

# LPL Financial LLC

(SEC I.D. No. 8-17668)

Statement of Financial Condition for the year ended December  
31, 2016, and Report of Independent Registered Public  
Accounting Firm



**Deloitte & Touche LLP**  
655 West Broadway  
Suite 700  
San Diego, CA 92101-8590  
USA

Tel: +1 619 232 6500  
Fax: +1 619 237 6802  
[www.deloitte.com](http://www.deloitte.com)

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Member of  
LPL Financial LLC  
Boston, Massachusetts

We have audited the accompanying statement of financial condition of LPL Financial LLC (the "Company") (an indirect wholly owned subsidiary of LPL Financial Holdings Inc.) as of December 31, 2016, that you are filing pursuant to Rule 17a-5 under the Securities Exchange Act of 1934. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such statement of financial condition presents fairly, in all material respects, the financial position of LPL Financial LLC as of December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

February 24, 2017

**LPL FINANCIAL LLC**  
**Statement of Financial Condition**  
**December 31, 2016**  
**(in thousands)**

**ASSETS**

Cash and cash equivalents	\$ 322,934
Cash and securities segregated under federal and other regulations	768,219
Restricted cash	631
Receivables from:	
Clients, net	341,199
Product sponsors, broker-dealers, and clearing organizations	175,096
Advisor loans, net	194,526
Others, net	167,102
Securities owned, trading — at fair value	11,404
Securities borrowed	5,558
Fixed assets, net	144,985
Goodwill	84,216
Intangible assets, net	58,331
Due from affiliates	312
Other assets	78,511
Total assets	<u>\$ 2,353,024</u>

**LIABILITIES AND MEMBER'S EQUITY**

LIABILITIES:

Drafts payable	\$ 198,674
Payables to clients	863,765
Payables to broker-dealers and clearing organizations	63,032
Accrued commission and advisory expenses payable	127,592
Accounts payable and accrued liabilities	164,223
Due to affiliates	15,976
Securities sold, but not yet purchased — at fair value	183
Unearned revenue	62,765
Total liabilities	<u>1,496,210</u>

COMMITMENTS AND CONTINGENCIES (Notes 10 and 14)

MEMBER'S EQUITY	856,814
Total liabilities and member's equity	<u>\$ 2,353,024</u>

See notes to the financial statement.

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

**1. Organization and Description of the Company**

LPL Financial LLC ("LPL Financial" or the "Company") provides an integrated platform of brokerage and investment advisory services to independent financial advisors and financial advisors at financial institutions (collectively "advisors") in the U.S.. Through its custody and clearing platform, using both proprietary and third-party technology, the Company provides access to diversified financial products and services enabling its advisors to offer independent financial advice and brokerage services to retail investors (their "clients"). LPL Financial is a wholly owned subsidiary of LPL Holdings, Inc. ("LPLH"), a Massachusetts holding corporation, which is a wholly owned subsidiary of LPL Financial Holdings Inc. ("LPLFH" or the "Parent"), a Delaware holding corporation.

LPL Financial is a clearing broker-dealer registered with the Financial Industry Regulatory Authority ("FINRA") and the Securities and Exchange Commission ("SEC") pursuant to the Securities Exchange Act of 1934 and an investment adviser registered with the SEC pursuant to the Investment Advisers Act of 1940 with primary offices in Boston, Massachusetts; Fort Mill, South Carolina; and San Diego, California. The Company is registered as an introducing broker-dealer with the Commodity Futures Trading Commission ("CFTC") and is a member of the National Futures Association ("NFA"). LPL Financial introduces commodities and futures products to ADM Investor Services Inc. ("ADM"), and all commodities accounts and related positions are held by ADM. LPL Financial is regulated by the CFTC and NFA.

**2. Summary of Significant Accounting Policies**

***Basis of Presentation***

This financial statement is prepared in accordance with accounting principles generally accepted in the U.S. ("GAAP"), which require the Company to make estimates and assumptions regarding the valuation of certain financial instruments, intangible assets, allowance for doubtful accounts, accruals for liabilities, income taxes, revenue and expense accruals, and other matters that affect the financial statement and related disclosures. Actual results could differ materially from those estimates under different assumptions or conditions and the difference may be material to the financial statement. The Company has evaluated subsequent events up to and including the date this financial statement was issued.

***Cash and Cash Equivalents***

Cash equivalents are highly liquid investments with an original maturity of 90 days or less that are not required to be segregated under federal or other regulations. The Company's cash and cash equivalents are composed of interest and noninterest-bearing deposits, money market funds, and U.S. government obligations.

***Cash and Securities Segregated Under Federal and Other Regulations***

As a broker-dealer carrying client accounts, the Company is subject to requirements related to maintaining cash or qualified securities in a segregated reserve account for the exclusive benefit of its clients in accordance with Rule 15c3-3 of the Security Exchange Act of 1934, as amended, and other regulations. Held within this account is approximately \$100,000 for the proprietary accounts of introducing brokers.

***Restricted Cash***

Restricted cash represents escrow deposits.

***Fair Value of Financial Instruments***

The Company's financial assets and liabilities are carried at fair value or at amounts that, because of their short-term nature, approximate fair value.

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

**Receivables from and Payables to Clients**

Receivables from clients include amounts due on cash and margin transactions. The Company extends credit to clients of its advisors to finance their purchases of securities on margin and receives income from interest charged on such extensions of credit. Payables to clients represent credit balances in client accounts arising from deposits of funds, proceeds from sales of securities, and dividend and interest payments received on securities held in client accounts. At December 31, 2016, \$836.6 million of the balance represents free credit balances that are held pending re-investment by the clients. The Company pays interest on certain client payable balances.

To the extent that margin loans and other receivables from clients are not fully collateralized by client securities, management establishes an allowance that it believes is sufficient to cover any probable losses. When establishing this allowance, management considers a number of factors, including its ability to collect from the client or the client's financial advisor and the Company's historical experience in collecting on such transactions.

The following schedule reflects the Company's activity in providing for an allowance for uncollectible amounts due from clients for the year ended December 31, 2016 (in thousands):

Beginning Balance — January 1	\$ 1,464
Provision for bad debts	116
Ending Balance — December 31	<u>\$ 1,580</u>

**Advisor Loans**

The Company periodically extends credit to its advisors in the form of recruiting loans, commission advances, and other loans. The decisions to extend credit to advisors are generally based on the advisor's credit history and their ability to generate future commissions. Certain loans made in connection with recruiting are forgivable over terms ranging from three to eight years provided that the advisor remains licensed through LPL Financial. At December 31, 2016, \$136.7 million of the advisor loan balance was forgivable. If an advisor terminates their arrangement with the Company prior to the forgivable loan term date or repayment of an other loan, an allowance for uncollectible amounts is recorded using an analysis that takes into account the advisor's registration status and the specific type of receivable. The aging thresholds and specific percentages used represent management's best estimates of probable losses. Management monitors the adequacy of these estimates through periodic evaluations against actual trends experienced.

The following schedule reflects the Company's activity in providing for an allowance for uncollectible amounts for advisor loans for the year ended December 31, 2016 (in thousands):

Beginning Balance — January 1	\$ 697
Provision for bad debts	1,155
Charge-offs, net of recoveries	—
Ending Balance — December 31	<u>\$ 1,852</u>

**Receivables from Others**

Receivables from others primarily consist of accrued fees from product sponsors and amounts due from advisors. Management maintains an allowance for uncollectible amounts using an aging analysis that takes into account the specific type of receivable. The aging thresholds and specific percentages used represent management's best estimates of probable losses. Management monitors the adequacy of these estimates through periodic evaluations against actual trends experienced.

The following schedule reflects the Company's activity in providing for an allowance for uncollectible amounts due from others for the year ended December 31, 2016 (in thousands):

Beginning Balance — January 1	\$ 9,802
Provision for bad debts	2,593
Charge-offs, net of recoveries	(254)
Ending Balance — December 31	<u>\$ 12,141</u>

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

***Securities Owned and Securities Sold, But Not Yet Purchased***

Securities owned and securities sold, but not yet purchased include trading securities, which are carried at fair value. The Company uses prices obtained from independent third-party pricing services to measure the fair value of its trading securities. Prices received from the pricing services are validated using various methods, including comparison to prices received from additional pricing services, comparison to available quoted market prices, and review of other relevant market data including implied yields of major categories of securities. In general, these quoted prices are derived from active markets for identical assets or liabilities. When quoted prices in active markets for identical assets and liabilities are not available, the quoted prices are based on similar assets and liabilities or inputs other than the quoted prices that are observable, either directly or indirectly. For certificates of deposit and treasury securities, the Company utilizes market-based inputs including observable market interest rates that correspond to the remaining maturities or the next interest reset dates. At December 31, 2016, the Company did not adjust prices received from the independent third-party pricing services.

***Securities Borrowed***

The Company borrows securities from other broker-dealers to make deliveries or to facilitate customer short sales. Securities borrowed are accounted for as collateralized financings and are recorded at contract value, representing the amount of cash provided for securities borrowed transactions (generally in excess of market values). The adequacy of the collateral deposited for securities borrowed is continuously monitored and adjusted when considered necessary to minimize the risk associated with this activity. As of December 31, 2016, the contract and collateral market value of borrowed securities was \$5.6 million and \$5.4 million, respectively.

***Fixed Assets***

Internally developed software, computers and software, leasehold improvements, and furniture and equipment are recorded at historical cost, net of accumulated depreciation and amortization. Depreciation is recognized using the straight-line method over the estimated useful lives of the assets. The Company charges software development costs to operations as incurred during the preliminary project stage, while capitalizing costs at the point at which the conceptual formulation, design and testing of possible software project alternatives are complete and management authorizes and commits to funding the project. The costs of internally developed software that qualify for capitalization are capitalized as fixed assets and subsequently amortized over the estimated useful life of the software, which is generally three years. The Company does not capitalize pilot projects or projects where it believes that the future economic benefits are less than probable. Leasehold improvements are amortized over the lesser of their useful lives or the terms of the underlying leases. Computers and software, as well as furniture and equipment, are depreciated over a period of three to seven years.

Management reviews fixed assets for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable. No impairment of fixed assets occurred for the year ended December 31, 2016.

***Goodwill and Other Intangible Assets***

Goodwill and other indefinite-lived assets are not amortized; however, intangible assets that are deemed to have definite lives are amortized over their useful lives, generally ranging from 5 to 20 years.

Goodwill and other indefinite-lived assets are tested annually for impairment in the fourth fiscal quarter and between annual tests if certain events occur indicating that the carrying amounts may be impaired. If a qualitative assessment is used and the Company determines that the fair value of a reporting unit is more likely than not (i.e., a likelihood of more than 50%) less than its carrying amount, a quantitative impairment test will be performed. If goodwill or other indefinite-lived assets are quantitatively assessed for impairment, a two-step approach is applied. First, the Company compares the estimated fair value of the reporting unit in which the goodwill resides to its carrying value. The second step, if necessary, measures the amount of such impairment by comparing the implied fair value of goodwill to its carrying value. No impairment of goodwill occurred for the year ended December 31, 2016.

Long-lived assets, such as intangible assets subject to amortization, are reviewed for impairment when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset or asset group to estimated undiscounted future cash flows expected to be generated by the asset or asset group. If the carrying amount of an asset or asset group exceeds its estimated future cash flows, an

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

impairment charge is recognized for the amount by which the carrying amount of the asset or asset group exceeds the estimated fair value of the asset or asset group. Long-lived assets to be disposed of by sale are reported at the lower of their carrying amounts or their estimated fair values less costs to sell and are not depreciated. No impairment of long-lived assets occurred for the year ended December 31, 2016.

***Commitments and Contingencies***

The Company recognizes a liability with regard to loss contingencies when it believes it is probable a liability has occurred and the amount can be reasonably estimated. If some amount within a range of loss appears at the time to be a better estimate than any other amount within the range, the Company accrues that amount. When no amount within the range is a better estimate than any other amount, however, the Company accrues the minimum amount in the range.

The Company has established an accrual for those legal proceedings and regulatory matters for which a loss is both probable and the amount can be reasonably estimated, except as otherwise covered by third-party insurance or self-insurance liabilities through the Parent.

***Income Taxes***

As a single member limited liability corporation, the Company is considered similar to a corporate division and recognizes an allocation of income taxes in its financial statements because it has an income tax allocation agreement (the "Tax Agreement") with LPLH and LPLFH and is included in the consolidated federal and certain state income tax returns filed by LPLFH. In accordance with the terms of the Tax Agreement, the Company shall pay to or receive from LPLH an amount equal to the total provision for income taxes that the Company discloses on its financial statements, less the amount of certain income tax benefits that are excluded from the calculation of the total provision for income taxes in accordance with GAAP. Since the Tax Agreement calls for a cash settlement based on the total income tax provision, the Company does not reflect a separate deferred income tax provision and corresponding deferred tax assets or liabilities.

The Company recognizes the tax effects of a position in the financial statements only if it is more-likely-than-not to be sustained based solely on its technical merits, otherwise no benefits of the position are recognized. The more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of a benefit. Moreover, each tax position meeting the recognition threshold is required to be measured as the largest amount that is greater than 50 percent likely to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information.

***Recently Issued Accounting Pronouncements***

In February 2016, the FASB issued ASU 2016-02, *Leases*, which establishes a right-of-use model that requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of operations. The Company expects to adopt the provisions of this guidance on January 1, 2019. The Company is currently evaluating the impact that ASU 2016-02 will have on its financial statement and related disclosures.

**3. Fair Value Measurements**

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

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

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

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

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

There were no transfers of assets or liabilities between fair value measurement classifications during the year ended December 31, 2016.

The Company's fair value measurements are evaluated within the fair value hierarchy, based on the nature of inputs used to determine the fair value at the measurement date. At December 31, 2016, the Company had the following financial assets and liabilities that are measured at fair value on a recurring basis:

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

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

The Company uses prices obtained from independent third-party pricing services to measure the fair value of its trading securities. Prices received from the pricing services are validated using various methods including comparison to prices received from additional pricing services, comparison to available quoted market prices, and review of other relevant market data including implied yields of major categories of securities. In general, these quoted prices are derived from active markets for identical assets or liabilities. When quoted prices in active markets for identical assets and liabilities are not available, the quoted prices are based on similar assets and liabilities or inputs other than the quoted prices that are observable, either directly or indirectly. For certificates of deposit and treasury securities, the Company utilizes market-based inputs, including observable market interest rates that correspond to the remaining maturities or the next interest reset dates. At December 31, 2016, the Company did not adjust prices received from the independent third-party pricing services.

*Other Assets* — The Company's other assets primarily consist of deferred compensation plan assets that are invested in money market and other mutual funds, which are actively traded and valued based on quoted market prices.

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

***Level 3 Recurring Fair Value Measurements***

The Company determines the fair value for its contingent consideration obligations using an income approach whereby the Company assesses the expected future performance of the acquired assets. The contingent payment is estimated using a discounted cash flow of the expected payment amount to calculate the fair value as of the valuation date. The Company's management evaluates the underlying projections and other related factors used in determining fair value each period and makes updates when there have been significant changes in management's expectations.



**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

The following table summarizes the Company's financial assets and financial liabilities measured at fair value on a recurring basis at December 31, 2016 (in thousands):

	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash equivalents	\$ 73,300	\$ —	\$ —	\$ 73,300
Securities owned — trading:				
Money market funds	474	—	—	474
Mutual funds	7,585	—	—	7,585
Equity securities	35	—	—	35
Debt securities	—	314	—	314
U.S. treasury obligations	2,996	—	—	2,996
Total securities owned — trading	11,090	314	—	11,404
Other assets	2,894	1,574	—	4,468
Total assets at fair value	\$ 87,284	\$ 1,888	\$ —	\$ 89,172
<b>Liabilities</b>				
Securities sold, but not yet purchased:				
Equity securities	\$ 168	\$ —	\$ —	\$ 168
Debt securities	—	15	—	15
Total securities sold, but not yet purchased	168	15	—	183
Accounts payable and accrued liabilities	—	—	527	527
Total liabilities at fair value	\$ 168	\$ 15	\$ 527	\$ 710

**4. Receivables from Product Sponsors, Broker-Dealers, and Clearing Organizations and Payables to Broker-Dealers and Clearing Organizations**

At December 31, 2016, receivables from product sponsors, broker-dealers, and clearing organizations and payables to broker-dealers and clearing organizations were as follows (in thousands):

**Receivables:**

Commissions receivable from product sponsors and others	\$ 116,192
Receivables from clearing organizations	50,656
Receivables from broker-dealers	1,309
Securities failed-to-deliver	6,939
Total receivables	\$ 175,096

**Payables:**

Payables to clearing organizations	\$ 26,517
Payables to broker-dealers	32,065
Securities failed-to-receive	4,450
Total payables	\$ 63,032

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

**5. Fixed Assets**

The components of fixed assets at December 31, 2016 were as follows (in thousands):

Internally developed software	\$ 200,082
Computers and software	110,963
Leasehold improvements	2,246
Furniture and equipment	1,477
Construction in progress	55,568
Total fixed assets	370,336
Accumulated depreciation and amortization	(225,351)
Fixed assets, net	\$ 144,985

**6. Intangible Assets**

At December 31, 2016, intangible assets was as follows (dollars in thousands):

	Weighted Average Life Remaining (in years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Advisor relationships	9.9	\$ 60,232	\$ (25,800)	\$ 34,432
Product sponsor relationships	9.9	31,087	(13,859)	17,228
Client relationships	8.1	12,736	(6,065)	6,671
Total		\$ 104,055	\$ (45,724)	\$ 58,331

**7. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities were as follows at December 31, 2016 (in thousands):

Accrued compensation	\$ 62,938
Accounts payable	14,946
Deferred rent	379
Advisor deferred compensation plan liability	1,470
Other accrued liabilities	84,490
Total accounts payable and accrued liabilities	\$ 164,223

**8. Debt**

The Company maintains three uncommitted lines of credit. Two of the lines have an unspecified limit and are primarily dependent on the Company's ability to provide sufficient collateral. The third line has a \$200.0 million limit and allows for both collateralized and uncollateralized borrowings. During the year ended December 31, 2016, the Company drew a total of \$105.0 million on one of the lines of credit, which was outstanding for one day at a weighted average interest rate of 1.59%. The lines were not otherwise utilized in 2016. In addition, LPLH provides the Company access to a credit facility. There were no funds drawn under this credit facility at December 31, 2016.

**9. Income Taxes**

The following table reflects a reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits including interest and penalties (in thousands):

Balance — January 1, 2016	\$ 3,715
Increases for tax positions taken in the current year	16,757
Decrease related to transfers to LPLH	(3,715)
Balance — December 31, 2016	\$ 16,757

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

Gross unrecognized tax benefits of \$3.7 million were transferred to LPLH during 2016 in accordance with the provisions of the Tax Agreement. The Company has additional gross unrecognized tax benefits of \$16.8 million as of December 31, 2016, which has been included in due from affiliates, net of any related tax benefit, in the statement of financial condition. The Company records gross unrecognized tax adjustments through its income tax provision and settles with LPLH for cash in the period in which the activity is realized. Under the terms of the Tax Agreement, no additional payments will be made between the Company and LPLH for the affects of future recognition of unrecognized tax benefits to be settled with LPLH. As a result, unrecognized tax benefits will have no effect on the Company's annual effective tax rate when recognized.

The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes. At December 31, 2016, the liability for unrecognized tax benefits included penalties of \$0.6 million. The tax years of 2007 to 2016 remain open to examination by major taxing jurisdictions to which the Company is subject. Since future unrecognized tax benefits will be settled in accordance with the Tax Agreement, the Company does not anticipate a material change in unrecognized tax benefits within the next 12 months.

## **10. Commitments and Contingencies**

### **Leases**

The Company leases office space and equipment under various operating leases. These leases are generally subject to scheduled base rent and maintenance cost increases, which are recognized on a straight-line basis over the period of the leases.

### **Service Contracts**

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

Future minimum payments under leases, lease commitments, service contracts, and other contractual obligations with initial terms greater than one year as of December 31, 2016 were as follows (in thousands):

2017	\$	27,768
2018		27,473
2019		9,338
2020		3,501
2021		435
Thereafter		1,380
Total	\$	<u>69,895</u>

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

The Company also provides guarantees to securities clearing houses and exchanges under their standard membership agreements, which require a member to guarantee the performance of other members. Under these agreements, if a member becomes unable to satisfy its obligations to the clearing houses and exchanges, all other members would be required to meet any shortfall. The Company's liability under these arrangements is not quantifiable and may exceed the cash and securities it has posted as collateral. However, the potential requirement for the Company to make payments under these agreements is remote. Accordingly, no liability has been recognized for these transactions.

### **Loan Commitments**

From time to time, the Company makes loans to its advisors, primarily to newly recruited advisors to assist in the transition process, which may be forgivable. Due to timing differences, the Company may make commitments to issue such loans prior to actually funding them. These commitments are generally contingent upon certain events occurring, including but not limited to the advisor joining the Company. The Company had no significant unfunded commitments at December 31, 2016.

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

***Legal & Regulatory Matters***

The Company is subject to extensive regulation and supervision by U.S. federal and state agencies and various self-regulatory organizations. The Company and its advisors periodically engage with such agencies and organizations, in the context of examinations or otherwise, to respond to inquiries, informational requests, and investigations. From time to time, such engagements result in regulatory complaints or other matters, the resolution of which can include fines and other remediation. Assessing the probability of a loss occurring and the amount of any loss related to a legal proceeding or regulatory matter is inherently difficult. While the Company exercises significant and complex judgments to make certain estimates presented in its financial statement, there are particular uncertainties and complexities involved when assessing the potential outcomes of legal proceedings and regulatory matters. The Company's assessment process considers a variety of factors and assumptions, which may include the procedural status of the matter and any recent developments; prior experience and the experience of others in similar matters; the size and nature of potential exposures; available defenses; the progress of fact discovery; the opinions of counsel and experts; potential opportunities for settlement and the status of any settlement discussions; as well as the potential for insurance coverage and indemnification, if available. The Company monitors these factors and assumptions for new developments and re-assesses the likelihood that a loss will occur and the estimated range or amount of loss, if those amounts can be reasonably determined. The Company has established an accrual for those legal proceedings and regulatory matters for which a loss is both probable and the amount can be reasonably estimated, except as otherwise covered by third-party insurance or self-insurance liabilities through the Parent.

***Third-Party Insurance***

The Company maintains insurance coverage for certain legal proceedings, including those involving client claims. With respect to client claims, the estimated losses on many of the pending matters are less than the applicable deductibles of the insurance policies.

***Other Commitments***

As of December 31, 2016, the Company had approximately \$219.1 million of client margin loans that were collateralized with securities having a fair value of approximately \$306.7 million that it can repledge, loan, or sell. Of these securities, approximately \$37.6 million were client-owned securities pledged to the Options Clearing Corporation as collateral to secure client obligations related to options positions. As of December 31, 2016 there were no restrictions that materially limited the Company's ability to repledge, loan, or sell the remaining \$269.1 million of client collateral.

Trading securities on the statement of financial condition at December 31, 2016 include \$3.0 million pledged to clearing organizations.

**11. Employee Benefit Plan**

The Company has a 401(k) defined contribution plan. All employees meeting minimum age and length of service requirements are eligible to participate. The Company has an employer matching program whereby employer contributions are made to the 401(k) plan, and employees are eligible for matching contributions after completing one year of service. For 2016, employer contributions were made in an amount equal to 65% of the first 8% of an employee's designated deferral of their eligible compensation.

The Company participates in an employee stock purchase plan (the "ESPP"), sponsored by LPLFH, through which eligible employees are able to purchase common stock of LPLFH at a discount from the market price through payroll deductions, subject to limitations. Eligible employees may elect to participate in the ESPP only during an open enrollment period. The offering period immediately follows the open enrollment window, upon which time ESPP contributions are withheld from the participant's regular paycheck. The ESPP provides for a 15% discount on the market value of LPLFH's stock at the lower of the grant date price (first day of the offering period) and the purchase date price (last day of the offering period).

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

**12. Related-Party Transactions**

In addition to transactions discussed elsewhere in the notes to the financial statement, the Company has a variety of relationships with LPLFH and its subsidiaries under which it earns revenues for services provided and incurs expenses for services received. Unless a right of offset exists, the Company records intercompany transactions on a gross basis and amounts are classified on the statement of financial condition as due from or due to affiliates.

The Company has an intercompany service agreement to provide various infrastructure and broker-dealer support services to affiliates that are subsidiaries of LPLFH. As part of the agreement, the Company also receives client support services.

Included in the intercompany service agreement are other transactions that create additional intercompany balances. Intercompany activities for the year ended December 31, 2016 included, but were not limited to, payables resulting from the Company's Tax Agreement with LPLH, allocated employee healthcare self-insurance costs, allocated occupancy costs, and various other business transactions with commonly controlled entities of LPLFH.

The Company has related party transactions with certain portfolio companies of TPG Capital, a 3.7% shareholder of the Parent's common stock and a firm of which one of its directors previously served as a partner. Additionally, the Company provides services and charitable contributions to the LPL Financial Foundation, an organization that provides volunteer and financial support within the Company's local communities. As of December 31, 2016 receivables and payables to related parties were not material.

**13. Net Capital and Regulatory Requirements**

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

The Company is subject to the SEC's Net Capital Rule (Rule 15c3-1 under the Exchange Act), which requires the maintenance of minimum net capital, as defined. Under the alternative method permitted by the rules, LPL Financial must maintain minimum net capital equal to the greater of \$250,000 or 2% of aggregate debit items arising from client transactions. The net capital rules also provide that the Company's capital may not be withdrawn if resulting net capital would be less than minimum requirements. Additionally, certain withdrawals require the approval of the SEC and FINRA to the extent they exceed defined levels, even though such withdrawals would not cause net capital to be less than minimum requirements. Net capital and the related net capital requirement may fluctuate on a daily basis. The Company is a clearing broker-dealer and, as of December 31, 2016, had net capital of \$116.2 million with a minimum net capital requirement of \$6.4 million. As of December 31, 2016 LPL Financial has met all capital adequacy requirements to which it is subject.

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

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

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

**LPL FINANCIAL LLC**  
**NOTES TO THE FINANCIAL STATEMENT**

reduce this risk by generally requiring that clients deposit cash or securities into their account prior to placing an order.

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

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