



75 State Street, 24th Floor  
Boston, MA 02109

2810 Coliseum Centre Drive  
Charlotte, NC 28217-4645

9785 Towne Centre Drive  
San Diego, CA 92121-1968

**LPL Financial LLC**  
(SEC I.D. No. 8-17668)

**Statement of Financial Condition**

**December 31, 2012**

## INDEPENDENT AUDITORS' REPORT

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, 2012 and related notes (the "financial statement").

### Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

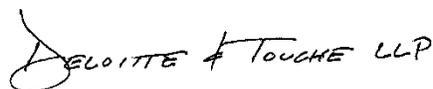
### Auditors' Responsibility

Our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and in accordance with the auditing 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 from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statement in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statement referred to above presents fairly, in all material respects, the financial position of the Company at December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.



February 25, 2013

**LPL FINANCIAL LLC**  
**STATEMENT OF FINANCIAL CONDITION**  
**AS OF DECEMBER 31, 2012**  
(Dollars in thousands)

**ASSETS**

Cash and cash equivalents	\$ 265,206
Cash and securities segregated under federal and other regulations	577,433
Receivables from:	
Clients, net of allowance of \$587	369,814
Product sponsors, broker-dealers and clearing organizations	152,764
Others, net of allowance of \$5,115	194,052
Due from affiliates (Note 12)	33,079
Securities owned—trading, at fair value (including \$900 pledged as collateral)	7,687
Securities borrowed	9,448
Fixed assets, net of accumulated depreciation and amortization of \$220,635	88,038
Goodwill	52,717
Intangible assets, net of accumulated amortization of \$26,164	82,642
Other assets	44,771
	<hr/>
Total assets	<u>\$ 1,877,651</u>

**LIABILITIES AND MEMBER'S EQUITY**

LIABILITIES:

Drafts payable	\$ 202,648
Payables to clients	749,505
Payables to broker-dealers and clearing organizations	53,031
Accrued commission and advisory expenses payable	127,223
Accounts payable and accrued liabilities	122,450
Due to affiliates (Note 12)	103
Securities sold, but not yet purchased—at fair value	366
Unearned revenue	61,085
	<hr/>
Total liabilities	<u>1,316,411</u>

COMMITMENTS AND CONTINGENCIES (Notes 10 and 14)

MEMBER'S EQUITY	<hr/> 561,240
-----------------	---------------

Total liabilities and member's equity	<u>\$ 1,877,651</u>
---------------------------------------	---------------------

See notes to financial statement.

**LPL FINANCIAL LLC**  
**NOTES TO STATEMENT OF FINANCIAL CONDITION**

**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 United States of America. Through its custody and clearing platform, the Company provides access to diversified financial products and services enabling its advisors to offer independent financial advice and brokerage services, using integrated technology, 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"), 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, Charlotte and San Diego. LPL Financial is also registered as a Futures Commission Merchant with the Commodity Futures Trading Commission ("CFTC") and is a member of the National Futures Association. Certain futures products known as security futures products ("SFP") include options on security futures and are regulated by both the SEC and CFTC. Client accounts held at LPL Financial may contain SFPs. LPL Financial's futures activities are limited to conducting business as a guaranteed introducing broker. As a guaranteed introducing broker, LPL Financial clears commodities and futures products through ADM Investor Services International Limited ("ADM"), and all commodities accounts and related client positions are held by ADM.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation** — This statement of financial condition is prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), which require the Company to make estimates and assumptions regarding the valuations of certain financial instruments, intangible assets, allowance for doubtful accounts, accruals for liabilities, income taxes and other matters that affect the statement of financial condition and related disclosures. Actual results could differ materially from those estimates under different assumptions or conditions and the difference may be material to the statement of financial condition. The Company has evaluated subsequent events up to and including the date this statement of financial condition was issued. See Note 15 for further discussion of a subsequent event.

**Cash and Cash Equivalents** — Cash and cash equivalents are composed of interest-bearing deposits, money market mutual funds and U.S. treasury obligations that meet the definition of a cash equivalent. Cash equivalents are highly liquid investments with original maturities of less than 90 days that are not required to be segregated under federal or other regulations.

**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 SEC Rule 15c3-3. At December 31, 2012, the Company had \$577.4 million in cash segregated in a special reserve bank account for the exclusive benefit of clients. Included within this account balance, the Company holds approximately \$60,000 for the Proprietary Accounts of Introducing Brokers.

**Fair Value of Financial Instruments** — The Company's financial assets and liabilities are carried at fair value or at amounts that, because of their short-term nature, approximate current fair value. Client receivables, primarily consisting of floating rate margin loans collateralized by client securities, are charged interest at rates similar to such other loans made within the industry.

**Receivables from and Payables to Clients** — Receivables from and payables to clients include amounts due on cash and margin transactions. The Company extends credit to its clients to finance their purchases of securities on margin. The Company 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, 2012, \$729.1 million of the balance represents free credit balances which are held pending re-investment by the

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

clients. The remaining balance represents funds received from clients to support their trading activities, primarily as collateral for clients' short selling of securities. 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.

**Receivables from Product Sponsors, Broker-Dealers and Clearing Organizations** — Receivables from product sponsors, broker-dealers and clearing organizations primarily consist of commission and transaction-related receivables.

**Receivables from Others** — Receivables from others primarily consists of other accrued fees from product sponsors and advisors. The Company periodically extends credit to its advisors in the form of recruiting and other loans. The decisions to extend credit to advisors are generally based on either the advisor's credit history, their ability to generate future commissions, or both. Management maintains an allowance for uncollectible amounts using an aging analysis that takes into account the advisors' 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.

**Securities Owned and Securities Sold, But Not Yet Purchased** — Securities owned and securities sold, but not yet purchased are reflected on a trade-date basis at fair value.

**Securities Borrowed and Securities Loaned** — Securities borrowed and securities loaned are accounted for as collateralized financings and are recorded at contract value, the amount of the cash provided for securities borrowed transactions and cash received for securities loaned (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. The collateral received for securities loaned is generally cash and is adjusted daily through the National Securities Clearing Corporation's ("NSCC") net settlement process and is classified as payables to broker-dealers and clearing organizations in the statement of financial condition. Securities loaned generally represent client securities that can be hypothecated under standard margin loan agreements.

At December 31, 2012, the values of the securities borrowed by the Company and the hypothecated securities loaned under the NSCC Stock Borrow Program are as follows (in thousands):

	<b>Contract Value</b>	<b>Collateral Market Value</b>
Securities borrowed	\$ 9,448	\$ 9,416
Securities loaned	\$ 19,314	\$ 19,314

**Fixed Assets** — Furniture, equipment, computers, purchased software, internally developed software and leasehold improvements are recorded at historical cost, net of accumulated depreciation and amortization. Management reviews fixed assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

**Software Development Costs** — Software development costs include costs incurred in the development and enhancement of software used in connection with services provided by the Company that do not otherwise qualify for capitalization. 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 costs of internally developed software are included in fixed assets 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 Company does not capitalize pilot projects and projects where it believes that the future economic benefits are less than probable.

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

**Intangible Assets and Goodwill** — The Company classifies intangible assets into two categories: (1) intangible assets with definite lives subject to amortization and (2) goodwill. The Company determines the useful lives of identifiable intangible assets after considering the specific facts and circumstances related to each intangible asset. Factors considered when determining useful lives include the contractual term of any agreement, the history of the asset, the Company's long-term strategy for the use of the asset, any laws or other local regulations which could impact the useful life of the asset and other economic factors, including competition and specific market conditions. Intangible assets that are deemed to have definite lives are amortized over their useful lives, generally ranging from 5 - 20 years. See Note 6 for further discussion.

When facts and circumstances indicate that the carrying value of definite-lived intangible assets may not be recoverable, the Company assesses the recoverability of the carrying value by preparing estimates of future cash flows. The Company recognizes an impairment loss if the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount. The impairment loss recognized is the amount by which the asset's carrying amount exceeds its fair value. The Company uses a variety of methodologies to determine the fair value of these assets, including discounted cash flow models, which are consistent with the assumptions the Company believes hypothetical marketplace participants would use. No impairment of definite-lived intangibles occurred for the year ended December 31, 2012.

On the first day of the Company's fourth fiscal quarter of 2011 (October 1<sup>st</sup>), the Company elected to adopt Accounting Standards Update ("ASU") No. 2011-08, *Goodwill and Other (Topic 350)—Testing Goodwill for Impairment* ("ASU 2011-08"), which updated guidance on the periodic testing of goodwill for impairment. ASU 2011-08 allows companies to assess qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired and whether it is necessary to perform the two-step goodwill impairment test.

ASU 2011-08 is intended to reduce the costs and complexity of performing the annual goodwill impairment test. The qualitative assessment requires management to perform the assessment using a more-likely-than-not approach to determine whether there is a greater than 50 percent chance that the fair value of the reporting unit is less than their carrying values. If, after performing the qualitative assessment, management determines there is a less than 50 percent chance that the fair value of a reporting unit is less than its carrying amount, then performing the two-step test is unnecessary.

If the Company deems the two-step test is necessary, the first step is to compare the fair value of a reporting unit to its carrying value, including goodwill. The Company typically uses an income approach methodology to determine the fair value of a reporting unit, which includes the discounted cash flow method and the market approach methodology that includes the use of market multiples. The assumptions used in these models are consistent with those the Company believes hypothetical marketplace participants would use. If the fair value of the reporting unit is less than its carrying value, the second step of the impairment test must be performed in order to determine the amount of impairment loss, if any. The second step compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds its implied fair value, an impairment charge is recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of goodwill.

As part of the qualitative assessment, the Company considered macroeconomic conditions such as general deterioration in economic conditions, limitations on accessing capital and other developments in equity and credit markets. The Company evaluated industry and market considerations for any deterioration in the environment in which the Company operates, the increased competitive environment, a decline in market-dependent multiples or metrics (considered in both absolute terms and relative to peers), any change in the market for products or services and regulatory and political developments. The Company assessed its overall financial performance, cost factors that would have a negative effect on earnings and prior quantitative assessments.

Based on a qualitative assessment, the Company has determined that it is not necessary to perform a quantitative goodwill impairment test. The annual goodwill impairment assessment performed has indicated that it is more-likely-than-not that the fair value of the reporting units is substantially in excess of carrying value and not at risk of failing the first step of the quantitative goodwill impairment test. Accordingly, no goodwill impairment has been recognized during the year ended December 31, 2012.

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

**Drafts Payable** — Drafts payable represent checks drawn against the Company, which have not yet cleared through the bank. At December 31, 2012, the Company had amounts drawn of \$191.1 million related to client activities and \$11.5 million of corporate overdrafts.

**Legal Reserves** — The Company records legal reserves and related insurance recoveries on a gross basis. The determination of these reserve amounts requires significant judgment on the part of management. Management considers many factors including, but not limited to, future legal expenses, the amount of the claim, the amount of the loss in the client's account, the basis and validity of the claim, the possibility of wrongdoing on the part of an advisor, likely insurance coverage, previous results in similar cases and legal precedents and case law. Each legal proceeding is reviewed with counsel in each accounting period and the reserve is adjusted as deemed appropriate by management.

**Commitments and Contingencies** — The Company recognizes liabilities for contingencies when analysis indicates it is both probable that a liability has been incurred and the amount of loss can be reasonably estimated. When a range of probable loss can be estimated, the Company accrues the most likely amount.

**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. See Note 8 for additional detail regarding the Company's uncertain tax positions.

**Employee Healthcare Self-Insurance** — The Company participates in self-insured employee healthcare programs administered by LPLH. LPLH estimates self-insurance costs with the assistance of insurance actuaries, based on historical experience and trends related to claims and payments, information provided by the insurance broker and industry experience. Self insurance costs are allocated to the Company based on rates comparable to market rates as set by LPLH's insurance actuaries. The Company is not liable for unfavorable claims and does not benefit from favorable experience.

**Recently Issued Accounting Pronouncements** — Recent accounting pronouncements or changes in accounting pronouncements during the year ended December 31, 2012, that are of significance, or potential significance, to the Company are discussed below.

In July 2012, the Financial Accounting Standards Board ("FASB") issued ASU 2012-02, *Intangibles—Goodwill and Other (Topic 350)—Testing Indefinite-Lived Intangible Assets for Impairment* ("ASU 2012-02"), which updated guidance on the periodic testing of indefinite-lived intangible assets, other than goodwill, for impairment. This guidance will allow companies to make a qualitative assessment about the likelihood that an indefinite-lived intangible asset, other than goodwill, is impaired in order to determine whether it is necessary to perform a quantitative impairment test. ASU 2012-02 will be effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The Company does not plan to early adopt ASU 2012-02; therefore, the ASU 2012-02 is effective for the Company beginning in fiscal year 2013. The Company does not anticipate the adoption of ASU 2012-02 to have a material impact on its statement of financial condition.

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

**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.

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, 2012, 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, 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 next interest reset dates. At December 31, 2012, the Company did not adjust prices received from the independent third-party pricing services.

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

There have been no transfers of assets or liabilities between fair value measurement classifications during the year ended December 31, 2012. The following table summarizes the Company's financial assets and financial liabilities measured at fair value on a recurring basis at December 31, 2012 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Measurements
<b>Assets</b>				
Cash equivalents	\$ 687	\$ —	\$ —	\$ 687
Securities owned—trading:				
Money market funds	302	—	—	302
Mutual funds	5,336	—	—	5,336
Equity securities	414	—	—	414
Debt securities	—	235	—	235
U.S. treasury obligations	1,400	—	—	1,400
Total securities owned	<u>7,452</u>	<u>235</u>	<u>—</u>	<u>7,687</u>
Total assets at fair value	<u>\$ 8,139</u>	<u>\$ 235</u>	<u>\$ —</u>	<u>\$ 8,374</u>
<b>Liabilities</b>				
Securities sold, but not yet purchased:				
Mutual funds	\$ 38	\$ —	\$ —	\$ 38
Equity securities	247	—	—	247
Debt securities	—	55	—	55
Certificates of deposit	—	26	—	26
Total securities sold, but not yet purchased	<u>285</u>	<u>81</u>	<u>—</u>	<u>366</u>
Total liabilities at fair value	<u>\$ 285</u>	<u>\$ 81</u>	<u>\$ —</u>	<u>\$ 366</u>

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

At December 31, 2012, receivables from product sponsors, broker-dealers and clearing organizations and payables to broker-dealers and clearing organizations are as follows (in thousands):

Receivables:	
Commissions receivable from product sponsors and others	\$ 97,394
Receivables from clearing organizations	35,454
Receivables from broker-dealers	13,375
Securities failed-to-deliver	6,541
Total receivables	<u>\$ 152,764</u>
Payables:	
Payables to clearing organizations	\$ 23,903
Securities loaned	19,314
Securities failed-to-receive	8,868
Payables to broker-dealers	946
Total payables	<u>\$ 53,031</u>

The Company clears commodities transactions for its advisors through another broker-dealer on a fully disclosed basis. The amount payable to broker-dealers relates to the aforementioned transactions and is collateralized by securities owned by the Company.

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

**5. Fixed Assets**

The components of fixed assets at December 31, 2012 are as follows (in thousands):

Internally developed software	\$ 157,872
Computers and software	94,103
Leasehold improvements	43,719
Furniture and equipment	12,979
Total fixed assets	<u>308,673</u>
Accumulated depreciation and amortization	(220,635)
Fixed assets—net	<u><u>\$ 88,038</u></u>

Internally developed software, computers and purchased software have useful lives of three to seven years. Leasehold improvements are amortized over the lesser of their useful lives or the terms of the underlying leases.

**6. Intangible Assets**

In 2012, the Company received a capital contribution of intangible assets with a gross carrying amount of \$6.9 million from LPLH, which is included in client relationships and has a weighted average remaining life of 13.5 years. The intangible assets have been recorded at their approximate carrying values as the transaction occurred between entities under common control.

At December 31, 2012, intangible assets are as follows (dollars in thousands):

	Weighted Average Life Remaining	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Advisor relationships	13.8 years	\$ 69,263	\$ (19,308)	\$ 49,955
Product sponsor relationships	13.4 years	27,917	(5,069)	22,848
Client relationships	11.9 years	11,626	(1,787)	9,839
Total		<u>\$ 108,806</u>	<u>\$ (26,164)</u>	<u>\$ 82,642</u>

**7. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities were as follows at December 31, 2012 (in thousands):

Accrued net payroll	\$ 48,743
Accounts payable accruals	43,314
Deferred rent	6,311
Other accrued liabilities	24,082
Total accounts payable and accrued liabilities	<u><u>\$ 122,450</u></u>

**8. 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, 2012	\$ 4,329
Increase related to prior year tax positions	1
Decrease related to prior year tax positions	(33)
Increase related to current year tax positions	2,603
Decrease related to transfers to LPLH	(4,297)
Balance—December 31, 2012	<u><u>\$ 2,603</u></u>

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

Gross unrecognized tax benefits of \$4.3 million were transferred to LPLH during fiscal year 2012 in accordance with the provisions of the Tax Agreement. The Company has additional gross unrecognized tax benefits of \$2.6 million as of December 31, 2012, 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 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, 2012, the liability for unrecognized tax benefits included penalties of \$0.5 million. The tax years of 2008 to 2012 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.

**9. Bank Loans Payable**

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 other line has a \$150.0 million limit and allows for both collateralized and uncollateralized borrowings. The lines were utilized during the year; however, there were no balances outstanding at December 31, 2012.

For the year ended December 31, 2012, the Company's credit facilities had an average outstanding balance of \$0.4 million, with a corresponding weighted-average interest rate of 1.64%.

**10. Commitments and Contingencies**

**Leases** — The Company leases certain office space and equipment at its headquarters under various operating leases. These leases are generally subject to scheduled base rent and maintenance cost increases, which are recognized on a straight-line basis over the period of the leases. Total rental expense for all operating leases was approximately \$16.4 million in 2012.

**Service Contracts** — The Company is party to certain long-term contracts for systems and services that enable its back office trade processing and clearance.

Future minimum payments under leases, lease commitments and other noncancellable contractual obligations with remaining terms greater than one year as of December 31, 2012, are approximately as follows (in thousands):

2013	\$	25,820
2014		18,342
2015		8,678
2016		7,867
2017		697
Thereafter		2,931
Total	<u>\$</u>	<u>64,335</u>

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

The Company 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

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

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.

**Litigation** — The Company has been named as a defendant in various legal actions, substantially all of which are arbitrations. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, the Company cannot predict with certainty what the eventual loss or range of loss related to such matters will be. The Company recognizes a legal liability 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.

**Other Commitments** — As of December 31, 2012, the Company had received collateral primarily in connection with client margin loans with a market value of approximately \$375.8 million, which it can sell or repledge. Of this amount, approximately \$41.5 million has been pledged or sold as of December 31, 2012; \$22.2 million was pledged with client-owned securities to the Options Clearing Corporation as collateral to secure client obligations related to options positions, and \$19.3 million was loaned to the NSCC through participation in its Stock Borrow Program. Additionally, approximately \$40.3 million are held at banks in connection with unutilized secured margin lines of credit; these securities may be used as collateral for loans from these banks. The remainder of \$294.0 million has not been re-pledged or sold and as of December 31, 2012 there are no restrictions that materially limit the Company's ability to re-pledge or sell the remaining \$334.3 million of client collateral.

As part of its brokerage operations, the Company periodically enters into when-issued and delayed delivery transactions on behalf of its clients. Settlement of these transactions after December 31, 2012 did not have a material impact on the Company's statement of financial condition.

The Company provides brokerage, clearing and custody services on a fully disclosed basis, offers its investment advisory programs and platforms and provides technology and additional processing and related services to the advisors of a broker-dealer subsidiary of a large global insurance company and their clients under a multi-year agreement. Termination fees may be payable by a terminating or breaching party depending on the specific cause of termination.

#### **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 in an amount equal to 30% of the first 10% of the amount designated by the employee for withholding from their total compensation. At December 31, 2012, the Company has accrued an additional match equal to 10% of the first 10% of an employee's designated deferral of their eligible compensation. Employees are eligible for matching contributions after completing one year of service.

#### **12. Related-Party Transactions**

In addition to transactions discussed elsewhere in the notes to the financial statements, 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. In addition to the intercompany service agreement, the Company is party to other transactions that create additional intercompany balances. Intercompany activities for the year ended December 31, 2012 included but were not limited to the Company's Tax Agreement resulting in a receivable from LPLH, periodic settlement of allocated employee healthcare self-insurance costs and various other business transactions with commonly controlled entities of LPLFH.

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

Set forth below is a reconciliation of the Company's due from affiliates and due to affiliates as of December 31, 2012 (in thousands):

	Due from Affiliates	Due to Affiliates
LPL Holdings, Inc.	\$ 32,066	\$ —
Concord Equity Group Advisors	565	—
Fortigent, LLC	179	—
UVEST Financial Services Group, Inc.	127	—
NestWise LLC	61	—
LPL Independent Advisor Services Group LLC	57	—
PTC Holdings, Inc.	24	—
Mutual Service Corporation	—	60
LPL Insurance Associates, Inc.	—	37
Concord Capital Partners, Inc.	—	6
Total	<u>\$ 33,079</u>	<u>\$ 103</u>

The Company transacts with certain entities in which its parent, LPLFH, or LPLFH's significant stockholders have an equity interest or an affiliation through a majority stockholder, as described below:

Artisan Partners Limited Partnership ("Artisan"), a company majority-owned by one of LPLFH's significant stockholders, pays fees to the Company in exchange for product distribution and record-keeping services. As of December 31, 2012, the Company had a receivable from Artisan of \$0.8 million, which is included in receivables from product sponsors, broker-dealers and clearing organizations in the statement of financial condition.

### **13. Net Capital and Regulatory Requirements**

The Company operates in a highly regulated industry. Applicable laws and regulations restrict permissible activities and investments. These policies 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 Uniform Net Capital Rule (Rule 15c3-1 under the Exchange Act), which requires the maintenance of minimum net capital, as defined. Net capital and the related net capital requirement may fluctuate on a daily basis. The Company is a clearing broker-dealer and had net capital of \$58.5 million with a minimum net capital requirement of \$7.4 million and net capital in excess of the minimum requirement of \$51.1 million as of December 31, 2012. LPL Financial has met all capital adequacy requirements to which they are subject as of December 31, 2012.

### **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 clients fail to meet their obligation to the Company. Clients are required to complete their transactions on the settlement

**LPL FINANCIAL LLC**  
**NOTES TO FINANCIAL STATEMENTS**

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 reduce this risk by generally requiring that clients deposit cash and/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 inventory positions are marked-to-market daily and are continuously monitored by the Company.

**15. Subsequent Event (Unaudited)**

On February 5, 2013, LPLFH committed to an expansion of its Service Value Commitment, an ongoing effort to position the Company for sustainable long-term growth by improving the service experience of its financial advisors and delivering efficiencies in its operating model. As a result, LPLFH has committed to undertake a course of action to reposition the Company's labor force and invest in technology, human capital, marketing and other strategic areas to enable future growth.

\*\*\*\*\*

Statement of Financial Condition filed pursuant to Rule 17a-5(e)(3) under the Securities Exchange Act of 1934 is available for inspection at the principal office of the Company and at the Boston Regional Office of the Commission.



LPL Financial Corporation  
Member FINRA/SIPC