STIFEL FINANCIAL CORP
Form 10-Q
August 08, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2016

OR

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to

Commission File Number: 001-09305

STIFEL FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Delaware	43-1273600
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

501 N. Broadway, St. Louis, Missouri 63102-2188

(Address of principal executive offices and zip code)

(314) 342-2000

(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 (“the Exchange Act”) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if smaller reporting company)	Smaller reporting company ¨

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

The number of shares outstanding of the registrant’s common stock, $0.15 par value per share, as of the close of business on August 1, 2016, was 66,209,775.

STIFEL FINANCIAL CORP.

Form 10-Q

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STIFEL FINANCIAL CORP.

Consolidated Statements of Financial Condition

(in thousands)	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Cash and cash equivalents	$364,101	$811,019
Cash segregated for regulatory purposes	60,132	227,727
Receivables:		
Brokerage clients, net	1,387,716	1,599,218
Brokers, dealers, and clearing organizations	533,264	601,831
Securities purchased under agreements to resell	293,766	160,423
Financial instruments owned, at fair value	1,086,446	749,443
Available-for-sale securities, at fair value	2,466,706	1,629,907
Held-to-maturity securities, at amortized cost	2,119,888	1,855,399
Loans held for sale, at lower of cost or market	250,725	189,921
Bank loans, net	4,170,858	3,143,515
Investments, at fair value	156,198	181,017
Fixed assets, net	176,439	181,966
Goodwill	975,921	915,602
Intangible assets, net	95,188	63,177
Assets held for sale	148,606	-
Loans and advances to financial advisors and other employees, net	414,573	401,293
Deferred tax assets, net	229,383	285,127
Other assets	455,692	329,466
Total Assets	$15,385,602	$13,326,051

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Financial Condition (continued)

(in thousands, except share and per share amounts)	June 30, 2016 (Unaudited)	December 31, 2015
Liabilities and Shareholders' Equity		
Payables:		
Brokerage clients	$898,193	$1,000,422
Brokers, dealers, and clearing organizations	440,939	438,031
Drafts	56,914	183,857
Securities sold under agreements to repurchase	317,002	278,674
Bank deposits	7,881,219	6,638,356
Financial instruments sold, but not yet purchased, at fair value	615,662	521,744
Accrued compensation	176,913	363,791
Accounts payable and accrued expenses	362,628	349,040
Liabilities related to assets held for sale	136,825	—
Federal Home Loan Bank advances	865,000	148,000
Borrowings	335,157	89,084
Senior notes	740,785	740,136
Debentures to Stifel Financial Capital Trusts	67,500	82,500
Total liabilities	12,894,737	10,833,635
Shareholders' Equity:		
Preferred stock - $1 par value; authorized 3,000,000 shares; none issued	—	—
Common stock - $0.15 par value; authorized 97,000,000 shares; issued 69,507,842 and 69,507,842 shares, respectively	10,426	10,426
Additional paid-in-capital	1,805,258	1,820,772
Retained earnings	819,929	805,685
Accumulated other comprehensive loss	(43,489)	(39,533)
	2,592,124	2,597,350
Treasury stock, at cost, 2,927,455 and 2,483,071 shares, respectively	(101,259)	(104,934)
Total Shareholders' Equity	2,490,865	2,492,416
Total Liabilities and Shareholders' Equity	$15,385,602	$13,326,051

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Operations

(Unaudited)

(in thousands, except per share amounts)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Revenues:				
Commissions	$182,104	$183,771	$380,034	$364,073
Principal transactions	126,426	85,542	247,374	186,275
Investment banking	133,125	161,007	233,783	285,568
Asset management and service fees	144,567	119,936	289,099	233,805
Interest	65,780	43,852	128,607	86,588
Other income	17,405	13,741	24,595	25,541
Total revenues	669,407	607,849	1,303,492	1,181,850
Interest expense	17,262	10,098	31,373	23,117
Net revenues	652,145	597,751	1,272,119	1,158,733
Non-interest expenses:				
Compensation and benefits	460,023	409,998	871,136	765,691
Occupancy and equipment rental	58,746	48,346	116,002	92,516
Communications and office supplies	37,426	31,114	74,086	60,348
Commissions and floor brokerage	12,145	9,124	23,876	19,193
Other operating expenses	68,012	61,098	127,313	112,848
Total non-interest expenses	636,352	559,680	1,212,413	1,050,596
Income from operations before income tax expense	15,793	38,071	59,706	108,137
Provision for income taxes	6,022	17,183	22,880	44,152
Net income	$9,771	$20,888	$36,826	$63,985
Earnings per common share:				
Basic	$0.15	$0.31	$0.55	$0.94
Diluted	$0.13	$0.27	$0.48	$0.82
Weighted-average number of common shares outstanding:				
Basic	66,792	68,370	67,186	68,189
Diluted	75,982	77,856	76,084	77,624

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Comprehensive Income

(Unaudited)

(in thousands)	Three Months Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Net income	$9,771	$20,888	$36,826	$63,985
Other comprehensive income/(loss), net of tax: [1]				
Changes in unrealized gains/(losses) on available-for-sale securities [2]	11,449	(3,349)	10,421	3,597
Amortization of losses of securities transferred to held-to-maturity from available-for-sale	800	1,545	1,309	2,276
Changes in unrealized gains/(losses) on cash flow hedging instruments [3]	(3,427)	713	(8,407)	487
Foreign currency translation adjustment	(5,093)	5,293	(7,279)	1,315
Total other comprehensive income/(loss), net of tax	3,729	4,202	(3,956)	7,675
Comprehensive income	$13,500	$25,090	$32,870	$71,660

(1) Net of tax expense of $2.3 million $2.6 million for the three months ended June 30, 2016 and 2015, respectively. Net of tax benefit of $2.5 million and tax expense of $4.8 million for the six months ended June 30, 2016 and 2015, respectively.

(2) There were no reclassifications to earnings during the three and six months ended June 30, 2016. Amounts are net of reclassifications to earnings of realized gains of $1.9 million and $1.9 million for the three and six months ended June 30, 2015, respectively.

(3) Amounts are net of reclassifications to earnings of losses of $1.5 million and $1.0 million for the three months ended June 30, 2016 and 2015, respectively. Amounts are net of reclassifications to earnings of losses of $2.9 million and $2.2 million for the six months ended June 30, 2016 and 2015, respectively.

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	Six Months Ended June 30, 2016	2015
Cash Flows From Operating Activities:		
Net income	$36,826	$63,985
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	21,604	14,899
Amortization of loans and advances to financial advisors and other employees	33,079	28,692
Amortization of premium on investment portfolio	4,655	2,222
Provision for loan losses and allowance for loans and advances to financial advisors and other employees	6,579	4,393
Amortization of intangible assets	8,008	3,673
Deferred income taxes	54,651	16,797
Excess tax benefits/(tax deficit) from stock-based compensation	5,197	(12,454)
Stock-based compensation	94,349	81,160
(Gains)/losses on sale of investments	3,911	(4,941)
Gain on extinguishment of Stifel Financial Capital Trust	(5,607)	—
Other, net	864	(7,012)
Decrease/(increase) in operating assets, net of assets acquired:		
Cash segregated for regulatory purposes and restricted cash	167,593	49,496
Receivables:		
Brokerage clients	133,799	(160,766)
Brokers, dealers, and clearing organizations	12,396	(150,642)
Securities purchased under agreements to resell	(133,343)	(187,866)
Financial instruments owned, including those pledged	(337,032)	(100,353)
Loans originated as held for sale	(1,093,740)	(969,064)
Proceeds from mortgages held for sale	1,041,457	904,798
Loans and advances to financial advisors and other employees	(47,760)	(48,472)
Other assets	(149,190)	(27,769)
Increase/(decrease) in operating liabilities, net of liabilities assumed:		
Payables:		
Brokerage clients	(36,181)	128,338
Brokers, dealers, and clearing organizations	4,439	57,487
Drafts	(115,039)	(15,619)
Financial instruments sold, but not yet purchased	93,941	(20,539)
Other liabilities and accrued expenses	(237,486)	(222,792)
Net cash used in operating activities	$(432,030)	$(572,349)

See accompanying Notes to Consolidated Financial Statements.

7

STIFEL FINANCIAL CORP.

Consolidated Statements of Cash Flows (continued)

(Unaudited)

(in thousands)	Six Months Ended June 30, 2016	2015
Cash Flows From Investing Activities:		
Proceeds from:		
Maturities and principal paydowns of available-for-sale securities	$104,660	$728,809
Calls and principal paydowns of held-to-maturity securities	93,686	52,903
Sale or maturity of investments	26,150	50,912
Increase in bank loans, net	(1,032,497)	(356,580)
Payments for:		
Purchase of available-for-sale securities	(927,687)	(199)
Purchase of held-to-maturity securities	(359,337)	—
Purchase of investments	(5,242)	(30,283)
Purchase of fixed assets	(14,159)	(32,309)
Acquisitions, net of cash acquired	(71,924)	18,456
Net cash provided by/(used in) investing activities	(2,186,350)	431,709
Cash Flows From Financing Activities:		
Proceeds from borrowings	246,073	327,568
Proceeds from Federal Home Loan Bank advances	717,000	—
Increase in securities sold under agreements to repurchase	38,328	303,170
Increase/(decrease) in bank deposits, net	1,242,863	(476,144)
Increase in securities loaned	44,008	99,446
Excess tax benefits/(tax deficit) from stock-based compensation	(5,197)	12,454
Issuance of common stock for stock option exercises	175	245
Repurchase of common stock	(95,116)	—
Extinguishment of Stifel Financial Capital Trust	(9,393)	—
Repayment of senior notes	—	(175,000)
Net cash provided by financing activities	2,178,741	91,739
Effect of exchange rate changes on cash	(7,279)	1,056
Decrease in cash and cash equivalents	(446,918)	(47,845)
Cash and cash equivalents at beginning of period	811,019	689,782
Cash and cash equivalents at end of period	$364,101	$641,937
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds	$21,211	$31,951
Cash paid for interest	30,256	20,073
Noncash financing activities:		
Unit grants, net of forfeitures	131,736	105,448
Issuance of common stock for acquisitions	11,427	80,981
Shares surrendered into treasury	—	223

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 1 – Nature of Operations and Basis of Presentation

Nature of Operations

Stifel Financial Corp. (the "Company"), through its wholly owned subsidiaries, is principally engaged in retail brokerage; securities trading; investment banking; investment advisory; retail, consumer, and commercial banking; and related financial services. We have offices throughout the United States and Europe. Our major geographic area of concentration is throughout the United States, with a growing presence in Europe. Our company's principal customers are individual investors, corporations, municipalities, and institutions.

On January 4, 2016, the Company completed the acquisition of Eaton Partners, LLC ("Eaton Partners"), a global fund placement and advisory firm. Eaton Partners will retain its brand name and will be run as a Stifel company. The acquisition was funded with cash from operations and our common stock.

On May 5, 2016, the Company completed the acquisition of ISM Capital LLP ("ISM"), an independent investment bank focused on international debt capital markets. The acquisition of ISM adds to the Company's debt capital markets origination, sales and research capabilities in Europe, including an end-to-end platform for convertible securities and other equity-linked debt instruments. The acquisition was funded with cash from operations.

Basis of Presentation

The consolidated financial statements include Stifel Financial Corp. and its wholly owned subsidiaries, principally Stifel, Nicolaus & Company, Incorporated ("Stifel"), Keefe, Bruyette & Woods, Inc., and Stifel Bank & Trust ("Stifel Bank"). All material intercompany balances and transactions have been eliminated. Unless otherwise indicated, the terms "we," "us," "our," or "our company" in this report refer to Stifel Financial Corp. and its wholly owned subsidiaries.

We have prepared the accompanying unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Pursuant to these rules and regulations, we have omitted certain information and footnote disclosures we normally include in our annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles. In management's opinion, we have made all adjustments (consisting only of normal, recurring adjustments, except as otherwise noted) necessary to fairly present our financial position, results of operations and cash flows. Our interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and the notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2015 on file with the SEC.

Certain amounts from prior periods have been reclassified to conform to the current period's presentation. The effect of these reclassifications on our company's previously reported consolidated financial statements was not material.

There have been no material changes in our significant accounting policies, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2015.

NOTE 2 – Recently Issued Accounting Guidance

Financial Instruments – Credit Losses

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The guidance requires that credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security. The guidance is effective for fiscal years beginning after December 15, 2019 (January 1, 2020 for our Company), including interim periods within that reporting period. Early adoption is permitted for annual periods beginning after December 15, 2018. We are currently evaluating the effect that the new guidance will have on our consolidated financial statements.

Share-Based Payments

In March 2016, the FASB issued ASU No. 2016-09, "Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09") that requires an entity to record all excess tax benefits and tax deficiencies as an income tax benefit or expense in the income statement. ASU 2016-09 will also require an entity to elect an accounting policy to either estimate the number of forfeitures or account for forfeitures when they occur. The guidance is effective for fiscal years beginning after December 15, 2016 (January 1, 2017 for our company). We are currently evaluating the effect that the new guidance will have on our consolidated financial statements.

Leases

In February 2016, the FASB issued ASU No. 2016-02, “Leases” that requires lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases. For lessees, leases will continue to be classified as either operating or finance leases in the income statement. Lessor accounting is similar to the current model but updated to align with certain changes to the lessee model. Lessors will continue to classify leases as operating, direct financing or sales-type leases. The new standard must be adopted using a modified retrospective transition and requires application of the new guidance at the beginning of the earliest comparative period presented. The guidance is effective for fiscal years beginning after December 15, 2018 (January 1, 2019 for our company). Early adoption is permitted. We are currently evaluating the transition method that will be elected and the effect that the new guidance will have on our consolidated financial statements.

Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities” that will change the income statement impact of equity investments held by an entity, and the recognition of changes in fair value of financial liabilities when the fair value option is elected. The guidance is effective for fiscal years beginning after December 15, 2017 (January 1, 2018 for our company). We are currently evaluating the effect that the new guidance will have on our consolidated financial statements.

Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share

In May 2015, the FASB issued ASU No. 2015-07, “Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)” (“ASU 2015-07”). The guidance removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The guidance also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. The guidance is effective for fiscal years beginning after December 15, 2015 (January 1, 2016 for our company). See Note 4 – Fair Value Measurements.

Interest - Imputation of Interest

In April 2015, the FASB issued ASU No. 2015-03, “Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs” (“ASU 2015-03”). The guidance in ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The guidance is effective for fiscal years beginning after December 15, 2015 (January 1, 2016 for our company) and is required to be applied retrospectively to all periods presented beginning in the year of adoption. Upon the adoption of ASU 2015-03 by our company on January 1, 2016, the impact was a reduction in both other assets and senior notes of $9.6 million. In accordance with ASU No. 2015-03, previously reported amounts have been conformed to the current presentation, as reflected in the consolidated statements of financial condition. The impact as of December 31, 2015 was a reduction to both total assets and total liabilities of $9.9 million.

Revenue Recognition

In April 2016, the FASB issued ASU No. 2016-10, “Identifying Performance Obligations and Licensing” that amends the revenue guidance in ASU 2014-09 on identifying performance obligations. The effective date of the new guidance will coincide with ASU 2014-09 during the first quarter 2018. We are currently evaluating the effect that the new guidance will have on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-08, “Principal versus Agent Considerations (Reporting Revenue Gross versus Net)” (“ASU 2016-08”) that amends the principal versus agent guidance in ASU 2014-09. ASU 2016-08 clarifies that the analysis must focus on whether the entity has control of the goods or services before they are transferred to the customer. ASU 2016-08 also provides additional guidance about how to apply the control principle when services are provided and when goods or services are combined with other goods or services. The effective date of the standard for the Company will coincide with ASU 2014-09 during the first quarter 2018. We are currently evaluating the effect that the new guidance will have on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," ("ASU 2014-09") that supersedes current revenue recognition guidance, including most industry-specific guidance. ASU 2014-09 requires a company to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods and services. The guidance also requires additional disclosures regarding the nature, amount, timing and uncertainty of revenue that is recognized. The FASB has approved a one year deferral of this standard, and this pronouncement is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period and is to be applied using one of two retrospective application methods, with early application not permitted. We are currently evaluating the impact the new guidance will have on our consolidated financial statements.

NOTE 3 – Receivables From and Payables to Brokers, Dealers, and Clearing Organizations

Amounts receivable from brokers, dealers, and clearing organizations at June 30, 2016 and December 31, 2015, included (in thousands):

	June 30, 2016	December 31, 2015
Deposits paid for securities borrowed	$379,244	$318,105
Receivables from clearing organizations	78,635	260,077
Securities failed to deliver	75,385	23,649
	$533,264	$601,831

Amounts payable to brokers, dealers, and clearing organizations at June 30, 2016 and December 31, 2015, included (in thousands):

	June 30, 2016	December 31, 2015
Deposits received from securities loaned	$357,207	$329,670
Securities failed to receive	35,718	16,353
Payable to clearing organizations	48,014	92,008
	$440,939	$438,031

Deposits paid for securities borrowed approximate the market value of the securities. Securities failed to deliver and receive represent the contract value of securities that have not been delivered or received on settlement date.

NOTE 4 – Fair Value Measurements

We measure certain financial assets and liabilities at fair value on a recurring basis, including financial instruments owned, available-for-sale securities, investments, financial instruments sold, but not yet purchased, and derivatives.

We generally utilize third-party pricing services to value Level 1 and Level 2 available-for-sale investment securities, as well as certain derivatives designated as cash flow hedges. We review the methodologies and assumptions used by the third-party pricing services and evaluate the values provided, principally by comparison with other available market quotes for similar instruments and/or analysis based on internal models using available third-party market data. We may occasionally adjust certain values provided by the third-party pricing service when we believe, as the result of our review, that the adjusted price most appropriately reflects the fair value of the particular security.

Following are descriptions of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value. The descriptions include an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Financial Instruments Owned and Available-For-Sale Securities

When available, the fair value of financial instruments is based on quoted prices in active markets and reported in Level 1. Level 1 financial instruments include highly liquid instruments with quoted prices, such as equity securities listed in active markets, corporate fixed income securities, and U.S. government securities.

If quoted prices are not available for identical instruments, fair values are obtained from pricing services, broker quotes, or other model-based valuation techniques with observable inputs, such as the present value of estimated cash flows, and reported as Level 2. The nature of these financial instruments include instruments for which quoted prices are available but traded less frequently, instruments whose fair value has been derived using a model where inputs to the model are directly observable in the market, or can be derived principally from or corroborated by observable market data, and instruments that are fair valued using other financial instruments, the parameters of which can be directly observed. Level 2 financial instruments include U.S. government agency securities, mortgage-backed securities, corporate fixed income securities infrequently traded, state and municipal securities, asset-backed securities, and equity securities not actively traded.

We have identified Level 3 financial instruments to include certain equity securities with unobservable pricing inputs and certain mortgage-backed securities. Level 3 financial instruments have little to no pricing observability as of the report date. These financial instruments do not have active two-way markets and are measured using management’s best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

Investments

Investments carried at fair value primarily include corporate equity securities, auction-rate securities (“ARS”), and private company investments.

Corporate equity securities and U.S. government securities are valued based on quoted prices in active markets and reported in Level 1.

ARS for which the market has been dislocated and largely ceased to function are reported as Level 3 assets. ARS are valued based upon our expectations of issuer redemptions and using internal discounted cash flow models that utilize unobservable inputs.

Direct investments in private companies may be valued using the market approach and were valued based on an assessment of each underlying investment, incorporating evaluation of additional significant third-party financing, changes in valuations of comparable peer companies, the business environment of the companies, market indices, assumptions relating to appropriate risk adjustments for nonperformance, and legal restrictions on disposition, among other factors. The fair value derived from the methods used are evaluated and weighted, as appropriate, considering the reasonableness of the range of values indicated. Under the market approach, fair value may be determined by reference to multiples of market-comparable companies or transactions, including earnings before interest, taxes, depreciation, and amortization (“EBITDA”) multiples. For securities utilizing the market comparable companies valuation technique, a significant increase (decrease) in the EBITDA multiple in isolation could result in a significantly higher (lower) fair value measurement.

Investments in Funds That Are Measured at Net Asset Value Per Share

Investments at fair value include investments in funds that are measured at NAV. The Company uses NAV to measure the fair value of its fund investments when (i) the fund investment does not have a readily determinable fair value and (ii) the NAV of the investment fund is calculated in a manner consistent with the measurement principles of investment company accounting, including measurement of the underlying investments at fair value. The Company adopted ASU No. 2015-07 in January 2016 and, as required, disclosures in the paragraphs and tables below are limited to only those investments in funds that are measured at NAV. In accordance with ASU No. 2015-07, previously reported amounts have been conformed to the current presentation.

The Company's investments in funds measured at NAV include private company investments, partnership interests, mutual funds, private equity funds, and money market funds. Private equity funds primarily invest in a broad range of industries worldwide in a variety of situations, including leveraged buyouts, recapitalizations, growth investments and distressed investments. The private equity funds are primarily closed-end funds in which the Company's investments are generally not eligible for redemption. Distributions will be received from these funds as the underlying assets are liquidated or distributed.

The general and limited partnership interests in investment partnerships were primarily valued based upon NAVs received from third-party fund managers. The various partnerships are investment companies, which record their underlying investments at fair value based on fair value policies established by management of the underlying fund. Fair value policies at the underlying fund generally require the funds to utilize pricing/valuation information, including independent appraisals, from third-party sources. However, in some instances, current valuation information for illiquid securities or securities in markets that are not active may not be available from any third-party source or fund management may conclude that the valuations that are available from third-party sources are not reliable. In these instances, fund management may perform model-based analytical valuations that may be used as an input to value these investments.

The tables below present the fair value of our investments in, and unfunded commitments to, funds that are measured at NAV (in thousands):

	June 30, 2016	
	Fair value of investments	Unfunded commitments
Private company investments	$28,639	$ 10,561
Partnership interests	20,962	1,822
Mutual funds	12,857	—
Private equity funds	12,109	9,337
Money market funds	9,822	—
Total	$84,389	$ 21,720

	December 31, 2015	
	Fair value of investments	Unfunded commitments
Private company investments	$34,385	$ 14,178
Partnership interests	22,502	2,018
Mutual funds	20,399	—
Private equity funds	12,970	9,352
Money market funds	77,097	—
Total	$167,353	$ 25,548

Financial Instruments Sold, But Not Yet Purchased

Financial instruments sold, but not purchased, recorded at fair value based on quoted prices in active markets and other observable market data include highly liquid instruments with quoted prices, such as U.S. government securities, corporate fixed income securities, and equity securities listed in active markets, which are reported as Level 1.

If quoted prices are not available, fair values are obtained from pricing services, broker quotes, or other model-based valuation techniques with observable inputs, such as the present value of estimated cash flows, and reported as Level 2. The nature of these financial instruments include instruments for which quoted prices are available but traded less frequently, instruments whose fair value has been derived using a model where inputs to the model are directly observable in the market, or can be derived principally from or corroborated by observable market data, and instruments that are fair valued using other financial instruments, the parameters of which can be directly observed. Level 2 financial instruments include U.S. government agency securities, mortgage-backed securities not actively traded, corporate fixed income and equity securities, and state and municipal securities.

Derivatives

Derivatives are valued using quoted market prices for identical instruments when available or pricing models based on the net present value of estimated future cash flows. The valuation models used require market observable inputs, including contractual terms, market prices, yield curves, credit curves, and measures of volatility. We manage credit risk for our derivative positions on a counterparty-by-counterparty basis and calculate credit valuation adjustments, included in the fair value of these instruments, on the basis of our relationships at the counterparty portfolio/master netting agreement level. These credit valuation adjustments are determined by applying a credit spread for the counterparty to the total expected exposure of the derivative after considering collateral and other master netting arrangements. We have classified our interest rate swaps as Level 2.

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2016, are presented below (in thousands):

	June 30, 2016			
	Total	Level 1	Level 2	Level 3
Financial instruments owned:				
U.S. government securities	$11,258	$11,258	$—	$—
U.S. government agency securities	210,849	1,008	209,841	—
Mortgage-backed securities:				
Agency	209,021	—	209,021	—
Non-agency	28,954	—	27,719	1,235
Corporate securities:				
Fixed income securities	278,643	22,986	255,365	292
Equity securities	125,446	124,827	—	619
State and municipal securities	222,275	—	222,275	—
Total financial instruments owned	1,086,446	160,079	924,221	2,146
Available-for-sale securities:				
U.S. government agency securities	2,688	101	2,587	—
State and municipal securities	74,712	—	74,712	—
Mortgage-backed securities:				
Agency	395,271	—	395,271	—
Commercial	2,787	—	2,787	—
Non-agency	2,188	—	2,188	—
Corporate fixed income securities	652,093	—	652,093	—
Asset-backed securities	1,336,967	—	1,336,967	—
Total available-for-sale securities	2,466,706	101	2,466,605	—
Investments:				
Corporate equity securities	27,898	22,041	1,328	4,529
Auction rate securities:				
Equity securities	50,750	—	—	50,750
Municipal securities	1,355	—	—	1,355
Other [1]	1,628	—	388	1,240
Investments in funds measured at NAV	74,567			
Total investments	156,198	22,041	1,716	57,874
Cash equivalents measured at NAV	9,822			
	$3,719,172	$182,221	$3,392,542	$60,020

[1] Includes certain private company and other investments.

June 30, 2016

	Total	Level 1	Level 2	Level 3
Liabilities:				
Financial instruments sold, but not yet purchased:				
U.S. government securities	$271,337	$271,337	$—	$ —
Agency mortgage-backed securities	75,289	—	75,289	—
Corporate securities:				
Fixed income securities	210,586	2,901	207,685	—
Equity securities	58,429	58,429	—	—
State and municipal securities	21	—	21	—
Total financial instruments sold, but not yet purchased	615,662	332,667	282,995	—
Derivative contracts [2]	17,707	—	17,707	—
	$633,369	$332,667	$300,702	$ —

[2] Included in accounts payable and accrued expenses in the consolidated statements of financial condition.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2015, are presented below (in thousands):

	December 31, 2015			
	Total	Level 1	Level 2	Level 3
Financial instruments owned:				
U.S. government securities	$45,167	$45,167	$—	$—
U.S. government agency securities	116,949	—	116,949	—
Mortgage-backed securities:				
Agency	205,473	—	205,473	—
Non-agency	33,319	—	31,843	1,476
Corporate securities:				
Fixed income securities	203,910	13,203	190,707	—
Equity securities	31,642	29,388	1,635	619
State and municipal securities	112,983	—	112,983	—
Total financial instruments owned	749,443	87,758	659,590	2,095
Available-for-sale securities:				
U.S. government agency securities	1,698	—	1,698	—
State and municipal securities	74,167	—	74,167	—
Mortgage-backed securities:				
Agency	304,893	—	304,893	—
Commercial	11,310	—	11,310	—
Non-agency	2,518	—	2,518	—
Corporate fixed income securities	319,408	—	319,408	—
Asset-backed securities	915,913	—	915,913	—
Total available-for-sale securities	1,629,907	—	1,629,907	—
Investments:				
Corporate equity securities	30,737	26,436	1,359	2,942
U.S. government securities	102	102	—	—
Auction rate securities:				
Equity securities	55,710	—	5,268	50,442
Municipal securities	1,315	—	—	1,315
Other [1]	2,897	4	2,873	20
Investments measured at NAV	90,256			
Total investments	181,017	26,542	9,500	54,719
Cash equivalents measured at NAV	77,097			
	$2,637,464	$114,300	$2,298,997	$56,814

[1] Includes certain private company and other investments.

	December 31, 2015			
	Total	Level 1	Level 2	Level 3

Liabilities:				
Financial instruments sold, but not yet purchased:				
U.S. government securities	$186,030	$186,030	$—	$ —
Agency mortgage-backed securities	50,830	—	50,830	—
Corporate securities:				
Fixed income securities	255,700	3,601	252,099	—
Equity securities	29,184	22,894	6,290	—
Total financial instruments sold, but not yet purchased	521,744	212,525	309,219	—
Derivative contracts [2]	3,591	—	3,591	—
	$525,335	$212,525	$312,810	$ —

[2] Included in accounts payable and accrued expenses in the consolidated statements of financial condition.

15

The following table summarizes the changes in fair value carrying values associated with Level 3 financial instruments during the three months ended June 30, 2016 (in thousands):

	Three Months Ended June 30, 2016						
	Financial instruments owned			Investments			
	Mortgage-Backed Securities – Non-Agency	Fixed Income Securities	Equity Securities	Corporate Equity Securities	Auction Rate Securities – Equity	Auction Rate Securities – Municipal	Other [1]
Balance at March 31, 2016	$1,433	—	$ 619	$2,979	$ 50,864	$ 1,351	$775
Unrealized gains/(losses):							
Included in changes in net assets [2]	(18)	—	—	1,550	361	4	—
Included in OCI [3]	—	—	—	—	—	—	—
Realized gains [2]	2	—	—	—	—	—	—
Purchases	—	292	—	—	—	—	—
Sales	—	—	—	—	—	—	—
Redemptions	(182)	—	—	—	(475)	—	—
Transfers:							
Into Level 3	—	—	—	—	—	—	465
Out of Level 3	—	—	—	—	—	—	—
Net change	(198)	292	—	1,550	(114)	4	465
Balance at June 30, 2016	$1,235	$ 292	$ 619	$4,529	$ 50,750	$ 1,355	$1,240

[1] Includes private company and other investments.

[2] Realized and unrealized gains related to financial instruments owned and investments are reported in other income in the consolidated statements of operations.

[3] Unrealized gains/(losses) related to available-for-sale securities are reported in accumulated other comprehensive loss in the consolidated statements of financial condition.

The following table summarizes the change in fair value associated with Level 3 financial instruments during the six months ended June 30, 2016 (in thousands):

	Six Months Ended June 30, 2016						
	Financial instruments owned			Investments			
	Mortgage-Backed Securities – Non-Agency	Fixed Income Securities	Equity Securities	Corporate Equity Securities	Auction Rate Securities – Equity	Auction Rate Securities – Municipal	Other [1]
Balance at December 31, 2015	$1,476	—	$ 619	$2,942	$ 50,442	$ 1,315	$ 20

Unrealized gains/(losses):							
Included in changes in net assets [2]	(18)	—	—	1,587	783	40	—
Included in OCI [3]	—	—	—	—	—	—	—
Realized gains [2]	9	—	—				