

	September 30, 2014	December 31, 2013
Amortized cost	$9,345	$6,853
Gross unrealized loss	(28)	(58)
Fair value	$9,317	$6,795

At September 30, 2014, 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	$3,849	$4,996	$500	$9,345
U.S. government notes — at fair value	$3,850	$4,982	$485	$9,317

6. Derivative Financial Instruments

In May 2013, in conjunction with its Service Value Commitment program, 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 anniversary 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 that will be reclassified out of accumulated other comprehensive income and recognized in net income ratably over a 12-month period ending May 31, 2015 to match the timing of the underlying hedged item.

The details related to the remaining non-deliverable foreign currency contracts at September 30, 2014 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 #2	6/2/2015	560.4	69.35	$8.1
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				$23.4

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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, 2014	December 31, 2013
Cash flow hedges	$1,549	$187

7. Goodwill and Other Intangible Assets

Goodwill and intangible assets were a result of various acquisitions. See Note 9. Goodwill and Other Intangible Assets, in the Company's 2013 Annual Report on Form 10-K for a discussion of the components of goodwill and additional information regarding intangible assets.

8. Debt

Senior Secured Credit Facilities — On May 13, 2013, the Company entered into the First Amendment and Incremental Assumption Agreement (“Credit Agreement”) with its wholly owned subsidiary, LPL Holdings, Inc., and other parties thereto. The Credit Agreement amended the Company's previous credit agreement, which was dated March 29, 2012. See Note 17. Subsequent Events, for details regarding the amendment of the Credit Agreement.

The Credit Agreement provides for a term loan A (“Term Loan A”), a term loan B (“Term Loan B”), and a revolving credit facility (“Revolving Credit Facility”). Term Loan A had an initial principal amount of $459.4 million maturing on March 29, 2017; Term Loan B had an initial principal amount of $1,083.9 million maturing on March 29, 2019; and the Revolving Credit Facility has a borrowing capacity of $250.0 million maturing on March 29, 2017.

At the time the Company entered into the Credit Agreement, all mandatory payments required under Term Loan A were prepaid, with the remaining principal and accrued interest due upon maturity. Term Loan B includes quarterly payments at an annual rate of 1.0% of principal per year, with the remaining principal and accrued interest due upon maturity.

Borrowings under Term Loan A and Term Loan B bear interest at a base rate equal to a LIBOR based rate (the “Eurodollar Rate”) plus the applicable interest rate margin, or an alternative base rate (“ABR”) plus the applicable interest rate margin. The Eurodollar Rate with respect to Term Loan B shall in no event be less than 0.75%. The ABR is equal to the greatest of (a) the prime rate in effect on such day; (b) the effective federal funds rate in effect on such day plus 0.50%; (c) the Eurodollar Rate plus 1.00%; or (d) solely in the case of Term Loan B, 1.75%. The Company may repay outstanding loans under its Credit Agreement at any time without premium or penalty, other than customary “breakage” costs with respect to Eurodollar Rate loans.

As of September 30, 2014, borrowings under the term loans bore interest at the Eurodollar Rate with an applicable interest rate margin of 2.50%. The Company’s outstanding borrowings were as follows (dollars in thousands):

		September 30, 2014			December 31, 2013		
	Maturity	Balance	Interest Rate		Balance	Interest Rate	
Senior secured term loans:							
Term Loan A	3/29/2017	$459,375	2.65	%(1)	$459,375	2.67	%(3)
Term Loan B	3/29/2019	1,067,592	3.25	%(2)	1,075,721	3.25	%(4)
Total borrowings		1,526,967			1,535,096		
Less current portion		10,839			10,839		
Long-term borrowings — net of current portion		$1,516,128			$1,524,257		

(1) As of September 30, 2014, the Eurodollar Rate for Term Loan A was 0.15%.

(2) As of September 30, 2014, the elected LIBOR was less than 0.75%; as a result, the Eurodollar Rate for Term Loan B was 0.75%.

(3) As of December 31, 2013, the Eurodollar Rate for Term Loan A was 0.17%.

(4) As of December 31, 2013, the elected LIBOR was less than 0.75%; as a result, the Eurodollar Rate for Term Loan B was 0.75%.

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As of September 30, 2014, the Revolving Credit Facility was being used to support the issuance of $21.5 million of irrevocable letters of credit for the construction of the Company's San Diego office building and other items, with an applicable interest rate margin of 2.50%. The remaining available balance of $228.5 million was undrawn at September 30, 2014.

The Credit Agreement subjects the Company to certain financial and non-financial covenants. As of September 30, 2014, 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 $200.0 million limit, and allows for both collateralized and uncollateralized borrowings. The lines have not been utilized in 2014, but were utilized in 2013; however, there were no balances outstanding at September 30, 2014 or December 31, 2013.

The following summarizes borrowing activity in the revolving and uncommitted line of credit facilities (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Average balance	$—	$80	$—	$4,637
Weighted-average interest rate	—%	1.50%	—%	1.80%

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 $6.5 million and $4.8 million for the three months ended September 30, 2014 and 2013, respectively, and $23.5 million and $14.7 million for the nine months ended September 30, 2014 and 2013, respectively.

In March 2014 the Company entered into a lease agreement for additional office space in Charlotte, North Carolina with a lease commencement date of March 1, 2014 and an expiration date of February 28, 2017. Future minimum payments for this lease commitment are $0.2 million, $1.0 million, $1.1 million, and $0.2 million, for the years 2014, 2015, 2016, and 2017, respectively.

Service 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 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, 2014.

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Legal Proceedings & Regulatory Matters — The Company maintains insurance coverage for certain legal proceedings, including those involving client claims. With respect to client claims, the estimated losses on the majority of 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.

In accordance with applicable accounting guidance, the Company establishes an accrual for legal proceedings and regulatory matters when it is both probable that a loss has been incurred and the amount of loss can be reasonably estimated. Where it is not probable that a loss has been incurred, 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. Assessing the probability of a loss occurring and the amount of any loss related to a legal proceeding or regulatory matter is inherently difficult, requiring significant and complex judgments. 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 regarding potential exposures; potential opportunities for settlement and the status of any settlement discussions; and potential insurance coverage and indemnification, if available. The Company monitors these matters 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. Due to these considerations, the Company may have exposure to losses that are not yet predictable or cannot yet be reasonably estimated in amounts that exceed those that have been accrued.

As of September 30, 2014, the Company had accrued a liability of $23.0 million for potential remediation of regulatory matters. As of September 30, 2014, management believes, based on available information and consideration the factors above, that the results of pending legal proceedings and regulatory matters, in the aggregate, will not have a material adverse effect on the Company's financial condition, but may be material to operating results for any particular period.

Other Commitments — As of September 30, 2014, the Company had received collateral primarily in connection with client margin loans with a market value of approximately $379.8 million, which it can re-pledge, loan, or sell. Of these securities, approximately $31.9 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, 2014 there were no restrictions that materially limited the Company's ability to re-pledge, loan, or sell the remaining $347.9 million of client collateral.

Trading securities on the unaudited condensed consolidated statements of financial condition includes $2.4 million and $1.4 million pledged to clearing organizations at September 30, 2014 and December 31, 2013, respectively.

Brokerage, clearing, and custody services are provided by LPL Financial on a fully disclosed basis. LPL Financial also has a multi-year agreement to provide its investment advisory programs, platforms, technology, and additional processing and related services to the advisors of the broker-dealer subsidiary of a large global insurance company and the clients of such advisors at specified service levels. Failures by LPL Financial to meet certain specified service levels may result in service level credits against future fees payable by or give rise to a termination right for such broker-dealer. Termination fees may be payable by a terminating or breaching party depending on the specific cause of termination.

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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):

	2014		2013	
	Dividend per Share	Total Cash Dividend	Dividend per Share	Total Cash Dividend
First quarter	$0.24	$24.1	$0.135	$14.4
Second quarter	$0.24	$24.0	$0.135	$14.4
Third quarter	$0.24	$24.0	$0.19	$19.9

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, 2014 and 2013, the Company had the following activity under its approved share repurchase programs (in millions, except share and per share data):

			Three Months Ended September 30,					
			2014			2013		
Approval Date	Authorized Repurchase Amount	Amount Remaining at September 30, 2014	Shares Purchased	Weighted-Average Price Paid Per Share	Total Cost	Shares Purchased	Weighted-Average Price Paid Per Share	Total Cost
September 27, 2012	$150.0	$—	—	$ —	$—	759,786	$ 38.40	$29.2
May 28, 2013	$200.0	—	—	—	—	2,566,630	37.94	97.3
February 10, 2014	$150.0	67.9	531,426	47.06	25.0	—	—	—
		$67.9	531,426	$ 47.06	$25.0	3,326,416	$ 38.04	$126.5

For the nine months ended September 30, 2014 and 2013, the Company had the following activity under its approved share repurchase programs (in millions, except share and per share data):

			Nine Months Ended September 30,					
			2014			2013		
Approval Date	Authorized Repurchase Amount	Amount Remaining at September 30, 2014	Shares Purchased	Weighted Average Price Paid Per Share	Total Cost	Shares Purchased	Weighted Average Price Paid Per Share	Total Cost
September 27, 2012	$150.0	$—	—	$—	$—	2,343,651	$37.10	$87.0
May 28, 2013	$200.0	—	1,306,288	52.00	67.9	2,566,630	37.94	97.3
February 10, 2014	$150.0	67.9	1,683,424	48.77	82.1	—	—	—
		$67.9	2,989,712	$50.18	$150.0	4,910,281	$37.54	$184.3

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

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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.

On November 17, 2010, the Company adopted a 2010 Omnibus Equity Incentive Plan (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 are 12,055,945 shares authorized for grant under the 2010 Plan. As of September 30, 2014, there were 6,292,812 shares reserved for issuance upon exercise or conversion of outstanding awards granted under the 2010 Plan.

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, officer, and director stock options that have been granted during the nine months ended September 30, 2014:

Expected life (in years)	6.02	
Expected stock price volatility	44.25	%
Expected dividend yield	1.77	%
Risk-free interest rate	2.17	%
Fair value of options	$20.51	

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, 2014:

Expected life (in years)	5.86	
Expected stock price volatility	33.70	%
Expected dividend yield	2.08	%
Risk-free interest rate	1.92	%
Fair value of options	$21.73	

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The following table summarizes the Company’s stock option and warrant activity for the nine months ended September 30, 2014:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding — December 31, 2013	7,016,521	$28.45		
Granted	748,353	54.21		
Exercised	(960,961)	25.12		
Forfeited	(376,378)	35.19		
Outstanding — September 30, 2014	6,427,535	$31.56	6.63	$93,163
Exercisable — September 30, 2014	3,319,409	$27.10	5.42	$62,892

The following table summarizes information about outstanding stock options and warrants at September 30, 2014:

	Outstanding			Exercisable	
Range of Exercise Prices	Total Number of Shares	Weighted-Average Remaining Life (Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
$2.38	17,382	0.67	$2.38	17,382	$2.38
$15.84 - $23.02	1,313,120	4.71	21.42	1,250,803	21.34
$23.41 - $30.00	1,631,196	5.97	28.11	926,796	27.62
$31.60 - $32.33	1,624,929	7.90	31.87	493,184	31.94
$34.01 - $39.60	1,162,060	6.40	34.58	625,729	34.50
$45.89 - $54.81	678,848	9.44	54.26	5,515	54.81
	6,427,535	6.63	$31.56	3,319,409	$27.10

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 $3.8 million and $2.5 million during the three months ended September 30, 2014 and 2013, respectively, and $11.4 million and $9.8 million during the nine months ended September 30, 2014 and 2013, respectively, which is included in compensation and benefits expense on the unaudited condensed consolidated statements of income. As of September 30, 2014, total unrecognized compensation cost related to non-vested stock options granted to employees, officers, and directors was $25.3 million, which is expected to be recognized over a weighted-average period of 2.28 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 $1.1 million and $1.6 million during the three months ended September 30, 2014 and 2013, respectively, and $5.9 million and $5.9 million for during the nine months ended September 30, 2014 and 2013, 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, 2014, total unrecognized compensation cost related to non-vested stock options and warrants granted to advisors and financial institutions was $12.2 million, which is expected to be recognized over a weighted-average period of 2.52 years.

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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, 2014:

	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, 2013	39,153	$ 33.20	256,684	$ 32.12
Granted	15,846	49.22	376,582	48.94
Vested	(9,300)	32.26	(39,419)	31.44
Forfeited	(4,550)	32.96	(49,401)	38.92
Nonvested at September 30, 2014	41,149	$ 39.60	544,446	$ 43.19

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 $1.7 million and $0.6 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, 2014 and 2013, respectively, and $4.4 million and $1.6 million during the nine months ended September 30, 2014 and 2013, respectively, which is included in compensation and benefits expense on the unaudited condensed consolidated statements of income. As of September 30, 2014, total unrecognized compensation cost for restricted stock awards and restricted stock units granted to employees, officers, and directors was $13.0 million, which is expected to be recognized over a weighted-average remaining period of 2.29 years.

In the second quarter of 2014, the Company began granting restricted stock units to its advisors and to financial institutions. 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 $0.6 million related to the vesting of these restricted stock units during the three and nine months ended September 30, 2014, which is classified within commission and advisory expense on the unaudited condensed consolidated statements of income. As of September 30, 2014, total unrecognized compensation cost for restricted stock units granted to advisors and financial institutions was $4.3 million, which is expected to be recognized over a weighted-average remaining period of 2.62 years.

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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 for the three and nine months ended September 30, 2014 and 2013 is as follows (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$33,272	$37,631	$129,498	$137,439
Basic weighted-average number of shares outstanding	100,052	104,271	100,519	105,670
Dilutive common share equivalents	1,782	1,434	1,865	1,264
Diluted weighted-average number of shares outstanding	101,834	105,705	102,384	106,934
Basic earnings per share	$0.33	$0.36	$1.29	$1.30
Diluted earnings per share	$0.33	$0.36	$1.26	$1.29

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, 2014 and 2013, stock options, warrants, and restricted stock units representing common share equivalents of 1,478,016 shares and 3,075,389 shares, respectively, were anti-dilutive. For the nine months ended September 30, 2014 and 2013, stock options, warrants, and restricted stock units representing common share equivalents of 1,344,782 shares and 3,744,198 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 40.0% and 38.6% for the three months ended September 30, 2014 and 2013, respectively, and 39.5% and 39.4% for the nine months ended September 30, 2014 and 2013, respectively. 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 TPG Capital, one of the Company's significant stockholders, as well as certain portfolio companies of TPG Capital. During the nine months ended September 30, 2014 and 2013 the Company recognized revenue for services provided to these portfolio companies of $0.7 million and $0.4 million, respectively. During the nine months ended September 30, 2014 and 2013, the Company incurred expenses for services provided by TPG Capital or these portfolio companies of $0.9 million and $0.4 million, respectively. As of September 30, 2014 and 2013, receivables from related parties were $0.1 million. As of September 30, 2014 and 2013, payables to related parties were $0.4 million and less than $0.1 million, respectively.
During the nine months ended September 30, 2013, the Company incurred $0.8 million in expenses for services provided by Aplifi, Inc., a privately held technology company in which the Company held an equity interest until its sale in October 2013.
On February 12, 2014, the Company entered into a share repurchase agreement with an investment fund associated with TPG Capital, 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.

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

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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 $109.2 million with a minimum net capital requirement of $6.7 million and net capital in excess of the minimum requirement of $102.5 million as of September 30, 2014.

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, 2014 and December 31, 2013, 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 1, 2014, the Company entered into the Second Amendment, Extension and Incremental Assumption Agreement (“Amended Credit Agreement”) with its wholly owned subsidiary, LPL Holdings, Inc., and other parties thereto, which amended the Company's Credit Agreement, dated May 13, 2013. The Amended Credit Agreement extends the maturity date of Term Loan A and the Revolving Credit Facility to September 30, 2019, and increases the Revolving Credit Facility borrowing capacity to $400.0 million.

On October 1, 2014, the Company's Board of Directors approved an increase in the Company's share repurchase plan by $150.0 million to a total of $217.9 million.

On October 28, 2014, the Board of Directors declared a cash dividend of $0.24 per share on the Company's outstanding common stock to be paid on November 26, 2014 to stockholders of record on November 11, 2014.
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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

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 13,900 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 4,400 financial advisors who are affiliated and licensed with insurance companies that use our customized clearing, advisory platforms, and technology solutions.

Fortigent Holdings Company, Inc. and its subsidiaries (“Fortigent”) provide solutions and consulting services to RIAs, banks, and trust companies serving high-net-worth clients, while The Private Trust Company, N.A. (“PTC”) manages trusts and family assets.

Our singular focus is to provide 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 we are 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.

For over 20 years, we have served the independent advisor market. We currently support the largest independent advisor base and we believe we have the fourth largest overall advisor base in the United States based on the information available as of the date this Quarterly Report on Form 10-Q has been issued. Through our advisors, we are also one of the largest distributors of financial products in the United States. Our scale is a substantial competitive advantage and enables us to more effectively attract and retain advisors. Our unique business model allows us to invest in more resources for our advisors, increasing their revenues and creating a virtuous cycle of growth. We have 3,397 employees, with primary offices in Boston, Charlotte, and San Diego.

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 11,000 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, 2014 Total (millions)	% of Total Net Revenue	% Recurring
Advisor-driven revenue with ~85%-90% payout ratio	Commission	- Transactions - Brokerage asset levels	$1,590	49%	44%
	Advisory	- Advisory asset levels	$998	31%	99%
	Asset-Based - Cash Sweep Fees - Sponsorship Fees - Record Keeping	- Cash balances - Interest rates - Client asset levels - Number of accounts	$354	11%	97%
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	$276	8%	64%
	Other	- Margin account balances - Alternative investment transactions	$51	1%	34%
	Total Net Revenue		$3,269	100%	68%
	Total Recurring Revenue		$2,228	68%	

Commission and Advisory Revenues. Commission and advisory revenues both represent advisor-generated revenue, generally 85-90% of which is paid to advisors.

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.

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 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 independent RIAs who conduct their advisory business through separate entities by establishing their own RIA (“Independent RIAs”) pursuant to the Investment Advisers Act of 1940, rather than through LPL Financial. The assets held under these 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. The advisory revenue generated by an Independent RIA is earned by the Independent RIA, and accordingly is not included in our advisory

revenue. However, we charge administrative fees to Independent RIAs for clearing and custody of these assets based on the value of assets within these advisory accounts. The administrative fees collected on our Independent 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.

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.

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.

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 or losses on assets held by us for the advisors' non-qualified deferred compensation plan and our model portfolios, revenues from our Retirement Partners program, interest income from client margin accounts and cash equivalents, net of operating interest expense, and other items.

Our Operating 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 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

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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.

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.

General and Administrative Expenses. General and administrative expenses include promotional, occupancy and equipment, professional services, communications and data processing, regulatory fees, and other expenses. General and administrative expenses also include expenses for our hosting of certain advisor conferences that serve as training, sales, and marketing events.

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.

Restructuring Charges. Restructuring charges primarily represent expenses incurred as a result of our expansion of our Service Value Commitment announced in 2013 (see Note 3. Restructuring, within the notes to unaudited condensed consolidated financial statements).

Other Expenses. Other expenses represent charges incurred arising from the shutdown of our subsidiary NestWise, which ceased operations in the third quarter of 2013 (the “NestWise Closure”). The assets and liabilities acquired through the 2012 acquisition of Veritat Advisors Inc. (“Veritat”) were held at NestWise as a result of a merger of Veritat into NestWise. In connection with the NestWise Closure, we determined that a majority of the assets held at NestWise, consisting primarily of goodwill and fixed assets, had no future economic benefit. Accordingly, the carrying values of goodwill and fixed assets were derecognized during the third quarter of 2013. Additionally, we revised our estimate of the potential payment obligation to the former shareholders of Veritat, which resulted in a $7.8 million decrease in the estimated fair value of the contingent consideration obligation during the third quarter of 2013.

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, 2014	2013	% Change
Business Metrics			
Advisors	13,910	13,563	2.6 %
Advisory and brokerage assets (in billions)(1)	$464.8	$414.7	12.1 %
Advisory assets under custody (in billions)(2)(3)	$169.5	$141.1	20.1 %
Net new advisory assets (in billions)(4)	$13.5	$10.7	26.2 %
Insured cash account balances (in billions)(3)	$16.9	$17.3	(2.3)%
Money market account balances (in billions)(3)	$7.1	$8.2	(13.4)%

	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Financial Metrics				
Revenue growth from prior period	3.4 %	16.1 %	7.3 %	12.1 %
Recurring revenue as a % of net revenue(5)	70.2 %	64.0 %	68.1 %	65.0 %
Net income (in millions)	$33.3	$37.6	$129.5	$137.4
Earnings per share (diluted)	$0.33	$0.36	$1.26	$1.29
Non-GAAP Measures:				
Gross margin (in millions)(6)	$331.1	$317.0	$990.6	$927.9
Gross margin as a % of net revenue(6)	30.4 %	30.1 %	30.3 %	30.5 %
Adjusted EBITDA (in millions)	$108.9	$120.3	$378.6	$387.2
Adjusted EBITDA as a % of net revenue	10.0 %	11.4 %	11.6 %	12.7 %
Adjusted EBITDA as a % of gross margin(6)	32.9 %	37.9 %	38.2 %	41.7 %
Adjusted Earnings (in millions)	$48.8	$59.6	$181.6	$193.6
Adjusted Earnings per share (diluted)	$0.48	$0.56	$1.77	$1.81

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(1) 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. Set forth below are other client assets at September 30, 2014 and 2013, 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, 2014	2013
Retirement plan assets(a)	$76.2	$56.6
Trust assets(b)	$3.0	$12.0
High-net-worth assets(c)	$83.9	$69.3

(a) Retirement plan assets are held in retirement plans that are supported by advisors licensed with LPL Financial. At September 30, 2014 and 2013, our retirement plan assets represent assets that are custodied with 36 third-party providers and 30 third-party providers, respectively, of retirement plan administrative services who provide reporting feeds. We estimate the total assets in retirement plans supported to be between $110.0 billion and $120.0 billion at September 30, 2014 and between $80.0 billion and $95.0 billion at September 30, 2013. 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. Since September 30, 2013, we began receiving reporting feeds from 7 such providers, which accounted for $6.6 billion of the $19.6 billion increase in retirement plan assets.

(b) Represents trust assets that are on the wealth management platform of the Concord Trust and Wealth Solutions division of LPL Financial ("Concord").

(c) Represents high-net-worth assets that are on the platform of performance reporting, investment research, and practice management services of Fortigent.

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

(3) Advisory assets under custody, insured cash account balances, and money market account balances are components of advisory and brokerage assets.

(4) Represents net new advisory assets consisting of funds from new accounts and additional funds deposited into existing advisory accounts that are custodied in our fee-based advisory platforms, less account attrition and funds withdrawn from advisory accounts.

(5) Recurring revenue, which is a characterization of net revenue and a statistical measure, is derived from sources such as advisory revenues, asset-based revenues, trailing commission revenues, revenues related to our cash sweep programs, interest earned on margin accounts, and technology and service revenues, and is not meant as a substitute for net revenues.

(6) Gross margin is calculated as net revenues less production expenses. Because our gross margin amounts do not include any depreciation and amortization expense, we consider our gross margin 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 GAAP results, 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 of Directors (the "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, 2014 and 2013 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$33,272	$37,631	$129,498	$137,439
Non-operating interest expense	12,897	13,363	38,651	38,190
Provision for income taxes	22,181	23,671	84,663	89,316
Amortization of intangible assets	9,634	9,731	29,046	29,275
Depreciation and amortization of fixed assets	14,885	11,701	41,572	32,176
EBITDA	92,869	96,097	323,430	326,396
EBITDA Adjustments:				
Employee share-based compensation expense(1)	5,550	2,957	16,087	11,405
Acquisition and integration related expenses(2)	(328)	3,630	764	7,356
Restructuring and conversion costs(3)	9,958	7,340	26,606	20,925
Debt extinguishment costs(4)	—	—	—	7,968
Other(5)	829	10,259	11,667	13,198
Total EBITDA Adjustments	16,009	24,186	55,124	60,852
Adjusted EBITDA	$108,878	$120,283	$378,554	$387,248

(1) Represents share-based compensation for equity awards granted to employees, officers, and directors. Such awards 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.

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

(3) Represents organizational restructuring charges, conversion, and other related costs primarily resulting from the expansion of our Service Value Commitment.

(4) Represents expenses incurred resulting from the early extinguishment and repayment of amounts outstanding under prior senior secured credit facilities and the establishment of new senior secured credit facilities.

(5) Results for the three and nine months ended September 30, 2014 include approximately $0.6 million and $9.8 million, respectively, in parallel rent, property tax, common area maintenance expenses, and fixed asset disposals incurred in connection with our relocation to our San Diego office building. Results for the third quarter of 2013 include costs related to our decision to cease operations of our subsidiary NestWise LLC (the "NestWise Closure"), consisting of the derecognition of $10.2 million of goodwill, $6.9 million of fixed asset charges that were determined to have no future economic benefit, a $7.8 million decrease in the estimated fair value of contingent consideration as related milestones were not achieved, and severance

and termination benefits. Results for the nine months ended September 30, 2013 also include $2.7 million of severance and termination benefits related to a change in management structure. Other amounts include certain excise and other taxes.

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 GAAP results 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, 2014 and 2013 (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$33,272	$37,631	$129,498	$137,439
After-Tax:				
EBITDA Adjustments(1)				
Employee share-based compensation expense(2)	3,666	2,153	10,778	8,255
Acquisition and integration related expenses(3)	(703)	2,240	(33)	3,186
Restructuring and conversion costs	6,114	4,529	16,336	12,911
Debt extinguishment costs	—	—	—	4,916
Other(4)	509	6,993	7,164	8,806
Total EBITDA Adjustments	9,586	15,915	34,245	38,074
Amortization of intangible assets(1)	5,915	6,004	17,834	18,063
Adjusted Earnings	$48,773	$59,550	$181,577	$193,576
Adjusted Earnings per share(5)	$0.48	$0.56	$1.77	$1.81
Weighted-average shares outstanding — diluted	101,834	105,705	102,384	106,934

(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% and 3.3%, net of the federal tax benefit, for the periods ended September 30, 2014 and 2013, respectively, except as noted below.

(2) Represents the after-tax expense of non-qualified stock options for which we receive a tax deduction upon exercise, restricted stock awards and restricted stock units for which we receive a tax deduction upon vesting, and the full expense 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. Share-based compensation expense for vesting of incentive stock options was $0.7 million and $0.9 million for the three months ended September 30, 2014 and 2013, respectively, and $2.3 million and $3.2 million for the nine months ended September 30, 2014 and 2013, respectively.

(3) Represents the after-tax expense of acquisition and related costs for which we receive a tax deduction.

(4) Results for the three and nine months ended September 30, 2013 include the after-tax expense of severance and termination benefits and derecognition of fixed assets related to the NestWise Closure, for which we received a tax deduction, as well as the full expense impact of the derecognition of $10.2 million of goodwill and the $7.8 million decrease in the estimated fair value of contingent consideration related to the NestWise Closure, for which we did not receive a tax deduction. Other amounts include the after-tax expense of excise and other taxes.

(5) 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,	
	2014	2013	2014	2013
Earnings per share — diluted	$0.33	$0.36	$1.26	$1.29
After-Tax:				
EBITDA Adjustments per share	0.09	0.14	0.33	0.35
Amortization of intangible assets per share	0.06	0.06	0.18	0.17
Adjusted Earnings per share	$0.48	$0.56	$1.77	$1.81

Service Value Commitment

The Program

In February 2013, we committed to an expansion of our Service Value Commitment (the "Program"), an ongoing effort to position us for sustainable long-term growth by improving the service experience of our advisors and delivering efficiencies in our operating model. After assessing our information technology delivery, governance, organization, and strategy, we 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.

The Program is expected to be completed in 2015, and we estimate total charges of $65.0 million for technology transformation costs, outsourcing and other related costs, employee severance obligations and other related costs, and non-cash charges for impairment of certain fixed assets related to internally developed software.

We expect to incur approximately $38.4 million of expense during 2014, of which we had incurred $25.4 million as of September 30, 2014, consisting of: $5.0 million for outsourcing and other services such as parallel processing provided by outside consultants; $16.0 million for the implementation of foundational changes to our technology platform and outsourcing of our disaster recovery facilities; and $4.4 million for employee severance and termination benefits related to positions that were outsourced as of September 30, 2014, within accounting, data reconciliation, operations, and insurance processing. We remain focused on the next wave of outsourced functions in the remainder of 2014, including additional opportunities in compliance and back office processing activities. By 2015, we expect annual pre-tax savings to approach $30.0 million. See Note 3. Restructuring, within the notes to unaudited condensed consolidated financial statements for additional information regarding the Program.

Derivative Financial Instruments

During the second quarter of 2013, and in conjunction with the Program, we entered into a long-term contractual obligation (the "Agreement") with a third-party provider to enhance the quality, speed, and 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 and provides that we settle the cost of our contractual obligation to the third-party provider each month in U.S. dollars. However, the Agreement provides that on each annual anniversary date of the signing of the Agreement, the price for services (as denominated in U.S. dollars) is to be adjusted for the then-current exchange rate between the U.S. dollar and the Indian rupee. 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 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 the risk during each period until the next annual reset date. We bear the risk of currency movement at each of the annual reset dates following the first anniversary.

Upon completion of the Program, we estimate annual costs for our long-term contractual obligation with the third-party provider to be approximately $10.0 million. We use derivative financial instruments consisting solely of non-deliverable foreign currency contracts, all of which have been designated as cash flow hedges. These instruments are operating effectively as intended and our use of them has 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 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, 2014. See our 2013 Annual Report on Form 10-K for 2013 activity.

Economic Overview and Impact of Financial Market Events

Our business is directly and indirectly sensitive to several macroeconomic factors, primarily in the United States. One of these factors is the current and expected future level of short-term interest rates, particularly overnight rates. The Federal Reserve remained highly accommodative in the third quarter of 2014, extending, but

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continuing to wind down, its bond buying program while maintaining a 0.0% to 0.25% target range for the federal funds rate. At its September policy meeting, the Federal Reserve reaffirmed its rate policy and stated that it would continue to assess labor markets, inflation levels, financial developments, and general economic conditions to determine how long to keep the federal funds target rate near zero. It also restated that rates would be held near zero for a “considerable time” after it ended its bond purchase program, which did end in late October 2014. The Federal Reserve has underscored that it would take a balanced approach once it began to raise rates and that it could keep rates below what members would consider normal in the longer term if conditions warranted, even if inflation and labor markets were near levels consistent with its mandate.

As a result of the accommodative monetary policy, interest rates, including the rate on overnight funds, remain low on a historical basis, with the average federal funds effective rate for the third quarter of 2014 at 9 basis points. The lower interest rate environment and fee compression, resulting from contract repricing in order to keep yields on our cash sweep programs competitive, has had a negative impact on our profitability on our cash sweep programs, and fee compression is expected to increase further in 2015 and 2016. Additionally, we’ve seen decreasing levels of demand for fixed income and fixed annuity products as investors move to equity and alternative products.

Another macro-economic factor affecting our business is the valuation of equity securities across the various markets in the United States. The S&P 500 index closed the quarter at 1,972, up 0.6% from its close on June 30, 2014, the seventh consecutive quarter of positive returns, and reflected a 6.7% year-to-date gain through September 30, 2014. Investor confidence remained stable as the market showed signs of incremental economic growth despite volatility and continued tapering of the Federal Reserve’s bond buying program. Consumer spending rebounded toward the end of the summer while September marked the sixth consecutive month of job gains, and the third quarter also included strong performance by the U.S. dollar. While the market demonstrated impressive resilience through the third quarter, lingering economic worries remain about geopolitical concerns, Federal Reserve monetary policy, U.S. and global growth rates, and policy uncertainty in Washington, D.C.

Results of Operations

The following discussion presents an analysis of our results of operations for the three and nine months ended September 30, 2014 and 2013. 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,		
	2014	2013	% Change	2014	2013	% Change
	(In thousands)					
Revenues						
Commission	$520,388	$527,419	(1.3)%	$1,590,139	$1,521,390	4.5 %
Advisory	340,369	299,101	13.8 %	998,016	878,421	13.6 %
Asset-based	121,283	107,447	12.9 %	354,494	318,718	11.2 %
Transaction and fee	94,674	93,799	0.9 %	276,284	271,808	1.6 %
Other	12,520	25,446	(50.8)%	50,461	56,591	(10.8)%
Net revenues	1,089,234	1,053,212	3.4 %	3,269,394	3,046,928	7.3 %
Expenses						
Production	758,091	736,195	3.0 %	2,278,800	2,119,033	7.5 %
Compensation and benefits	106,290	102,310	3.9 %	317,459	299,317	6.1 %
General and administrative	122,056	102,834	18.7 %	323,232	265,075	21.9 %
Depreciation and amortization	24,519	21,432	14.4 %	70,618	61,451	14.9 %
Restructuring charges	9,928	6,482	53.2 %	26,473	19,851	33.4 %
Other	—	9,294	(100.0)%	—	9,294	(100.0)%
Total operating expenses	1,020,884	978,547	4.3 %	3,016,582	2,774,021	8.7 %
Non-operating interest expense	12,897					