

LEGG MASON, INC.  
Form 10-K  
May 23, 2016  
Table of Contents

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

FORM 10-K

(Mark  
One)

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

For the fiscal year ended March 31, 2016  
or

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

For the  
transition to  
period from

Commission File  
Number 1-8529

LEGG MASON, INC.  
(Exact name of  
registrant as specified  
in its charter)

Maryland	52-1200960
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 International Drive Baltimore, MD	21202
(Address of principal executive offices)	(Zip Code)

Registrant's  
 telephone number, (410)  
 including area 539-0000  
 code:

Securities registered  
 pursuant to Section  
 12(b) of the Act:

	Name of each exchange on
Title of each class	which registered
Common Stock, \$.10 par value	New York Stock Exchange

Securities registered  
 pursuant to Section 12(g)  
 of the Act: NONE

Indicate by check mark if the registrant is a  
 well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is  
 not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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  No   
 for the past 90 days.

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 such shorter period that  
 the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers  
 pursuant to Item 405 of Regulation S-K (§229.405 of this  
 chapter) is not contained herein,  
 and will not be contained, to the best of registrant's  
 knowledge, in definitive proxy or information statements  
 incorporated by reference in Part III of

this Form 10-K or  
any amendment to  
this Form 10-K.

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 <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

(Do not check  
if a smaller  
reporting  
company)

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

As of September 30, 2015 the aggregate market value of the  
registrant's voting stock, consisting of the registrant's  
common stock, held by  
non-affiliates  
was  
\$4,446,042,065.

As of May 17, 2016, the number of shares outstanding of  
the registrant's common stock was 105,402,210.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its  
Annual Meeting of Stockholders to be held on July 26,  
2016 are incorporated by  
reference  
into Part III  
of this  
Report.

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Table of Contents

## TABLE OF CONTENTS

	Page
<u>Forward-Looking Statements</u>	<u>1</u>
<u>PART I</u>	
<u>Item 1. Business</u>	<u>2</u>
<u>Item 1A. Risk Factors</u>	<u>16</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>28</u>
<u>Item 2. Properties</u>	<u>28</u>
<u>Item 3. Legal Proceedings</u>	<u>28</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>28</u>
<u>Item 4A. Executive Officers of the Registrant</u>	<u>29</u>
<u>PART II</u>	
<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>30</u>
<u>Item 6. Selected Financial Data</u>	<u>31</u>
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>32</u>
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>77</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>78</u>
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>144</u>
<u>Item 9A. Controls and Procedures</u>	<u>144</u>
<u>Item 9B. Other Information</u>	<u>144</u>
<u>PART III</u>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>145</u>
<u>Item 11. Executive Compensation</u>	<u>145</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>146</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>146</u>
<u>Item 14. Principal Accountant Fees and Services</u>	<u>146</u>
<u>PART IV</u>	
<u>Item 15. Exhibits and Financial Statement Schedules</u>	<u>147</u>

---

Table of Contents

**FORWARD-LOOKING STATEMENTS.**

We have made in this Report on Form 10-K, and from time to time may otherwise make in our public filings, press releases and statements by our management, "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, including information relating to anticipated growth in revenues, margins or earnings per share, anticipated changes in our business or in the amount of our client assets under management ("AUM") or assets under advisement ("AUA"), anticipated future performance of our business, including expected earnings per share in future periods, anticipated future investment performance of our affiliates, our expected future net client cash flows, anticipated expense levels, changes in expenses, the expected effects of acquisitions and expectations regarding financial market conditions. The words or phrases "can be," "may be," "expects," "may affect," "may depend," "believes," "estimate," "project," "anticipate" and similar words and phrases are intended to identify such forward-looking statements. Such forward-looking statements are subject to various known and unknown risks and uncertainties and we caution readers that any forward-looking information provided by or on behalf of Legg Mason is not a guarantee of future performance.

Actual results may differ materially from those in forward-looking information as a result of various factors, some of which are beyond our control, including but not limited to those discussed below and those discussed under the heading "Risk Factors" and elsewhere in this Report on Form 10-K and our other public filings, press releases and statements by our management. Due to such risks, uncertainties and other factors, we caution each person receiving such forward-looking information not to place undue reliance on such statements. Further, such forward-looking statements speak only as of the date on which such statements are made, and we undertake no obligations to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

Our future revenues may fluctuate due to numerous factors, such as: the total value and composition of our AUM; the mix of our AUM among our affiliates, asset classes, client type and geography; the revenue yield of our AUM; the volatility and general level of securities prices and interest rates; the relative investment performance of company-sponsored investment funds and other asset management products both in absolute terms and relative to competing offerings and market indices; investor sentiment and confidence; general economic conditions; our ability to maintain investment management and administrative fees at current levels; competitive conditions in our business; the ability to attract and retain key personnel and the effects of acquisitions, including prior acquisitions.

Our future operating results are also dependent upon the level of operating expenses, which are subject to fluctuation for the following or other reasons: variations in the level of compensation expense incurred as a result of changes in the number of total employees, competitive factors, changes in the percentages of revenues paid as compensation or other reasons; increases in distribution expenses; variations in expenses and capital costs, including depreciation, amortization and other non-cash charges incurred by us to maintain our administrative infrastructure; unanticipated costs that may be incurred by Legg Mason from time to time to protect client goodwill, to otherwise support investment products or in connection with litigation or regulatory proceedings; and the effects of acquisitions and dispositions.

Our business is also subject to substantial governmental regulation and changes in legal, regulatory, accounting, tax and compliance requirements that may have a substantial effect on our business and results of operations.



Table of Contents

PART I

ITEM 1. BUSINESS.

General

Legg Mason is a global asset management company. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other pooled investment vehicles. We offer these products and services directly and through various financial intermediaries. We provide our asset management services through a number of asset managers, each of which generally markets its products and services under its own brand name and, in many cases, distributes retail products and services through a centralized global distribution platform.

Legg Mason, Inc. was incorporated in Maryland in 1981 to serve as a holding company for its various subsidiaries. The predecessor companies to Legg Mason trace back to Legg & Co., a Maryland-based broker-dealer formed in 1899. Our subsequent growth occurred primarily through internal expansion and the acquisition of asset management and broker-dealer firms. In December 2005, Legg Mason completed a transaction in which it sold its primary broker-dealer businesses to concentrate on the asset management industry.

Additional information about Legg Mason is available on our website at <http://www.leggmason.com>. We make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and our proxy statements. Investors can find this information under the “Investor Relations” section of our website. These reports are available through our website as soon as reasonably practicable after we electronically file the material with, or furnish it to, the Securities and Exchange Commission (“SEC”). In addition, the Legg Mason, Inc. Corporate Governance Principles, our Code of Conduct for all employees and directors, and the charters for the committees of our Board of Directors are also available on our corporate website at <http://www.leggmason.com> under the “About - Corporate Governance” section. A copy of any of these materials may also be obtained, free of charge, by sending a written request to Corporate Secretary, Legg Mason, Inc., 100 International Drive, Baltimore, MD 21202. As required, and within the time frames required, by the SEC or the New York Stock Exchange (“NYSE”), we will post on our website any amendments to the Code of Conduct and any waiver of the Code of Conduct applicable to any executive officer, director, chief financial officer, principal accounting officer or controller. The information on our website is not incorporated by reference into this Report.

Unless the context otherwise requires, all references in this Report to “we,” “us,” “our” and “Legg Mason” include Legg Mason, Inc. and its predecessors and subsidiaries, and the term “asset managers” refers to the asset management businesses operated by our subsidiaries. References to “fiscal year 2016” or other fiscal years refer to the 12-month period ended March 31st of the year specified.

Business Developments During the Fiscal Year Ended March 31, 2016

During fiscal year 2016, in addition to the normal course operation of our business, we continued to improve our affiliate portfolio through strategic acquisitions and issued additional debt to finance those acquisitions. We also implemented a management equity plan at one of our affiliates in order to better align the interests of the affiliate’s management team with those of our shareholders.

Acquisitions

On October 21, 2015, we acquired a majority equity interest in RARE Infrastructure Ltd. (“RARE Infrastructure”). RARE Infrastructure specializes in global listed infrastructure investing, is headquartered in Sydney, Australia, and had approximately \$6.3 billion in AUM as of March 31, 2016. Legg Mason holds a 75% ownership interest in the firm, the firm's management team retained a 15% equity stake and a previous minority owner retained 10%. The

acquisition of RARE Infrastructure fills gaps in our liquid alternatives products line-up.

On January 21, 2016, we entered into an agreement to acquire an 82% equity interest in Clarion Partners, a diversified real estate asset management firm based in New York. As of April 30, 2016, Clarion Partners managed approximately \$41.5

2

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## Table of Contents

billion in AUM across the real estate risk/return spectrum. The Clarion Partners management team retained 18% of the outstanding equity in Clarion Partners. The acquisition of Clarion Partners fills gaps in our illiquid alternative product offerings. The transaction with Clarion Partners was completed on April 13, 2016.

On January 22, 2016, we entered into an agreement to combine the Permal Group, our existing hedge fund of funds platform, with EnTrust Capital ("EnTrust"), a leading alternative asset management firm headquartered in New York with approximately \$10 billion in AUM as of March 31, 2016, and largely complementary investment strategies, investor base, and business mix to Permal. As a result of the combination, we own 65% of the combined entity, branded EnTrustPermal, and 35% is owned by EnTrustPermal's chief executive officer. The combination of the businesses of EnTrust and Permal will create a new global alternatives solutions firm. The transaction with EnTrust was completed on May 2, 2016.

On January 22, 2016, we acquired a minority equity position in Precidian Investments, LLC ("Precidian"), a firm specializing in creating innovative products and solutions and solving market structure issues, particularly with regard to the exchange-traded fund ("ETF") marketplace. Under the terms of the transaction, we acquired preferred units of Precidian that entitle us to approximately 20% of the voting and economic interests of Precidian, along with customary preferred equity protections. At our sole option during the 48 months following the initial investment, we may, subject to satisfaction of certain closing conditions, convert our preferred units to 75% of the common equity of Precidian on a fully diluted basis. The investment in Precidian expands our ETF capabilities and provides the opportunity to partner with Precidian to create new products and offerings.

## Management Equity Plan

On March 1, 2016, we implemented a management equity plan and revised revenue sharing arrangement with our subsidiary, Royce & Associates ("Royce"). Under the terms of the management equity plan, Royce's management team was issued equity interests in Royce which allow the holders to receive quarterly distributions of a portion of Royce's net income. Our prior revenue sharing arrangement with Royce was replaced with a new arrangement which reduced the percentage of Royce net revenues reserved to pay expenses (including bonus awards) and increased the percentage of revenues payable to us. The management equity plan and new revenue sharing arrangement help to align the interests of Royce's management with our interests and provide continued incentives to grow revenues and control operating expenses.

## Financings

On December 29, 2015, we entered into a Credit Agreement (the "Credit Agreement") pursuant to which we have available a multi-currency revolving credit facility in an amount of \$1 billion (as amended from time to time, the "Revolving Facility"). We borrowed \$40 million on the Revolving Facility on December 29, 2015 to repay the outstanding \$40 million balance on our previous revolving credit facility, which was terminated. On May 4, 2016, we borrowed \$460 million under the Revolving Facility in order to replenish cash used to pay for the acquisitions of EnTrust and Clarion Partners. We will use the remainder of the available borrowings under the Revolving Facility to fund working capital needs and for general corporate purposes.

On March 14, 2016, we completed the issuance and sale of \$250 million aggregate principal amount of 6.375% Junior Subordinated Notes due 2056 (the "2056 Notes"). On March 22, 2016, we completed the issuance and sale of \$450 million aggregate principal amount of 4.750% Senior Notes due 2026 (the "2026 Notes"). The net proceeds of both offerings, together with borrowings under our Revolving Facility, were used to finance the purchase prices of the acquisitions of EnTrust and Clarion Partners and to pay fees and expenses related to those transactions.

See “Item 8. Financial Statements and Supplementary Data” for the revenues, net income and assets of Legg Mason, which operates in a single reportable business segment. See Note 16 of Notes to Consolidated Financial Statements in Item 8 of this Report for our revenues generated in, and our long-lived assets (consisting primarily of intangible assets and goodwill) located in, each of the principal geographic regions in which we conduct business. See Note 7 of Notes to Consolidated Financial Statements in Item 8 of this Report for our deferred tax assets in the U.S. and in all other countries, in aggregate.

Table of Contents

## Business Overview

Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored investment funds and retail separately managed account programs. Operating from asset management offices located in the United States, the United Kingdom and a number of other countries worldwide, our businesses provide a broad array of investment management products and services. We offer these products and services directly and through various financial intermediaries. Our investment advisory services include discretionary and non-discretionary management of separate investment accounts in numerous investment styles for institutional and individual investors. Our investment products include proprietary mutual funds ranging from money market and other liquidity products to fixed income, equity and alternative funds managed in a wide variety of investment styles. We also offer other domestic and offshore funds to both retail and institutional investors and funds-of-hedge funds.

Our subsidiary asset managers primarily earn revenues by charging fees for managing the investment assets of clients. Fees are typically calculated as a percentage of the value of AUM; accordingly, the fee income of each of our asset managers will typically increase or decrease as its average AUM increases or decreases. In addition, the fees on our AUM vary with the type of account managed, the amount of assets in the account, the asset manager and the type of client. Increases in AUM generally result from inflows of additional assets from new and existing clients and from appreciation in the value of client assets (including investment income earned on client assets). Conversely, decreases in AUM generally result from client redemptions and declines in the value of client assets. Our AUM may also increase as a result of business acquisitions, or decrease as a result of dispositions.

We may earn performance fees from certain accounts if the investment performance of the assets in the account meets or exceeds a specified benchmark, high water mark or hurdle rate during a measurement period. For the fiscal years ended March 31, 2016, 2015 and 2014, of our \$2.7 billion, \$2.8 billion and \$2.7 billion in total revenues, \$42.0 million, \$83.5 million and \$107.1 million, respectively represented performance fees. As of March 31, 2016, approximately 7% of our total AUM was in accounts that were eligible to pay performance fees.

As of March 31 of each of the last three fiscal years, we had the following aggregate AUM (in billions, except percentages):

			% of		% of		% of
Assets Under Management	Equity Assets	Total in Equity Assets	Fixed Income Assets	Total in Fixed Income Assets	Liquidity Assets	Total in Liquidity Assets	
2016	\$ 669.6	\$180.5	27 %	\$376.8	56 %	\$ 112.3	17 %
2015	702.7	199.4	28	376.1	54	127.2	18
2014	701.8	186.4	27	365.2	52	150.2	21

From time to time, our reported equity or fixed income assets under management may exclude assets that we are retained to manage on a short-term or temporary basis. Beginning in fiscal year 2017, we will report Alternative Assets as part of our AUM classifications. We currently define Alternative Assets as all AUM managed by Clarion Partners, EnTrustPermal, RARE Infrastructure or Permal Capital Management.

We believe that market conditions and our investment performance are critical elements in our attempts to grow our AUM and business. When securities markets are increasing, our AUM will tend to increase because of market performance, resulting in additional asset management revenues. Similarly, if we can produce positive investment results, our AUM will tend to increase as a result of our asset managers' investment performance. In addition, favorable market conditions or strong relative investment performance can result in increased inflows in assets from existing and new clients. Conversely, in periods when securities markets are weak or declining, or when we have

produced poor investment performance, absolute or relative to benchmarks or peers, it is likely to be more difficult to grow our AUM and business and, in such periods, our AUM and business may decline.

## Table of Contents

We generally manage the accounts of our clients pursuant to written investment management or sub-advisory contracts between one of our asset managers and the client (or a financial intermediary acting on behalf of the client). These contracts usually specify, among other things, the management fees to be paid to the asset manager and the investment strategy for the account, and are generally terminable by either party on relatively short notice. Typically, investment management contracts may not be assigned (including as a result of transactions, such as a direct or indirect change of control of the asset manager, if it would constitute an assignment under the Investment Advisers Act of 1940 or other applicable regulatory requirements) without the prior consent of the client. When the asset management client is a U.S. registered mutual fund or closed-end fund (whether or not one of our asset managers has sponsored the fund), the fund's board of directors generally must annually approve the investment management contract, and any material changes to the contract, and the fund's board of directors and fund shareholders must approve any assignment of the contract (including as a result of transactions that would constitute an assignment under the Investment Company Act of 1940).

We conduct the majority of our business through our asset managers. Our asset managers are individual businesses, each of which generally focuses on a portion of the asset management industry in terms of the types of assets managed (primarily equity or fixed income), the types of products and services offered, the investment styles utilized, the distribution channels used, and the types and geographic locations of its clients. Each asset manager is housed in one or more different subsidiaries, all of the voting equity of which, as of March 31, 2016, is directly or indirectly owned by Legg Mason except for Royce, which is 17% owned by its management team, RARE Infrastructure, which is 15% owned by its management team and 10% owned by another shareholder and one joint venture that we own with a former employee.

Each of our primary asset managers is generally operated as a separate business, in many cases with certain distribution functions being provided by the parent company and other affiliates, that typically markets its products and services under its own brand name. Consistent with this approach, we have in place revenue sharing arrangements with certain of our asset managers: Brandywine Global Investment Management, ClearBridge Investments, RARE Infrastructure, Royce & Associates, and Western Asset Management Company, and/or certain of their key officers. Pursuant to these revenue sharing arrangements, a specified percentage of the asset manager's revenues, net of certain third party distribution expenses, is required to be distributed to the equity owners of the business and the balance of the revenues (or net revenues) is retained to pay operating expenses, including salaries and bonuses, but excluding certain expenses such as amortization of acquired intangible assets and excluding income taxes. Specific compensation allocations are determined by the asset manager's management, subject to corporate management approval in certain cases. Although, without renegotiation, the revenue sharing arrangements impede our ability to increase our profit margins from these businesses, we believe the agreements are important because they help us retain and attract talented employees. In addition, the revenue sharing arrangements provide management of these asset managers with incentives to (i) grow the asset managers' revenues, since management is able to participate in the revenue growth through the portion that is retained; and (ii) control operating expenses, which will increase the portion of the revenues retained that is available to fund growth initiatives and for incentive compensation. In addition, the management teams of Royce and RARE Infrastructure have significant equity interests in the applicable company, which helps to align the interests of the management of those two affiliates with the interests of our shareholders.

### Asset Managers

Our asset managers provide a wide range of investment advisory services to separately managed account clients, including institutional clients such as pension and other retirement plans, corporations, insurance companies, endowments and foundations and governments, as well as retail clients such as high net worth individuals and families, and retail separately managed account programs. In addition, our asset managers also manage or sub-advise various groups of proprietary and non-proprietary U.S. mutual funds registered under the Investment Company Act of

1940, as amended, including equity, fixed income, liquidity and balanced funds. Certain of our asset managers also manage or sub-advise numerous international mutual funds that are domiciled and distributed in countries around the globe.

Western Asset Management Company is a leading global fixed income asset manager for institutional clients. Headquartered in Pasadena, California, Western Asset Management's operations include investment operations in New York City, the United Kingdom, Japan, Brazil, Australia and Singapore. Western Asset Management offers a broad range of products spanning the yield curve and encompassing the world's major bond markets, including a suite of limited duration and core products, emerging market and high yield portfolios, municipal portfolios and a variety of sector-oriented and global products. Among the services Western Asset Management provides are management of separate accounts and U.S. mutual funds, one real estate investment trust, closed-end funds, international funds and other structured investment products. As of March 31, 2016, Western Asset Management managed assets with a value of \$428.9 billion.

Table of Contents

ClearBridge Investments is an equity asset management firm based in New York City that also has an office in Baltimore, Maryland. ClearBridge Investments provides asset management services to certain of the equity funds (including balanced funds and closed-end funds) in the Legg Mason Funds, to retail separately managed account programs, to certain of our international funds and, primarily through separate accounts, to institutional clients. ClearBridge Investments also sub-advises non-proprietary U.S. mutual funds that are sponsored by third parties. ClearBridge Investments offers a diverse array of investment styles and disciplines, designed to address a range of investment objectives. Significant ClearBridge Investments investment styles include low volatility, high active shares and income solutions. In managing assets, ClearBridge Investments generally utilizes a bottoms-up, research intensive, fundamental approach to security selection that seeks to identify companies with the potential to provide solid economic returns relative to their risk-adjusted valuations. As of March 31, 2016, ClearBridge Investments managed assets with a value of \$96.0 billion.

Brandywine Global Investment Management is a global asset management firm headquartered in Philadelphia, Pennsylvania with offices also in the United Kingdom, Canada and Singapore. Brandywine Global provides investment advisory services primarily to separately managed accounts for institutional clients in a range of fixed income, including global and international fixed income, and equity investment strategies. Brandywine Global also provides investment advisory services to high net worth clients through separately managed account programs, including various non-proprietary wrap accounts sponsored by third parties. In addition, Brandywine Global manages nine of our proprietary U.S. mutual funds and a number of our international funds. Brandywine Global pursues a value investing approach in its management of both equity and fixed income assets. As of March 31, 2016, Brandywine Global managed assets with a value of \$70.2 billion.

QS Investors is a customized solutions and global quantitative equities investment firm providing asset management and advisory services to a diverse array of institutional clients. Headquartered in New York City, QS Investors has developed approaches to integrating quantitative and behavioral investment insights and dynamically weighting opportunities in response to changing conditions in the economy and the market. QS Investors offers a broad spectrum of strategies which includes actively managed U.S. and Global equities, Liquid Alternatives, and Customized Solutions. Following our acquisition of QS Investors in May 2014, two of our wholly-owned subsidiaries, Batterymarch and LMGAA, were integrated into QS Investors. As of March 31, 2016, QS Investors managed approximately \$18.1 billion of AUM.

Royce is the investment advisor to all of The Royce Funds, a proprietary range of equity U.S. mutual funds and to certain of our international funds. In addition, Royce manages other pooled and separately managed accounts, primarily for institutional clients. Headquartered in New York City, Royce generally invests in smaller company stocks, using a value approach. Royce's stock selection process generally seeks to identify companies with strong balance sheets and the ability to generate free cash flow. Royce pursues securities that are priced below its estimate of the issuer's current worth. As of March 31, 2016, Royce managed assets with a value of \$17.7 billion.

Permal Group Limited is a leading global funds-of-hedge funds management firm with its investment teams located in London, New York City and Paris and additional offices in Boston, Dubai, Hong Kong, Singapore and Nassau. Permal Group manages products which include both directional and absolute return strategies, and are available through multi-manager and single manager funds, separately managed accounts and structured products sponsored by several large financial institutions. Permal Group selects from among thousands of investment managers and investment firms in designing portfolios that are intended to meet a wide variety of specific investment objectives, including global, regional, class and sector specific offerings. In managing its directional offerings, Permal Group's objective is to participate significantly in strong markets, preserve capital in down or volatile markets and outperform market indices over a full market cycle with reduced risk and volatility. In managing its absolute return strategies, Permal Group seeks to achieve positive investment returns in all market conditions with low correlation to the overall

equity markets. As of March 31, 2016, Permal managed assets with a value of \$16.4 billion. On May 2, 2016, we completed a transaction which combined the Permal Group with EnTrust Capital. We own 65% of the combined firm, EnTrustPermal.

Martin Currie is an international equity specialist headquartered in Edinburgh, Scotland. It manages active equity portfolios for a global client base of financial institutions, charities, foundations, endowments, pension funds, family offices, government agencies and investment funds. Following our acquisition of Martin Currie, our Melbourne-based Australian equities investment team, which specializes in Australian equity products, Australian property trusts and asset allocation products, was combined into Martin Currie. As of March 31, 2016, Martin Currie, including the Australian equities investment team, managed approximately \$11.5 billion in AUM.



## Table of Contents

RARE Infrastructure is a global listed infrastructure investing specialist, which we acquired in October 2015. Legg Mason holds a 75% ownership interest in the firm, the firm's management team retained a 15% equity stake and a previous minority owner retained 10%. Headquartered in Sydney, Australia, RARE Infrastructure had approximately \$6.3 billion in AUM as of March 31, 2016.

We and one of our former employees each own 50% of a joint venture that serves as investment manager of two equity U.S. mutual funds, the Legg Mason Opportunity Trust and the Miller Income Opportunity Trust, within the Legg Mason Funds family. We include all of the assets managed by the joint venture, which totaled \$2.1 billion at March 31, 2016, in our AUM.

Legg Mason Poland engages in portfolio management, servicing and distribution of both separate account management services and local funds in Poland. Based in Warsaw, the firm provides portfolio management services primarily for equity assets to institutions, including corporate pension plans and insurance companies, and, through funds distributed through banks and insurance companies and individual investors. As of March 31, 2016, Legg Mason Poland managed assets with a value of \$1.1 billion.

In April 2016, we acquired Clarion Partners. We hold an 82% equity interest in Clarion Partners, while the Clarion Partners management team holds the remaining 18% of outstanding equity. Clarion Partners managed approximately \$41.5 billion in AUM as of April 30, 2016.

### United States Mutual Funds

Our U.S. mutual funds primarily consist of two groups of proprietary mutual and closed-end funds (the "Legg Mason Funds" and the "Royce Funds"). The Legg Mason Funds invest in a wide range of domestic and international equity and fixed income securities utilizing a number of different investment styles, and also include several money market funds. The Royce Funds invest primarily in smaller-cap company stocks using a value investment approach.

The Legg Mason Funds consist of 128 mutual funds and 32 closed-end funds in the United States, all of which are primarily managed or sub-advised by Brandywine Global, ClearBridge Investments, Permal, QS Investors, Western Asset Management, Martin Currie, RARE Infrastructure and our joint venture with a former employee. The mutual funds and closed-end funds within the Legg Mason Funds include 69 equity funds (including balanced funds) that invest in a wide spectrum of equity securities utilizing numerous investment styles, including large- and mid-cap growth funds and international funds. The fixed income and liquidity mutual funds and closed-end funds within the Legg Mason Funds include 91 funds that offer a wide variety of investment strategies and objectives, including income funds, investment grade funds and municipal securities funds. As of March 31, 2016 and 2015, the Legg Mason Funds included \$147.5 billion and \$157.2 billion in assets, respectively, in their mutual funds and closed-end funds, of which approximately 34% and 37%, respectively, were equity assets, approximately 37% and 35%, respectively, were fixed income assets and approximately 29% and 28%, respectively, were liquidity assets.

The Royce Funds consist of 20 mutual funds and three closed-end funds, most of which invest primarily in smaller-cap company or micro-cap company stocks using a value approach. The funds differ in their approach to investing in smaller companies and the universe of securities from which they can select. As of March 31, 2016 and 2015, The Royce Funds included \$16.0 billion and \$26.9 billion in assets, respectively, substantially all of which were equity assets. The Royce Funds are distributed through non-affiliated fund supermarkets, Legg Mason Global Distribution, non-affiliated wrap programs, and direct distribution. In addition, two of the portfolios in The Royce Funds are distributed only through insurance companies.

### International Funds

Outside the United States, we manage, support and distribute numerous proprietary funds across a wide array of global fixed income, liquidity and equity investment strategies. Our international funds include a broad range of cross border funds that are domiciled in Ireland and are sold in a number of countries across Asia, Europe and Latin America. Our international funds also include local fund ranges that are domiciled in the United Kingdom, Australia, Japan, Singapore and Poland and offered to investors in the country of domicile. Our international funds are distributed and serviced by Legg Mason Global Distribution, as discussed below. Our international funds, which include equity, fixed income, liquidity and

## Table of Contents

balanced funds are primarily managed or sub-advised by Brandywine Global, ClearBridge Investments, Permal, QS Investors, Martin Currie, RARE Infrastructure, Royce and Western Asset Management. In the aggregate, we sponsored and managed 208 and 187 of these international funds, respectively at March 31, 2016 and 2015, which at those dates had an aggregate of approximately \$105.9 billion and \$119.8 billion in assets, respectively, of which approximately 17% and 14%, respectively, were equity assets, approximately 22% and 20%, respectively were fixed income assets and approximately 61% and 66%, respectively, were liquidity assets. The information above does not include the funds-of-hedge funds sponsored and managed by Permal, or the Brazil-domiciled funds managed by Western Asset Management.

### Retail Separately Managed Account Programs

We are a leading provider of asset management services to retail separately managed account programs, commonly known as managed account or wrap programs. These programs typically allow securities brokers or other financial intermediaries to offer their clients the opportunity to choose from a number of asset management services pursuing different investment strategies provided by one or more asset managers, and generally charge an all-inclusive fee that covers asset management, trade execution, asset allocation and custodial and administrative services. We provide investment management services through more than 100 retail separately managed account programs sponsored by various financial institutions.

### Distribution

Our centralized global distribution group, Legg Mason Global Distribution, operates two divisions, the U.S. Distribution Group and the International Distribution Group. The U.S. Distribution Group markets, distributes and supports our U.S. mutual funds and retail separately managed account programs. The International Distribution Group markets, distributes and supports our international funds. In general, our U.S. and international sales and marketing teams are housed in separate subsidiaries from our asset managers.

In addition, each of our asset managers has its own sales and marketing teams that distribute its products and services, primarily, in most cases, to institutional investors or high net worth individuals and families. The institutional sales and marketing teams of our asset managers distribute asset management services to potential clients, both directly and through consultants. Consultants play a large role in institutional asset management by helping clients select and retain asset managers. Institutional asset management clients and their consultants tend to be highly sophisticated and investment performance-driven.

### U.S. Distribution

The U.S. Distribution Group of Legg Mason Global Distribution employs a team of U.S. based sales, marketing and support staff that market, distribute and support our U.S. mutual funds, including the Legg Mason Funds and the Royce Funds. Our mutual fund wholesalers distribute the Legg Mason Funds through a number of third-party distributors. While we have worked to diversify our distribution network, historically, many of the Legg Mason Funds were principally sold through the retail brokerage business of Citigroup. The retail business created by the combination of Morgan Stanley's brokerage unit and Citigroup's Smith Barney unit into Morgan Stanley Wealth Management remains a significant intermediary selling the Legg Mason Funds.

The U.S. Distribution Group distributes institutional share classes of the Legg Mason Funds to institutional clients and also distributes variable annuity sub-advisory services provided by our asset managers to insurance companies (including advisory services provided to certain of the Legg Mason Funds that are specifically designed for purchase through variable annuity contracts and variable life insurance policies offered by participating insurance companies). Our institutional liquidity funds are primarily distributed by Western Asset Management's sales team. The Royce

Funds are distributed by Royce's sales team in addition to the U.S. Distribution Group.

In addition to distributing funds, the wholesalers in Legg Mason Global Distribution also market and support our retail separately managed account program services. These services are provided through programs sponsored by a variety of financial institutions.

## Table of Contents

### International Distribution

The International Distribution Group of Legg Mason Global Distribution employs a team of sales, marketing and support staff that markets, distributes and supports our international funds to individual and institutional investors across Asia, Europe and the Americas. The International Distribution Group has sales teams operating out of distribution offices in 16 cities in 13 countries and distributing our cross border international funds globally and our international local fund ranges in their respective countries. The goal of our International Distribution Group is to be a global partner for firms that utilize or distribute asset management products around the world, but also to be viewed as a local partner through an understanding of the nuances and needs of each local market that they cover. These distributors seek to develop deep distribution relationships with retail banks, private banks, asset managers, fund platforms, pension plans and insurance plans. Our international distribution offices also work with our asset managers on a case-by-case basis to take advantage of preferences for local distributors or to meet regulatory requirements in distributing products and services into their local markets.

Legg Mason Investments is the largest business component within the International Distribution Group. It is responsible for the distribution and servicing of cross border and local fund ranges across Europe, the Americas and Asia. Legg Mason Investments has offices in locations including London, Paris, Milan, Zurich, Frankfurt, Madrid, Singapore, Hong Kong, Taipei, Miami, Santiago and New York. Our distribution efforts are not limited to the locations where we have offices, as Legg Mason Investments distributes cross border funds in more than 30 countries around the world. This global presence provides Legg Mason Investments with the capabilities to provide a platform of sales, service, marketing and products that can cater to the different distribution dynamics in each of the three regions that it covers. Client coverage is local, coordinated across regions, and encompasses multiple distribution channels including broker-dealers, funds-of-funds, asset managers, independent financial advisers, banks, fund platforms, insurance companies and other distribution partners. The extent to which each channel takes precedence in any one market is governed by local market dynamics.

In addition to Legg Mason Investments, Legg Mason Global Distribution includes separate distribution operations in Australia and Japan. In Australia, our distribution operations distribute local and cross border funds sub-advised by our asset managers primarily to retail investors, pension plans, fund-of-funds managers, insurance companies and government funds/agencies. In Japan, our distribution operations distribute domestic investment funds, cross border funds and institutional separate accounts primarily to the retail market, which includes retail banks, private banks, asset managers, funds platforms and insurance companies.

Permal's products and services are sold outside the United States to non-U.S. high net worth investors through a network of financial intermediaries by Permal's distribution operations as well as through our International Distribution Group. Permal's relationships with its financial intermediaries have resulted in wide international distribution of Permal's products and services. In addition, Permal distributes its products and services to U.S. and international institutions through Permal's internal distribution teams.

### Employees

At March 31, 2016, 2015 and 2014, we had 3,066, 2,982 and 2,843 employees, respectively. None of our employees are covered by a collective bargaining agreement. We consider our relations with our employees to be satisfactory. However, competition for experienced asset management personnel is intense and from time to time we may experience a loss of valuable personnel. We recognize the importance to our business of hiring, training and retaining skilled professionals.

### Competition

We are engaged in an extremely competitive business and are subject to substantial competition in all aspects of our business. Our competition includes, with respect to one or more aspects of our business, numerous international and domestic asset management firms and broker-dealers, mutual fund complexes, hedge funds, commercial banks, insurance companies, other investment companies and other financial institutions. Many of these organizations offer products and services that are similar to, or compete with, those we offer, and many of these organizations have substantially more personnel and greater financial resources than we have. Some of these competitors have proprietary products and distribution channels that make it more difficult for us to compete with them. In addition, many of our competitors have long-standing and established relationships with distributors and clients. The principal competitive factors relating to our business are the quality of advice and services provided to investors, the performance records of that advice and service, the reputation of

## Table of Contents

the company providing the services, the price of the services, the products and services offered and distribution relationships and compensation offered to distributors.

Competition in our business periodically has been affected by significant developments in the asset management industry. See “Item 1A. Risk Factors - Risks Related to our Asset Management Business - Competition in the Asset Management Industry Could Reduce our Revenues and Net Income.”

## Regulation

The asset management industry in the United States is subject to extensive regulation under both federal and state securities and other laws. The SEC is the federal agency charged with administration of the federal securities laws. Our distribution activities also may be subject to regulation by federal agencies, self-regulatory organizations and state securities commissions in those states in which we conduct business. In addition, asset management firms are subject to regulation by various foreign governments, securities exchanges, central banks and regulatory bodies, particularly in those countries where they have established offices. Due to the extensive laws and regulations to which we are subject, we must devote substantial time, expense and effort to remaining vigilant about, and addressing, legal and regulatory compliance matters. Moreover, regulatory changes in one jurisdiction often affect our business operations in other jurisdictions.

Virtually all aspects of our business are subject to various laws and regulations around the world, some of which are summarized below. These laws and regulations are primarily intended to protect investment advisory clients and investors in registered and unregistered investment companies. Under these laws and regulations, agencies that regulate investment advisers, investment funds and other individuals and entities have broad administrative powers, including the power to limit, restrict or prohibit the regulated entity or person from conducting business if it fails to comply with such laws and regulations. Regulators also have a variety of informal enforcement mechanisms available that could have a significant impact on our business. Possible sanctions for significant compliance failures include the suspension of individual employees, limitations on engaging in certain lines of business for specified periods of time, revocation of investment adviser and other registrations, censures and fines. A regulatory proceeding, regardless of whether it results in a sanction, can require substantial expenditures and can have an adverse effect on our reputation or business.

## Regulatory Reform

We are subject to numerous regulatory reform initiatives around the world. Any such initiative, or any new laws or regulations or changes in enforcement of existing laws or regulations, could materially and adversely impact us by leading to business disruptions, requiring us to change certain business practices and exposing us to additional costs (including compliance and legal costs). The rules governing the regulation of financial institutions and their holding companies and subsidiaries are very detailed and technical. Accordingly, the discussion below is general in nature, does not purport to be complete and is current only as of the date of this report.

## Dodd-Frank Wall Street Reform and Consumer Protection Act

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was signed into law in the United States. The Dodd-Frank Act requires the adoption of extensive regulations and numerous regulatory decisions, many of which have been adopted and others of which will be forthcoming. As the impact of these rules will become evident over time, it is not yet possible to predict the ultimate effects that the Dodd-Frank Act or subsequent implementing regulations and decisions will have on us.

## Systemically Important Financial Institution Review

On July 31, 2014, the Financial Stability Oversight Council (“FSOC”) principals directed the staff to undertake a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry, and on December 18, 2014 the FSOC issued a Request for Information related to this analysis. On April 18, 2016, the FSOC released a statement providing an update on its review of asset management products and activities and their potential risks to U.S. financial stability. The statement outlines FSOC’s recent analysis of risks focused on the following areas: (i) liquidity and redemption; (ii) leverage; (iii) operational functions; (iv) securities lending; and (v) resolvability and transition planning. The statement also includes the FSOC’s views on ways to mitigate potential financial instability risk relating to such areas.



## Table of Contents

In addition, on January 8, 2014, the Financial Stability Board (“FSB”) and the International Organization of Securities Commissions (“IOSCO”) issued a consultative document on proposed methodologies to identify nonbank/noninsurance global systemically important financial institutions (“G-SIFI”). A second FSB-IOSCO consultation is expected to be released in the near future.

Under the Dodd-Frank Act, we could be designated a systemically important financial institution (“SIFI”) and become subject to direct supervision by the Board of Governors of the Federal Reserve System (the “Federal Reserve”). If we or any other asset manager were designated a SIFI or G-SIFI, we could become subject to enhanced prudential, capital, supervisory and other requirements, such as risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, concentration limits, a contingent capital requirement, enhanced public disclosures, short-term debt limits and overall risk management requirements. Requirements such as these, which were designed to regulate banking institutions, would likely need to be modified to be applicable to an asset manager. No proposals have been made indicating how such measures would be adapted for asset managers.

### Money Market Fund Reform

On July 23, 2014, the SEC adopted final rules on money market fund reform (the “2014 Rules”), which are designed to reform the regulatory structure governing money market funds and to address the perceived systemic risks that such funds present. The 2014 Rules require any institutional prime money market fund and any institutional municipal (or tax-exempt) money market fund that is registered under the Investment Company Act of 1940 to utilize market-based valuations to calculate a floating net asset value (“NAV”) rather than using the amortized cost method for valuing securities maturing in more than 60 days to seek to maintain a stable NAV. The 2014 Rules also provide for new tools for the funds’ boards designed to address unanticipated changes in the demand for liquidity, or liquidity shocks, including liquidity fees and redemption gates. Institutional prime and institutional municipal money market funds and retail money market funds must comply with liquidity fees and redemption gate requirements, but these are optional for U.S. Government money market funds. Approximately 16% of our AUM as of March 31, 2016, consisted of assets in money market funds, of which institutional prime or institutional municipal money market funds (including offshore funds that feed into such money market funds) comprised approximately 80% of that total. While various changes prompted by the 2014 Rules have phased in over time, final implementation of all reforms must be completed by October 14, 2016. The potential impact of the rules that affect the structure of the funds on our business remains untested.

### Securities and Exchange Commission Review of Asset Managers and Mutual Funds

Our business may also be impacted by additional regulatory initiatives by the SEC. In December 2014, the Chair of the SEC recommended that the SEC enhance its oversight of asset managers by (i) expanding and updating data requirements with which asset managers must comply, (ii) improving fund level controls, including those related to liquidity levels and the nature of specific instruments and (iii) ensuring that asset management firms have appropriate transition plans in place to deal with market stress events or situations where an investment adviser is no longer able to serve its clients. In May 2015, the SEC issued proposed amendments to Form ADV, the form filed by an investment adviser to register with the SEC as an investment adviser, to require that a registered investment adviser provide additional and more detailed information about itself and the separately managed accounts (i.e., non-pooled investment vehicles) that it advises, including information on the types of assets held in client accounts and the use of derivatives and borrowings in client accounts. Also in May 2015, the SEC proposed new rules (as well as amendments to existing rules) to modernize the reporting and disclosure of information by registered investment companies. Although the proposed changes have not been finalized, any additional SEC oversight or the introduction of any new reporting, disclosure or control requirements could expose us to additional compliance costs and may require us to change how we operate our business.

## Regulation of Derivatives

The SEC, the Internal Revenue Service (“IRS”) and the Commodity Futures Trading Commission (“CFTC”) each continue to review the use of futures, swaps and other derivatives by mutual funds. Such reviews could result in regulations that further limit the use of such products by mutual funds. If adopted, these limitations could require us to change certain mutual fund business practices or to register additional entities with the CFTC, which could result in additional costs and/or restrictions. We also report certain information about a number of our private funds to the SEC and certain information to the CFTC, under systemic risk reporting requirements adopted by both agencies. These reporting obligations have required,

## Table of Contents

and will continue to require, investments in people and systems to assure timely and accurate reporting. The rules and regulations applicable to offshore funds, accounts and counterparties will require us to build and implement new compliance monitoring procedures to address the enhanced level of oversight to which we will be subject. These rule changes also introduce new requirements for centrally clearing certain swap, and eventually security-based swap, transactions and for executing certain swap, and eventually security-based swap, transactions on or through CFTC or SEC-registered trading venues. Jurisdictions outside the United States in which we operate also have adopted and implemented, or are in the process of considering, adopting or implementing more pervasive regulation of many elements of the financial services industry, which could further impact us and the broader markets. This includes the implementation of mandated central clearing of swaps in the European Union (“EU”) and the implementation of trade reporting, documentation, central clearing and other requirements in various jurisdictions globally.

### Use of Derivatives by US Registered Investment Companies - SEC Proposed Rule

On December 11, 2015 the SEC proposed a new exemptive rule designed to provide an updated and more comprehensive approach to the regulation of US mutual funds’ use of derivatives. The proposed rule would permit mutual funds, ETFs, closed-end funds, and companies that have elected to be treated as business development companies under the Act to enter into derivatives transactions and financial commitment transactions, notwithstanding the prohibitions and restrictions on the issuance of senior securities under the Act, provided that the funds comply with the conditions of the proposed rule. A fund that relies on the proposed rule in order to enter into derivatives transactions would be required to: comply with one of two alternative portfolio limitations designed to impose a limit on the amount of leverage the fund may obtain through derivatives transactions and other senior securities transactions; manage the risks associated with the fund’s derivatives transactions by maintaining an amount of certain assets, defined in the proposed rule as “qualifying coverage assets,” designed to enable the fund to meet its obligations under its derivatives transactions; and, depending on the extent of its derivatives usage, establish a formalized derivatives risk management program. A fund that relies on the proposed rule in order to enter into financial commitment transactions would be required to maintain qualifying coverage assets equal in value to the fund’s full obligations under those transactions. The potential impact of the new rule, which is still subject to change and is likely to have a lengthy transition period prior to implementation, on the funds and/or our business is unclear.

### Proposed SEC Liquidity Management Rule covering US Registered Open-End Funds, including ETFs

On September 22, 2015, the SEC proposed a new rule (and amendments to existing rules) designed to promote effective liquidity risk management throughout the open-end fund industry, thereby reducing the risk that funds will be unable to meet redemption obligations and mitigating dilution of the interests of fund shareholders. The proposed amendments also seek to enhance disclosure regarding fund liquidity and redemption practices. The proposed new rule would require each registered open-end fund, including open-end ETFs (but not including money market funds), to establish a liquidity risk management program. The Commission also proposed amendments to existing rule 22c-1 to permit a fund, under certain circumstances, to use “swing pricing,” the process of adjusting the net asset value of a fund’s shares to effectively pass on the costs stemming from shareholder purchase or redemption activity to the shareholders associated with that activity. The potential impact of the new and amended rules, which are still subject to change and are likely to have a lengthy transition period prior to implementation, on the funds and/or our business is unclear.

### Benchmark Reform

In 2013, the IOSCO published principles for regulatory oversight of financial benchmarks, with standards applying to methodologies for benchmark calculation, and transparency and governance issues in the benchmarking process. Regulators in some of the jurisdictions in which we operate are analyzing the application of these principles, with a draft European Regulation published in September 2013. In July 2014, the FSB published a report aimed at reforming

major interest rate benchmarks. These regulations may result in business disruptions or strictly control the activities of financial services firms.

#### Alternative Investment Fund Managers Directive

Our European business is impacted by the EU Alternative Investment Fund Managers Directive (“AIFMD”), which became effective on July 21, 2011. The AIFMD regulates managers of, and service providers to, a broad range of alternative investment funds (“AIFs”) domiciled within and (depending on the precise circumstances) outside the EU. The AIFMD also regulates the marketing of all AIFs inside the European Economic Area (“EEA”). The AIFMD is being implemented in

## Table of Contents

stages, which run through 2018. Compliance with the AIFMD's requirements restrict alternative investment fund marketing and impose additional compliance and disclosure obligations regarding remuneration, capital requirements, leverage, valuation, stakes in EU companies, depositaries, the domicile of custodians and liquidity management on us. We have incurred, and expect to continue to incur, additional expenses related satisfying these new compliance and disclosure obligations and the associated risk management and reporting requirements.

### Markets in Financial Instrument Directives

We are subject to numerous regulatory reform initiatives in Europe. The United Kingdom and other European jurisdictions in which we operate have implemented the Markets in Financial Instruments Directive ("MiFID") rules into national legislation, and have begun to implement MiFID 2. MiFID 2 builds upon many of the initiatives introduced through MiFID, which focused primarily on equities, to encourage trading across all asset classes to migrate onto open and transparent markets. MiFID 2, which will come into full effect in January 2018, will be implemented through a number of more detailed directives, regulations and standards to be made by the European Commission and by the European Securities and Markets Authority ("ESMA"). It is expected that MiFID 2 will have significant and wide-ranging impacts on EU securities and derivatives markets, including (i) enhanced investor protection and governance standards, (ii) rules regarding the ability of portfolio management firms to receive and pay for investment research relating to all asset classes, (iii) enhanced regulation of algorithmic trading, (iv) the movement of trading in certain shares and derivatives onto regulated execution venues, (v) the extension of pre- and post-trade transparency requirements to wider categories of financial instruments, (vi) restrictions on the use of so-called dark pool trading, (vii) the creation of a new type of trading venue called the Organized Trading Facility for non-equity financial instruments, (viii) commodity derivative position limits and reporting requirements, (ix) a move away from vertical silos in execution, clearing and settlement, (x) an enhanced role for ESMA in supervising EU securities and derivatives markets and (xi) new requirements regarding non-EU investment firms' access to EU financial markets. Implementation of these measures will have direct and indirect impacts on us and certain of our affiliates.

### Undertakings for Collective Investment in Transferable Securities

The EU has adopted directives on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS") with respect to depositary functions, remuneration policies and sanctions. UCITS V, which became effective in September 2014, seeks to align the depositary regime, remuneration rules and sanctioning powers of regulators under UCITS with the requirements of the AIFMD. UCITS V is required to be incorporated into the national law of each EU member state by second quarter of 2016. In addition, in August 2014 ESMA revised the guidelines it published in 2012 on ETFs and other UCITS funds. The guidelines introduced new collateral management requirements for UCITS funds concerning collateral received in the context of derivatives using Efficient Portfolio Management ("EPM") techniques (including securities lending) and over-the-counter derivative transactions. These rules, which are now in effect, required us to make a series of changes to collateral management arrangements applicable to the EPM of UCITS fund ranges and will cause us to incur additional expenses associated with new risk management and reporting requirements.

### Extension of Retail Distribution Review

The United Kingdom and other European jurisdictions in which we operate have recently implemented rules regarding retail distribution review (the "RDR") aimed at enhancing consumer protections, overhauling mutual fund fee structures and increasing professionalism in the retail investment sector. In order to achieve this, RDR requires advisory firms to explicitly disclose and separately charge clients for their services and clearly describe their services as either independent or restricted. It also requires individual advisers to adhere to consistent professional standards, including a code of ethics. Similarly, MiFID 2 will contain a ban on certain advisers recovering commissions and other nonmonetary benefits from fund managers. These rules, if implemented, may lead to changes to the fees and

commissions we are able to charge to our clients, as well as to our client servicing and distribution models.

#### Existing U.S. Regulation

Our U.S. asset managers are registered as investment advisors with the SEC, as are several of our international asset managers, and are also required to make notice filings in certain states. We and certain of our affiliates are also currently subject to regulation by the SEC, the Department of Labor (the “DOL”), the Federal Reserve, the Financial Industry Regulatory Authority (“FINRA”), the National Futures Association (“NFA”), the CFTC and other government agencies and

## Table of Contents

regulatory bodies. Certain of our affiliates are also subject to various anti-terrorist financing, privacy, anti-money laundering regulations and economic sanctions laws and regulations established by various agencies.

The Investment Advisers Act of 1940 imposes numerous obligations on registered investment advisers such as certain of our asset managers, including record-keeping, operational and marketing requirements, disclosure obligations and prohibitions on fraudulent activities. The Investment Company Act of 1940 imposes stringent governance, compliance, operational, disclosure and related obligations on registered investment companies and their investment advisers and distributors. The SEC is authorized to institute proceedings and impose sanctions for violations of the Investment Advisers Act of 1940 and the Investment Company Act of 1940, ranging from fines and censure to termination of an investment adviser's registration. Investment advisers also are subject to certain state securities laws and regulations. Non-compliance with the Investment Advisers Act of 1940, the Investment Company Act of 1940 or other federal and state securities laws and regulations could result in investigations, sanctions, disgorgement, fines and reputational damage.

Our trading and investment activities for client accounts are regulated under the Securities Exchange Act of 1934 (the "Exchange Act"), as well as the rules of various U.S. and non-U.S. securities exchanges and self-regulatory organizations, including laws governing trading on inside information, market manipulation and a broad number of technical requirements and market regulation policies in the United States and globally.

Our broker-dealer subsidiaries are subject to regulations that cover all aspects of the securities business. Much of the regulation of broker-dealers has been delegated to self-regulatory organizations, principally FINRA. These self-regulatory organizations have adopted extensive regulatory requirements relating to matters such as sales practices, compensation and disclosure, and conduct periodic examinations of member broker-dealers in accordance with rules they have adopted and amended from time to time, subject to approval by the SEC. The SEC, self-regulatory organizations and state securities commissions may conduct administrative proceedings that can result in censure, fine, suspension or expulsion of a broker-dealer, its officers or registered employees. These administrative proceedings, whether or not resulting in adverse findings, can require substantial expenditures and can have an adverse impact on the reputation or business of a broker-dealer. The principal purpose of regulation and discipline of broker-dealers is the protection of clients and the securities markets, rather than protection of creditors and stockholders of the regulated entity.

In addition, our asset managers also may be subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and related regulations, particularly insofar as they act as a "fiduciary" under ERISA with respect to benefit plan clients. ERISA and related provisions of the Internal Revenue Code impose duties on persons who are fiduciaries under ERISA, and prohibit certain transactions involving the assets of ERISA plan clients and certain transactions by the fiduciaries (and several other related parties) to the plans. The Department of Labor, which administers ERISA, has been increasingly active in proposing and adopting regulations affecting the asset management industry. On April 6, 2016, the Department of Labor issued a final fiduciary rule expanding the circumstances in which advice furnished to retirement investors will be treated as fiduciary in nature as well as related prohibited transaction class exemptions. The fiduciary rule and exemptions are focused on financial intermediaries who provide advice to institutional and retail retirement plan clients, including the third-party distributors who market and sell Legg Mason Funds and separately managed account program services, and mandate increased disclosure of financial intermediary compensation and mitigation of conflicts of interest. We and our asset managers may be adversely impacted by the fiduciary rule and exemptions to the extent that they lead to changes in financial intermediary and retirement plan investment preferences and increased pressure on product fees and expenses.

## Existing International Regulation

In our international business, we have fund management, asset management, broker-dealer and distribution subsidiaries domiciled in a number of jurisdictions, including Australia, Brazil, Japan, Hong Kong, Ireland, Poland, Singapore, Taiwan and the United Kingdom that are subject to extensive regulation under the laws of, and to supervision by, governmental authorities and regulatory agencies in each of these jurisdictions. Our international subsidiaries are also authorized or licensed to offer their products and services in several other countries around the world, and thus are subject to the laws of, and to supervision by, governmental authorities in these additional countries. In addition, a subsidiary of Permal is a Bahamas bank regulated by the Central Bank of the Bahamas. In some instances, our international subsidiaries are also affected by U.S. laws and regulations that have extra-territorial application. Our offshore proprietary funds are subject to the laws and regulatory bodies of the jurisdictions in which they are domiciled and, for funds listed on exchanges, to the rules of the applicable exchanges. Certain of our funds domiciled in Ireland are also registered for public sale in several



## Table of Contents

countries around the world and are subject to the laws of, and supervision by, the governmental authorities of those countries. All of these non-U.S. governmental authorities generally have broad supervisory and disciplinary powers, including, among others, the power to set minimum capital requirements, to temporarily or permanently revoke the authorization to carry on regulated business, to suspend registered employees, and to invoke censures and fines for both the regulated business and its registered employees.

The Financial Conduct Authority (“FCA”) currently regulates certain of our affiliates in the United Kingdom. Authorization by the FCA is required to conduct certain financial services related business in the United Kingdom under the Financial Services and Markets Act 2000. The FCA’s rules adopted under that Act govern capital resources requirements, senior management arrangements, conduct of business, interaction with clients, and systems and controls. The FCA monitors our compliance with its requirements through a combination of proactive engagement, event-driven and reactive supervision and thematic based reviews. Breaches of the FCA’s rules may result in a wide range of disciplinary actions.

In addition, certain of our affiliates must comply with the pan-European regulatory regime established by MiFID, which became effective on November 1, 2007 and regulates the provision of investment services and activities throughout the wider EEA. MiFID, the scope of which is being enhanced through MiFID 2, sets out detailed requirements governing the organization and conduct of business of investment firms and regulated markets. It also includes pre- and post-trade transparency requirements for equity markets and extensive transaction reporting requirements.

Certain of our affiliates are subject to an EU regulation on OTC derivatives, central counterparties and trade repositories, which was adopted in August 2012 and which requires (i) the central clearing of standardized OTC derivatives, (ii) the application of risk-mitigation techniques to non-centrally cleared OTC derivatives and (iii) the reporting of all derivative contracts from February 2014.

In Australia, our affiliates are subject to various Australian federal and state laws and certain subsidiaries are regulated by the Australian Securities and Investments Commission (“ASIC”). ASIC is Australia’s corporate, markets and financial services regulator and is responsible for promoting investor, creditor and consumer protection.

### Net Capital Requirements

We have three small, non-clearing broker-dealer subsidiaries that primarily distribute our funds and other asset management products. These broker-dealer subsidiaries are subject to net capital rules that mandate that they maintain certain levels of capital. In addition, certain of our subsidiaries that operate outside the United States are subject to net capital or liquidity requirements in the jurisdictions in which they operate. For example, in addition to requirements in other jurisdictions, our United Kingdom-based subsidiaries and our Singapore-based subsidiaries are subject to the net capital requirements of the FCA and the Monetary Authority of Singapore, respectively.

## Table of Contents

### ITEM 1A. RISK FACTORS.

Our business, and the asset management industry in general, is subject to numerous risks, uncertainties and other factors that could negatively affect our business or results of operations. These risks, uncertainties and other factors, including the ones discussed below and those discussed elsewhere herein and in our other filings with the SEC, could cause actual results to differ materially from any forward-looking statements that we or any of our employees may make.

#### Risks Related to our Asset Management Business

##### Poor Investment Performance Could Lead to a Loss of Assets Under Management and a Decline in Revenues

We believe that investment performance is one of the most important factors for the maintenance and growth of our AUM. Poor investment performance, either on an absolute or relative basis, could impair our revenues and growth because:

- existing clients might withdraw funds in favor of better performing products, which would result in lower investment advisory and other fees;
- our ability to attract funds from existing and new clients might diminish; and
- negative absolute investment performance will directly reduce our managed assets.

In addition, in the ordinary course of our business we may reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. If our revenues decline without a commensurate reduction in our expenses, our net income will be reduced. From time to time, several of our key equity and fixed income asset managers generated poor investment performance, on a relative basis or an absolute basis, in certain products or accounts that they managed, which contributed to a significant reduction in their AUM and revenues and a reduction in performance fees, and several of our asset managers currently face these issues, particularly in connection with shorter-term performance. We face periodic performance issues with certain of our products, and there is typically a lag before improvements in investment performance produce a positive effect on asset flows. There can be no assurances as to when, or if, investment performance issues will cease to negatively influence our AUM and revenues.

##### Assets Under Management May Be Withdrawn, Which May Reduce our Revenues and Net Income

Our investment advisory and administrative contracts are generally terminable at will or upon relatively short notice, and investors in the mutual funds that we manage may redeem their investments in the funds at any time without prior notice. Institutional and individual clients can terminate their relationships with us, reduce the aggregate amount of AUM, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, changes in investment preferences of clients, changes in our reputation in the marketplace, changes in management or control of clients or third-party distributors with whom we have relationships, loss of key investment management or other personnel and financial market performance. This risk is underscored by the fact that we have one international client that represents approximately 7% (primarily liquidity assets) of our total AUM that generates approximately 2% of our operating revenues. In addition, in a declining securities market, the pace of mutual fund redemptions and withdrawal of assets from other accounts could accelerate. Poor investment performance generally or relative to other investment management firms tends to result in decreased purchases of fund shares, increased redemptions of fund shares, and the loss of institutional or individual accounts.

We have experienced net outflows of equity AUM for the last ten fiscal years due in part to investment performance issues. During fiscal years 2016 and 2015, we had \$26.1 billion and \$5.7 billion of net client outflows, respectively.

Fiscal year 2016 outflows included \$14.9 billion, \$10.8 billion, and \$0.4 billion of liquidity, equity, and fixed income net client outflows, respectively. Fiscal year 2015 net outflows included \$22.2 billion in liquidity outflows and \$2.7 billion in equity outflows, which were partially offset by \$19.2 billion in fixed income inflows.

## Table of Contents

### If we Are Unable to Maintain our Fee Levels or If our Asset Mix Changes, our Revenues and Margins Could Be Reduced

Our profit margins and net income are dependent in significant part on our ability to maintain current fee levels for the products and services that our asset managers offer. There has been a trend toward lower fees in some segments of the asset management industry, and no assurances can be given that we will be able to maintain our current fee structure. Competition could lead to our asset managers reducing the fees that they charge their clients for products and services. See “Competition in the Asset Management Industry Could Reduce our Revenues and Net Income.” In addition, our asset managers may be required to reduce their fee levels, or restructure the fees they charge, because of, among other things, regulatory initiatives or proceedings that are either industry-wide or specifically targeted, or court decisions. A reduction in the fees that our asset managers charge for their products and services will reduce our revenues and could reduce our net income. These factors also could inhibit our ability to increase fees for certain products.

Our AUM can generate very different revenues per dollar of managed assets based on factors such as the type of asset managed (equity assets generally produce greater revenues than fixed income assets), the type of client (institutional clients generally pay lower fees than other clients), the type of asset management product or service provided and the fee schedule of the asset manager providing the service. A shift in the mix of our AUM from higher revenue-generating assets to lower revenue-generating assets may result in a decrease in our revenues even if our aggregate level of AUM remains unchanged or increases. A decrease in our revenues, without a commensurate reduction in expenses, will reduce our net income. We experienced a shift in the mix of our AUM during fiscal year 2016, during which our equity AUM decreased to \$180.5 billion (27% of our total AUM) on March 31, 2016 from \$199.4 billion (28% of our total AUM) on March 31, 2015. In addition, average AUM operating revenue yields, excluding performance fees, decreased to 38.2 basis points in fiscal year 2016 from 38.9 basis points in fiscal year 2015 due to a less favorable product mix with lower yielding products comprising a higher percentage of our total average AUM for fiscal year 2016 as compared to fiscal year 2015. There can be no assurance that we will achieve a more favorable product mix in future fiscal years.

### Our Mutual Fund Management Contracts May Not Be Renewed, Which May Reduce our Revenues and Net Income

A substantial portion of our revenue comes from managing U.S. mutual funds. We generally manage these funds pursuant to management contracts with the funds that must be renewed and approved by the funds' boards of directors annually. A majority of the directors of each mutual fund are independent from us. Although the funds' boards of directors have historically approved each of our management contracts, there can be no assurance that the board of directors of each fund that we manage will continue to approve the funds' management contracts each year, or will not condition its approval on the terms of the management contract being revised in a way that is adverse to us. If a mutual fund management contract is not renewed, or is revised in a way that is adverse to us, it could result in a reduction in our revenues and, if our revenues decline without a commensurate reduction in our expenses, our net income will be reduced.

### Unavailability of Appropriate Investment Opportunities Could Hamper our Investment Performance or Growth

An important component of investment performance is the availability of appropriate investment opportunities for new client funds. If any of our asset managers are not able to find sufficient investments for new client assets in a timely manner, the asset manager's investment performance could be adversely affected. Alternatively, if one of our asset managers does not have sufficient investment opportunities for new funds, it may elect to limit its growth by reducing the rate at which it receives new funds. Depending on, among other factors, prevailing market conditions, the asset manager's investment style, regulatory and other limits and the market sectors and types of opportunities in which the asset manager typically invests (such as less capitalized companies and other more thinly traded securities in which relatively smaller investments are typically made), the risks of not having sufficient investment opportunities

may increase when an asset manager increases its AUM, particularly when the increase occurs very quickly. If our asset managers are not able to identify sufficient investment opportunities for new client funds, their investment performance or ability to grow may be reduced.

## Table of Contents

### Changes in Securities Markets and Prices May Affect our Revenues and Net Income

A large portion of our revenue is derived from investment advisory contracts with clients. Under these contracts, the investment advisory fees we receive are typically based on the market value of assets under management.

Accordingly, a decline in the prices of securities generally may cause our revenues and income to decline by:

- causing the value of our AUM to decrease, which would result in lower investment advisory and other fees;
- causing our clients to withdraw funds in favor of investments they perceive offer greater opportunity or lower risk, which would also result in lower investment advisory and other fees; or
- decreasing the performance fees earned by our asset managers.

There are often substantial fluctuations in price levels in the securities markets. These fluctuations can occur on a daily basis and over longer periods as a result of a variety of factors, including national and international economic and political events, broad trends in business and finance, and interest rate movements. Reduced securities market prices generally may result in reduced revenues from lower levels of AUM and loss or reduction in advisory, incentive and performance fees. Periods of reduced market prices may adversely affect our profitability because fixed costs remain relatively unchanged. Because we operate in one industry, the business cycles of our asset managers may occur contemporaneously. Consequently, the effect of an economic downturn may have a magnified negative effect on our business.

In addition, as of March 31, 2016, a substantial portion of our invested assets consisted of securities and other seed capital investments. A decline in the value of equity, fixed income or other alternative securities could lower the value of these investments and result in declines in our non-operating income and net income. Increases or decreases in the value of these investments could increase the volatility of our earnings.

### Changes in Interest Rates Could Have Adverse Effects on our Assets Under Management

Increases in interest rates from their historically low present levels may adversely affect the net asset values of our AUM. In addition, in a rising interest rate environment, institutional investors may shift liquidity assets that we manage in pooled investment vehicles to direct investments in the types of assets in which the pooled vehicles invest in order to realize higher yields than those available in money market and other products or strategies holding lower-yielding instruments. Furthermore, increases in interest rates may result in reduced prices in equity markets. Conversely, decreases in interest rates could lead to outflows in fixed income or liquidity assets that we manage as investors seek higher yields. Any of these effects could lower our AUM and revenues and, if our revenues decline without a commensurate reduction in our expenses, our net income will be reduced.

The current historically low interest rate environment affects the yields of money market funds, which are based on the income from the underlying securities less the operating costs of the funds. With short-term interest rates at or near zero, the operating expenses of money market funds may become greater than the income from the underlying securities, which reduces the yield of the money market funds to very low levels. In addition, bank deposits may become more attractive to investors and money market funds could experience redemptions, which could decrease our revenues and net income. We are monitoring the industry wide low yields of money market funds, which may result in negative yields, particularly in Europe, which could have a significant adverse effect on the industry in general and our liquidity business in particular. During the past four fiscal years, we voluntarily waived certain fees or assumed expenses of money market funds for competitive reasons, such as to maintain competitive yields, which reduces our advisory fee income and net income. These fee waivers for competitive reasons resulted in approximately \$70 million in reduced investment advisory revenues in fiscal year 2016, and have continued into the present fiscal year.

### Competition in the Asset Management Industry Could Reduce our Revenues and Net Income

The asset management industry in which we are engaged is extremely competitive and we face substantial competition in all aspects of our business. We compete with numerous international and domestic asset management firms and broker-dealers, mutual fund complexes, hedge funds, commercial banks, insurance companies, other investment companies and other financial institutions. Many of these organizations offer products and services that are similar to, or compete with, those offered by our asset managers and have substantially more personnel and greater financial resources than we do. Some of these competitors have proprietary products and distribution channels that make it more difficult for us to compete with them. In addition, many of our competitors have long-standing and established relationships with

## Table of Contents

distributors and clients. From time to time, our asset managers also compete with each other for clients and assets under management. Our ability to compete may be adversely affected if, among other things, our asset managers lose key employees or, as has been the case for certain of the products managed by our asset managers, under-perform in comparison to relevant performance benchmarks or peer groups.

The asset management industry has experienced from time to time the entry of many new firms, as well as significant consolidation as numerous asset management firms have either been acquired by other financial services firms or ceased operations. In many cases, this has resulted in firms with greater financial resources than we have. In addition, a number of heavily capitalized companies, including commercial banks and foreign entities have made investments in and acquired asset management firms. Access to mutual fund distribution channels has also become increasingly competitive. All of these factors could make it more difficult for us to compete, and no assurance can be given that we will be successful in competing and growing our AUM and business. If clients and potential clients decide to use the services of competitors, it could reduce our revenues and growth rate, and if our revenues decrease without a commensurate reduction in our expenses, our net income will be reduced. In this regard, there are a number of asset classes and product types that are not well covered by our current products and services. When these asset classes or products are in favor with investors, we will miss the opportunity to gain the assets under management that are being invested in these assets and face the risk of our managed assets being withdrawn in favor of competitors who provide services covering these classes or products. For example, to the extent there is a trend in the asset management business in favor of passive products such as index and certain types of exchange-traded funds, it favors our competitors who provide those products over active managers like our asset managers. In addition, our asset managers are not typically the lowest cost provider of asset management services. To the extent that we compete on the basis of price in any of our businesses, we may not be able to maintain our current fee structure in that business, which could adversely affect our revenues and net income. In the retail separately managed account program business, there has been a trend toward more open programs that involve more asset managers who provide only investment models which the financial institution sponsor's employees use to allocate assets. A number of the programs for which we provide services have followed this trend, and additional programs could do so in the future. This trend could result in AUM retention issues due to additional competition within the programs, particularly for products with performance issues, and reduced management fees, which are typical results of providing investment models rather than advisory services.

Our business is asset management. As a result, we may be more affected by trends and issues affecting the asset management industry, such as industry-wide regulatory issues and inquiries, publicity about, and public perceptions of the industry and asset management industry market cycles, than other financial services companies that have more diversified businesses.

**We May Support Money Market Funds to Maintain Their Stable Net Asset Values, or Other Products we Manage, Which Could Affect our Revenues or Operating Results**

Approximately 16% of our AUM as of March 31, 2016, consisted of assets in money market funds. Money market funds seek to preserve a stable net asset value. The money market funds our asset managers manage have always maintained this stable net asset value. However, there is no guarantee that this stable net asset value will be achieved in the future. Market conditions could lead to severe liquidity or security pricing issues, which could impact their net asset values. If the net asset value of a money market fund managed by our asset managers were to fall below its stable net asset value, we would likely experience significant redemptions in AUM and reputational harm, which could have a material adverse effect on our revenues or net income.

If a money market fund's stable net asset value comes under pressure, we may elect, as we have done in the past, to provide credit, liquidity, or other support to the fund. We may also elect to provide similar or other support, including by providing liquidity to a fund, to other products we manage for any number of reasons. We are not legally required



to support any money market fund or other product and there can be no assurance that any support would be sufficient to avoid an adverse impact on any product or investors in any product. A decision to provide support may arise from factors specific to our products or from industry-wide factors. If we elect to provide support, we could incur losses from the support we provide and incur additional costs, including financing costs, in connection with the support. These losses and additional costs could be material, and could adversely affect our earnings. If we were to take such actions we may also restrict our corporate assets, limiting our flexibility to use these assets for other purposes, and may be required to raise additional capital. In addition, certain proposed regulatory reforms could adversely impact the operating results of our money market funds. See “Item 1. Business - Regulation - Regulatory Reform - Money Market Fund Reform.”

## Table of Contents

### Failure to Comply With Contractual Requirements or Guidelines Could Result in Liability and Loss of Assets Under Management, Both of Which Could Cause our Net Income to Decline

The asset management contracts under which we manage client assets, including contracts with investment funds, often specify guidelines or contractual requirements that we are obligated to observe in providing asset management services. A failure to comply with these guidelines or requirements could result in damage to our reputation, liability to the client or the client reducing its assets under our management, any of which could cause our revenues and net income to decline. This risk is increased by the trend toward customized, specialized mandates seen by many of our asset managers, which tends to result in more complex mandates that are more difficult to administer.

### The Soundness of Other Financial Institutions Could Adversely Affect our Business

Volatility in the markets has highlighted the interconnection of the global markets and demonstrated how the deteriorating financial condition of one institution may materially and adversely impact the performance of other institutions. Legg Mason, and the funds and accounts that we manage, has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial industry. We, and the funds and accounts we manage, may be exposed to credit, operational or other risk in the event of a default by a counterparty or client, or in the event of other unrelated systemic failures in the markets.

### Performance-Based Fee Arrangements May Increase the Volatility of our Revenues

A portion of our total revenues is derived from performance fees. Our asset managers earn performance fees under certain client agreements if the investment performance in the portfolio meets or exceeds a specified benchmark. If the investment performance does not meet or exceed the investment return benchmark for a particular period, the asset manager will not generate a performance fee for that period and, if the benchmark is based on cumulative returns, the asset manager's ability to earn performance fees in future periods may be impaired. As of March 31, 2016, approximately 7% of our AUM was in accounts or products that are eligible to earn performance fees. We earned \$42.0 million, \$83.5 million and \$107.1 million in performance fees during fiscal years 2016, 2015 and 2014, respectively. An increase or decrease in performance fees, or in performance-based fee arrangements with our clients, could create greater fluctuations in our revenues.

### We Rely Significantly on Third Parties to Distribute Mutual Funds and Certain Other Products

Our ability to market and distribute mutual funds and certain other investment products that we manage is significantly dependent on access to third-party financial intermediaries that distribute these products. These distributors are generally not contractually required to distribute our products, and typically offer their clients various investment products and services, including proprietary products and services, in addition to and in competition with our products and services. Relying on third-party distributors also exposes us to the risk of increasing costs of distribution, as we compensate them for selling our products and services in amounts that are agreed between them and us but which, in many cases, are largely determined by the distributor. There has been a recent trend of increasing fees paid to certain distributors in the asset management business, and our distribution costs have increased as a result. While we have worked to diversify our distribution network, historically, many of the Legg Mason Funds were principally sold through the retail brokerage business of Citigroup. The retail business created by the combination of Morgan Stanley's brokerage unit and Citigroup's Smith Barney unit into Morgan Stanley Wealth Management remains a significant intermediary selling the Legg Mason Funds. While the third-party distributors are compensated for distributing our products and services, there can be no assurances that we will be successful in distributing our products and services through them. In addition, mergers and other corporate transactions among distributors may affect our distribution relationships. For example, we are not able to predict the long-term effect of the Morgan Stanley Wealth Management business on our ability to continue to successfully distribute our funds and other

products through it, or the costs of doing so. If we are unable to distribute our products and services successfully, it will adversely affect our revenues and net income, and any increase in distribution-related expenses could adversely affect our net income.

## Table of Contents

### Our Funds-of-Hedge Funds Business Entails a Number of Additional Risks

Permal operates a portion of its business in the international funds-of-hedge funds business. The funds-of-hedge funds business typically involves clients being charged fees on two levels - at the funds-of-funds level and at the underlying funds level. These fees may include management fees and performance fees. There can be no assurance that Permal will not be forced to change its fee structures by competitive or other pressures or that Permal's fee structures will not hamper its growth. Furthermore, Permal, consistent with other funds-of-hedge funds managers, has experienced a trend in recent years of outflows in business from retail high net worth clients and inflows from institutional clients, which has negatively impacted Permal's revenues and profits. On May 2, 2016, we completed a transaction which combines Permal with EnTrust, a leading independent hedge fund investor and alternative asset manager headquartered in New York. There can be no assurance that the combined EnTrustPermal will be able to continue to transition the historical Permal business into the institutional business, or that this transition will not further affect the revenues or profits of EnTrustPermal. In addition, EnTrustPermal may generate significant performance fees from time to time, which could increase the volatility of our revenues. See "Performance-Based Fee Arrangements May Increase the Volatility of our Revenues." Because Permal operates in the funds-of-hedge funds business globally, it is exposed to a number of regulatory authorities and requirements in different jurisdictions.

### Risks Related to our Company

#### Our Leverage May Affect our Business and May Restrict our Operating Results

At March 31, 2016, on a consolidated basis, we had approximately \$1.8 billion in total indebtedness, and total stockholders' equity of \$4.2 billion, and our goodwill and other intangible assets were \$1.5 billion and \$3.1 billion, respectively. After drawing \$460 million on our revolving credit facility in May 2016, in connection with the acquisitions of EnTrust and Clarion Partners, we had \$500 million of additional borrowing capacity available under our revolving credit facility, subject to certain conditions and compliance with the covenants in our credit agreement. As a result of this substantial indebtedness, we are currently required to use a portion of our cash flow to service interest on our debt, which will limit the cash flow available for other business opportunities. In addition, these servicing obligations will increase in the future as the principal payments on this debt become due or if we incur additional indebtedness.

Our ability to make scheduled payments of principal, to pay interest, or to refinance our indebtedness and to satisfy our other debt obligations will depend upon our future operating performance, which may be affected by general economic, financial, competitive, legislative, regulatory, business and other factors beyond our control and by a variety of factors specific to our business.

The level of our indebtedness could:

- limit our ability to obtain additional debt financing in the future or to borrow under our existing credit facilities (our principal bank debt facility requires that (i) our ratio of net debt (total debt less unrestricted cash in excess of working capital) to Consolidated EBITDA (as defined therein) not exceed (a) 3.5 to 1 at any time for the period from March 31, 2016 through and including September 30, 2016, (b) 3.25 to 1 at any time for the period from October 1, 2016, through and including December 31, 2016 and (c) 3 to 1 at any other time., and (ii) our ratio of Consolidated EBITDA to total cash interest payments on certain Indebtedness (as defined therein) exceeds 4.0 to 1);
- limit cash flow available for general corporate purposes due to the ongoing cash flow requirements for debt service;
- limit our flexibility, including our ability to react to competitive and other changes in the industry and economic conditions; and
- place us at a competitive disadvantage compared to our competitors that have less debt.

As of March 31, 2016, under the terms of our bank credit agreement our ratio of net debt to Consolidated EBITDA was 1.3 to 1 (excluding cash held on that date to fund the acquisitions of Clarion Partners and EnTrust) and our ratio of Consolidated EBITDA to interest expense was 13.0 to 1, and, therefore, Legg Mason was in compliance with its bank financial covenants. If our net income significantly declines for any reason, it may be difficult to remain in compliance with these covenants. Similarly, to the extent that we spend our available cash for purposes other than repaying debt or acquiring businesses that increase our EBITDA, we will increase our net debt to Consolidated EBITDA ratio. Although there are

## Table of Contents

actions that we may take if our financial covenant compliance becomes an issue, there can be no assurance that Legg Mason will remain in compliance with its bank debt covenants.

Our access to credit on reasonable terms is also partially dependent on our credit ratings. If our credit ratings are downgraded, it will likely become more difficult and costly for us to access the credit markets or otherwise incur new debt.

Upon the occurrence of various events, such as a change of control, some or all of our outstanding debt obligations may come due prior to their maturity dates and may require payments in excess of their outstanding amounts, which in certain circumstances may be significant.

### We May Engage in Strategic Transactions That Could Create Risks

As part of our business strategy, we regularly review, are currently reviewing, and from time to time have discussions with respect to potential strategic transactions, including potential acquisitions, dispositions, consolidations, joint ventures or similar transactions and “lift-outs” of portfolio management teams, some of which may be material. There can be no assurance that we will find suitable candidates for strategic transactions at acceptable prices, have sufficient capital resources to accomplish our strategy, or be successful in entering into agreements for desired transactions. In addition, these transactions typically involve a number of risks and present financial, managerial and operational challenges, including:

• adverse effects on our reported earnings per share in the event acquired intangible assets or goodwill become impaired;

- existence of unknown liabilities or contingencies that arise after closing; and

• potential disputes with counterparties.

Acquisitions, related transactions and completed acquisitions, including the acquisitions of RARE Infrastructure, Clarion Partners and EnTrust and the combination of EnTrust with Permal to form EnTrustPermal, pose the risk that any business we acquire may lose customers or employees or could underperform relative to expectations. We could also experience financial or other setbacks if transactions encounter unanticipated problems, including problems related to execution or integration. Following the completion of an acquisition, we may have to rely on the seller to provide administrative and other support, including financial reporting and internal controls, to the acquired business for a period of time. There can be no assurance that the seller will do so in a manner that is acceptable to us.

Strategic transactions typically are announced publicly even though they may remain subject to numerous closing conditions, contingencies and approvals and there is no assurance that any announced transaction will actually be consummated. The failure to consummate an announced transaction could have an adverse effect on us. Future transactions may also further increase our leverage or, if we issue equity securities to pay for acquisitions, dilute the holdings of our existing stockholders.

### If our Reputation is Harmed, we Could Suffer Losses in our Business, Revenues and Net Income

Our business depends on earning and maintaining the trust and confidence of clients and other market participants, and the resulting good reputation is critical to our business. Our reputation is vulnerable to many threats that can be difficult or impossible to control, and costly or impossible to remediate. Regulatory inquiries, employee misconduct and rumors, among other things, can substantially damage our reputation, even if they are baseless or satisfactorily addressed. Regulatory sanctions or adverse litigation results can also cause substantial damage to our reputation. Any damage to our reputation could impede our ability to attract and retain clients and key personnel, and lead to a

reduction in the amount of our AUM, any of which could have a material adverse effect on our revenues and net income.

#### Failure to Properly Address Conflicts of Interest Could Harm our Reputation, Business and Results of Operations

As we have expanded the scope of our businesses and our client base, we must continue to address conflicts between our interests and those of our clients. In addition, the SEC and other regulators have increased their scrutiny of potential conflicts of interest. We have procedures and controls that are reasonably designed to address these issues. However, appropriately dealing with conflicts of interest is complex and difficult and if we fail, or appear to fail, to deal appropriately with conflicts of interest, we could face reputational damage, litigation or regulatory proceedings or penalties, any of which may adversely affect our revenues or net income.

## Table of Contents

### Loss of Key Personnel Could Harm our Business

We are dependent on the continued services of a number of our key asset management personnel and our management team, including our Chief Executive Officer. The loss of any of such personnel without adequate replacement could have a material adverse effect on us. Moreover, since certain of our asset managers operate with lean management teams and contribute significantly to our revenues and net income, the loss of even a small number of key personnel at these businesses could have a disproportionate impact on our overall business. Additionally, we need qualified managers and skilled employees with asset management experience in order to operate our business successfully. The market for experienced asset management professionals is extremely competitive and is increasingly characterized by the movement of employees among different firms. Due to the competitive market for asset management professionals and the success of some of our employees, our costs to attract and retain key employees are significant and will likely increase over time. From time to time, we may work with key employees to revise revenue sharing arrangements and other employment-related terms to reflect current circumstances, including in situations where a revenue sharing arrangement may result in insufficient revenues being retained by the subsidiary. In addition, since the investment track record of many of our products and services is often attributed to a small number of individual employees, and sometimes one person, the departure of one or more of these employees could cause the business to lose client accounts or managed assets, which could have a material adverse effect on our results of operations and financial condition. If we are unable to attract and retain qualified individuals or our costs to do so increase significantly, our operations and financial results would be materially adversely affected.

### Our Business is Subject to Numerous Operational Risks

We face numerous operational risks related to our business on a day-to-day basis. Among other things, we must be able to consistently and reliably obtain securities pricing information, process trading activity, process client and investor transactions and provide reports and other customer service to our clients, investors and distributors. Failure to keep current and accurate books and records can render us subject to disciplinary action by governmental and self-regulatory authorities, as well as to claims by our clients. A portion of our software is licensed from and supported by outside vendors upon whom we rely to prevent operating system failure. A suspension or termination of these licenses or the related support, upgrades and maintenance could cause system delays or interruption. If any of our financial, portfolio accounting or other data processing systems, or the systems of third parties on whom we rely, do not operate properly or are disabled or if there are other shortcomings or failures in our internal processes, people or systems, or those of third parties on whom we rely, we could suffer an impairment to our liquidity, a financial loss, a disruption of our businesses, liability to clients, regulatory problems or damage to our reputation. These systems may fail to operate properly or become disabled as a result of events that are wholly or partially beyond our control, including a disruption of electrical or communications services or our inability to occupy one or more offices. In addition, our operations are dependent upon information from, and communications with, third parties, and operational problems at third parties may adversely affect our ability to carry on our business.

We depend on our headquarters, the offices of our subsidiaries, our operations centers and third-party providers for the continued operation of our business. The failure to maintain an infrastructure commensurate with the size and scope of our business, a disaster or a disruption in the infrastructure that supports our asset managers, or an event disrupting the ability of our employees to perform their job functions, including terrorist attacks or a disruption involving electrical communications, transportation or other services used by us or third parties with whom we conduct business, directly affecting our headquarters, the offices of our subsidiaries, our operations centers or the travel of our sales, client service and other personnel, may have a material adverse impact on our ability to continue to operate our business without interruption or impede the growth of our business. Although we have disaster recovery and business continuity programs in place, there can be no assurance that these will be sufficient to mitigate the harm that may result from such a disaster or disruption. If we fail to keep business continuity plans up-to-date or if such plans, including secure back-up facilities and systems, are improperly implemented or deployed during a disruption, our



ability to operate could be adversely impacted or our ability to comply with regulatory obligations leading to reputational harm, regulatory fines and sanctions. In addition, insurance and other safeguards might only partially reimburse us for our losses.

## Table of Contents

Failure to implement effective information and cyber security policies, procedures and capabilities could disrupt operations and cause financial losses

Our operations rely on the effectiveness of our information and cyber security policies, procedures and capabilities to provide secure processing, storage and transmission of confidential and other information in our computer systems, networks and mobile devices and on the computer systems, networks and mobile devices of third parties on which we rely. Although we take protective measures and endeavor to modify them as circumstances warrant, our computer systems, software, networks and mobile devices, and those of third parties on whom we rely, may be vulnerable to cyber-attacks, sabotage, unauthorized access, computer viruses, worms or other malicious code, and other events that have a security impact. An externally caused information security incident, such as a hacker attack, virus or worm, or an internally caused issue, such as failure to control access to sensitive systems, could materially interrupt business operations or cause disclosure or modification of sensitive or confidential client or competitive information and could result in material financial loss, loss of competitive position, regulatory actions, breach of client contracts, reputational harm or legal liability. If one or more of such events occur, it potentially could jeopardize our or our clients', employees' or counterparties' confidential and other information processed and stored in, and transmitted through, our or third party computer systems, networks and mobile devices, or otherwise cause interruptions or malfunctions in our, our clients', our counterparties' or third parties' operations. As a result, we could experience material financial loss, loss of competitive position, regulatory actions, breach of client contracts, reputational harm or legal liability, which, in turn, could cause a decline in our earnings. We may be required to spend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against fully or not fully covered through any insurance that we maintain.

### We May Incur Charges Related to Leased Facilities

We continue to be exposed to the risk of incurring charges related to subleases or vacant space for several of our leased offices. As of March 31, 2016, our future commitments from third parties under non-cancellable subleases were approximately \$141 million, which in total, net of reserves, effectively offsets obligations under our leases for the properties. As of March 31, 2016, our total future lease commitments for office space that we vacated and are seeking to sublease were approximately \$32 million, of which we reserved approximately \$15 million through lease charges to our earnings during the fiscal year ended March 31, 2016. Under generally accepted accounting principles, at the time a sublease is entered into or space is deemed permanently abandoned, we must incur a charge equal to the present value of the amount by which the commitments under the lease exceeds the amount due, or amount expected to be received, under a sublease. As a result, in a period of declining commercial lease markets, we are exposed to the risk of incurring charges relating to any premises we are seeking to sublease resulting from longer periods to identify sub-tenants and reduced market rent rates leading to new sub-tenants paying less in rent than we are paying under our lease. Also, if a sub-tenant defaults on its sublease, we would likely incur a charge for the rent that we will incur during the period that we expect would be required to sublease the premises and any reduction in rent that current market rent rates lead us to expect a new sub-tenant will pay. This risk is underscored by the fact that one sub-tenant represents approximately half of the future sublease rent commitments described above. There can be no assurance that we will not recognize additional lease-related charges, which may be material to our results of operations.

### Potential Impairment of Goodwill and Intangible Assets Could Increase our Expenses and Reduce our Assets

Determining goodwill and intangible assets, and evaluating them for impairment, requires significant management estimates and judgment, including estimating value and assessing life in connection with the allocation of purchase price in the acquisition creating them. Our goodwill and intangible assets may become impaired as a result of any number of factors, including losses of investment management contracts or declines in the value of managed assets. Any impairment of goodwill or intangibles could have a material adverse effect on our results of operations. For

example, during the quarter ended December 31, 2015, we incurred aggregate impairment charges of \$371 million (\$297 million, net of taxes) relating to the Permal/Fauchier funds-of-hedge funds contracts and Permal trade name. Changes in the assumptions underlying projected cash flows from the assets or reporting unit, resulting from market conditions, reduced AUM or other factors, could result in an impairment of any of these assets.

The domestic mutual fund contracts asset acquired in the 2005 acquisition of the CAM business of \$2.1 billion and the Permal funds-of-hedge funds contracts assets of \$334 million account for approximately 70% and 10%, respectively, of our indefinite-life intangible assets, while the goodwill in our reporting unit aggregates \$1.5 billion. As of March 31, 2016,

## Table of Contents

we also have \$618 million of other indefinite-life intangible assets, which includes indefinite-life mutual funds contract assets of \$130 million and \$120 million recorded at fair value in connection with the acquisitions of RARE Infrastructure Limited in October 2015 and Martin Currie (Holdings) Limited in October 2014, respectively.

The carrying value of the Permal funds-of-hedge funds contracts asset has recently been written down to fair value as a result of the aforementioned impairment during the quarter ended December 31, 2015, while the carrying value of the domestic mutual fund contracts asset was written down to fair value as a result of an impairment during the fiscal year ended March 31, 2013. As a result, decreases in our cash flow projections or increases in the discount rates, resulting from actual results, or changes in assumptions due to market conditions, reduced AUM, less favorable operating margins, lower yielding asset mixes, and other factors, may result in further impairment of these assets. There can be no assurances that continued market uncertainty or asset outflows, or other factors, will not produce an additional impairment in either asset, particularly for the Permal funds-of-hedge funds contracts asset.

Cash flows through December 31, 2015, from our domestic mutual fund contracts compared favorably to the growth assumptions related to the domestic mutual fund contracts assets impairment testing at December 31, 2014, but the related carrying value remains sensitive to changes in the actual results or assumptions noted above. Therefore, market decreases, outflows or other changes in actual results or the assumptions noted above may result in an impairment of the domestic mutual fund contracts assets. As of December 31, 2015, the date of our most recent annual testing, the estimated fair value of the domestic mutual fund contracts asset exceeded the related carrying value by approximately \$1.0 billion. Assuming all other factors remain the same, our actual results and/or changes in assumptions for the domestic mutual fund contracts cash flow projections over the long term would have to deviate by more than 30%, or the discount rate would have to increase from 13.0% to more than 16.5% for the asset to be deemed impaired. The estimated fair value of our reporting unit exceeds its aggregate carrying value by a material amount at December 31, 2015. However, changes in the assumptions underlying projected cash flows from the reporting unit or its EBITDA multiple, resulting from market conditions, reduced AUM or other factors, could still result in an impairment of goodwill.

There can be no assurances that continued market uncertainty or asset outflows, or other factors, will not produce an additional impairment. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates - Intangible Assets and Goodwill.”

### Our Deferred Tax Assets May Not Be Fully Realizable

As of March 31, 2016, we had approximately \$712 million in U.S. federal deferred tax assets, which represent tax benefits that we expect to realize in future periods. Under accounting rules, we are required to recognize a charge to earnings to reduce our deferred tax assets if it is determined that any future tax benefits are not likely to be realized before they expire. Deferred tax assets generated in U.S. jurisdictions resulting from net operating losses generally expire 20 years after they are generated. Those resulting from foreign tax credits generally expire 10 years after they are generated. In order to realize these future tax benefits, we estimate that we must generate approximately \$3.2 billion in future U.S. earnings, of which \$740 million must be foreign sourced earnings, before the benefits expire. There can be no assurances that we will achieve this level of earnings before some portion of these tax benefits expires. In addition, our belief that we will likely be able to realize these future tax benefits is based in part upon our estimates of the timing of other differences in revenue and expense recognition between tax returns and financial statements and our understanding of the application of tax regulations, which may prove to be incorrect for any number of reasons, including future changes in tax or accounting regulations. Further, our estimates and assumptions do not contemplate certain possible future changes in the ownership of Legg Mason stock, which, under the U.S. Internal Revenue Code (the “Code”), could limit our utilization of net operating loss and foreign tax credit benefits. Under the relevant Code provisions, an “ownership change” occurs if there is a cumulative net increase in the aggregate ownership of Legg Mason stock by “5% shareholders” (as defined in the Code) of more than 50 percent of the total

outstanding shares of Legg Mason stock during a rolling three-year period. An ownership change would prospectively establish an annual limitation on the amount of pre-change net operating loss and foreign tax credit carryforwards we could utilize to reduce our tax liability. The amount of the limitation would generally equal the amount of our market capitalization immediately prior to the ownership change multiplied by the long-term tax-exempt interest rate in effect at that time. Such an ownership change would impact the timing or amount of net operating loss or foreign tax credit benefits we ultimately realize before they expire. If we are required to recognize a charge to earnings to reduce our deferred tax assets, the charge may be material to our earnings or financial condition.

## Table of Contents

### We Are Exposed to a Number of Risks Arising From our International Operations

Our asset managers operate in a number of jurisdictions outside of the United States on behalf of international clients. We have offices in numerous countries and many cross border and local proprietary funds that are domiciled outside the United States. Our international operations require us to comply with the legal requirements of various foreign jurisdictions, expose us to the political consequences of operating in foreign jurisdictions and subject us to expropriation risks, expatriation controls and potential adverse tax consequences which, among other things, make it more difficult to repatriate to the United States the cash that we generate outside the U.S. At March 31, 2016, our total liquid assets, which include cash, cash equivalents and certain current investment securities, were \$1.7 billion, approximately \$700 million of which was used to fund the acquisitions of Clarion Partners in April 2016 and EnTrust in May 2016. The remaining \$1.0 billion of liquid assets included approximately \$378 million of cash and investments held by our foreign subsidiaries, some of which, if repatriated, may be subject to material tax effects. Furthermore, despite controls and other actions reasonably designed to mitigate these risks, our international operations expose us to risks arising from Legg Mason's potential responsibility for actions of third party agents and other representatives of our business operating outside our primary jurisdictions of operation. Our foreign business operations are also subject to the following risks:

- difficulty in managing, operating and marketing our international operations;
- fluctuations in currency exchange rates which may result in substantial negative effects on AUM and revenues in our U.S. dollar-based financial statements; and
- significant adverse changes in foreign political, economic, legal and regulatory environments.

### Legal and Regulatory Risks

#### Regulatory Matters May Negatively Affect our Business and Results of Operations

Our business is subject to regulation by various regulatory authorities around the world that are charged with protecting the interests of our clients. We could be subject to civil liability, criminal liability, or sanction, including revocation of our subsidiaries' registrations as investment advisers, revocation of the licenses of our employees, censures, fines, or temporary suspension or permanent bar from conducting business, if we violate such laws or regulations. Any such liability or sanction could have a material adverse effect on our financial condition, results of operations, reputation, and business prospects. In addition, the regulatory environment in which we operate frequently changes and has seen significant increased regulation in recent years. Our profitability could be materially and adversely affected by modification of the rules and regulations that impact the business and financial communities in general, including changes to the laws governing taxation, antitrust regulation and electronic commerce. In particular, we have incurred, and will continue to incur, significant additional costs as a result of regulatory changes affecting U.S. mutual funds and changes to European mutual fund regulation.

We may be adversely affected as a result of new or revised legislation or regulations or by changes in the interpretation or enforcement of existing laws and regulations. The challenges associated with consistently interpreting regulations issued in multiple countries may add to such risks. For example, we note that the U.S. federal government has made, and has proposed further, significant changes to the regulatory structure of the financial services industry, and we expect to spend time and resources to comply with these regulatory changes. For a summary of the laws, regulations and regulators to which we are subject, see "Item 1 - Business - Regulation."

Instances of criminal activity and fraud by participants in the asset management industry, disclosures of trading and other abuses by participants in the financial services industry and significant governmental intervention and investment in the financial markets and financial firms have led the U.S. government and regulators to increase the rules and regulations governing, and oversight of, the U.S. financial system. This activity has resulted in changes to

the laws and regulations governing the asset management industry and more aggressive enforcement of the existing laws and regulations. For example, the Dodd-Frank Act provides for a comprehensive overhaul of the financial services regulatory environment and requires the adoption of extensive regulations and many regulatory decisions to be implemented. Certain provisions of the Dodd-Frank Act will, and other provisions may, require us to change or impose new limitations on the manner in which we conduct business, will or may increase regulatory compliance burdens, and may have unintended adverse consequences on the liquidity or structure of the financial markets. The ongoing revisions to the laws and regulations governing our business, and their counterparts internationally, are an ongoing process. The cumulative effect of these actions may result in increased expenses, or lower management or other fees, and therefore adversely affect the revenues or profitability of our business.

Table of Contents

**Our Business Involves Risks of Being Engaged in Litigation and Liability That Could Increase our Expenses and Reduce our Net Income**

Many aspects of our business involve substantial risks of liability. In the normal course of business, our asset managers are from time to time named as defendants or co-defendants in lawsuits, or are involved in disputes that involve the threat of lawsuits, seeking substantial damages. We are also involved from time to time in governmental and self-regulatory organization investigations and proceedings, including the regulatory proceedings discussed in Note 8 of Notes to Consolidated Financial Statements. In addition, we are involved in a tax dispute in Brazil arising from matters relating to the tax deductibility of goodwill amortization with respect to the Brazilian business of our subsidiary, Western Asset Management. While the assessments have been withdrawn for a portion of the years that were subject to the dispute, the amount at issue in the years still subject to the assessment is over \$14 million. It may take another five years or more to achieve final resolution of this matter as it potentially could go through multiple levels of appeal. During that time the current \$14 million amount in dispute could increase to approximately \$35 million due to additional interest and penalty accruals and denial of future year deductions. While there can be no assurance of the timing or outcome of this dispute, or that we will receive additional favorable judgments in connection with this matter, we and our local advisors believe that our tax position is correct and it is more likely than not that we will not be required to pay the taxes in question or any related interest and penalties.

In addition, the investment funds that our asset managers manage are subject to actual and threatened lawsuits and governmental and self-regulatory organization investigations and proceedings, any of which could harm the investment returns or reputation of the applicable fund or result in our asset managers being liable to the funds for any resulting damages. There has been an increased incidence of litigation and regulatory investigations in the asset management industry in recent years, including customer claims as well as class action suits seeking substantial damages. Any litigation can increase our expenses and reduce our net income.

**Insurance May Not Be Available on a Cost Effective Basis to Protect us From Liability**

We face the inherent risk of liability related to litigation from clients, third-party vendors or others and actions taken by regulatory agencies. To help protect against these potential liabilities, we purchase insurance in amounts, and against risks, that we consider appropriate, where such insurance is available at prices we deem acceptable. There can be no assurance, however, that a claim or claims will be covered by insurance or, if covered, will not exceed the limits of available insurance coverage, that any insurer will remain solvent and will meet its obligations to provide us with coverage or that insurance coverage will continue to be available with sufficient limits at a reasonable cost. Insurance costs are impacted by market conditions and the risk profile of the insured, and may increase significantly over relatively short periods. In addition, certain insurance coverage may not be available or may only be available at prohibitive costs. Renewals of insurance policies may expose us to additional costs through higher premiums or the assumption of higher deductibles or co-insurance liability.



Table of Contents

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

We lease all of our office space. Our headquarters and certain other functions are located in an office building in Baltimore, Maryland, in which we currently hold under lease approximately 372,000 square feet, of which approximately 159,000 square feet has been subleased to third parties. We are currently seeking to secure additional tenants to sublease an additional 27,000 square feet.

Our asset managers and other subsidiaries are housed in office buildings in 35 cities in 18 countries around the world. The largest of the leases include:

- ClearBridge Investments, Western Asset Management and our distribution and administrative services subsidiaries currently occupy approximately 130,000 square feet in an office building located in New York, New York in which we hold under lease approximately 193,000 square feet. The remaining 63,000 square feet has been subleased to a third party;
- Western Asset Management's headquarters is housed in an office building in Pasadena, California in which we occupy approximately 190,000 square feet; and
- our distribution and administrative services subsidiaries occupy approximately 79,000 square feet in an office building located in Stamford, Connecticut in which we hold under lease approximately 138,000 square feet. 47,000 square feet has been subleased to a third party. We are seeking to secure additional tenants to sublease the remaining 12,000 square feet.

See Note 8 of Notes to Consolidated Financial Statements in Item 8 of this Report for a discussion of our lease obligations.

ITEM 3. LEGAL PROCEEDINGS.

Our current and former subsidiaries have been the subject of customer complaints and have also been named as defendants in various legal actions arising primarily from asset management, securities brokerage and investment banking activities, including certain class actions, which primarily allege violations of securities laws and seek unspecified damages, which could be substantial. For example, we are aware of litigation against certain underwriters of offerings in which one or more of our former subsidiaries was a participant, but where the former subsidiary is not now a defendant. In these latter cases, it is possible that we may be called upon to contribute to settlements or judgments. In the normal course of our business, our current and former subsidiaries have also received subpoenas and are currently involved in governmental and self-regulatory agency inquiries, investigations and, from time to time, proceedings. While the ultimate resolution of any threatened or pending litigation, regulatory investigations and other matters cannot be currently determined, in the opinion of our management, after consultation with legal counsel, due in part to the preliminary nature of certain of these matters, we are currently unable to estimate the amount or range of potential losses from these matters, and our financial condition, results of operations and cash flows could be materially affected during a period in which a matter is ultimately resolved. See Note 8 of Notes to Consolidated Financial Statements in Item 8 of this Report.

ITEM 4. MINE SAFETY DISCLOSURES.

Not Applicable.



Table of Contents

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT.

Information (not included in our definitive proxy statement for the 2015 Annual Meeting of Stockholders) regarding certain of our executive officers is as follows:

Thomas K. Hoops, age 51, was appointed Executive Vice President and Head of Business and Product Development in January 2014. From March 2000 through January 2014, Mr. Hoops held a variety of positions at Wells Fargo Corporation and its predecessors, most recently as Head of Affiliated Managers at Wells Fargo Asset Management. Prior to joining Wells Fargo / Wachovia, he was a Managing Director at a boutique investment bank which specialized in M&A advisory services for emerging growth and middle-market companies and their owners. He began his career as a credit analyst at First Union National Bank in Charlotte.

Terence Johnson, age 43, was appointed Head of Global Distribution in March 2013 and elected Executive Vice President in April 2013. Since October 2012, he had been serving as interim Head of Global Distribution, overseeing U.S. Distribution, International Distribution, Global Product Development, Marketing, and Administration and Operations of the division. Prior to that, Mr. Johnson headed International Distribution at Legg Mason. Mr. Johnson joined Legg Mason in December 2005 from Citigroup Asset Management following its acquisition by Legg Mason.

Thomas C. Merchant, age 48, was appointed General Counsel in March 2013 and elected Executive Vice President in April 2013. Mr. Merchant continues to serve as Corporate Secretary, a position he has held since 2008. Mr. Merchant oversees Legg Mason's legal and compliance departments. Mr. Merchant previously served as Corporate General Counsel and Deputy General Counsel. Mr. Merchant joined Legg Mason as Associate General Counsel in 1998.

Peter H. Nachtwey, age 60, was elected Chief Financial Officer and Senior Executive Vice President of Legg Mason in January 2011 when he joined the firm. From July 2007 through December 2010, Mr. Nachtwey served as Chief Financial Officer of The Carlyle Group, an alternative investment management firm, where he had responsibility for all of the financial and a number of the operational functions at the firm. Prior to The Carlyle Group, Mr. Nachtwey spent more than 25 years at Deloitte & Touche, LLP, an accounting firm, most recently as Managing Partner of the Investment Management practice.

Ursula Schliessler, age 57, was appointed Chief Administrative Officer in March 2015 and elected Executive Vice President in April 2015. Ms. Schliessler oversees Legg Mason's technology, human resources, risk management, internal audit and global fund accounting. Prior to her appointment as Chief Administrative Officer, Ms. Schliessler served as Head of Global Distribution Business Management for Legg Mason, managing day to day operations and aligning strategic initiatives to support the growth of Legg Mason's retail business. Ms. Schliessler has been in senior roles with Legg Mason or predecessor firms since 1988, with a brief interruption between 2007 and 2010.

Table of Contents

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Shares of Legg Mason, Inc. common stock are listed and traded on the New York Stock Exchange (symbol LM). As of March 31, 2016, there were approximately 1,300 holders of record of Legg Mason common stock. Information with respect to our dividends and stock prices is as follows:

	Quarter ended			
	Mar. 3	Dec. 31	Sept. 30	June 30
Fiscal Year 2016				
Cash dividend declared per share	\$0.20	\$ 0.20	\$ 0.20	\$ 0.20
Stock price range:				
High	39.97	46.41	52.61	55.88
Low	24.93	37.84	40.60	50.39
Fiscal Year 2015				
Cash dividend declared per share	\$0.16	\$ 0.16	\$ 0.16	\$ 0.16
Stock price range:				
High	59.19	57.15	52.00	51.80
Low	52.16	45.78	45.68	43.25

We expect to continue paying cash dividends. However, the declaration of dividends is subject to the discretion of our Board of Directors. In determining whether to declare dividends, or how much to declare in dividends, our Board will consider factors it deems relevant, which may include our results of operations and financial condition, our financial requirements, general business conditions and the availability of funds from our subsidiaries, including all restrictions on the ability of our subsidiaries to provide funds to us. On April 26, 2016, our Board of Directors declared a regular, quarterly dividend of \$0.22 per share, increasing the regular, quarterly dividend rate paid on shares of our common stock during the prior fiscal quarter.

## Purchases of our Common Stock

The following table sets out information regarding our purchases of Legg Mason common stock during the quarter ended March 31, 2016:

Period	(a) Total number of shares purchased (1)	(b) Average price paid per share (2)	(c) Total number of shares purchased as part of publicly announced plans or programs(3)	(d) Approximate dollar value that may yet be purchased under the plans or programs(3)
January 1, 2016 Through January 31, 2016	669	\$ 39.08	—	\$830,611,864
February 1, 2016 Through February 29, 2016	2,501	30.16	—	830,611,864
March 1, 2016 Through March 31, 2016	776,042	34.33	776,042	803,973,237
Total	779,212	\$ 34.32	776,042	

(1) Includes shares of vesting restricted stock, and shares received on vesting of restricted stock units, surrendered to Legg Mason to satisfy related income tax withholding obligations of employees via net share transactions.

(2) Amounts exclude fees.

(3) On January 27, 2015, our Board of Directors approved a share repurchase authorization for up to \$1 billion for additional repurchases of common stock. There is no expiration attached to this share repurchase authorization.



Table of Contents

## ITEM 6. SELECTED FINANCIAL DATA.

(Dollars in thousands, except per share amounts or unless otherwise noted)

	Years ended March 31,					
	2016	2015	2014	2013	2012	
<b>OPERATING RESULTS</b>						
Operating Revenues	\$2,660,844	\$2,819,106	\$2,741,757	\$2,612,650	\$2,662,574	
Operating expenses, excluding impairment	2,239,013	2,320,887	2,310,864	2,313,149	2,323,821	
Impairment of intangible assets and goodwill	371,000	—	—	734,000	—	
Operating Income (Loss)	50,831	498,219	430,893	(434,499 )	338,753	
Other non-operating expense, net, including \$107,074 debt extinguishment loss in July 2014 and \$68,975 in May 2012	(68,806 )	(136,114 )	(13,726 )	(73,287 )	(54,006 )	
Other non-operating income (expense) of consolidated investment vehicles, net	(7,243 )	5,888	2,474	(2,821 )	18,336	
Income (Loss) before Income Tax Provision (Benefit)	(25,218 )	367,993	419,641	(510,607 )	303,083	
Income tax provision (benefit)	7,692	125,284	137,805	(150,859 )	72,052	
Net Income (Loss)	(32,910 )	242,709	281,836	(359,748 )	231,031	
Less: Net income (loss) attributable to noncontrolling interests	(7,878 )	5,629	(2,948 )	(6,421 )	10,214	
Net Income (Loss) Attributable to Legg Mason, Inc.	\$(25,032 )	\$237,080	\$284,784	\$(353,327 )	\$220,817	
<b>PER SHARE</b>						
Net Income (Loss) per Share Attributable to Legg Mason, Inc. Shareholders:						
Basic	\$(0.25 )	\$2.06	\$2.34	\$(2.65 )	\$1.54	
Diluted	\$(0.25 )	\$2.04	\$2.33	\$(2.65 )	\$1.54	
Weighted-Average Number of Shares Outstanding: <sup>(1)</sup>						
Basic	107,406	112,019	121,941	133,226	143,292	
Diluted	107,406	113,246	122,383	133,226	143,349	
Dividends Declared	\$0.80	\$0.64	\$0.52	\$0.44	\$0.32	
<b>BALANCE SHEET</b>						
Total Assets <sup>(2)</sup>	\$7,520,446	\$7,064,834	\$7,103,203	\$7,264,582	\$8,547,381	
Long-term debt <sup>(2)</sup>	1,740,985	1,048,946	1,031,118	1,139,876	1,128,526	
Total Stockholders' Equity Attributable to Legg Mason, Inc.	4,213,563	4,484,901	4,724,724	4,818,351	5,677,291	
<b>FINANCIAL RATIOS AND OTHER DATA</b>						
Adjusted Income <sup>(3)</sup>	\$370,271	\$378,751	\$417,805	\$347,169	\$397,030	
Adjusted Income per diluted share <sup>(3)</sup>	\$3.36	\$3.26	\$3.41	\$2.61	\$2.77	
Operating Margin	1.9	% 17.7	% 15.7	% (16.6 )	% 12.7	%
Operating Margin, as Adjusted <sup>(4)</sup>	18.6	% 23.0	% 22.0	% 17.5	% 22.3	%
Adjusted EBITDA <sup>(5)</sup>	\$621,722	\$686,499	\$617,092	\$555,725	\$585,275	
Total debt to total capital <sup>(6)</sup>	29.9	% 19.1	% 18.0	% 19.2	% 19.6	%
Assets under management (in millions)	\$669,615	\$702,724	\$701,774	\$664,609	\$643,318	
Full-time employees	3,066	2,982	2,843	2,975	2,979	

(1) Excludes weighted-average unvested restricted shares deemed to be participating securities for the years ended March 31, 2016 and 2015. Basic and diluted shares are the same for periods with a Net Loss Attributable to Legg Mason, Inc. See Note 12 of Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplemental Data.

(2) For the year ended March 31, 2016, Legg Mason elected to early adopt updated accounting guidance which requires unamortized debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated long-term debt liability. This guidance was adopted on a retrospective basis. Therefore, for years prior to fiscal 2016, unamortized debt issuance costs have been reclassified from Other assets to Long-term debt in the Consolidated Balance Sheets. See Note 1 of Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplemental Data.

(3) Adjusted Income is a non-GAAP performance measure. We define Adjusted Income as Net Income (Loss) Attributable to Legg Mason, Inc., plus amortization and deferred taxes related to intangible assets and goodwill, and imputed interest and tax benefits on contingent convertible debt less deferred income taxes on goodwill and indefinite-life intangible asset impairment, if any. We also adjust for certain non-core items, such as intangible asset impairments, the impact of fair value adjustments of contingent consideration liabilities, if any, the impact of tax rate adjustments on certain deferred tax liabilities related to indefinite-life intangible assets, and loss on extinguishment of contingent convertible debt. The calculation of Adjusted Income per diluted share includes weighted-average unvested restricted shares. See Supplemental Non-GAAP Information in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(4) Operating Margin, as Adjusted, is a non-GAAP performance measure we calculate by dividing (i) Operating Income (Loss), adjusted to exclude the impact on compensation expense of gains or losses on investments made to fund deferred compensation plans, the impact on compensation expense of gains or losses on seed capital investments by our affiliates under revenue sharing agreements, amortization related to intangible assets, transition-related costs of streamlining our business model, if any, income (loss) of consolidated investment vehicles, the impact of fair value adjustments of contingent consideration liabilities, if any, and impairment charges by (ii) our Operating Revenues, adjusted to add back net investment advisory fees eliminated upon consolidation of investment vehicles, less distribution and servicing expenses which we use as an approximate measure of revenues that are passed through to third parties, which we refer to as "Operating Revenues, as Adjusted." See Supplemental Non-GAAP Information in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(5) Adjusted EBITDA is a non-GAAP liquidity measure we define as cash provided by operations plus (minus) allocation of debt redemption payments, interest expense, net of accretion and amortization of debt discounts and premiums, current income tax expense, net gains on investment securities, the net change in other assets and liabilities and other. This definition results in a metric that is the same amount as EBITDA used in covenants in our revolving credit facility agreement. See Supplemental Non-GAAP Information in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(6) Calculated based on total gross debt as a percentage of total capital (total stockholders' equity attributable to Legg Mason, Inc. plus total gross debt) as of March 31.

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

EXECUTIVE OVERVIEW

Legg Mason, Inc., a holding company, with its subsidiaries (which collectively comprise "Legg Mason") is a global asset management firm. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other investment vehicles. We offer these products and services directly and through various financial intermediaries. We have operations principally in the U.S. and the U.K. and also have offices in Australia, Bahamas, Brazil, Canada, Chile, China, Dubai, France, Germany, Italy, Japan, Poland, Singapore, Spain, Switzerland and Taiwan. All references to fiscal 2016, 2015 or 2014, refer to our fiscal year ended March 31 of that year. Terms such as "we," "us," "our," and "Company" refer to Legg Mason.

Our operating revenues primarily consist of investment advisory fees from separate accounts and funds, and distribution and service fees. Investment advisory fees are generally calculated as a percentage of the assets of the investment portfolios that we manage. In addition, performance fees may be earned under certain investment advisory contracts for exceeding performance benchmarks or hurdle rates. The largest portion of our performance fees is earned based on 12-month performance periods that end in differing quarters during the year, with a portion based on quarterly performance periods. Distribution and service fees are received for distributing investment products and services, for providing other support services to investment portfolios, or for providing non-discretionary advisory services, and are generally calculated as a percentage of the assets in an investment portfolio or as a percentage of new assets added to an investment portfolio. Our revenues, therefore, are dependent upon the level of our assets under management ("AUM") and assets under advisement ("AUA") and fee rates, and thus are affected by factors such as securities market conditions, our ability to attract and maintain AUM and key investment personnel, and investment performance. Our AUM varies in large part from period to period due to inflows and outflows of client assets as well as market performance and changes in foreign exchange rates. Client decisions to increase or decrease their assets under our management, and decisions by potential clients to utilize our services, may be based on one or more of a number of factors. These factors include our reputation in the marketplace, the investment performance (both absolute and relative to benchmarks or competitive products) of our products and services, the fees we charge for our investment services, the client or potential client's situation, including investment objectives, liquidity needs, investment horizon and amount of assets managed, our relationships with distributors and the external economic environment, including market conditions.

The fees that we charge for our investment services vary based upon factors such as the type of underlying investment product, the amount of AUM, the asset management affiliate that provides the services, and the type of services (and investment objectives) that are provided. Fees charged for equity asset management services are generally higher than fees charged for fixed income or liquidity asset management services. Accordingly, our revenues and average operating revenue yields will be affected by the composition of our AUM, with changes in the relative level of equity assets and alternatives typically more significantly impacting our revenues and average operating revenue yields. Average operating revenue yields are calculated as the ratio of annualized investment advisory fees, distribution and service fees, and other revenues, less performance fees, to average AUM. In addition, in the ordinary course of our business, we may reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. We have revenue sharing arrangements in place for most of our asset management affiliates, under which specified percentages of the affiliates' revenues are required to be distributed to us and the balance of the revenues is retained by the affiliates to pay their operating expenses, including compensation expenses, but excluding certain expenses and income taxes. Under these arrangements, our asset management affiliates retain different percentages of revenues to cover their costs. As such, our Net Income (Loss) Attributable to Legg Mason, Inc., operating margin and compensation as a percentage of operating revenues are impacted based on which affiliates and



products generate our AUM, and a change in AUM at one affiliate or with respect to one product or class of products can have a dramatically different effect on our revenues and earnings than an equal change at another affiliate or in another product or class of products. In addition, from time to time, we may agree to changes in revenue sharing and other arrangements with our asset management personnel, which may impact our compensation expenses and profitability.

The most significant component of our cost structure is employee compensation and benefits, of which a majority is variable in nature and includes incentive compensation that is primarily based upon revenue levels, non-compensation related operating expense levels at revenue share-based affiliates, and our overall profitability. The next largest component of our cost structure is distribution and servicing expense, which consists primarily of fees paid to third-party distributors for selling

Table of Contents

our asset management products and services and are largely variable in nature. Certain other operating costs are typically consistent from period to period, such as occupancy, depreciation and amortization, and fixed contract commitments for market data, communication and technology services, and usually do not decline with reduced levels of business activity or, conversely, usually do not rise proportionately with increased business activity.

Our financial position and results of operations are materially affected by the overall trends and conditions of global financial markets. Results of any individual period should not be considered representative of future results. Our profitability is sensitive to a variety of factors, including the amount and composition of our AUM, and the volatility and general level of securities prices, and interest rates, as well as changes in foreign currency exchange rates, among other things. Periods of unfavorable market conditions are likely to have an adverse effect on our profitability. In addition, the diversification of services and products offered, investment performance, access to distribution channels, reputation in the market, attraction and retention of key employees and client relations are significant factors in determining whether we are successful in the attraction and retention of clients. In the last few years, the industry has seen flows into products for which we do not currently garner significant market share. For a further discussion of factors that may affect our results of operations, refer to Item 1A. Risk Factors included herein.

The financial services business in which we are engaged is extremely competitive. Our competition includes numerous global, national, regional and local asset management firms, commercial banks, insurance companies and other financial services companies. The industry has been impacted by continued economic uncertainty, the constant introduction of new products and services, and the consolidation of financial services firms through mergers and acquisitions. The industry in which we operate is also subject to extensive regulation under federal, state, and foreign laws. Like most firms, we have been and will continue to be impacted by regulatory and legislative changes. Responding to these changes and keeping abreast of regulatory developments, has required, and will continue to require, us to incur costs that impact our profitability.

Our strategic priorities are focused on four primary areas listed below. Management keeps these strategic priorities in mind when it evaluates our operating performance and financial condition. Consistent with this approach, we have also presented in the table below the most important initiatives on which management currently focuses in evaluating our performance and financial condition.

Strategic Priorities	Initiatives
Products	<p>Create an innovative portfolio of investment products and promote revenue growth by developing new products and leveraging the capabilities of our affiliates</p> <p>Identify and execute strategic acquisitions to increase product offerings, strengthen our affiliates, and fill gaps in products and services</p>
Performance	<p>Deliver compelling and consistent performance against both relevant benchmarks and the products and services of our competitors</p>
Distribution	<p>Evaluate and reallocate resources within and to our distribution platform to continue to maintain and enhance our leading distribution function with the capability to offer solutions to relevant investment challenges and grow market share worldwide</p>
Productivity	<p>Operate with a high level of effectiveness and improve ongoing efficiency</p> <p>Manage expenses</p> <p>Align economic relationships with affiliate management teams, including retained affiliate management equity and the implementation of affiliate management equity plan agreements</p>

The strategic priorities discussed above are designed to drive improvements in our net flows, earnings, cash flows, AUM and other key metrics, including operating margin. Certain of these key metrics are discussed in our annual results discussion to follow.

## Table of Contents

In connection with these strategic priorities (principally products and productivity):

On May 2, 2016, we completed the transaction to combine The Permal Group, Limited ("Permal"), our existing hedge fund platform, with EnTrust Capital ("EnTrust"). EnTrust is a leading alternative asset management firm headquartered in New York with approximately \$10 billion in AUM and \$2 billion in AUA and committed capital. We own 65% of the combined entity, which is branded EnTrustPermal.

The combination of the businesses of EnTrust and Permal creates a new global alternatives firm with over \$26 billion in AUM and total client assets (including AUA and committed capital) of approximately \$30 billion. In connection with the restructuring of Permal for the combination with EnTrust, we expect to incur up to \$100 million of total restructuring and transition-related costs, of which \$43.3 million was incurred during the year ended March 31, 2016. Approximately \$40 million to \$50 million of the anticipated remaining costs associated with the restructuring are expected to be incurred in the year ending March 31, 2017. We expect to achieve approximately \$35 million in annual savings from the cost structures of the two businesses. See Notes 2 and 18 of Notes to Consolidated Financial Statements for additional information.

- On April 13, 2016, we acquired an 82% majority equity interest in Clarion Partners, a diversified real estate asset management firm based in New York. Clarion Partners managed approximately \$41.5 billion in AUM as of April 30, 2016. See Note 18 of Notes to Consolidated Financial Statements for additional information.

In March 2016, we completed the implementation of a management equity plan with the management of Royce & Associates ("Royce"). We incurred a non-cash charge of \$21.4 million upon the issuance of management equity plan units in fiscal 2016. See Note 11 of Notes to Consolidated Financial Statements for additional information regarding the Royce management equity plan.

In March 2016, we issued \$450 million of Senior Notes due 2026, and \$250 million of Junior Subordinated Notes due 2056, the net proceeds of which were used to finance the acquisitions of EnTrust and Clarion Partners. See Note 6 of Notes to Consolidated Financial Statements for additional information.

On January 22, 2016, we acquired a 20% minority equity position in Precidian Investments, LLC ("Precidian"), a firm specializing in creating innovative products and solutions and solving market structure issues, particularly with regard to the exchange-traded fund ("ETF") marketplace. See Note 2 of Notes to Consolidated Financial Statements for additional information.

In December 2015, we launched four new ETF products on the NASDAQ Stock Exchange. These outcome-oriented index-based ETF funds are managed by our wholly-owned asset management affiliate QS Investors Holdings, LLC ("QS Investors").

On October 21, 2015, we acquired a 75% majority interest in RARE Infrastructure Limited ("RARE Infrastructure"). RARE Infrastructure specializes in global listed infrastructure investing, is headquartered in Sydney, Australia, and had approximately \$6.8 billion in AUM at closing. See Note 2 of Notes to Consolidated Financial Statements for additional information.

Net Loss Attributable to Legg Mason, Inc. for the year ended March 31, 2016, was \$25.0 million, or \$0.25 per diluted share, as compared to Net Income Attributable to Legg Mason, Inc. of \$237.1 million, or \$2.04 per diluted share for the year ended March 31, 2015. In addition to the \$43.3 million of expenses related to the restructuring of Permal for the combination with EnTrust and the \$21.4 million charge related to the Royce management equity plan, as discussed above, the year ended March 31, 2016, included pre-tax impairment charges of \$371.0 million, or \$2.76 per diluted share, related to Permal indefinite-life intangible assets, inclusive of the related intangible asset from Fauchier

Partners Management Limited ("Fauchier"). The year ended March 31, 2015, included a pre-tax, non-operating charge of \$107.1 million, or \$0.59 per diluted share, related to the refinancing of our previously outstanding 5.5% Senior Notes, as well as \$35.8 million in expenses related to the integration of two of our existing affiliates, Batterymarch Financial Management, Inc. ("Batterymarch") and Legg Mason Global Asset Management, LLC ("LMGAA") into QS Investors. Average AUM and total revenues decreased in fiscal 2016, as compared to fiscal 2015, as further discussed below.

Table of Contents

Total AUM decreased during the year ended March 31, 2016, due to the negative impact of market performance and other and net client outflows in both long-term and liquidity AUM, which were offset in part by the acquisition of RARE Infrastructure in October 2015.

The following discussion and analysis provides additional information regarding our financial condition and results of operations.

**BUSINESS ENVIRONMENT AND RESULTS OF OPERATIONS**

During fiscal 2016, while the U.S. economic environment was characterized by continued growth and improving fundamentals, the business environment was strongly influenced by overall markets, which remained sensitive to increasing concerns over economic and political conditions in other countries, as well as the U.S. Federal Reserve Board's decision to increase the target federal funds rate in December 2015 for the first time since 2006.

Both U.S. and international equity markets experienced significant volatility during fiscal 2016. Despite recovering a significant portion of the losses experienced as a result of this volatility, all three major U.S. equity market indices decreased during fiscal 2016, after increasing for the past two fiscal years, while bond indices were mixed, as illustrated in the table below:

Indices <sup>(1)</sup>	% Change for the year ended March 31:		
	2016	2015	2014
Dow Jones Industrial Average <sup>(2)</sup>	(0.5)%	8.0 %	12.9 %
S&P 500 <sup>(2)</sup>	(0.4)%	10.4 %	19.3 %
NASDAQ Composite Index <sup>(2)</sup>	(0.6)%	16.7 %	28.5 %
Barclays Capital U.S. Aggregate Bond Index	2.0 %	5.7 %	(0.1) %
Barclays Capital Global Aggregate Bond Index	4.6 %	(3.7) %	1.9 %

(1) Indices are trademarks of Dow Jones & Company, McGraw-Hill Companies, Inc., NASDAQ Stock Market, Inc., and Barclays Capital, respectively, which are not affiliated with Legg Mason.

(2) Excludes the impact of the reinvestment of dividends and stock splits.

In December 2015, the Federal Reserve Board increased the target federal funds rate for the first time since 2006, from 0.25% to 0.50%. While the economic outlook for the U.S. has remained more positive in recent years, the financial environment in which we operate continues to reflect a heightened level of sensitivity as we move into fiscal 2017.

Table of Contents

The following table sets forth, for the periods indicated, amounts in the Consolidated Statements of Income (Loss) as a percentage of operating revenues and the increase (decrease) by item as a percentage of the amount for the previous period:

	Percentage of Operating Revenues			Period to Period Change <sup>(1)</sup>	
	Years Ended			2016	2015
	March 31,			Compared	Compared
	2016	2015	2014	to 2015	to 2014
Operating Revenues					
Investment advisory fees					
Separate accounts	31.0 %	29.2 %	28.4 %	0.2 %	6.0 %
Funds	53.0	54.8	54.7	(8.8 )	2.9
Performance fees	1.6	3.0	3.9	(49.7)	(22.0 )
Distribution and service fees	14.3	12.8	12.7	5.6	3.9
Other	0.1	0.2	0.3	(60.7)	(32.1 )
Total Operating Revenues	100.0	100.0	100.0	(5.6 )	2.8
Operating Expenses					
Compensation and benefits	45.3	43.7	44.1	(2.3 )	1.9
Distribution and servicing	20.5	21.1	22.6	(8.3 )	(3.9 )
Communications and technology	7.4	6.5	5.8	8.5	15.5
Occupancy	4.6	3.9	4.2	11.8	(4.8 )
Amortization of intangible assets	0.2	0.1	0.4	89.7	(78.9 )
Impairment of intangible assets	13.9	—	—	n/m	n/m
Other	6.1	7.0	7.2	(17.9)	1.3
Total Operating Expenses	98.0	82.3	84.3	12.5	0.4
Operating Income (Loss)	2.0	17.7	15.7	(89.8)	15.6
Other Non-Operating Income (Expense)					
Interest income	0.2	0.3	0.2	(24.3)	17.2
Interest expense	(1.8 )	(2.1 )	(1.9 )	(16.8)	10.2
Other income (expense), net	(1.0 )	(3.0 )	1.2	(69.5)	n/m
Other non-operating income (expense) of consolidated investment vehicles, net	(0.3 )	0.2	0.1	n/m	n/m
Total other non-operating expense	(2.9 )	(4.6 )	(0.4 )	(41.6)	n/m
Income (Loss) before Income Tax Provision (Benefit)	(0.9 )	13.1	15.3	n/m	(12.3 )
Income tax provision (benefit)	0.3	4.5	5.0	n/m	(9.1 )
Net Income (Loss)	(1.2 )	8.6	10.3	n/m	(13.9 )
Less: Net income (loss) attributable to noncontrolling interests	(0.3 )	0.2	(0.1 )	n/m	n/m
Net Income (Loss) Attributable to Legg Mason, Inc.	(0.9 )%	8.4 %	10.4 %	n/m	(16.8 )%
n/m-not meaningful					

(1) Calculated based on the change in actual amounts between fiscal years as a percentage of the prior year amount.

Table of Contents

## ASSETS UNDER MANAGEMENT AND ASSETS UNDER ADVISEMENT

## Assets Under Management

Our AUM is primarily managed across the following asset classes:

Equity	Fixed Income	Liquidity
Large Cap Growth	U.S. Intermediate Investment Grade	U.S. Managed Cash
Large Cap Value	U.S. Credit Aggregate	U.S. Municipal Cash
Small Cap Core	Global Opportunistic Fixed Income	
Equity Income	Global Government	
Large Cap Core	U.S. Municipal	
International Equity	Global Fixed Income	
Infrastructure Value	U.S. Long Duration	
Small Cap Value	U.S. Limited Duration	
Sector Equity	U.S. High Yield	
Mid Cap Core	Emerging Markets	
Emerging Markets Equity		
Global Equity		

The components of the changes in our AUM (in billions) for the years ended March 31, were as follows:

	2016	2015	2014
Beginning of period	\$702.7	\$701.8	\$664.6
Net client cash flows			
Investment funds, excluding liquidity funds <sup>(1)</sup>			
Subscriptions	50.3	72.1	52.1
Redemptions	(62.3 )	(61.2 )	(58.1 )
Separate account flows, net	0.8	5.6	2.2
Total long-term flows	(11.2 )	16.5	(3.8 )
Liquidity fund flows, net	(15.1 )	(21.3 )	11.8
Separate account flows, net	0.2	(0.9 )	0.3
Total liquidity flows	(14.9 )	(22.2 )	12.1
Total net client cash flows	(26.1 )	(5.7 )	8.3
Market performance and other <sup>(2)</sup>	(15.3 )	20.1	35.1
Impact of foreign exchange	1.4	(18.5 )	(4.9 )
Acquisitions (dispositions), net <sup>(3)</sup>	6.9	5.0	(1.3 )
End of period	\$669.6	\$702.7	\$701.8

(1) Subscriptions and redemptions reflect the gross activity in the funds and include assets transferred between funds and between share classes.

(2) Other is primarily the reclassification of \$0.5 billion and \$12.8 billion of client assets from AUM to AUA for fiscal 2016 and 2015, respectively, and the reinvestment of dividends.

(3) Includes \$6.8 billion related to the acquisition of RARE Infrastructure and \$0.1 billion related to the acquisition of PK Investments, LLP ("PK Investments") during the year ended March 31, 2016; and \$9.5 billion related to the acquisition of Martin Currie (Holdings) Limited ("Martin Currie") and \$5.0 billion related to the acquisition of QS Investors, offset in part by \$9.5 billion related to the disposition of Legg Mason Investments Counsel and Trust ("LMIC"), for the year ended March 31, 2015.

AUM at March 31, 2016, was \$669.6 billion, a decrease of \$33.1 billion, or 4.7%, from March 31, 2015. Total net client outflows were \$26.1 billion, consisting of net client outflows from the liquidity and long-term asset classes of \$14.9 billion and \$11.2 billion, respectively. Net long-term asset outflows were comprised of equity and fixed income



net outflows of \$10.8 billion and \$0.4 billion, respectively. Equity net outflows were primarily in products managed by Royce, for which outflows are expected to continue for the near-term, and ClearBridge Investments, LLC ("ClearBridge"), offset in part by equity net inflows at QS Investors. Fixed income net outflows were primarily in products managed by Western Asset Management Company ("Western Asset") and Permal, offset in part by fixed income net inflows at Brandywine Global

Table of Contents

Investment Management, LLC ("Brandywine"). We generally earn higher fees and profits on equity AUM, and outflows in the equity asset class will more negatively impact our revenues and Net Income (Loss) Attributable to Legg Mason, Inc. than would outflows in other asset classes. Market performance and other was \$(15.3) billion and the positive impact of foreign currency exchange rate fluctuations was \$1.4 billion. Acquisitions of \$6.9 billion primarily relate to the acquisition of RARE Infrastructure in October 2015.

AUM at March 31, 2015, was \$702.7 billion, an increase of \$0.9 billion, or 0.1%, from March 31, 2014. Total net client outflows were \$5.7 billion, as net client outflows of \$22.2 billion from the liquidity asset class were substantially offset by \$16.5 billion of net client inflows into long-term asset classes. In fiscal 2015, we experienced net inflows into long-term asset classes for the only time since fiscal 2007. Net long-term asset inflows were comprised of fixed income net inflows of \$19.2 billion offset in part by equity net outflows of \$2.7 billion. Fixed income net inflows were primarily in products managed by Brandywine and Western Asset. Equity net outflows were primarily in products managed by Royce and QS Investors and were partially offset by equity inflows at ClearBridge and Brandywine. Market performance and other totaled \$20.1 billion, as the positive impact of market performance and other of \$32.9 billion was offset in part by the reclassification of \$12.8 billion of client assets from AUM to AUA in the first quarter of fiscal 2015, as further discussed below. The negative impact of foreign currency exchange rate fluctuations was \$(18.5) billion. Acquisitions (dispositions), net, totaled \$5.0 billion, with \$9.5 billion related to the acquisition of Martin Currie and \$5.0 billion related to the acquisition of QS Investors, offset in part by \$9.5 billion related to the disposition of LMIC.

Our investment advisory and administrative contracts are generally terminable at will or upon relatively short notice, and investors in the mutual funds that we manage may redeem their investments in the funds at any time without prior notice. Institutional and individual clients can terminate their relationships with us, reduce the aggregate amount of assets under management, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, changes in our reputation in the marketplace, changes in management or control of clients or third-party distributors with whom we have relationships, loss of key investment management personnel or financial market performance.

## AUM by Asset Class

AUM by asset class (in billions) for the years ended March 31 were as follows:

	2016	% of Total	2015	% of Total	2014	% of Total	% Change 2016 Compared to 2015		% Change 2015 Compared to 2014	
Equity	\$180.5	27 %	\$199.4	28 %	\$186.4	27 %	(9 )	7	%	
Fixed Income	376.8	56	376.1	54	365.2	52	—	3		
Total long-term assets	557.3	83	575.5	82	551.6	79	(3 )	4		
Liquidity	112.3	17	127.2	18	150.2	21	(12)	(15 )		
Total	\$669.6	100%	\$702.7	100%	\$701.8	100%	(5 )	—		

Average AUM by asset class (in billions) for the years ended March 31 were as follows:

	2016	% of Total	2015	% of Total	2014	% of Total	% Change 2016 Compared to 2015		% Change 2015 Compared to 2014	
Equity	\$189.2	28 %	\$195.4	28 %	\$172.8	26 %	(3 )	13	%	
Fixed Income	372.5	54	367.1	52	358.7	54	1	2		

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Total long-term assets	561.7	82	562.5	80	531.5	80	—	6
Liquidity	123.1	18	140.0	20	135.9	20	(12)	3
Total	\$684.8	100%	\$702.5	100%	\$667.4	100%	(3 )	5

38

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Table of Contents

The component changes in our AUM by asset class (in billions) for the fiscal years ended March 31, 2016, 2015 and 2014, were as follows:

	Equity	Fixed Income	Total Long-Term	Liquidity	Total
March 31, 2013	\$ 161.8	\$ 365.1	\$ 526.9	\$ 137.7	\$ 664.6
Investment funds, excluding liquidity funds					
Subscriptions	27.0	25.1	52.1	—	52.1
Redemptions <sup>(1)</sup>	(30.1 )	(28.0 )	(58.1 )	—	(58.1 )
Separate account flows, net	(1.9 )	4.1	2.2	0.3	2.5
Liquidity fund flows, net	—	—	—	11.8	11.8
Net client cash flows	(5.0 )	1.2	(3.8 )	12.1	8.3
Market performance and other <sup>(2)</sup>	31.0	3.6	34.6	0.5	35.1
Impact of foreign exchange	(0.1 )	(4.7 )	(4.8 )	(0.1 )	(4.9 )
Acquisitions (dispositions), net	(1.3 )	—	(1.3 )	—	(1.3 )
March 31, 2014	186.4	365.2	551.6	150.2	701.8
Investment funds, excluding liquidity funds					
Subscriptions	29.4	42.7	72.1	—	72.1
Redemptions	(33.7 )	(27.5 )	(61.2 )	—	(61.2 )
Separate account flows, net	1.6	4.0	5.6	(0.9 )	4.7
Liquidity fund flows, net	—	—	—	(21.3 )	(21.3 )
Net client cash flows	(2.7 )	19.2	16.5	(22.2 )	(5.7 )
Market performance and other <sup>(2)</sup>	11.4	8.4	19.8	0.3	20.1
Impact of foreign exchange	(2.7 )	(14.7 )	(17.4 )	(1.1 )	(18.5 )
Acquisitions (dispositions), net <sup>(3)</sup>	7.0	(2.0 )	5.0	—	5.0
March 31, 2015	199.4	376.1	575.5	127.2	702.7
Investment funds, excluding liquidity funds					
Subscriptions	22.6	27.7	50.3	—	50.3
Redemptions	(36.1 )	(26.2 )	(62.3 )	—	(62.3 )
Separate account flows, net	2.7	(1.9 )	0.8	0.2	1.0
Liquidity fund flows, net	—	—	—	(15.1 )	(15.1 )
Net client cash flows	(10.8 )	(0.4 )	(11.2 )	(14.9 )	(26.1 )
Market performance and other <sup>(2)</sup>	(15.3 )	(0.1 )	(15.4 )	0.1	(15.3 )
Impact of foreign exchange	0.3	1.2	1.5	(0.1 )	1.4
Acquisitions (dispositions), net <sup>(3)</sup>	6.9	—	6.9	—	6.9
March 31, 2016	\$ 180.5	\$ 376.8	\$ 557.3	\$ 112.3	\$ 669.6

Fixed income redemptions include \$4.7 billion for the year ended March 31, 2014, related to a single, low-fee (1) global sovereign mandate client. Assets related to this client were reclassified from AUM to AUA during the first quarter of fiscal 2015, as further discussed below.

(2) Other is primarily the reclassification of client assets from AUM to AUA for fiscal 2016 and 2015 of \$0.5 billion and \$12.8 billion, respectively, and the reinvestment of dividends.

(3) Includes \$6.8 billion related to the acquisition of RARE Infrastructure and \$0.1 billion related to the acquisition of PK Investments during the year ended March 31, 2016; and \$9.5 billion related to the acquisition of Martin Currie and \$5.0 billion related to the acquisition of QS Investors, offset in part by \$9.5 billion related to the disposition of LMIC for the year ended March 31, 2015.

## Alternative Asset Class

Beginning in the first quarter of fiscal 2017, we will present alternative assets as a separate asset class of our AUM. We currently define alternative assets as all AUM managed by EnTrustPermal, Permal Capital Management, Clarion Partners, and RARE Infrastructure.



Table of Contents

## AUM by Distribution Channel

Broadly, we have two principal distribution channels, Global Distribution and Affiliate/Other, through which we sell a variety of investment products and services. Global Distribution, which consists of our centralized global distribution operations, principally sells U.S. and international mutual funds and other commingled vehicles, retail separately managed account programs, and sub-advisory accounts for insurance companies and similar clients. Affiliate/Other consists of the distribution operations within our asset managers which principally sell institutional separate account management, liquidity (money market) funds, and funds-of-hedge funds.

The component changes in our AUM by distribution channel (in billions) for the years ended March 31, 2016, 2015 and 2014, were as follows:

	Global Distribution	Affiliate/Other	Total
March 31, 2013	\$ 232.1	\$ 432.5	\$664.6
Net client cash flows, excluding liquidity funds	(1.2 )	(2.3 )	(3.5 )
Liquidity fund flows, net	—	11.8	11.8
Net client cash flows	(1.2 )	9.5	8.3
Market performance and other	18.7	16.4	35.1
Impact of foreign exchange	(2.2 )	(2.7 )	(4.9 )
Acquisitions (dispositions), net	—	(1.3 )	(1.3 )
March 31, 2014	247.4	454.4	701.8
Net client cash flows, excluding liquidity funds	16.4	(0.8 )	15.6
Liquidity fund flows, net	—	(21.3 )	(21.3 )
Net client cash flows	16.4	(22.1 )	(5.7 )
Market performance and other	11.9	8.2	20.1
Impact of foreign exchange	(5.7 )	(12.8 )	(18.5 )
Acquisitions (dispositions), net	—	5.0	(1) 5.0
March 31, 2015	270.0	432.7	702.7
Net client cash flows, excluding liquidity funds	(3.5 )	(7.5 )	(11.0 )
Liquidity fund flows, net	—	(15.1 )	(15.1 )
Net client cash flows	(3.5 )	(22.6 )	(26.1 )
Market performance and other	(13.1 )	(2.2 )	(15.3 )
Impact of foreign exchange	1.2	0.2	1.4
Acquisitions (dispositions), net	—	6.9	(1) 6.9
March 31, 2016	\$ 254.6	\$ 415.0	\$669.6

(1) Includes \$6.8 billion related to the acquisition of RARE Infrastructure and \$0.1 billion related to the acquisition of PK Investments during the year ended March 31, 2016; and \$9.5 billion related to the acquisition of Martin Currie and \$5.0 billion related to the acquisition of QS Investors, offset in part by \$9.5 billion related to the disposition of LMIC for the year ended March 31, 2015.

## Operating Revenue Yield

Our overall operating revenue yield, less performance fees, across all asset classes and distribution channels was 38 basis points for the year ended March 31, 2016, and 39 basis points for each of the years ended March 31, 2015 and 2014. Fees for equity assets are generally higher, averaging approximately 70 basis points, 75 basis points and 85 basis points for the years ended March 31, 2016, 2015, and 2014, respectively. The average fee rate for equity assets has declined over the last four years due to a shift in the mix of equity assets from higher fee equity products to lower fee equity products. This compares to fees for fixed income assets, which averaged approximately 30 basis points for each of the years ended March 31, 2016, 2015 and 2014, respectively, and liquidity assets, which averaged under 10 basis points (reflecting the impact of current advisory fee waivers due to the low interest rate environment) for each of the years ended March 31, 2016, 2015, and 2014. Equity assets are primarily managed by ClearBridge, Royce,

Brandywine, Permal, QS Investors, Martin Currie and RARE Infrastructure; fixed income assets are primarily managed by Western Asset, Brandywine, and Permal; and liquidity assets are managed by Western Asset. Fee rates for assets distributed through Legg Mason Global Distribution, which are predominately retail in nature, averaged approximately 45 basis points for the year ended March 31, 2016, and approximately 50 basis points for each of the years ended March 31, 2015 and 2014, while fee rates for assets distributed

## Table of Contents

through the Affiliate/Other channel averaged approximately 35 basis points for each of the years ended March 31, 2016, 2015, and 2014.

### Investment Performance

Overall investment performance of our AUM for the years ended March 31, 2016, 2015 and 2014, was mixed compared to relevant benchmarks.

#### Year ended March 31, 2016

For the year ended March 31, 2016, U.S. indices produced mixed returns. The best performing was the Dow Jones Industrial Average, returning 2.1%. These returns were achieved in an economic environment characterized by unexpected declines in oil prices, a strong U.S. dollar, along with a slow-to-recover U.S. economy, and Chinese currency devaluation.

In the fixed income markets, in December 2015, the Federal Reserve raised its target rate 0.25%, representing the Federal Reserve's first step toward monetary policy normalization, however, expectations of future Federal Reserve interest rate increases lessened as forecasts pointed to fewer future rate increases. This resulted in the yield curve continuing to flatten over the fiscal year as many long-dated yields declined.

The lowest performing fixed income sector for the year ended March 31, 2016, was high yield bonds, as measured by the Barclays U.S. High Yield Index, which declined 3.7%. The best performing fixed income sector for the year ended March 31, 2016, was U.S. Government bonds as measured by the Barclays U.S. Government Index, which returned 2.4%.

#### Year ended March 31, 2015

For the year ended March 31, 2015, most U.S. indices produced positive returns. The best performing was the NASDAQ Composite, which returned 16.7%. These returns were achieved in an economic environment characterized by uneven global growth and heightened sensitivity to economic news such as declining oil prices and unrest in the Middle East.

In the fixed income markets, the Federal Reserve kept the target rate and discount rate steady while signaling an increase in the Federal Reserve funds target rate in the near term. Overall, the yield curve flattened over the fiscal year as many long-dated yields declined.

The lowest performing fixed income sector for the year ended March 31, 2015, was high yield bonds, as measured by the Barclays U.S. High Yield Index, which returned 2.0%. The best performing fixed income sector for the year ended March 31, 2015, was corporate bonds as measured by the Barclays U.S. Credit Index, which returned 6.7%.

#### Year ended March 31, 2014

For the year ended March 31, 2014, most U.S. indices produced positive returns. The best performing was the NASDAQ Composite, which returned 28.5%. These returns were achieved in an economic environment characterized by uneven global growth and heightened sensitivity to economic news, such as concerns for economic growth in China and the then ongoing Ukraine/Russia crisis.

In the fixed income markets, the Federal Reserve kept the target rate and discount rate steady while tapering the bond-buying program. The yield curve steepened over the fiscal year but flattened in the last quarter as many long-dated yields declined.



The lowest performing fixed income sector for the year ended March 31, 2014, was U.S. Treasury Inflation Protected Securities ("TIPS"), as measured by the Barclays U.S. TIPS Index, which declined 6.5%. The best performing fixed income sector for the year ended March 31, 2014, was high yield bonds as measured by the Barclays U.S. High Yield Bond Index, which returned 7.5%.

Table of Contents

The following table presents a summary of the percentages of our AUM by strategy<sup>(1)</sup> that outpaced their respective benchmarks as of March 31, 2016, 2015 and 2014, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2016				As of March 31, 2015				As of March 31, 2014			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total (includes liquidity)	48	% 66	% 86	% 82	% 67	% 84	% 86	% 88	% 75	% 87	% 84	% 92
Equity:												
Large cap	45	% 23	% 86	% 69	% 24	% 64	% 74	% 94	% 67	% 91	% 52	% 76
Small cap	70	% 19	% 30	% 63	% 10	% 11	% 26	% 42	% 33	% 26	% 29	% 82
Total equity (includes other equity)	51	% 32	% 74	% 68	% 30	% 58	% 66	% 81	% 54	% 69	% 45	% 77
Fixed income:												
U.S. taxable	31	% 78	% 87	% 79	% 74	% 94	% 93	% 88	% 94	% 94	% 94	% 97
U.S. tax-exempt	100	% 0	% 100	% 100	% 100	% 100	% 100	% 100	% 0	% 100	% 100	% 100
Global taxable	11	% 75	% 85	% 84	% 77	% 89	% 88	% 84	% 54	% 82	% 98	% 93
Total fixed income	29	% 72	% 87	% 82	% 76	% 93	% 92	% 88	% 74	% 91	% 96	% 96

The following table presents a summary of the percentages of our U.S. mutual fund assets<sup>(2)</sup> that outpaced their Lipper category averages as of March 31, 2016, 2015 and 2014, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2016				As of March 31, 2015				As of March 31, 2014			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total (excludes liquidity)	48	% 61	% 72	% 65	% 55	% 65	% 63	% 70	% 44	% 63	% 56	% 68
Equity:												
Large cap	47	% 69	% 89	% 52	% 46	% 82	% 73	% 69	% 49	% 86	% 55	% 54
Small cap	36	% 15	% 20	% 60	% 15	% 19	% 21	% 59	% 27	% 19	% 25	% 72
Total equity (includes other equity)	45	% 52	% 67	% 54	% 38	% 57	% 53	% 63	% 39	% 55	% 42	% 60
Fixed income:												
U.S. taxable	76	% 83	% 84	% 81	% 80	% 87	% 86	% 86	% 80	% 85	% 92	% 85
U.S. tax-exempt	11	% 51	% 63	% 88	% 83	% 57	% 60	% 88	% 27	% 61	% 68	% 86
Global taxable	30	% 75	% 83	% 50	% 79	% 86	% 81	% 55	% 27	% 86	% 84	% 86

Total fixed income 51 % 73 % 78 % 81 % 80 % 78 % 77 % 84 % 54 % 78 % 83 % 86

For purposes of investment performance comparisons, strategies are an aggregation of discretionary portfolios (separate accounts, investment funds, and other products) into a single group that represents a particular investment objective. In the case of separate accounts, the investment performance of the account is based upon the (1) performance of the strategy to which the account has been assigned. Each of our asset managers has its own specific guidelines for including portfolios in their strategies. For those managers which manage both separate accounts and investment funds in the same strategy, the performance comparison for all of the assets is based upon the performance of the separate account.

As of March 31, 2016, 2015 and 2014, 91%, 90% and 91% of total AUM is included in strategy AUM, respectively, although not all strategies have three-, five-, and ten-year histories. Total strategy AUM includes liquidity assets. Certain assets are not included in reported performance comparisons. These include: accounts that are not managed in accordance with the guidelines outlined above; accounts in strategies not marketed to potential clients; accounts that have not yet been assigned to a strategy; and certain smaller products at some of our affiliates.

Past performance is not indicative of future results. For AUM included in institutional and retail separate accounts and investment funds included in the same strategy as separate accounts, performance comparisons are based on gross-of-fee performance. For investment funds (including fund-of-hedge funds) which are not managed in a separate account format, performance comparisons are based on net-of-fee performance. These performance comparisons do not reflect the actual performance of any specific separate account or investment fund; individual separate account and investment fund performance may differ.

Source: Lipper Inc. includes open-end, closed-end, and variable annuity funds. As of March 31, 2016, 2015 and (2) 2014, the U.S. long-term mutual fund assets represented in the data accounted for 19%, 21% and 20%, respectively, of our total AUM. The performance of our U.S. long-term mutual fund assets is included in the strategies.

Table of Contents

The following table presents a summary of the absolute and relative performance compared to the applicable benchmark for a representative sample of funds within our AUM, net of management and other fees as of the end of the period presented, for the 1-year, 3-year, 5-year, and 10-year periods, and from each fund's inception. The table includes a representative sample of funds from each significant subclass of our investment strategies (i.e., large cap equity, small cap equity, etc.). The funds within this group are representative of the performance of significant investment strategies we offer, that as of March 31, 2016, constituted an aggregate of approximately \$433 billion, or approximately 65% of our total AUM. The only meaningful exclusion of funds are our funds-of-hedge funds strategies, which involve privately placed hedge funds, and represent only 2% of our total AUM as of March 31, 2016, for which investment performance is not made publicly available. Presenting investment returns of funds provides a relevant representation of our performance while avoiding the many complexities relating to factors such as multiple fee structures, bundled pricing, and asset level break points, that would arise in reporting performance for strategies or other product aggregations.

Fund Name/Index <sup>(1)</sup>	Inception Date	Performance Type <sup>(2)</sup>	Annualized Absolute/Relative Total Return vs. Benchmark				
			1-year	3-year	5-year	10-year	Inception
Equity							
Large Cap							
Clearbridge Aggressive Growth Fund	10/24/1983	Absolute	(9.70)%	9.99%	11.68%	6.24%	11.86%
Russell 3000 Growth		Relative	(11.04)%	(3.18)%	(0.33)%	(1.86)%	1.99%
Clearbridge Appreciation Fund	3/10/1970	Absolute	2.42%	10.28%	10.65%	7.22%	10.26%
S&P 500		Relative	0.64%	(1.54)%	(0.93)%	0.21%	(0.08)%
Clearbridge Dividend Strategy	11/6/1992	Absolute	1.62%	8.67%	10.55%	5.96%	8.39%
S&P 500		Relative	(0.16)%	(3.16)%	(1.03)%	(1.05)%	(0.69)%
Clearbridge Large Cap Growth Fund	8/29/1997	Absolute	4.58%	14.64%	13.99%	7.67%	7.92%
Russell 1000 Growth		Relative	2.06%	1.03%	1.61%	(0.61)%	2.02%
Clearbridge Value Trust	4/16/1982	Absolute	(5.70)%	9.50%	9.33%	0.68%	11.49%
S&P 500		Relative	(7.48)%	(2.32)%	(2.25)%	(6.33)%	(0.17)%
Clearbridge All Cap Value	11/12/1981	Absolute	(7.37)%	5.32%	5.44%	3.81%	9.77%
Russell 3000 Value		Relative	(5.32)%	(3.76)%	(4.51)%	(1.80)%	(1.87)%
Clearbridge Large Cap Value Fund	12/31/1988	Absolute	(0.92)%	9.65%	10.62%	6.22%	9.49%
Russell 1000 Value		Relative	0.62%	0.27%	0.37%	0.50%	(0.56)%
Legg Mason Brandywine Diversified Large Cap Value Fund	9/7/2010	Absolute	(2.34)%	8.77%	10.02%	n/a	12.82%
Russell 1000 Value		Relative	(0.80)%	(0.61)%	(0.23)%	n/a	0.26%
Small Cap							
Royce Total Return Fund	12/15/1993	Absolute	(4.09)%	5.88%	6.80%	5.44%	10.43%
Russell 2000		Relative	5.67%	(0.96)%	(0.41)%	0.19%	2.19%
Royce Pennsylvania Mutual	6/30/1967	Absolute	(6.99)%	4.67%	4.92%	4.87%	11.45%
Russell 2000		Relative	2.77%	(2.17)%	(2.28)%	(0.39)%	n/a
Clearbridge Small Cap Growth	7/1/1998	Absolute	(14.24)%	4.37%	7.50%	5.83%	9.25%
Russell 2000 Growth		Relative	(2.40)%	(3.54)%	(0.20)%	(0.17)%	3.54%
Royce Premier Fund	12/31/1991	Absolute	(8.34)%	3.75%	3.64%	5.79%	11.11%
Russell 2000		Relative	1.42%	(3.09)%	(3.56)%	0.53%	2.05%
Royce Special Equity	5/1/1998	Absolute	(9.60)%	3.67%	5.76%	6.57%	8.58%
Russell 2000		Relative	0.16%	(3.17)%	(1.44)%	1.32%	2.05%
n/a - not applicable							



Table of Contents

Fund Name/Index <sup>(1)</sup>	Inception Date	Performance Type <sup>(2)</sup>	Annualized Absolute/Relative Total Return vs. Benchmark				
			1-year	3-year	5-year	10-year	Inception
Fixed Income							
U.S. Taxable							
Western Asset Core Plus Fund	7/8/1998	Absolute	1.71%	3.27%	4.78%	6.02%	6.30%
Barclays US Aggregate		Relative	(0.25)%	0.77%	1.00%	1.13%	1.06%
Western Asset Core Bond Fund	9/4/1990	Absolute	2.07%	3.22%	4.40%	5.43%	7.04%
Barclays US Aggregate		Relative	0.11%	0.72%	0.62%	0.54%	0.68%
Western Asset Total Return Unconstrained	7/6/2006	Absolute	(0.85)%	0.87%	2.26%	n/a	4.37%
Barclays US Aggregate		Relative	(2.81)%	(1.63)%	(1.51)%	n/a	(0.56)%
Western Asset Short Term Bond Fund	11/11/1991	Absolute	0.12%	0.55%	1.12%	1.86%	3.59%
Citi Treasury Government/Credit 1-3 YR		Relative	(0.87)%	(0.36)%	0.00%	(0.93)%	(0.69)%
Western Asset Inflation Index Plus Bond	3/1/2001	Absolute	(0.78)%	(1.67)%	2.28%	4.10%	5.14%
Barclays US TIPS		Relative	(2.30)%	(0.96)%	(0.74)%	(0.53)%	(0.35)%
Western Asset Intermediate Bond Fund	7/1/1994	Absolute	2.14%	2.20%	3.58%	5.03%	5.90%
Barclays Intermediate Government/Credit		Relative	0.08%	0.37%	0.57%	0.69%	0.59%
Western Asset Corporate Bond Fund	11/6/1992	Absolute	(0.64)%	3.38%	5.37%	5.06%	6.47%
Barclays US Credit		Relative	(1.58)%	0.52%	0.37%	(0.64)%	0.00%
Western Asset Mortgage Defined Opportunity Fund Inc.	2/24/2010	Absolute	0.16%	9.13%	12.28%	n/a	14.59%
BOFAML Floating Rate Home Loan Index		Relative	(0.65)%	6.95%	8.31%	n/a	9.26%
Western Asset High Yield Fund	9/28/2001	Absolute	(8.62)%	(1.04)%	2.94%	5.39%	6.54%
Barclays US Corp High Yield		Relative	(4.93)%	(2.88)%	(1.99)%	(1.62)%	(1.60)%
Western Asset Adjustable Rate Income	6/22/1992	Absolute	(0.03)%	0.54%	1.21%	1.47%	2.70%
Citi T-Bill 6-Month		Relative	(0.20)%	0.44%	1.10%	0.25%	(0.13)%
U.S. Tax-Exempt							
Western Asset Managed Municipals Fund	3/4/1981	Absolute	3.06%	3.28%	6.71%	5.32%	7.84%
Barclays Municipal Bond		Relative	(0.92)%	(0.35)%	1.12%	0.46%	0.48%
Global Taxable							
Legg Mason Western Asset Macro Opportunities Bond	11/30/2013	Absolute	(0.39)%	n/a	n/a	n/a	4.43%
3-Month LIBOR		Relative	(0.80)%	n/a	n/a	n/a	4.12%
Legg Mason Brandywine Global Opportunities Bond	11/1/2006	Absolute	(0.30)%	0.56%	3.91%	n/a	5.78%
Citi World Government Bond		Relative	(6.23)%	0.06%	2.74%	n/a	2.19%
Legg Mason Brandywine Absolute Return Opportunities Fund	2/28/2011	Absolute	(3.70)%	0.07%	2.96%	n/a	2.98%
Citi 3-Month T-Bill		Relative	(3.78)%	0.02%	2.90%	n/a	2.93%
Legg Mason Brandywine Global Fixed Income	10/31/2003	Absolute	(0.94)%	(0.75)%	2.15%	4.31%	4.41%
Citi World Government Bond		Relative	(6.87)%	(1.24)%	0.99%	0.12%	0.39%
Legg Mason Western Asset Global Multi Strategy Fund	8/31/2002	Absolute	(4.21)%	(0.87)%	1.34%	3.84%	6.01%
50% Bar. Global Agg./ 25% Bar. HY 2%/25% JPM EMBI +		Relative	(7.03)%	(2.51)%	(2.35)%	(1.98)%	(1.14)%
Western Asset Global High Yield Bond Fund	2/22/1995	Absolute	(6.50)%	(1.51)%	2.53%	4.55%	6.66%

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Barclays Global High Yield		Relative	(7.13)%	(3.86)%	(2.61)%	(2.83)%	(2.20)%
Legg Mason Western Asset Global Core Plus Bond Fund	12/31/2010	Absolute	(0.30)%	3.60%	4.87%	n/a	4.86%
Barclays Global Aggregate Index		Relative	(2.75)%	(0.08)%	0.28%	n/a	0.54%
Legg Mason Western Asset Australian Bond Trust	6/30/1983	Absolute	1.99%	5.70%	7.14%	6.75%	6.41%
UBS Australian Composite Bond Index		Relative	0.02%	0.30%	0.52%	0.48%	0.56%
Western Asset Emerging Markets Debt	10/17/1996	Absolute	0.42%	(1.29)%	2.74%	5.73%	9.31%
JPM EMBI Global Liquidity		Relative	(3.94)%	(3.72)%	(3.23)%	(1.38)%	0.27%
Western Asset Institutional Liquid Reserves Ltd.	12/31/1989	Absolute	0.21%	0.12%	0.14%	1.38%	3.30%
Citi 3-Month T-Bill		Relative	0.14%	0.07%	0.09%	0.31%	0.29%

n/a - not applicable

(1) Listed in order of size based on AUM of fund within each subcategory.

(2) Absolute performance is the actual performance (i.e., rate of return) of the fund. Relative performance is the difference (or variance) between the performance of the fund and its stated benchmark.

Table of Contents

## Assets Under Advisement

During the quarter ended June 30, 2014, we began reporting AUA as a result of the acquisition of approximately \$98 billion of AUA from QS Investors. Also during the first quarter of fiscal 2015, approximately \$12.8 billion of assets previously reported as AUM, primarily related to a low-fee global sovereign mandate for which investment discretion had abated over time, were reclassified to AUA. We experienced significant AUA outflows during the year ended March 31, 2015 as a result of one client withdrawing approximately \$80 billion. These redemptions did not have a material impact on our net income due to their low fee nature.

As of March 31, 2016 and 2015, AUA was approximately \$39 billion and \$35 billion, respectively. AUA as of March 31, 2016 was comprised of approximately \$17 billion related to QS Investors, approximately \$10 billion related to Western Asset, approximately \$8 billion related to ClearBridge, approximately \$2 billion related to Permal, and approximately \$2 billion related to Brandywine. AUA fee rates vary with the level of non-discretionary service provided. Our average annualized fee rate related to AUA was approximately 10 basis points for the year ended March 31, 2016 and was in the low single digit basis points for the year ended March 31, 2015. The increase in the average fee rate was due to the previously discussed \$80 billion redemption of very low fee AUA in the quarter ended March 31, 2015. Fees for AUA, aggregating \$41 million and \$30 million, are considered servicing fees and are therefore recorded in Distribution and service fees in the Consolidated Statement of Income for the years ended March 31, 2016 and 2015, respectively. Prior to fiscal 2015, fees for AUA were not material.

## RESULTS OF OPERATIONS

In accordance with financial accounting standards on consolidation, we consolidate and separately identify certain sponsored investment vehicles. The consolidation of these investment vehicles has no impact on Net Income (Loss) Attributable to Legg Mason, Inc. and does not have a material impact on our consolidated operating results. We also hold investments in other consolidated sponsored investment funds and the change in the value of these investments, which is recorded in Other non-operating income (expense), is reflected in Net Income (Loss) Attributable to Legg Mason, Inc. See Notes 1, 3, and 17 of Notes to Consolidated Financial Statements for additional information regarding the consolidation of investment vehicles.

## Operating Revenues

The components of Total Operating Revenues (in millions), and the dollar and percentage changes between periods were as follows:

	Years Ended March 31,			2016 Compared to 2015		2015 Compared to 2014	
	2016	2015	2014	\$ Change	% Change	\$ Change	% Change
Investment advisory fees:							
Separate accounts	\$826.1	\$824.2	\$777.4	\$1.9	— %	\$46.8	6 %
Funds	1,409.0	1,544.5	1,501.3	(135.5)	(9 )	43.2	3
Performance fees	42.0	83.5	107.1	(41.5)	(50 )	(23.6)	(22 )
Distribution and service fees	381.5	361.2	347.6	20.3	6	13.6	4
Other	2.2	5.7	8.4	(3.5)	(61 )	(2.7)	(32 )
Total Operating Revenues	\$2,660.8	\$2,819.1	\$2,741.8	\$(158.3)	(6 )	\$77.3	3

Total Operating Revenues for the year ended March 31, 2016, were \$2.66 billion, a decrease of 6% from \$2.82 billion for the year ended March 31, 2015. The decrease was primarily due to a decrease in our operating revenue yield, excluding performance fees, from 39 basis points to 38 basis points, a 3% decrease in average AUM, and a decrease in performance fees. Although equity and fixed income AUM together comprised a higher percentage of our total



average AUM for the year ended March 31, 2016, as compared to the year ended March 31, 2015, our operating revenue yield, excluding performance fees, declined due to a less favorable product mix, with lower yielding products comprising a higher percentage of our total average AUM for the year ended March 31, 2016, as compared to March 31, 2015.

Total Operating Revenues for the year ended March 31, 2015, were \$2.82 billion, an increase of 3% from \$2.74 billion for the year ended March 31, 2014. This increase was primarily due to the impact of a 6% increase in average long-term AUM, offset in part by a decrease in performance fees. Although equity AUM comprised a higher percentage of our total AUM

Table of Contents

as of March 31, 2015, as compared to March 31, 2014, our operating revenue yield, excluding performance fees, was 39 basis points in each of the years ended March 31, 2015 and 2014, due to a slightly less favorable product mix, with lower yielding products comprising a higher percentage of our total average AUM for the year ended March 31, 2015, as compared to the year ended March 31, 2014.

**Investment Advisory Fees from Separate Accounts**

For the year ended March 31, 2016, investment advisory fees from separate accounts increased \$1.9 million, to \$826.1 million, as compared to \$824.2 million for the year ended March 31, 2015. Of this increase, \$11.4 million was due to RARE Infrastructure after it was acquired in October 2015, \$8.7 million was due to a full year of results for Martin Currie, which was acquired in October 2014, \$6.8 million was the result of higher average equity assets managed by Brandywine, \$6.9 million was the result of higher average fixed income assets managed by Brandywine and \$3.1 million was the result of higher average assets managed by Permal. These increases were substantially offset by a decrease of \$27.7 million due to the sale of LMIC in November 2014 and a decrease of \$6.9 million due to lower averaged fixed income assets managed by Western Asset.

For the year ended March 31, 2015, investment advisory fees from separate accounts increased \$46.8 million, or 6%, to \$824.2 million, as compared to \$777.4 million for the year ended March 31, 2014. Of this increase, \$34.7 million was due to higher average equity assets managed by ClearBridge, \$29.5 million was due to higher average fixed income assets managed by Western Asset and Brandywine, and \$17.4 million was due to Martin Currie, which was acquired in October 2014, including an increase in revenues related to Martin Currie Australia ("MC Australia"), which includes our legacy Australian asset manager. These increases were offset in part by approximately \$25 million of revenues associated with certain existing client assets which were reclassified from AUM to AUA during the year ended March 31, 2015, as previously discussed. These revenues are now included in Distribution and service fees for fiscal 2015. The increases were also offset in part by a decrease of \$15.8 million resulting from the sale of LMIC in November 2014.

**Investment Advisory Fees from Funds**

For the year ended March 31, 2016, investment advisory fees from funds decreased \$135.5 million, or 9%, to \$1.41 billion, as compared to \$1.54 billion for the year ended March 31, 2015. Of this decrease, \$104.9 million was due to lower average equity assets managed by Royce, \$43.9 million was due to lower average assets managed by Permal and approximately \$28 million was related to revenues which, due to a change in the distributor for certain funds in May 2015, are no longer included in advisory fee revenue. Revenues related to these funds is included in Distribution and service fees for fiscal 2016. These decreases were offset in part by an increase of \$28.8 million due to higher average fixed income assets managed by Western Asset and Brandywine and a net increase of \$18.3 million in fees from liquidity assets, largely due to a reduction in fee waivers on liquidity funds managed by Western Asset.

For the year ended March 31, 2015, investment advisory fees from funds increased \$43.2 million, or 3%, to \$1.54 billion, as compared to \$1.50 billion for the year ended March 31, 2014. Of this increase, \$80.1 million was due to higher average equity assets managed by ClearBridge, \$30.5 million was due to higher average fixed income assets managed by Brandywine and Western Asset, and \$14.7 million was due to Martin Currie, which was acquired in October 2014, including the increase in revenues related to MC Australia. These increases were offset in part by a decrease of \$40.5 million due to lower average equity assets managed by Royce, a decrease of \$33.8 million due to lower average assets managed by Permal, and a net decrease of \$9.3 million in fees from liquidity assets, due to fee waivers on liquidity funds managed by Western Asset.

**Investment Advisory Performance Fees**

Of our total AUM as of March 31, 2016, 2015, and 2014, approximately 7%, 7%, and 6% was in accounts that were eligible to earn performance fees. For the year ended March 31, 2016, Investment advisory performance fees decreased \$41.5 million to \$42.0 million, as compared to \$83.5 million for the year ended March 31, 2015, primarily

due to lower fees earned on assets managed at Permal and Brandywine.

For the year ended March 31, 2015, investment advisory performance fees decreased \$23.6 million to \$83.5 million, as compared to \$107.1 million for the year ended March 31, 2014, primarily due to lower fees earned on assets managed at Permal, offset in part by an increase in fees earned on assets managed at Brandywine.

#### Distribution and Service Fees

For the year ended March 31, 2016, Distribution and service fees increased \$20.3 million, or 6%, to \$381.5 million, as compared to \$361.2 million for the year ended March 31, 2015, primarily as a result of approximately \$29 million of revenue

Table of Contents

which is included in Distribution and service fees in fiscal 2016, due to a change in the distributor for certain funds in May 2015. Revenues related to these funds were previously included in Investment advisory fees from funds. An increase of \$11.6 million in advisement fees associated with our AUA also contributed to the increase. These increases were offset in part by a decline in average mutual fund AUM subject to distribution and service fees.

For the year ended March 31, 2015, Distribution and service fees increased \$13.6 million, or 4%, to \$361.2 million, as compared to \$347.6 million for the year ended March 31, 2014, primarily as a result of approximately \$25 million of revenues related to client assets that were reclassified from AUM to AUA, as well as an increase in average mutual fund AUM subject to distribution and service fees. As previously discussed, the revenues associated with AUA are included in Distribution and service fees beginning in fiscal 2015. These increases were offset in part by the impact of increased fee waivers related to liquidity funds managed by Western Asset.

## Operating Expenses

The components of Total Operating Expenses (in millions), and the dollar and percentage changes between periods were as follows:

	Years Ended March 31,			2016 Compared to 2015		2015 Compared to 2014	
	2016	2015	2014	\$ Change	% Change	\$ Change	% Change
Compensation and benefits	\$1,172.6	\$1,208.2	\$1,208.2	\$(35.6)	(3)%	\$—	n/m
Transition-related compensation	32.2	24.6	2.2	7.6	31	22.4	n/m
Total Compensation and Benefits	1,204.8	1,232.8	1,210.4	(28.0)	(2)	22.4	2
Distribution and servicing	545.7	594.8	619.1	(49.1)	(8)	(24.3)	(4)
Communications and technology	197.9	182.4	157.9	15.5	8	24.5	16
Occupancy	122.6	109.7	115.2	12.9	12	(5.5)	(5)
Amortization of intangible assets	5.0	2.6	12.3	2.4	92	(9.7)	(79)
Impairment of intangible assets	371.0	—	—	371.0	n/m	—	n/m
Other, net, including \$(33.4) million and \$5.0 million of contingent consideration fair value (reduction) increase in fiscal 2016 and 2014, respectively	163.0	198.6	196.0	(35.6)	(18)	2.6	1
Total Operating Expenses	\$2,610.0	\$2,320.9	\$2,310.9	\$289.1	12	\$10.0	—
n/m - not meaningful							

Total Operating Expenses for the year ended March 31, 2016, increased \$289.1 million, or 12%, to \$2.61 billion, as compared to \$2.32 billion for the year ended March 31, 2015. The increase was primarily due to intangible asset impairment charges of \$371 million recorded during the year ended March 31, 2016, as further discussed below. Total operating expenses for the year ended March 31, 2015, remained relatively flat at \$2.32 billion, as compared to \$2.31 billion, for the year ended March 31, 2014.

Operating expenses for the years ended March 31, 2016, 2015, and 2014, incurred at the investment management affiliate level comprised approximately 70% of total operating expenses in each year, excluding the impairment charges which are deemed to be corporate expenses. The remaining operating expenses are comprised of corporate costs, including costs of our global distribution operations.

Table of Contents

## Compensation and Benefits

The components of Total Compensation and Benefits (in millions), and the dollar and percentage changes between periods were as follows:

	Years Ended March 31,			2016 Compared to 2015		2015 Compared to 2014	
	2016	2015	2014	\$ Change	% Change	\$ Change	% Change
Salaries and incentives	\$915.8	\$976.9	\$949.5	\$(61.1)	(6)%	\$27.4	3%
Benefits and payroll taxes (including deferred compensation)	232.6	214.7	214.5	17.9	8	0.2	—
Transition and severance costs	36.2	31.8	29.4	4.4	14	2.4	8
Royce management equity plan	21.4	—	—	21.4	n/m	—	—
Gains (losses) on deferred compensation and seed capital investments	(1.2)	9.4	17.0	(10.6)	n/m	(7.6)	(45)%
Total Compensation and Benefits	\$1,204.8	\$1,232.8	\$1,210.4	\$(28.0)	(2)%	\$22.4	2%

n/m - not meaningful

Total Compensation and Benefits for the year ended March 31, 2016, decreased 2% to \$1.20 billion, as compared to \$1.23 billion for the year ended March 31, 2015; and for the year ended March 31, 2015, increased 2% to \$1.23 billion, as compared to \$1.21 billion for the year ended March 31, 2014:

Salaries and incentives decreased \$61.1 million, to \$915.8 million for the year ended March 31, 2016, as compared to \$976.9 million for the year ended March 31, 2015, primarily due to a decrease of \$58.6 million in net compensation at investment affiliates, which was substantially the result of a reduction in operating revenue at revenue share-based affiliates, which creates an offsetting decrease in compensation per the applicable revenue share arrangements, and the sale of LMIC in November 2014, offset in part by the acquisition of Martin Currie in October 2014.

Salaries and incentives increased \$27.4 million, to \$976.9 million for the year ended March 31, 2015, as compared to \$949.5 million for the year ended March 31, 2014, principally due to an increase of \$15.8 million in incentive-based compensation for distribution and corporate personnel, primarily related to increased retail sales in our global distribution group. A \$9.7 million increase in net compensation at investment affiliates also contributed to the increase. The increase in net compensation at investment affiliates was primarily due to the acquisition of Martin Currie and the impact of increased revenues at certain revenue-share based affiliates, offset in part by the impact of the sale of LMIC in November 2014 and the sale of a small affiliate and the closing down of certain businesses in connection with various corporate initiatives in fiscal 2014.

Benefits and payroll taxes increased \$17.9 million, to \$232.6 million for the year ended March 31, 2016, as compared to \$214.7 million for the year ended March 31, 2015, primarily as a result of an increase in costs associated with certain employee benefit plans.

Benefits and payroll taxes increased slightly to \$214.7 million for the year ended March 31, 2015, as compared to \$214.5 million for the year ended March 31, 2014, primarily as a result of an increase in payroll taxes and recruiting costs.

Transition and severance costs increased \$4.4 million, to \$36.2 million for the year ended March 31, 2016, as compared to \$31.8 million for the year ended March 31, 2015. Transition and severance costs for the year ended March 31, 2016, were primarily comprised of \$32.2 million of costs associated with the previously discussed

restructuring of Permal in preparation for the combination with EnTrust. For the year ended March 31, 2015, transition and severance costs were primarily comprised of \$24.6 million of costs associated with the integration of Batterymarch and LMGAA into QS Investors, and \$4.3 million related to the sale of LMIC.

• Transition costs and severance increased \$2.4 million, to \$31.8 million for the year ended March 31, 2015, as compared to \$29.4 million for the year ended March 31, 2014, primarily due to higher compensation costs associated

## Table of Contents

with the previously discussed integration of Batterymarch and LMGAA over time into QS Investors, as compared to compensation costs associated with various corporate initiatives recognized in the prior year.

Royce management equity plan represents the charge arising from the grant of equity units under the Royce management equity plan, as previously discussed.

For the year ended March 31, 2016, compensation as a percentage of operating revenues increased to 45.3% from 43.7% for the year ended March 31, 2015, due to the impact of the charge associated with the Royce management equity plan grant, the impact of the acquisition of Martin Currie in October 2014, and the impact of higher transition and severance costs in the current year, offset in part by the impact of decreased revenues at certain revenue share-based affiliates that retain a relatively higher percentage of revenues as compensation.

For the year ended March 31, 2015, compensation as a percentage of operating revenues decreased to 43.7% from 44.1% for the year ended March 31, 2014, due to the impact of decreased revenues at certain revenue share-based affiliates that retain a higher percentage of revenues as compensation, offset in part by the impact of higher compensation costs for corporate and distribution personnel.

### Distribution and Servicing

For the year ended March 31, 2016, Distribution and servicing expenses decreased 8% to \$545.7 million, as compared to \$594.8 million for the year ended March 31, 2015, primarily due to the impact of lower average AUM in certain products for which we pay fees to third-party distributors.

For the year ended March 31, 2015, Distribution and servicing expenses decreased 4% to \$594.8 million, as compared to \$619.1 million for the year ended March 31, 2014, primarily due to a net decrease of \$20.9 million in structuring fees related to closed-end fund launches.

### Communications and Technology

For the year ended March 31, 2016, Communications and technology expense increased 8% to \$197.9 million, as compared to \$182.4 million for the year ended March 31, 2015, as a result of an increase in technology consulting and license fees for software product implementations in the current year period, and the addition of Martin Currie, which was acquired in October 2014.

For the year ended March 31, 2015, Communications and technology expense increased 16% to \$182.4 million, as compared to \$157.9 million for the year ended March 31, 2014, primarily due to increases in technology consulting, data management, depreciation expenses, and market data costs, principally resulting from cyber-security and data governance enhancements and the addition of Martin Currie and QS Investors expenses.

### Occupancy

For the year ended March 31, 2016, Occupancy expense increased 12% to \$122.6 million, as compared to \$109.7 million for the year ended March 31, 2015. Real estate related charges of \$17.7 million were recognized in the current year related to reduced space requirements and the restructuring of Permal for the combination with EnTrust, while real estate related charges of \$8.2 million were recognized in the prior year in connection with the integration of Batterymarch and LMGAA into QS Investors.

For the year ended March 31, 2015, Occupancy expense decreased 5% to \$109.7 million, as compared to \$115.2 million for the year ended March 31, 2014, primarily due to a decrease of \$2.0 million in depreciation on furniture and leaseholds and a \$1.9 million decrease in rent expense, principally as a result of lease reserves taken on vacant space in fiscal 2014.

Amortization and Impairment of Intangible Assets

For the year ended March 31, 2016, Amortization of intangible assets increased to \$5.0 million, as compared to \$2.6 million for the year ended March 31, 2015, primarily due to additional amortization expense related to the acquisition of RARE Infrastructure in October 2015.

For the year ended March 31, 2015, Amortization of intangible assets decreased 79% to \$2.6 million, as compared to \$12.3 million for the year ended March 31, 2014, primarily due to certain management contracts becoming fully amortized in



Table of Contents

October 2014 and December 2013 and the sale of LMIC, offset in part by additional amortization expense related to the acquisitions of QS Investors in May 2014 and Martin Currie in October 2014.

Impairment of intangible assets was \$371.0 million in the year ended March 31, 2016. The impairment charges relate to our Permal funds-of-hedge funds contracts asset and Permal trade name. The impairment charges resulted from a number of current trends and factors, including (i) periods of moderate inflows or outflows over recent years and related reductions in AUM; (ii) a reduction in growth assumptions for the next five years; (iii) a decrease in projected margins for the next two years; and (iv) an increase in the rate used to discount projected future cash flows primarily due to company specific factors including continued market influences. These changes resulted in a reduction of the projected cash flows and our overall assessment of fair value of the assets, such that the fair values of the Permal funds-of-hedge funds contracts asset and Permal trade name declined below their carrying values, and accordingly were impaired by \$364.0 million and \$7.0 million, respectively. See Critical Accounting Policies and Note 5 of Notes to Consolidated Financial Statements for further discussion of the impairment charges.

**Other**

For the year ended March 31, 2016, Other expenses decreased \$35.6 million, or 18%, to \$163.0 million, as compared to \$198.6 million for the year ended March 31, 2015, primarily due to a \$33.4 million credit related to fair value adjustments to decrease the contingent consideration liabilities associated with the acquisitions of Martin Currie and Fauchier and a \$14.6 million decrease in expense reimbursements paid to certain mutual funds. These decreases were partially offset by a \$13.6 million increase in professional fees, due in part to costs for the acquisitions of Clarion Partners and EnTrust.

For the year ended March 31, 2015, Other expenses increased \$2.6 million, or 1%, to \$198.6 million, as compared to \$196.0 million for the year ended March 31, 2014, primarily due to a \$5.9 million increase in travel and entertainment expenses, a \$5.3 million increase in advertising expenses, and a \$4.7 million increase in professional fees. These increases were offset in part by a \$14.2 million decrease in expense reimbursements paid to certain mutual funds.

**Non-Operating Income (Expense)**

The components of total other non-operating income (expense) (in millions), and the dollar and percentage changes between periods were as follows:

	Years Ended March 31,			2016 Compared to 2015		2015 Compared to 2014	
	2016	2015	2014	\$ Change	% Change	\$ Change	% Change
Interest income	\$5.6	\$7.5	\$6.4	\$(1.9)	(25)%	\$1.1	17%
Interest expense	(48.4)	(58.3)	(52.9)	9.9	(17)	(5.4)	10
Other income (expense), net, including \$107.1 million debt extinguishment loss in July 2014	(26.0)	(85.3)	32.8	59.3	(70)	(118.1)	n/m
Other non-operating income (expense) of consolidated investment vehicles, net	(7.2)	5.9	2.4	(13.1)	n/m	3.5	146
Total Other Non-Operating Income (Expense)	\$(76.0)	\$(130.2)	\$(11.3)	\$54.2	(42)	\$(118.9)	n/m
n/m - not meaningful							

**Interest Income**

For the year ended March 31, 2016, Interest income decreased 25% to \$5.6 million, as compared to \$7.5 million for the year ended March 31, 2015, primarily due to a \$0.9 million decrease in the current year related to lower average interest-bearing investment balances and lower yields earned on those balances, and \$0.7 million of interest income received in the prior year in connection with a tax refund.

For the year ended March 31, 2015, Interest income increased 17% to \$7.5 million, as compared to \$6.4 million for the year ended March 31, 2014, driven by higher yields earned on investment balances.

## Table of Contents

### Interest Expense

For the year ended March 31, 2016, Interest expense decreased 17% to \$48.4 million, as compared to \$58.3 million for the year ended March 31, 2015. The decrease of \$6.4 million was primarily due to a decrease in interest accruals for uncertain tax positions, offset in part by interest accretion on contingent consideration liabilities related to the acquisitions of Martin Currie and RARE Infrastructure.

For the year ended March 31, 2015, Interest expense increased 10% to \$58.3 million, as compared to \$52.9 million for the year ended March 31, 2014, primarily due to an increase in interest accruals for uncertain tax positions and interest accretion on Contingent consideration liabilities related to the acquisitions of QS Investors and Martin Currie.

### Other Income (Expense), Net

For the year ended March 31, 2016, Other expense, net, decreased \$59.3 million, to expense of \$26.0 million, as compared to expense of \$85.3 million in fiscal 2015, primarily due to a \$107.1 million charge recognized in the prior year related to the refinancing of our 5.5% Senior Notes in July 2014. This decrease was offset in part by net market losses of \$27.0 million on corporate investments, which are not offset in compensation, net market losses of \$10.6 million on seed capital investments and assets invested for deferred compensation plans, which are offset by corresponding increases in compensation, mentioned above, net market losses of \$5.6 million on investments of consolidated sponsored investment vehicles that are not designated as consolidated investment vehicles ("CIVs"), which have no impact on Net Income Attributable to Legg Mason, Inc., as the losses are fully attributable to noncontrolling interests, and a \$4.5 million loss on a foreign currency forward contract related to the acquisition of RARE Infrastructure.

For the year ended March 31, 2015, Other income (expense), net, decreased \$118.1 million, to expense of \$85.3 million, as compared to income of \$32.8 million in fiscal 2014. This decrease was primarily due to a \$107.1 million charge related to the refinancing of the 5.5% Senior Notes in July 2014. A reduction in net market gains of \$7.6 million on seed capital investments and assets invested for deferred compensation plans, which are offset by corresponding decreases in compensation mentioned above, and a reduction in net market gains of \$5.3 million on corporate investments, which are not offset in compensation, also contributed to the decrease.

### Other Non-Operating Income (Loss) of Consolidated Investment Vehicles

For the year ended March 31, 2016, Other non-operating income (expense) of consolidated investment vehicles, net, decreased \$13.1 million to expense of \$7.2 million, as compared to income of \$5.9 million in fiscal 2015, primarily due to the deconsolidation of a CIV during the quarter ended March 31, 2015, and net market losses on investments of certain CIVs.

For the year ended March 31, 2015, Other non-operating income (expense) of consolidated investment vehicles, net, increased \$3.5 million to income of \$5.9 million, primarily due to an increase in net market gains on investments of certain CIVs.

### Income Tax Provision

For the year ended March 31, 2016, the provision for income taxes was \$7.7 million, as compared to \$125.3 million in the year ended March 31, 2015. The effective tax rate was (30.5)% for the year ended March 31, 2016, as compared to 34.0% for the year ended March 31, 2015. The change in the effective tax rate was largely due to the impact of the \$371.0 million of impairment charges recognized in lower tax rate jurisdictions. In November 2015, the U.K. Finance Bill 2015 was enacted, which reduced the main U.K. corporate tax rate from 20% to 19% effective April 1, 2017, and to 18% effective April 1, 2020. The reductions in the U.K. corporate tax rate resulted in tax benefits of \$8.4 million in fiscal 2016. The impact of CIVs increased the effective rate by 23.8 percentage points for the year ended March 31, 2016, and decreased the effective rate by 0.5 percentage points for the year ended March 31, 2015.

For the year ended March 31, 2015, the provision for income taxes was \$125.3 million, as compared to \$137.8 million in the year ended March 31, 2014. The effective tax rate was 34.0% for the year ended March 31, 2015, as compared to 32.8% for the year ended March 31, 2014. The change in the effective rate was primarily related to the impact of \$19.2 million of income tax benefits recorded in fiscal 2014 with respect to U.K. corporate tax rate reductions, which impacted the effective tax rate by 4.6 percentage points in fiscal 2014. The impact of CIVs decreased the effective rate by 0.5 percentage points for the year ended March 31, 2015, and increased the effective rate by 0.2 percentage points for the year ended March 31, 2014.

Table of Contents

## Net Income (Loss) Attributable to Legg Mason, Inc. and Operating Margin

Net Loss Attributable to Legg Mason, Inc. for the year ended March 31, 2016, totaled \$25.0 million, or \$0.25 per diluted share, compared to Net Income Attributable to Legg Mason, Inc. of \$237.1 million, or \$2.04 per diluted share, in the year ended March 31, 2015. The decrease was primarily attributable to the impact of the pre-tax impairment charges of \$371.0 million (\$296.8 million, net of income tax benefits, or \$2.76 per diluted share) related to our indefinite-life intangible assets in the year ended March 31, 2016, offset in part by the pre-tax non-operating charge of \$107.1 million (\$68.5 million, net of income tax benefits, or \$0.59 per diluted share) recognized in the year ended March 31, 2015, in connection with the refinancing of the 5.5% Senior Notes. Operating margin was 1.9% for the year ended March 31, 2016, compared to 17.7% for the year ended March 31, 2015, with the decrease primarily attributable to the impairment charges.

Net Income Attributable to Legg Mason, Inc. for the year ended March 31, 2015, totaled \$237.1 million, or \$2.04 per diluted share, compared to \$284.8 million, or \$2.33 per diluted share, in the year ended March 31, 2014. The decrease was primarily attributable to the pre-tax, non-operating charge of \$107.1 million (\$68.5 million, net of income tax benefits, or \$0.59 per diluted share) related to the refinancing of the 5.5% Senior Notes in the year ended March 31, 2015, offset in part by a \$20.7 million decrease in costs related to closed-end fund launches, and the net impact of increased operating revenues. Operating margin was 17.7% for the year ended March 31, 2015, compared to 15.7% for the year ended March 31, 2014.

## Supplemental Non-GAAP Financial Information

As supplemental information, we are providing performance measures for "Adjusted Income" and "Operating Margin, as Adjusted" and a liquidity measure for "Adjusted EBITDA", each of which are based on methodologies other than generally accepted accounting principles ("non-GAAP"). Our management uses these measures as benchmarks in evaluating and comparing our period-to-period operating performance and liquidity.

Adjusted Income decreased to \$370.3 million for the year ended March 31, 2016, from \$378.8 million for the year ended March 31, 2015; however, due to a reduction in weighted-average shares outstanding as a result of share repurchases, Adjusted Income per diluted share increased to \$3.36 per diluted share for the year ended March 31, 2016, from \$3.26 per diluted share for the year ended March 31, 2015. The decrease in Adjusted Income was primarily attributable to the net impact of decreased operating revenues, offset in part by the impact of the pre-tax, non-operating charge of \$107.1 million (\$68.5 million, net of income tax, or \$0.59 per diluted share) related to the refinancing of the 5.5% Senior Notes in the prior year. Operating Margin, as Adjusted, for the years ended March 31, 2016 and 2015, was 18.6% and 23.0%, respectively. Operating Margin, as Adjusted, for the year ended March 31, 2016, was reduced by 2.0 percentage points due to costs associated with the restructuring of Permal for the combination with EnTrust, by 1.0 percentage point due to the compensation charge associated with the Royce management equity plan grant, and by 0.4 percentage points for real estate related charges recognized in the current year associated with reduced space requirements. Operating Margin, as Adjusted, for the year ended March 31, 2015 was reduced by 1.7 percentage points due to costs associated with the integration of Batterymarch and LMGAA into QS Investors and various other corporate initiatives.

Adjusted EBITDA for the years ended March 31, 2016 and 2015, was \$621.7 million and \$686.5 million, respectively. The decrease in Adjusted EBITDA was primarily the result of a decrease in cash provided by operating activities.

Adjusted Income decreased to \$378.8 million, or \$3.26 per diluted share, for the year ended March 31, 2015, from \$417.8 million, or \$3.41 per diluted share, for the year ended March 31, 2014. The decrease was primarily attributable to the pre-tax, non-operating charge of \$107.1 million (\$68.5 million, net of income tax, or \$0.59 per diluted share) related to the refinancing of the 5.5% Senior Notes in the year ended March 31, 2015, offset in part by the net impact of increased operating revenues. Operating Margin, as Adjusted, for the years ended March 31, 2015 and 2014, was

23.0% and 22.0%, respectively. Operating Margin, as Adjusted, for the years ended March 31, 2015 and 2014, was reduced by 1.7 and 1.5 percentage points, respectively, due to costs associated with the integration of Batterymarch and LMGAA into QS Investors and various other corporate initiatives. Operating Margin, as Adjusted, for the year ended March 31, 2014, was also reduced by 1.0 percentage point due to structuring fees related to closed-end fund and real estate investment trust launches during that fiscal year.

Adjusted EBITDA for the years ended March 31, 2015 and 2014, was \$686.5 million and \$617.1 million, respectively. The \$69.4 million increase in Adjusted EBITDA was primarily the result of an increase in cash provided by operating activities.

## Table of Contents

### Adjusted Income

We define “Adjusted Income” as Net Income (Loss) Attributable to Legg Mason, Inc., plus amortization and deferred taxes related to intangible assets and goodwill less deferred income taxes on goodwill and indefinite-life intangible asset impairment, if any. We also adjust for non-core items that are not reflective of our economic performance, such as intangible asset impairments, the impact of fair value adjustments of contingent consideration liabilities, if any, and the impact of tax rate adjustments on certain deferred tax liabilities related to indefinite-life intangible assets.

We believe that Adjusted Income provides a useful representation of our operating performance adjusted for non-cash acquisition related items and other items that facilitate comparison of our results to the results of other asset management firms that have not made significant acquisitions. We also believe that Adjusted Income is an important metric in estimating the value of an asset management business.

Adjusted Income only considers adjustments for certain items that relate to operating performance and comparability, and therefore, is most readily reconcilable to Net Income (Loss) Attributable to Legg Mason, Inc. determined under GAAP. This measure is provided in addition to Net Income (Loss) Attributable to Legg Mason, Inc., but is not a substitute for Net Income (Loss) Attributable to Legg Mason, Inc. and may not be comparable to non-GAAP performance measures, including measures of adjusted earnings or adjusted income, of other companies. Further, Adjusted Income is not a liquidity measure and should not be used in place of cash flow measures determined under GAAP. Fair value adjustments of contingent consideration liabilities may or may not provide a tax benefit, depending on the tax attributes of the acquisition transaction. We consider Adjusted Income to be useful to investors because it is an important metric in measuring the economic performance of asset management companies, as an indicator of value, and because it facilitates comparison of our operating results with the results of other asset management firms that have not made significant acquisitions.

In calculating Adjusted Income, we adjust for the impact of the amortization of management contract assets and impairment of indefinite-life intangible assets, and add (subtract) the impact of fair value adjustments on contingent consideration liabilities, if any, all of which arise from acquisitions, to Net Income (Loss) Attributable to Legg Mason, Inc. to reflect the fact that these items distort comparisons of our operating results with the results of other asset management firms that have not engaged in significant acquisitions. Deferred taxes on indefinite-life intangible assets and goodwill include actual tax benefits from amortization deductions that are not realized under GAAP absent an impairment charge or the disposition of the related business. Because we fully expect to realize the economic benefit of the current period tax amortization, we add this benefit to Net Income (Loss) Attributable to Legg Mason, Inc. in the calculation of Adjusted Income. However, because of our net operating loss carry-forward, we will receive the benefit of the current tax amortization over time. Conversely, we subtract the non-cash income tax benefits on goodwill and indefinite-life intangible asset impairment charges and U.K. tax rate adjustments on excess book basis on certain acquired indefinite-life intangible assets, if applicable, that have been recognized under GAAP. These adjustments reflect that these items distort comparisons of our operating results to other periods and the results of other asset management firms that have not engaged in significant acquisitions, including any related impairments.

Should a disposition, impairment charge or other non-core item occur, its impact on Adjusted Income may distort actual changes in the operating performance or value of our firm. Accordingly, we monitor these items and their related impact, including taxes, on Adjusted Income to ensure that appropriate adjustments and explanations accompany such disclosures.

Although depreciation and amortization of fixed assets are non-cash expenses, we do not add these charges in calculating Adjusted Income because these charges are related to assets that will ultimately require replacement.





Table of Contents

A reconciliation of Net Income (Loss) Attributable to Legg Mason, Inc. to Adjusted Income (in thousands except per share amounts) is as follows:

	For the Years Ended March 31,		
	2016	2015	2014
Net Income (Loss) Attributable to Legg Mason, Inc.	\$(25,032 )	\$237,080	\$284,784
Plus (less):			
Amortization of intangible assets	4,979	2,625	12,314
Impairment of intangible assets	371,000	—	—
Contingent consideration fair value adjustments	(33,375 )	—	5,000
Deferred income taxes on intangible assets:			
Impairment charges	(74,200 )	—	—
Tax amortization benefit	135,260	139,046	134,871
U.K. tax rate adjustment	(8,361 )	—	(19,164 )
Adjusted Income	\$370,271	\$378,751	\$417,805
Net Income (Loss) per diluted share Attributable to Legg Mason, Inc. Shareholders	\$(0.25 )	\$2.04	\$2.33
Plus (less): <sup>(1)</sup>			
Amortization of intangible assets	0.05	0.02	0.10
Impairment of intangible assets	3.45	—	—
Contingent consideration fair value adjustments	(0.31 )	—	0.04
Deferred income taxes on intangible assets:			
Impairment charges	(0.69 )	—	—
Tax amortization benefit	1.26	1.20	1.10
U.K. tax rate adjustment	(0.08 )	—	(0.16 )
Allocation to participating securities <sup>(2)</sup>	(0.07 )	—	—
Adjusted Income per diluted share	\$3.36	\$3.26	\$3.41

In calculating Adjusted Income per diluted share, during periods of Net Income after participating securities dividends, we include the weighted-average of unvested restricted shares deemed to be participating securities and the earnings allocated to these participating securities. Weighted-average unvested restricted shares were 3,065 for (1) the year ended March 31, 2015. For purposes of this non-GAAP performance measure, earnings are allocated in the same ratio to participating securities and common shares. As a result, the inclusion of these participating securities and the earnings allocated thereto do not impact the per share amounts of the adjustments made to Net Income (Loss) per diluted share Attributable to Legg Mason, Inc. Shareholders.

In calculating Adjusted Income per diluted share during periods of Net Loss after participating securities dividends, we exclude the weighted-average of unvested restricted shares deemed to be participating securities. Weighted-average unvested restricted shares were 2,831 for the year ended March 31, 2016.

(2) During periods of Net Loss after participating securities dividends, there is an impact from weighted-average unvested restricted shares deemed to participating securities.

#### Operating Margin, as Adjusted

We calculate "Operating Margin, as Adjusted," by dividing (i) Operating Income (Loss), adjusted to exclude the impact on compensation expense of gains or losses on investments made to fund deferred compensation plans, the impact on compensation expense of gains or losses on seed capital investments by our affiliates under revenue sharing arrangements, amortization related to intangible assets, income (loss) of CIVs, the impact of fair value adjustments of contingent consideration liabilities, if any, and impairment charges by (ii) our operating revenues, adjusted to add back net investment advisory fees eliminated upon consolidation of investment vehicles, less distribution and servicing expenses which we use as an approximate measure of revenues that are passed through to third parties, which we refer to as "Operating Revenues, as Adjusted." The compensation items are removed from Operating

Income (Loss) in the calculation because they are offset by an equal amount in Other non-operating income (expense), and thus have no impact on Net Income (Loss) Attributable to Legg Mason, Inc. We adjust for the impact of amortization of management contract assets and the impact of fair value adjustments of contingent consideration liabilities, if any, which arise from acquisitions to reflect the fact that these items distort comparison of our operating results with results of other asset management firms that have not engaged in significant acquisitions. Impairment charges and income (loss) of CIVs are removed from Operating Income (Loss) in the calculation because these items are not reflective of our core asset management operations. We use Operating Revenues, as Adjusted, in the calculation to show the operating margin without distribution and servicing expenses, which we use to approximate

Table of Contents

our distribution revenues that are passed through to third parties as a direct cost of selling our products, although distribution and servicing expenses may include commissions paid in connection with the launching of closed-end funds for which there is no corresponding revenue in the period. Operating Revenues, as Adjusted, also include our advisory revenues we receive from CIVs that are eliminated in consolidation under GAAP.

We believe that Operating Margin, as Adjusted, is a useful measure of our performance because it provides a measure of our core business activities. It excludes items that have no impact on Net Income (Loss) Attributable to Legg Mason, Inc. and indicates what our operating margin would have been without the distribution revenues that are passed through to third parties as a direct cost of selling our products, amortization related to intangible assets, changes in the fair value of contingent consideration liabilities, if any, impairment charges, and the impact of the consolidation of certain investment vehicles described above. The consolidation of these investment vehicles does not have an impact on Net Income (Loss) Attributable to Legg Mason, Inc. This measure is provided in addition to our operating margin calculated under GAAP, but is not a substitute for calculations of margins under GAAP and may not be comparable to non-GAAP performance measures, including measures of adjusted margins of other companies.

The calculation of Operating Margin and Operating Margin, as Adjusted, is as follows (dollars in thousands):

	For the Years Ended March 31,			
	2016	2015	2014	
Operating Revenues, GAAP basis	\$2,660,844	\$2,819,106	\$2,741,757	
Plus (less):				
Operating revenues eliminated upon consolidation of investment vehicles	318	721	1,950	
Distribution and servicing expense, excluding consolidated investment vehicles	(545,668 )	(594,746 )	(619,022 )	
Operating Revenues, as Adjusted	\$2,115,494	\$2,225,081	\$2,124,685	
Operating Income, GAAP basis	\$50,831	\$498,219	\$430,893	
Plus:				
Gains (losses) on deferred compensation and seed investments, net	(1,205 )	9,369	16,987	
Impairment of intangible assets	371,000	—	—	
Contingent consideration fair value adjustments	(33,375 )	—	5,000	
Amortization of intangible assets	4,979	2,625	12,314	
Operating income and expenses of consolidated investment vehicles, net	461	899	2,370	
Operating Income, as Adjusted	\$392,691	\$511,112	\$467,564	
Operating Margin, GAAP basis	1.9	% 17.7	% 15.7	%
Operating Margin, as Adjusted	18.6	23.0	22.0	

Adjusted EBITDA

We define Adjusted EBITDA as cash provided by operating activities plus (minus) allocation of debt redemption payments, interest expense, net of accretion and amortization of debt discounts and premiums, current income tax expense, net gains (losses) on investment securities, the net change of other assets and liabilities and other. The net change of other assets and liabilities adjustment aligns with the Consolidated Statements of Cash Flows. This definition results in a metric that is the same amount as EBITDA used in covenants in our revolving credit facility agreement.

We believe that Adjusted EBITDA is useful to investors as a liquidity measure that provides additional information with regard to our compliance with debt covenants and ability to meet future working capital requirements. This measure is provided in addition to Cash provided by operating activities and may not be comparable to non-GAAP liquidity measures, including measures of EBITDA or cash flow measures, of other companies. Further, Adjusted EBITDA is not to be confused



Table of Contents

with Cash provided by operating activities or other measures of cash flows under GAAP, and is provided as a supplement to, and not in replacement of, a GAAP measure.

A reconciliation of Cash provided by operating activities to Adjusted EBITDA is as follows (dollars in thousands):

	Trailing twelve months ended March 31,		
	2016	2015	2014
Cash provided by operating activities, GAAP basis	\$454,451	\$568,118	\$437,324
Plus (less):			
Debt redemption payments allocated to operations	—	98,418	—
Interest expense, net of accretion and amortization of debt discounts and premiums	45,324	53,999	49,846
Current tax expense	15,419	24,897	19,375
Net gain on investment securities	8,563	50,853	27,370
Net change of other assets and liabilities	30,084	(118,919)	76,140
Other, principally transition-related costs in fiscal 2016	67,881	9,133	7,037
Adjusted EBITDA	\$621,722	\$686,499	\$617,092

**LIQUIDITY AND CAPITAL RESOURCES**

The primary objective of our capital structure is to appropriately support our business strategies and to provide needed liquidity at all times, including maintaining required capital in certain subsidiaries. Liquidity and the access to liquidity is important to the success of our ongoing operations. Our overall funding needs and capital base are continually reviewed to determine if the capital base meets the expected needs of our businesses. We intend to continue to explore potential acquisition opportunities as a means of diversifying and strengthening our asset management business. These opportunities may from time to time involve acquisitions that are material in size and may require, among other things, and subject to existing covenants, the raising of additional equity capital and/or the issuance of additional debt.

The consolidation of variable interest entities discussed above does not impact our liquidity and capital resources. We have no rights to the benefits from, nor do we bear the risks associated with, the assets and liabilities of the CIVs and other consolidated sponsored investment vehicles beyond our investments in and investment advisory fees generated from these vehicles, which are eliminated in consolidation. Additionally, creditors of the CIVs and other consolidated sponsored investment vehicles have no recourse to our general credit beyond the level of our investment, if any, so we do not consider these liabilities to be our obligations.

Our assets consist primarily of intangible assets, goodwill, cash and cash equivalents, investment securities, and investment advisory and related fee receivables. Our assets have been principally funded by equity capital, long-term debt and the results of our operations. At March 31, 2016, cash and cash equivalents, total assets, long-term debt and stockholders' equity were \$1.3 billion, \$7.5 billion, \$1.7 billion and \$4.2 billion, respectively. Total assets include amounts related to CIVs of \$0.1 billion.

Cash and cash equivalents are primarily invested in liquid domestic and non-domestic money market funds that hold principally domestic and non-domestic corporate commercial paper and bonds, government and agency securities, and bank deposits. We have not recognized any losses on these investments. Our monitoring of cash and cash equivalents partially mitigates the potential that material risks may be associated with these balances.

Table of Contents

The following table summarizes our Consolidated Statements of Cash Flows for the years ended March 31 (in millions):

	2016	2015	2014
Cash flows provided by operating activities	\$454.5	\$568.1	\$437.3
Cash flows provided by/(used in) investing activities	(244.6 )	(208.0 )	137.6
Cash flows provided by/(used in) financing activities	465.7	(507.0 )	(639.0 )
Effect of exchange rate changes	(16.1 )	(41.5 )	(10.9 )
Net change in cash and cash equivalents	659.5	(188.4 )	(75.0 )
Cash and cash equivalents, beginning of period	669.6	858.0	933.0
Cash and cash equivalents, end of period	\$1,329.1	\$669.6	\$858.0

Cash inflows provided by operating activities during fiscal 2016, were \$454.5 million, primarily related to Net Loss, adjusted for non-cash items. Cash inflows provided by operating activities during fiscal 2015 were \$568.1 million, primarily related to Net Income, adjusted for non-cash items, and net activity related to CIVs. Cash inflows provided by operating activities during fiscal 2014 were \$437.3 million, primarily related to Net Income, adjusted for non-cash items, offset in part by net purchases of trading and other investments and a decrease in net activity related to CIVs, primarily due to the wind-down of a consolidated loan obligation ("CLO"). See Note 17 of Notes to Consolidated Financial Statements for additional information regarding the CLO.

Cash outflows used in investing activities during fiscal 2016, were \$244.6 million, primarily related to payments associated with the acquisitions of RARE Infrastructure and PK Investments, and the investment in Precidian Investments, aggregating \$234.1 million (net of acquired cash). Cash outflows used in investing activities during fiscal 2015, were \$208.0 million, primarily related to payments associated with the acquisitions of Martin Currie and QS Investors of \$183.7 million (net of acquired cash) and payments made for fixed assets of \$45.8 million; offset in part by the proceeds from businesses sold of \$47.0 million. Cash inflows provided by investing activities during fiscal 2014, were \$137.6 million, primarily related to net activity related to CIVs, offset in part by payments made for fixed assets.

Cash inflows provided by financing activities during fiscal 2016, were \$465.7 million, primarily related to the proceeds of the issuance of \$699.8 million of long-term debt, offset in part by the repurchase of 4.5 million shares of our common stock for \$209.6 million. Cash outflows used in financing activities during fiscal 2015, were \$507.0 million, primarily related to the repayment of long-term debt of \$645.8 million, the repurchase of 6.9 million shares of our common stock for \$356.5 million, the repayment of long-term debt of CIVs of \$79.2 million, and dividends paid of \$70.8 million, offset in part by the proceeds from the issuance of \$658.8 million of long-term debt. Cash outflows used in financing activities during fiscal 2014, were \$639.0 million, primarily related to the repayment of long-term debt of \$500.4 million, the repayment of long-term debt of CIVs of \$133.0 million, the repurchase of 9.7 million shares of our common stock for \$360.0 million, and dividends paid of \$62.0 million, offset in part by the proceeds from the long-term debt issuances of \$393.7 million.

Table of Contents

## Financing Transactions

The table below reflects our primary sources of financing (in thousands) as of March 31, 2016:

Type	Available at March 31, 2016	Amount Outstanding at March 31, 2016		Interest Rate	Maturity
2.7% Senior Notes due July 2019	\$250,000	\$250,000	\$250,000	2.70%	July 2019
3.95% Senior Notes due July 2024	250,000	250,000	250,000	3.95%	July 2024
4.75% Senior Notes Due March 2026	450,000	450,000	—	4.75%	March 2026
5.625% Senior Notes due January 2044	550,000	550,000	550,000	5.625%	January 2044
6.375% Junior Subordinated Notes Due March 2056	250,000	250,000	—	6.375%	March 2056
Revolving credit agreements	1,000,000	40,000	—	Eurocurrency Rate + 1.25% + 0.175% annual commitment fee	December 2020

In March 2016, we issued \$250 million of 6.375% Junior Subordinated Notes due 2056 (the "2056 Notes") and \$450 million of 4.75% Senior Notes due 2026 (the "2026 Notes"). The net proceeds of these offerings were used to finance the acquisitions of Clarion Partners in April 2016 and EnTrust in May 2016, as further discussed below and in Note 18 of Notes to the Consolidated Financial Statements.

In December 2015, we entered into a new unsecured credit agreement which provides for a \$1.0 billion multi-currency revolving credit facility, and borrowed \$40 million under this revolving credit facility, which remained outstanding as of March 31, 2016. The proceeds were used to repay the \$40 million of outstanding borrowings under our previous revolving credit facility, which were used to partially finance the acquisition of RARE Infrastructure in October 2015, as further discussed below. In May 2016, we used \$460 million of additional borrowings under the new revolving credit facility to finance the acquisition of EnTrust and to replenish cash used to complete the acquisitions of Clarion Partners and RARE Infrastructure. The amount of total borrowings outstanding under this facility is \$500 million as of the date of filing.

The new revolving credit facility may be increased by an aggregate amount of up to \$500 million, to \$1.5 billion, subject to the approval of the lenders, expires in December 2020, and can be repaid at any time. This revolving credit facility is available to fund working capital needs and for general corporate purposes.

The financial covenants under our credit agreement were modified in March 2016 and include: maximum net debt to EBITDA ratio of 3.5 to 1 for the period from March 31, 2016 through September 30, 2016, 3.25 to 1 for the period from October 1, 2016 through December 31, 2016, and 3.0 to 1 thereafter; and minimum EBITDA to interest ratio of 4.0 to 1. Debt is defined to include all obligations for borrowed money, excluding non-recourse debt of CIVs and capital leases. Under these net debt covenants, our debt is reduced by the amount of our unrestricted cash in excess of the greater of subsidiary cash or \$300 million, by the lesser of 50% of the aggregate amount of our seed capital investments or \$125 million, and an amount equal to 50% of our hybrid capital securities. EBITDA is defined as consolidated net income (loss) plus/minus tax expense (benefit), interest expense, depreciation and amortization, amortization of intangibles, any extraordinary expense or losses, any non-cash charges, and certain transition-related costs, as defined in the agreements. As of March 31, 2016, Legg Mason's net debt to EBITDA ratio was 1.3 to 1 and EBITDA to interest expense ratio was 13.0 to 1, and therefore, Legg Mason has maintained compliance with the applicable covenants.

If our net income (loss) significantly declines, or if we spend our available cash, it may impact our ability to maintain compliance with the financial covenants. If we determine that our compliance with these covenants may be under pressure at a time when we either have outstanding borrowings under this facility, want to utilize available borrowings, or otherwise desire to keep borrowings available, we may elect to take a number of actions, including reducing our expenses in order to increase our EBITDA, using available cash to repay all or a portion of our outstanding debt subject to these covenants or seeking to negotiate with our lenders to modify the terms or to restructure our debt. Using available cash to repay indebtedness would make the cash unavailable for other uses and might affect the liquidity discussions and conclusions. Entering into any modification or restructuring of our debt would likely result in additional fees or interest payments.



## Table of Contents

In May 2012, we refinanced our then outstanding 2.5% Senior Convertible Notes (the "Convertible Notes"). The refinancing was effected through the issuance of \$650 million of 5.5% Senior Notes, the net proceeds of which, together with cash on hand and \$250 million of remaining borrowing capacity under a then existing revolving credit facility, were used to repurchase all \$1.25 billion of the Convertible Notes. The terms of the repurchase included the issuance of warrants to the holders of the Convertible Notes. The warrants replaced a conversion feature of the Convertible Notes, and provide for the purchase, in the aggregate and subject to adjustment, of 14.2 million shares of our common stock, on a net share settled basis, at an exercise price of \$88 per share. The warrants expire in July 2017 and can be settled, at our election, in either shares of common stock or cash.

In June 2012, we entered into an unsecured credit agreement which provided for a \$500 million revolving credit facility and a \$500 million term loan, which was repaid in fiscal 2014, as further discussed below. The proceeds of the term loan were used to repay \$500 million of outstanding borrowings under a previous revolving credit facility, which was then terminated.

In January 2014, we issued \$400 million of 5.625% Senior Notes due 2044, the net proceeds of which, together with cash on hand, were used to repay the \$450 million of then outstanding borrowings under the five-year term loan entered into in conjunction with the unsecured credit agreement noted above. The 5.625% Senior Notes were sold at a discount of \$6.3 million, which is being amortized to interest expense over the 30 year term.

Also in January 2014, we entered into a \$250 million incremental revolving credit facility, which was contemplated in, and was in addition to the \$500 million revolving credit facility available under, the credit agreement we entered into in June 2012. These revolving credit facilities were available to fund working capital needs and for general corporate purposes and were to expire in June 2017. There were no borrowings outstanding under either facility as of March 31, 2015. In October 2015, Legg Mason borrowed \$40 million under these facilities to partially finance the acquisition of RARE Infrastructure, which was repaid in December 2015 upon entering into a new unsecured credit agreement, as discussed above. These revolving credit facilities were terminated effective upon the repayment.

In June 2014, we issued \$250 million of 2.7% Senior Notes due 2019 at a discount of \$0.6 million, \$250 million of 3.95% Senior Notes due 2024 at a discount of \$0.5 million, and an additional \$150 million of 5.625% Senior Notes due 2044 at a premium of \$9.8 million. In July 2014, these proceeds of \$659 million, net of related fees, together with cash on hand, were used to redeem the then outstanding \$650 million of the 5.5% Senior Notes. The retirement of the 5.5% Senior Notes resulted in a pre-tax, non-operating charge of \$107.1 million in July 2014, consisting of a cash make-whole premium payment of \$98.6 million, net of \$0.6 million from a reverse treasury lock, to call the 5.5% Senior Notes and \$8.5 million associated with existing deferred costs and original issue discount.

Our outstanding revolving credit facility agreement is currently impacted by the ratings of two rating agencies. The interest rate and annual commitment fee on our revolving line of credit are based on the higher credit rating of the two rating agencies. In June 2011, our rating by one of these agencies was downgraded one grade below the other. Should the other agency downgrade our rating, absent an upgrade from the former agency, our interest costs will rise modestly.

See Note 6 of Notes to Consolidated Financial Statements for additional information regarding our debt.

### Other Transactions

We expect that over the next 12 months cash generated from our operating activities and available cash on hand will be adequate to support our operating and investing cash needs, other than acquisitions, as discussed below. In May 2016, we utilized \$460 million of borrowing capacity under our revolving credit facility and the proceeds from the issuance of the 2026 Notes and the 2056 Notes to finance the acquisition of EnTrust, as further discussed below, and to replenish cash used to complete the acquisitions of Clarion Partners in April 2016 and RARE Infrastructure in October 2015. We may also utilize our other available resources for any number of potential activities, including, but not limited to, acquisitions, seed capital investments in new products, repurchase of shares of our common stock, repayment of outstanding debt, or payment of increased dividends. In addition to our ordinary operating cash needs,

we anticipate other cash needs during the next 12 months, as discussed below.

59

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Table of Contents

## Acquisitions

	RARE Infrastructure	Martin Currie	PK Investments	QS Investors	Fauchier	Total
Maximum Remaining Contingent Consideration <sup>(1)</sup>	\$ 81.3	\$467.1	\$ 2.5	\$ 30.0	\$ 28.7	\$609.6
Contingent consideration liability						
Current Contingent consideration	\$ 7.0	\$12.8	\$ —	\$ 6.6	\$ —	\$26.4
Non-current Contingent consideration	20.1	28.4	2.5	7.2	—	58.2
Balance as of March 31, 2016	\$ 27.1	\$41.2	\$ 2.5	\$ 13.8	\$ —	\$84.6

(1) Using the applicable exchange rate as of March 31, 2016 for amounts denominated in currencies other than the U.S. dollar.

On May 2, 2016, we closed the transaction to combine Permal and EnTrust, to create EnTrustPermal, of which we own 65%. The transaction required a cash payment of \$400 million, which was funded with borrowings under our revolving credit facility, as well as a portion of the proceeds from the 2026 Notes and the 2056 Notes that were issued in March 2016. In connection with the combination, we expect to incur restructuring and transition costs of approximately \$100 million, of which approximately 15% are non-cash charges. As of March 31, 2016, approximately \$43 million of these charges have been incurred, and approximately \$24 million have been paid. A significant portion of the remaining costs will be paid in the year ending March 31, 2017. See Notes 2 and 18 of Notes to Consolidated Financial Statements for additional information.

On April 13, 2016, we acquired a majority interest in Clarion Partners. The acquisition required a cash payment of \$577 million, which was funded with a portion of the proceeds from the issuance of the 2026 Notes and the 2056 Notes in March 2016. In conjunction with the acquisition, we committed to provide \$100 million of seed capital to Clarion Partners products within two years of closing. See Note 18 of Notes to Consolidated Financial Statements for additional information.

On October 21, 2015, we acquired a majority interest in RARE Infrastructure. The acquisition required an initial cash payment of approximately \$214 million (using the foreign exchange rate as of October 21, 2015 for the 296 million Australian dollar payment), which was funded with \$40 million of net borrowings under our previous revolving credit facility, as well as existing cash resources. Contingent consideration may be due March 31, 2017 and March 31, 2018, aggregating up to approximately \$81 million (using the foreign exchange rate as of March 31, 2016 for the maximum 106 million Australia dollar amount per the contract), dependent on the achievement of certain net revenue targets, and subject to potential catch-up adjustments extending through March 31, 2019. Noncontrolling interests of 25% are subject to put and call provisions that may result in future cash outlays.

On October 1, 2014, we acquired all outstanding equity interests of Martin Currie. The transaction included an initial cash payment of \$203 million (using the foreign exchange rate as of October 1, 2014 for the £125 million payment), which was funded from existing cash. Contingent consideration payments may be due on the March 31 following the second and third anniversaries of closing, aggregating up to approximately \$467 million (using the foreign exchange rate as of March 31, 2016 for the maximum £325 million contract amount), inclusive of the payment of certain potential pension and other obligations, and dependent on the achievement of certain financial metrics, as specified in the share purchase agreement, at March 31, 2017 and 2018. No contingent consideration payment was due as of March 31, 2016, for the first anniversary payment. Actual payments to be made may also include amounts for certain potential pension and other obligations that are accounted for separately. In addition, Martin Currie and the trustees of the pension plan referenced above have received a notice that the Pensions Regulator in the U.K. is reviewing the plan's current structure and funding status. While the review is still in process, there can be no assurance that the review will not result in accelerated funding.

In December 2015, Martin Currie acquired certain assets of PK Investments. The business acquisition was comprised of an initial cash payment of \$5.0 million and a contingent payment, due on December 31, 2017, which is currently estimated at \$2.5 million. The amount of any ultimate contingent payment will be based on certain financial metrics. The initial cash payment was funded with existing cash resources.

Effective May 31, 2014, we completed the acquisition of QS Investors. In July 2016, we may be required to pay up to \$10 million for the second anniversary contingent consideration, with the amount of the payment dependent on the achievement

## Table of Contents

of certain net revenue targets. We intend to fund any amount due with existing cash resources. In addition, contingent consideration of up to \$20 million for the fourth anniversary payment may be due in July 2018, also dependent on the achievement of certain net revenue targets, and subject to a potential catch-up adjustment in the fourth anniversary payment for any second anniversary payment shortfall.

In March 2013, we completed the acquisition of all of the outstanding share capital of Fauchier. Contingent consideration of up to approximately \$29 million (using the exchange rate as of March 31, 2016, for the £20 million maximum contractual amount), may be due on or about the fourth anniversary of closing, dependent on achieving certain levels of revenue, net of distribution costs.

See Note 2 of Notes to Consolidated Financial Statements for additional information related to the acquisitions of RARE Infrastructure, Martin Currie, QS Investors, and Fauchier.

### Other

In March 2016, we implemented an affiliate management equity plan with the management of Royce. Under this management equity plan, minority interests equivalent to 16.9% in the Royce entity were issued to its management team. In addition, in June 2013 and March 2014, we implemented affiliate management equity plans that will entitle certain key employees of Permal and ClearBridge, respectively, to participate in 15% of the future growth of the respective enterprise value (subject to appropriate discounts), if any, as further discussed in Note 11 of Notes to Consolidated Financial Statements. Repurchases of units granted under these plans may impact future liquidity requirements. In conjunction with the acquisition of Clarion Partners, we implemented an affiliate management equity plan similar to the plan implemented for ClearBridge, with immediate vesting for the initial grant.

Certain of our asset management affiliates maintain various credit facilities for general operating purposes. Certain affiliates are subject to the capital requirements of various regulatory agencies. All such affiliates met their respective capital adequacy requirements during the periods presented.

In January 2015, our Board of Directors authorized \$1.0 billion for additional purchases of our common stock, approximately \$800 million of which remained available as of March 31, 2016. We intend to utilize up to \$90 million of cash generated from future operations to purchase shares of our common stock on a quarterly basis, subject to market conditions and other potential uses of cash.

### Future Outlook

As described above, we currently project that our cash flows from operating activities will be sufficient to fund our present and foreseeable, near-term liquidity needs, other than for the acquisitions of Clarion Partners in April 2016 and EnTrust in May 2016. As of March 31, 2016, we had approximately \$1.1 billion in cash and cash equivalents in excess of our working capital requirements, \$689 million of which was used to fund the previously discussed acquisitions of Clarion Partners and EnTrust. As discussed above, we intend to utilize up to \$90 million of cash generated from future operations to purchase shares of our common stock during each quarter of the year ending March 31, 2017, subject to market conditions and other cash needs. We temporarily interrupted share repurchases in November 2015 and resumed share repurchases in March 2016. We intend to catch up an additional \$12 million in share repurchases in the quarter ending June 30, 2016. In addition, in fiscal 2017, we intend to repay approximately \$50 million of the outstanding \$500 million of borrowings under our revolving credit facility, subject to market conditions and other cash needs. After drawing \$460 million on our revolving credit facility in May 2016, in connection with the acquisitions of Clarion Partners and EnTrust, subject to compliance with applicable covenants, we have approximately \$350 million of available borrowing capacity under our revolving credit facility, which expires in December 2020. We do not currently expect to raise incremental debt or equity financing over the next 12 months beyond our current levels, unless we enter into one or more acquisitions or refinancings. Going forward, there can be no assurances of these expectations as our projections could prove to be incorrect, events may occur that require

additional liquidity in excess of amounts under our revolving credit facility, such as an opportunity to refinance indebtedness, or market conditions might significantly worsen, affecting our results of operations and generation of available cash. If these events result in our operations and available cash being insufficient to fund liquidity needs, we would likely seek to manage our available resources by taking actions such as reducing future share repurchases, reducing operating expenses, reducing our expected expenditures on investments, selling assets (such as investment securities), repatriating earnings from foreign subsidiaries, reducing our dividend, or modifying arrangements with our affiliates and/or employees. Should these types of actions prove insufficient, or should an acquisition or refinancing opportunity arise, we would likely utilize borrowing capacity under our revolving credit facility or seek to raise additional equity or debt.

Table of Contents

Our liquid assets include cash, cash equivalents, and certain current investment securities. At March 31, 2016, our total liquid assets were \$1.7 billion, \$689 million of which was used to fund the previously discussed acquisitions of Clarion Partners in April 2016 and EnTrust in May 2016. The remaining \$1.0 billion of liquid assets included \$378 million of cash and investments held by foreign subsidiaries. Other net working capital amounts of foreign subsidiaries are not significant. In order to increase our cash available in the U.S. for general corporate purposes, we plan to utilize up to \$170 million of foreign cash over the next several years, of which \$8.5 million is accumulated foreign earnings. Any additional tax provision associated with these repatriations was previously recognized. No further repatriation of accumulated prior period foreign earnings is currently planned. However, if circumstances change, we will provide for and pay any applicable additional U.S. taxes in connection with repatriation of offshore earnings. It is not practical at this time to determine the income tax liability that would result from any further repatriation of accumulated foreign earnings.

**Credit and Liquidity Risk**

Cash and cash equivalent deposits involve certain credit and liquidity risks. We maintain our cash and cash equivalents with a number of high quality financial institutions or funds and from time to time may have concentrations with one or more of these institutions. The balances with these financial institutions or funds and their credit quality are monitored on an ongoing basis.

**Off-Balance Sheet Arrangements**

Off-balance sheet arrangements, as defined by the Securities and Exchange Commission ("SEC"), include certain contractual arrangements pursuant to which a company has an obligation, such as certain contingent obligations, certain guarantee contracts, retained or contingent interest in assets transferred to an unconsolidated entity, certain derivative instruments classified as equity or material variable interests in unconsolidated entities that provide financing, liquidity, market risk or credit risk support. Disclosure is required for any off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on our financial condition, results of operations, liquidity or capital resources. We generally do not enter into off-balance sheet arrangements, as defined, other than those described in the Contractual Obligations section that follows and Consolidation discussed in Critical Accounting Policies and Notes 1 and 17 of Notes to Consolidated Financial Statements.

### Contractual and Contingent Obligations

We have contractual obligations to make future payments, principally in connection with our long-term debt, non-cancelable lease agreements, acquisition agreements and service agreements. See Notes 6 and 8 of Notes to Consolidated Financial Statements for additional disclosures related to our commitments.

The following table sets forth these contractual obligations (in millions) by fiscal year, and excludes contractual obligations of CIVs, as we are not responsible or liable for these obligations:

	2017	2018	2019	2020	2021	Thereafter	Total
<b>Contractual Obligations</b>							
Short-term borrowings by contract maturity <sup>(1)</sup>	\$40.0	\$—	\$—	\$—	\$—	\$—	\$40.0
Long-term borrowings by contract maturity	—	—	—	250.0	—	1,500.0	1,750.0
Interest on long-term borrowings and credit facility commitment fees	86.9	86.7	86.7	83.3	79.4	1,410.8	1,833.8
Minimum rental and service commitments	128.0	109.4	88.6	79.8	73.4	225.7	704.9
<b>Total Contractual Obligations</b>	<b>254.9</b>	<b>196.1</b>	<b>175.3</b>	<b>413.1</b>	<b>152.8</b>	<b>3,136.5</b>	<b>4,328.7</b>
<b>Contingent Obligations</b>							
<b>Payments related to business acquisitions<sup>(2)</sup></b>							
Clarion Partners	577.5	—	—	—	—	—	577.5
EnTrust	400.0	—	—	—	—	—	400.0
Martin Currie	467.1	—	—	—	—	—	467.1
RARE Infrastructure	23.8	57.5	—	—	—	—	81.3
Other	38.7	2.5	20.0	—	—	—	61.2
<b>Total payments related to business acquisitions</b>	<b>1,507.1</b>	<b>60.0</b>	<b>20.0</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>1,587.1</b>
<b>Total Obligations<sup>(3)(4)(5)(6)</sup></b>	<b>\$1,762.0</b>	<b>\$256.1</b>	<b>\$195.3</b>	<b>\$413.1</b>	<b>\$152.8</b>	<b>\$3,136.5</b>	<b>\$5,915.8</b>

Represents borrowings under our revolving credit facility which does not expire until December 2020. In April 2016, we borrowed an additional \$460 million under this facility and exercised an amortizing variable for fixed (1) interest rate swap with the intention of repaying the \$500 million of borrowings through December 2020. However, we may elect to repay this debt sooner if management elects to utilize a portion of our available cash for this purpose.

The amount of contingent payments reflected for any year represents the maximum amount that could be payable at the earliest possible date under the terms of the business purchase agreements, using the applicable exchange rate as of March 31, 2016, for amounts denominated in currencies other than the U.S. dollar. The related contingent (2) consideration liabilities had a fair value of \$84.6 million as of March 31, 2016, net of certain potential pension and other obligations related to Martin Currie. See Notes 2 and 8 of Notes to Consolidated Financial Statements. The fiscal 2017 amounts reflected for Clarion Partners and EnTrust represent the cash payments made in April 2016 and May 2016, respectively, in connection with the acquisitions, which are further discussed in Note 18 of Notes to Consolidated Financial Statements.

(3) The table above does not include approximately \$28.9 million in capital commitments to investment partnerships in which we are a limited partner or \$100 million of co-investment commitment associated with the Clarion Partners acquisition. These obligations will be outstanding, or funded as required, through the end of the commitment periods running through fiscal 2021.

(4) The table above does not include amounts for uncertain tax positions of \$49.6 million (net of the federal benefit for state tax liabilities), because the timing of any related cash outflows cannot be reliably estimated.

(5) The table above does not include redeemable noncontrolling interests, primarily related to affiliate minority interests and CIVs, of \$175.8 million as of March 31, 2016, because the timing of any related cash outflows cannot be reliably estimated. As further described in Note 18 of Notes to Consolidated Financial Statements, Clarion Partners and EnTrust will also have redeemable noncontrolling interests.

(6) The table above excludes potential obligations arising from the ultimate settlement of awards under the affiliate management equity plans with key employees of Permal, ClearBridge, and Royce due to the uncertainty of the timing and amounts ultimately payable. See Notes 1 and 11 of Notes to Consolidated Financial Statements for



additional information regarding affiliate management equity plans.

Table of Contents**MARKET RISK**

We maintain an enterprise risk management program to oversee and coordinate risk management activities of Legg Mason and its subsidiaries. Under the program, certain risk activities are managed at the subsidiary level. The following describes certain aspects of our business that are sensitive to market risk.

**Revenues and Net Income (Loss)**

The majority of our revenue is calculated from the market value of our AUM. Accordingly, a decline in the value of the underlying securities will cause our AUM, and thus our revenues, to decrease. In addition, our fixed income and liquidity AUM are subject to the impact of interest rate fluctuations, as rising interest rates may tend to reduce the market value of bonds held in various mutual fund portfolios or separately managed accounts. In the ordinary course of our business, we may also reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. Market conditions, such as the current historical low interest rate environment, may lead us to take such actions. Performance fees may be earned on certain investment advisory contracts for exceeding performance benchmarks, and strong markets tend to increase these fees. Declines in market values of AUM will result in reduced fee revenues and net income. We generally earn higher fees on equity assets than fees charged for fixed income and liquidity assets. Declines in market values of AUM in this asset class will have a greater impact on our revenues. In addition, under revenue sharing arrangements, certain of our affiliates retain different percentages of revenues to cover their costs, including compensation. Our net income (loss), profit margin and compensation as a percentage of operating revenues are impacted based on which affiliates generate our revenues, and a change in AUM at one subsidiary can have a dramatically different effect on our revenues and earnings than an equal change at another subsidiary.

**Trading and Non-Trading Assets**

Our trading and non-trading assets are comprised of investment securities, including seed capital in sponsored mutual funds and products, limited partnerships, limited liability companies and certain other investment products.

Trading and other current investments, excluding CIVs, at March 31, 2016 and 2015, subject to risk of security price fluctuations are summarized in the table below (in thousands):

	2016	2015
Investment securities, excluding CIVs:		
Trading investments relating to long-term incentive compensation plans	\$ 106,564	\$ 80,529
Trading investments of proprietary fund products and other trading investments	393,400	358,034
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments	15,371	16,172
Total current investments, excluding CIVs	\$ 515,335	\$ 454,735

Trading and other current investments of \$113.0 million and \$89.2 million at March 31, 2016 and 2015, respectively, relate to long-term incentive plans which will have offsetting liabilities at the end of the respective vesting periods, but for which the related liabilities may not completely offset at the end of each reporting period due to vesting provisions. Therefore, fluctuations in the market value of these trading investments will impact our compensation expense, non-operating income (expense) and, dependent on the vesting provisions of the plan, our net income (loss).

Approximately \$402.3 million and \$365.5 million of trading and other current investments at March 31, 2016 and 2015, respectively, are investments in proprietary fund products and other investments for which fluctuations in market value will impact our non-operating income (expense). Of these amounts, the fluctuations in market value related to approximately \$35.8 million and \$37.5 million of proprietary fund products as of March 31, 2016 and 2015, respectively, have offsetting compensation expense under revenue share arrangements. The fluctuations in market value related to approximately \$141.3 million and \$163.0 million in proprietary fund products as of March 31, 2016

and 2015, respectively, are substantially offset by gains (losses) on market hedges and therefore do not materially impact Net Income (Loss) Attributable to Legg Mason, Inc. Investments in proprietary fund products are not liquidated before the related fund establishes a track record, has other investors, or a decision is made to no longer pursue the strategy.

Table of Contents

Non-trading assets, excluding CIVs, at March 31, 2016 and 2015, subject to risk of security price fluctuations are summarized in the table below (in thousands):

	2016	2015
Investment securities, excluding CIVs:		
Investments in partnerships, LLCs and other	\$8,013	\$14,511
Equity method investments in partnerships and LLCs	37,292	48,344
Other investments	83	77
Total non-trading assets, excluding CIVs	\$45,388	\$62,932

Investment securities of CIVs totaled \$48.7 million and \$48.0 million as of March 31, 2016 and 2015, respectively. As of March 31, 2016 and 2015, we held equity investments in the CIVs of \$13.6 million and \$15.6 million, respectively. Fluctuations in the market value of investments of CIVs in excess of our equity investment will not impact Net Income (Loss) Attributable to Legg Mason, Inc. However, it may have an impact on other non-operating income (expense) of CIVs with a corresponding offset in Net income (loss) attributable to noncontrolling interests.

Valuation of trading and non-trading investments is described below within Critical Accounting Policies under the heading "Valuation of Financial Instruments." See Notes 1 and 15 of Notes to Consolidated Financial Statements for further discussion of derivatives.

The following is a summary of the effect of a 10% increase or decrease in the market values of our financial instruments subject to market valuation risks at March 31, 2016 (in thousands):

	Carrying Value	Fair Value Assuming a 10% Increase <sup>(1)</sup>	Fair Value Assuming a 10% Decrease <sup>(1)</sup>
Investment securities, excluding CIVs:			
Trading investments relating to long-term incentive compensation plans	\$106,564	\$117,220	\$95,908
Trading investments of proprietary fund products and other trading investments	393,400	432,740	354,060
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments	15,371	16,908	13,834
Total current investments, excluding CIVs	515,335	566,868	463,802
Investments in CIVs	13,641	15,005	12,277
Investments in partnerships, LLCs and other	8,013	8,814	7,212
Equity method investments in partnerships and LLCs	37,292	41,021	33,563
Other investments	83	91	75
Total investments subject to market risk	\$574,364	\$631,799	\$516,929

(1) Gains and losses related to investments in deferred compensation plans and proprietary fund products are directly offset over the vesting period by a corresponding adjustment to compensation expense and related liability. In addition, investments in proprietary fund products of approximately \$141.3 million have been economically hedged to limit market risk. As a result, a 10% increase or decrease in the unrealized market value of our financial instruments subject to market valuation risks would result in a \$28.4 million increase or decrease in our pre-tax earnings as of March 31, 2016.

Also, as of March 31, 2016 and 2015, cash and cash equivalents included \$1.1 billion and \$353.3 million, respectively, of money market funds.

## Foreign Exchange Sensitivity

We operate primarily in the U.S., but provide services, earn revenues and incur expenses outside the U.S. Accordingly, fluctuations in foreign exchange rates for currencies, principally in the U.K., Brazil, Japan, Canada, Singapore, Australia, and those denominated in the euro, may impact our AUM, revenues, expenses, comprehensive income (loss) and net income (loss). We and certain of our affiliates have entered into forward contracts to manage a portion of the impact of fluctuations in foreign exchange rates on their results of operations. We do not expect foreign currency fluctuations to have a material effect on our net income (loss) or liquidity.

## Table of Contents

### Interest Rate Risk

Exposure to interest rate changes on our outstanding debt is substantially mitigated as our \$250 million of 3.95% Senior Notes due July 2024, \$550 million of 5.625% Senior Notes due July 2044, \$450 million of 4.75% Senior Notes due March 2026, and \$250 million of 6.375% Junior Subordinated Notes due March 2056 are at fixed interest rates. In June 2014, we entered into an interest rate swap contract, designated as a fair value hedge, to effectively convert our \$250 million of 2.7% Senior Notes due July 2019 from fixed rate debt to floating rate debt. In addition, the \$40 million of outstanding borrowings under our revolving credit agreement as of March 31, 2016, is also subject to fluctuations in interest rates. As of March 31, 2016, and as a result of the interest rate swap and the outstanding borrowings under our revolving credit agreement, we estimate that a 1% change in interest rates would result in a net annual change to interest expense of \$2.9 million. On an economic basis, the interest rate swap contract wholly or partially hedges interest rate exposure on operating cash.

On April 21, 2016, the interest rate swap designated as a fair value hedge was terminated. Therefore, as of this date, the \$250 million of 2.7% Senior Notes are at a fixed interest rate. In addition, on April 29, 2016, we entered into a 4.67-year amortizing interest rate swap, designated as a cash flow hedge, that reduces our exposure to interest rate risk on the \$500 million of outstanding borrowings under our revolving credit facility.

See Notes 6 and 15 of Notes to Consolidated Financial Statements for additional discussion of debt and derivatives and hedging, respectively.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Accounting policies are an integral part of the preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America. Understanding these policies, therefore, is a key factor in understanding our reported results of operations and financial position. See Note 1 of Notes to Consolidated Financial Statements for a discussion of our significant accounting policies and other information. Certain critical accounting policies require us to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in the financial statements. Due to their nature, estimates involve judgment based upon available information. Therefore, actual results or amounts could differ from estimates and the difference could have a material impact on the consolidated financial statements.

We consider the following to be our critical accounting policies that involve significant estimates or judgments.

#### Consolidation

In the normal course of our business, we sponsor and manage various types of investment vehicles. For our services, we are entitled to receive management fees and may be eligible, under certain circumstances, to receive additional subordinate management fees or other incentive fees. Our exposure to risk in these entities is generally limited to any equity investment we have made or are required to make, and any earned but uncollected management fees.

Uncollected management fees from managed investment vehicles were not material at March 31, 2016, we have not issued any investment performance guarantees to these investment vehicles or their investors, and we did not sell or transfer assets to any of these investment vehicles. In accordance with financial accounting standards, we consolidate certain sponsored investment vehicles, some of which are designated as CIVs.

Certain investment vehicles we sponsor and are the manager of are considered to be variable interest entities ("VIEs") (further described below) while others are considered to be voting rights entities ("VREs") subject to traditional consolidation concepts based on ownership rights. Sponsored investment vehicles that are considered VREs are consolidated if we have a controlling financial interest in the investment vehicle, absent substantive investor rights to replace the manager of the entity (kick-out rights). We may also fund the initial cash investment in certain VRE investment vehicles to generate an investment performance track record in order to attract third-party investors in the

product. Our initial investment in a new product typically represents 100% of the ownership in that product. As further discussed below, these “seed capital investments” are consolidated as long as we maintain a controlling financial interest in the product, but they are not designated as CIVs unless the investment is longer-term.

A VIE is an entity which does not have adequate equity to finance its activities without additional subordinated financial support; or the equity investors, as a group, do not have the normal characteristics of equity for a potential controlling financial interest.

## Table of Contents

### Investment Company VIEs

For most sponsored investment fund VIEs deemed to be investment companies, including money market funds, we determine we are the primary beneficiary of the VIE if we absorb a majority of the VIE's expected losses, or receive a majority of the VIE's expected residual returns, if any. Our determination of expected residual returns excludes gross fees paid to a decision maker if certain criteria are met. In determining whether we are the primary beneficiary of an investment company VIE, we consider both qualitative and quantitative factors such as the voting rights of the equity holders; economic participation of all parties, including how fees are earned and paid to us; related party (including employees') ownership; guarantees and implied relationships.

In determining the primary beneficiary, we must make assumptions and estimates about, among other things, the future performance of the underlying assets held by the VIE, including investment returns, cash flows, and credit and interest rate risks. In determining whether a VIE is significant for disclosure purposes, we consider the same factors used for determination of the primary beneficiary.

### Other VIEs

For other sponsored investment funds that do not meet the investment company criteria, such as collateralized debt obligation entities and CLO entities, we determine if we are the primary beneficiary of a VIE if we have both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and the obligation to absorb losses, or the right to receive benefits, that potentially could be significant to the VIE. We consider the management fee structure, including the seniority level of our fees, the current and expected economic performance of the entity, as well as other provisions included in the governing documents that might restrict or guarantee an expected loss or residual return.

In evaluating whether we have the obligation to absorb losses, or the right to receive benefits, that could potentially be significant to a VIE, we consider factors regarding the design, terms, and characteristics of the investment vehicles, including the following qualitative factors: if we have involvement with the investment vehicle beyond providing management services; if we hold equity or debt interests in the investment vehicle; if we have transferred any assets to the investment vehicle; if the potential aggregate fees in future periods are insignificant relative to the potential cash flows of the investment vehicle; and if the variability of the expected fees in relation to the potential cash flows of the investment vehicle is more than insignificant.

We must consolidate any VIE for which we are deemed to be the primary beneficiary.

See Notes 1, 3, and 17 of Notes to Consolidated Financial Statements for additional discussion of CIVs and other VIEs.

### Revenue Recognition

The vast majority of our revenues are calculated as a percentage of the fair value of our AUM. The underlying securities within the portfolios we manage, which are not reflected within our consolidated financial statements, are generally valued as follows: (i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith.

For most of our mutual funds and other pooled products, their boards of directors or similar bodies are responsible for establishing policies and procedures related to the pricing of securities. Each board of directors generally delegates the execution of the various functions related to pricing to a fund valuation committee which, in turn, may rely on information from various parties in pricing securities such as independent pricing services, the fund accounting agent, the fund manager, broker-dealers, and others (or a combination thereof). The funds have controls reasonably designed to ensure that the prices assigned to securities they hold are accurate. Management has established policies to ensure consistency in the application of revenue recognition.



As manager and advisor for separate accounts, we are generally responsible for the pricing of securities held in client accounts (or may share this responsibility with others) and have established policies to govern valuation processes similar to those discussed above for mutual funds that are reasonably designed to ensure consistency in the application of revenue recognition. Management relies extensively on the data provided by independent pricing services and the custodians in the pricing of separate account AUM. Separate account customers typically select the custodian.

Valuation processes for AUM are dependent on the nature of the assets and any contractual provisions with our clients. Equity securities under management for which market quotations are available are usually valued at the last reported sales

Table of Contents

price or official closing price on the primary market or exchange on which they trade. Debt securities under management are usually valued at bid, or the mean between the last quoted bid and asked prices, provided by independent pricing services that are based on transactions in debt obligations, quotations from bond dealers, market transactions in comparable securities and various other relationships between securities. Short-term debt obligations are generally valued at amortized cost, which approximates fair value. The vast majority of our AUM is valued based on data from third parties such as independent pricing services, fund accounting agents, custodians and brokers. This varies slightly from time to time based upon the underlying composition of the asset class (equity, fixed income and liquidity) as well as the actual underlying securities in the portfolio within each asset class. Regardless of the valuation process or pricing source, we have established controls reasonably designed to assess the reasonableness of the prices provided. Where market prices are not readily available, or are determined not to reflect fair value, value may be determined in accordance with established valuation procedures based on, among other things, unobservable inputs. Management fees on AUM where fair values are based on unobservable inputs are not material. As of March 31, 2016, equity, fixed income, and liquidity AUM values aggregated \$180.5 billion, \$376.8 billion and \$112.3 billion, respectively.

As the vast majority of our AUM is valued by independent pricing services based upon observable market prices or inputs, we believe market risk is the most significant risk underlying the value of our AUM. Economic events and financial market turmoil have increased market price volatility; however, the valuation of the vast majority of the securities held by our funds and in separate accounts continues to be derived from readily available market price quotations. As of March 31, 2016, less than 1% of total AUM is valued based on unobservable inputs. All AUM related to Clarion Partners will be Level 3.

#### Valuation of Financial Instruments

Substantially all financial instruments are reflected in the financial statements at fair value or amounts that approximate fair value, except a portion of our long-term debt. Trading investments, investment securities and derivative assets and liabilities included in the Consolidated Balance Sheets include forms of financial instruments. Unrealized gains and losses related to these financial instruments are reflected in Net Income (Loss) or Other Comprehensive Income (Loss), depending on the underlying purpose of the instrument.

For equity investments where we do not control the investee, and where we are not the primary beneficiary of a VIE, but can exert significant influence over the financial and operating policies of the investee, we follow the equity method of accounting. The evaluation of whether we exert control or significant influence over the financial and operational policies of an investee requires significant judgment based on the facts and circumstances surrounding each individual investment. Factors considered in these evaluations may include investor voting or other rights, any influence we may have on the governing board of the investee, the legal rights of other investors in the entity pursuant to the fund's operating documents and the relationship between us and other investors in the entity. Our equity method investees that are investment companies record their underlying investments at fair value. Therefore, under the equity method of accounting, our share of the investee's underlying net income or loss predominantly represents fair value adjustments in the investments held by the equity method investee. Our share of the investee's net income or loss is based on the most current information available and is recorded as a net gain (loss) on investments within non-operating income (expense).

For investments, we value equity and fixed income securities using closing market prices for listed instruments or broker or dealer price quotations, when available. Fixed income securities may also be valued using valuation models and estimates based on spreads to actively traded benchmark debt instruments with readily available market prices. We evaluate our non-trading investment securities for "other than temporary" impairment. Impairment may exist when the fair value of an investment security has been below the adjusted cost for an extended period of time. If an "other than temporary" impairment is determined to exist, the difference between the adjusted cost of the investment security and its current fair value is recognized as a charge to earnings in the period in which the impairment is

determined.

For investments in illiquid or privately-held securities for which market prices or quotations are not readily available, the determination of fair value requires us to estimate the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry. As of March 31, 2016 and 2015, excluding investments in CIVs, we owned approximately \$0.2 million and \$0.3 million, respectively, of financial investments that were valued on our assumptions or estimates and unobservable inputs.

At March 31, 2016 and 2015, we also had approximately \$45.3 million and \$62.9 million, respectively, of other investments, such as investment partnerships, that are included in Other noncurrent assets on the Consolidated Balance Sheets, of which approximately \$37.3 million and \$48.3 million, respectively, are accounted for under the equity method. The remainder is

68

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## Table of Contents

accounted for under the cost method, which considers if factors indicate there may be an impairment in the value of these investments. In addition, as of March 31, 2016 and 2015, we had \$15.4 million and \$16.2 million, respectively, of equity method investments that are included in Investment securities on the Consolidated Balance Sheets.

The accounting guidance for fair value measurements and disclosures defines fair value and establishes a framework for measuring fair value. The accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value measurement should reflect all of the assumptions that market participants would use in pricing the asset or liability, including assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset, and the risk of non-performance.

The accounting guidance for fair value measurements establishes a hierarchy that prioritizes the inputs for valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

Our financial instruments measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1 — Financial instruments for which prices are quoted in active markets, which, for us, include investments in publicly traded mutual funds with quoted market prices and equities listed in active markets.

Level 2 — Financial instruments for which prices are quoted for similar assets and liabilities in active markets; prices are quoted for identical or similar assets in inactive markets; or prices are based on observable inputs, other than quoted prices, such as models or other valuation methodologies. For us, this category may include fixed income securities, certain proprietary fund products, and certain long-term debt.

Level 3 — Financial instruments for which values are based on unobservable inputs, including those for which there is little or no market activity. This category includes investments in partnerships, limited liability companies, and private equity funds. This category may also include certain proprietary fund products with redemption restrictions.

The valuation of an asset or liability may involve inputs from more than one level of the hierarchy. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Proprietary fund products and certain investments held by CIVs are valued at net asset value ("NAV") determined by the fund administrator. These funds are typically invested in exchange traded investments with observable market prices. Their valuations may be classified as Level 1, Level 2, or Level 3 based on whether the fund is exchange traded, the frequency of the related NAV determinations and the impact of redemption restrictions. For investments in illiquid and privately-held securities (private equity and investment partnerships) for which market prices or quotations may not be readily available, including certain investments held by CIVs, management must estimate the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry to which it applies in order to determine fair value. These valuation processes for illiquid and privately-held securities inherently require management's judgment and are therefore classified in Level 3.

Futures contracts are valued at the last settlement price at the end of each day on the exchange upon which they are traded and are classified as Level 1.

As a practical expedient, we rely on the NAVs of certain investments as their fair value. The NAVs that have been provided by investees are derived from the fair values of the underlying investments as of the reporting date.

Table of Contents

As of March 31, 2016, approximately 1% of total assets (3% of financial assets measured at fair value) and 3% of total liabilities (82% of financial liabilities measured at fair value) meet the definition of Level 3. Excluding the assets and liabilities of CIVs, approximately 1% of total assets (3% of financial assets measured at fair value) and 3% of liabilities (82% of financial liabilities measured at fair value) meet the definition of Level 3.

Any transfers between categories are measured at the beginning of the period.

See Note 3 and 17 of Notes to Consolidated Financial Statements for additional information.

#### Intangible Assets and Goodwill

Balances as of March 31, 2016, are as follows (in thousands):

Amortizable intangible asset management contracts	\$88,344
Indefinite-life intangible assets	3,000,954
Trade names	57,187
Goodwill	1,479,516
	\$4,626,001

Our identifiable intangible assets consist primarily of asset management contracts, contracts to manage proprietary mutual funds or funds-of-hedge funds, and trade names resulting from acquisitions. Asset management contracts are amortizable intangible assets that are capitalized at acquisition and amortized over the expected life of the contract. Contracts to manage proprietary mutual funds or funds-of-hedge funds are indefinite-life intangible assets because we assume that there is no foreseeable limit on the contract period due to the likelihood of continued renewal at little or no cost. Similarly, trade names are considered indefinite-life intangible assets because they are expected to generate cash flows indefinitely.

In allocating the purchase price of an acquisition to intangible assets, we must determine the fair value of the assets acquired. We determine fair values of intangible assets acquired based upon projected future cash flows, which take into consideration estimates and assumptions including profit margins, growth or attrition rates for acquired contracts based upon historical experience and other factors, estimated contract lives, discount rates, projected net client flows and market performance. The determination of estimated contract lives requires judgment based upon historical client turnover and attrition rates and the probability that contracts with termination provisions will be renewed. The discount rate employed is a weighted-average cost of capital that takes into consideration a premium representing the degree of risk inherent in the asset, as more fully described below.

Goodwill represents the residual amount of acquisition cost in excess of identified tangible and intangible assets and assumed liabilities.

Given the relative significance of our intangible assets and goodwill to our consolidated financial statements, on a quarterly basis we consider if triggering events have occurred that may indicate a significant change in fair values. Triggering events may include significant adverse changes in our business or the legal or regulatory environment, loss of key personnel, significant business dispositions, or other events, including changes in economic arrangements with our affiliates that will impact future operating results. If a triggering event has occurred, we perform quantitative tests, which include critical reviews of all significant assumptions, to determine if any intangible assets or goodwill are impaired. If we have not qualitatively concluded that it is more likely than not that the respective fair values exceed the related carrying values, we perform these tests for indefinite-life intangible assets and goodwill annually at December 31.

We completed our annual impairment tests of goodwill and indefinite-life intangible assets as of December 31, 2015. As a result of these impairment tests, our Permal funds-of-hedge funds contracts and trade name indefinite-life

intangible assets were determined to be partially impaired, resulting in aggregate pre-tax operating charges of \$371 million. Neither goodwill nor any other intangible assets were deemed to be impaired. Further, no impairments in the value of amortizable intangible assets were recognized during the year ended March 31, 2016, as our estimates of the related future cash flows exceeded the asset carrying values. We also determined that no triggering events had occurred as of March 31, 2016, therefore, no additional indefinite-life intangible asset and goodwill impairment testing was necessary. As a result of uncertainty regarding future market conditions, assessing the fair value of the reporting unit and intangible assets requires management to exercise significant judgment. Details of our intangible assets and goodwill and the related impairment tests follow.

## Table of Contents

Our acquisition of RARE Infrastructure resulted in the addition of an indefinite-life mutual fund contracts asset, an amortizable separate accounts asset, a trade name asset and goodwill of \$123 million, \$68 million, \$5 million, and \$162 million (170 million Australian dollars, 94 million Australian dollars, 7 million Australian dollars, and 225 million Australian dollars), respectively, using the foreign exchange rate as of October 21, 2015. Because the fair values of the RARE Infrastructure indefinite-life mutual fund contracts asset and amortizable separate accounts asset were established as of the October 21, 2015 acquisition date, our December 31, 2015, impairment consideration was limited to a review of AUM trends and other critical valuation inputs, which noted no significant changes.

### Amortizable Intangible Assets

Intangible assets subject to amortization are considered for impairment at each reporting period using an undiscounted cash flow analysis. Significant assumptions used in assessing the recoverability of management contract intangible assets include projected cash flows generated by the contracts and the remaining lives of the contracts. Projected cash flows are based on fees generated by current AUM for the applicable contracts. Contracts are generally assumed to turnover evenly throughout the life of the intangible asset. The remaining life of the asset is based upon factors such as average client retention and client turnover rates. If the amortization periods are no longer appropriate, the expected lives are adjusted and the impact on the fair value is assessed. Actual cash flows in any one period may vary from the projected cash flows without resulting in an impairment charge because a variance in any one period must be considered in conjunction with other assumptions that impact projected cash flows.

As of March 31, 2016, the estimated remaining useful lives of amortizable intangible assets range from three to 12 years with a weighted-average life of approximately 10.9 years.

### Indefinite-Life Intangible Assets

For intangible assets with lives that are indeterminable or indefinite, fair value is determined from a market participant's perspective based on projected discounted cash flows, taking into account the values market participants would pay in a taxable transaction to acquire the respective assets. We have two primary types of indefinite-life intangible assets: proprietary fund contracts and, to a lesser extent, trade names.

We determine the fair value of our intangible assets based upon discounted projected cash flows, which take into consideration estimates of future fees, profit margins, growth rates, taxes, and discount rates. The determination of the fair values of our indefinite-life intangible assets is highly dependent on these estimates and changes in these inputs could result in a material impairment of the related carrying values. An asset is determined to be impaired if the current implied fair value is less than the recorded carrying value of the asset. If an asset is impaired, the difference between the current implied fair value and the carrying value of the asset reflected on the financial statements is recognized as an Operating expense in the period in which the impairment is determined to exist.

Contracts that are managed and operated as a single unit, such as contracts within the same family of funds, are reviewed in aggregate and are considered interchangeable because investors can transfer between funds with limited restrictions. Similarly, cash flows generated by new funds added to the fund group are included when determining the fair value of the intangible asset. The Fauchier acquisition completed by Permal in March 2013 included a funds-of-hedge fund business, which was merged with the existing Permal fund business through common management, shared resources (including infrastructure, employees and processes) and co-branding initiatives. Accordingly, the related carrying values and cash flows of these funds have been aggregated for impairment testing.

Projected cash flows are based on annualized cash flows for the applicable contracts projected forward 40 years, assuming annual cash flow growth from estimated net client flows and projected market performance. To estimate the projected cash flows, projected growth rates by affiliate are used to project their AUM. Cash flow growth rates consider estimates of both AUM flows and market expectations by asset class (equity, fixed income and liquidity) and



by investment manager based upon, among other things, historical experience and expectations of future market and investment performance from internal and external sources. Currently, our market growth assumptions are 6% for equity, 3% for fixed income, and 0% for liquidity products, with a general assumption of 2% organic growth for all products, subject to exceptions for organic growth (contraction), generally in years one through five.

The starting point for these assumptions is our corporate planning process that includes three-year AUM projections from the management of each operating affiliate that consider the specific business circumstances of each affiliate, with flow

## Table of Contents

assumptions for certain affiliates adjusted, as appropriate, to reflect a market participant view. Beyond year three, the estimates move towards our general organic growth assumption of 2%, as appropriate for each affiliate and asset class, through year 20. The resulting cash flow growth rate for year 20 is held constant and used to further project cash flows through year 40. Based on projected AUM by affiliate and asset class, affiliate advisory fee rates are applied to determine projected revenues. The domestic mutual fund contracts projected revenues are applied to a weighted-average margin for the applicable affiliates that manage the AUM. Margins are based on arrangements currently in place at each affiliate. Projected operating income is further reduced by an appropriate tax rate to calculate the projected cash flows.

We believe our growth assumptions are reasonable given our consideration of multiple inputs, including internal and external sources, although our assumptions are subject to change based on fluctuations in our actual results and market conditions. Our assumptions are also subject to change due to, among other factors, poor investment performance by one or more of our operating affiliates, the withdrawal of AUM by clients, changes in business climate, adverse regulatory actions, or loss of key personnel. We consider these risks in the development of our growth assumptions and discount rates, discussed further below. Further, actual cash flows in any one period may vary from the projected cash flows without resulting in an impairment charge because a variance in any one period must be considered in conjunction with other assumptions that impact projected cash flows.

Our process includes comparison of actual results to prior growth projections. However, differences between actual results and our prior projections are not necessarily indicative of a need to reassess our estimates given that: our discounted projected cash flow analyses include projections well beyond three years and variances in the near-years may be offset in subsequent years; fair value assessments are point-in-time, and the consistency of a fair value assessment with other indicators of value that reflect expectations of market participants at that point-in-time is critical evidence of the soundness of the estimate of value. In subsequent periods, we consider the differences in actual results from our prior projections in considering the reasonableness of the growth assumptions used in our current impairment testing.

Discount rates are based on appropriately weighted estimated costs of debt and equity capital using a market participant perspective. We estimate the cost of debt based on published debt rates. We estimate the cost of equity capital based on the Capital Asset Pricing Model, which considers the risk-free interest rate, peer-group betas, and company and equity risk premiums. The equity risk is further adjusted to consider the relative risk associated with each of our indefinite-life intangible asset and our reporting unit. The discount rates are also calibrated based on an assessment of relevant market values.

Consistent with standard valuation practices for taxable transactions, the projected discounted cash flow analysis also factors in a tax benefit value, as appropriate. This tax benefit represents the discounted tax savings a third party that purchased an asset on a given valuation date would receive from future tax deductions for the amortization of the purchase price over 15 years.

The Permal funds-of-hedge funds contracts of \$698 million accounted for approximately 20% of our indefinite-life intangible assets, prior to the previously discussed impairment charge, and are supported by the combined funds-of-hedge funds business. These funds have continued to experience periods of moderate inflows or outflows over recent years and certain increased risks, as follows. The past several years have seen declines in the traditional high net worth client funds-of-hedge funds business, Permal's historical focus, which Permal has offset to some extent with inflows in their institutional business. Further, funds-of-hedge fund managers are subject to certain market influences, as evidenced in Permal's growth in institutional funds and separate accounts, adding additional uncertainty to our estimates. Due in part to these factors, actual results for the 12 months ended December 31, 2015, generally compared unfavorably to growth assumptions for the Permal funds-of-hedge funds contracts used in the asset impairment testing at December 31, 2014. Additionally, the historical Fauchier portion of Permal's business is now

subject to risk associated with the loss of certain key staff. As a result, in our December 2015 testing, the growth assumptions for these contracts were reduced in the first five years, which, together with the impact of decreased margins in the first two years, led to decreased projected cash flows from the business. Also, the projected cash flows from the Permal funds-of-hedge funds contracts were discounted at 16.5%, compared to 14.5% used in the prior year's impairment testing, reflecting the factors noted above.

Based upon our projected discounted cash flow analyses, the carrying value of the Permal funds-of-hedge funds contracts asset exceeded its fair value of \$335 million, resulting in an impairment charge of \$364 million for the excess. Cash flows on the Permal funds-of-hedge funds contracts are assumed to have an average annual growth rate of approximately 7% (5% market and 2% organic/other). However, given current experience, projected near-year cash flows reflect moderate AUM outflows in years one and two, no net AUM flows in year three, and trend to modest AUM inflows in year four. Investment

## Table of Contents

performance, including its expected impact on future asset flows, is a significant factor in our growth projections for the Permal funds-of-hedge funds contracts. Our market performance projections are supported by the fact that the two largest funds that comprise approximately half of the contracts asset AUM, have 10-year average returns approximating 5%. Our market projections are further supported by industry statistics.

The domestic mutual fund contracts acquired in the Citigroup Asset Management (“CAM”) transaction of \$2.1 billion, account for approximately 70% of our indefinite-life intangible assets. As of December 31, 2015, approximately \$150 billion of AUM, primarily managed by ClearBridge and Western Asset, are associated with this asset, with approximately 35% in each of equity and fixed income AUM and 30% in liquidity AUM. Previously disclosed uncertainties regarding market conditions and asset flows and risks related to potential regulatory changes in the liquidity business, are reflected in our projected discounted cash flow analyses. Based on our projected discounted cash flow analyses, the related fair value exceeded its carrying value by approximately \$1.0 billion. For our impairment test, cash flows from the domestic mutual fund contracts are assumed to have annual growth rates that average approximately 6%, and reflect moderate AUM inflows in years 1 and 2. Projected cash flows of the domestic mutual fund contracts are discounted at 13.0%. Results for the 12 months through December 31, 2015, compared favorably to the growth assumptions related to the domestic mutual fund contracts asset impairment testing at December 31, 2014.

Assuming all other factors remain the same, our actual results and/or changes in assumptions for the domestic mutual fund contracts cash flow projections over the long-term would have to deviate more than 30% from previous projections, or the discount rate would have to be raised from 13.0% to more than 16.5%, for the asset to be deemed impaired. Despite the higher excess of fair value over the related carrying value, given the current uncertainty regarding future market conditions, it is reasonably possible that fund performance, flows and AUM levels may decrease in the near term such that actual cash flows from the domestic mutual funds contracts could deviate from the projections by more than 30% and the asset could be deemed to be impaired by a material amount.

Trade names account for 2% of indefinite-life intangible assets and are primarily related to Permal, which had a carrying value of \$45 million. We tested these intangible assets using assumptions similar to those described above for indefinite-life contracts. The Permal trade name carrying value exceeded its estimated fair value of \$38 million, resulting in a \$7 million impairment for the excess. The resulting fair values of the other trade names significantly exceeded the related carrying amounts.

### Goodwill

Goodwill is evaluated at the reporting unit level and is considered for impairment when the carrying amount of the reporting unit exceeds the implied fair value of the reporting unit. In estimating the implied fair value of the reporting unit, we use valuation techniques based on discounted projected cash flows and EBITDA multiples, similar to techniques employed in analyzing the purchase price of an acquisition. We continue to manage our business as one Global Asset Management operating segment. Internal management reporting of discrete financial information regularly received by the chief operating decision maker, our Chief Executive Officer, is at the consolidated Global Asset Management business level. As a result, goodwill is recorded and evaluated at one Global Asset Management reporting unit level. Our Global Asset Management reporting unit consists of the operating businesses of our asset management affiliates and our centralized global distribution operations. In our impairment testing process, all consolidated assets (except for certain tax benefits) and liabilities are allocated to our single Global Asset Management reporting unit. Similarly, the projected operating results of the reporting unit include our holding company corporate costs and overhead, including costs associated with executive management, finance, human resources, legal and compliance, internal audit and other central corporate functions.

Goodwill principally originated from the acquisitions of CAM, Permal, Royce, Martin Currie, and more recently RARE Infrastructure. The value of the reporting unit is based in part, on projected consolidated net cash flows,

including all cash flows of assets managed in our mutual funds, closed-end funds and other proprietary funds, in addition to separate account assets of our managers.

Significant assumptions used in assessing the implied fair value of the reporting unit under the discounted cash flow method are consistent with the methodology discussed above for indefinite-life intangible assets. Also, at the reporting unit level, future corporate costs are estimated and consolidated with the projected operating results of all our affiliates.

## Table of Contents

Actual cash flows in any one period may vary from the projected cash flows without resulting in an impairment charge because a variance in any one period must be considered in conjunction with other assumptions that impact projected cash flows.

Discount rates are based on appropriately weighted estimated costs of equity using a market participant perspective, also consistent with the methodology discussed above for indefinite-life intangible assets.

We also perform a market-based valuation of our reporting unit value, which applies an average of EBITDA multiples paid in change of control transactions for peer companies to our EBITDA. The results of our two estimates of value for the reporting unit (the discounted cash flow and EBITDA multiple analyses) are compared and any significant differences, if any, are assessed to determine the reasonableness of each value and whether any adjustment to either result is warranted. Once the values are accepted, the appropriately weighted average of the two reporting unit valuations (the discounted cash flow and EBITDA multiple analyses) is used as the implied fair value of our Global Asset Management reporting unit, which at December 31, 2015, exceeded the carrying value by a material amount. Considering the relative merits of the details involved in each valuation process, we used an equal weighting of the two values for the December 2015 testing.

We further assess the accuracy of the reporting unit value determined from these valuation methods by comparing their results to our market capitalization to determine an implied control premium. The reasonableness of this implied control premium is considered by comparing it to control premiums that have been paid in relevant actual change of control transactions. This assessment provides evidence that our underlying assumptions in our analyses of our reporting unit fair value are reasonable.

In calculating our market capitalization for these purposes, market volatility can have a significant impact on our capitalization, and if appropriate, we may consider the average market prices of our stock for a period of one or two months before the test date to determine market capitalization. A control premium arises from the fact that in an acquisition, there is typically a premium paid over current market prices of publicly traded companies that relates to the ability to control the operations of an acquired company. Further, assessments of control premiums in the asset management industry are difficult because many acquisitions involve privately held companies, or involve only portions of a public company, such that no control premium can be calculated.

Based on our analysis and consideration, we believe the implied control premium determined by our reporting unit value estimation at December 31, 2015, which is at the lower end of the observed range, is reasonable.

### Contingent Consideration Liabilities

In connection with business acquisitions, we may be required to pay additional future consideration based on the achievement of certain designated financial metrics. We estimate the fair value of these potential future obligations at the time a business combination is consummated and record a Contingent consideration liability in the Consolidated Balance Sheet. The fair values of contingent consideration liabilities are revised as of each quarterly reporting date. As of March 31, 2016, the fair values of our contingent consideration liabilities aggregate \$84.6 million, relating to our acquisitions of RARE Infrastructure, Martin Currie, QS Investors, and PK Investments. There was no contingent consideration liability associated with the Fauchier acquisition as of March 31, 2016.

We estimate the fair value of contingent consideration liabilities using probability-weighted modeling specific to each business acquisition and its arrangement for contingent consideration. Estimated payments are discounted to their present value at the measurement date.

The Martin Currie purchase agreement requires us to pay additional consideration based on the achievement of certain financial metrics, as specified in the share purchase agreement, at certain future dates over the three and one-half year earn-out term. Our modeling of the Martin Currie contingent payment arrangement includes Monte Carlo simulation of projected AUM, performance fees and product performance to determine the related estimated payment amounts. If

the expected payment amounts subsequently change, the contingent consideration liabilities are (reduced) or increased in the current period, resulting in a (gain) or loss, which is reflected within Other operating expense in the Consolidated Statements of Income (Loss). Significant increases (decreases) in projected AUM or performance fee levels for Martin Currie would result in significantly higher (lower) contingent consideration liability fair value and the resulting changes could be material to our operating results. The RARE Infrastructure, Fauchier, and QS Investors purchase agreements require us to pay additional consideration based on whether certain future revenue thresholds are achieved. Likewise, significant increases (decreases)

## Table of Contents

in projected revenue levels for RARE Infrastructure, Fauchier, and QS Investors would result in significantly higher (lower) contingent consideration liability fair value and the resulting changes could be material to our operating results.

### Stock-Based Compensation

Our stock-based compensation plans include stock options, an employee stock purchase plan, market-based performance shares payable in common stock, restricted stock awards and units, affiliate management equity plans and deferred compensation payable in stock. Under our stock compensation plans, we issue equity awards to directors, officers, and key employees.

In accordance with the applicable accounting guidance, compensation expense for the years ended March 31, 2016, 2015, and 2014, includes compensation cost for all non-vested share-based awards at their grant date fair value amortized over the respective vesting periods on the straight-line method. Also, under the accounting guidance, cash flows related to income tax deductions in excess of or less than the stock-based compensation expense are classified as financing cash flows.

We granted 0.9 million, 0.9 million, and 1.2 million stock options in fiscal 2016, 2015, and 2014, respectively. During fiscal 2016, we implemented an affiliate management equity plan with Royce which resulted in the issuance of minority equity interests in the affiliate to its management team. These interests allow the holders to receive quarterly distributions of the affiliate's net revenues in amounts equal to the percentage of ownership represented by the equity they hold. During fiscal 2014, we also implemented management equity plans for Permal and ClearBridge and granted units to certain of their employees that entitle them to participate in 15% of the future growth of the respective affiliate's enterprise value (subject to appropriate discounts). For additional information on share-based compensation, see Notes 1 and 11 of Notes to Consolidated Financial Statements.

We determine the fair value of each option grant using the Black-Scholes option-pricing model, except for market-based grants, for which we use a Monte Carlo option-pricing model. Both models require management to develop estimates regarding certain input variables. The inputs for the Black-Scholes model include: stock price on the date of grant, exercise price of the option, dividend yield, volatility, expected life and the risk-free interest rate, all of which, with the exception of the grant date stock price and the exercise price, require estimates or assumptions. We calculate the dividend yield based upon the average of the historical quarterly dividend payments over a term equal to the expected life of the options. We estimate volatility equally weighted between the historical prices of our stock over a period equal to the expected life of the option and the implied volatility of market listed options at the date of grant. The expected life is the estimated length of time an option will be held before it is either exercised or canceled, based upon our historical option exercise experience. The risk-free interest rate is the rate available for zero-coupon U.S. Government issues with a remaining term equal to the expected life of the options being valued. If we used different methods to estimate our variables for the Black-Scholes and Monte Carlo models, or if we used a different type of option-pricing model, the fair value of our option grants might be different.

We also determine the fair value of option-like affiliate management equity plan grants using the Black-Scholes option-pricing model, subject to any post-vesting illiquidity discounts. Inputs to the Black-Scholes model are generally determined in a fashion similar to the fair value of grants of options in our own stock, described above. However, because our affiliates are private companies without quoted stock prices, we utilize discounted cash flow analyses and market-based valuations, similar to those discussed above under the heading "Intangible Assets and Goodwill", to determine the respective business enterprise values, subject to appropriate discounts for lack of control and marketability.

### Noncontrolling Interests



Noncontrolling interests include affiliate minority interests, third-party investor equity in consolidated sponsored investment vehicles, and vested management equity plan interests. Noncontrolling interests where the holder may be able to request settlement are classified as redeemable, and are reported at their estimated settlement values. When settlement is not expected to occur until a future date, changes in the expected settlement value are recognized over the settlement period. Nonredeemable noncontrolling interests do not permit the holder to request settlement, and are reported at their issuance value, together with undistributed net income allocated to noncontrolling interests.

We estimate the settlement value of noncontrolling interests as their fair value. For consolidated sponsored investment vehicles, where the investor may request withdrawal at any time, fair value is based on market quotes of the underlying securities held by the investment vehicles. For affiliate minority interests and management equity plan interests, fair value reflects the related total business enterprise value, after appropriate discounts for lack of marketability and control. There

## Table of Contents

may also be features of these equity interests, such as dividend subordination, that are contemplated in their valuations. The fair value of option-like management equity plan interests also relies on Black-Scholes option pricing model calculations, as noted above.

### Income Taxes

We are subject to the income tax laws of the federal, state and local jurisdictions of the U.S. and numerous foreign jurisdictions in which we operate. We file income tax returns representing our filing positions with each jurisdiction. Due to the inherent complexities arising from conducting business and being taxed in a substantial number of jurisdictions, we must make certain estimates and judgments in determining our income tax provision for financial statement purposes.

These estimates and judgments are used in determining the tax basis of assets and liabilities and in the calculation of certain tax assets and liabilities that arise from differences in the timing of revenue and expense recognition for tax and financial statement purposes. Management assesses the likelihood that we will be able to realize our deferred tax assets. If it is more likely than not that the deferred tax asset will not be realized, then a valuation allowance is established with a corresponding increase to deferred tax provision.

As a result of the prospective application of new accounting guidance, we have offset all deferred tax assets, liabilities, and any related valuation allowances, and present them as a single non-current amount as of March 31, 2016. We have not retrospectively adjusted prior periods.

Substantially all of our deferred tax assets relate to U.S. federal and state, and U.K. taxing jurisdictions. As of March 31, 2016, U.S. federal deferred tax assets aggregated \$711.5 million, realization of which is expected to require \$3.2 billion of future U.S. earnings, of which \$740 million must be foreign sourced earnings. Deferred tax assets generated in U.S. jurisdictions resulting from net operating losses generally expire 20 years after they are generated and those resulting from foreign tax credits generally expire 10 years after they are generated. Based on estimates of future taxable income, using assumptions consistent with those used in our goodwill impairment testing, it is more likely than not that substantially all of the current federal tax benefits relating to net operating losses are realizable. With respect to those resulting from foreign tax credit carryforwards, it is more likely than not that tax benefits relating to the utilization of approximately \$23.5 million of foreign taxes as credits will not be realized and a valuation allowance has been established. Further, our estimates and assumptions do not contemplate certain possible future changes in the ownership of Legg Mason stock, which, under the U.S. Internal Revenue Code, could limit our utilization of net operating loss and foreign tax credit benefits.

As of March 31, 2016, federal valuation allowances aggregated \$21.0 million. The decrease in federal valuation allowances from the prior year relates to \$12.7 million of expiring foreign tax credits. The release was offset in part by \$6.9 million, of which \$2.5 million relates to foreign tax credits, \$3.4 million relates to charitable contributions, and \$1.0 million relates to Martin Currie's operating losses.

While tax planning may enhance our tax positions, the realization of tax benefits on deferred tax assets for which valuation allowances have not been provided is not dependent on implementation of any significant tax strategies.

As of March 31, 2016, U.S. state deferred tax assets aggregated \$175.7 million. Due to limitations on the utilization of net operating loss carryforwards and taking into consideration state tax planning strategies, the related valuation allowance was \$26.8 million, substantially all of which relates to prior years for state net operating loss benefits generated in certain jurisdictions in cases where it is more likely that these benefits will not ultimately be realized. Due to the uncertainty of future state apportionment factors and future effective state tax rates, the value of state net operating loss benefits ultimately realized may vary.

For foreign jurisdictions, a decrease in valuation allowances of \$11.4 million in fiscal 2016 primarily relates to the change in statutory rates, tax planning to utilize attributes previously considered realizable, and adjustments to intercompany pricing models.

To the extent our analysis of the realization of deferred tax assets relies on deferred tax liabilities, we have considered the timing, nature and jurisdiction of reversals, as well as, future increases relating to the tax amortization of goodwill and indefinite-life intangible assets. In the event we determine all or any portion of our deferred tax assets that are not already subject to a valuation allowance are not realizable, we will be required to establish a valuation allowance by a charge to the

Table of Contents

income tax provision in the period in which that determination is made. Depending on the facts and circumstances, the charge could be material to our earnings.

The calculation of our tax liabilities involves uncertainties in the application of complex tax regulations. We recognize liabilities for anticipated tax uncertainties in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will be due.

RECENT ACCOUNTING DEVELOPMENTS

See discussion of Recent Accounting Developments in Note 1 of Notes to Consolidated Financial Statements.

EFFECTS OF INFLATION

The rate of inflation can directly affect various expenses, including employee compensation, communications and technology and occupancy, which may not be readily recoverable in charges for services provided by us. Further, to the extent inflation adversely affects the securities markets, it may impact revenues and recorded intangible asset and goodwill values. See discussion of "Market Risk — Revenues and Net Income (Loss)" and "Critical Accounting Policies — Intangible Assets and Goodwill" previously discussed.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk" for disclosures about market risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

REPORT OF MANAGEMENT ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Legg Mason, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting.

Legg Mason's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Legg Mason's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Legg Mason; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of Legg Mason are being made only in accordance with authorizations of management and directors of Legg Mason; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of Legg Mason's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Legg Mason's internal control over financial reporting as of March 31, 2016, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control — Integrated Framework (2013). Based on that assessment, management concluded that, as of March 31, 2016, Legg Mason's internal control over financial reporting is effective based on the criteria established in the COSO framework.

The effectiveness of Legg Mason's internal control over financial reporting as of March 31, 2016, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing herein, which expresses an unqualified opinion on the effectiveness of Legg Mason's internal control over financial reporting as of March 31, 2016.

Joseph A. Sullivan  
Chairman and Chief Executive Officer

Peter H. Nachtwey  
Senior Executive Vice President and Chief Financial Officer

REPORT OF INDEPENDENT  
REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors  
and Stockholders of Legg Mason, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income (loss), comprehensive income (loss), changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Legg Mason, Inc. and its subsidiaries ("the Company") at March 31, 2016 and March 31, 2015, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Baltimore, Maryland  
May 23, 2016



Table of Contents

LEGG MASON, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands)

	March 31, 2016	March 31, 2015
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 1,329,126	\$ 669,552
Cash and cash equivalents of consolidated investment vehicles	297	2,808
Restricted cash	19,580	32,114
Receivables:		
Investment advisory and related fees	334,922	368,399
Other	74,694	118,850
Investment securities	515,335	454,735
Investment securities of consolidated investment vehicles	48,715	48,000
Deferred income taxes	—	169,706
Other	55,405	51,002
Other assets of consolidated investment vehicles	7,054	6,121
Total Current Assets	2,385,128	1,921,287
Fixed assets, net	163,305	179,606
Intangible assets, net	3,146,485	3,313,334
Goodwill	1,479,516	1,339,510
Deferred income taxes	206,797	161,978
Other	139,215	149,119
<b>TOTAL ASSETS</b>	<b>\$ 7,520,446</b>	<b>\$ 7,064,834</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Current Liabilities		
Accrued compensation	\$ 430,736	\$ 400,245
Accounts payable and accrued expenses	201,572	208,210
Short-term borrowings	40,000	—
Contingent consideration	26,396	22,276
Other	138,301	177,879
Other current liabilities of consolidated investment vehicles	4,548	6,436
Total Current Liabilities	841,553	815,046
Deferred compensation	65,897	51,706
Deferred income taxes	260,386	362,209
Contingent consideration	58,189	88,508
Other	141,886	167,998
Long-term debt	1,740,985	1,048,946
<b>TOTAL LIABILITIES</b>	<b>3,108,896</b>	<b>2,534,413</b>
Commitments and Contingencies (Note 8)		
<b>REDEEMABLE NONCONTROLLING INTERESTS</b>	<b>175,785</b>	<b>45,520</b>
<b>STOCKHOLDERS' EQUITY</b>	<b>10,701</b>	<b>11,147</b>



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Common stock, par value \$.10; authorized 500,000,000 shares; issued 107,011,664 shares in March 2016 and 111,469,142 shares in March 2015

Additional paid-in capital	2,693,113	2,844,441
Employee stock trust	(26,263 )	(29,570 )
Deferred compensation employee stock trust	26,263	29,570
Retained earnings	1,576,242	1,690,055
Accumulated other comprehensive loss, net	(66,493 )	(60,742 )
Total stockholders' equity attributable to Legg Mason, Inc.	4,213,563	4,484,901
Nonredeemable noncontrolling interest	22,202	—
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>4,235,765</b>	<b>4,484,901</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$7,520,446</b>	<b>\$7,064,834</b>

See Notes to Consolidated Financial Statements

Table of ContentsLEGG MASON, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(Dollars in thousands, except per share amounts)

	Years Ended March 31,		
	2016	2015	2014
<b>OPERATING REVENUES</b>			
Investment advisory fees:			
Separate accounts	\$826,080	\$824,211	\$777,420
Funds	1,409,059	1,544,494	1,501,278
Performance fees	41,982	83,519	107,087
Distribution and service fees	381,486	361,188	347,598
Other	2,237	5,694	8,374
Total Operating Revenues	2,660,844	2,819,106	2,741,757
<b>OPERATING EXPENSES</b>			
Compensation and benefits	1,172,645	1,208,214	1,208,226
Transition-related compensation	32,172	24,556	2,161
Total Compensation and Benefits	1,204,817	1,232,770	1,210,387
Distribution and servicing	545,710	594,788	619,070
Communications and technology	197,857	182,438	157,872
Occupancy	122,610	109,708	115,234
Amortization of intangible assets	4,979	2,625	12,314
Impairment charges	371,000	—	—
Other, net, including \$(33,375) and \$5,000 of contingent consideration fair value (reduction) increase in fiscal 2016 and 2014, respectively	163,040	198,558	195,987
Total Operating Expenses	2,610,013	2,320,887	2,310,864
<b>OPERATING INCOME</b>	<b>50,831</b>	<b>498,219</b>	<b>430,893</b>
<b>OTHER NON-OPERATING INCOME (EXPENSE)</b>			
Interest income	5,634	7,440	6,367
Interest expense	(48,463 )	(58,274 )	(52,911 )
Other income (expense), net, including \$107,074 debt extinguishment loss in fiscal 2015	(25,977 )	(85,280 )	32,818
Other non-operating income (expense) of consolidated investment vehicles, net	(7,243 )	5,888	2,474
Total Other Non-Operating Income (Expense)	(76,049 )	(130,226 )	(11,252 )
<b>INCOME (LOSS) BEFORE INCOME TAX PROVISION (BENEFIT)</b>	<b>(25,218 )</b>	<b>367,993</b>	<b>419,641</b>
Income tax provision	7,692	125,284	137,805
<b>NET INCOME (LOSS)</b>	<b>(32,910 )</b>	<b>242,709</b>	<b>281,836</b>
Less: Net income (loss) attributable to noncontrolling interests	(7,878 )	5,629	(2,948 )
<b>NET INCOME (LOSS) ATTRIBUTABLE TO LEGG MASON, INC.</b>	<b>\$(25,032 )</b>	<b>\$237,080</b>	<b>\$284,784</b>
<b>NET INCOME (LOSS) PER SHARE ATTRIBUTABLE TO LEGG MASON, INC. SHAREHOLDERS:</b>			
Basic	\$(0.25 )	\$2.06	\$2.34
Diluted	\$(0.25 )	\$2.04	\$2.33

See Notes to Consolidated Financial Statements

Table of Contents

LEGG MASON, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(Dollars in thousands)

	Years Ended March 31,		
	2016	2015	2014
NET INCOME (LOSS)	\$(32,910)	\$242,709	\$281,836
Other comprehensive loss:			
Foreign currency translation adjustment	(8,525 )	(88,982 )	(9,424 )
Unrealized losses on investment securities:			
Unrealized holding losses, net of tax benefit of \$3 and \$123, respectively	—	(5 )	(184 )
Reclassification adjustment for losses included in net income	—	5	18
Net unrealized losses on investment securities	—	—	(166 )
Net actuarial gains (losses) on defined benefit pension plan	2,774	(9,595 )	—
Unrealized gains on reverse treasury rate lock, net of tax provision of \$233	—	405	—
Reclassification for realized gain on termination of reverse treasury rate lock, net of tax provision of \$233	—	(405 )	—
Reclassification of assets held for sale	—	(114 )	—
Total other comprehensive loss	(5,751 )	(98,691 )	(9,590 )
COMPREHENSIVE INCOME (LOSS)	(38,661 )	144,018	272,246
Less: Comprehensive income (loss) attributable to noncontrolling interests	(11,738 )	5,629	(2,948 )
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO LEGG MASON, INC.	\$(26,923)	\$138,389	\$275,194

See Notes to Consolidated Financial Statements

Table of Contents

LEGG MASON, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
(Dollars in thousands)

	Years Ended March 31,		
	2016	2015	2014
<b>STOCKHOLDERS' EQUITY ATTRIBUTABLE TO LEGG MASON, INC.</b>			
<b>COMMON STOCK</b>			
Beginning balance	\$11,147	\$11,717	\$12,534
Stock options exercised	33	71	78
Deferred compensation employee stock trust	2	5	5
Stock-based compensation	14	94	123
Employee tax withholdings by settlement of net share transactions	(41	) (47	) (55
Shares repurchased and retired	(454	) (693	) (968
Ending balance	10,701	11,147	11,717
<b>ADDITIONAL PAID-IN CAPITAL</b>			
Beginning balance	2,844,441	3,148,396	3,449,190
Stock options exercised	9,482	21,994	23,741
Deferred compensation employee stock trust	505	2,218	1,779
Stock-based compensation	65,373	54,935	53,939
Additional tax benefit on Equity Unit exchange in fiscal 2010	9,173	—	—
Employee tax withholdings by settlement of net share transactions	(21,596	) (22,067	) (19,409
Shares repurchased and retired	(209,178	) (355,829	) (359,028
Redeemable noncontrolling interest reclassification for affiliate management equity plans	(5,087	) (5,206	) (1,816
Ending balance	2,693,113	2,844,441	3,148,396
<b>EMPLOYEE STOCK TRUST</b>			
Beginning balance	(29,570	) (29,922	) (32,623
Shares issued to plans	(507	) (2,223	) (1,784
Distributions and forfeitures	3,814	2,575	4,485
Ending balance	(26,263	) (29,570	) (29,922
<b>DEFERRED COMPENSATION EMPLOYEE STOCK TRUST</b>			
Beginning balance	29,570	29,922	32,623
Shares issued to plans	507	2,223	1,784
Distributions and forfeitures	(3,814	) (2,575	) (4,485
Ending balance	26,263	29,570	29,922
<b>RETAINED EARNINGS</b>			
Beginning balance	1,690,055	1,526,662	1,304,259
Net Income (Loss) Attributable to Legg Mason, Inc.	(25,032	) 237,080	284,784
Dividends declared	(87,818	) (73,687	) (62,381
Reclassification for net increase in estimated redemption value of affiliate management equity plans	(963	) —	—
Ending balance	1,576,242	1,690,055	1,526,662
<b>APPROPRIATED RETAINED EARNINGS FOR CONSOLIDATED INVESTMENT VEHICLE</b>			
Beginning balance	—	—	4,829
Net income reclassified to appropriated retained earnings	—	—	(4,829
Ending balance	—	—	—
<b>ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET</b>			
Beginning balance	(60,742	) 37,949	47,539

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Net unrealized losses on investment securities	—	—	(166 )
Net actuarial gains (losses) on defined benefit pension plan	2,774	(9,595 )	—
Reclassification to assets held for sale	—	(114 )	—
Foreign currency translation adjustment	(8,525 )	(88,982 )	(9,424 )
Ending balance	(66,493 )	(60,742 )	37,949
<b>TOTAL STOCKHOLDERS' EQUITY ATTRIBUTABLE TO LEGG MASON, INC.</b>	<b>4,213,563</b>	<b>4,484,901</b>	<b>\$4,724,724</b>
Nonredeemable noncontrolling interest	22,202	—	—
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>\$4,235,765</b>	<b>\$4,484,901</b>	<b>\$4,724,724</b>
See Notes to Consolidated Financial Statements			

83

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Table of Contents

LEGG MASON, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollars in thousands)

	Years Ended March 31,		
	2016	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net Income (Loss)	\$(32,910 )	\$242,709	\$281,836
5.5% Senior Notes Due 2019:			
Loss on extinguishments	—	107,074	—
Allocation of redemption payments	—	(98,418 )	—
Adjustments to reconcile Net Income to net cash provided by operations:			
Impairment of intangible assets	371,000	—	—
Depreciation and amortization	60,297	55,086	62,845
Accretion and amortization of securities discounts and premiums, net	3,140	4,275	3,037
Stock-based compensation	92,927	66,245	66,488
Net losses (gains) on investments	26,056	(13,912 )	(26,805 )
Net losses (gains) of consolidated investment vehicles	2,496	(1,308 )	(643 )
Deferred income taxes	(7,727 )	100,387	118,430
Contingent consideration fair value adjustments	(33,375 )	—	5,000
Other	2,631	(12,939 )	3,276
Decrease (increase) in assets:			
Investment advisory and related fees receivable	34,308	(28,668 )	(2,061 )
Net sales (purchases) of trading and other investments	(82,423 )	47,357	(44,293 )
Other receivables	(9,545 )	19,547	14,105
Other assets	4,947	(9,936 )	(24,042 )
Other assets of consolidated investment vehicles	(1,631 )	114,934	(62,916 )
Increase (decrease) in liabilities:			
Accrued compensation	30,998	(17,727 )	76,968
Deferred compensation	14,316	10,314	(7,191 )
Accounts payable and accrued expenses	(7,593 )	(14,763 )	319
Other liabilities	(11,573 )	1,182	(23,310 )
Other liabilities of consolidated investment vehicles	(1,888 )	(3,321 )	(3,719 )
<b>CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$454,451</b>	<b>\$568,118</b>	<b>\$437,324</b>

Table of Contents

LEGG MASON, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)  
(Dollars in thousands)

	Years Ended March 31,		
	2016	2015	2014
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Payments for fixed assets	\$(40,330 )	\$(45,773 )	\$(40,452 )
Business investments and acquisitions, net of cash acquired of \$9,667 and \$29,830 in fiscal 2016 and 2015, respectively	(234,053 )	(183,747 )	—
Proceeds from sale of businesses and assets	—	47,001	1,351
Change in restricted cash	21,065	(25,571 )	(5,801 )
Purchases of investment securities	—	(2,641 )	(4,335 )
Proceeds from sales and maturities of investments	8,749	2,688	4,306
Purchases of investments by consolidated investment vehicles	—	—	(17,328 )
Proceeds from sales and maturities of investments by consolidated investment vehicles	—	—	199,886
<b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>	<b>(244,569 )</b>	<b>(208,043 )</b>	<b>137,627</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net increase in short-term borrowings	40,000	—	—
Repayments of debt	—	(645,780 )	(500,439 )
Payment of contingent consideration	(22,765 )	—	—
Repayment of long-term debt of consolidated investment vehicles	—	(79,179 )	(133,047 )
Proceeds from issuance of long-term debt	699,793	658,769	393,740
Debt issuance costs	(13,539 )	(5,250 )	(3,940 )
Issuances of common stock for stock-based compensation	10,022	24,288	25,603
Employee tax withholdings by settlement of net share transactions	(21,637 )	(22,114 )	(19,464 )
Repurchases of common stock	(209,632 )	(356,522 )	(359,996 )
Dividends paid	(84,093 )	(70,815 )	(61,966 )
Dividends paid to noncontrolling interest holders	(1,016 )	—	—
Net (redemptions/distributions paid to) subscriptions received and other noncontrolling interests	68,639	(10,459 )	20,438
<b>CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>465,772</b>	<b>(507,062 )</b>	<b>(639,071 )</b>
<b>EFFECT OF EXCHANGE RATES ON CASH</b>	<b>(16,080 )</b>	<b>(41,483 )</b>	<b>(10,894 )</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>659,574</b>	<b>(188,470 )</b>	<b>(75,014 )</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>669,552</b>	<b>858,022</b>	<b>933,036</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$1,329,126</b>	<b>\$669,552</b>	<b>\$858,022</b>
<b>SUPPLEMENTAL DISCLOSURE</b>			
Cash paid for:			
Income taxes, net of refunds of \$(4,689), \$(865), and \$(13,835), respectively	\$23,743	\$19,578	\$10,140
Interest	49,393	59,039	44,295
See Notes to Consolidated Financial Statements			

Table of Contents

LEGG MASON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Amounts in thousands, except per share amounts or unless otherwise noted)

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Legg Mason, Inc. ("Parent") and its subsidiaries (collectively, "Legg Mason" or "the Company") are principally engaged in providing asset management and related financial services to individuals, institutions, corporations and municipalities.

The consolidated financial statements include the accounts of the Parent and its subsidiaries in which it has a controlling financial interest. Generally, an entity is considered to have a controlling financial interest when it owns a majority of the voting interest in an entity. Legg Mason is also required to consolidate any variable interest entity ("VIE") in which it is considered to be the primary beneficiary. See "Consolidation" below and Note 17 for a further discussion of VIEs. All material intercompany balances and transactions have been eliminated.

Certain amounts in prior year financial statements have been reclassified to conform to the current year presentation, including the classification in our Consolidated Balance Sheets of deferred debt issuance costs, as more fully described below.

All references to fiscal 2016, 2015 or 2014, refer to Legg Mason's fiscal year ended March 31 of that year.

Use of Estimates

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and the applicable rules and regulations of the Securities and Exchange Commission, which require management to make assumptions and estimates that affect the amounts reported in the consolidated financial statements and accompanying notes, including revenue recognition, valuation of financial instruments, intangible assets and goodwill, stock-based compensation, income taxes, and consolidation. Management believes that the estimates used are reasonable, although actual amounts could differ from the estimates and the differences could have a material impact on the consolidated financial statements.

Consolidation

In the normal course of its business, Legg Mason sponsors and manages various types of investment vehicles. For its services, Legg Mason is entitled to receive management fees and may be eligible, under certain circumstances, to receive additional subordinated management fees or other incentive fees. Legg Mason's exposure to risk in these entities is generally limited to any equity investment it has made or is required to make, and any earned but uncollected management fees. Legg Mason did not sell or transfer assets to any of these investment vehicles. In accordance with financial accounting standards, Legg Mason consolidates certain sponsored investment vehicles, some of which are designated and reported as consolidated investment vehicles ("CIVs"). The consolidation of sponsored investment vehicles, including those designated as CIVs, has no impact on Net Income (Loss) Attributable to Legg Mason, Inc. and does not have a material impact on Legg Mason's consolidated operating results. The change in the value of all consolidated sponsored investment vehicles, is recorded in Other Non-Operating Income (Expense) and reflected in Net income (loss) attributable to noncontrolling interests.

Certain investment vehicles Legg Mason sponsors and is the manager of are considered to be VIEs (as further described below) while others are considered to be voting rights entities ("VREs") subject to traditional consolidation



concepts based on ownership rights. Sponsored investment vehicles that are considered VREs are consolidated if Legg Mason has a controlling financial interest in the investment vehicle, absent substantive investor rights to replace the manager of the entity (kick-out rights). Legg Mason may also fund the initial cash investment in certain VRE investment vehicles to generate an investment performance track record in order to attract third-party investors in the product. Legg Mason's initial investment in a new product typically represents 100% of the ownership in that product. As further discussed below, these "seed capital investments" are consolidated as long as Legg Mason maintains a controlling financial interest in the product, but they are not designated as CIVs by Legg Mason unless the investment is longer-term. Legg Mason held a longer-term controlling financial interest in one sponsored investment fund VRE, which has third-party investors and was consolidated and included as a CIV prior to the quarter ended March 31, 2015. Prior to March 31, 2015, Legg Mason redeemed a significant portion

## Table of Contents

of its investment in this fund and as a result no longer had a controlling financial interest in the fund; therefore, the fund was not included as a CIV as of or subsequent to March 31, 2015.

A VIE is an entity which does not have adequate equity to finance its activities without additional subordinated financial support; or the equity investors, as a group, do not have the normal characteristics of equity investors for a potential controlling financial interest.

### Investment Company VIEs

For most sponsored investment fund VIEs deemed to be investment companies, including money market funds, Legg Mason determines it is the primary beneficiary of the VIE if it absorbs a majority of the VIE's expected losses, or receives a majority of the VIE's expected residual returns, if any. Legg Mason's determination of expected residual returns excludes gross fees paid to a decision maker if certain criteria relating to the fees are met. In determining whether it is the primary beneficiary of an investment company VIE, Legg Mason considers both qualitative and quantitative factors such as the voting rights of the equity holders; economic participation of all parties, including how fees are earned and paid to Legg Mason; related party (including employees) ownership; guarantees and implied relationships.

Legg Mason concluded it was the primary beneficiary of one sponsored investment fund VIE, which was consolidated (and designated as a CIV) as of March 31, 2016, 2015, and 2014, despite significant third-party investments in this product. As of March 31, 2016, 2015, and 2014, Legg Mason also concluded it was the primary beneficiary of 14, 17, and 17 employee-owned funds it sponsors, respectively, which were consolidated and designated as CIVs.

### Other VIEs

For other sponsored investment funds that do not meet the investment company criteria, Legg Mason determines it is the primary beneficiary of a VIE if it has both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and the obligation to absorb losses, or the right to receive benefits, that potentially could be significant to the VIE.

As of March 31, 2016 and 2015, Legg Mason had a variable interest in four collateralized loan obligations ("CLOs"). Legg Mason concluded it was not the primary beneficiary of these CLOs, which were not consolidated, as it holds no equity interest in these investment vehicles and the level of fees they are expected to pay to Legg Mason is insignificant. As of March 31, 2014, Legg Mason had a variable interest in two of these CLOs, which also were not consolidated during that period.

As of March 31, 2014, Legg Mason concluded that it was the primary beneficiary of another CLO in which it held a variable interest. Although it held no equity interest in this investment vehicle, it had both the power to control the CLO and had a significant variable interest because of the level of its expected subordinated fees. As of March 31, 2014, the balances related to this CLO were consolidated and reported as a CIV in the Company's consolidated financial statements. During the three months ended June 30, 2014, this CLO was substantially liquidated and therefore was not consolidated by Legg Mason as of, or subsequent to, June 30, 2014.

Legg Mason's investment in CIVs as of March 31, 2016 and 2015 was \$13,641 and \$15,553, respectively, which represents its maximum risk of loss, excluding uncollected advisory fees, which were not material. The assets of these CIVs are primarily comprised of investment securities. Investors and creditors of these CIVs have no recourse to the general credit or assets of Legg Mason beyond its investment in these funds.

See Notes 3 and 17 for additional information regarding VIEs and VREs.

### Cash and Cash Equivalents

Cash equivalents are highly liquid investments with original maturities of 90 days or less.

**Restricted Cash**

Restricted cash represents cash collateral required for market hedge arrangements, long-term escrow deposits, and other cash that is not available to Legg Mason for general corporate use.

## Table of Contents

### Financial Instruments

Substantially all financial instruments are reflected in the financial statements at fair value or amounts that approximate fair value, except Legg Mason's long-term debt not designated for a hedging transaction.

As discussed above in "Consolidation," seed capital investments in proprietary fund products are initially consolidated and the individual securities within the portfolio are accounted for as trading investments. Legg Mason consolidates these products as long as it holds a controlling financial interest in the product. Upon deconsolidation, which typically occurs after several years, Legg Mason accounts for its investments in proprietary fund products as equity method investments (further described below) if its ownership is between 20% and 50%, or it otherwise has the ability to significantly influence the financial and operating policies of the investee. For partnerships and LLCs, where third-party investors may have less ability to influence operations, the equity method of accounting is considered if Legg Mason's ownership is greater than 3%. Changes in the fair value of proprietary fund products classified as trading or equity method investments are recognized in Other Non-Operating Income (Expense) on the Consolidated Statements of Income (Loss).

Legg Mason generally redeems its investment in proprietary fund products when the related product establishes a sufficient track record, when third-party investments in the related product are sufficient to sustain the strategy, or when a decision is made to no longer pursue the strategy. The length of time Legg Mason holds a majority interest in a product varies based on a number of factors, such as market demand, market conditions and investment performance. See Notes 3 and 17 for additional information regarding Legg Mason's seed capital investments and the determination of whether investments in proprietary fund products represent VIEs, respectively.

For equity investments in which Legg Mason does not control the investee and is not the primary beneficiary of a VIE, but can exert significant influence over the financial and operating policies of the investee, Legg Mason follows the equity method of accounting. The evaluation of whether Legg Mason can exert control or significant influence over the financial and operational policies of an investee requires significant judgment based on the facts and circumstances surrounding each individual investment. Factors considered in these evaluations may include investor voting or other rights, any influence Legg Mason may have on the governing board of the investee, the legal rights of other investors in the entity pursuant to the fund's operating documents and the relationship between Legg Mason and other investors in the entity. Legg Mason's equity method investees that are investment companies record their underlying investments at fair value. Therefore, under the equity method of accounting, Legg Mason's share of the investee's underlying net income or loss predominantly represents fair value adjustments in the investments held by the equity method investee. Legg Mason's share of the investee's net income or loss is based on the most current information available and is recorded as a net gain (loss) on investments within Non-Operating Income (Expense). A significant portion of earnings (losses) attributable to Legg Mason's equity method investments has offsetting compensation expense adjustments under revenue sharing arrangements and deferred compensation arrangements, therefore, fluctuations in the market value of these investments will not have a material impact on Net Income (Loss) Attributable to Legg Mason, Inc.

Legg Mason also holds debt and marketable equity investments which are classified as trading. Certain investment securities, including those held by CIVs, are also classified as trading securities. These investments are recorded at fair value and unrealized gains and losses are included in current period earnings. Realized gains and losses for all investments are included in current period earnings.

Equity and fixed income securities classified as trading are valued using closing market prices for listed instruments or broker price quotations, when available. Fixed income securities may also be valued using valuation models and estimates based on spreads to actively traded benchmark debt instruments with readily available market prices.

Legg Mason evaluates its non-trading investment securities for "other-than-temporary" impairment. Impairment may exist when the fair value of an investment security has been below the adjusted cost for an extended period of time. If an "other-than-temporary" impairment is determined to exist, the amount of impairment that relates to credit losses is

recognized as a charge to income. As of March 31, 2016, 2015 and 2014, the amount of temporary unrealized losses for investment securities not recognized in income was not material.

For investments in illiquid or privately-held securities for which market prices or quotations may not be readily available, management estimates the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry.

88

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## Table of Contents

In addition to the financial instruments described above and the derivative instruments described below, other financial instruments that are carried at fair value or amounts that approximate fair value include Cash and cash equivalents and Short-term borrowings. The fair value of Long-term debt at March 31, 2016 and 2015, aggregated \$1,773,852 and \$1,166,697, respectively. Except for long-term debt designated for a hedging transaction, these fair values were estimated using publicly quoted market prices and were classified as Level 2 in the fair value hierarchy, as described below. Additionally, the 2.7% Senior Notes due 2019 designated for a hedging transaction are valued as the sum of the amortized cost of the debt and the fair value of the related interest rate contract designated for a hedging transaction which approximates the debt fair value, and was classified as a Level 2 measurement, as discussed below.

### Derivative Instruments

The fair values of derivative instruments are recorded as assets or liabilities on the Consolidated Balance Sheets. Legg Mason has used foreign exchange forwards and interest rate swaps to hedge the risk of movement in exchange rates or interest rates on financial assets and liabilities on a limited basis. Also, Legg Mason has used futures contracts on index funds to hedge the market risk of certain seed capital investments.

With the exception of an interest rate swap and a reverse treasury rate lock contract, as further discussed in Note 6, Legg Mason has not designated any financial instruments for hedge accounting, as defined in the accounting literature, during the periods presented. The gains or losses on derivative instruments not designated for hedge accounting are included as Other operating income (expense) or Other Non-Operating Income (Expense) in the Consolidated Statements of Income (Loss), depending on the strategy. Gains and losses on derivative instruments of CIVs are recorded as Other non-operating income (loss) of consolidated investment vehicles, net, in the Consolidated Statements of Income (Loss), if applicable. See Note 15 for additional information regarding derivatives and hedging.

### Fair Value Measurements

Accounting guidance for fair value measurements defines fair value and establishes a framework for measuring fair value. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Under accounting guidance, a fair value measurement should reflect all of the assumptions that market participants would use in pricing the asset or liability, including assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset, and the risk of non-performance.

The objective of fair value accounting measurements is to reflect, at the date of the financial statements, how much an asset would be sold for in an orderly transaction (as opposed to a distressed or forced transaction) under current market conditions. Specifically, it requires the use of judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. This accounting guidance also relates to other-than-temporary impairments and is intended to bring greater consistency to the timing of impairment recognition. It is also intended to provide greater clarity to investors about the credit and noncredit components of impaired debt securities that are not expected to be sold. The guidance also requires timely disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses.

Fair value accounting guidance also establishes a hierarchy that prioritizes the inputs for valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

Legg Mason's financial instruments are measured and reported at fair value (except debt not designated for a hedging transaction) and are classified and disclosed in one of the following categories:

Level 1 — Financial instruments for which prices are quoted in active markets, which, for Legg Mason, include investments in publicly traded mutual funds with quoted market prices and equities listed in active markets and certain derivative instruments.

Level 2 — Financial instruments for which: prices are quoted for similar assets and liabilities in active markets; prices are quoted for identical or similar assets in inactive markets; or prices are based on observable inputs, other than quoted prices, such as models or other valuation methodologies. For Legg Mason, this category may include fixed income securities, certain proprietary fund products and certain long-term debt.

## Table of Contents

Level 3 — Financial instruments for which values are based on unobservable inputs, including those for which there is little or no market activity. This category includes investments in partnerships, limited liability companies, and private equity funds. This category may also include certain proprietary fund products with redemption restrictions and contingent consideration liabilities.

The valuation of an asset or liability may involve inputs from more than one level of the hierarchy. The level in the fair value hierarchy in which a fair value measurement falls in its entirety is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Certain proprietary fund products and investments held by CIVs are valued at net asset value ("NAV") determined by the applicable fund administrator. These funds are typically invested in exchange traded investments with observable market prices. Their valuations may be classified as Level 1, Level 2 or Level 3 based on whether the fund is exchange traded, the frequency of the related NAV determinations and the impact of redemption restrictions. For investments in illiquid and privately-held securities (private equity and investment partnerships) for which market prices or quotations may not be readily available, management must estimate the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry to which it applies in order to determine fair value. These valuation processes for illiquid and privately-held securities inherently require management's judgment and are therefore classified as Level 3.

Futures contracts are valued at the last settlement price at the end of each day on the exchange upon which they are traded and are classified as Level 1.

As a practical expedient, Legg Mason relies on the NAV of certain investments, classified as Level 2 or Level 3, as their fair value. The NAVs that have been provided by investees are derived from the fair values of the underlying investments as of the reporting date.

Any transfers between categories are measured at the beginning of the period.

See Note 3 for additional information regarding fair value measurements.

### Appropriated Retained Earnings

Prior to June 30, 2014, Legg Mason elected the fair value option for certain eligible assets and liabilities, including corporate loans and debt, of the then consolidated CLO. Upon the election of the fair value option for eligible assets and liabilities of the CLO, Legg Mason recorded a cumulative effect adjustment to Appropriated retained earnings for consolidated investment vehicle on the Consolidated Balance Sheets equal to the difference between the fair values of the CLO's assets and liabilities. This difference was recorded as "Appropriated retained earnings for consolidated investment vehicle" because the investors in the CLO, not Legg Mason shareholders, would ultimately realize any benefits or losses associated with the CLO. Changes in the fair values of the CLO assets and liabilities were recorded as Net income (loss) attributable to noncontrolling interests in the Consolidated Statements of Income (Loss) and Appropriated retained earnings for consolidated investment vehicle in the Consolidated Balance Sheet. The CLO substantially liquidated and was deconsolidated as of June 30, 2014. At March 31, 2014, the CLO was in the final stage of liquidation, and the fair value of its assets and liabilities were substantially equal, and there were no Appropriated retained earnings.

### Fixed Assets

Fixed assets primarily consist of equipment, software and leasehold improvements. Equipment consists primarily of communications and technology hardware and furniture and fixtures. Capitalized software includes both purchased software and internally developed software. The cost of software used under a service contract where Legg Mason



does not own or control the software is expensed over the term of the contract. Fixed assets are reported at cost, net of accumulated depreciation and amortization. Depreciation and amortization are determined by use of the straight-line method. Equipment is depreciated over the estimated useful lives of the assets, generally ranging from three to eight years. Software is amortized over the estimated useful lives of the assets, generally three years. Leasehold improvements are amortized or depreciated over the initial term of the lease unless options to extend are likely to be exercised. Maintenance and repair costs are expensed as incurred. Internally developed software is reviewed periodically to determine if there is a change in the useful life, or if an impairment in value may exist. If impairment is deemed to exist, the asset is written down to its fair value or is written off if the asset is determined to no longer have any value.

## Table of Contents

### Intangible Assets and Goodwill

Legg Mason's identifiable intangible assets consist principally of asset management contracts, contracts to manage proprietary mutual funds or funds-of-hedge funds, and trade names resulting from acquisitions. Intangible assets are amortized over their estimated useful lives, using the straight-line method, unless the asset is determined to have an indefinite useful life. Asset management contracts are amortizable intangible assets that are capitalized at acquisition and amortized over the expected life of the contract. The value of contracts to manage assets in proprietary mutual funds or funds-of-hedge funds and the value of trade names are classified as indefinite-life intangible assets. The assignment of indefinite lives to proprietary fund contracts is based upon the assumption that there is no foreseeable limit on the contract period to manage proprietary funds due to the likelihood of continued renewal at little or no cost. The assignment of indefinite lives to trade names is based on the assumption that they are expected to generate cash flows indefinitely.

Goodwill represents the residual amount of acquisition cost in excess of identified tangible and intangible assets and assumed liabilities. Indefinite-life intangible assets and goodwill are not amortized for financial statement purposes. Given the relative significance of intangible assets and goodwill to the Company's consolidated financial statements, on a quarterly basis Legg Mason considers if triggering events have occurred that may indicate that the fair values have declined below their respective carrying amounts. Triggering events may include significant adverse changes in the Company's business or the legal or regulatory environment, loss of key personnel, significant business dispositions, or other events, including changes in economic arrangements with our affiliates that will impact future operating results. If a triggering event has occurred, the Company will perform quantitative tests, which include critical reviews of all significant factors and assumptions, to determine if any intangible assets or goodwill are impaired. Legg Mason considers factors such as projected cash flows and revenue multiples, to determine whether the value of the assets is impaired and the indefinite-life assumptions are appropriate. If an asset is impaired, the difference between the value of the asset reflected on the consolidated financial statements and its current fair value is recognized as an expense in the period in which the impairment is determined. If a triggering event has not occurred, the Company performs quantitative tests annually at December 31, for indefinite-life intangible assets and goodwill, unless the Company can qualitatively conclude that it is more likely than not that the respective fair values exceed the related carrying values. The fair values of intangible assets subject to amortization are considered for impairment at each reporting period using an undiscounted cash flow analysis. For intangible assets with indefinite lives, fair value is determined from a market participant's perspective based on projected discounted cash flows, which take into consideration estimates of future fees, profit margins, growth rates, taxes, and discount rates. Proprietary fund contracts that are managed and operated as a single unit and meet other criteria may be aggregated for impairment testing. Goodwill is evaluated at the reporting unit level, and is considered for impairment when the carrying value of the reporting unit exceeds the implied fair value of the reporting unit. In estimating the implied fair value of the reporting unit, Legg Mason uses valuation techniques principally based on discounted projected cash flows and EBITDA multiples, similar to techniques employed in analyzing the purchase price of an acquisition. Goodwill is deemed to be recoverable at the reporting unit level, which is also the operating segment level that Legg Mason defines as the Global Asset Management segment. This results from the fact that the chief operating decision maker, Legg Mason's Chief Executive Officer, regularly receives discrete financial information at the consolidated Global Asset Management business level and does not regularly receive discrete financial information, such as operating results, at any lower level, such as the asset management affiliate level. Allocations of goodwill for management restructures, acquisitions, and dispositions are based on relative fair values of the respective businesses restructured, acquired, or divested.

See Note 5 for additional information regarding intangible assets and goodwill and Note 16 for additional business segment information.

### Debt

For the year ended March 31, 2016, Legg Mason elected to early adopt updated accounting guidance which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated long-term debt liability, consistent with the presentation of a debt discount. This updated guidance was adopted on a retrospective basis and, as a result, Legg Mason reclassified unamortized debt issuance costs of \$8,395 from Other non-current assets and \$748 from Other current assets to Long-term debt within the Consolidated Balance Sheet for the year ended March 31, 2015.

#### Contingent Consideration Liabilities

In connection with business acquisitions, Legg Mason may be required to pay additional future consideration based on the achievement of certain designated financial metrics. Legg Mason estimates the fair value of these potential future obligations

## Table of Contents

at the time a business combination is consummated and records a Contingent consideration liability in the Consolidated Balance Sheet.

Legg Mason accretes contingent consideration liabilities to the expected payment amounts over the related earn-out terms until the obligations are ultimately paid, resulting in Interest expense in the Consolidated Statements of Income (Loss). If the expected payment amounts subsequently change, the contingent consideration liabilities are (reduced) or increased in the current period, resulting in a (gain) or loss, which is reflected within Other operating expense in the Consolidated Statements of Income (Loss). See Notes 2 and 8 for additional information regarding contingent consideration liabilities.

### Translation of Foreign Currencies

Assets and liabilities of foreign subsidiaries that are denominated in non-U.S. dollar functional currencies are translated at exchange rates as of the Consolidated Balance Sheet dates. Revenues and expenses are translated at average exchange rates during the period. The gains or losses resulting from translating foreign currency financial statements into U.S. dollars are included in stockholders' equity and comprehensive income (loss). Gains or losses resulting from foreign currency transactions are included in Net Income (Loss).

### Investment Advisory Fees

Legg Mason earns investment advisory fees on assets in separately managed accounts, investment funds, and other products managed for Legg Mason's clients. These fees are primarily based on predetermined percentages of the market value of the assets under management ("AUM"), and are recognized over the period in which services are performed and may be billed in advance of the period earned based on AUM at the beginning of the billing period in accordance with the related advisory contracts. Revenue associated with advance billings is deferred and included in Other current liabilities in the Consolidated Balance Sheets and is recognized over the period earned. Performance fees may be earned on certain investment advisory contracts for exceeding performance benchmarks on a relative or absolute basis, depending on the product, and are recognized at the end of the performance measurement period. Accordingly, neither advanced billings nor performance fees are subject to reversal. The largest portion of performance fees are earned based on 12-month performance periods that end in differing quarters during the year, with a portion also based on quarterly performance periods.

Legg Mason has responsibility for the valuation of AUM, substantially all of which is based on observable market data from independent pricing services, fund accounting agents, custodians or brokers.

### Distribution and Service Fees Revenue and Expense

Distribution and service fees represent fees earned from funds to reimburse the distributor for the costs of marketing and selling fund shares and servicing proprietary funds and are generally determined as a percentage of client assets. Reported amounts also include fees earned from providing client or shareholder servicing, including record keeping or administrative services to proprietary funds, and non-discretionary advisory services. Distribution fees earned on company-sponsored investment funds are reported as revenue. When Legg Mason enters into arrangements with broker-dealers or other third parties to sell or market proprietary fund shares, distribution and servicing expense is accrued for the amounts owed to third parties, including finders' fees and referral fees paid to unaffiliated broker-dealers or introducing parties. Distribution and servicing expense also includes payments to third parties for certain shareholder administrative services and sub-advisory fees paid to unaffiliated asset managers.

### Deferred Sales Commissions

Commissions paid to financial intermediaries in connection with sales of certain classes of company-sponsored mutual funds are capitalized as deferred sales commissions. The asset is amortized over periods not exceeding six years, which represent the periods during which commissions are generally recovered from distribution and service fee revenues and from contingent deferred sales charges ("CDSC") received from shareholders of those funds upon

redemption of their shares. CDSC receipts are recorded as distribution and service fee revenue when received and a reduction of the unamortized balance of deferred sales commissions, with a corresponding expense.

Management periodically tests the deferred sales commission asset for impairment by reviewing the changes in value of the related shares, the relevant market conditions and other events and circumstances that may indicate an impairment in value has occurred. If these factors indicate an impairment in value, management compares the carrying value to the estimated undiscounted cash flows expected to be generated by the asset over its remaining life. If management determines that the deferred sales commission asset is not fully recoverable, the asset will be deemed impaired and a loss will be recorded in the amount by which the recorded amount of the asset exceeds its estimated fair value. For the years ended March 31, 2016,

## Table of Contents

2015 and 2014, no impairment charges were recorded. Deferred sales commissions, included in Other non-current assets in the Consolidated Balance Sheets, were \$6,713 and \$10,422 at March 31, 2016 and 2015, respectively.

### Income Taxes

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the financial statements. Deferred income tax assets are subject to a valuation allowance if, in management's opinion, it is more likely than not that these benefits will not be realized. Legg Mason's deferred income taxes principally relate to net operating loss and other carryforward benefits, business combinations, amortization of intangible assets and accrued compensation.

Under applicable accounting guidance, a tax benefit should only be recognized if it is more likely than not that the position will be sustained based on its technical merits. A tax position that meets this threshold is measured as the largest amount of benefit that has a greater than 50% likelihood of being realized upon settlement by the appropriate taxing authority having full knowledge of all relevant information.

The Company's accounting policy is to classify interest related to tax matters as interest expense and related penalties, if any, as other operating expense.

For the year ended March 31, 2016, Legg Mason elected to early adopt new accounting guidance relating to the balance sheet classification of deferred taxes. The updated guidance requires that all deferred tax assets, liabilities, and any related valuation allowances be classified prospectively as noncurrent in a classified balance sheet.

See Note 7 for additional information regarding income taxes.

### Loss Contingencies

Legg Mason accrues estimates for loss contingencies related to legal actions, investigations, and proceedings, exclusive of legal fees, when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. Related insurance recoveries are recorded separately when the underwriter has confirmed coverage of a specific claim amount. See Note 8 for additional information.

### Stock-Based Compensation

Legg Mason's stock-based compensation includes stock options, an employee stock purchase plan, market-based performance shares payable in common stock, restricted stock awards and units, management equity plans for certain affiliates and deferred compensation payable in stock. Under its stock compensation plans, Legg Mason issues equity awards to directors, officers, and other key employees.

In accordance with the applicable accounting guidance, compensation expense includes costs for all non-vested share-based awards classified as equity at their grant date fair value amortized over the respective vesting periods on the straight-line method. The grant-date fair value of equity-classified share-based awards with immediate vesting is also included in Compensation and benefits expense. Legg Mason determines the fair value of stock options using the Black-Scholes option-pricing model, with the exception of market-based performance grants, which are valued with a Monte Carlo option-pricing model. Legg Mason also determines the fair value of option-like affiliate management equity plan grants using the Black-Scholes option-pricing model, subject to any post-vesting illiquidity discounts. See Note 11 for additional information regarding stock-based compensation.

### Earnings Per Share

Basic earnings per share attributable to Legg Mason, Inc. shareholders ("EPS") is calculated by dividing Net Income (Loss) Attributable to Legg Mason, Inc. (adjusted by earnings allocated to participating securities) by the weighted-average number of shares outstanding. Legg Mason has issued to employees restricted stock that are deemed

to be participating securities prior to vesting, because the unvested restricted shares entitle their holder to nonforfeitable dividend rights. In this circumstance, accounting guidance requires a “two-class method” for EPS calculations that excludes earnings (potentially both distributed and undistributed) allocated to participating securities.

Diluted EPS is similar to basic EPS, but adjusts for the effect of potential common shares unless they are antidilutive. For periods with a net loss, potential common shares other than potentially unvested restricted shares, are considered antidilutive.

See Note 12 for additional discussion of EPS.

## Table of Contents

### Restructuring Costs

As further discussed in Note 2, Legg Mason is restructuring The Permal Group, Ltd. ("Permal") for the combination with EnTrust Capital ("EnTrust"). The costs associated with this restructuring primarily relate to employee termination benefits, including severance and retention incentives, which are recorded as Transition-related compensation in the Consolidated Statement of Income (Loss), and charges for consolidating leased office space, which are recorded as Occupancy in the Consolidated Statement of Income (Loss).

Also, as further discussed in Note 2, in May 2014, Legg Mason acquired QS Investors Holdings, LLC ("QS Investors") and integrated its two existing affiliates, Batterymarch Financial Management, Inc. ("Batterymarch") and Legg Mason Global Asset Allocation, LLC ("LMGAA") into QS Investors to leverage the best aspects of each subsidiary. The costs related to this integration primarily related to employee termination benefits, including severance and retention incentives, which were recorded as Transition-related compensation in the Consolidated Statements of Income (Loss).

### Noncontrolling Interests

Noncontrolling interests include affiliate minority interests, third-party investor equity in consolidated sponsored investment vehicles, and vested affiliate management equity plan interests. For CIVs and other consolidated sponsored investment vehicles with third-party investors, the related noncontrolling interests are classified as redeemable noncontrolling interests if investors in these funds may request withdrawals at any time. Also included in redeemable noncontrolling interests are vested affiliate management equity plan interests for which the holder may, at some point, request settlement of their interests. Redeemable noncontrolling interests are reported in the Consolidated Balance Sheets at their estimated settlement values. When settlement is not expected to occur until a future date, changes in the expected settlement value are recognized over the settlement period as an adjustment from retained earnings. Nonredeemable noncontrolling interests include vested affiliate management equity plan interests that do not permit the holder to request settlement of their interests. Nonredeemable noncontrolling interests are reported in the Consolidated Balance Sheets at their issuance value, together with undistributed net income allocated to noncontrolling interests.

Legg Mason estimates the settlement value of noncontrolling interests as their fair value. For consolidated sponsored investment vehicles, where the investor may request withdrawal at any time, fair value is based on market quotes of the underlying securities held by the investment vehicles. For affiliate minority interests and management equity plan interests, fair value reflects the related total business enterprise value, after appropriate discounts for lack of marketability and control. There may also be features of these equity interests, such as dividend subordination, that are contemplated in their valuations. The fair value of option-like management equity plan interests also relies on Black-Scholes option pricing model calculations, as noted above.

Net income (loss) attributable to noncontrolling interests in the Consolidated Statements Of Income (Loss) includes that share of income (loss) of the respective subsidiary allocated to the minority interest holders. Net income (loss) attributable to noncontrolling interests in the Consolidated Statement of Income (Loss) for the year ended March 31, 2014, also includes Net loss reclassified to Appropriated retained earnings for consolidated investment vehicle.

See Note 14 for additional information regarding noncontrolling interests.

### Related Parties

For its services to sponsored investment funds, Legg Mason earns management fees, incentive fees, distribution and service fees, and other revenue and incurs distribution and servicing and other expenses, as disclosed in the Consolidated Statements of Income. Sponsored investment funds are deemed to be affiliated entities under the related party definition in relevant accounting guidance.



Recent Accounting Developments

In March 2016, the Financial Accounting Standards Board ("FASB") updated the guidance on stock-based compensation accounting. The updated guidance simplifies several aspects of accounting for stock-based compensation including the income tax consequences, classification criteria for awards as either equity or liabilities, and classification of related amounts in statements of cash flows. The guidance will be effective in fiscal 2018, with the option for early adoption in fiscal 2017. Legg Mason is evaluating the impact of its adoption.

Table of Contents

In February 2016, the FASB updated the guidance on accounting for leases. The updated guidance requires that a lessee shall recognize the assets and liabilities that arise from lease transactions. A lessee will recognize a right-of-use asset to use the underlying asset and a liability representing the lease payments. The updated guidance also requires an evaluation at the inception of a contract, to determine whether the contract is or contains a lease. The guidance will be effective in fiscal 2020. Legg Mason is evaluating the impact of its adoption.

In May 2015, the FASB updated the guidance on fair value measurement. The updated guidance removes the requirement for all investments for which fair value is measured using the NAV practical expedient to be categorized within the fair value hierarchy and related sensitivity disclosures. The amount of such investments would instead be disclosed as a reconciling item between the fair value hierarchy table and the investment amounts reported on the balance sheet. This guidance will be effective for Legg Mason in fiscal 2017. Legg Mason is evaluating the impact of its adoption.

In February 2015, the FASB updated the guidance for consolidation requirements. The updated guidance eliminates the presumption that a general partner should consolidate a limited partnership, and modifies the evaluation of whether limited partnerships and similar legal entities are VIEs or VREs. Additionally, the updated guidance affects the conclusion such that certain fees paid to decision makers are no longer variable interests, and certain related party relationships with a sponsored investment fund may no longer require its consolidation. The update also eliminates the deferral of accounting guidance that requires separate evaluation for investment company VIEs and other VIEs. This update will be effective in fiscal 2017, and Legg Mason intends to adopt it on the modified retrospective basis. Legg Mason expects under the new guidance that certain of its sponsored investment vehicles residing in foreign mutual fund trusts will qualify as VIEs and will be subject to consolidation at a lower ownership percentage than the currently employed threshold of 50%.

In May 2014, the FASB updated the guidance on revenue recognition. The updated guidance improves comparability and removes inconsistencies in revenue recognition practices across entities, industries, jurisdictions, and capital markets. In March 2016, the FASB further updated the revenue guidance on determining whether to report revenue on a gross versus net basis. The updated guidance clarifies how entities evaluate principal versus agent aspects of the revenue recognition guidance issued in May 2014. The evaluation will require entities to identify all goods or services to be provided to the customer, and determine whether they obtain control of the good or service before it is transferred to the customer, where control would suggest a principal relationship, which would be accounted for on a gross basis. These updates are effective for Legg Mason in fiscal 2019. Legg Mason is evaluating the impact of its adoption.

Table of Contents

## 2. ACQUISITIONS AND DISPOSITION

## Acquisitions

The following table presents a summary of the acquisition-date fair values of the assets acquired and liabilities assumed for each of Legg Mason's significant recent acquisitions:

	RARE Infrastructure Limited <sup>(1)</sup>	Martin Currie (Holdings) Limited	QS Investors Holdings, LLC	Fauchier Partners Management, Limited
Acquisition Date	October 21, 2015	October 1, 2014	May 30, 2014	March 13, 2013
Purchase price				
Cash	\$ 213,739	\$ 202,577	\$ 11,000	\$ 63,433
Estimated contingent consideration	25,000	75,211	13,370	21,566
Total Consideration	238,739	277,788	24,370	84,999
Fair value of noncontrolling interest	62,722	—	—	—
Total	301,461	277,788	24,370	84,999
Identifiable assets and liabilities				
Cash	9,667	29,389	441	8,156
Investments	—	—	3,281	—
Receivables	6,612	—	2,699	12,174
Indefinite-life intangible fund management contracts	122,755	135,321	—	65,126
Amortizable intangible asset management contracts	67,877	15,234	7,060	2,865
Indefinite-life trade name	4,766	7,130	—	—
Fixed assets	673	784	599	—
Other current liabilities, net	(10,605 )	—	—	(16,667 )
Liabilities, net	(3,948 )	(4,388 )	(6,620 )	—
Pension liability	—	(32,433 )	—	—
Deferred tax liabilities	(58,619 )	(31,537 )	—	(15,638 )
Total identifiable assets and liabilities	139,178	119,500	7,460	56,016
Goodwill	\$ 162,283	\$ 158,288	\$ 16,910	\$ 28,983

(1) Subject to prospective adjustments, including for amounts ultimately realized and adjustments provided for in the share purchase agreement.

## RARE Infrastructure Limited

On October 21, 2015, Legg Mason acquired a majority equity interest in RARE Infrastructure Limited ("RARE Infrastructure"). RARE Infrastructure specializes in global listed infrastructure security investing, is headquartered in Sydney, Australia, and had approximately \$6,800,000 in AUM at the closing of the transaction. Under the terms of the related transaction agreements, Legg Mason acquired a 75% ownership interest in the firm, the firm's management team retained a 15% equity interest and The Treasury Group, a continuing minority owner, retained 10%. The acquisition required an initial cash payment of \$213,739 (using the foreign exchange rate as of October 21, 2015 for the 296,000 Australian dollar payment), which was funded with approximately \$40,000 of net borrowings under the Company's previous revolving credit facility, as further discussed in Note 6, as well as existing cash resources. In August 2015, Legg Mason executed a currency forward contract to economically hedge the risk of movement in the exchange rate between the U.S. dollar and the Australian dollar in which the initial cash payment was denominated. This currency forward contract was closed in October 2015. See Note 15 for additional information regarding derivatives and hedging. In addition, contingent consideration may be due March 31, 2017 and 2018, aggregating up to \$81,320 (using the foreign exchange rate as of March 31, 2016, for the maximum 106,000 Australian dollar amount

per the related agreements), dependent on the achievement of certain net revenue targets, and subject to potential catch-up adjustments extending through March 31, 2019.

Table of Contents

The noncontrolling interests can be put by the holders or called by Legg Mason for settlement at fair value, except for the non-management portion of the noncontrolling interests, which are callable at a pre-agreed formula, as specified in the agreements. The fair value of the noncontrolling interests reflects the total business enterprise value, after appropriate discounts for lack of marketability and control.

The fair value of the acquired amortizable intangible asset management contracts had a useful life of 12 years at acquisition. Purchase price allocated to intangible assets and goodwill is not deductible for Australian tax purposes. Goodwill is principally attributable to synergies expected to arise with RARE Infrastructure.

Management estimated the fair values of the indefinite-life intangible fund management contracts, indefinite-life trade name, and amortizable intangible asset management contracts based upon discounted cash flow analyses, using unobservable market data inputs, which are Level 3 measurements. The significant assumptions used in these analyses at acquisition, including projected annual cash flows, projected AUM growth rates and discount rates, are summarized as follows:

	Projected Cash Flow Growth	Discount Rate
Indefinite-life intangible fund management contracts and indefinite-life trade name	0% to 10% (weighted-average - 7%)	16.5%
	Projected AUM Growth / (Attrition)	Discount Rate
Amortizable intangible asset management contracts	7% / (8)%	16.5%

The fair value of the contingent consideration was estimated using Monte Carlo simulation in a risk-neutral framework with various observable inputs, as well as, with various unobservable data inputs which are Level 3 measurements. The simulation considered variables, including AUM growth and performance fee levels. Consistent with risk-neutral framework, projected AUM and performance fees were dampened by a measure of risk referred to as 'market price of risk' to account for its market risk or systematic risk before calculating the earn-out payments. These earn-out payments were then discounted commensurate with their timing. A summary of various assumption values follows:

AUM growth rates	0% to 14% (weighted-average - 7%)
Performance fee growth rates	0% to 7% (weighted-average - 3%)
Projected AUM and performance fee market price of risk	6.5%
AUM volatility	20.0%
Earn-out payment discount rate	1.9%

Significant increases (decreases) in projected AUM or performance fees would result in a significantly higher (lower) contingent consideration liability fair value.

The contingent consideration liability established at closing had an acquisition date fair value of \$25,000 (using the foreign exchange rate as of October 21, 2015). As of March 31, 2016, the fair value of the contingent consideration liability was \$27,145, of which \$7,001 relates to the first anniversary payment and is included in current Contingent consideration in the Consolidated Balance Sheet, with the remainder included in non-current Contingent consideration in the Consolidated Balance Sheet. The increase of \$2,145 from October 21, 2015, was attributable to changes in the exchange rate, which is included in Accumulated other comprehensive loss, net, as Foreign currency translation adjustment, and accretion. The contingent consideration liability is recorded at an entity with an Australian dollar functional currency, such that related changes in the exchange rate do not impact net income (loss).

The Company has not presented pro forma combined results of operations for this acquisition because the results of operations as reported in the accompanying Consolidated Statements of Income (Loss) would not have been materially different. The financial results of RARE Infrastructure included in Legg Mason's consolidated financial results for the year ended March 31, 2016, include revenues of \$18,420, and did not have a material impact on Net Income (Loss) Attributable to Legg Mason, Inc.

Table of Contents

## Martin Currie (Holdings) Limited

On October 1, 2014, Legg Mason acquired all outstanding equity interests of Martin Currie (Holdings) Limited ("Martin Currie"), an international equity specialist based in the United Kingdom. The acquisition required an initial payment of \$202,577 (using the foreign exchange rate as of October 1, 2014 for the £125,000 contract amount), which was funded from existing cash. In addition, contingent consideration payments may be due March 31 following the second and third anniversaries of closing, aggregating up to approximately \$467,076 (using the foreign exchange rate as of March 31, 2016 for the maximum £325,000 contract amount), inclusive of the payment of certain potential pension and other obligations, and dependent on the achievement of certain financial metrics at March 31, 2017, and 2018, as specified in the share purchase agreement. The agreement provided for a potential first anniversary payment due as of March 31, 2016, however no such payment was due based on relevant financial metrics.

The fair value of the amortizable intangible asset management contracts asset is being amortized over a period of 12 years. Goodwill is principally attributable to synergies expected to arise with Martin Currie. These acquired intangible assets and goodwill are not deductible for U.K. tax purposes.

Management estimated the fair values of the indefinite-life intangible fund management contracts, indefinite-life trade name, and amortizable intangible asset management contracts based upon discounted cash flow analyses, using unobservable market data inputs, which are Level 3 measurements. The significant assumptions used in these analyses at acquisition, including projected annual cash flows, projected AUM growth rates and discount rates, are summarized as follows:

	Projected Cash Flow Growth	Discount Rate
Indefinite-life intangible fund management contracts and indefinite-life trade name	0% to 25% (weighted-average - 11%)	15.0%
	Projected AUM Growth / (Attrition)	Discount Rate
Amortizable intangible asset management contracts	6% / (17)%	15.0%

The fair value of the contingent consideration was measured using Monte Carlo simulation with various unobservable market data inputs, which are Level 3 measurements. The simulation considered variables, including AUM growth, performance fee levels and relevant product performance. Projected AUM, performance fees and earn-out payments were discounted as appropriate. A summary of various assumption values follows:

AUM growth rates	0% to 28% (weighted-average - 14%)
Performance fee growth rates	0% to 30% (weighted-average - 15%)
Discount rates:	
Projected AUM	13.0%
Projected performance fees	15.0%
Earn-out payments	1.3%
AUM volatility	18.8%

Significant future increases (decreases) in projected AUM or performance fees would result in a significantly higher (lower) contingent consideration liability fair value.

The contingent consideration liability established at closing had an acquisition date fair value of \$75,211 (using the foreign exchange rate as of October 1, 2014). Actual payments to be made may also include amounts for certain potential pension and other obligations that are accounted for separately. As of March 31, 2016, the fair value of the

contingent consideration liability was \$41,222, a decrease of \$28,892 from March 31, 2015. During the year ended March 31, 2016, a decrease in projected AUM and performance fees resulted in a \$28,361 reduction in the estimated contingent consideration liability, recorded as a credit to Other operating expense in the Consolidated Statement of Income (Loss). Changes related to the exchange rate of \$531 for the year ended March 31, 2016, which are included in Accumulated other comprehensive loss, net, as Foreign currency translation adjustment, net of accretion, also impacted the contingent consideration liability. The contingent consideration liability is recorded at an entity with a British pound functional currency, such that related changes in the exchange rate do not impact net income (loss). The total contingent consideration liability as of March 31, 2016,



Table of Contents

includes \$12,846 related to the second anniversary payment, which is included in current Contingent consideration in the Consolidated Balance Sheet, with the remainder included in non-current Contingent consideration in the Consolidated Balance Sheet.

The Company has not presented pro forma combined results of operations for this acquisition because the results of operations as reported in the accompanying Consolidated Statements of Income (Loss) would not have been materially different. The financial results of Martin Currie included in Legg Mason's consolidated financial results for the year ended March 31, 2015, include revenues of \$32,293 and did not have a material impact on Net Income (Loss) Attributable to Legg Mason, Inc.

**Martin Currie Defined Benefit Pension Plan**

Martin Currie sponsors a retirement and death benefits plan, a defined benefit pension plan with assets held in a separate trustee-administered fund. Plan assets are measured at fair value and comprised of 60% equities (Level 1) and 40% bonds (Level 2) as of March 31, 2016, and 58% equities (Level 1) and 42% bonds (Level 2) as of March 31, 2015. Assumptions used to determine the expected return on plan assets targets a 55% / 45% equity/bond allocation with reference to the 15-year FTSE U.K. Gilt yield for equities and U.K. long-dated bond yields for bonds. Plan liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate on a high quality bond in the local U.K. market and currency. There were no significant concentrations of risk in plan assets as of March 31, 2016 or 2015. The most recent actuarial valuation was performed as of May 31, 2013, which was updated through the acquisition and at subsequent balance sheet dates. Accrual of service credit under the plan ceased on October 3, 2014.

The resulting net benefit obligation, comprised as follows, is included in the March 31, 2016 and 2015, Consolidated Balance Sheets as Other non-current liabilities:

	2016	2015
Fair value of plan assets (at 5.2 % and 6.3%, respectively, expected weighted-average long-term return)	\$57,253	\$59,404
Benefit obligation (at 3.6% and 3.3%, respectively, discount rate)	(90,010 )	(98,110 )
Unfunded status (excess of benefit obligation over plan assets)	\$(32,757)	\$(38,706)

The change in the benefit obligation is summarized below:

	Year ended March 31, 2016	Period from Acquisition through March 31, 2015
Beginning benefit obligation	\$98,110	\$ 91,750
Interest costs	3,268	1,730
Actuarial (gain) loss	(6,922 )	14,461
Benefits paid	(1,524 )	(762 )
Plan curtailments	—	(789 )
Exchange rate changes	(2,922 )	(8,280 )
Ending benefit obligation	\$90,010	\$ 98,110

Table of Contents

The change in plan assets is summarized below:

	Year ended March 31, 2016	Period from Acquisition through March 31, 2015
Beginning plan assets	\$59,404	\$ 59,317
Actual return on plan assets	(984 )	6,028
Employer contributions	2,262	1
Benefits paid	(1,524 )	(762 )
Exchange rate changes	(1,905 )	(5,180 )
Ending plan assets	\$57,253	\$ 59,404

For the years ended March 31, 2016 and 2015, a net periodic loss (gain) of \$92 and \$(815), respectively, was included in Compensation and benefits expense in the Consolidated Statements of Income (Loss).

The components of the net periodic loss (gain) for the year ended March 31, 2016, and for the period from acquisition through March 31, 2015, are as follows:

	2016	2015
Interest costs	\$3,268	\$1,730
Expected return on plan assets	(3,176 )	(1,756 )
Curtailment gain recognized	—	(789 )
Net periodic benefit loss (gain)	\$92	\$(815 )

Net actuarial losses of \$6,821 and \$9,595 were included in Accumulated other comprehensive loss, net, in the Consolidated Balance Sheets at March 31, 2016 and 2015, respectively.

As of March 31, 2016, the plan expects to make benefit payments over the next 10 fiscal years as follows:

2017	\$1,195
2018	1,281
2019	1,559
2020	1,537
2021	1,884
2022 - 2026	14,789

The contingent consideration payments are expected to provide some, if not all, funding of the net plan benefit obligation, through a provision of the share purchase agreement requiring certain amounts to be paid to the plan. Any contingent consideration payments to the plan are based on determination of the plan benefit obligation under local technical provisions utilized by the plan trustees. Absent any such funding or any regulatory requirement for additional payments, Martin Currie expects to contribute \$2,156 to the plan during the year ending March 31, 2017.

The contingent consideration provisions of the share purchase agreement also require a designated percentage of the earn-out payments, net of any pension contribution, to be allocated to fund an incentive plan for Martin Currie's management. No payments to employees under the arrangement will be made until the end of the earn-out period. The estimated payment (adjusted quarterly) is being amortized over the earn-out term.



Table of Contents

## Other

In December 2015, Martin Currie acquired certain assets of PK Investment Management, LLP ("PK Investments"), a London based equity manager, for an initial cash payment of \$4,981 and an estimated contingent payment of \$2,469 due on December 31, 2017. The amount of any ultimate contingent payment will be based on certain financial metrics. The initial cash payment was funded with existing cash resources. In connection with the acquisition, Legg Mason recognized indefinite-life intangible fund management contracts and goodwill of \$6,619 and \$827, respectively.

## QS Investors Holdings, LLC

Effective May 31, 2014, Legg Mason acquired all of the outstanding equity interests of QS Investors, a customized solutions and global quantitative equities provider. The initial purchase price was a cash payment of \$11,000, funded from existing cash. In addition, contingent consideration of up to \$10,000 and \$20,000 for the second and fourth anniversary payments may be due in July 2016 and July 2018, respectively, dependent on the achievement of certain net revenue targets, and subject to a potential catch-up adjustment in the fourth anniversary payment for any second anniversary payment shortfall.

The fair value of the amortizable intangible asset management contracts had a useful life of 10 years at acquisition. Purchase price allocated to goodwill is expected to be deductible for U.S. tax purposes over a period of 15 years.

Management estimated the fair values of the amortizable intangible asset management contracts based upon a discounted cash flow analysis, and the contingent consideration expected to be paid and discounted, based upon probability-weighted revenue projections, using unobservable market data inputs, which are Level 3 measurements. The significant assumptions used in these analyses at acquisition including projected annual cash flows, revenues and discount rates, are summarized as follows:

Amortizable intangible asset management contracts	Projected Cash Flow Attrition, Net (10.0)%	Discount Rate 15.0%
Contingent consideration	Projected Revenue Growth Rates 0% to 10% (weighted-average - 6%)	Discount Rates 1.2% / 2.1%

Goodwill is principally attributable to synergies expected to arise with QS Investors.

The contingent consideration liability established at closing had an acquisition date fair value of \$13,370. As of March 31, 2016, the fair value of the contingent consideration liability has accreted to \$13,749, an increase of \$196 from March 31, 2015. Of the \$13,749, \$6,549 relates to the second anniversary payment and is included in current Contingent consideration in the Consolidated Balance Sheet, with the remainder included in non-current Contingent consideration in the Consolidated Balance Sheet as of March 31, 2016.

The Company has not presented pro forma combined results of operations for this acquisition because the results of operations as reported in the accompanying Consolidated Statements of Income (Loss) would not have been materially different. The financial results of QS Investors included in Legg Mason's consolidated financial results for the year ended March 31, 2015, include revenues of \$12,340 and did not have a material impact on Net Income (Loss) Attributable to Legg Mason, Inc.

Legg Mason integrated two existing affiliates, Batterymarch and LMGAA, into QS Investors to capture synergies and leverage the best capabilities of each entity. In connection with the integration, total charges for restructuring and transition costs of \$38,404 were recognized through the completion of the plan in March 31, 2015, which includes \$35,846, and \$2,558 for the years ended March 31, 2015 and 2014, respectively, primarily recorded in Compensation and benefits in the Consolidated Statements of Income (Loss). These costs were primarily comprised of charges for

employee termination benefits, including severance and retention incentives, as well as real estate related charges. Any additional charges related to the integration are not expected to be material.

Table of Contents

The table below presents a summary of changes in the restructuring and transition-related liability from December 31, 2013 through March 31, 2016 and cumulative charges incurred through the completion of the plan in fiscal 2015:

	Compensation	Other	Total
Balance as of December 31, 2013	\$ —	\$—	\$—
Accrued charges	2,161	111	2,272
Balance as of March 31, 2014	2,161	111	2,272
Accrued charges	22,897	9,720	(1)32,617
Payments	(24,658 )	(3,940 )	(28,598 )
Balance as of March 31, 2015	400	5,891	6,291
Payments	(400 )	(2,148 )	(2,548 )
Balance as of March 31, 2016	\$ —	\$3,743	\$3,743
Non-cash charges <sup>(2)</sup>			
Year ended March 31, 2014	\$ —	\$286	\$286
Year ended March 31, 2015	1,659	1,570	3,229
Total	\$ 1,659	\$1,856	\$3,515

Cumulative charges incurred through March 31, 2015 \$ 26,717 \$11,687 \$38,404

(1)Includes lease loss reserve of \$6,760 for space permanently abandoned.

(2)Includes stock-based compensation expense and accelerated fixed asset depreciation.

**Fauchier Partners Management, Limited**

On March 13, 2013, Permal, a wholly-owned subsidiary of Legg Mason, acquired all of the outstanding share capital of Fauchier Partners Management, Limited ("Fauchier"), a European based manager of funds-of-hedge funds. The initial purchase price was a cash payment of \$63,433, which was funded from existing cash resources. In May 2015, Legg Mason paid contingent consideration of \$22,765 (using the exchange rate as of May 5, 2015 for the maximum £15,000 payment amount) for the second anniversary payment. Additional contingent consideration of up to approximately \$28,743 (using the exchange rate as of March 31, 2016 for the £20,000 maximum contract amount), may be due on or about the fourth anniversary of closing, dependent on achieving certain levels of revenue, net of distribution costs.

The fair value of the amortizable intangible asset management contracts is being amortized over a period of six years. These acquired intangible assets and goodwill are not deductible for U.K. tax purposes.

Management estimated the fair values of the indefinite-life intangible fund management contracts based upon discounted cash flow analyses, and the contingent consideration expected to be paid based upon probability-weighted revenue projections, using unobservable market data inputs, which are Level 3 measurements. As is typical with the acquisition of a portion of a business from a larger financial services firm with other related operations, Legg Mason expected some initial contraction in the acquired business. The significant assumptions used in these analyses at acquisition, including projected annual cash flows, revenues and discount rates, are summarized as follows:

	Projected Cash Flow Growth Rates	Discount Rate
Indefinite-life intangible fund management contracts	(35)% to 11% (weighted-average - 6%)	16.0%
	Projected Revenue Growth Rates	Discount Rate
Contingent consideration	(16)% to 3% (weighted-average - (5)%)	2.0%

As of March 31, 2016, no contingent consideration liability was included in the Consolidated Balance Sheet, and a liability of \$27,117 was included as of March 31, 2015. During the three months ended December 31, 2015, due to

lower actual and expected performance fees earned over the earn out period, the contingent consideration liability was reduced by \$5,014, recorded as a credit to Other operating expense in the Consolidated Statement of Income (Loss). The decrease of \$27,117 from March 31, 2015, reflects this reduction and the payment discussed above, offset in part by changes in the exchange

102

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Table of Contents

rate, net of accretion. In December 2015, Legg Mason closed the currency forward contracts that were previously executed to economically hedge the risk of movements in the exchange rate between the U.S. dollar and the British pound in which the estimated contingent liability payment amounts were denominated. See Note 15 for additional information regarding derivatives and hedging.

**Precidian Investments, LLC**

On January 22, 2016, Legg Mason acquired a minority equity position in Precidian Investments, LLC ("Precidian"), a firm specializing in creating innovative products and solutions and solving market structure issues, particularly with regard to the Exchange Traded Funds marketplace.

The transaction required a cash payment, which was funded from existing cash resources. Under the terms of the transaction, Legg Mason acquired series B preferred units of Precidian that entitle Legg Mason to approximately 20% of the voting and economic interests of Precidian, along with customary preferred equity protections. At its sole option during the 48 months following the initial investment, Legg Mason may, subject to satisfaction of certain closing conditions, convert its preferred units to 75% of the common equity of Precidian on a fully diluted basis.

Legg Mason accounts for its investment in Precidian, which is included in Other assets in the Consolidated Balance Sheet as of March 31, 2016, under the equity method of accounting.

**EnTrustPermal**

On May 2, 2016, Legg Mason closed a transaction to combine Permal, Legg Mason's existing hedge fund platform, with EnTrust, an alternative asset management firm with largely complimentary investment strategies, investor base and business mix to Permal. In connection with the combination, Legg Mason expects to incur total restructuring and transition-related charges of approximately \$100,000, primarily comprised of charges for employee termination benefits, including severance and retention incentives, and real estate related charges. Charges for restructuring and transition costs for the year ended March 31, 2016, were \$43,296, primarily recorded as Transition-related compensation in the Consolidated Statement of Income (Loss). Legg Mason expects that approximately \$40,000 to \$50,000 of the remaining anticipated costs associated with the combination will be incurred in the year ending March 31, 2017.

The table below presents a summary of changes in the restructuring and transition-related liability from December 31, 2015 through March 31, 2016 and cumulative charges incurred through March 31, 2016:

	Compensation	Other	Total
Balance as of December 31, 2015	\$ —	\$—	\$—
Accrued charges	31,581	9,981	(1)41,562
Payments	(21,938	) (2,097	) (24,035 )
Balance as of March 31, 2016	\$ 9,643	\$7,884	\$ 17,527
Non-cash charges <sup>(2)</sup>			
Year ended March 31, 2016	\$ 591	\$1,143	\$ 1,734
Cumulative charges incurred through March 31, 2016	\$ 32,172	\$11,124	\$ 43,296

(1)Includes lease loss reserve of \$7,212 for space permanently abandoned.

(2)Includes stock-based compensation expense and accelerated fixed asset depreciation.

**Clarion Partners**

On April 13, 2016, Legg Mason acquired a majority equity interest in Clarion Partners, a diversified real estate asset management firm based in New York. Clarion Partners managed approximately \$41,500,000 in AUM as of April 30, 2016.



See Note 18 for additional information regarding the acquisitions of EnTrust and Clarion Partners.

Disposition

Legg Mason Investment Counsel & Trust

On November 7, 2014, Legg Mason completed the previously announced sale of all of its equity interests in Legg Mason Investment Counsel & Trust Company N.A. ("LMIC") for proceeds of \$47,000 to Stifel Financial Corporation's Global

103

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Table of Contents

Wealth Management segment. The sale did not have a material impact on Legg Mason's consolidated financial condition or results of operations.

## 3. INVESTMENTS AND FAIR VALUES OF ASSETS AND LIABILITIES

The disclosures below include details of Legg Mason's financial assets and financial liabilities that are measured at fair value, excluding the financial assets and financial liabilities of CIVs. See Note 17, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the assets and liabilities of CIVs that are measured at fair value.

The fair values of financial assets and (liabilities) of the Company were determined using the following categories of inputs:

	As of March 31, 2016			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Cash equivalents: <sup>(1)</sup>				
Money market funds	\$ 1,057,916	\$ —	\$ —	\$ 1,057,916
Time deposits and other	—	35,265	—	35,265
Total cash equivalents	1,057,916	35,265	—	1,093,181
Trading investments of proprietary fund products and other trading investments: <sup>(2)</sup>				
Seed capital investments	205,608	120,216	112	325,936
Other <sup>(3)</sup>	65,112	2,352	—	67,464
Trading investments relating to long-term incentive compensation plans <sup>(4)</sup>	105,979	585	—	106,564
Equity method investments relating to proprietary fund products and long-term incentive compensation plans: <sup>(5)</sup>				
Seed capital investments	1,329	7,575	—	8,904
Investments related to long-term incentive compensation plans	—	6,467	—	6,467
Total current investments <sup>(6)</sup>	378,028	137,195	112	515,335
Equity method investments in partnerships and LLCs: <sup>(5)(7)</sup>				
Seed capital investments	—	—	20,439	20,439
Investments related to long-term incentive compensation plans	—	—	7,501	7,501
Other	—	—	9,352	9,352
Investments in partnerships and LLCs <sup>(7)</sup>	—	—	8,013	8,013
Derivative assets <sup>(7)(8)</sup>	1,051	7,599	—	8,650
Other investments <sup>(7)</sup>	—	—	83	83
Total	\$ 1,436,995	\$ 180,059	\$ 45,500	\$ 1,662,554
Liabilities:				
Contingent consideration liabilities <sup>(9)</sup>	—	—	(84,585 )	(84,585 )
Derivative liabilities <sup>(8)</sup>	(18,079 )	—	—	(18,079 )
Total	\$(18,079 )	\$ —	\$(84,585 )	\$(102,664 )



Table of Contents

	As of March 31, 2015			
	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
Cash equivalents: <sup>(1)</sup>				
Money market funds	\$353,265	\$—	\$—	\$353,265
Time deposits and other	—	47,035	—	47,035
Total cash equivalents	353,265	47,035	—	400,300
Trading investments of proprietary fund products and other trading investments: <sup>(2)</sup>				
Seed capital investments	259,840	85,220	186	345,246
Other	9,807	2,981	—	12,788
Trading investments relating to long-term incentive compensation plans <sup>(4)</sup>	80,529	—	—	80,529
Equity method investments relating to proprietary fund products and long-term incentive compensation plans: <sup>(5)</sup>				
Seed capital investments	2,148	5,296	—	7,444
Investments related to long-term incentive compensation plans	—	8,728	—	8,728
Total current investments <sup>(6)</sup>	352,324	102,225	186	454,735
Equity method investments in partnerships and LLCs: <sup>(5)(7)</sup>				
Seed capital investments	—	—	23,796	23,796
Investments related to long-term incentive compensation plans	—	—	5,595	5,595
Other	—	—	18,953	18,953
Investments in partnerships and LLCs <sup>(7)</sup>	—	—	14,511	14,511
Derivative assets <sup>(7)(8)</sup>	580	5,462	—	6,042
Other investments <sup>(7)</sup>	—	—	77	77
Total	\$706,169	\$154,722	\$63,118	\$924,009
Liabilities:				
Contingent consideration liabilities <sup>(9)</sup>	—	—	(110,784)	(110,784)
Derivative liabilities <sup>(8)</sup>	(8,665)	—	—	(8,665)
Total	\$(8,665)	\$—	\$(110,784)	\$(119,449)

Cash equivalents include highly liquid investments with original maturities of 90 days or less. Cash investments in actively traded money market funds are measured at NAV and are classified as Level 1. Cash investments in time deposits and other are measured at amortized cost, which approximates fair value because of the short time between purchase of the instrument and its expected realization, and are classified as Level 2.

Trading investments of proprietary fund products and other trading investments consist of approximately 68% and 32% of equity and debt securities, respectively, as of March 31, 2016, and approximately 63% and 37% of equity and debt securities, respectively, as of March 31, 2015.

Includes \$54,392 in noncontrolling interests associated with consolidated seed investment products as of March 31, 2016.

Primarily mutual funds where there is minimal market risk to the Company as any change in value is primarily offset by an adjustment to compensation expense and related deferred compensation liability.

Legg Mason's equity method investments that are investment companies record underlying investments at fair value. Therefore, fair value is measured using Legg Mason's share of the investee's underlying net income or loss, which is predominately representative of fair value adjustments in the investments held by the equity method investee.

- (6) Excludes seed capital investments of \$13,641 and \$15,553 related to Legg Mason's investments in CIVs as of March 31, 2016 and 2015, respectively.
- (7) Amounts are included in Other non-current assets in the Consolidated Balance Sheets for each of the periods presented.
- (8) See Note 15.
- (9) See Note 2 and Note 8.

Table of Contents

Proprietary fund products include seed capital investments made by Legg Mason to fund new investment strategies and products. Legg Mason had seed capital investments in proprietary fund products, which totaled \$368,920 and \$392,039, as of March 31, 2016 and 2015, respectively, which are substantially comprised of investments in 63 funds and 52 funds, respectively, that are individually greater than \$1,000, with minimal third-party investment, and together comprise over 90% of the total seed capital investments at each period end.

See Notes 1 and 17 for information regarding the determination of whether investments in proprietary fund products represent VIEs and consolidation.

Substantially all of the above financial instruments where valuation methods rely on other than observable market inputs as a significant input utilize the equity method, the cost method, or NAV practical expedient discussed below, such that measurement uncertainty has little relevance.

The net realized and unrealized gain (loss) for investment securities classified as trading was \$(27,654), \$10,545, and \$22,963 for the years ended March 31, 2016, 2015, and 2014, respectively.

The net unrealized gains (losses) relating to trading investments still held as of the reporting dates were \$(35,111), \$(10,858), and \$26,618 for the years ended March 31, 2016, 2015, and 2014, respectively.

Table of Contents

The changes in financial assets and (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the years ended March 31, 2016 and 2015, are presented in the tables below:

	Value as of March 31, 2015	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of March 31, 2016
Assets:							
Trading investments of seed capital investments in proprietary fund products	\$186	\$1	\$(80 )	\$—	\$	-\$ 5	\$112
Investments in partnerships and LLCs	14,511	—	(27 )	(5,647 )	—	(824 )	8,013
Equity method investments in partnerships and LLCs:							
Seed capital investments	23,796	678	—	(3,127 )	—	(908 )	20,439
Investments related to long-term incentive compensation plans	5,595	1,906	—	—	—	—	7,501
Other	18,953	—	(6,774 )	(2,037 )	—	(790 )	9,352
Other investments	77	—	—	—	—	6	83
	\$63,118	\$2,585	\$(6,881)	\$(10,811)	\$	-\$ (2,511)	\$45,500
Liabilities:							
Contingent consideration liabilities n/a - not applicable	\$(110,784)	\$(27,457)	n/a	\$ 22,765	n/a	\$ 30,891	\$(84,585)

Table of Contents

	Value as of March 31, 2014	Purchases	Sales	Redemptions/Settlements/ Other	Transfers	Realized and unrealized gains/(losses) net	Value as of March 31, 2015
<b>Assets:</b>							
Trading investments of seed capital investments in proprietary fund products	\$190	\$2	\$(27)	\$ —		\$ —\$ 21	\$186
Investments in partnerships and LLCs	21,586	—	(24)	(5,108)	—	(1,943)	14,511
Equity method investments in partnerships and LLCs:							
Seed capital investments	33,611	725	(11,617)	1,426	—	(349)	23,796
Investments related to long-term incentive compensation plans	4,284	1,311	—	—	—	—	5,595
Other	25,078	12	(2,484)	(2,547)	—	(1,106)	18,953
Other investments	90	—	—	—	—	(13)	77
	\$84,839	\$2,050	\$(14,152)	\$ (6,229)	\$ —	—\$ (3,390)	\$63,118
<b>Liabilities:</b>							
Contingent consideration liabilities	\$(29,553)	\$(88,581)	n/a	\$ —	n/a	\$ 7,350	\$(110,784)
n/a - not applicable							

Realized and unrealized gains and losses recorded for Level 3 investments are primarily included in Other Non-Operating Income (Expense) in the Consolidated Statements of Income (Loss). The change in unrealized gains (losses) for Level 3 investments and liabilities still held at the reporting date was \$24,182, \$2,439, \$(5,210) and for the years ended March 31, 2016, 2015, and 2014, respectively.

There were no significant transfers between Level 1 and Level 2 during the years ended March 31, 2016 and 2015.



Table of Contents

As a practical expedient, Legg Mason relies on the NAV of certain investments as their fair value. The NAVs that have been provided by the investees have been derived from the fair values of the underlying investments as of the respective reporting dates. The following table summarizes, as of March 31, 2016 and 2015, the nature of these investments and any related liquidation restrictions or other factors which may impact the ultimate value realized:

Category of Investment	Investment Strategy	Fair Value		As of March 31, 2016	
		Determined Using NAV	March 31, 2015	Unfunded Commitments	Remaining Term
Funds-of-hedge funds	Global macro, fixed income, long/short equity, natural resources, systematic, emerging market, European hedge	\$ 19,139(1)	\$23,787	n/a	n/a
Hedge funds	Fixed income - developed market, event driven, fixed income - hedge, relative value arbitrage, European hedge	11,403	14,515	\$20,000	n/a
Private equity funds	Long/short equity	20,471 (2)	23,563	8,254	Up to 8 years
Other	Various	678	1,129	n/a	Various (3)
Total		\$51,691(4)	\$62,994(4)	\$28,254	

n/a - not applicable

(1) Liquidation restrictions: 2% daily redemption, 11% monthly redemption and 87% quarterly redemption as of March 31, 2016.

(2) Liquidations are expected over the remaining term.

(3) Of this balance, 28% has a remaining term of less than one year and 72% has a remaining term of 16 years.

(4) Comprised of 1%, 36%, and 63% of Level 1, Level 2, and Level 3 assets, respectively, as of March 31, 2016 and 38% and 62% of Level 2 and Level 3 assets, respectively, as of March 31, 2015.

There are no current plans to sell any of these investments held as of March 31, 2016.

As of March 31, 2016 and 2015, Legg Mason did not hold any available-for-sale investments.

#### 4. FIXED ASSETS

The following table reflects the components of fixed assets as of March 31:

	2016	2015
Equipment	\$ 150,259	\$ 152,893
Software	293,844	269,745
Leasehold improvements	199,354	203,420
Total cost	643,457	626,058
Less: accumulated depreciation and amortization	(480,152 )	(446,452 )
Fixed assets, net	\$ 163,305	\$ 179,606

Depreciation and amortization expense related to fixed assets was \$55,318, \$52,461, and \$50,531 for the years ended March 31, 2016, 2015, and 2014, respectively. The expense includes accelerated depreciation and amortization of \$4,147 in fiscal 2016 primarily related to reduced space requirements and the restructuring of Permal for the combination with EnTrust, \$1,265 in fiscal 2015 primarily related to the integration of Batterymarch into QS Investors, and \$2,542 in fiscal 2014 primarily related to various corporate initiatives.



Table of Contents

## 5. INTANGIBLE ASSETS AND GOODWILL

Goodwill and indefinite-life intangible assets are not amortized, and the values of other identifiable intangible assets are amortized over their useful lives, unless the assets are determined to have indefinite useful lives. Goodwill and indefinite-life intangible assets are analyzed to determine if the fair value of the assets exceeds the book value. Intangible assets subject to amortization are considered for impairment at each reporting period. If the fair value is less than the book value, Legg Mason will record an impairment charge.

The following table reflects the components of intangible assets as of:

	March 31, 2016	March 31, 2015
Amortizable intangible asset management contracts		
Cost	\$259,513	\$188,312
Accumulated amortization	(171,169 )	(166,583 )
Net <sup>(1)</sup>	88,344	21,729
Indefinite-life intangible assets		
U.S. domestic mutual fund management contracts	2,106,351	2,106,351
Permal funds-of-hedge funds management contracts	334,104	698,104
Other fund management contracts <sup>(1)</sup>	560,499	427,816
Trade names <sup>(1)</sup>	57,187	59,334
	3,058,141	3,291,605
Intangible assets, net	\$3,146,485	\$3,313,334

(1) As of March 31, 2016, Amortizable intangible asset management contracts, net, Other fund management contracts, and Trade names include \$69,610, \$130,419, and \$5,063, respectively, related to the acquisition of RARE Infrastructure. See Note 2 for additional information.

Certain of Legg Mason's intangible assets are denominated in currencies other than the U.S. dollar and balances related to these assets will fluctuate with changes in the related foreign currency exchange rates.

Legg Mason completed its annual impairment testing process as of December 31, 2015, and determined that the carrying value of the Permal indefinite-life funds-of-hedge funds management contracts intangible asset, inclusive of the related indefinite-life funds-of-hedge funds management contracts intangible asset from Fauchier, and the Permal trade name asset exceeded their respective fair values, and the assets were impaired by an aggregate amount of \$371,000. The impairment charges resulted from a number of current trends and factors, including (i) periods of moderate inflows or outflows over recent years and related reductions in AUM; (ii) reduced growth assumptions for the next five years; (iii) a decrease in projected margins for the next two years; and (iv) an increase in the rate used to discount projected future cash flows primarily due to company specific factors including continued market influences. These changes resulted in a reduction of the projected cash flows and Legg Mason's overall assessment of fair value of the assets such that the fair values of the Permal funds-of-hedge funds contracts asset and Permal trade name declined below their carrying values, and accordingly were impaired by \$364,000 and \$7,000, respectively.

Management estimated the fair values of these assets based upon discounted cash flow analyses using unobservable market data inputs, which are Level 3 measurements. The significant assumptions used in these cash flow analyses included projected revenue growth rates and discount rates. Total revenues related to the Permal funds-of-hedge funds contracts were assumed to have annual growth rates ranging from (6)% to 6% (average - 5%), and the projected cash flows from the Permal funds-of-hedge funds contracts were discounted at 16.5%.

Projected revenue growth rates for these assets are most dependent on client AUM flows, changes in market conditions, and product investment performance. Discount rates are also influenced by changes in market conditions,

as well as interest rates and other factors. Decreases in the projected revenue growth rates and/or increases in the discount rates could result in lower fair value measurements and potential additional impairments.

There were no other impairments to indefinite-life intangible assets, amortizable management contracts intangible assets, or goodwill as of December 31, 2015. Legg Mason also determined that no triggering events occurred as of March 31, 2016, that would require further impairment testing.

Table of Contents

The December 31, 2015, assessed fair value of the indefinite-life domestic mutual funds contracts asset related to the Citigroup Asset Management ("CAM") acquisition exceeds the carrying value by 48%.

As of March 31, 2016, amortizable intangible asset management contracts are being amortized over a weighted-average remaining life of 10.9 years.

Estimated amortization expense for each of the next five fiscal years is as follows:

2017	\$8,569
2018	8,569
2019	8,569
2020	8,085
2021	8,085
Thereafter	46,467
Total	\$88,344

The change in the carrying value of goodwill is summarized below:

	Gross Book Value	Accumulated Impairment	Net Book Value
Balance as of March 31, 2014	\$2,402,423	\$(1,161,900)	\$1,240,523
Impact of excess tax basis amortization	(21,742 )	—	(21,742 )
Business acquisitions, net of \$(9,271) relating to the sale of LMIC (See Note 2)	165,927	—	165,927
Changes in foreign exchange rates and other	(45,198 )	—	(45,198 )
Balance as of March 31, 2015	2,501,410	(1,161,900 )	1,339,510
Impact of excess tax basis amortization	(20,920 )	—	(20,920 )
Business acquisitions (See Note 2)	163,110	—	163,110
Changes in foreign exchange rates and other	(2,184 )	—	(2,184 )
Balance as of March 31, 2016	\$2,641,416	\$(1,161,900)	\$1,479,516

Legg Mason recognizes the tax benefit of the amortization of excess tax benefit related to the CAM acquisition. In accordance with accounting guidance for income taxes, the tax benefit is recorded as a reduction of goodwill and deferred tax liabilities as the benefit is realized.

## 6. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

### Short-term borrowings

In June 2012, Legg Mason entered into an unsecured credit agreement which provided for a \$500,000 revolving credit facility. In January 2014, Legg Mason entered into a \$250,000 incremental borrowing credit facility, which was contemplated in, and was in addition to the \$500,000 revolving credit facility. Both revolving credit facilities were to expire in June 2017. The revolving credit facilities had interest rates of LIBOR plus 150 basis points and annual commitment fees of 20 basis points and were available for capital needs and for general corporate purposes. In October 2015, Legg Mason borrowed \$40,000 under these facilities to partially finance the acquisition of RARE Infrastructure. There were no borrowings outstanding under these facilities as of March 31, 2015.

On December 29, 2015, Legg Mason entered into a new unsecured credit agreement which provides for a \$1,000,000 multi-currency revolving credit facility. Legg Mason borrowed \$40,000 under this revolving credit facility, which remained outstanding as of March 31, 2016, and used the proceeds to repay the \$40,000 of outstanding borrowings under its previous revolving credit facility, as discussed above. The previous revolving credit facility was terminated

effective upon the repayment.

111

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Table of Contents

The new revolving credit facility may be increased by an aggregate amount of up to \$500,000, subject to the approval of the lenders, expires in December 2020, and can be repaid at any time. The revolving credit facility has an interest rate of the monthly Eurocurrency Rate plus 125 basis points and an annual commitment fee of 17.5 basis points. As of March 31, 2016, the effective interest rate was 1.9%. Interest is payable at least quarterly on any amounts outstanding under the revolving credit facility and the interest rate may change in the future based on changes in Legg Mason's credit ratings. This revolving credit facility is available to fund working capital needs and for general corporate purposes.

The revolving credit facility has standard financial covenants. These covenants were modified in March 2016 and include: maximum net debt to EBITDA ratio (as defined in the documents) of 3.5 to 1 for the period from March 31, 2016 through September 30, 2016, 3.25 to 1 for the period from October 1, 2016 through December 31, 2016, and 3.0 to 1 thereafter; and minimum EBITDA to interest ratio (as defined in the documents) of 4.0 to 1. As of March 31, 2016, Legg Mason's net debt to EBITDA ratio was 1.3 to 1 and EBITDA to interest expense ratio was 13.0 to 1, and therefore, Legg Mason has maintained compliance with the applicable covenants.

As of March 31, 2016 and 2015, Legg Mason had \$960,000 and \$750,000 of undrawn revolving credit facility capacity.

On April 29, 2016, Legg Mason entered into a forward starting, amortizing interest rate swap agreement with a financial intermediary, which was designated as a cash flow hedge. The interest rate swap is being used to hedge interest rate risk on outstanding borrowings under the revolving credit facility. The swap has a 4.67-year term, with five reductions beginning on March 31, 2017, and expires on December 29, 2020. Under the terms of the interest rate swap agreement, Legg Mason will pay a fixed interest rate of 2.3% on a notional amount of \$500,000. As previously discussed, the interest rate on the revolving credit facility may change in the future based on changes in Legg Mason's credit ratings, and such a change would result in a corresponding change in the fixed interest rate paid under the interest rate swap agreement. The interest rate swap has similar terms to the underlying debt being hedged. Changes in the market value of the interest rate swap will be recorded in Other comprehensive income on the Consolidated Balance Sheets.

In May 2016, Legg Mason used additional borrowings under the new revolving credit facility to finance the acquisition of EnTrust, as further discussed in Note 18, and to replenish cash used to complete the acquisitions of Clarion Partners in April 2016 and RARE Infrastructure in October 2015. The amount of total borrowings outstanding under this facility is \$500,000, as of the date of filing.

## Long-term Debt

Long-term debt consists of the following:

	March 31, 2016					March 31, 2015
	Carrying Value	Fair Value Hedge Adjustment	Unamortized Discount (Premium)	Debt Issuance Costs <sup>(1)</sup>	Maturity Amount	Carrying Value <sup>(1)</sup>
2.7% Senior Notes due July 2019	\$256,055	\$ (7,599 )	\$ 359	\$ 1,185	\$250,000	\$253,452
3.95% Senior Notes due July 2024	248,028	—	377	1,595	250,000	247,792
4.75% Senior Notes due March 2026	447,030	—	—	2,970	450,000	—
5.625% Senior Notes due January 2044	547,781	—	(3,396 )	5,615	550,000	547,702
6.375% Junior Notes due March 2056	242,091	—	—	7,909	250,000	—
Total	\$1,740,985	\$ (7,599 )	\$ (2,660 )	\$ 19,274	\$1,750,000	\$1,048,946

(1) As previously discussed in Note 1, for the year ended March 31, 2016, Legg Mason elected to early adopt updated accounting guidance which requires unamortized debt issuance costs to be presented in the balance sheet as a direct

deduction from the carrying value of the associated long-term debt liability. This updated guidance was adopted on a retrospective basis; therefore, the carrying value of debt as of March 31, 2015, has been reduced by the amount of related unamortized debt issuance costs.

In March 2016, Legg Mason issued \$450,000 of 4.75% Senior Notes due 2026 (the "2026 Notes") and \$250,000 of 6.375% Junior Subordinated Notes due 2056 (the "2056 Notes"). Legg Mason used the net proceeds of these offerings to finance the acquisitions of EnTrust in May 2016 and Clarion Partners in April 2016, as further discussed in Note 18.



Table of Contents

In May 2012, Legg Mason repurchased the Company's then outstanding 2.5% convertible notes (the "Convertible Notes"). The terms of the repurchase included a non-cash exchange of warrants to the holders of the Convertible Notes that replicated and extended the contingent conversion feature of the Convertible Notes.

The warrants issued to the holders of the Convertible Notes in connection with the repurchase of the Convertible Notes provide for the purchase, in the aggregate and subject to adjustment, of 14,205 shares of our common stock, on a net share settled basis, at an exercise price of \$88 per share. The warrants expire in July 2017 and can be settled, at the Company's election, in either shares of common stock or cash. Accordingly, the warrants are accounted for as equity.

In January 2014, Legg Mason issued \$400,000 of 5.625% Senior Notes due January 2044, the net proceeds of which, together with cash on hand, were used to repay the \$450,000 of borrowings under the Company's then outstanding five-year term loan. The 5.625% Senior Notes were sold at a discount of \$6,260, which is being amortized to interest expense over the 30-year term.

In June 2014, Legg Mason issued \$250,000 of 2.7% Senior Notes due 2019 (the "2019 Notes"), \$250,000 of 3.95% Senior Notes due 2024 (the "2024 Notes"), and an additional \$150,000 of the existing 5.625% Senior Notes due 2044 (the "2044 Notes" and, together with the 2019 Notes and the 2024 Notes, the "Notes"). In July 2014, the Company used \$658,769 in proceeds from the sale of the Notes, net of related fees, together with cash on hand, to call the then outstanding \$650,000 of 5.5% Senior Notes and pay a related make-whole premium of \$98,418, as discussed below.

On June 23, 2014, Legg Mason entered into a reverse treasury rate lock contract with a financial intermediary with a notional amount of \$650,000, which was designated as a cash flow hedge. The contract was issued in connection with the retirement of the 5.5% Senior Notes. The Company entered into the reverse treasury rate lock agreement in order to hedge the variability in the retirement payment on the entire principal amount of debt. The reverse treasury rate lock contract effectively fixed the present value of the forecasted debt make-whole payment which was priced on July 18, 2014, to eliminate risk associated with changes in the five-year U.S. treasury yield.

The 5.5% Senior Notes were retired on July 23, 2014, and resulted in a pre-tax, non-operating charge of \$107,074, consisting of a make-whole premium of \$98,418 to call the 5.5% Senior Notes, net of \$638 from the settlement of the reverse treasury lock before related administrative fees, and \$8,656 associated with existing deferred charges and original issue discount.

**2.7% Senior Notes due July 2019**

The \$250,000 2019 Notes were sold at a discount of \$553, which is being amortized to interest expense over the five-year term. The 2019 Notes can be redeemed at any time prior to the scheduled maturity in part or in aggregate, at the greater of the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.20%, together with any related accrued and unpaid interest.

On June 23, 2014, Legg Mason entered into an interest rate swap contract with a financial intermediary with a notional amount of \$250,000, which was designated as a fair value hedge. The interest rate swap was being used to effectively convert the 2019 Notes from fixed rate debt to floating rate debt and has identical terms as the underlying debt being hedged, so no ineffectiveness is expected. The related hedging gains and losses offset one another resulting in no net income or loss impact. The swap has a five-year term, and matures on July 15, 2019. The fair value of the contract at March 31, 2016 and 2015, was a derivative asset of \$7,599 and \$5,462, respectively, classified as Other assets in the Consolidated Balance Sheets. The increase of \$2,137 and \$5,462 for the years ended March 31, 2016 and 2015, respectively, reflects a gain on hedging activity related to the fair value adjustment on the derivative asset, which is recorded as Other income (gain on hedging activity) in the Consolidated Statements of Income (Loss). The carrying value of the debt in the Consolidated Balance Sheets was likewise increased by \$7,599 and \$5,462 as of

March 31, 2016 and 2015, respectively. The increase of \$2,137 and \$5,462 for the years ended March 31, 2016 and 2015, respectively, reflects a loss on hedging activity related to the fair value adjustment on the debt, which is recorded as Other expense (loss on hedging activity) in the Consolidated Statements of Income (Loss). The swap payment dates coincide with the debt payment dates on July 15 and January 15. The related receipts/payments by Legg Mason are recorded as Interest expense in the Consolidated Statements of Income (Loss). Since the original terms and conditions of the hedged instruments are unchanged, the swap was an effective fair value hedge.

On April 21, 2016, the fair value hedge swap was terminated for a receipt of approximately \$6,500, which will be amortized over the hedge term.

Table of Contents

*3.95% Senior Notes due July 2024*

The \$250,000 2024 Notes were sold at a discount of \$458, which is being amortized to interest expense over the 10-year term. The 2024 Notes can be redeemed at any time prior to the scheduled maturity in part or in aggregate, at the greater of the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.25%, together with any related accrued and unpaid interest.

*4.75% Senior Notes due March 2026*

The \$450,000 2026 Notes were sold at a discount of \$207, and Legg Mason incurred debt issuance costs of \$2,970 in connection with the issuance. The 2026 Notes can be redeemed in part or in aggregate at the greater of the related principal amount at the time of redemption or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.45%, together with any related accrued and unpaid interest.

*5.625% Senior Notes due January 2044*

As previously discussed, in January 2014, Legg Mason issued \$400,000 of 5.625% Senior Notes, sold at a discount of \$6,260, which is being amortized to interest expense over the 30-year term. An additional \$150,000 of 2044 Notes were issued in June 2014 and were sold at a premium of \$9,779, which is also being amortized to interest expense over the 30-year term. All of the 2044 Notes can be redeemed at any time prior to their scheduled maturity in part or in aggregate, at the greater of the related principal amount at that time or the sum of the remaining scheduled payments discounted at the treasury rate (as defined) plus 0.30%, together with any related accrued and unpaid interest.

*6.375% Junior Subordinated Notes due March 2056*

The \$250,000 2056 Notes were issued at 100% of principal amount and Legg Mason incurred debt issuance costs of \$7,909 in connection with the issuance. The 2056 Notes rank junior and subordinate in right of payment to all of Legg Mason's current and future senior indebtedness. Prior to March 15, 2021, the 2056 Notes can be redeemed in aggregate, but not in part, at 100% of the principal amount, plus any accrued and unpaid interest, if called for a tax event (as defined), or 102% of the principal amount, plus any accrued and unpaid interest, if called for a rating agency event (as defined). On or after March 15, 2021, the 2056 Notes can be redeemed in aggregate or in part, at 100% of the principal amount, plus any related accrued and unpaid interest.

As of March 31, 2016, \$250,000 of long-term debt matures in fiscal 2020, and \$1,500,000 matures thereafter.

Table of Contents

## 7. INCOME TAXES

The components of income (loss) before income tax provision are as follows:

	2016	2015	2014
Domestic	\$245,046	\$249,380	\$320,890
Foreign	(270,264 )	118,613	98,751
Total	\$(25,218 )	\$367,993	\$419,641

The components of income tax expense (benefit) are as follows:

	2016	2015	2014
Federal	\$87,166	\$95,499	\$125,494
Foreign	(71,828 )	20,365	(1,450 )
State and local	(7,646 )	9,420	13,761
Total income tax provision	\$7,692	\$125,284	\$137,805
Current	\$15,419	\$24,897	\$19,375
Deferred	(7,727 )	100,387	118,430
Total income tax provision	\$7,692	\$125,284	\$137,805

A reconciliation of the difference between the effective income tax rate and the statutory federal income tax rate is as follows:

	2016	2015	2014
Tax provision at statutory U.S. federal income tax rate	35.0 %	35.0 %	35.0 %
State income taxes, net of federal income tax benefit <sup>(1)</sup>	43.2	4.0	1.0
Uncertain tax benefits	41.8	1.8	0.6
Effect of foreign tax rates <sup>(1)</sup>	(172.5)	(4.8 )	(4.8 )
Changes in U.K. tax rates on deferred tax assets and liabilities	33.2	—	(4.6 )
Net (income) loss attributable to noncontrolling interests	(15.6 )	(0.5 )	0.3
Change in valuation allowances <sup>(2)</sup>	(33.9 )	(2.7 )	2.2
Federal effect of permanent tax adjustments	39.1	1.7	2.2
Other, net	(0.8 )	(0.5 )	0.9
Effective income tax rate	(30.5 )%	34.0 %	32.8 %

State income taxes include changes in valuation allowances related to change in apportionment and provision to return differences, net of the impact on deferred tax assets of changes in state apportionment factors and planning strategies. The effect of foreign tax rates for fiscal 2016 also includes a \$66,780 tax benefit for non-cash impairment charges related to the intangible assets of the Permal business, as further discussed in Note 5.

(2) See schedule below for the change in valuation allowances by jurisdiction.

In July 2013, the Finance Bill 2013 was enacted, which reduced the main U.K. corporate tax rate from 23% to 21% effective April 1, 2014, and 20% effective April 1, 2015. In November 2015, the U.K. Finance Bill 2015 was enacted, which further reduced the main U.K. corporate tax rate to 19% effective April 1, 2017, and to 18% effective April 1, 2020. The reductions in the U.K. corporate tax rate resulted in tax benefits of \$8,383 and \$19,164, recognized in fiscal 2016 and 2014, respectively, as a result of the revaluation of deferred tax assets and liabilities at the new rates.

Table of Contents

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the Consolidated Balance Sheets. These temporary differences result in taxable or deductible amounts in future years. A summary of Legg Mason's deferred tax assets and liabilities are as follows:

	2016	2015
<b>DEFERRED TAX ASSETS</b>		
Accrued compensation and benefits	\$185,311	\$158,369
Accrued expenses	50,865	60,282
Operating loss carryforwards	273,133	290,765
Capital loss carryforwards	3,121	5,335
Foreign tax credit carryforward	258,486	247,027
Federal benefit of uncertain tax positions	12,290	18,461
Mutual fund launch costs	30,234	30,968
Martin Currie defined benefit pension liability	5,896	7,741
Charitable contributions carryforwards	4,552	—
Net unrealized losses from investments	4,389	—
Basis differences in partnerships	—	4,174
Other	5,181	—
Deferred tax assets	833,458	823,122
Valuation allowance	(79,476 )	(96,687 )
Deferred tax assets after valuation allowance	\$753,982	\$726,435
<b>DEFERRED TAX LIABILITIES</b>		
Basis differences, principally for intangible assets and goodwill	\$56,625	\$82,636
Depreciation and amortization	686,421	666,057
Net unrealized gains from investments	—	7,832
Basis differences in partnerships	64,525	—
Other	—	435
Deferred tax liabilities	807,571	756,960
Net deferred tax liabilities	\$(53,589 )	\$(30,525 )

Certain tax benefits associated with Legg Mason's employee stock plans are recorded directly in Stockholders' Equity. No tax benefit was recorded to equity in fiscal 2016, 2015 or 2014, due to the cumulative net operating loss position of the Company. As of March 31, 2016, an aggregate \$22,585 of tax benefit will be recognized as an increase in Stockholders' Equity when the related net operating losses are ultimately realized.

Legg Mason has various loss and tax credit carryforwards that may provide future tax benefits. Related valuation allowances are established in accordance with accounting guidance for income taxes, if it is management's opinion that it is more likely than not that these benefits will not be realized. To the extent the analysis of the realization of deferred tax assets relies on deferred tax liabilities, Legg Mason has considered the timing, nature, and jurisdiction of reversals, as well as, future increases relating to the tax amortization of goodwill and indefinite-life intangible assets.

On March 1, 2016, Legg Mason executed agreements with the management of its wholly-owned subsidiary Royce and Associates ("Royce") which changed the tax reporting of Royce from a disregarded entity to a partnership. As a result, Legg Mason's deferred balance for tax basis differences in partnership investments changed by \$68,526 with an offsetting change to the tax basis of other temporary differences.

Substantially all of Legg Mason's deferred tax assets relate to U.S. federal, state and U.K. taxing jurisdictions. As of March 31, 2016, U.S. federal deferred tax assets aggregated \$711,535, realization of which is expected to require approximately \$3,200,000 of future U.S. earnings, of which \$740,000 must be foreign sourced earnings. Based on

estimates of future taxable income, using assumptions consistent with those used in Legg Mason's goodwill impairment testing, it is more likely than not that substantially all of the current federal tax benefits relating to net operating losses will be realizable. With respect to deferred tax assets relating to foreign tax credit carryforwards, it is more likely than not that tax benefits relating

Table of Contents

to the utilization of approximately \$23,465 of foreign taxes as credits will not be realized and a valuation allowance has been established. Further, the Company's estimates and assumptions do not contemplate certain possible future changes in the ownership of Legg Mason stock, which, under the U.S. Internal Revenue Code, could limit the utilization of net operating loss and foreign tax credit benefits. Any such limitation would impact the timing or amount of net operating loss or foreign tax credit benefits ultimately realized before they expire.

As of March 31, 2016, federal valuation allowances aggregated \$20,950. Of the decrease in federal valuation allowances from the prior year, \$12,677 relates to expiring foreign tax credits which have been reclassified to net operating losses. The release was offset in part by \$6,916, of which \$2,500 relates to foreign tax credits, \$3,443 relates to charitable contributions, and \$973 relates to Martin Currie's operating losses.

While tax planning may enhance Legg Mason's tax positions, the realization of tax benefits on deferred tax assets for which valuation allowances have not been provided is not dependent on implementation of any significant tax strategies.

As of March 31, 2016, U.S. state deferred tax assets aggregated approximately \$175,749. Due to limitations on utilization of net operating loss carryforwards and taking into consideration certain state tax planning strategies, the related valuation allowance of \$26,816 was substantially established in prior years for state net operating loss benefits generated in certain jurisdictions in cases where it is more likely that these benefits will ultimately not be realized.

For foreign jurisdictions, the decrease in valuation allowances of \$11,438 during fiscal 2016, primarily relates to the change in statutory rates, the expiration of certain deferred tax assets, and the utilization of attributes previously considered unrealizable.

The following deferred tax assets and valuation allowances relating to carryforwards have been recorded at March 31, 2016 and 2015, respectively.

	2016	2015	Expires Beginning after Fiscal Year
<b>DEFERRED TAX ASSETS</b>			
U.S. federal net operating losses	\$82,350	\$96,774	2028
U.S. federal foreign tax credits	258,486	247,027	2017
U.S. charitable contributions	4,552	233	2016
U.S. state net operating losses <sup>(1,2)</sup>	166,772	168,069	2017
U.S. state capital losses	44	44	2017
U.S. state tax credits	308	—	2022
Foreign net operating losses	24,192	25,877	2027
Foreign capital losses	3,077	5,290	n/a
Total deferred tax assets for carryforwards	\$539,781	\$543,314	
<b>VALUATION ALLOWANCES</b>			
U.S. federal net operating losses	\$2,255	\$1,282	
U.S. federal foreign tax credits	15,252	25,429	
U.S. charitable contributions	3,443	—	
U.S. state net operating losses	26,816	26,828	
U.S. state capital losses	44	44	
Foreign net operating losses	20,631	23,504	
Foreign capital losses	3,077	5,290	
Valuation allowances for carryforwards	71,518	82,377	
Foreign other deferred assets	7,958	14,310	

Total valuation allowances \$79,476 \$96,687

(1) Substantially all of the U.S. state net operating losses carryforward through fiscal 2036.

Due to potential for change in the factors relating to apportionment of income to various states, Legg Mason's  
(2) effective state tax rates are subject to fluctuation which will impact the value of the Company's deferred tax assets, including net operating losses, and could have a material impact on the future effective tax rate of the Company.

117

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Table of Contents

Legg Mason had total gross unrecognized tax benefits of approximately \$73,873, \$92,344 and \$77,892 as of March 31, 2016, 2015 and 2014, respectively. Of these totals, approximately \$49,629, \$62,775 and \$51,518, respectively, (net of the federal benefit for state tax liabilities) are the amounts of unrecognized benefits which, if recognized, would favorably impact future income tax provisions and effective tax rates. During fiscal 2016, as a result of the net impact of effective settlement of tax examinations, previously unrecognized benefits of \$24,106 were realized, of which \$5,145 was recorded in equity.

A reconciliation of the beginning and ending amount of unrecognized gross tax benefits for the years ended March 31, 2016, 2015 and 2014, is as follows:

	2016	2015	2014
Balance, beginning of year	\$92,344	\$77,892	\$72,650
Additions based on tax positions related to the current year	3,514	9,919	5,659
Additions for tax positions of prior years	10,078	13,054	12,610
Reductions for tax positions of prior years	(155 )	—	(138 )
Decreases related to settlements with taxing authorities	(25,046 )	(8,521 )	(12,889 )
Expiration of statutes of limitations	(6,862 )	—	—
Balance, end of year	\$73,873	\$92,344	\$77,892

Although management cannot predict with any degree of certainty the timing of ultimate resolution of matters under review by various taxing jurisdictions, it is reasonably possible that the Company's gross unrecognized tax benefits balance may change within the next 12 months by up to \$9,000 as a result of the expiration of statutes of limitations and the completion of tax authorities' examinations.

On April 13, 2015, reforms to New York City's corporate tax structure were enacted which included changes in the calculation of net operating loss carryforwards and changes in the way sales revenue is sourced. The revaluation of deferred tax assets and liabilities under the new rules resulted in the recognition of a one-time income tax benefit of \$17,053 for the year ended March 31, 2016.

The Company accrues interest related to unrecognized tax benefits in interest expense and recognizes penalties in other operating expense. During the years ended March 31, 2016, 2015 and 2014, the Company recognized approximately \$(4,441), \$1,492, and \$(580), respectively, which was substantially all interest. At March 31, 2016, 2015 and 2014, Legg Mason had approximately \$1,900, \$8,570, and \$7,300, respectively, accrued for interest and penalties on tax contingencies in the Consolidated Balance Sheets.

Legg Mason's prior year tax returns are subject to examination by the Internal Revenue Service, Her Majesty's Revenue & Customs, Brazilian and other tax authorities in various other countries and states. The following tax years remain open to income tax examination for each of the more significant jurisdictions where Legg Mason is subject to income taxes: after fiscal 2014 for U.S. federal; after fiscal 2014 for the U.K.; after calendar year 2008 for Brazil; after fiscal 2011 for the state of California; after fiscal 2008 for the state of New York; and after fiscal 2012 for the states of Connecticut and Maryland. The Company does not anticipate making any significant cash payments with the settlement of these audits in excess of amounts that have been reserved.

Except as noted below, Legg Mason intends to permanently reinvest overseas substantially all of the cumulative undistributed earnings of its foreign subsidiaries. Accordingly, no additional U.S. federal income taxes have been provided for undistributed earnings to the extent that they are permanently reinvested in Legg Mason's foreign operations. It is not practical at this time to determine the income tax liability that would result upon repatriation of additional accumulated foreign earnings.

In order to increase the amount of cash available in the U.S. for general corporate purposes, Legg Mason plans to utilize up to \$170,000 of foreign cash over the next several years, of which \$8,500 is accumulated foreign earnings.

Any additional tax provision associated with these repatriations was previously recognized. No further repatriation of accumulated prior period foreign earnings is currently planned. However, if circumstances change, Legg Mason will provide for and pay any applicable additional U.S. taxes in connection with repatriation of offshore funds. It is not practical at this time to determine the income tax liability that would result from any further repatriation of accumulated foreign earnings. Excluding cash used to fund the acquisitions of Clarion Partners in April 2016 and EnTrust in May 2016, Legg Mason had available domestically cash and cash equivalents of approximately \$375,000 as of March 31, 2016; and, after borrowing \$460,000 in

Table of Contents

May 2016 in connection with these acquisitions, had \$500,000 of remaining undrawn capacity on our revolving credit facility to meet domestic liquidity needs, subject to compliance with applicable covenants, and to provide flexibility in maximizing cost effective capital deployment without repatriating additional accumulated foreign earnings.

## 8. COMMITMENTS AND CONTINGENCIES

Legg Mason leases office facilities and equipment under non-cancelable operating leases, and also has multi-year agreements for certain services. These leases and service agreements expire on varying dates through fiscal 2028. Certain leases provide for renewal options and contain escalation clauses providing for increased rentals based upon maintenance, utility and tax increases.

As of March 31, 2016, the minimum annual aggregate rentals under operating leases and service agreements are as follows:

2017	\$ 128,023
2018	109,368
2019	88,644
2020	79,765
2021	73,432
Thereafter	225,678
Total	\$704,910

The minimum rental commitments shown above have not been reduced by \$140,780 for minimum sublease rentals to be received in the future under non-cancelable subleases, of which approximately 35% is due from one counterparty. The lease reserve liability, which is included in the table below, for space subleased as of March 31, 2016 and 2015, was \$31,745 and \$43,726, respectively. If a sub-tenant defaults on a sublease, Legg Mason may incur operating charges to adjust the existing lease reserve liability to reflect expected future sublease rentals at reduced amounts, as a result of the then current commercial real estate market.

The above minimum rental commitments include \$633,350 in real estate and equipment leases and \$71,560 in service and maintenance agreements.

The minimum rental commitments shown above include \$32,395 for commitments related to space that has been vacated, but for which subleases are being pursued. The related lease reserve liability, also included in the table below, was \$20,495 and \$2,213 as of March 31, 2016 and 2015, respectively, and remains subject to adjustment based on circumstances in the real estate markets that may require a change in assumptions or the actual terms of a sublease that is ultimately secured. The lease reserve liability takes into consideration various assumptions, including the expected amount of time it will take to secure a sublease agreement and prevailing rental rates in the applicable real estate markets.

During fiscal 2016, certain headquarters space was permanently vacated to pursue a sublease and certain office space was permanently vacated in connection with the restructuring of Permal for the combination with EnTrust, both of which are reflected in the lease reserve liability in the table below.

Table of Contents

The lease reserve liability for subleased space and vacated space for which subleases are being pursued is included in Other current liabilities and Other non-current liabilities in the Consolidated Balance Sheets. The table below presents a summary of the changes in the lease reserve liability:

Balance as of March 31, 2014	\$55,500
Accrued charges for vacated and subleased space <sup>(1) (2)</sup>	9,023
Payments, net	(15,001 )
Adjustments and other	(3,583 )
Balance as of March 31, 2015	45,939
Accrued charges for vacated and subleased space <sup>(1) (2)</sup>	14,642
Payments, net	(12,689 )
Adjustments and other	4,348
Balance as of March 31, 2016	\$52,240

(1) Included in Occupancy expense in the Consolidated Statements of Income (Loss)

Includes \$7,212 related to the restructuring of Permal for the merger with EnTrust and \$6,760 related to the

(2) integration of Batterymarch and LMGAA into QS Investors for the years ended March 31, 2016 and 2015, respectively. See Note 2 for additional information.

The following table reflects rental expense under all operating leases and servicing agreements:

	2016	2015	2014
Rental expense	\$135,850	\$136,414	\$130,880
Less: sublease income	21,154	19,672	16,289
Net rent expense	\$114,696	\$116,742	\$114,591

Legg Mason recognizes rent expense ratably over the lease period based upon the aggregate lease payments. The lease period is determined as the original lease term without renewals, unless and until the exercise of lease renewal options is reasonably assured, and also includes any periods provided by the landlord as a "free rent" period. Aggregate lease payments include all rental payments specified in the contract, including contractual rent increases, and are reduced by any lease incentives received from the landlord, including those used for tenant improvements.

As of March 31, 2016, Legg Mason had commitments to invest \$28,859 in limited partnerships that make private investments. These commitments are expected to be outstanding, or funded as required, through the end of their respective investment periods ranging through fiscal 2024.

Table of Contents

As of March 31, 2016, Legg Mason had various commitments to pay contingent consideration relating to business acquisitions. The following table presents a summary of the maximum remaining contingent consideration and changes in the contingent consideration liability for each of Legg Mason's recent acquisitions. See Note 2 for additional details regarding each significant acquisition.

Acquisition Date	RARE Infrastructure	Martin Currie	PK Investments	QS Investors	Fauchier	Total
	October 21, 2015	October 1, 2014	December 31, 2015	May 30, 2014	March 13, 2013	
Maximum Remaining Contingent Consideration <sup>(1)</sup>	\$ 81,320	\$467,076	\$ 2,469	\$ 30,000	\$28,743	\$609,608
Contingent Consideration Liability						
Balance as of March 31, 2014	\$ —	\$—	\$ —	\$—	\$29,553	\$29,553
Initial purchase accounting accrual <sup>(2)</sup>	—	75,211	—	13,370	—	88,581
Foreign exchange and accretion	—	(5,097 )	—	183	(2,436 )	(7,350 )
Balance as of March 31, 2015	—	70,114	—	13,553	27,117	110,784
Initial purchase accounting accrual <sup>(2)</sup>	25,000	—	2,457	—	—	27,457
Payment	—	—	—	—	(22,765 )	(22,765 )
Foreign exchange and accretion	2,145	(531 )	12	196	662	2,484
Fair value adjustment	—	(28,361 )	—	—	(5,014 )	(33,375 )
Balance as of March 31, 2016	\$ 27,145	\$41,222	\$ 2,469	\$ 13,749	\$—	\$84,585
Balance Sheet Classification						
Current Contingent consideration	\$ 7,001	\$12,846	\$ —	\$ 6,549	\$—	\$26,396
Non-current Contingent consideration	20,144	28,376	2,469	7,200	—	58,189
Balance as of March 31, 2016	\$ 27,145	\$41,222	\$ 2,469	\$ 13,749	\$—	\$84,585

(1) Using the applicable exchange rate as of March 31, 2016 for amounts denominated in currencies other than the U.S. dollar.

(2) Using the applicable exchange rate on the date of acquisition for amounts denominated in currencies other than the U.S. dollar.

In the normal course of business, Legg Mason enters into contracts that contain a variety of representations and warranties and that provide general indemnifications, which are not considered financial guarantees by relevant accounting guidance. Legg Mason's maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against Legg Mason that have not yet occurred.

Legg Mason has been the subject of customer complaints and has also been named as a defendant in various legal actions arising primarily from asset management, securities brokerage, and investment banking activities, including certain class actions, which primarily allege violations of securities laws and seek unspecified damages, which could be substantial. In the normal course of its business, Legg Mason has also received subpoenas and is currently involved in governmental and industry self-regulatory agency inquiries, investigations and, from time to time, proceedings involving asset management activities. In accordance with guidance for accounting for contingencies, Legg Mason has established provisions for estimated losses from pending complaints, legal actions, investigations and proceedings when it is probable that a loss has been incurred and a reasonable estimate of loss can be made.

Legg Mason cannot estimate the reasonably possible loss or range of loss associated with matters of litigation and other proceedings, including those described above as customer complaints, legal actions, inquiries, proceedings and investigations. The inability to provide a reasonably possible amount or range of losses is not because there is uncertainty as to the ultimate outcome of a matter, but because liability and damage issues have not developed to the point where Legg Mason can conclude that there is both a reasonable possibility of a loss and a meaningful amount or range of possible losses. There are numerous aspects to customer complaints, legal actions, inquiries, proceedings and

investigations that prevent Legg Mason from estimating a related amount or range of reasonably possible losses. These aspects include, among other things, the nature of the matters; that significant relevant facts are not known, are uncertain or are in dispute; and that damages

## Table of Contents

sought are not specified, are uncertain, unsupported or unexplained. In addition, for legal actions, discovery may not yet have started, may not be complete or may not be conclusive, and meaningful settlement discussions may not have occurred. Further, for regulatory matters, investigations may run their course without any clear indication of wrongdoing or fault until their conclusion.

In management's opinion, an adequate accrual has been made as of March 31, 2016, to provide for any probable losses that may arise from matters for which the Company could reasonably estimate an amount. Legg Mason's financial condition, results of operations and cash flows could be materially affected during a period in which a matter is ultimately resolved. In addition, the ultimate costs of litigation-related charges can vary significantly from period-to-period, depending on factors such as market conditions, the size and volume of customer complaints and claims, including class action suits, and recoveries from indemnification, contribution, insurance reimbursement, or reductions in compensation under revenue share arrangements.

As of March 31, 2016 and 2015, Legg Mason's liability for losses and contingencies was \$400 and \$200, respectively. During fiscal 2016, 2015, and 2014, Legg Mason incurred charges relating to litigation and other proceedings of approximately \$250, \$200, and \$200, respectively (net of recoveries of \$19,300 in fiscal 2014).

As further described in Note 2, Legg Mason may be obligated to settle noncontrolling interests related to RARE Infrastructure. The balance of the related noncontrolling interests was \$67,155 as of March 31, 2016. Also, as further described in Note 11, in April 2016, in conjunction with the Permal restructuring in preparation for the combination with EnTrust, the Permal management equity plan was liquidated with the payment of \$7,150 to its participants.

As further described in Note 18, subsequent to March 31, 2016, Legg Mason acquired Clarion Partners and EnTrust. Both of these acquisitions resulted in redeemable noncontrolling interests and the Clarion Partners acquisition terms included the implementation of an affiliate management equity plan.

## 9. EMPLOYEE BENEFITS

Legg Mason, through its subsidiaries, maintains various defined contribution plans covering substantially all employees. Through these plans, Legg Mason can make two types of discretionary contributions. One is a profit sharing contribution to eligible plan participants based on a percentage of qualified compensation and the other is a match of employee 401(k) contributions. Matches range from 50% to 100% of employee 401(k) contributions, up to a maximum of the lesser of up to 6% of employee compensation or a specified amount up to \$16 per year. Corporate profit sharing and matching contributions, together with contributions made under subsidiary plans, totaled \$33,152, \$27,888 and \$29,355 in fiscal 2016, 2015 and 2014, respectively. In addition, employees can make voluntary contributions under certain plans.

In connection with the acquisition of Martin Currie on October 1, 2014, Legg Mason assumed the obligations of Martin Currie's defined benefit pension plan, more fully discussed in Note 2.

## 10. CAPITAL STOCK

At March 31, 2016, the authorized numbers of common and preferred shares were 500,000 and 4,000, respectively. At March 31, 2016 and 2015, there were 6,988 and 8,815 shares of common stock, respectively, reserved for issuance under Legg Mason's equity plans.

In May 2012, Legg Mason's Board of Directors approved a share repurchase authorization for up to \$1,000,000 for purchases of common stock. All but \$13,515 of the share repurchases under this authorization were completed by March 2015, and the remaining share repurchases under this authorization were completed in April 2015. In January

2015, Legg Mason's Board of Directors approved a new share repurchase authorization for up to \$1,000,000 for additional repurchases of common stock. There is no expiration attached to this share repurchase authorization. During fiscal 2016, 2015, and 2014, Legg Mason purchased and retired 4,537, 6,931, and 9,677 shares of its common stock, respectively, for \$209,632, \$356,522, and \$359,996, respectively, through open market purchases. The remaining balance of the authorized stock buyback is approximately \$804,000.

As discussed in Note 6, warrants issued in connection with the repurchase of the Convertible Notes could result in the issuance of a maximum of 14,205 shares of Legg Mason common stock, subject to adjustment, if certain conditions are met.



Table of Contents

Changes in common stock for the years ended March 31, 2016, 2015 and 2014, respectively, are as follows:

	Years Ended March 31,		
	2016	2015	2014
<b>COMMON STOCK</b>			
Beginning balance	111,469	117,173	125,341
Shares issued for:			
Stock option exercises	338	718	781
Deferred compensation employee stock trust	12	44	50
Stock-based compensation	142	938	1,233
Shares repurchased and retired	(4,537 )	(6,931 )	(9,677 )
Employee tax withholding by settlement of net share transactions	(412 )	(473 )	(555 )
Ending balance	107,012	111,469	117,173

Dividends declared per share were \$0.80, \$0.64 and \$0.52 for fiscal 2016, 2015 and 2014, respectively. Dividends declared but not paid at March 31, 2016, 2015 and 2014, were \$22,038, \$17,837 and \$14,945, respectively, and are included in Other current liabilities of the Consolidated Balance Sheets.

**11. STOCK-BASED COMPENSATION**

Legg Mason's stock-based compensation includes stock options, an employee stock purchase plan, market-based performance shares payable in common stock, restricted stock awards and units, affiliate management equity plans and deferred compensation payable in stock. Shares available for issuance under the active equity incentive stock plan as of March 31, 2016, were 6,476. Options under Legg Mason's employee stock plans have been granted at prices not less than 100% of the fair market value. Options are generally exercisable in equal increments over four or five years and expire within eight to ten years from the date of grant.

As further discussed below, the components of Legg Mason's total stock-based compensation expense for the years ended March 31, 2016, 2015, and 2014, were as follows:

	Years Ended March 31,		
	2016	2015	2014
Stock options	\$9,403	\$11,584	\$13,530
Restricted stock and restricted stock units	52,670	45,975	48,263
Employee stock purchase plan	729	673	315
Affiliate management equity plans	26,184	5,206	2,270
Non-employee director awards	1,150	1,550	1,950
Performance share units	2,766	1,056	—
Employee stock trust	25	201	160
Total stock-based compensation expense	\$92,927	\$66,245	\$66,488

Table of Contents

## Stock Options

Stock option transactions under Legg Mason's equity incentive plans during the years ended March 31, 2016, 2015, and 2014, are summarized below:

	Number of Shares	Weighted-Average Exercise Price Per Share
Options outstanding at March 31, 2013	5,361	\$ 53.13
Granted	1,215	33.64
Exercised	(804 )	30.52
Canceled/forfeited	(971 )	97.49
Options outstanding at March 31, 2014	4,801	43.02
Granted	918	47.65
Exercised	(694 )	30.75
Canceled/forfeited	(593 )	90.31
Options outstanding at March 31, 2015	4,432	39.58
Granted	876	54.51
Exercised	(349 )	28.35
Canceled/forfeited	(453 )	88.06
Options outstanding at March 31, 2016	4,506	\$ 38.48

The total intrinsic value of options exercised during the years ended March 31, 2016, 2015, and 2014, was \$5,811, \$14,351, and \$6,064, respectively. At March 31, 2016, the aggregate intrinsic value of options outstanding was \$11,009.

The following information summarizes Legg Mason's stock options outstanding at March 31, 2016:

Exercise Price Range	Option Shares Outstanding	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Life (in years)
\$ 14.81 - \$ 25.00	567	\$ 23.68	4.10
25.01 - 35.00	1,706	31.88	3.39
35.01 - 55.18	2,233	47.28	6.27
	4,506		