LPL Financial Holdings Inc.
Form 10-Q
November 03, 2016

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, 2016
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	Smaller reporting company o
		(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No
The number of shares of Common Stock, par value $0.001 per share, outstanding as of October 31, 2016 was 89,155,100.

TABLE OF CONTENTS

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, 22nd 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, outlook, growth, plans, business strategies, liquidity, future indebtedness, future share repurchases, and future dividends, including statements regarding future resolution of regulatory matters, legal proceedings, and related costs, future revenues and expenses, and projected savings and anticipated improvements to the Company's operating model, services, and technology as a result of its initiatives and programs, as well as any other statements that are not related to present facts or current conditions or that are not purely historical, constitute forward-looking statements. These forward-looking statements are based on the Company's historical performance and its plans, estimates, and expectations as of November 3, 2016. The words “anticipates”, “believes”, “expects”, “may”, “plans”, “predicts,” “will”, and s 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; fluctuations in the number of retail investors served by the Company; effects of competition in the financial services industry and the success of the Company in attracting and retaining financial advisors and institutions; 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; the Company's strategy in managing cash sweep program fees; changes in the growth and profitability of the Company’s fee-based business; the effect of current, pending, and future legislation, regulation, and regulatory actions, including the U.S. Department of Labor's final rule ("DOL Rule") and disciplinary actions imposed by federal and state securities regulators and self-regulatory organizations; the costs of settling and remediating issues related to pending or future regulatory matters or legal proceedings; changes made to the Company’s offerings and services in response to current, pending, and future legislation, regulation, and regulatory actions, including the DOL Rule, and the effect that such changes may have on the Company’s gross profit streams and costs; execution of the Company’s capital management plans, including its compliance with the terms of its existing credit agreement; the price, the availability of shares, and the trading volumes of the Company’s common stock, which will affect the timing and size of future share repurchases by the Company; execution of the Company's plans and its success in realizing the expense savings and service improvements and efficiencies expected to result from its initiatives and programs, particularly its expense plans and technological initiatives; the Company's success in negotiating and developing commercial arrangements with third-party services providers; the performance of third-party service providers 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 2015 Annual Report on Form 10-K, as may be amended or updated in the Company's Quarterly Reports on Form 10-Q. Except as required by law, the Company specifically disclaims any obligation to update any forward-looking statements as a result of 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 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Business Overview

We are a leader in the retail financial advice market, the nation's largest independent broker-dealer (based on total revenues, Financial Planning magazine June 1996-2016), a top custodian for registered investment advisors ("RIAs"), and a leading independent consultant to retirement plans. We provide an integrated platform of brokerage and investment advisory services to more than 14,000 independent financial advisors, including financial advisors at more than 700 financial institutions (our "advisors") across the country, enabling them to provide their retail investors ("clients") with objective financial advice through a lower conflict model. We also support approximately 4,200 financial advisors who are affiliated and licensed with insurance companies that use our customized clearing, advisory platforms, and technology solutions.

Through our advisors, we are one of the largest distributors of financial products and services in the United States, and we believe we are one of the top five firms in terms of overall advisor base in the United States.

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

We believe investors achieve better outcomes when working with a financial advisor. LPL makes it easy for advisors to do what is best for their clients, protecting advisors and investors while promoting independence and choice through access to a wide range of diligently evaluated non-proprietary products.

Executive Summary

Financial Highlights

Results for the third quarter of 2016 included net income of $52.0 million or $0.58 per share, which compares to $41.1 million, or $0.43 per share, in the third quarter of 2015. Management tax planning initiatives resulted in a $0.12 earnings per share benefit related to prior periods and account termination fees related to an institutional client that was acquired by a bank with its own broker-dealer resulted in a $0.04 earnings per share benefit, contributing to the earnings per share growth.

Asset Growth Trends

Net new advisory assets were $4.1 billion for the three months ended September 30, 2016, compared to $4.2 billion in the same period in 2015, leaving total brokerage and advisory assets served at $502.4 billion as of September 30, 2016, up from the September 30, 2015, balance of $461.8 billion.

As of September 30, 2016, our advisory assets had grown to $205.5 billion from $179.7 billion as of September 30, 2015 and represented 40.9% of total brokerage and advisory assets served. Our advisory assets include assets on our platform that are served by independent RIAs which conduct their advisory business through separate entities ("Hybrid RIAs") operating pursuant to the Investment Advisers Act of 1940 or through their respective states' investment advisory licensing rules, rather than through LPL Financial. These advisory assets had grown to $142.5 billion as of September 30, 2016, compared to $110.0 billion as of September 30, 2015, and represented 28.4% of total brokerage and advisory assets served.

Gross Profit Trends

Third quarter gross profit, a non-GAAP measure, was $346.9 million, which was up from $339.8 million in the comparable period in 2015. Management presents gross profit, which is calculated as net revenues less commission and advisory expenses and brokerage, clearing, and exchange fees. We believe that measure may be useful to investors in evaluating the Company's core operating performance before indirect costs that are general and administrative in nature. See footnote 6 to the Financial Metrics table within the "How We Evaluate Our Business" section for additional information on gross profit. Third quarter gross profit included an increase in cash sweep revenue from the impact of the increase in the target range for the federal funds effective rate announced in

1

December 2015 and higher average cash balances and account termination fees which resulted from the departure of an institutional client due to an acquisition by a bank with its own broker-dealer. These increases were partially offset by decreases in commissions and advisory revenues, net of the correlated reduction in commission and advisory expenses and brokerage, clearing, and exchange fees.

Capital Management Activity

We paid $22.3 million of dividends to shareholders and did not conduct any share repurchases in the three months ended September 30, 2016.

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 that provides our cash sweep programs and access to over 750 product providers that offer the following product lines:

• Alternative Investments	• Retirement Plan Products
• Annuities	• Separately Managed Accounts
• Exchange Traded Products	• Structured Products
• Insurance Based Products	• Unit Investment Trusts
• Mutual Funds	

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. 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 and drivers of our revenue:

			Nine Months Ended September 30, 2016			
	Sources of Revenue	Primary Drivers	Total (millions)	% of Total Net Revenue	Total Recurring (millions)	% Recurring
Advisor-driven revenue with ~85%-90% payout ratio	Commission	- Transactions - Brokerage asset levels	$1,314	43.2%	$685	52.1%
	Advisory	- Advisory asset levels	$964	31.7%	$960	99.6%
	Asset-Based - Cash Sweep Fees - Sponsorship Fees - Record Keeping	- Cash balances - Interest rates - Client asset levels - Number of accounts	$413	13.6%	$401	97.1%
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 - Premium technology subscribers	$313	10.3%	$186	59.4%
	Other	- Margin account balances - Alternative investment transactions	$38	1.2%	$18	47.4%
	Total Net Revenue		$3,042	100.0%	$2,250	74.0%

We regularly review various aspects of our operations and service offerings, including our policies, procedures, and platforms, in response to marketplace developments. We currently expect to implement changes to aspects of our operations and service offerings in order to position our advisors for long-term growth and to align with competitive and regulatory developments.

How We Evaluate Our Business

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

	September 30,		
Business Metrics	2016	2015	% Change
Brokerage and advisory assets served (in billions)(1)	$502.4	$461.8	8.8 %
Advisory assets under custody (in billions)(1)(2)	$205.5	$179.7	14.4 %
Net new advisory assets (in billions)(3)	$8.9	$13.7	(35.0)%
Insured cash account balances (in billions)(1)	$21.1	$19.5	8.2 %
Deposit cash account balances (in billions) (1)	$4.2	$—	n/m
Money market account balances (in billions)(1)	$3.9	$8.2	(52.4)%
Advisors(4)	14,185	14,073	0.8 %

	Three Months Ended September 30,		Nine Months Ended September 30,	
Financial Metrics	2016	2015	2016	2015
Revenue (in millions)	1,017.4	1,054.7	3,041.9	3,254.7
Revenue decrease	(3.5)%	(3.2)%	(6.5)%	(0.4)%
Recurring revenue as a % of net revenue	74.3 %	72.4 %	74.0 %	71.1 %
Pre-tax income (in millions)	$68.2	$68.7	$232.6	$237.5
Net income (in millions)	$52.0	$41.1	$150.2	$142.0
Earnings per share (diluted)	$0.58	$0.43	$1.67	$1.46
Non-GAAP Measures:(5)				
Gross profit (in millions)(6)	$346.9	$339.8	$1,047.5	$1,035.3
Gross profit growth from prior period(6)	2.1 %	2.6 %	1.2 %	4.5 %
Gross profit as a % of net revenue(6)	34.1 %	32.2 %	34.4 %	31.8 %

(1) Brokerage and advisory assets served 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. Insured cash account balances, money market account balances, and beginning in July 2016, deposit cash account balances are also included in brokerage and advisory assets served. Set forth below are other client asset balances from September 30, 2016 and 2015, including retirement plan assets and certain trust and high-net-worth assets that are custodied with third-party providers and therefore excluded from total brokerage and advisory assets served (in billions):

	September 30,	
	2016	2015
Retirement plan assets(a)	$91.3	$80.8
Trust assets	$1.0	$1.0
High-net-worth assets	$86.8	$94.4

(a) Retirement plan assets are held in retirement plans that are supported by advisors licensed with LPL Financial. At September 30, 2016 and 2015, our retirement plan assets represent those assets that are custodied with various third-party providers of retirement plan administrative services who provide reporting feeds. We estimate the total assets in retirement plans supported to be approximately $128.6 billion at September 30, 2016. If we receive reporting feeds in the future from providers from whom we do not currently receive feeds, we intend to include and identify such additional assets in this metric. Such additional feeds since September 30, 2015, accounted for $2.0 billion of the total retirement plan assets.

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

advisory assets under custody.

(3) Represents net new assets for the nine months ended September 30, 2016 and 2015 consisting of total inflows of funds deposited into new advisory accounts and additional funds deposited into existing advisory accounts that are custodied in our fee-based advisory platforms and total outflows from all closed and existing advisory accounts custodied on such platforms during the period.

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

(5) Our management believes that presenting certain non-GAAP measures by excluding or including certain items can be helpful to investors and analysts who may wish to use some or all of this information to analyze our current performance, prospects, and valuation. Our management uses this non-GAAP information internally to evaluate operating performance and in formulating the budget for future periods. Our management believes that the non-GAAP measures and metrics discussed below are appropriate for evaluating the performance of the Company.

(6) Gross profit is calculated as net revenues less commission and advisory expenses and brokerage, clearing, and exchange fees. All other expense categories, including depreciation and amortization of fixed assets and amortization of intangible assets, are considered general and administrative in nature. Because our gross profit amounts do not include any depreciation and amortization expense, we consider our gross profit amounts to be non-GAAP measures that may not be comparable to those of others in our industry. We believe that gross profit amounts can be useful to investors because they show the Company's core operating performance before indirect costs that are general and administrative in nature.

Legal & Regulatory Matters

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

Our accruals, including those established through the captive insurance subsidiary, at September 30, 2016, include estimated costs for significant regulatory matters, generally relating to the adequacy of our compliance and supervisory systems and procedures and other controls, for which we believe losses are both probable and reasonably estimable. One of the matters relates to sales of certain securities over several years, and our accrual at September 30, 2016, includes an estimate for the loss we expect to incur in resolving this matter, including if we were to repurchase certain affected securities at their original sales prices.

The outcome of regulatory matters could result in legal liability, regulatory fines, or monetary penalties in excess of our accruals and insurance, which could have a material adverse effect on our business, results of operations, cash flows, or financial condition. For more information on management's loss contingency policies, see Note 8. Commitments and Contingencies, within the notes to the unaudited condensed consolidated financial statements.

In April 2016, the U.S. Department of Labor issued a final rule (the "DOL Rule"): "Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice." The DOL Rule broadens the circumstances under which we may be considered a "fiduciary" with respect to certain accounts that are subject to the Employee Retirement Income Security Act, and the prohibited transaction rules under section 4975 of the Internal Revenue Code, including many employer-sponsored retirement plans and individual retirement accounts. The DOL Rule will likely affect the products and services we provide to these types of accounts and the compensation that we and our advisors receive in connection with such products and services, as well as our regulatory compliance and other costs and those of our advisors. In addition, the DOL Rule creates increased risk of private arbitration and litigation, including potential class action litigation, based on violations of the DOL Rule. As we implement the DOL rule, we

5

continue to analyze the potential effects on our business, including implications for both our revenues and expenses, and the broader financial services industry as of the date of this quarterly report.

Derivative Financial Instruments

In May 2013, we entered into a long-term contractual obligation (the "Agreement") with a third-party provider to enhance the quality and speed and reduce the cost of our processes by outsourcing certain functions. The Agreement provides that on each annual anniversary date of the signing of the Agreement, the price for services (as denominated in US dollars) is to be adjusted for the then-current exchange rate between the U.S. dollar and the Indian rupee. We bear the risk of currency movement at each annual reset date.

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

See Note 5. Derivative Financial Instruments, within the notes to the unaudited condensed consolidated financial statements for additional information regarding our derivative financial instruments.

Acquisitions, Integrations, and Divestitures

From time to time we undertake acquisitions or divestitures outside the ordinary course of business based on opportunities in the competitive landscape. These activities are part of our overall growth strategy, but can distort comparability when reviewing revenue and expense trends for periods presented. There have been no material acquisitions, integrations, or divestitures during the nine months ended September 30, 2016. See our 2015 Annual Report on Form 10-K for 2015 activity.

Economic Overview and Impact of Financial Market Events

Our business is directly and indirectly sensitive to several macroeconomic factors and the state of financial markets, particularly in the United States. In the U.S., economic data continues to point to fairly steady economic growth. According to the most recent estimate by the Bureau of Economic Analysis, real gross domestic product (“GDP”) growth accelerated to a 2.9% annualized rate in the third quarter of 2016 from 1.4% in the second quarter, putting the overall growth rate over the last four quarters at 1.5%. A largely healthy labor market, a relatively strong U.S. consumer spending, and low interest rates have all been supportive of growth. In addition, stabilizing oil prices have helped manufacturing to rebound modestly, while services sector activity remains steady. Nevertheless, a lack of support from global growth continues to be a concern. In addition, uncertainty arising from the impact of the U.K.'s vote to leave the European Union, despite a muted effect thus far, and the upcoming election in the U.S. may be causing some businesses to delay committing to major projects pending greater clarity. While growth of 2-3% is modest by historical standards, such a growth rate, should it continue, would still be above the Congressional Budget Office’s estimate of potential GDP growth, and therefore could be enough to continue to slowly tighten the labor market, push wages higher, and increase the probability of the Federal Reserve ("Fed") raising rates later this year or in early 2017.

Equity markets exhibited relatively low volatility over the quarter and measures of financial stress, while not at cycle lows, remained considerably better than levels seen earlier this year. The S&P 500 index advanced in the third quarter, with a bulk of gains coming in July, and posted a new all-time high in early July for the first time since May 21, 2015. However, fund flow data and investor sentiment surveys continue to indicate caution among retail investors. Market leadership shifted during the quarter from high dividend-paying sectors to more economically sensitive sectors, such as technology and industrials, with a similar shift in fixed income toward less rate-sensitive sectors. The change in sector leadership in part reflected a change in interest rate behavior during the quarter after rates fell sharply in the first half of the year. Treasury yields, which started the quarter at depressed levels following declines in response to the U.K. referendum vote, rose steadily over the quarter to end higher across the yield curve. Yields were pushed higher by a modest advance in market-based and macroeconomic measures of inflation and the absence of any meaningful expansion of policy support by major global central banks at their September meetings, which, in the context of a very accommodative policy environment overall has been interpreted as a move toward tighter monetary policy than had previously been expected.

Our business is also sensitive to current and expected short-term interest rates, which are largely driven by Federal Reserve policy. In particular, low short-term rates can weigh on the profitability of our cash sweep program, due to the fee compression needed to keep our rates competitive. Low interest rates and the prospect of rising rates over the long term can also have an impact on demand for fixed and variable annuity products. The Fed did not increase its policy rate at its September meeting, but for the first time since December 2014 there were three dissenting votes (out of 10 voting members). In addition, several Fed members in interviews and speeches continued to reinforce that every Fed policy meeting was “live,” as the Fed tried to prepare markets for the next potential interest rate increase. While sentiment in favor of a hike has grown, the expected path of rates continues to be moderate. In updated projections that accompanied the September policy statement, Fed members’ median expectation of the Fed Funds Effective Rate for year-end 2017 fell from 1.6% to 1.1%, while median expectation for year-end 2018 fell from 2.4% to 1.9%. The policy statement released after the meeting continued to signal the possibility of a December rate hike and to highlight that “the case for an increase in the federal funds rate has strengthened,” with the added qualification that any decision would be data dependent.

Results of Operations

The following table and discussion below presents an analysis of our results of operations for the three and nine months ended September 30, 2016 and 2015. 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,		
	2016	2015	% Change	2016	2015	% Change
Revenues	(In thousands)					
Commission	$431,686	$480,271	(10.1)%	$1,314,168	$1,513,359	(13.2)%
Advisory	321,911	341,217	(5.7)%	964,298	1,028,213	(6.2)%
Asset-based	138,291	123,921	11.6 %	412,339	369,625	11.6 %
Transaction and fee	108,413	105,593	2.7 %	312,927	305,099	2.6 %
Interest income, net of interest expense	5,372	5,221	2.9 %	15,940	14,976	6.4 %
Other	11,767	(1,478)	n/m	22,254	23,436	(5.0)%
Total net revenues	1,017,440	1,054,745	(3.5)%	3,041,926	3,254,708	(6.5)%
Expenses						
Commission and advisory	657,432	701,585	(6.3)%	1,954,123	2,179,686	(10.3)%
Compensation and benefits	107,988	110,494	(2.3)%	327,816	335,111	(2.2)%
Promotional	42,609	42,040	1.4 %	113,010	104,416	8.2 %
Depreciation and amortization	18,434	17,231	7.0 %	56,145	50,856	10.4 %
Amortization of intangible assets	9,502	9,535	(0.3)%	28,536	28,708	(0.6)%
Occupancy and equipment	23,530	19,760	19.1 %	67,347	61,957	8.7 %
Professional services	17,045	15,341	11.1 %	49,184	43,914	12.0 %
Brokerage, clearing, and exchange	13,098	13,403	(2.3)%	40,296	39,680	1.6 %
Communications and data processing	10,333	11,253	(8.2)%	31,801	33,974	(6.4)%
Restructuring charges	—	3,071	(100.0)%	—	11,487	(100.0)%
Other	25,356	28,852	(12.1)%	69,512	86,796	(19.9)%
Total operating expenses	925,327	972,565	(4.9)%	2,737,770	2,976,585	(8.0)%
Non-operating interest expense	23,889	13,493	77.0 %	71,583	40,671	76.0 %
Income before provision for income taxes	68,224	68,687	(0.7)%	232,573	237,452	(2.1)%
Provision for income taxes	16,270	27,635	(41.1)%	82,378	95,480	(13.7)%
Net income	$51,954	$41,052	26.6 %	$150,195	$141,972	5.8 %

Revenues

Commission Revenues

We generate two types of commission revenues: sales-based commissions and trailing commissions. Sales-based commission revenues, which occur whenever clients trade securities or purchase various types of investment products, primarily represent gross commissions earned by our advisors. The levels of sales-based 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. Trailing commission revenues are recurring in nature and are earned based on the market value of investment holdings in trail eligible assets. 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.

The following table sets forth our commission revenue, by product category, included in our unaudited condensed consolidated statements of income (in thousands):

	Three Months Ended September 30,			
	2016	2015	$ Change	% Change
Variable annuities	$169,413	$189,623	$(20,210)	(10.7)%
Mutual funds	137,238	144,441	(7,203)	(5.0)%
Alternative investments	8,514	26,113	(17,599)	(67.4)%
Fixed annuities	44,933	42,417	2,516	5.9%
Equities	20,263	24,875	(4,612)	(18.5)%
Fixed income	21,756	21,778	(22)	(0.1)%
Insurance	18,083	19,105	(1,022)	(5.3)%
Group annuities	11,266	11,777	(511)	(4.3)%
Other	220	142	78	54.9%
Total commission revenue	$431,686	$480,271	$(48,585)	(10.1)%

The following table sets forth our commission revenue, by sales-based and trailing commission revenue (in thousands):

	Three Months Ended September 30, 2016	2015	$ Change	% Change
Sales-based				
Variable annuities	$57,337	$78,113	$(20,776)	(26.6)%
Mutual funds	34,985	39,463	(4,478)	(11.3)%
Alternative investments	7,198	24,932	(17,734)	(71.1)%
Fixed annuities	41,995	40,552	1,443	3.6 %
Equities	20,263	24,875	(4,612)	(18.5)%
Fixed income	16,588	16,588	—	— %
Insurance	16,520	17,675	(1,155)	(6.5)%
Group annuities	1,258	1,701	(443)	(26.0)%
Other	220	142	78	54.9 %
Total sales-based revenue	$196,364	$244,041	$(47,677)	(19.5)%
Trailing				
Variable annuities	$112,076	$111,510	$566	0.5 %
Mutual funds	102,253	104,978	(2,725)	(2.6)%
Alternative investments	1,316	1,181	135	11.4 %
Fixed annuities	2,938	1,865	1,073	57.5 %
Fixed income	5,168	5,190	(22)	(0.4)%
Insurance	1,563	1,430	133	9.3 %
Group annuities	10,008	10,076	(68)	(0.7)%
Total trailing revenue	$235,322	$236,230	$(908)	(0.4)%
Total commission revenue	$431,686	$480,271	$(48,585)	(10.1)%

The decrease in sales-based commission revenue for the three months ended September 30, 2016, compared with the same period in 2015, was primarily due to a decrease in activity for variable annuities, alternative investments, equities, and mutual funds. Continued investor uncertainty in the low interest rate environment led to a decline in demand for variable annuities and mutual funds. Alternative investment sales commissions were primarily challenged by marketplace uncertainties in response to regulatory changes.

Trailing revenues are recurring in nature and the decrease in revenue for the period reflects a decrease in the market value of the underlying assets.

The following table sets forth our commission revenue, by product category, included in our unaudited condensed consolidated statements of income (in thousands):

	Nine Months Ended September 30,			
	2016	2015	$ Change	% Change
Variable annuities	$514,521	$585,354	$(70,833)	(12.1)%
Mutual funds	406,741	453,658	(46,917)	(10.3)%
Alternative investments	25,415	116,793	(91,378)	(78.2)%
Fixed annuities	150,622	113,616	37,006	32.6 %
Equities	61,588	75,684	(14,096)	(18.6)%
Fixed income	63,703	69,836	(6,133)	(8.8)%
Insurance	56,297	60,817	(4,520)	(7.4)%
Group annuities	34,708	37,160	(2,452)	(6.6)%
Other	573	441	132	29.9 %
Total commission revenue	$1,314,168	$1,513,359	$(199,191)	(13.2)%

The following table sets forth our commission revenue, by sales-based and trailing commission revenue (in thousands):

	Nine Months Ended September 30,			
	2016	2015	$ Change	% Change
Sales-based				
Variable annuities	$186,963	$243,556	$(56,593)	(23.2)%
Mutual funds	111,548	136,388	(24,840)	(18.2)%
Alternative investments	20,892	110,957	(90,065)	(81.2)%
Fixed annuities	142,962	108,206	34,756	32.1 %
Equities	61,588	75,684	(14,096)	(18.6)%
Fixed income	48,648	54,378	(5,730)	(10.5)%
Insurance	52,047	55,493	(3,446)	(6.2)%
Group annuities	4,222	5,197	(975)	(18.8)%
Other	573	441	132	29.9 %
Total sales-based revenue	$629,443	$790,300	$(160,857)	(20.4)%
Trailing				
Variable annuities	327,558	341,798	(14,240)	(4.2)%
Mutual funds	295,193	317,270	(22,077)	(7.0)%
Alternative investments	4,523	5,836	(1,313)	(22.5)%
Fixed annuities	7,660	5,410	2,250	41.6 %
Fixed income	15,055	15,458	(403)	(2.6)%
Insurance	4,250	5,324	(1,074)	(20.2)%
Group annuities	30,486	31,963	(1,477)	(4.6)%
Total trailing revenue	$684,725	$723,059	$(38,334)	(5.3)%
Total commission revenue	$1,314,168	$1,513,359	$(199,191)	(13.2)%

The decrease in sales-based commission revenue for the nine months ended September 30, 2016, compared with the same period in 2015, was primarily due to a decrease in activity for alternative investments, variable annuities, and mutual funds. Alternative investment sales commissions were primarily challenged by marketplace uncertainties in response to regulatory changes. Significant market volatility and investor uncertainty in the low interest rate environment led to a decline in demand for variable annuities and mutual funds and shifted investors' focus from portfolio growth to income streams with minimal risk to principal. This led to the increase in sales of fixed annuities, which pay guaranteed rates of interest and can appeal to investors wary of market volatility.

Trailing revenues are recurring in nature and the decrease in revenue for the period reflects a decrease in the market value of the underlying assets.

Advisory Revenues

Advisory revenues primarily represent fees charged on our corporate RIA platform provided through LPL Financial LLC (“LPL Financial”) to clients of our advisors based on the value of their advisory assets. Advisory fees are billed to clients on either a calendar quarter or non-calendar quarter basis, depending on their choice, at the beginning of that period, and are recognized as revenue ratably during the quarter. The value of the assets in an advisory account on the billing date determines the amount billed, and accordingly, the revenues earned in the following three month period. The majority of our accounts are billed in advance using values as of the last business day of each calendar quarter. Advisory revenues collected on our corporate RIA platform are proposed by the advisor and agreed to by the client and average 1.1% of the underlying assets, and can range anywhere from 0.5% to 3.0%.

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

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

The following table summarizes all activity in advisory assets under our custody (in billions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Balance - Beginning of period	$196.1	$186.8	$187.2	$175.8
Net new advisory assets	4.1	4.2	8.9	13.7
Market impact	5.3	(11.3)	9.4	(9.8)
Balance - End of period	$205.5	$179.7	$205.5	$179.7

Net new advisory assets for the three and nine months ended September 30, 2016 and 2015 had a limited impact on advisory fee revenue for those respective periods. Rather, net new advisory assets are a primary driver of future advisory fee revenue and have resulted primarily from recruiting of new advisors to our Hybrid RIA platform and the continued shift by our existing advisors from brokerage towards more advisory business. With advisory fees for the period calculated based on the ending market value of the immediately preceding period, revenues for any particular quarter are primarily driven by each of the prior quarter's month-end advisory assets under management. The decrease in advisory revenue for the three and nine months ended September 30, 2016, compared with the same periods in 2015 is due to a shift of advisors to our Hybrid RIA platform that more than offset the net new advisory assets.

Assets on our Hybrid RIA platform have been growing rapidly through the recruiting of new advisors and the transition of existing advisors onto that platform. This continued shift of advisors to our Hybrid RIA platform has caused the growth in advisory revenue to appear to lag behind the rate of growth of advisory assets under custody, as we earn the administrative and other fees discussed above as opposed to earning advisory fees.

The following table summarizes the composition of total advisory assets under our custody as of September 30, 2016 and 2015 (in billions):

	September 30,				
	2016	2015	$ Change	% Change	
Advisory assets under management(1)	$124.9	$119.1	$ 5.8	4.9	%
Hybrid RIA assets in advisory accounts custodied by LPL Financial	80.6	60.6	20.0	33.0	%
Total advisory assets under custody	$205.5	$179.7	$ 25.8	14.4	%

(1) Consists of advisory assets under management on our corporate advisory platform.

Asset-Based Revenues

Asset-based revenues are comprised of our sponsorship programs with financial product manufacturers, omnibus processing and networking services, and fees from our cash sweep program. We receive fees from certain financial product manufacturers in connection with sponsorship programs that support our marketing and sales education and training efforts. 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. Pursuant to contractual arrangements, uninvested cash balances in our advisors' client accounts are swept into either insured cash 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.

Asset-based revenues for the three months ended September 30, 2016, increased to $138.3 million, or 11.6% from $123.9 million for the three months ended September 30, 2015. The increase is due primarily to increased revenues from our cash sweep program. Cash sweep revenue increased to $40.7 million for the three months ended September 30, 2016, from $24.0 million for the three months ended September 30, 2015, due to the impact of the increase in the target range for the federal funds effective rate and an increase in average assets in our cash sweep program as investors increased the balances of their assets held in cash in response to the volatility in the financial markets. As of September 30, 2016, our cash sweep balances had grown to $29.2 billion from $27.7 billion as of September 30, 2015, with average cash sweep balances of $29.1 billion and $26.7 billion during the three months ended September 30, 2016 and 2015, respectively. The increase in cash sweep revenue was partially offset by a 2.3% decrease in other asset-based revenues, due in part to lower average billable assets.

Asset-based revenues for the nine months ended September 30, 2016, increased to $412.3 million, or 11.6%, from $369.6 million compared with the same period in 2015. The increase is due primarily to increased revenues from our cash sweep program. Cash sweep revenues increased to $125.0 million for the nine months ended September 30, 2016, from $68.1 million for the nine months ended September 30, 2015, due to the impact of the increase in the target range for the federal funds effective rate and an increase in average assets in our cash sweep program as investors increased the balances of their assets held in cash in response to the volatility in the financial markets. Our average assets in our cash sweep assets have grown to $29.7 billion from $25.2 billion an increase of 17.9% for the nine months ended September 30, 2016 and 2015, respectively. The increase in cash sweep revenue was partially offset by a 4.7% decrease in other asset-based revenues, due in part to lower average billable assets.

Transaction and Fee Revenues

Transaction revenues primarily include fees we charge to our advisors and their clients for executing certain transactions in brokerage and fee-based advisory accounts. Fee revenues primarily include Individual Retirement Account ("IRA") custodian fees, contract and licensing fees, and other client account fees. In addition, we host certain advisor conferences that serve as training, education, sales, and marketing events, for which we charge a fee for attendance.

Transaction and fee revenues increased for the three and nine months ended September 30, 2016, compared to the same periods in 2015, primarily due to the increase in account termination fees which resulted from the departure of an institutional client due to an acquisition by a bank with its own broker-dealer.

Interest Income, net of Interest Expense

We earn interest income, net from client margin accounts and cash equivalents. Period-over-period variances correspond to changes in the average balances of assets in margin accounts and cash equivalents.

Other Revenues

Other revenues primarily include marketing allowances received from certain financial product manufacturers, primarily those who offer alternative investments, such as non-traded real estate investment trusts and business development companies, mark-to-market gains and losses on assets held by us for the advisor non-qualified deferred compensation plan and our model research portfolios, and other miscellaneous revenues.

Other revenues increased for the three months ended September 30, 2016, compared to the same period in 2015 primarily due to the increase in gains of $14.0 million in realized and unrealized gains on approximately $130.4 million of assets held in our advisor non-qualified deferred compensation plan, which are based on the market performance of the underlying investment allocations chosen by advisors in the plan.

Other revenues decreased for the nine months ended September 30, 2016, compared to the same period in 2015 primarily due to decreases in alternative investment marketing allowances of $17.0 million associated with a decline in related sales due to marketplace uncertainties in response to regulatory changes, which were offset by the increase in gains of $14.2 million in realized and unrealized gains on assets held in our advisor non-qualified deferred compensation plan, which are based on the market performance of the underlying investment allocations chosen by advisors in the plan.

Expenses

Commission and Advisory Expenses

Commission and advisory expenses are comprised of the following: base payout amounts that are earned by and paid out to advisors and institutions based on commission and advisory revenues earned on each client's account (referred to as gross dealer concessions, or “GDC”); production bonuses earned by advisors and institutions 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; and the deferred commissions and advisory fee expenses associated with mark-to-market gains or losses on the non-qualified deferred compensation plan offered to our advisors.

Our production payout ratio is calculated as commission and advisory expenses divided by GDC. We calculate GDC as the sum of our commission and advisory revenues, as set forth on our unaudited condensed consolidated statements of income. The following table shows the components of our production payout and total payout ratios, each of which is a statistical or operating measure:

	Three Months Ended September 30,		Change	Nine Months Ended September 30,		Change
	2016	2015		2016	2015	
Base payout rate(1)	83.10%	83.17 %	(7 bps)	82.93%	83.35 %	(42 bps)
Production based bonuses	3.04 %	3.12 %	(8 bps)	2.39 %	2.49 %	(10 bps)
GDC sensitive payout	86.14%	86.29 %	(15 bps)	85.32%	85.84 %	(52 bps)
Non-GDC sensitive payout(2)	1.10 %	(0.89)%	199 bps	0.44 %	(0.08)%	52 bps
Total Payout Ratio	87.24%	85.40 %	184 bps	85.76%	85.76 %	—

(1) Our production payout ratio is calculated as commission and advisory expenses, divided by GDC (see description above).

(2) Non-GDC Sensitive Payout includes share-based compensation expense from equity awards granted to advisors and financial institutions and mark-to-market gains or losses on amounts designated by advisors as deferred.

The increase in our total payout ratio, a statistical or operating measure, for the three months ended September 30, 2016, compared to the same period in 2015 was primarily driven by higher advisor share-based compensation following an increase in our stock price.

Our total payout ratio, a statistical or operating measure, for the nine months ended September 30, 2016, compared with the same period in 2015 remained unchanged but was primarily affected by the ongoing movement of advisors to our Hybrid RIA platform, a decrease in our production bonuses correlating to lower sales during the period, offset by higher advisor share-based compensation following increases in our stock price. Production based bonuses are based on qualified levels of commission and advisory revenues produced by advisors during a calendar year.

14

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.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	Change	2016	2015	Change
Average Number of Employees	3,262	3,394	(3.9)%	3,332	3,369	(1.1)%

The decrease in compensation and benefits expense for the three months ended September 30, 2016, compared with the same period in 2015 was primarily driven by share-based compensation expense timing and an increase in capitalized salary and benefits associated with technology projects.

The decrease in compensation and benefits expense for the nine months ended September 30, 2016, compared with the same period in 2015 was primarily driven by share-based compensation expense timing and an increase in capitalized salary and benefits associated with technology projects.

Promotional Expense

Promotional expenses include costs related to our hosting of certain advisor conferences that serve as training, sales, and marketing events, as well as business development costs related to recruiting, such as transition assistance and amortization related to forgivable loans issued to advisors.

The increase in promotional expense for the three months ended September 30, 2016, compared with the same period in 2015 was primarily driven by increases in business development associated with advisor transition assistance, partially offset by reduced expenses related to our annual national advisor conference.

The increase in promotional expense for the nine months ended September 30, 2016, compared with the same period in 2015 was primarily driven by increases in business development associated with advisor transition assistance and advisor referral bonuses.

Depreciation and Amortization Expense

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

The increase in depreciation and amortization of $1.2 million and $5.3 million for the three and nine months ended September 30, 2016, compared with the same periods in 2015, respectively, was primarily due to increases in internally developed software and purchased hardware and software.

Amortization of Intangible assets

Amortization of intangible assets is consistent over prior periods and represents the benefits received for using long-lived assets, which consist of intangible assets established through our acquisitions.

Occupancy and Equipment Expense

Occupancy and equipment expense includes the costs of leasing and maintaining our office spaces, software licensing and maintenance costs, and maintenance expenses on computer hardware and other equipment.

The increase in occupancy and equipment expense of $3.8 million and $5.4 million for the three and nine months ended September 30, 2016, compared with the same periods in 2015, respectively, was primarily due to an increase in costs related to repairs and maintenance of computer hardware and equipment as well as an increase in software licensing fees.

Professional Services

Professional services includes costs paid to outside firms for assistance with legal, accounting, technology, regulatory, marketing, and general corporate matters, as well as non-capitalized costs related to service and technology enhancements.

The increase in professional services of $1.7 million and $5.3 million for the three and nine months ended September 30, 2016, compared with the same periods in 2015, respectively, was primarily due to an increase in non-capitalized costs related to service and technology enhancements and an increase in costs associated with legal matters.

Brokerage, Clearing, and Exchange Fees

Brokerage, clearing, and exchange fees include expenses originating from trading or clearing operations as well as any exchange membership fees. Changes in brokerage, clearing and exchange fees fluctuate largely in line with the volume of sales and trading activity.

Brokerage, clearing, and exchange fees have remained relatively flat and consistent with the volume of sales and trading activity for the three and nine months ended September 30, 2016, compared with the same periods in 2015.

Communications and Data Processing

Communications expense consists primarily of the cost of voice and data telecommunication lines supporting our business, including connectivity to data centers, exchanges, and markets. Data processing expense consists primarily of customer statement processing and postage costs.

The decrease in communications and data processing expenses of $0.9 million and $2.2 million for the three and nine months ended September 30, 2016, compared with the same periods in 2015, respectively, was primarily due to reduced data and conferencing services.

Restructuring Charges

The restructuring charges for the three and nine months ended September 30, 2015, primarily represent expenses incurred as a result of our Service Value Commitment initiative, which was completed in 2015. These charges relate primarily to consulting fees paid to support our technology transformation as well as employee severance obligations and other related costs and non-cash charges for impairment. Also included in the 2015 restructuring charges are expenses incurred as part of the restructuring of our subsidiary, Fortigent Holdings Company, Inc. (together with its subsidiaries, "Fortigent"), which was completed in 2015.

Other Expenses

Other expenses include the estimated costs of the investigation, settlement, and resolution of regulatory matters, licensing fees, insurance, broker-dealer regulator fees, and other miscellaneous expenses.

The decrease in other expenses of $3.5 million and $17.3 million for the three and nine months ended September 30, 2016, compared with the same periods in 2015, respectively, was primarily driven by lower costs of the investigation, settlement, and resolution of regulatory matters as well as reduced travel expenses.

Non-Operating Interest Expense

Non-operating interest expense results from our senior secured credit facilities. Period-over-period variances correspond to an increase in interest rate and changes in the level of outstanding indebtedness relating to these facilities.

Provision for Income Taxes

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

Our effective tax rate was 23.8% and 40.2% for the three months ended September 30, 2016 and 2015, respectively. Our effective tax rate was 35.4% and 40.2% for the nine months ended September 30, 2016 and 2015, respectively. During the third quarter of 2016, we updated our calculation of the tax benefits that we could obtain associated with internally developed software. The total additional tax benefit recorded during the third quarter, net of potential tax contingencies, was approximately $11.7 million.

Liquidity and Capital Resources

Senior management establishes our liquidity and capital policies. These policies include senior management’s review of short- and long-term cash flow forecasts, review of capital expenditures, and daily monitoring of liquidity for our subsidiaries. Decisions on the allocation of capital are based upon, among other things, projected profitability and cash flow, risks of the business, regulatory capital requirements, and future liquidity needs for strategic activities. Our Treasury Department assists in evaluating, monitoring, and controlling the business activities that impact our financial condition, liquidity, and capital structure and maintains relationships with various lenders. The objectives of these policies are to support the executive business strategies while ensuring ongoing and sufficient liquidity.

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

	Nine Months Ended September 30,	
	2016	2015
Net cash flows provided by (used in):		
Operating activities	$262,085	$208,467
Investing activities	(96,025)	(53,196)
Financing activities	(103,225)	(157,567)
Net increase (decrease) in cash and cash equivalents	62,835	(2,296)
Cash and cash equivalents — beginning of period	724,529	412,332
Cash and cash equivalents — end of period	$787,364	$410,036

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

Net cash provided by operating activities includes changes in operating asset and liability balances related to settlement and funding of client transactions, receivables from product sponsors, and accrued commission and advisory expenses due to our advisors. Operating assets and liabilities that arise from the settlement and funding of transactions by our advisors’ clients are the principal drivers of changes to our net cash from operating activities and can fluctuate significantly from day-to-day and period-to-period depending on overall trends and clients' behaviors.

The change in cash flows provided by operating activities for the nine months ended September 30, 2016, compared to the same period in 2015 was primarily attributable to an increase in cash provided by client receivables, an increase in cash provided by accounts payable and accrued liabilities, a decrease in cash used in drafts payable and payable to clients, partially offset by a decrease in cash provided by cash segregated under federal and other regulations, an increase in cash used in receivables from product sponsors and advisor loans.

The change in cash flows used in investing activities for the nine months ended September 30, 2016, as compared to the same period in 2015 was primarily attributable to an increase in capital expenditures related to the construction of the Company's new campus in Fort Mill, South Carolina and an increase in capital expenditures for technology to support growth.

The change in the cash flows used in financing activities for the nine months ended September 30, 2016, compared to the same period in 2015 was primarily attributable to a decrease in repurchases of our common stock under our repurchase programs approved by our board of directors (the "Board of Directors" or "Board"), and a decrease in dividends due to a lower number of shares outstanding in the current period compared to the prior period, partially offset by decreases in proceeds from our revolving credit facility, a decrease in proceeds from stock option exercises, and an increase in our repayment of senior secured term loans.

We believe that based on current levels of operations and anticipated growth, cash flow from operations, together with other available sources of funds, which include three uncommitted lines of credit available and the revolving credit facility established through our senior secured credit agreement, will be adequate to satisfy our working capital needs, the payment of all of our obligations, and the funding of anticipated capital expenditures for the foreseeable future. In addition, we have certain capital adequacy requirements related to our registered broker-dealer subsidiary and bank trust subsidiary and have met all such requirements and expect to continue to do so for the foreseeable future. We regularly evaluate our existing indebtedness, including refinancing thereof, based on a number of factors, including our capital requirements, future prospects, contractual restrictions, the availability of refinancing on attractive terms, and general market conditions. See the Risks Related to our Debt section within

Part I, “Item 1A. Risk Factors” in our 2015 Annual Report on Form 10-K for more information about the risks associated with our debt obligations and their potential effect on our liquidity.

Share Repurchases

The Board of Directors has approved several share repurchase programs pursuant to which we may repurchase issued and outstanding shares of our common stock. Purchases may be effected in open market or privately negotiated transactions, including transactions with our affiliates, with the timing of purchases and the amount of stock purchased generally determined at our discretion within the constraints of our senior secured credit agreement and general operating needs. See Note 9. Stockholders' Equity, within the notes to the unaudited condensed consolidated financial statements for additional information regarding our share repurchases.

Dividends

The payment, timing, and amount of any dividends are subject to approval by our Board as well as certain limits under our credit facilities. See Note 9. Stockholders' Equity, within the notes to the unaudited condensed consolidated financial statements for additional information regarding our dividends.

Operating Capital Requirements

Our primary requirement for working capital relates to funds we loan to our advisors’ clients for trading conducted on margin and funds we are required to maintain for regulatory capital and reserves based on the requirements of our regulators and clearing organizations, which also consider client balances and trading activities. We have several sources of funds that enable us to meet increases in working capital requirements that relate to increases in client margin activities and balances. These sources include cash and cash equivalents on hand, cash and securities segregated under federal and other regulations, and proceeds from re-pledging or selling client securities in margin accounts. When an advisor's client purchases securities on margin or uses securities as collateral to borrow from us on margin, we are permitted, pursuant to the applicable securities industry regulations, to repledge, loan, or sell securities, up to 140% of the client's margin loan balance, that collateralize those margin accounts. As of September 30, 2016, we had approximately $202.9 million of client margin loans, collateralized with securities having a fair value of approximately $284.0 million that we can re-pledge, loan, or sell. Of these securities, approximately $35.6 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, 2016, there were no restrictions that materially limited our ability to re-pledge, loan, or sell the remaining $248.4 million of client collateral.

Our other working capital needs are primarily related to advisor loans and timing associated with receivables and payables, which we have satisfied in the past from internally generated cash flows.

Notwithstanding the self-funding nature of our operations, we may sometimes be required to fund timing differences arising from the delayed receipt of client funds associated with the settlement of client transactions in securities markets. These timing differences are funded either with internally generated cash flow or, if needed, with funds drawn on our uncommitted lines of credit at our broker-dealer subsidiary LPL Financial, or under our revolving credit facility.

Our registered broker-dealer, LPL Financial, is subject to the SEC’s Uniform Net Capital Rule, which requires the maintenance of minimum net capital. LPL Financial computes net capital requirements under the alternative method, which requires firms to maintain minimum net capital, as defined, equal to the greater of $250,000 or 2.0% of aggregate debit balances arising from client transactions. At September 30, 2016, LPL Financial's excess net capital was $87.1 million.

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

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

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

Debt and Related Covenants

We are party to a debt agreement with our wholly-owned subsidiary, LPL Holdings, Inc., and other parties thereto (the "Credit Agreement"). See Note 7. Debt, within the notes to the unaudited condensed consolidated financial statements for further detail.

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

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

Credit Agreement EBITDA, a non-GAAP measure, is defined in, and calculated by management in accordance with, the Credit Agreement as “Consolidated EBITDA”, which is Consolidated Net Income (as defined in the Credit Agreement) plus interest expense, tax expense, depreciation and amortization, and adjusted to exclude certain non-cash charges and other adjustments and gains. We present Credit Agreement EBITDA because we believe that it can be a useful financial metric in understanding our debt capacity and covenant compliance. However, Credit Agreement EBITDA is not a measure of our financial performance under GAAP and should not be considered as an alternative to net income or any other performance measure derived in accordance with GAAP, or as an alternative to cash flows from operating activities as a measure of profitability or liquidity. In addition, our Credit Agreement-defined EBITDA measure can differ significantly from adjusted EBITDA calculated by other companies, depending on long-term strategic decisions regarding capital structure, the tax jurisdictions in which companies operate, and capital investments.

Set forth below is a reconciliation from our net income to Credit Agreement EBITDA for the three months ended September 30, 2016 (in thousands):

Net income	$51,954
Non-operating interest expense	23,889
Provision for income taxes	16,270
Depreciation and amortization	18,434
Amortization of intangible assets	9,502
EBITDA	120,049
Credit Agreement Adjustments:	
Employee share-based compensation expense(1)	4,431
Advisor share-based compensation expense(2)	2,327
Other(3)	5,727
Credit Agreement EBITDA	$132,534

(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 share-based compensation for stock options and warrants awarded to advisors and to financial institutions based on the fair value of the awards at each reporting period.

19

(3) Represents other items that are adjustable in accordance with our Credit Agreement to arrive at Credit Agreement EBITDA including employee severance costs, employee signing costs, employee retention or completion bonuses, and other non-recurring costs.

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

As of September 30, 2016, we were in compliance with all of our covenant requirements. Our covenant requirements and actual ratios were as follows:

Financial Ratio	Covenant Requirement	Actual Ratio
Leverage Test (Maximum)	5.0	3.57
Interest Coverage (Minimum)	3.0	6.20

Off-Balance Sheet Arrangements

We enter into various off-balance-sheet arrangements in the ordinary course of business, primarily to meet the needs of our advisors' clients. These arrangements include firm commitments to extend credit. For information on these arrangements, see Note 8. Commitments and Contingencies and Note 15. Financial Instruments with Off-Balance-Sheet Credit Risk and Concentrations of Credit Risk, within the notes to the unaudited condensed consolidated financial statements.

Contractual Obligations

We are involved in a build-to-suit lease arrangement in Fort Mill, South Carolina, under which we serve as the construction agent on behalf of the landlord. Under such arrangement, we have obligations to fund cost over-runs in our capacity as the construction agent, and accordingly have determined that under lease accounting standards we bear substantially all of the risks and rewards of ownership as measured under GAAP. We are therefore required to report the landlord's costs of construction on our balance sheet as a fixed asset during the construction period as if we owned such asset. As of September 30, 2016, we have recorded $105.9 million in fixed assets in connection with this arrangement and an equal and off-setting leasehold financing obligation on the unaudited condensed consolidated statement of financial condition. Once construction is complete, if it is determined that the asset does not qualify for sale-leaseback accounting treatment, we will amortize the obligation over the lease term and depreciate the asset over the life of the lease. We will not report rent expense for the lease; rather, lease payments will be recognized as a reduction of the financing obligation and interest expense. See Note 2. Summary of Significant Accounting Policies within the notes to the unaudited condensed consolidated financial statements for further detail as well as Risks Related to Our Business Generally section within Part I, "Item 1A. Risk Factors" in our 2015 Annual Report on Form 10-K for more information about the risks associated with this real estate development project.

During the nine months ended September 30, 2016, there have been no material changes in our contractual obligations, other than in the ordinary course of business or as noted above, from those disclosed in our 2015 Annual Report on Form 10-K. See Note 7. Debt and Note 8. Commitments and Contingencies, within the notes to the unaudited condensed consolidated financial statements, as well as the Contractual Obligations section within Part II, "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our 2015 Annual Report on Form 10-K, for further detail on operating lease obligations and obligations under noncancelable service contracts.

Fair Value of Financial Instruments

We use fair value measurements to record certain financial assets and liabilities at fair value and to determine fair value disclosures. See Note 3. Fair Value Measurements, within the notes to the unaudited condensed consolidated financial statements for a detailed discussion regarding our fair value measurements.

20

Critical Accounting Policies and Estimates

In the notes to our consolidated financial statements and in “Item 7-Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our 2015 Annual Report on Form 10-K, we have disclosed those accounting policies that we consider to be significant in determining our results of operations and financial condition. There have been no material changes to those policies that we consider to be significant since the filing of our 2015 Annual Report on Form 10-K. The accounting principles used in preparing our unaudited condensed consolidated financial statements conform in all material respects to GAAP.

Recently Issued Accounting Pronouncements

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

Item 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,	
	2016	2015	2016	2015
REVENUES				
Commission	$431,686	$480,271	$1,314,168	$1,513,359
Advisory	321,911	341,217	964,298	1,028,213
Asset-based	138,291	123,921	412,339	369,625
Transaction and fee	108,413	105,593	312,927	305,099
Interest income, net of interest expense	5,372	5,221	15,940	14,976
Other	11,767	(1,478)	22,254	23,436
Total net revenues	1,017,440	1,054,745	3,041,926	3,254,708
EXPENSES				
Commission and advisory	657,432	701,585	1,954,123	2,179,686
Compensation and benefits	107,988	110,494	327,816	335,111
Promotional	42,609	42,040	113,010	104,416
Depreciation and amortization	18,434	17,231	56,145	50,856
Amortization of intangible assets	9,502	9,535	28,536	28,708
Occupancy and equipment	23,530	19,760	67,347	61,957
Professional services	17,045	15,341	49,184	43,914
Brokerage, clearing, and exchange	13,098	13,403	40,296	39,680
Communications and data processing	10,333	11,253	31,801	33,974
Restructuring charges	—	3,071	—	11,487
Other	25,356	28,852	69,512	86,796
Total operating expenses	925,327	972,565	2,737,770	2,976,585
Non-operating interest expense	23,889	13,493	71,583	40,671
INCOME BEFORE PROVISION FOR INCOME TAXES	68,224	68,687	232,573	237,452
PROVISION FOR INCOME TAXES	16,270	27,635	82,378	95,480
NET INCOME	$51,954	$41,052	$150,195	$141,972
EARNINGS PER SHARE (NOTE 11)				
Earnings per share, basic	$0.58	$0.43	$1.69	$1.48
Earnings per share, diluted	$0.58	$0.43	$1.67	$1.46
Weighted-average shares outstanding, basic	89,092	94,972	89,025	95,744
Weighted-average shares outstanding, diluted	89,951	96,472	89,732	97,303

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,	
	2016	2015	2016	2015
NET INCOME	$51,954	$41,052	$150,195	$141,972
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on cash flow hedges, net of tax expense (benefit) of $85, ($98), $133, and $96 for the three and nine months ended September 30, 2016 and 2015, respectively	135	(156)	209	121
Reclassification adjustment for realized gain on cash flow hedges included in professional services in the condensed consolidated statements of income, net of tax expense of $48, $62, $204, and $290 for the three and nine months ended September 30, 2016 and 2015, respectively	(70)	(100)	(318)	(463)
Total other comprehensive income (loss), net of tax	65	(256)	(109)	(342)
TOTAL COMPREHENSIVE INCOME	$52,019	$40,796	$150,086	$141,630

See notes to unaudited condensed consolidated financial statements.

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Financial Condition
(Unaudited)
(In thousands, except share data)

	September 30, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents	$ 787,364	$ 724,529
Cash and securities segregated under federal and other regulations	597,114	671,339
Restricted cash	38,471	27,839
Receivables from:		
Clients, net of allowance of $1,629 at September 30, 2016 and $1,464 at December 31, 2015	292,549	339,089
Product sponsors, broker-dealers, and clearing organizations	176,741	161,224
Advisor loans, net of allowance of $697 at September 30, 2016 and $697 at December 31, 2015	178,924	148,978
Others, net of allowance of $12,486 at September 30, 2016 and $9,856 at December 31, 2015	191,874	180,161
Securities owned:		
Trading — at fair value	11,835	11,995
Held-to-maturity — at amortized cost	9,864	9,847
Securities borrowed	10,446	6,001
Income taxes receivable	2,305	—
Fixed assets, net of accumulated depreciation and amortization of $378,764 at September 30, 2016 and $328,880 at December 31, 2015	373,098	275,419
Goodwill	1,365,838	1,365,838
Intangible assets, net of accumulated amortization of $371,276 at September 30, 2016 and $342,740 at December 31, 2015	363,495	392,031
Other assets	209,838	206,771
Total assets	$ 4,609,756	$ 4,521,061
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Drafts payable	$ 161,444	$ 189,083
Payables to clients	715,289	747,421
Payables to broker-dealers and clearing organizations	51,890	48,032
Accrued commission and advisory expenses payable	129,249	129,512
Accounts payable and accrued liabilities	367,096	332,492
Income taxes payable	—	8,680
Unearned revenue	72,959	65,480
Securities sold, but not yet purchased — at fair value	85	268
Senior secured credit facilities, net of unamortized debt issuance cost of $23,139 at September 30, 2016 and $26,797 at December 31, 2015	2,178,641	2,188,240
Leasehold financing obligation	105,939	59,940
Deferred income taxes, net	36,038	36,303
Total liabilities	3,818,630	3,805,451
Commitments and contingencies (Note 8)		
STOCKHOLDERS' EQUITY:		
Common stock, $.001 par value; 600,000,000 shares authorized; 119,766,574 shares issued at September 30, 2016 and 119,572,352 shares issued at December 31, 2015	120	119
Additional paid-in capital	1,435,037	1,418,298

Treasury stock, at cost — 30,638,748 shares at September 30, 2016 and 30,048,027 shares at December 31, 2015	(1,195,282)	(1,172,490)
Accumulated other comprehensive income	444	553
Retained earnings	550,807	469,130
Total stockholders’ equity	791,126	715,610
Total liabilities and stockholders’ equity	$ 4,609,756	$ 4,521,061

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 Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
BALANCE — December 31, 2014	118,235	$ 118	$ 1,355,085	21,090	$ (780,661)	$ 937	$ 396,121	$ 971,600
Net income and other comprehensive income (loss), net of tax expense						(342)	141,972	141,630
Issuance of common stock to settle restricted stock units, net	172	1		64	(2,868)			(2,867)
Treasury stock purchases				3,325	(140,835)			(140,835)
Cash dividends on common stock							(72,056)	(72,056)
Stock option exercises and other	832		22,331	(44)	1,547		22	23,900
Share-based compensation			22,577					22,577
Excess tax benefits (tax deficiency) from share-based compensation			1,448					1,448
BALANCE — September 30, 2015	119,239	$ 119	$ 1,401,441	24,435	$ (922,817)	$ 595	$ 466,059	$ 945,397
BALANCE — December 31, 2015	119,572	$ 119	$ 1,418,298	30,048	$ (1,172,490)	$ 553	$ 469,130	$ 715,610
Net income and other comprehensive income (loss), net of tax expense						(109)	150,195	150,086
Issuance of common stock to settle restricted stock units, net	141	1		49	(1,099)			(1,098)
Treasury stock purchases				635	(25,013)			(25,013)
Cash dividends on common stock							(66,773)	(66,773