LEGG MASON, INC.
Form 10-K
May 24, 2013

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

FORM 10-K

(Mark One)

S ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended March 31, 2013
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
1-8529

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

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

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

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes S No £

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. S

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
(Check one)

Large accelerated filer S	Accelerated filer £
Non-accelerated filer £	Smaller reporting company £
(Do not check if a smaller reporting company)	

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

As of September 30, 2012 the aggregate market value of the registrant's voting stock, consisting of the registrant's common stock, held by non-affiliates was $2,723,419,268.

As of May 21, 2013, the number of shares outstanding of the registrant's common stock was 125,269,631.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its Annual Meeting of Stockholders to be held on July 23, 2013 are incorporated by reference into Part III of this Report.

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PART I

ITEM 1. BUSINESS.

General

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

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

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

Unless the context otherwise requires, all references in this Report to “we,” “us,” “our” and “Legg Mason” include Legg Mason, Inc. and its predecessors and subsidiaries, and the term “asset managers” refers to the asset management businesses operated by our subsidiaries. References to “fiscal year 2013” or other fiscal years refer to the 12-month period ended March 31st of the year specified.

Business Developments During the Fiscal Year Ended March 31, 2013

During fiscal year 2013, in addition to the normal course operation of our business, we changed our Chief Executive Officer ("CEO") and reorganized our executive management team to more closely align it with our key strategic priorities, adopted a capital management plan to restructure and reduce our debt and continue to manage our balance sheet to return capital to shareholders, completed the acquisition of a leading European based fund-of-hedge funds manager, and entered into a transaction to better align the interests of one of our affiliate managers with those of our shareholders by providing an equity interest in one of our asset managers to the management of that manager.

On October 1, 2012, Mark R. Fetting stepped down as Chairman and CEO of Legg Mason, and the Board of Directors appointed Legg Mason executive Joseph A. Sullivan, formerly Head of Global Distribution, as interim CEO. In February 2013, following a thorough process of evaluating numerous candidates, the Board named Mr. Sullivan as CEO. In April 2013, Mr. Sullivan announced the reorganization of the executive team, including retaining an executive to serve as Chief Administrative Officer and establishing the new position of Head of Business and Product Development. The goal of the reorganization was to align the executive team structure with three critical revenue generating strategic priorities while managing our corporate structure efficiently: expanding investment products organically and through acquisition;

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working with our investment managers to support their businesses; and strengthening our global distribution in support of our investment products and strategies.

In May 2012, we announced the adoption of a capital management plan. Under that plan, we restructured our outstanding corporate debt by repaying $1.25 billion in senior convertible notes that were scheduled to mature in 2015 and $250 million in outstanding borrowings under our revolving credit facility with a $500 million amortizing term loan maturing in five years, and $650 million in senior notes maturing in 2019. This restructuring reduced our outstanding debt, and significantly improves our financial flexibility for the next several years. The capital management plan also provides for returning capital to shareholders by using up to 65% of our cash generated from operations to repurchase shares of our common stock. During fiscal year 2013, we repurchased 16.2 million shares of common stock for $426 million and paid $55 million in dividends (an increase of 27% in dividend payout over the previous year). In April 2013, our Board of Directors declared quarterly dividends which further increased our dividend rate by 18%. Despite this return of capital to shareholders, we have maintained a strong balance sheet, with $933 million in cash and cash equivalents as of March 31, 2013.

In fiscal year 2013, we also completed the acquisition of Fauchier Partners, a leading European-based manager of funds-of-hedge funds, and combined that business with our existing subsidiary, Permal Group. We view the two businesses as highly complementary, and expect the transaction to significantly expand Permal's institutional business and add new product capabilities and distribution outlets for Permal products. In addition, to improve Permal's alignment with the interests of our shareholders and provide growth incentives, we agreed to provide an equity interest in the Permal Group to the management of that business. This transaction and other developments prompted us to reassess in December 2012 the value of our Intangible assets and Goodwill, which resulted in a write-down of $734 million of the intangible assets on our Consolidated Balance Sheet, to approximately $4.4 billion as of March 31, 2013.

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

Business Overview

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

Our subsidiary asset managers primarily earn revenues by charging fees for managing the investment assets of clients. Fees are typically calculated as a percentage of the value of assets under management and vary with the type of account managed, the amount of assets in the account, the asset manager and the type of client. Accordingly, the fee income of each of our asset managers will typically increase or decrease as its average assets under management increases or decreases. We may also earn performance fees from certain accounts if the investment performance of the assets in the account meets or exceeds a specified benchmark during a measurement period. For the fiscal years ended

March 31, 2013, 2012 and 2011, of our $2.6 billion, $2.7 billion and $2.8 billion in total revenues, $98.6 million, $49.5 million and $96.7 million, respectively, represented performance fees. As of March 31, 2013, approximately 6% of our total assets under management were in accounts that were eligible to pay performance fees. Increases in assets under management generally result from inflows of additional assets from new and existing clients and from appreciation in the value of client assets (including investment income earned on client assets). Conversely, decreases in assets under management generally result from client redemptions and depreciation in the value of client assets. Our assets under management may also increase as a result of business acquisitions, or decrease as a result of dispositions.

As of March 31 of each of the last three fiscal years, we had the following aggregate assets under management (in billions, except percents):

	Assets Under Management	Equity Assets	% of Total in Equity Assets	Fixed Income Assets	% of Total in Fixed Income Assets	Liquidity Assets	% of Total in Liquidity Assets
2013	$664.6	$161.8	24 %	$365.1	55 %	$137.7	21 %
2012	643.3	163.4	26	356.1	55	123.8	19
2011	677.6	189.6	28	356.6	53	131.4	19

From time to time, our reported equity or fixed income assets under management may exclude assets that we are retained to manage on a short-term or temporary basis.

We believe that market conditions and our investment performance are critical elements in our attempts to grow our assets under management and business. When securities markets are increasing, our assets under management will tend to increase because of market growth, resulting in additional asset management revenues. Similarly, if we can produce positive investment results, our assets under management will tend to increase as a result of the investment performance. In addition, favorable market conditions or strong relative investment performance can result in increased inflows in assets from existing and new clients. Conversely, in periods when securities markets are weak or declining, or when we have produced poor investment performance, absolute or relative to benchmarks or peers, it is likely to be more difficult to grow our assets under management and business and, in such periods, our assets under management and business are likely to decline.

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

We conduct our business primarily through 12 asset managers. Our asset managers are individual businesses, each of which generally focuses on a portion of the asset management industry in terms of the types of assets managed (primarily equity or fixed income), the types of products and services offered, the investment styles utilized, the distribution channels used, and the types and geographic locations of its clients. Each asset manager is housed in one or more different subsidiaries, all of the voting equity of which is directly or indirectly owned by Legg Mason. Each of our asset managers is generally operated as a separate business, in many cases with certain distribution functions being provided by the parent company and other affiliates, that typically markets its products and services under its own brand name. Consistent with this approach, we have in place revenue sharing agreements with certain of our asset managers: Batterymarch Financial Management, Brandywine Global Asset Management, Legg Mason Capital Management, Permal Group, Private Capital Management, Royce & Associates and Western Asset Management Company, and/or certain of their key officers. Pursuant to these revenue sharing agreements, a specified percentage of the asset manager's revenues, net of certain third party distribution expenses, is required to be distributed to us and the balance of the revenues (or net revenues) is retained to pay operating expenses, including salaries and bonuses, but excluding certain expenses such as amortization of acquired intangible assets and excluding income taxes. Specific compensation allocations are determined by the asset manager's management, subject to corporate management approval in certain cases. Although, without renegotiation, the revenue sharing agreements impede our ability to increase our profit margins of these businesses, we believe the agreements are important because they help us retain and attract talented employees and provide management of the businesses with incentives to (i) grow the asset

managers' revenues, since management is able to participate in the revenue growth through the portion that is retained; and (ii) control

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operating expenses, which will increase the portion of the revenues retained that is available to fund growth initiatives and for incentive compensation.

Asset Managers

Our asset managers provide a wide range of separate account investment management services to institutional clients, including pension and other retirement plans, corporations, insurance companies, endowments and foundations and governments, and to high net worth individuals and families. In addition, our asset managers also sponsor and manage various groups of U.S. mutual funds, including the Legg Mason Funds, The Royce Funds and the Western Asset Funds, funds-of-hedge funds and numerous proprietary equity, fixed income, liquidity and balanced funds that are domiciled and distributed in countries around the globe, and provide investment advisory services to a number of retail separately managed account programs.

Western Asset Management Company is a leading global fixed income asset manager for institutional clients. Headquartered in Pasadena, California, Western Asset's operations include investment operations in New York City, the United Kingdom, Japan, Brazil, Australia and Singapore. Western Asset offers a broad range of products spanning the yield curve and encompassing the world's major bond markets, including a suite of limited duration and core products, emerging market and high yield portfolios, municipal portfolios and a variety of sector-oriented and global products. Among the services Western Asset provides are management of separate accounts and management of mutual funds, closed-end funds, international funds and other structured investment products. As of March 31, 2013, Western Asset managed assets with a value of $458.9 billion.

ClearBridge Investments is an equity asset management firm based in New York City that also has an office in San Francisco, California. ClearBridge Investments provides asset management services to 28 of the equity funds (including balanced funds and closed-end funds) in the Legg Mason Funds, to retail separately managed account programs, to certain of our international funds and, primarily through separate accounts, to institutional clients. ClearBridge also sub-advises domestic mutual funds that are sponsored by third parties. ClearBridge offers a diverse array of investment styles and disciplines, designed to address a range of investment objectives. Significant ClearBridge investment styles include large-cap growth and core equity management. In managing assets, ClearBridge generally utilizes a bottom-up, research intensive, fundamental approach to security selection that seeks to identify companies with the potential to provide solid economic returns relative to their risk-adjusted valuations. As of March 31, 2013, ClearBridge managed assets with a value of $65.9 billion.

Brandywine Global Investment Management manages fixed income, including global and international fixed income, and equity portfolios for institutional and, through wrap accounts, high net worth individual clients. Brandywine, based in Philadelphia, Pennsylvania, pursues a value investing approach in its management of both equity and fixed income assets. As of March 31, 2013, Brandywine managed assets with a value of $46.0 billion.

Royce & Associates is the investment advisor to all of The Royce Funds and to certain of our international funds. In addition, Royce & Associates manages other pooled and separate accounts, primarily institutional. Headquartered in New York City, Royce & Associates generally invests in smaller company stocks, using a value approach. Royce & Associates' stock selection process generally seeks to identify companies with strong balance sheets and the ability to generate free cash flow. Royce & Associates pursues securities that are priced below its estimate of the company's current worth. As of March 31, 2013, Royce & Associates managed assets with a value of $37.4 billion.

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

year 2013, we acquired the Fauchier Partners business, which is being combined with the business of Permal. As of March 31, 2013, Permal managed assets with a value of $21.3 billion.

Batterymarch Financial Management manages U.S., international and emerging markets equity portfolios for institutional clients. Based in Boston, Massachusetts, Batterymarch primarily uses a quantitative approach to asset management. The firm's investment process for U.S. and international portfolios, other than emerging market portfolios, is designed to enhance the fundamental investment disciplines by using quantitative tools to process fundamental data. As of March 31, 2013, Batterymarch managed assets with a value of $12.7 billion.

Legg Mason Investment Counsel & Trust Company, National Association is a national banking association with authority to exercise trust powers. Headquartered in Baltimore, Maryland, Legg Mason Investment Counsel & Trust Company provides services as a trustee for trusts established by our individual and employee benefit plan clients and manages fixed income and equity assets. Legg Mason Investment Counsel, LLC, a subsidiary of Legg Mason Investment Counsel & Trust Company, manages equity, fixed income and balanced portfolios for high net worth individual and institutional clients and several of our proprietary mutual funds. Legg Mason Investment Counsel is headquartered in Baltimore, Maryland, and operates out of offices in New York City, Cincinnati, Philadelphia, Easton, Maryland, and Bryn Mawr, Pennsylvania. As of March 31, 2013, Legg Mason Investment Counsel & Trust Company, including its subsidiary, managed assets with a value of $8.6 billion.

Legg Mason Capital Management is an equity asset management business based in Baltimore, Maryland, that manages both institutional separate accounts and mutual funds. Legg Mason Capital Management manages four Legg Mason Funds, and also sub-advises the mutual fund managed by the joint venture described below and investment products sponsored by our other subsidiaries, including certain of our international funds. Applying the principles of value investing, Legg Mason Capital Management's investment process uses a variety of techniques to develop an estimate of the worth of a business over the long term. The objective is to identify companies where the intrinsic value of the business is significantly higher than the current market value. As of March 31, 2013, Legg Mason Capital Management managed assets with a value of $5.7 billion. We are currently in the process of combining the business operations of Legg Mason Capital Management with those of ClearBridge Investments.

Legg Mason Australian Equities is an Australian asset management business that offers Australian equity products, Australian property trusts and asset allocation products. Based in Melbourne, the firm follows a fundamental, intrinsic value approach to portfolio management and its guiding philosophy is a belief that in-depth research can generate superior long-term investment performance. As of March 31, 2013, Legg Mason Australian Equities managed assets with a value of $2.3 billion.

We and one of our employees each own 50% of a consolidated joint venture subsidiary that serves as investment manager of one equity fund, Legg Mason Opportunity Trust, within the Legg Mason Funds family. We include all of the assets managed by this joint venture, $1.3 billion at March 31, 2013, in our assets under management.

Esemplia Emerging Markets is an emerging markets equities investment manager. Headquartered in London and with an office in Hong Kong, Esemplia offers a range of portfolio management strategies, including core long-only and alpha-extension portfolios, to institutional investors around the world, including pension funds and sovereign wealth funds. Esemplia has a disciplined, systematic and fundamental-based investment process with an integrated, top-down (via country strategy) and bottom-up (via stock and sector) equity security selection process. As of March 31, 2013, Esemplia managed assets with a value of $1.2 billion.

Private Capital Management manages equity assets for high net worth individuals and families, institutions, endowments and foundations in separate accounts and through limited partnerships. Based in Naples, Florida, Private Capital Management's value-focused investment philosophy leads to an effort to build an all-cap portfolio consisting primarily of securities of mid-cap companies that possess several basic elements, including significant free cash flow, a substantial resource base and a management team with the ability to correct problems. As of March 31, 2013, Private Capital Management managed assets with a value of $1.2 billion.

Legg Mason Poland engages in portfolio management, servicing and distribution of both separate account management services and local funds in Poland. Based in Warsaw, the firm provides portfolio management services primarily for equity assets to institutions, including corporate pension plans and insurance companies, and, through

funds distributed through banks and insurance companies and individual investors. As of March 31, 2013, Legg Mason Poland managed assets with a value of $1.0 billion.

United States Mutual Funds

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

The Legg Mason Funds consist of 110 mutual funds and 26 closed-end funds in the United States, all of which are sub-advised by our subsidiary asset managers. The mutual funds and closed-end funds within the Legg Mason Funds include 66 equity funds (including balanced funds) that invest in a wide spectrum of equity securities utilizing numerous investment styles, including large- and mid-cap growth funds and international funds. The fixed income and liquidity mutual funds and closed-end funds within the Legg Mason Funds include 70 funds that offer a similarly wide variety of investment strategies and objectives, including income funds, investment grade funds and municipal securities funds. Many of our asset managers provide investment advisory services to the Legg Mason Funds. As of March 31, 2013 and 2012, the Legg Mason Funds included $114.1 billion and $114.7 billion in assets, respectively, in their mutual funds and closed-end funds, of which approximately 35% and 30%, respectively, were equity assets, approximately 28% and 24%, respectively, were fixed income assets and approximately 37% and 46%, respectively, were liquidity assets.

The Royce Funds consist of 31 mutual funds and three closed-end funds, most of which invest primarily in smaller-cap company stocks using a value approach. The funds differ in their approach to investing in smaller or micro-cap companies and the universe of securities from which they can select. As of March 31, 2013 and 2012, The Royce Funds included $34.9 billion and $37.3 billion in assets, respectively, substantially all of which were equity assets. The Royce Funds are distributed through non-affiliated fund supermarkets, our centralized funds distribution operations, non-affiliated wrap programs, and direct distribution. In addition, two of the portfolios in The Royce Funds are distributed only through insurance companies.

Our mutual funds business also includes the Western Asset Funds, a proprietary family of nine mutual funds and two closed-end funds. The mutual funds are marketed primarily to institutional investors and retirement plans through our institutional funds marketing group. Western Asset Management Company manages these funds using a team approach under the supervision of Western Asset's investment committee. The funds primarily invest in fixed income securities. As of March 31, 2013 and 2012, the Western Asset Funds included $16.4 billion and $15.5 billion in assets, respectively.

International Funds

Outside the United States, we manage, support and distribute numerous proprietary funds across a wide array of global fixed income, liquidity and equity investment strategies. Our international funds include a broad range of cross border funds that are domiciled in Ireland and Luxembourg and are sold in a number of countries across Asia, Europe and Latin America. Our international funds also include local fund ranges that are available for distribution in the United Kingdom, Australia, Japan, Singapore, Poland, Hong Kong and Canada. Our international funds are distributed and serviced by Legg Mason's global distribution group, as discussed below. Our international funds include equity, fixed income, liquidity and balanced funds that are primarily managed or sub-advised by Batterymarch Financial Management, Brandywine Global, ClearBridge, Esemplia, Legg Mason Capital Management, Private Capital Management, Royce & Associates, Western Asset Management and our global asset allocation team. In aggregate, we sponsor and manage more than 230 of these international funds, which as of March 31, 2013 and 2012, had an aggregate of approximately $123.1 billion and $104.5 billion in assets, respectively. The information in this paragraph does not include the funds-of-hedge funds managed by Permal, or the Brazil-domiciled funds managed by Western Asset Management.

Retail Separately Managed Account Programs

We are a leading provider of asset management services to retail separately managed account programs, commonly known as managed account or wrap programs. These programs typically allow securities brokers or other financial

intermediaries to offer their clients the opportunity to choose from a number of asset management services pursuing different investment strategies provided by one or more asset managers, and generally charge an all-inclusive fee that covers asset management, trade execution, asset allocation and custodial and administrative services. We provide investment management services to a number of retail separately managed account programs sponsored by several financial institutions.

Distribution

Our centralized global distribution group distributes and supports our U.S. and international funds and retail separately managed account program business. In general, our fund distributors are housed in separate subsidiaries from our asset managers. In addition, each of our asset managers has its own distribution operations that distribute its products and services, primarily, in most cases, to institutional investors.

U.S. Distribution

The U.S.-based operations of our global distribution group support and distribute the Legg Mason Funds, The Royce Funds and the Western Asset Funds, and include our mutual fund wholesalers and our institutional funds marketing group. Our mutual fund wholesalers distribute the Legg Mason Funds through a number of third-party distributors. Historically, many of the Legg Mason Funds were principally sold through the retail brokerage business of Citigroup. While we have worked to diversify our distribution network, the retail business created by the combination of Morgan Stanley's brokerage unit and Citigroup's Smith Barney unit into Morgan Stanley Wealth Management remains the primary intermediary selling the Legg Mason Funds. We are not able to predict the long-term effect of the Morgan Stanley Wealth Management business on our ability to continue to successfully distribute our funds through it, or the costs of doing so. We have, however, experienced a reduction in our liquidity assets under management as a result of Morgan Stanley Wealth Management amending certain historic brokerage programs that had provided assets under management to liquidity funds our asset managers manage. Our institutional funds marketing group distributes institutional share classes of the Legg Mason Funds and the Western Asset Funds to institutional clients and also distributes variable annuity sub-advisory services provided by our asset managers to insurance companies. Our institutional liquidity funds are primarily distributed by Western Asset's distributors. In addition to our centralized funds distribution group, Royce & Associates' distributors also distribute The Royce Funds.

In addition to distributing funds, the wholesalers in our global distribution operations also support our retail separately managed account program services. These services are provided through programs sponsored by Morgan Stanley Wealth Management's retail business, as well as other financial institutions.

Outside of our global distribution group, each of our United States asset managers has its own marketing group that distributes its separate account management services to institutions or high net worth individuals and families. The institutional marketing groups distribute asset management services to potential clients, both directly and through consultants. Consultants play a large role in the institutional asset management business by helping clients select and retain asset managers. Institutional asset management clients and their consultants tend to be highly sophisticated and investment performance-driven. The high net worth individual marketing groups distribute asset management services for high net worth families and individuals both directly to clients and indirectly through financial intermediaries.

International Distribution

The international distributors within our global distribution group offer our investment management services to individual and institutional investors across Asia, Europe and the Americas. These distributors operate out of distribution offices in 16 cities in 14 countries and are the sole distributors of our cross border funds globally and our international local funds in their respective countries. The goal of our international distributors is to be a global partner for firms that utilize or distribute asset management products around the world, but also to be viewed as a local partner through an understanding of the nuances and needs of each local market that they cover. These distributors seek to develop deep distribution relationships with retail banks, private banks, asset managers, fund platforms, pension plans and insurance plans. Our international distribution offices also work with our asset managers on a case-by-case basis to take advantage of preferences for local distributors or to meet regulatory requirements in distributing products and services into their local markets.

Legg Mason Investments is the largest business component within our international distribution group. It is responsible for the distribution and servicing of cross border and local fund ranges across Europe, the Americas and Asia. Legg Mason Investments has offices in locations including London, Paris, Milan, Geneva, Frankfurt, Madrid, Singapore, Hong Kong, Taipei, Miami, Santiago and New York. Our distribution efforts are not limited to the locations where we have offices, as Legg Mason Investments distributes cross border funds in more than 30 countries

around the world. This global presence provides Legg Mason Investments with the capabilities to provide a platform of sales, service, marketing and products that can cater to the different distribution dynamics in each of the three regions that it covers. Client coverage is

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local, coordinated across regions, and encompasses multiple distribution channels including broker-dealers, funds-of-funds, asset managers, independent financial advisers, banks, fund platforms, insurance companies and other distribution partners. The extent to which each channel takes precedence in any one market is governed by local market dynamics.

In addition to Legg Mason Investments, our global distribution group includes separate distribution operations in Australia, Canada and Japan. In Australia, our distribution operations distribute local and cross border pooled investment vehicles sub-advised by our asset managers primarily to retail investors, pension plans, fund-of-funds managers, insurance companies and government funds/agencies. In Canada, our distribution operations distribute Legg Mason-managed products primarily to pension plans, endowments, foundations, banks and mutual fund companies and separately managed account programs. In Japan, our distribution operations distribute domestic investment funds, cross border funds and institutional separate accounts primarily to the retail market, which includes retail banks, private banks, asset managers, funds platforms and insurance companies.

Esemplia, Legg Mason Australian Equities and Legg Mason Poland cooperate from time to time on certain marketing and other similar activities as the Legg Mason Global Equities Group.

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

Employees

At March 31, 2013, 2012 and 2011, we had 2,975, 2,979 and 3,395 employees, respectively. None of our employees is covered by a collective bargaining agreement. We consider our relations with our employees to be satisfactory. However, competition for experienced asset management personnel is intense and from time to time we may experience a loss of valuable personnel. We recognize the importance to our business of hiring, training and retaining skilled professionals.

Competition

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

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

Regulation

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

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Our U.S. asset managers are registered as investment advisors with the SEC, as are several of our international asset managers, and are also required to make notice filings in certain states. Virtually all aspects of the asset management business, including related sales and distribution activities, are subject to various federal and state laws and regulations and self-regulatory organization rules. These laws, rules and regulations are primarily intended to protect the asset management clients and generally grant supervisory agencies and bodies broad administrative powers, including the power to limit or restrict an investment advisor from conducting its asset management business in the event that it fails to comply with such laws and regulations. Possible sanctions that may be imposed include the suspension of individual employees, the imposition of limitations on engaging in the asset management business for specified periods of time, the requirement to hire independent compliance consultants, the revocation of licenses or registrations, and imposition of censures and fines. A regulatory proceeding, regardless of whether it results in a sanction, can require substantial expenditures and can have an adverse effect on our reputation or business. Regulators also have a variety of informal enforcement mechanisms available that could have a significant impact on our business.

Our asset managers also may be subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and related regulations, particularly insofar as they act as a "fiduciary" under ERISA with respect to benefit plan clients. ERISA and related provisions of the Internal Revenue Code impose duties on persons who are fiduciaries under ERISA, and prohibit certain transactions involving the assets of ERISA plan clients and certain transactions by the fiduciaries (and several other related parties) to the plans. The Department of Labor, which administers ERISA, has been increasingly active in proposing and adopting regulations affecting the asset management industry. In addition, Legg Mason Investment Counsel & Trust Company is regulated by the Office of the Comptroller of the Currency.

In our international business, we have fund management, asset management and distribution subsidiaries domiciled in a number of jurisdictions, including Australia, Brazil, Canada, Japan, Hong Kong, Ireland, Luxembourg, Poland, Singapore, Taiwan and the United Kingdom that are subject to extensive regulation under the laws of, and to supervision by, governmental authorities in each of these jurisdictions. Our international subsidiaries are also authorized or licensed to offer their products and services in several other countries around the world, and thus are subject to the laws of, and to supervision by, governmental authorities in these additional countries. In addition, a subsidiary of Permal is a Bahamas bank regulated by the Central Bank of the Bahamas. Our offshore proprietary funds are subject to the laws and regulatory bodies of the jurisdictions in which they are domiciled and, for funds listed on exchanges, to the rules of the applicable exchanges. Certain of our funds domiciled in Ireland and Luxembourg are also registered for public sale in several countries around the world and are subject to the laws of, and supervision by, the governmental authorities of those countries. All of these non-U.S. governmental authorities generally have broad supervisory and disciplinary powers, including, among others, the power to set minimum capital requirements, to temporarily or permanently revoke the authorization to carry on regulated business, to suspend registered employees, and to invoke censures and fines for both the regulated business and its registered employees.

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

Net Capital Requirements

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

ITEM 1A. RISK FACTORS.

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

Risks Related to our Asset Management Business

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

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

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

In addition, in the ordinary course of our business we may reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. If our revenues decline without a commensurate reduction in our expenses, our net income will be reduced. During certain times over the last six fiscal years, several of our key equity and fixed income asset managers generated poor investment performance, on a relative basis or an absolute basis, in certain products or accounts that they managed. These investment performance issues contributed to a significant reduction in their assets under management and revenues and a reduction in performance fees. Although our overall investment performance has improved over the last three fiscal years, we still face performance issues with a number of our products, and there is typically a lag before improvements in investment performance produce a positive effect on asset flows. There can be no assurances as to when investment performance issues will cease to influence our assets under management and revenues.

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

Our investment advisory and administrative contracts are generally terminable at will or upon relatively short notice, and investors in the mutual funds that we manage may redeem their investments in the funds at any time without prior notice. Institutional and individual clients can terminate their relationships with us, reduce the aggregate amount of assets under management, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, changes in investment preferences of clients, changes in our reputation in the marketplace, changes in management or control of clients or third-party distributors with whom we have relationships, loss of key investment management or other personnel and financial market performance. This risk is underscored by the fact that we have two international clients that represent approximately 11.7% (primarily liquidity assets) and 2.7%, respectively, of our total assets under management that generate approximately 2.5% and less than 0.1%, respectively, of our operating revenues. In addition, in a declining securities market, the pace of mutual fund redemptions and withdrawal of assets from other accounts could accelerate. Poor investment performance generally or relative to other investment management firms tends to result in decreased purchases of fund shares, increased redemptions of fund shares, and the loss of institutional or individual accounts. Due in part to investment performance issues, we have experienced net outflows of equity and fixed income assets under management for the last seven and six fiscal years, respectively. While the rate of outflows decreased in fiscal year 2013, there can be no assurances as to when, or if, the flows will reverse. During fiscal years 2013 and 2012 we had $11.7 billion and $27.5 billion, respectively, in aggregate net client outflows. The fiscal year 2013 outflows included $20.4 billion in equity asset outflows and $11.0 in fixed income asset outflows, which were partially offset by $19.7 billion in liquidity asset inflows.

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

Our profit margins and net income are dependent in significant part on our ability to maintain current fee levels for the products and services that our asset managers offer. There has been a trend toward lower fees in some segments of the

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

Our assets under management can generate very different revenues per dollar of managed assets based on factors such as the type of asset managed (equity assets generally produce greater revenues than fixed income assets), the type of client (institutional clients generally pay lower fees than other clients), the type of asset management product or service provided and the fee schedule of the asset manager providing the service. A shift in the mix of our assets under management from higher revenue-generating assets to lower revenue-generating assets may result in a decrease in our revenues even if our aggregate level of assets under management remains unchanged or increases. A decrease in our revenues, without a commensurate reduction in expenses, will reduce our net income. We experienced such a shift in the mix of our assets under management during fiscal year 2013, during which our equity assets under management decreased from $163.4 billion (26% of our total assets under management) on March 31, 2012 to $161.8 billion (24% of our total assets under management) on March 31, 2013. There can be no assurances that this shift will not continue or reverse.

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

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

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

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

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

A large portion of our revenue is derived from investment advisory contracts with clients. Under these contracts, the investment advisory fees we receive are typically based on the market value of assets under management. Accordingly, a decline in the prices of securities generally may cause our revenues and income to decline by:

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

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

In addition, as of March 31, 2013, a substantial portion of our assets was invested in securities and other seed capital investments. A decline in the value of equity, fixed income or other alternative securities could lower the value of these investments and result in declines in our non-operating income and net income. Increases or decreases in the value of these investments could increase the volatility of our earnings.

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

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

The current historically low interest rate environment affects the yields of money market funds, which are based on the income from the underlying securities less the operating costs of the funds. With short-term interest rates at or near zero, the operating expenses of money market funds may become greater than the income from the underlying securities. We are monitoring the industry wide low yields of money market funds, which may result in negative yields, particularly in Europe, which could have a significant adverse effect on the industry in general and our liquidity business in particular. During the past three fiscal years, we voluntarily waived certain fees or assumed expenses of money market funds for competitive reasons, such as to maintain positive yields. These fee waivers resulted in $100 million in reduced investment advisory revenues in fiscal year 2013, and have continued into the present fiscal year.

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

The asset management industry in which we are engaged is extremely competitive and we face substantial competition in all aspects of our business. We compete with numerous international and domestic asset management firms and broker-dealers, mutual fund complexes, hedge funds, commercial banks, insurance companies, other investment companies and other financial institutions. Many of these organizations offer products and services that are similar to, or compete with, those offered by our asset managers and have substantially more personnel and greater financial resources than we do. Some of these competitors have proprietary products and distribution channels that make it more difficult for us to compete with them. In addition, many of our competitors have long-standing and established relationships with distributors and clients. From time to time, our asset managers also compete with each other for clients and assets under management. Our ability to compete may be adversely affected if, among other things, our asset managers lose key employees or, as has been the case for certain of the products managed by our asset managers, under-perform in comparison to relevant performance benchmarks or peer groups.

The asset management industry has experienced from time to time the entry of many new firms, as well as significant consolidation as numerous asset management firms have either been acquired by other financial services firms or ceased operations. In many cases, this has resulted in firms with greater financial resources than we have. In addition, a number of heavily capitalized companies, including commercial banks and foreign entities have made investments in and acquired asset management firms. Access to mutual fund distribution channels has also become increasingly competitive. All of these factors could make it more difficult for us to compete, and no assurance can be given that we

will be successful in competing and growing our assets under management and business. If clients and potential clients decide to use the services of competitors, it could reduce our revenues and growth rate, and if our revenues decrease without a commensurate reduction in our expenses, our net income will be reduced. In this regard, there are a number of asset classes and product types that are not well covered by our current products and services. When these asset classes or products are in favor with investors,

we will miss the opportunity to gain the assets under management that are being invested in these assets and face the risk of our managed assets being withdrawn in favor of competitors who provide services covering these classes or products. For example, to the extent there is a trend in the asset management business in favor of passive products such as index and exchange- traded funds, it favors our competitors who provide those products over active managers like our asset managers. In addition, our asset managers are not typically the lowest cost provider of asset management services. To the extent that we compete on the basis of price in any of our businesses, we may not be able to maintain our current fee structure in that business, which could adversely affect our revenues and net income.
In the retail separately managed account program business, there has been a trend toward more open programs that involve more asset managers who provide only investment models which the financial institution sponsor's employees use to allocate assets. A number of the programs for which we provide services have followed this trend, and additional programs could do so in the future. This trend could result in assets under management retention issues due to additional competition within the programs, particularly for products with performance issues, and reduced management fees, which are typical results of providing investment models rather than advisory services.
Our business is asset management. As a result, we may be more affected by trends and issues affecting the asset management industry, such as industry-wide regulatory issues and inquiries, publicity about, and public perceptions of the industry and asset management industry market cycles, than other financial services companies that have more diversified businesses.

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

Approximately 21% of our assets under management as of March 31, 2013, consisted of assets in money market funds. Money market funds seek to preserve a stable net asset value. The money market funds our asset managers manage have always maintained this stable net asset value. However, there is no guarantee that this stable net asset value will be achieved in the future. Market conditions could lead to severe liquidity or security pricing issues, which could impact their net asset values. If the net asset value of a money market fund managed by our asset managers were to fall below its stable net asset value, we would likely experience significant redemptions in assets under management and reputational harm, which could have a material adverse effect on our revenues or net income.
If a money market fund's stable net asset value comes under pressure, we may elect, as we have done in the past, to provide credit, liquidity, or other support to the fund. We may also elect to provide similar or other support, including by providing liquidity to a fund, to other products we manage for any number of reasons. We are not legally required to support any money market fund or other product and there can be no assurance that any support would be sufficient to avoid an adverse impact on any product or investors in any product. A decision to provide support may arise from factors specific to our products or from industry-wide factors. If we elect to provide support, we could incur losses from the support we provide and incur additional costs, including financing costs, in connection with the support. These losses and additional costs could be material, and could adversely affect our earnings. If we were to take such actions we may also restrict our corporate assets, limiting our flexibility to use these assets for other purposes, and may be required to raise additional capital.

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

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

The Soundness of Other Financial Institutions Could Adversely Affect our Business

Volatility in the markets in the recent past has highlighted the interconnection of the global markets and demonstrated how the deteriorating financial condition of one institution may materially and adversely impact the performance of other institutions. Legg Mason, and the funds and accounts that we manage, has exposure to many different industries

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counterparties, and routinely executes transactions with counterparties in the financial industry. We, and the funds and accounts we manage, may be exposed to credit, operational or other risk in the event of a default by a counterparty or client, or in the event of other unrelated systemic failures in the markets.

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

A portion of our total revenues is derived from performance fees. Our asset managers earn performance fees under certain client agreements if the investment performance in the portfolio meets or exceeds a specified benchmark. If the investment performance does not meet or exceed the investment return benchmark for a particular period, the asset manager will not generate a performance fee for that period and, if the benchmark is based on cumulative returns, the asset manager's ability to earn performance fees in future periods may be impaired. As of March 31, 2013, approximately 6% of our assets under management were in accounts or products that are eligible to earn performance fees. We earned $98.6 million, $49.5 million and $96.7 million in performance fees during fiscal 2013, 2012 and 2011, respectively. An increase in performance fees, or in performance-based fee arrangements with our clients, could create greater fluctuations in our revenues.

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

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

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

Permal operates in the international funds-of-hedge funds business. The funds-of-hedge funds business typically involves clients being charged fees on two levels - at the funds-of-funds level and at the underlying funds level. These fees may include management fees and performance fees. While we are not currently aware of any issues in this area, there is no assurance that Permal will not be forced to change its fee structures by competitive or other pressures or that Permal's fee structures will not hamper its growth. Furthermore, Permal, consistent with other funds-of-hedge funds managers, has experienced a trend in recent years of outflows in business from retail high net worth clients and inflows from institutional clients. There can be no assurance that Permal will be able to continue its transition into the institutional business, or that this transition will not affect the revenues or profits of Permal. In addition, Permal may generate significant performance fees from time to time, which could increase the volatility of our revenues. See " - Performance-Based Fee Arrangements May Increase the Volatility of our Revenues." Because Permal operates in the funds-of-hedge funds business globally, it is exposed to a number of regulatory authorities and requirements in different jurisdictions.

Risks Related to our Company

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

At March 31, 2013, on a consolidated basis, we had approximately $1.1 billion in total indebtedness, excluding debt of consolidated investment vehicles for which we are not responsible, and total stockholders' equity of $4.8 billion, and our goodwill and other intangible assets were $1.3 billion and $3.2 billion, respectively. As of March 31, 2013, we had $500 million of additional borrowing capacity available under our various credit agreements, subject to certain conditions and compliance with the covenants in our outstanding indebtedness. As a result of this substantial indebtedness, we are required to use a significant portion of our cash flow to service principal and interest on our debt, which will limit the cash flow available for other business opportunities. In addition, these servicing obligations would increase in the future if we incur additional indebtedness.

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

The level of our indebtedness could:

- limit our ability to obtain additional debt financing in the future or to borrow under our existing credit facilities (our principal bank debt facility requires that (i) our ratio of net debt (total debt less unrestricted cash in excess of working capital) to Consolidated EBITDA (as defined therein) not exceed 2.5 to 1, and (ii) our ratio of Consolidated EBITDA to total cash interest payments on certain Indebtedness (as defined therein) exceeds 4 to 1);
- limit cash flow available for general corporate purposes due to the ongoing cash flow requirements for debt service;
- limit our flexibility, including our ability to react to competitive and other changes in the industry and economic conditions; and
- place us at a competitive disadvantage compared to our competitors that have less debt.

As of March 31, 2013, under the terms of our bank credit agreement our ratio of net debt to Consolidated EBITDA was 1.4 to 1 and our ratio of Consolidated EBITDA to interest expense was 11.6 to 1, and, therefore, Legg Mason was in compliance with its bank financial covenants. If our net income significantly declines for any reason, it may be difficult to remain in compliance with these covenants. Similarly, to the extent that we spend our available cash for purposes other than repaying debt or acquiring businesses that increase our EBITDA, we will increase our net debt to Consolidated EBITDA ratio. Although there are actions that we may take if our financial covenant compliance becomes an issue, there can be no assurance that Legg Mason will remain in compliance with its bank debt covenants. In addition, the terms of the $650 million senior notes that we issued in May 2012 provide limitations on our ability to sell, and the use of proceeds from any sale of, certain significant subsidiaries.

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

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

We May Engage in Strategic Transactions That Could Create Risks

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

- adverse effects on our reported earnings per share in the event acquired intangible assets or goodwill become impaired;
- existence of unknown liabilities or contingencies that arise after closing; and
- potential disputes with counterparties.

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

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

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

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

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

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

Loss of Key Personnel Could Harm our Business

We are dependent on the continued services of a number of our key asset management personnel and our management team, including our Chief Executive Officer. The loss of any of such personnel without adequate replacement could have a material adverse effect on us. Moreover, since certain of our asset managers contribute significantly to our revenues and net income, the loss of even a small number of key personnel at these businesses could have a disproportionate impact on our overall business. Additionally, we need qualified managers and skilled employees with asset management experience in order to operate our business successfully. The market for experienced asset management professionals is extremely competitive and is increasingly characterized by the movement of employees among different firms. Due to the competitive market for asset management professionals and the success of some of

our employees, our costs to attract and retain key

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employees are significant and will likely increase over time. From time to time, we may work with key employees to revise revenue sharing agreements and other employment-related terms to reflect current circumstances, including in situations where a revenue sharing agreement may result in insufficient revenues being retained by the subsidiary. In addition, since the investment track record of many of our products and services is often attributed to a small number of individual employees, and sometimes one person, the departure of one or more of these employees could cause the business to lose client accounts or managed assets, which could have a material adverse effect on our results of operations and financial condition. If we are unable to attract and retain qualified individuals or our costs to do so increase significantly, our operations and financial results would be materially adversely affected.

Our Business is Subject to Numerous Operational Risks

We face numerous operational risks related to our business on a day-to-day basis. Among other things, we must be able to consistently and reliably obtain securities pricing information, process trading activity, process client and investor transactions and provide reports and other customer service to our clients, investors and distributors. Failure to keep current and accurate books and records can render us subject to disciplinary action by governmental and self-regulatory authorities, as well as to claims by our clients. If any of our financial, portfolio accounting or other data processing systems, or the systems of third parties on whom we rely, do not operate properly or are disabled or if there are other shortcomings or failures in our internal processes, people or systems, or those of third parties on whom we rely, we could suffer an impairment to our liquidity, a financial loss, a disruption of our businesses, liability to clients, regulatory problems or damage to our reputation. These systems may fail to operate properly or become disabled as a result of events that are wholly or partially beyond our control, including a disruption of electrical or communications services or our inability to occupy one or more offices (as occurred with one of our New York City offices when the office building in which it was located was flooded by Hurricane Sandy in October 2012). In addition, our operations are dependent upon information from, and communications with, third parties, and operational problems at third parties may adversely affect our ability to carry on our business.

Our operations rely on the secure processing, storage and transmission of confidential and other information in our computer systems, networks and mobile devices and on the computer systems, networks and mobile devices of third parties on whom we rely. Although we take protective measures and endeavor to modify them as circumstances warrant, our computer systems, software, networks and mobile devices, and those of third parties on whom we rely, may be vulnerable to unauthorized access, computer viruses or other malicious code, and other events that have a security impact. If one or more of such events occur, it potentially could jeopardize our or our clients', employees' or counterparties' confidential and other information processed and stored in, and transmitted through, our or third party computer systems, networks and mobile devices, or otherwise cause interruptions or malfunctions in our, our clients', our counterparties' or third parties' operations. We may be required to spend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against fully or not fully covered through any insurance that we maintain.

We depend on our headquarters, the offices of our subsidiaries, our operations centers and third-party providers for the continued operation of our business. A disaster or a disruption in the infrastructure that supports our asset managers, or an event disrupting the ability of our employees to perform their job functions, including terrorist attacks or a disruption involving electrical communications, transportation or other services used by us or third parties with whom we conduct business, directly affecting our headquarters, the offices of our subsidiaries, our operations centers or the travel of our sales, client service and other personnel, may have a material adverse impact on our ability to continue to operate our business without interruption. Although we have disaster recovery programs in place, there can be no assurance that these will be sufficient to mitigate the harm that may result from such a disaster or disruption. In addition, insurance and other safeguards might only partially reimburse us for our losses.

We May Incur Charges Related to Leased Facilities

We continue to be exposed to the risk of incurring charges related to subleases or vacant space for several of our leased offices. As of March 31, 2013, our future commitments from third parties under non-cancellable subleases were

approximately $152 million, which in total, net of reserves, effectively offsets obligations under our leases for the properties. As part of an evaluation of our real estate needs, we abandoned certain leased real estate during fiscal year 2013, and are pursuing sub-tenants for that space. As of March 31, 2013, our total future lease commitments for office space that we vacated and are seeking to sublease was approximately $76 million, of which we reserved approximately $29 million through lease charges to our earnings during the fiscal year ended March 31, 2013. Under generally accepted accounting principles,

at the time a sublease is entered into or space is deemed permanently abandoned, we must incur a charge equal to the present value of the amount by which the commitments under the lease exceeds the amount due, or amount expected to be received, under a sublease. As a result, in a period of declining commercial lease markets, we are exposed to the risk of incurring charges relating to any premises we are seeking to sublease resulting from longer periods to identify sub-tenants and reduced market rent rates leading to new sub-tenants paying less in rent than we are paying under our lease. Also, if a sub-tenant defaults on its sublease, we would likely incur a charge for the rent that we will incur during the period that we expect would be required to sublease the premises and any reduction in rent that current market rent rates lead us to expect a new sub-tenant will pay. This risk is underscored by the fact that one sub-tenant represents approximately half of the future sublease rent commitments described above. There can be no assurance that we will not recognize additional lease-related charges, which may be material to our results of operations.

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

Determining goodwill and intangible assets, and evaluating them for impairment, requires significant management estimates and judgment, including estimating value and assessing life in connection with the allocation of purchase price in the acquisition creating them. Our goodwill and intangible assets may become impaired as a result of any number of factors, including losses of investment management contracts or declines in the value of managed assets. Any impairment of goodwill or intangibles could have a material adverse effect on our results of operations. For example, during the fiscal year ended March 31, 2013, we incurred aggregate impairment charges of $734 million ($508 million, net of taxes) primarily relating to domestic mutual fund contracts and Permal funds-of-hedge funds contracts.

The domestic mutual fund contracts asset acquired in the 2005 acquisition of the Citigroup Asset Management ("CAM") business of $2,106 million and the Permal funds-of-hedge funds contracts asset of $626 million account for approximately 65% and 20%, respectively, of our indefinite-life intangible assets, while the goodwill in our reporting unit aggregates $1.3 billion.

The carrying values of domestic mutual fund contracts and Permal funds-of-hedge funds contracts assets have been recently written down to fair value, and any decreases in our cash flow projections or increases in the discount rates, resulting from actual results or changes in assumptions, resulting from market conditions, reduced assets under management, less favorable operating margins, lower yielding asset mixes, and other factors, may result in further impairments of these assets. The fair value of our reporting unit exceeded its carrying value by approximately $660 million at December 31, 2012. We now include all corporate consolidated assets and liabilities in our Global Asset Management Business reporting unit carrying and fair values. Likewise, all corporate costs are now included in our analyses of the reporting unit fair value. Similar to the intangible assets, changes in the assumptions underlying projected cash flows from the reporting unit or its EBITDA multiple, resulting from market conditions, reduced assets under management or other factors, could result in an impairment of goodwill.

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

Our Deferred Tax Assets May Not Be Fully Realizable

As of March 31, 2013, we had approximately $771 million in U.S. federal deferred tax assets, which represent tax benefits that we expect to realize in future periods. Under accounting rules, we are required to recognize a charge to earnings to reduce our deferred tax assets if it is determined that any future tax benefits are not likely to be realized before they expire. Deferred tax assets generated in U.S. jurisdictions resulting from net operating losses generally expire 20 years after they are generated. Those resulting from foreign tax credits generally expire 10 years after they are generated. In order to realize these future tax benefits, we estimate that we must generate approximately $4.2 billion in future U.S. earnings, approximately $332 million of which must be in the form of foreign source income, before the benefits expire. There can be no assurances that we will achieve this level of earnings before some

portion of these tax benefits expires. In addition, our belief that we will likely be able to realize these future tax benefits is based in part upon our estimates of the timing of other differences in revenue and expense recognition between tax returns and financial statements and our understanding of the application of tax regulations, which may prove to be incorrect for any number of reasons, including future changes in tax or accounting regulations. If we are required to recognize a charge to earnings to reduce our deferred tax assets, the charge may be material to our earnings or financial condition.

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

Our asset managers operate in a number of jurisdictions outside of the United States on behalf of international clients. We have offices in numerous countries and many cross border and local proprietary funds that are domiciled outside the United States. Our international operations require us to comply with the legal requirements of various foreign jurisdictions, expose us to the political consequences of operating in foreign jurisdictions and subject us to expropriation risks, expatriation controls and potential adverse tax consequences which, among other things, make it more difficult to repatriate to the United States the cash that we generate outside the U.S. At March 31, 2013, our total cash and cash equivalents of $933 million included approximately $415 million held by our foreign subsidiaries, some of which, if repatriated, may be subject to material tax effects. Furthermore, despite controls and other actions reasonably designed to mitigate these risks, our international operations expose us to risks arising from Legg Mason's potential responsibility for actions of third party agents and other representatives of our business operating outside our primary jurisdictions of operation. Our foreign business operations are also subject to the following risks:

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

Legal and Regulatory Risks

Regulatory Matters May Negatively Affect our Business and Results of Operations

Our business is subject to regulation by various regulatory authorities that are charged with protecting the interests of our clients. We could be subject to civil liability, criminal liability, or sanction, including revocation of our subsidiaries' registrations as investment advisers, revocation of the licenses of our employees, censures, fines, or temporary suspension or permanent bar from conducting business, if we violate such laws or regulations. Any such liability or sanction could have a material adverse effect on our financial condition, results of operations, reputation, and business prospects. In addition, the regulatory environment in which we operate frequently changes and has seen significant increased regulation in recent years. In particular, we have incurred, and will continue to incur, significant additional costs as a result of regulatory changes affecting U.S. mutual funds and changes to European mutual fund regulation, including the European Union directive on Undertakings for Collective Investments in Transferable Securities directives and the Alternative Investment Fund Managers directive. Furthermore, the SEC has proposed replacing Rule 12b-1 under the Investment Company Act of 1940, which regulates certain fees that may be paid to mutual fund distributors, with a new regulation that would significantly change fund distribution practices in the industry. This proposal, if adopted, could increase our operational and compliance costs and may affect our ability to compensate distributors for selling our products. We also are spending time and money to comply with the requirements of the U.S. Foreign Account Tax Compliance Act. Our business and results of operations can also be adversely affected by federal, state and foreign regulatory issues and proceedings.

We may be adversely affected as a result of new or revised legislation or regulations or by changes in the interpretation or enforcement of existing laws and regulations. For example, we note that the U.S. federal government has made, and has proposed further, significant changes to the regulatory structure of the financial services industry, and we expect to spend time and resources to comply with these regulatory changes.

We also note that recommendations for regulatory reform in the liquidity asset management business include the possible imposition of banking and banking-like regulations on liquidity funds and their managers or of ending the stable-value characteristic of these funds. Currently, SEC and European regulatory officials have stated publicly that they are considering proposing additional regulations for money market funds that are designed to address certain concerns arising from the 2007-2008 financial crisis. Among the changes under consideration are a possible requirement that money market funds have a capital buffer, the imposition of redemption holdbacks, and a requirement that money market funds convert to a floating net asset value. If adopted, these proposals, which also have been publicly supported by a number of banking officials, could significantly impact the money market fund industry. Depending on the nature of any changes adopted, the new regulations could, among other things, reduce the attractiveness of money market funds to retail and institutional investors and raise the costs of being in this business.

We continue to monitor this area carefully and, if new regulations are

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adopted, we will consider how they affect our liquidity management business and take action, as appropriate. Any of these revisions could adversely affect our liquidity asset management business and our results of operations.
Instances of criminal activity and fraud by participants in the asset management industry, disclosures of trading and other abuses by participants in the financial services industry and significant governmental intervention and investment in the financial markets and financial firms have led the U.S. government and regulators to increase the rules and regulations governing, and oversight of, the U.S. financial system. This activity has resulted in changes to the laws and regulations governing the asset management industry and more aggressive enforcement of the existing laws and regulations. For example, the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act in the U.S. provides for a comprehensive overhaul of the financial services regulatory environment and requires the adoption of extensive regulations and many regulatory decisions to be implemented. Certain provisions of the Dodd-Frank Act will, and other provisions may, require us to change or impose new limitations on the manner in which we conduct business, will or may increase regulatory compliance burdens, and may have unintended adverse consequences on the liquidity or structure of the financial markets. The ongoing revisions to the laws and regulations governing our business, and their counterparts internationally, are an ongoing process. The cumulative effect of these actions may result in increased expenses, or lower management or other fees, and therefore adversely affect the revenues or profitability of our business.

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

Many aspects of our business involve substantial risks of liability. In the normal course of business, our asset managers are from time to time named as defendants or co-defendants in lawsuits, or are involved in disputes that involve the threat of lawsuits, seeking substantial damages. For example, one of our asset managers was named as the defendant in a lawsuit filed by a former institutional client seeking damages in excess of $90 million. Although we believe the claims are without merit, no assurances can be given that this lawsuit will not adversely impact our expenses or net income. We are also involved from time to time in governmental and self-regulatory organization investigations and proceedings, including the regulatory proceedings discussed in Note 8 of Notes to Consolidated Financial Statements in Item 8 of this Report. Similarly, the investment funds that our asset managers manage are subject to actual and threatened lawsuits and governmental and self-regulatory organization investigations and proceedings, any of which could harm the investment returns or reputation of the applicable fund or result in our asset managers being liable to the funds for any resulting damages. There has been an increased incidence of litigation and regulatory investigations in the asset management industry in recent years, including customer claims as well as class action suits seeking substantial damages. Any litigation can increase our expenses and reduce our net income.

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

We lease all of our office space. Our headquarters and certain other functions are located in an office building in Baltimore, Maryland, in which we currently hold under lease approximately 372,000 square feet, of which approximately 82,000 square feet has been subleased to third parties.

Our asset managers and other subsidiaries are housed in office buildings in 32 cities in 19 countries around the world. The largest of the leases include:

- ClearBridge Investments, Western Asset Management Company and our distribution and administrative services subsidiaries currently occupy approximately 130,000 square feet in an office building located in New York, New York in which we hold under lease approximately 193,000 square feet. The remaining 63,000 square feet has been subleased to a third party;
- Western Asset Management Company's headquarters is housed in an office building in Pasadena, California in which we occupy approximately 190,000 square feet; and
- our distribution and administrative services subsidiaries occupy approximately 91,000 square feet in an office building located in Stamford, Connecticut in which we hold under lease approximately 138,000 square feet. The remaining 47,000 square feet has been subleased to a third party.

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

ITEM 3. LEGAL PROCEEDINGS.

Our current and former subsidiaries have been the subject of customer complaints and have also been named as defendants in various legal actions arising primarily from securities brokerage, asset management and investment banking activities, including certain class actions, which primarily allege violations of securities laws and seek unspecified damages, which could be substantial. For example, we are aware of litigation against certain underwriters of offerings in which one or more of our former subsidiaries was a participant, but where the former subsidiary is not now a defendant. In these latter cases, it is possible that we may be called upon to contribute to settlements or judgments. In the normal course of our business, our current and former subsidiaries have also received subpoenas and are currently involved in governmental and self-regulatory agency inquiries, investigations and, from time to time, proceedings involving asset management activities. In the 2005 transaction with Citigroup, we transferred to Citigroup the subsidiaries that constituted our private client brokerage and capital markets businesses, thus transferring the entities that would have primary liability for most of the customer complaint, litigation and regulatory liabilities and proceedings arising from those businesses. However, as part of that transaction, we agreed to indemnify Citigroup for most customer complaint, litigation and regulatory liabilities of our former private client brokerage and capital markets businesses that result from pre-closing events. In addition, the asset management business we acquired from Citigroup is a defendant in a number of legal actions, including class action litigation, arising from pre-closing asset management activities, some of which seek substantial damages. Under the terms of the transaction agreement with Citigroup, Citigroup has agreed to indemnify us for certain legal matters, including all currently known pre-closing legal matters, of the former CAM business. While the ultimate resolution of any pre-closing matters threatened or pending from our prior brokerage and capital markets businesses or the former CAM business cannot be determined at this time, based on current information and after consultation with legal counsel, management believes that any accrual or range of reasonably possible losses as of March 31, 2013 is not material. While the ultimate resolution of any other threatened or pending litigation and other matters cannot be currently determined, in the opinion of our management, after consultation with legal counsel, due in part to the preliminary nature of certain of these matters, we are currently unable to estimate the amount or range of potential losses from these matters, and our financial condition, results of operations and cash flows could be materially affected during a period in which a matter is ultimately resolved. See Note 8 of Notes to Consolidated Financial Statements in Item 8 of this Report.

ITEM 4. MINE SAFETY DISCLOSURES.

Not Applicable.

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ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT.

Information (not included in our definitive proxy statement for the 2013 Annual Meeting of Stockholders) regarding certain of our executive officers is as follows:
Terence Johnson, age 40, was appointed Head of Global Distribution in March 2013 and elected Executive Vice President in April 2013. Since October 2012, he had been serving as interim Head of Global Distribution, overseeing U.S. Distribution, International Distribution, Global Product Development, Marketing, and Administration and Operations of the division. Prior to that, Mr. Johnson headed International Distribution at Legg Mason. Mr. Johnson joined Legg Mason in December 2005 from Citigroup Asset Management following its acquisition by Legg Mason.

Thomas C. Merchant, age 45, was appointed General Counsel in March 2013 and elected Executive Vice President in April 2013. Mr. Merchant continues to serve as Corporate Secretary, a position he has held since 2008. Mr. Merchant oversees Legg Mason's legal and compliance departments. Mr. Merchant previously served as Corporate General Counsel and Deputy General Counsel. Mr. Merchant joined Legg Mason as Associate General Counsel in 1998.

Jennifer Murphy, age 48, was appointed Chief Administrative Officer in March 2013 and elected Executive Vice President in April 2013. Ms. Murphy oversees Legg Mason's technology, human resources, risk management, internal audit and fund boards and global fund accounting. Prior to her appointment as Chief Administrative Officer, Ms. Murphy served as President and CEO of Legg Mason Capital Management. Ms. Murphy initially joined Legg Mason in 1986, and has served in a variety of roles during two tenures with the company.

Peter H. Nachtwey, age 57, was elected Chief Financial Officer and Senior Executive Vice President of Legg Mason in January 2011 when he joined the firm. From July 2007 through December 2010, Mr. Nachtwey served as Chief Financial Officer of The Carlyle Group, an alternative investment management firm, where he had responsibility for all of the financial and a number of the operational functions at the firm. Prior to The Carlyle Group, Mr. Nachtwey spent more than 25 years at Deloitte and Touche, LLP, an accounting firm, most recently as Managing Partner of the Investment Management practice.

PART II

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

Shares of Legg Mason, Inc. common stock are listed and traded on the New York Stock Exchange (symbol LM). As of March 31, 2013, there were approximately 1,400 holders of record of Legg Mason common stock. Information with respect to our dividends and stock prices is as follows:

	Quarter ended			
	Mar. 31	Dec. 31	Sept. 30	June 30
Fiscal 2013				
Cash dividend declared per share	$0.11	$0.11	$0.11	$0.11
Stock price range:				
High	32.59	26.63	27.14	28.47
Low	25.43	23.88	23.31	22.36
Fiscal 2012				
Cash dividend declared per share	$0.08	$0.08	$0.08	$0.08
Stock price range:				
High	29.49	29.56	34.32	37.82
Low	23.75	22.61	24.11	30.86

We expect to continue paying cash dividends. However, the declaration of dividends is subject to the discretion of our Board of Directors. In determining whether to declare dividends, or how much to declare in dividends, our Board will consider factors it deems relevant, which may include our results of operations and financial condition, our financial requirements, general business conditions and the availability of funds from our subsidiaries, including all restrictions on the ability of our subsidiaries to provide funds to us. On April 23, 2013, our Board of Directors declared a regular, quarterly dividend of $0.13 per share, increasing the regular, quarterly dividend rate paid on shares of our common stock during the prior fiscal quarter.

Purchases of our Common Stock

The following table sets out information regarding our purchases of Legg Mason common stock during the quarter ended March 31, 2013:

Period	(a) Total number of shares purchased [1]		(b) Average price paid per share [2]	(c) Total number of shares purchased as part of publicly announced plans or programs[3]	(d) Approximate dollar value that may yet be purchased under the plans or programs[3]
January 1, 2013 Through January 31, 2013	2,246	[2]	$25.56	—	$838,502,766
February 1, 2013 Through February 29, 2013	980,900		27.58	980,900	811,445,882
March 1, 2013 Through March 31, 2013	2,819,090		30.24	2,708,920	729,724,597
Total	3,802,236		$29.55	3,689,820	$729,724,597

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

(2) Amounts exclude fees.

(3) In connection with a capital plan announced on May 16, 2012, our Board of Directors authorized $1 billion for additional purchases of common stock. The new capital plan authorizes using up to 65% of cash generated from future operations, beginning with fiscal 2013, to purchase shares of our common stock. There is no expiration date attached to the share repurchase authorization in the new capital plan.

ITEM 6. SELECTED FINANCIAL DATA.

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

	Years ended March 31,				
	2013	2012	2011	2010	2009
OPERATING RESULTS					
Operating revenues	$2,612,650	$2,662,574	$2,784,317	$2,634,879	$3,357,367
Operating expenses, excluding impairment	2,313,149	2,323,821	2,397,509	2,313,696	2,718,577
Impairment of intangible assets and goodwill	734,000	—	—	—	1,307,970
Operating income (loss)	(434,499)	338,753	386,808	321,183	(669,180)
Other non-operating expense	(73,287)	(54,006)	(23,315)	(32,027)	(243,577)
Other non-operating income (expense) of consolidated investment vehicles, net	(2,821)	18,336	1,704	17,329	7,796
Fund support	—	—	—	23,171	(2,283,236)
Income (loss) before income tax provision (benefit)	(510,607)	303,083	365,197	329,656	(3,188,197)
Income tax provision (benefit)	(150,859)	72,052	119,434	118,676	(1,223,203)
Net income (loss)	(359,748)	231,031	245,763	210,980	(1,964,994)
Less: Net income (loss) attributable to noncontrolling interests	(6,421)	10,214	(8,160)	6,623	2,924
Net income (loss) attributable to Legg Mason, Inc.	$(353,327)	$220,817	$253,923	$204,357	$(1,967,918)
PER SHARE					
Net income (loss) per share attributable to					
Legg Mason, Inc. common shareholders:					
Basic	$(2.65)	$1.54	$1.63	$1.33	$(13.99)
Diluted	$(2.65)	$1.54	$1.63	$1.32	$(13.99)
Weighted-average shares outstanding:					
Basic	133,226	143,292	155,321	153,715	140,669
Diluted [(1)]	133,226	143,349	155,484	155,362	140,669
Dividends declared	$0.44	$0.32	$0.20	$0.12	$0.96
BALANCE SHEET					
Total assets	$7,269,660	$8,555,747	$8,707,756	$8,622,632	$9,232,299
Long-term debt	1,144,954	1,136,892	1,201,868	1,170,334	2,740,190
Total stockholders' equity	4,818,351	5,677,291	5,770,384	5,841,724	4,598,625
FINANCIAL RATIOS AND OTHER DATA					
Adjusted income (loss) [(2)]	$347,169	$397,030	$439,248	$381,258	$(1,191,389)
Adjusted income (loss) per diluted share [(2)]	$2.61	$2.77	$2.83	$2.45	$(8.47)
Operating margin	(16.6)%	12.7%	13.9%	12.2%	(19.9)%
Operating margin, as adjusted [(3)]	16.8%	21.3%	23.2%	20.7%	23.9%
Total debt to total capital [(4)]	19.2%	19.6%	20.1%	19.6%	39.4%
Assets under management (in millions)	$664,609	$643,318	$677,646	$684,549	$632,404
Full-time employees	2,975	2,979	3,395	3,550	3,890

(1) Basic shares and diluted shares are the same for periods with a net loss.

(2) Adjusted income (loss) is a non-GAAP performance measure. We define Adjusted income (loss) as Net income (loss) attributable to Legg Mason, Inc., plus amortization and deferred taxes related to intangible assets and goodwill, and imputed interest and tax benefits on contingent convertible debt less deferred income taxes on goodwill and indefinite-life intangible asset impairment, if any. We also adjust for non-core items, such as intangible asset impairments, the impact of tax rate adjustments on certain deferred tax liabilities related to indefinite-life intangible assets, and loss on extinguishment of contingent convertible debt. See Supplemental Non-GAAP Information in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

(4) Calculated based on total debt as a percentage of total capital (total stockholders' equity plus total debt) as of March 31.

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

EXECUTIVE OVERVIEW

Legg Mason, Inc., a holding company, with its subsidiaries (which collectively comprise "Legg Mason") is a global asset management firm. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other investment vehicles. We offer these products and services directly and through various financial intermediaries. We have operations principally in the United States of America ("U.S.") and the United Kingdom ("U.K.") and also have offices in Australia, Bahamas, Brazil, Canada, Chile, China, Dubai, France, Germany, Italy, Japan, Luxembourg, Poland, Singapore, Spain, Switzerland and Taiwan. All references to fiscal 2013, 2012 or 2011, refer to our fiscal year ended March 31 of that year. Terms such as "we," "us," "our," and "Company" refer to Legg Mason.

In connection with a realignment of our executive management team during fiscal 2011, we no longer manage our business in two divisions and, during fiscal 2012, eliminated the previous separation of the Americas and International divisions and combined them into one operating segment, Global Asset Management. We believe this structure allows us to function as a global organization with a single purpose. As a result of this change, we no longer present assets under management ("AUM") or revenues by division.

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

The fees that we charge for our investment services vary based upon factors such as the type of underlying investment product, the amount of assets under management, the asset management affiliate that provides the services, and the type of services (and investment objectives) that are provided. Fees charged for equity asset management services are generally higher than fees charged for fixed income and liquidity asset management services. Accordingly, our revenues and average AUM advisory revenue yields will be affected by the composition of our AUM, with changes in the relative level of equity assets more significantly impacting our revenues and average AUM advisory revenue yields. Average AUM advisory revenue yields are calculated as the ratio of annualized investment advisory fees, excluding performance fees, to average AUM. In addition, in the ordinary course of our business, we may reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. We have in place revenue sharing agreements with most of our asset management affiliates, under which specified percentages of the

affiliates' revenues are required to be distributed to us and the balance of the revenues is retained to pay operating expenses, including compensation expenses, but excluding certain expenses and income taxes. Under these agreements, our asset management affiliates retain different percentages of revenues to cover their costs. As such, our Net Income (Loss) Attributable to Legg Mason, Inc., operating margin and compensation as a percentage of operating revenues are impacted based on which affiliates generate our revenues, and a change in AUM at one affiliate can have a dramatically different effect on our revenues and earnings than an equal change at another affiliate. In addition, from time to time we may agree to changes in revenue sharing agreements and other arrangements with our asset management personnel, which may impact our compensation expenses and profitability.

The most significant component of our cost structure is employee compensation and benefits, of which a majority is variable in nature and includes incentive compensation that is primarily based upon revenue levels, non-compensation related operating expense levels at revenue share-based affiliates, and profits. The next largest component of our cost structure is distribution and servicing expense, which are primarily fees paid to third-party distributors for selling our asset management products and services and are largely variable in nature. Certain other operating costs are quasi-fixed in nature, such as occupancy, depreciation and amortization, and fixed contract commitments for market data, communication and technology services, and usually do not decline with reduced levels of business activity or, conversely, usually do not rise proportionately with increased business activity.

Our financial position and results of operations are materially affected by the overall trends and conditions of the financial markets, particularly in the United States, but also in the other countries in which we operate. Results of any individual period should not be considered representative of future results. Our profitability is sensitive to a variety of factors, including the amount and composition of our AUM, and the volatility and general level of securities prices and interest rates, among other things. Periods of unfavorable market conditions are likely to adversely affect our profitability. In addition, the diversification of services and products offered, investment performance, access to distribution channels, reputation in the market, attracting and retaining key employees and client relations are significant factors in determining whether we are successful in attracting and retaining clients. In the last few years, the industry has seen flows into products for which we do not currently garner significant market share. In addition, the economic downturn of fiscal 2008 and 2009 contributed to a significant contraction in our business and we have not recovered to pre-downturn levels.

The financial services business in which we are engaged is extremely competitive. Our competition includes numerous global, national, regional and local asset management firms, broker-dealers and commercial banks. The industry has been impacted by continued economic uncertainty, and in prior years, by the consolidation of financial services firms through mergers and acquisitions.

The industry in which we operate is also subject to extensive regulation under federal, state, and foreign laws. Like most firms, we have been impacted by regulatory and legislative changes. Responding to these changes has required, and will continue to require, us to incur costs that continue to impact our profitability.

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

Strategic Priorities	Recent Initiatives
Product expansion	Promote revenue growth through new product development, leveraging the capabilities of our affiliates Identify and execute strategic acquisitions to increase product offerings and fill gaps in products and services
Investment performance	Deliver compelling and consistent performance against both relevant benchmarks and the products and services of our competitors for 1-year, 3-year, 5-year, and 10-year periods
Distribution focus	Evaluation and reallocation of resources within and to our distribution platform to continue to build a top distribution function with the capability to offer solutions to relevant investment challenges

Operating efficiency	Management of expenses
	Restructuring of affiliate arrangements

Net Loss Attributable to Legg Mason, Inc. for fiscal 2013 was $353.3 million, or $2.65 per diluted share, as compared to Net Income Attributable to Legg Mason, Inc. of $220.8 million, or $1.54 per diluted share, for fiscal 2012. The current year loss is primarily attributable to $734.0 million, or $3.81 per diluted share, of non-cash impairment charges related to intangible assets and a $69.0 million, or $0.34 per diluted share, non-operating charge from the extinguishment of debt.

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Average AUM, and total revenues, remained relatively flat in fiscal year 2013, as compared to fiscal year 2012. Strong overall performance and the improvement of our global distribution function contributed to a continued reduction in outflows. The modest outflows were mostly offset by increases in AUM due to market performance, an acquisition, and new product launches in fiscal 2013.

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

BUSINESS ENVIRONMENT AND RESULTS OF OPERATIONS

The business environment in fiscal 2013 was marked by uneven growth and a continued heightened sensitivity to economic news. Major economic events and news of the year included uneven domestic growth, periodic developments in the ongoing European sovereign debt crisis, the fiscal cliff, sequestration, and the actions of the Federal Reserve to maintain low interest rates, including beginning a third round of quantitative easing and the continued support of the secondary mortgage market. These events led to a challenging financial environment, both globally and in the United States. However, during fiscal 2013 most U.S. indices produced positive returns, with record highs in the equity markets in March 2013. While the economic outlook has remained more positive than in recent years, the financial environment in which we operate still reflects a heightened level of sensitivity as we move into fiscal 2014.

All three major U.S. equity market indices, as well as the Barclays Capital U.S. Aggregate Bond Index and Barclays Capital Global Aggregate Bond Index, increased over the past two fiscal years, as illustrated in the table below:

	% Change for the year ended March 31:			
Indices[1]	2013		2012	
Dow Jones Industrial Average	10.34	%	7.24	%
S&P 500	11.41	%	6.23	%
NASDAQ Composite Index	5.69	%	11.16	%
Barclays Capital U.S. Aggregate Bond Index	3.77	%	7.71	%
Barclays Capital Global Aggregate Bond Index	1.26	%	5.26	%

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

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

	Percentage of Operating Revenues Years Ended March 31,			Period to Period Change[1]	
	2013	2012	2011	2013 Compared to 2012	2012 Compared to 2011
Operating Revenues					
Investment advisory fees					
Separate accounts	28.0 %	29.1 %	29.3 %	(5.8)%	(4.9)%
Funds	55.3	56.0	53.4	(3.0)	0.3
Performance fees	3.8	1.9	3.5	99.1	(48.8)
Distribution and service fees	12.6	12.8	13.6	(3.1)	(10.1)
Other	0.3	0.2	0.2	37.3	(16.0)
Total operating revenues	100.0	100.0	100.0	(1.9)	(4.4)
Operating Expenses					
Compensation and benefits	45.5	41.7	41.0	7.1	(2.7)
Transition-related compensation	—	1.3	1.6	n/m	(23.1)
Total compensation and benefits	45.5	43.0	42.6	3.9	(3.5)
Distribution and servicing	23.0	24.4	25.6	(7.6)	(8.9)
Communications and technology	5.7	6.2	5.8	(9.1)	1.7
Occupancy	6.6	5.8	5.0	11.1	12.3
Amortization of intangible assets	0.5	0.7	0.8	(28.4)	(14.6)
Impairment of intangible assets	28.1	—	—	n/m	n/m
Other	7.2	7.2	6.3	(1.2)	8.0
Total operating expenses	116.6	87.3	86.1	31.1	(3.1)
Operating Income (Loss)	(16.6)	12.7	13.9	n/m	(12.4)
Other Income (Expense)					
Interest income	0.3	0.4	0.3	(33.9)	24.2
Interest expense	(2.4)	(3.3)	(3.3)	(28.2)	(5.0)
Other	(0.7)	0.8	2.1	n/m	(62.9)
Other non-operating income (expense) of consolidated investment vehicles	(0.1)	0.8	0.1	n/m	n/m
Total other income (expense)	(2.9)	(1.3)	(0.8)	n/m	n/m
Income (Loss) before Income Tax Provision (Benefit)	(19.5)	11.4	13.1	n/m	(17.0)
Income tax provision (benefit)	(5.7)	2.7	4.3	n/m	(39.7)
Net Income (Loss)	(13.8)	8.7	8.8	n/m	(6.0)
Less: Net income (loss) attributable to noncontrolling interests	(0.3)	0.4	(0.3)	n/m	n/m
Net Income (Loss) Attributable to Legg Mason, Inc.	(13.5)%	8.3 %	9.1 %	n/m	(13.0)%

n/m-not meaningful

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

FISCAL 2013 COMPARED WITH FISCAL 2012

Assets Under Management

Our AUM is primarily managed across the following asset classes:

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

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

	2013	2012
Beginning of period	$643.3	$677.6
Investment funds, excluding liquidity funds[1]		
Subscriptions	44.9	46.9
Redemptions	(49.0)	(51.1)
Separate account flows, net	(27.4)	(35.9)
Liquidity fund flows, net	19.8	12.6
Net client cash flows	(11.7)	(27.5)
Market performance and other [2]	34.2	17.1
Acquisitions (dispositions), net	(1.2)	(23.9)
End of period	$664.6	$643.3

(1) Subscriptions and redemptions reflect the gross activity in the funds and include assets transferred between funds and between share classes.
(2) Includes impact of foreign exchange, reinvestment of dividends, and other.

AUM at March 31, 2013, was $664.6 billion, an increase of $21.3 billion, or 3%, from March 31, 2012. The increase in AUM was attributable to market performance and other of $34.2 billion, including the negative impact of foreign currency exchange fluctuations of $8.3 billion, and $5.4 billion related to the acquisition of Fauchier Partners Management Limited ("Fauchier"). These increases were offset in part by net client outflows of $11.7 billion and dispositions of $6.6 billion. The dispositions were in liquidity assets which resulted from the amendment of historical Smith Barney brokerage programs providing for investment in liquidity funds that our asset managers manage. Long-term asset classes accounted for the net client outflows, with $20.4 billion and $11.0 billion in equity and fixed income outflows, respectively, partially offset by liquidity inflows of $19.7 billion. Equity outflows were primarily experienced by products managed at Batterymarch Financial Management, Inc. (“Batterymarch”), Royce & Associates (“Royce”), The Permal Group, Ltd. ("Permal"), and Legg Mason Capital Management, LLC ("LMCM"). Due in part to investment performance issues, we have experienced net annual outflows in our equity asset class since fiscal 2007. The majority of fixed income outflows were in products managed by Western Asset Management Company ("Western Asset"), including $6.4 billion in outflows from a single, low fee global sovereign mandate. We expect to continue to experience outflows from this mandate of approximately $500 million per month during fiscal 2014. Fixed income outflows were offset in part by inflows at Brandywine Global Investment Management, LLC ("Brandywine"). We

have experienced outflows in our fixed income asset class in all but two quarters since the fourth quarter of fiscal 2008. We generally earn higher fees and profits on equity AUM, and outflows in the equity asset class will more negatively impact our revenues and Net Income (Loss) Attributable to Legg Mason, Inc. than would outflows in other asset classes. We experienced liquidity outflows of approximately $13 billion from a sovereign wealth

client during the month ended April 30, 2013, however, we do not expect this outflow to have a material impact on our revenues or net income.

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

AUM by Asset Class

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

	2013	% of Total	2012	% of Total	% Change
Equity	$161.8	24 %	$163.4	26 %	(1)%
Fixed Income	365.1	55	356.1	55	3
Liquidity	137.7	21	123.8	19	11
Total	$664.6	100 %	$643.3	100 %	3 %

The component changes in our AUM by asset class (in billions) for the fiscal year ended March 31, 2013, were as follows:

	Equity	Fixed Income	Liquidity	Total
March 31, 2012	$163.4	$356.1	$123.8	$643.3
Investment funds, excluding liquidity funds				
Subscriptions	18.9	26.0	—	44.9
Redemptions	(26.4)	(22.6)	—	(49.0)
Separate account flows, net	(12.9)	(14.4)	(0.1)	(27.4)
Liquidity fund flows, net	—	—	19.8	19.8
Net client cash flows	(20.4)	(11.0)	19.7	(11.7)
Market performance and other	13.4	20.0	0.8	34.2
Acquisitions (dispositions), net	5.4	—	(6.6)	(1.2)
March 31, 2013	$161.8	$365.1	$137.7	$664.6

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

	2013	% of Total	2012	% of Total	% Change
Equity	$152.1	24 %	$168.4	26 %	(10)%
Fixed Income	364.5	56	359.8	56	1
Liquidity	128.9	20	116.6	18	11
Total	$645.5	100 %	$644.8	100 %	— %

AUM by Distribution Channel

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

and liquidity (money market) funds.

The component changes in our AUM by distribution channel (in billions) for the year ended March 31, 2013, were as follows:

	Global Distribution	Affiliate/Other	Total
March 31, 2012	$220.6	$422.7	$643.3
Net client cash flows, excluding liquidity funds	2.2	(33.7)	(31.5)
Liquidity fund flows, net	—	19.8	19.8
Net client cash flows	2.2	(13.9)	(11.7)
Market performance and other	9.3	24.9	34.2
Acquisitions/(dispositions), net	—	(1.2)	(1.2)
March 31, 2013	$232.1	$432.5	$664.6

For the years ended March 31, 2013 and 2012, our overall effective fee rate across all asset classes and distribution channels was 34 and 35 basis points, respectively. Fees for managing equity assets are generally higher, averaging approximately 75 basis points for each of the years ended March 31, 2013 and 2012. This compares to fees for managing fixed income assets, which averaged approximately 25 basis points for each of the years ended March 31, 2013 and 2012, and liquidity assets, which averaged under 10 basis points (reflecting the impact of current advisory fee waivers due to the low interest rate environment) for each of the years ended March 31, 2013 and 2012. Equity assets are primarily managed by ClearBridge, Royce, Batterymarch, and Permal; fixed income assets are primarily managed by Western Asset and Brandywine; and liquidity assets are primarily managed by Western Asset. Fee rates for assets distributed through Legg Mason Global Distribution, which are predominately retail in nature, averaged approximately 50 basis points for each of the years ended March 31, 2013 and 2012, while fee rates for assets distributed through the Affiliate/Other channel averaged approximately 20 basis points for each of the years ended March 31, 2013 and 2012. The decline in higher yielding equity assets has impacted our revenues, as further discussed below.

Investment Performance

Overall investment performance of our assets under management in the year ended March 31, 2013, was generally positive compared to relevant benchmarks.

For the year ended March 31, 2013, most U.S. indices produced positive returns. The best performing was the S&P 400 Mid Cap Index, returning 17.8% for the year ended March 31, 2013. These returns were achieved in an economic environment characterized by uneven domestic growth and heightened sensitivity to economic news which included improving unemployment and housing figures, the anticipation and implementation of the sequestration, concerns surrounding the fiscal cliff, and periodic developments in the continuing European sovereign debt crisis.

In the fixed income markets, the Federal Reserve affirmed its commitment to hold the federal funds rate at historic lows, by beginning a third round of quantitative easing and continuing support of the secondary mortgage market. These actions were taken to keep interest rates low and stimulate economic growth, and resulted in a downward shift in the yield curve over the year.

The lowest yielding fixed income sector for the year was U.S. government bonds, as measured by the Barclays U.S. Government Bond Index returning 3.0%. The best performing fixed income sector for the year was high yield bonds as measured by the Barclays U.S. High Yield Bond Index returning 13.1% as of March 31, 2013.

The following table presents a summary of the percentages of our AUM by strategy[1] that outpaced their respective benchmarks as of March 31, 2013 and 2012, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2013				As of March 31, 2012			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total (includes liquidity)	84 %	85 %	88 %	91 %	62 %	81 %	70 %	87 %
Equity:								
Large cap	65 %	68 %	88 %	80 %	66 %	43 %	66 %	78 %
Small cap	13 %	15 %	27 %	62 %	49 %	63 %	88 %	89 %
Total equity (includes other equity)	48 %	50 %	62 %	71 %	53 %	52 %	66 %	80 %
Fixed income:								
U.S. taxable	96 %	94 %	91 %	90 %	66 %	95 %	61 %	89 %
U.S. tax-exempt	100 %	100 %	100 %	100 %	2 %	2 %	2 %	1 %
Global taxable	89 %	94 %	95 %	98 %	38 %	93 %	70 %	97 %
Total fixed income	94 %	94 %	93 %	94 %	51 %	87 %	60 %	84 %

The following table presents a summary of the percentages of our U.S. mutual fund assets[2] that outpaced their Lipper category averages as of March 31, 2013 and 2012, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2013				As of March 31, 2012			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total long-term (excludes liquidity)	59 %	57 %	70 %	64 %	67 %	66 %	78 %	74 %
Equity:								
Large cap	90 %	79 %	77 %	40 %	78 %	51 %	48 %	45 %
Small cap	27 %	16 %	48 %	68 %	44 %	63 %	93 %	98 %
Total equity (includes other equity)	56 %	44 %	59 %	53 %	57 %	56 %	73 %	71 %
Fixed income:								
U.S. taxable	74 %	92 %	85 %	90 %	76 %	91 %	82 %	83 %
U.S. tax-exempt	50 %	57 %	86 %	84 %	91 %	70 %	91 %	82 %
Global taxable	71 %	74 %	95 %	54 %	96 %	81 %	87 %	83 %
Total fixed income	64 %	76 %	87 %	85 %	84 %	81 %	87 %	83 %

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

As of March 31, 2013 and 2012, 90% and 91% of total AUM is included in strategy AUM, respectively, although not all strategies have three-, five-, and ten-year histories. Total strategy AUM includes liquidity assets. Certain assets are not included in reported performance comparisons. These include: accounts that are not managed in accordance with the guidelines outlined above; accounts in strategies not marketed to potential clients; accounts that have not yet been assigned to a strategy; and certain smaller products at some of our affiliates.

Past performance is not indicative of future results. For AUM included in institutional and retail separate accounts and investment funds included in the same strategy as separate accounts, performance comparisons are based on gross-of-fee performance. For investment funds (including fund-of-hedge funds) which are not managed in a separate

account format, performance comparisons are based on net-of-fee performance. These performance comparisons do not reflect the actual performance of any specific separate account or investment fund; individual separate account and investment fund performance may differ.

Certain prior year amounts have been updated to conform to the current year presentation.

(2) Source: Lipper Inc. includes open-end, closed-end, and variable annuity funds. As of March 31, 2013 and 2012, the U.S. long-term mutual fund assets represented in the data accounted for 19% and 18%, respectively, of our total AUM. The performance of our U.S. long-term mutual fund assets is included in the strategies.

The following table presents a summary of the absolute and relative performance compared to the applicable benchmark for a representative sample of funds within our AUM, net of management and other fees as of the end of the period presented, for the 1-year, 3-year, 5-year, and 10-year periods, and from each fund's inception. The table below includes a representative sample of funds from each significant subclass of our investment strategies (i.e., large cap equity, small cap equity, etc.). The funds within this group are representative of the performance of significant investment strategies we offer, that as of March 31, 2013, constituted an aggregate of approximately $393 billion, or approximately 59%, of our AUM. The only meaningful exclusions are our funds-of-hedge funds strategies, which involve privately placed hedge funds, and represent only 3% of our total assets under management as of March 31, 2013, for which investment performance is not made publicly available. Providing investment returns of funds provides a relevant representation of our performance while avoiding the many complexities relating to factors such as multiple fee structures, bundled pricing, and asset level break points, that would arise in reporting performance for strategies or other product aggregations.

			Annualized Absolute & Relative Total Return (%) vs. Benchmark				
Fund Name/Index	Inception Date	Performance Type[(1)]	1-year	3-year	5-year	10-year	Inception
Equity							
Large Cap							
ClearBridge Appreciation Fund	3/10/1970	Absolute	14.80%	11.78%	5.77%	8.45%	10.26%
S&P 500		Relative	0.83%	(0.89)%	(0.04)%	(0.08)%	0.02%
ClearBridge All Cap Value Fund	11/12/1981	Absolute	15.65%	9.15%	3.72%	7.96%	11.69%
Russell 3000 Value		Relative	(3.06)%	(3.55)%	(1.32)%	(1.37)%	0.04%
Legg Mason Capital Management Value Trust	4/16/1982	Absolute	12.55%	7.65%	0.67%	3.64%	6.68%
S&P 500		Relative	(1.42)%	(5.02)%	(5.14)%	(4.90)%	2.19%
ClearBridge Aggressive Growth Fund	10/24/1983	Absolute	20.02%	16.86%	8.25%	9.14%	12.05%
Russell 3000 Growth		Relative	9.60%	3.67%	0.81%	0.30%	2.51%
ClearBridge Large Cap Value Fund	12/31/1988	Absolute	15.94%	12.51%	5.84%	9.03%	9.48%
Russell 1000 Value		Relative	(2.83)%	(0.23)%	0.99%	(0.14)%	(0.65)%
ClearBridge Equity Income Fund	11/6/1992	Absolute	16.20%	13.86%	5.81%	8.46%	8.35%
Russell 3000 Value		Relative	(2.51)%	1.16%	0.76%	(0.87)%	(1.38)%
ClearBridge Large Cap Growth Fund	8/29/1997	Absolute	16.52%	11.22%	7.07%	7.79%	10.20%
Russell 1000 Growth		Relative	6.44%	(1.84)%	(0.24)%	(0.83)%	(1.68)%
Legg Mason Brandywine Diversified Large Cap Value Fund	9/7/2010	Absolute	14.68%	n/a	n/a	n/a	17.74%
Russell 1000 Value		Relative	(4.08)%	n/a	n/a	n/a	1.26%
Small Cap							
Royce Pennsylvania Mutual	6/30/1967	Absolute	12.63%	12.03%	7.28%	12.17%	11.97%
Russell 2000		Relative	(3.68)%	(1.42)%	(0.96)%	0.65%	n/a
Royce Premier Fund	12/31/1991	Absolute	6.47%	11.80%	7.91%	13.77%	12.19%
Russell 2000		Relative	(9.83)%	(1.66)%	(0.33)%	2.25%	2.81%
Royce Total Return Fund	12/15/1993	Absolute	16.28%	12.70%	7.18%	10.46%	11.15%
Russell 2000		Relative	(0.03)%	(0.75)%	(1.06)%	(1.06)%	2.70%
Royce Low-Priced Stock	12/15/1993	Absolute	(5.04)%	4.42%	4.31%	10.78%	11.51%

Russell 2000		Relative	(21.34)%	(9.04)%	(3.93)%	(0.74)%	3.05%
Royce Special Equity	5/1/1998	Absolute	13.02%	11.75%	10.14%	10.76%	9.60%
Russell 2000		Relative	(3.28)%	(1.71)%	1.90%	(0.76)%	3.13%

Fund Name/Index	Inception Date	Performance Type[1]	Annualized Absolute & Relative Total Return (%) vs. Benchmark				
			1-year	3-year	5-year	10-year	Inception
Fixed Income							
U.S. Taxable							
Western Asset Core Bond Fund	9/4/1990	Absolute	5.17%	7.22%	7.76%	5.64%	7.55%
Barclays US Aggregate		Relative	1.39%	1.70%	2.30%	0.61%	0.67%
Western Asset Short Term Bond Fund	11/11/1991	Absolute	2.42%	3.24%	3.04%	2.14%	4.02%
Citi Treasury Gov't/Credit 1-3 YR		Relative	1.29%	1.60%	0.68%	(0.94)%	(0.74)%
Western Asset Adjustable Rate Income	6/22/1992	Absolute	3.97%	3.59%	2.30%	1.84%	3.11%
Citi T-Bill 6-Month		Relative	3.84%	3.45%	1.81%	0.03%	(0.12)%
Western Asset Corporate Bond Fund	11/6/1992	Absolute	9.25%	8.38%	7.38%	4.96%	6.93%
Barclays US Credit		Relative	2.25%	0.53%	(0.14)%	(1.00)%	(0.08)%
Western Asset Intermediate Bond Fund	7/1/1994	Absolute	5.37%	6.15%	6.59%	5.52%	6.50%
Barclays Intermediate Gov't/Credit		Relative	1.84%	1.40%	1.97%	1.03%	0.62%
Western Asset Core Plus Fund	7/8/1998	Absolute	6.73%	7.66%	8.63%	6.61%	6.93%
Barclays US Aggregate		Relative	2.95%	2.13%	3.16%	1.58%	1.12%
Western Asset Inflation Index Plus Bond	3/1/2001	Absolute	5.80%	8.02%	5.65%	6.15%	6.91%
Barclays US TIPS		Relative	0.12%	(0.55)%	(0.24)%	(0.17)%	(0.19)%
Western Asset High Yield Fund	9/28/2001	Absolute	14.63%	11.30%	10.56%	9.08%	8.61%
Barclays US Corp High Yield		Relative	1.51%	0.06%	(1.08)%	(1.04)%	(1.24)%
Western Asset Total Return Unconstrained	7/6/2006	Absolute	5.86%	5.22%	6.47%	n/a	5.97%
Barclays US Aggregate		Relative	2.09%	(0.30)%	1.00%	n/a	(0.07)%
Western Asset Mortgage Defined Opportunity Fund Inc.	2/24/2010	Absolute	31.77%	20.13%	n/a	n/a	20.14%
BOFAML Floating Rate Home Loan Index		Relative	15.30%	12.23%	n/a	n/a	12.31%
U.S. Tax-Exempt							
Western Asset Managed Municipals Fund	3/4/1981	Absolute	6.82%	7.01%	6.92%	5.71%	8.28%
Barclays Municipal Bond		Relative	1.58%	0.78%	0.82%	0.71%	0.56%
Global Taxable							
Legg Mason Australian Bond Trust	6/30/1983	Absolute	9.12%	9.02%	8.96%	6.70%	6.56%
UBS Australian Composite Bond Index		Relative	2.09%	1.07%	1.14%	0.60%	0.61%
Western Asset Global High Yield Bond Fund	2/22/1995	Absolute	14.42%	10.40%	9.67%	8.43%	8.08%
Barclays Global High Yield		Relative	1.44%	(0.78)%	(1.65)%	(2.50)%	(1.90)%

Legg Mason Core Plus Global Bond Trust	2/28/1995	Absolute	11.49	% 10.24	% 8.94	% 6.28	% 6.20	%		
Barclays Global Aggregate (AUD Hedged)		Relative	2.85	% 0.93	% (0.09	)% (1.33	)% (1.04	)%		
Western Asset Emerging Markets Debt	10/17/1996	Absolute	8.31	% 9.41	% 9.53	% 10.99	% 11.36	%		
JPM EMBI Global		Relative	(2.13	)% (1.14	)% (0.28	)% 0.40	% 1.07	%		
Western Asset Global Multi Strategy Fund	8/31/2002	Absolute	5.98	% 5.56	% 6.17	% 7.19	% 8.05	%		
50% Bar. Global Agg./ 5% Bar. HY 2%/25% JPM EMBI +		Relative	(0.26	)% (2.10	)% (1.10	)% (0.87	)% (0.72	)%		
Legg Mason Brandywine Global Fixed Income	9/30/2003	Absolute	5.03	% 7.08	% 6.11	% n/a	6.00	%		
Citi World Gov't Bond		Relative	5.70	% 3.22	% 3.34	% n/a	0.93	%		
Legg Mason Brandywine Global Opportunities Bond	11/1/2006	Absolute	9.30	% 10.33	% 8.30	% n/a	8.31	%		
Citi World Gov't Bond		Relative	9.97	% 6.47	% 5.53	% n/a	3.23	%		
Liquidity										
Western Asset Institutional Cash Reserves Ltd.	12/31/1989	Absolute	0.18	% 0.19	% 0.67	% 1.98	% 3.72	%		
Citi 3-Month T-Bill		Relative	0.10	% 0.10	% 0.37	% 0.32	% 0.32	%		

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

Business Model Streamlining Initiative

In May 2010, we announced an initiative to streamline our business model to drive increased profitability and growth that primarily involved transitioning certain shared services to our investment affiliates which are closer to the actual client relationships. The initiative resulted in over $140 million in annual cost savings, substantially all of which are cash savings. These cost savings consist of (i) over $80 million in compensation and benefits cost reductions from eliminating positions in certain corporate shared services functions as a result of transitioning such functions to the affiliates, and charging affiliates

for other centralized services that will continue to be provided to them without any corresponding adjustment in revenue sharing or other compensation arrangements; (ii) approximately $50 million in non-compensation costs from eliminating and streamlining activities in our corporate and distribution business units, including savings associated with consolidating office space; and (iii) approximately $10 million from our global distribution group sharing in affiliate revenues from retail assets under management without any corresponding adjustment in revenue sharing or other compensation arrangements.

The initiative involved $127.5 million in transition-related costs that primarily included charges for employee termination benefits and incentives to retain employees during the transition period. The transition-related costs also included charges for consolidating leased office space, early contract terminations, accelerated depreciation of fixed assets, asset disposals and professional fees. During the years ended March 31, 2012 and 2011, transition-related costs totaled $73.1 million and $54.4 million, respectively. All transition-related costs were accrued as of the completion of the initiative on March 31, 2012. We achieved total cost savings from the initiative of approximately $140 million and $97 million as of March 31, 2013 and 2012, respectively, when compared to similar expenses prior to the commencement of the streamlining initiative. A portion of the estimated transition-related savings were incremental to fiscal 2012, and are explained, where applicable, in the results of operations discussion to follow. See Note 15 of Notes to Consolidated Financial Statements for additional information on our business streamlining initiative.

RESULTS OF OPERATIONS

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

Operating Revenues

Total operating revenues for the year ended March 31, 2013, were $2.6 billion, a decrease of 1.9% from $2.7 billion in the year ended March 31, 2012, despite average AUM remaining essentially flat. This decrease was primarily due to the impact of a reduction in average AUM advisory revenue yields, from 35.2 basis points in the year ended March 31, 2012, to 33.7 basis points in the year ended March 31, 2013. The reduction in average AUM advisory revenue yields was the result of a less favorable average asset mix, with equity assets, which generally earn higher fees than fixed income and liquidity assets, comprising a lower percentage of our total average AUM for the year ended March 31, 2013, as compared to the year ended March 31, 2012. This decrease was offset in part by a $49.1 million increase in performance fees.

Investment advisory fees from separate accounts decreased $45.2 million, or 5.8%, to $730.3 million. Of this decrease, $41.5 million was the result of lower average equity assets managed by Batterymarch, LMCM and Legg Mason Global Equities Group ("LMGE"), and $12.3 million was due to the divestiture of an affiliate in February 2012. These decreases were offset in part by an increase of $9.6 million due to higher average fixed income assets managed by Brandywine.

Investment advisory fees from funds decreased $45.3 million, or 3.0%, to $1.4 billion. Of this decrease, $52.9 million was due to lower average assets managed by Permal, and $48.7 million was due to lower average equity assets managed by Royce, LMCM and LMGE. These decreases were offset in part by a $39.1 million increase as a result of higher average fixed income assets managed by Western Asset and Brandywine, and a $16.7 million increase as a result of higher average equity assets at ClearBridge.

Of our total AUM as of March 31, 2013 and 2012, approximately 6% was in accounts that were eligible to earn performance fees. Performance fees increased $49.1 million to $98.6 million, primarily due to $32.0 million of fees received by Western Asset related to the wind-down of its participation in the U.S. Treasury's Public-Private Investment Program ("PPIP"). Higher fees earned on assets managed at Permal and Brandywine also contributed to the increase.

Distribution and service fees decreased $10.5 million, or 3.1%, to $330.5 million, as the result of the decline in average fee rates received on mutual fund AUM subject to distribution and service fees.

Operating Expenses

Total operating expenses for the year ended March 31, 2013 were $3.0 billion, an increase of 31.1% from $2.3 billion in the prior year. The increase in total operating expenses was primarily the result of $734.0 million of intangible asset impairment charges recorded during the current year, as further discussed below. Operating expenses for the years ended March 31, 2013 and 2012 incurred at the investment management affiliate level comprised approximately 70% of total operating expenses in each year, excluding the impairment charges, which are deemed to be corporate expenses. The remaining operating expenses are comprised of corporate and distribution costs.

The components of total compensation and benefits (in millions) for the years ended March 31 were as follows:

	Years Ended March 31,	
	2013	2012
Salaries and incentives	$924.5	$895.0
Benefits and payroll taxes	204.5	196.7
Transition-related costs	—	34.6
Management transition compensation costs	17.9	—
Other	41.6	18.0
Total compensation and benefits	$1,188.5	$1,144.3

Total compensation and benefits increased 3.9% to $1.2 billion;

- Salaries and incentives increased $29.5 million, principally due to an increase of $38.5 million in incentive-based compensation at investment affiliates, primarily resulting from costs associated with the modification of employment and other arrangements, most significantly with the management of Permal, and the impact of reductions in other non-compensation related operating expenses at revenue share based affiliates, which create an offsetting increase in compensation per the applicable revenue share agreements. Additional salary and incentive costs of $12.2 million, resulting from market-based compensation increases among retained staff and new hires to support on-going growth initiatives, also contributed to the increase. These increases were offset in part by a $23.7 million decrease in corporate salaries primarily due to headcount reductions resulting from our business streamlining initiative.
- Benefits and payroll taxes increased $7.8 million, primarily as a result of an increase in non-cash amortization expense and other costs associated with certain deferred compensation plans.
- Transition-related costs decreased $34.6 million, due to the completion of our business streamlining initiative in March 2012.
- Management transition compensation costs in the current year were associated with our Chief Executive Officer stepping down in September 2012 and the subsequent reorganization of our executive committee. These costs were primarily comprised of $7.5 million of cash severance and $6.4 million of net non-cash accelerated vesting of stock based awards. Also included in this line item was $3.0 million of non-cash amortization expense related to retention awards granted to certain executives and key employees.
- Other compensation and benefits increased $23.6 million, primarily due to an increase in revenue-share based incentive obligations resulting from net market gains on assets invested for deferred compensation plans and seed capital investments, which were offset by corresponding increases in Other non-operating income (expense).

Compensation as a percentage of operating revenues increased to 45.5% from 43.0% in the prior year, due to the impact of reductions in other non-compensation related operating expenses at revenue share based affiliates, the impact of the modification of employment and other arrangements, as well as the impact of quasi-fixed compensation costs of administrative and distribution personnel which do not typically vary with revenues. These increases were offset in part by the impact of transition-related compensation recorded in the prior year, as well as the impact of lower corporate compensation costs, principally attributable to our business streamlining initiative.

Distribution and servicing expenses decreased 7.6% to $600.6 million, driven by a $53.8 million decrease due to a reduction in average AUM in certain products for which we pay fees to third-party distributors.

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Communications and technology expense decreased 9.1% to $149.6 million, driven by the impact of $8.4 million in transition-related costs recognized in the prior year, as well as $4.4 million in cost savings as a result of our business streamlining initiative.

Occupancy expense increased 11.1% to $171.9 million, primarily due to real estate related charges totaling $52.8 million, recorded during fiscal 2013 related to further space consolidation which will result in savings of approximately $10.0 million per year, prospectively. This increase was offset in part by the impact of $11.9 million of lease reserves recorded in the prior year, as well as the acceleration of $10.3 million of depreciation in the prior year, both primarily related to certain office space permanently vacated as a part of our business streamlining initiative. The increase was also offset in part by $6.0 million in cost savings, also as a result of our business streamlining initiative.

Amortization of intangible assets decreased 28.4% to $14.0 million, primarily due to certain management contracts becoming fully amortized during fiscal 2012.

Impairment of intangible assets was $734.0 million in the year ended March 31, 2013. The impairment charges relate to our domestic mutual fund contracts asset, Permal funds-of-hedge fund contracts asset, and Permal trade name. The impairment charges resulted from a number of current trends and factors, including (i) a decrease in near-term margin projections; (ii) an increase in the rate used to discount projected future cash flows primarily due to company specific factors including continued market and regulatory influences, continued stock price uncertainty and the search for a permanent Chief Executive Officer, which was ongoing as of our December 31, 2012, impairment testing date; (iii) recent outflows and related reductions in assets under management; and (iv) a reduction in the near-term projected growth rates. These changes resulted in a reduction of the projected cash flows and our overall assessment of fair value of the assets, such that the domestic mutual fund contracts asset, Permal funds-of-hedge funds contracts asset, and Permal trade name asset, declined below their carrying values, and accordingly were impaired by $396.0 million, $321.0 million, and $17.0 million, respectively. See Critical Accounting Policies and Note 5 of Notes to Consolidated Financial Statements for further discussion of the impairment charges.

Other expenses decreased $2.2 million, or 1.2%, to $188.4 million, primarily due to a $4.1 million reduction in charges for trading errors. A $2.5 million decrease in expense reimbursements paid to certain mutual funds, and the impact of $1.7 million of transition-related costs recognized in the prior year, also contributed to the decrease. These decreases were offset in part by a $5.0 million increase in litigation-related expenses as a result of certain regulatory investigations. See Note 8 of Notes to Consolidated Financial Statements for further discussion of these investigations. A $1.8 million increase in professional fees, primarily related to initiatives with Permal, including the acquisition of Fauchier during fiscal 2013, also offset the decrease.

Non-Operating Income (Expense)
Interest income decreased 33.9% to $7.6 million, driven by a $2.6 million decrease due to lower yields earned on investment balances and a $1.8 million decrease due to lower average investment balances.

Interest expense decreased 28.2% to $62.9 million, primarily as a result of the refinancing of the 2.5% Convertible Senior Notes (the "Notes") in May 2012.

Other non-operating income (expense) decreased $40.1 million, to an expense of $18.0 million, from income of $22.1 million in the prior year. This decrease was primarily a result of the $69.0 million loss on debt extinguishment recognized in connection with the repurchase of the Notes in May 2012. The impact of an $8.6 million gain related to an assigned bankruptcy claim, and a $7.5 million gain on the sale of a small affiliate, both recognized in the prior year, also contributed to the decrease. These decreases were offset in part by a $22.7 million increase in net market gains on seed capital investments and assets invested for deferred compensation plans, which are offset by corresponding increases in compensation discussed above, as well as a $20.8 million increase in net market gains on corporate

investments in proprietary fund products, which are not offset in compensation.

Other non-operating income (expense) of consolidated investment vehicles ("CIVs") decreased $21.2 million to an expense of $2.8 million, from income of $18.3 million in the prior year, primarily due to net market losses on investments of certain CIVs, as well as the impact of market gains recognized in the prior year period related to a previously consolidated CIV that was redeemed in the prior year.

Income Tax Provision (Benefit)
The benefit for income taxes was $150.9 million compared to a provision of $72.1 million in the prior year. In July 2011, The U.K. Finance Act 2011 was enacted, which reduced the main U.K. corporate tax rate from 27% to 26% effective April 1, 2011, and from 26% to 25% effective April 1, 2012. In July 2012, The U.K. Finance Act 2012 was enacted, further reducing the main U.K. corporate tax rate to 24% effective April 1, 2012 and 23% effective April 1, 2013. The impact of the tax rate changes on certain existing deferred tax assets and liabilities resulted in a tax benefit of $18.1 million in the current year. The prior year also included a similar U.K. tax benefit of $18.3 million on the revaluation of deferred tax assets and liabilities, and the impact was more substantial due to the higher level of pre-tax income in that fiscal year.

The effective benefit rate was 29.5% for the year ended March 31, 2013, compared to an effective tax rate of 23.8% in the prior year. Changes in the U.K. tax rate impacted the effective tax (benefit) rate by 3.5 percentage points in the year ended March 31, 2013, and 6.0 percentage points in the prior year. The impact of CIVs reduced the effective tax (benefit) rate by 0.5 and 0.8 percentage points for the years ended March 31, 2013 and 2012, respectively. Otherwise, the change in the effective tax rate was primarily related to a lower tax benefit associated with the intangible asset impairment charge recorded in fiscal 2013, due to the lower statutory rates in the jurisdictions where certain intangible assets were held, partially offset by adjustments to reserves and the impact of certain tax planning initiatives recorded in fiscal 2012.

Net Income (Loss) Attributable to Legg Mason, Inc.
Net Loss Attributable to Legg Mason, Inc. for the year ended March 31, 2013, totaled $353.3 million, or $2.65 per diluted share, compared to Net Income Attributable to Legg Mason, Inc. of $220.8 million, or $1.54 per diluted share, in the prior year. The decrease was primarily attributable to the impact of the pre-tax impairment charges of $734.0 million ($508.3 million, net of income tax benefits, or $3.82 per diluted share), recorded in the current year, related to our indefinite-life intangible assets, as well as the $69.0 million pre-tax loss ($44.8 million, net of income tax benefits, or $0.34 per diluted share) on debt extinguishment recognized in connection with the repurchase of the Notes in May 2012. Real estate related charges of $52.8 million also contributed to the decrease. These decreases were offset in part by the impact of transition-related costs recorded in the prior year, and the impact of increased cost savings in the current year, both in connection with our business streamlining initiative. These items were previously discussed above.

Supplemental Non-GAAP Financial Information
As supplemental information, we are providing performance measures that are based on methodologies other than generally accepted accounting principles (“non-GAAP”) for "Adjusted Income" and "Operating Margin, As Adjusted" that management uses as benchmarks in evaluating and comparing our period-to-period operating performance.

Adjusted Income decreased to $347.2 million, or $2.61 per diluted share, for the year ended March 31, 2013, from $397.0 million, or $2.77 per diluted share, in the prior year. Operating Margin, as Adjusted, for the years ended March 31, 2013 and 2012, was 16.8% and 21.3%, respectively. Operating Margin, as Adjusted for the year ended March 31, 2013 was reduced by 3.5 percentage points due to real estate related charges and management transition compensation costs recorded during fiscal 2013.

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

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

Adjusted Income only considers adjustments for certain items that relate to operating performance and comparability, and therefore, is most readily reconcilable to Net Income (Loss) Attributable to Legg Mason, Inc. determined under GAAP. This measure is provided in addition to Net Income (Loss) Attributable to Legg Mason, Inc., but is not a substitute for Net Income (Loss) Attributable to Legg Mason, Inc. and may not be comparable to non-GAAP performance measures, including measures

of adjusted earnings or adjusted income, of other companies. Further, Adjusted Income is not a liquidity measure and should not be used in place of cash flow measures determined under GAAP. We consider Adjusted Income to be useful to investors because it is an important metric in measuring the economic performance of asset management companies, as an indicator of value, and because it facilitates comparison of our operating results with the results of other asset management firms that have not issued/extinguished contingent convertible debt or made significant acquisitions.

In calculating Adjusted Income, we add the impact of the amortization of management contract assets and impairment of indefinite-life intangible assets, both of which arise from acquisitions, to Net Income (Loss) Attributable to Legg Mason, Inc. to reflect the fact that these non-cash expenses distort comparisons of our operating results with the results of other asset management firms that have not engaged in significant acquisitions. Deferred taxes on indefinite-life intangible assets and goodwill include actual tax benefits from amortization deductions that are not realized under GAAP absent an impairment charge or the disposition of the related business. Because we fully expect to realize the economic benefit of the current period tax amortization, we add this benefit to Net Income (Loss) Attributable to Legg Mason, Inc. in the calculation of Adjusted Income. However, because of our net operating loss carry-forward, we will receive the benefit of the current tax amortization over time. Conversely, we subtract the non-cash income tax benefits on goodwill and indefinite-life intangible asset impairment charges and United Kingdom tax rate adjustments on excess book basis on certain acquired indefinite-life intangible assets, if applicable, that have been recognized under GAAP. We also add back non-cash imputed interest and the extinguishment loss on contingent convertible debt adjusted for amounts allocated to the conversion feature, as well as adding the actual tax benefits on the imputed interest that are not realized under GAAP. These adjustments reflect that these items distort comparisons of our operating results to prior periods and the results of other asset management firms that have not engaged in significant acquisitions, including any related impairments, or issued/extinguished contingent convertible debt.

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

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

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

	For the Years Ended March 31,	
	2013	2012
Net Income (Loss) Attributable to Legg Mason, Inc.	$(353,327)	$220,817
Plus (less):		
Amortization of intangible assets	14,019	19,574
Loss on extinguishment of 2.5% senior notes	54,873	—
Impairment of intangible assets	734,000	—
Deferred income taxes on intangible assets:		
Impairment charges	(225,748)	—
Tax amortization benefit	135,588	135,830
U.K. tax rate adjustment	(18,075)	(18,268)
Imputed interest on convertible debt (2.5% senior notes)	5,839	39,077
Adjusted Income	$347,169	$397,030
Net Income (Loss) per diluted share Attributable to Legg Mason, Inc. common shareholders	$(2.65)	$1.54
Plus (less):		
Amortization of intangible assets	0.11	0.14
Loss on extinguishment of 2.5% senior notes	0.41	—
Impairment of intangible assets	5.51	—
Deferred income taxes on intangible assets:		
Impairment charges	(1.69)	—
Tax amortization benefit	1.02	0.95
U.K. tax rate adjustment	(0.14)	(0.13)
Imputed interest on convertible debt (2.5% senior notes)	0.04	0.27
Adjusted Income per diluted share	$2.61	$2.77

Operating Margin, as Adjusted

We calculate "Operating Margin, as Adjusted," by dividing (i) Operating Income (Loss), adjusted to exclude the impact on compensation expense of gains or losses on investments made to fund deferred compensation plans, the impact on compensation expense of gains or losses on seed capital investments by our affiliates under revenue sharing agreements, transition-related costs of streamlining our business model, income (loss) of CIVs, and impairment charges by (ii) our operating revenues, adjusted to add back net investment advisory fees eliminated upon consolidation of investment vehicles, less distribution and servicing expenses which we use as an approximate measure of revenues that are passed through to third parties, which we refer to as "Operating Revenues, as Adjusted." The compensation items, other than transition-related costs, are removed from Operating Income (Loss) in the calculation because they are offset by an equal amount in Other non-operating income (expense), and thus have no impact on Net Income (Loss) Attributable to Legg Mason, Inc. Transition-related costs, impairment charges and income (loss) of CIVs are removed from Operating Income (Loss) in the calculation because these items are not reflective of our core asset management operations. We use Operating Revenues, as Adjusted in the calculation to show the operating margin without distribution and servicing expenses, which we use to approximate our distribution revenues that are passed through to third parties as a direct cost of selling our products, although distribution and servicing expenses may include commissions paid in connection with the launching of closed-end funds for which there is no corresponding revenue in the period. Operating Revenues, as Adjusted, also include our advisory revenues we receive from CIVs that are eliminated in consolidation under GAAP.

We believe that Operating Margin, as Adjusted, is a useful measure of our performance because it provides a measure of our core business activities excluding items that have no impact on Net Income (Loss) Attributable to Legg Mason,

Inc. and because it indicates what our operating margin would have been without the distribution revenues that are passed through to third parties as a direct cost of selling our products, transition-related costs and impairment charges, and the impact of the consolidation of certain investment vehicles described above. The consolidation of these investment vehicles does not have an impact on Net Income (Loss) Attributable to Legg Mason, Inc. This measure is provided in addition to our operating

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margin calculated under GAAP, but is not a substitute for calculations of margins under GAAP and may not be comparable to non-GAAP performance measures, including measures of adjusted margins of other companies.

The calculation of Operating margin and Operating margin, as adjusted, is as follows (dollars in thousands):

	For the Years Ended March 31,	
	2013	2012
Operating Revenues, GAAP basis	$2,612,650	$2,662,574
Plus (less):		
Operating revenues eliminated upon consolidation of investment vehicles	2,397	3,094
Distribution and servicing expense excluding consolidated investment vehicles	(600,582)	(649,679)
Operating Revenues, as Adjusted	$2,014,465	$2,015,989
Operating Income (Loss), GAAP basis	$(434,499)	$338,753
Plus (less):		
Gains (losses) on deferred compensation and seed investments	36,497	13,809
Transition-related costs	—	73,066
Impairment of intangible assets	734,000	—
Operating income and expenses of consolidated investment vehicles	2,959	3,702
Operating Income, as Adjusted	$338,957	$429,330
Operating Margin, GAAP basis	(16.6)%	12.7%
Operating Margin, as Adjusted	16.8	21.3

FISCAL 2012 COMPARED WITH FISCAL 2011

Assets Under Management

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

	2012	2011
Beginning of period	$677.6	$684.5
Investment funds, excluding liquidity funds [(1)]		
Subscriptions	46.9	49.5
Redemptions	(51.1)	(44.3)
Separate account flows, net	(35.9)	(52.1)
Liquidity fund flows, net	12.6	(14.2)
Net client cash flows	(27.5)	(61.1)
Market performance and other [(2)]	17.1	56.3
Dispositions	(23.9)	(2.1)
End of period	$643.3	$677.6

(1) Subscriptions and redemptions reflect the gross activity in the funds and include assets transferred between funds and between share classes.
(2) Includes impact of foreign exchange, reinvestment of dividends, and other.

AUM at March 31, 2012, was $643.3 billion, a decrease of $34.3 billion, or 5%, from March 31, 2011. The decrease in AUM was attributable to net client outflows of $27.5 billion and dispositions of $23.9 billion, which were partially

offset by market performance and other of $17.1 billion, including the negative impact of foreign currency exchange fluctuations. The majority of dispositions were in liquidity assets, $19.9 billion, which resulted from the amendment of historical Smith

Barney brokerage programs discussed below. There were also $4.0 billion in dispositions from the divestiture of two small affiliates. Long-term asset classes accounted for the net client outflows, with $21.3 billion and $18.6 billion in equity and fixed income outflows, respectively, partially offset by liquidity inflows of $12.4 billion. Equity outflows were primarily experienced by products managed at LMCM, ClearBridge, Batterymarch and Royce. The majority of fixed income outflows were in products managed by Western Asset, including $12.7 billion in outflows from a single, low fee global sovereign mandate.

The amendment of certain historical Smith Barney brokerage programs during the first quarter of fiscal 2012, as previously discussed, resulted in a reduction of $19.9 billion in liquidity AUM during the year ended March 31, 2012. As a significant portion of the management fees generated by these assets were being waived prior to the disposition, the disposition of this liquidity AUM resulted in a reduction in operating revenue of $52.3 million, net of related fee waivers, in the year ended March 31, 2012, as compared to the year ended March 31, 2011. The disposition of this AUM also resulted in reductions in distribution and servicing expenses of $41.4 million in the year ended March 31, 2012, as compared to the year ended March 31, 2011.

AUM by Asset Class

AUM by asset class (in billions) as of March 31 were as follows:

	2012	% of Total	2011	% of Total	% Change
Equity	$163.4	26 %	$189.6	28 %	(14)%
Fixed income	356.1	55	356.6	53	—
Liquidity	123.8	19	131.4	19	(6)
Total	$643.3	100 %	$677.6	100 %	(5)%

The component changes in our AUM by asset class (in billions) for the fiscal year ended March 31, 2011, were as follows:

	Equity	Fixed Income	Liquidity	Total
March 31, 2011	$189.6	$356.6	$131.4	$677.6
Investment funds, excluding liquidity funds				
Subscriptions	21.7	25.2	—	46.9
Redemptions	(30.4)	(20.7)	—	(51.1)
Separate account flows, net	(12.6)	(23.1)	(0.2)	(35.9)
Liquidity fund flows, net	—	—	12.6	12.6
Net client cash flows	(21.3)	(18.6)	12.4	(27.5)
Market performance and other	(2.1)	19.3	(0.1)	17.1
Dispositions	(2.8)	(1.2)	(19.9)	(23.9)
March 31, 2012	$163.4	$356.1	$123.8	$643.3

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

	2012	% of Total	2011	% of Total	% Change
Equity	$168.4	26 %	$173.8	26 %	(3)%
Fixed Income	359.8	56	361.6	54	—
Liquidity	116.6	18	133.8	20	(13)
Total	$644.8	100 %	$669.2	100 %	(4)%

AUM by Distribution Channel

The component changes in our AUM by distribution channel (in billions) for the fiscal year ended March 31, 2012, were as follows:

	Global Distribution	Affiliate/Other	Total
March 31, 2011	$220.3	$457.3	$677.6
Net client cash flows, excluding liquidity funds	(2.3)	(37.8)	(40.1)
Liquidity fund flows, net	—	12.6	12.6
Net client cash flows	(2.3)	(25.2)	(27.5)
Market performance and other	2.6	14.5	17.1
Dispositions	—	(23.9)	(23.9)
March 31, 2012	$220.6	$422.7	$643.3

For the years ended March 31, 2012 and 2011, our overall effective fee rate across all asset classes and distribution channels was 35 and 34 basis points, respectively. Fees for managing equity assets are generally higher, averaging approximately 75 basis points for each of the years ended March 31, 2012 and 2011. This compares to fees for managing fixed income assets, which averaged approximately 25 basis points for each of the years ended March 31, 2012 and 2011, and liquidity assets, which averaged under 10 basis points (reflecting the impact of current advisory fee waivers due to the low interest rate environment) for each of the years ended March 31, 2012 and 2011. Fee rates for assets distributed through Legg Mason Global Distribution, which are predominately retail in nature, averaged approximately 50 basis points for each of the years ended March 31, 2012 and 2011, while fee rates for assets distributed through the Affiliate/Other channel averaged approximately 20 basis points for each of the years ended March 31, 2012 and 2011. The decline in higher yielding equity assets has impacted our revenues, as further discussed below.

Investment Performance

Overall investment performance of our assets under management in the year ended March 31, 2012, was generally positive compared to relevant benchmarks.

The equity markets ended a difficult year on a positive note, responding favorably to improving unemployment figures, the conclusion of bank stress tests resulting in certain banks increasing dividends, and reduced fears of a European debt fallout. As a result, most U.S. indices produced positive returns for our fiscal 2012. The most notable was the NASDAQ Composite returning 11.2% for the year ended March 31, 2012.

In the fixed income markets, improved economic data suggested that the recovery was strengthening. Flights-to-safety ebbed as the European debt crisis eased allowing U.S. Treasury rates to climb from historically low levels. The yield curve steepened over the year as economic releases from the Federal Reserve Board painted an increasingly optimistic picture and talk of a third round of quantitative easing diminished.

The worst performing fixed income sector for the year was high yield bonds, as measured by the Barclays High Yield Index returning 6.5%. The best performing fixed income sector for the year was Treasury Inflation Protected Securities (TIPS), as measured by the Barclays U.S. TIPS Index returning 12.2% as of March 31, 2012.

The following table presents a summary of the percentages by strategy[1] that outpaced their respective benchmarks as of March 31, 2012 and 2011, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2012				As of March 31, 2011			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total (includes liquidity)	62 %	81 %	70 %	87 %	76 %	79 %	74 %	84 %
Equity:								
Large cap	66 %	43 %	66 %	78 %	40 %	61 %	55 %	63 %
Small cap	49 %	63 %	88 %	89 %	68 %	75 %	89 %	99 %
Total equity (includes other equity)	53 %	52 %	66 %	80 %	47 %	59 %	60 %	77 %
Fixed income:								
U.S. taxable	66 %	95 %	61 %	89 %	93 %	83 %	77 %	83 %
U.S. tax-exempt	2 %	2 %	2 %	1 %	3 %	3 %	2 %	3 %
Global taxable	38 %	93 %	70 %	97 %	81 %	91 %	73 %	94 %
Total fixed income	51 %	87 %	60 %	84 %	82 %	80 %	70 %	81 %

The following table presents a summary of the percentages of our U.S. mutual fund assets[2] that outpaced their Lipper category averages as of March 31, 2012 and 2011, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2012				As of March 31, 2011			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total long-term (excludes liquidity)	67 %	66 %	78 %	74 %	56 %	74 %	70 %	67 %
Equity:								
Large cap	78 %	51 %	48 %	45 %	39 %	63 %	31 %	21 %
Small cap	44 %	63 %	93 %	98 %	72 %	76 %	91 %	98 %
Total equity (includes other equity)	57 %	56 %	73 %	71 %	58 %	70 %	68 %	60 %
Fixed income:								
U.S. taxable	76 %	91 %	82 %	83 %	79 %	85 %	78 %	80 %
U.S. tax-exempt	91 %	70 %	91 %	82 %	6 %	77 %	82 %	90 %
Global taxable	96 %	81 %	91 %	87 %	80 %	94 %	41 %	88 %
Total fixed income	84 %	81 %	87 %	83 %	52 %	83 %	78 %	85 %

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

As of March 31, 2012 and 2011, 91% of total AUM is included in strategy AUM in each period, although not all strategies have three-, five-, and ten-year histories. Total strategy AUM includes liquidity assets. Certain assets are not included in reported performance comparisons. These include: accounts that are not managed in accordance with the guidelines outlined above; accounts in strategies not marketed to potential clients; accounts that have not yet been assigned to a strategy; and certain smaller products at some of our affiliates.

Past performance is not indicative of future results. For AUM included in institutional and retail separate accounts and investment funds included in the same strategy as separate accounts, performance comparisons are based on gross-of-fee performance. For investment funds (including fund-of-hedge funds) which are not managed in a separate

account format, performance comparisons are based on net-of-fee performance. These performance comparisons do not reflect the actual performance of any specific separate account or investment fund; individual separate account and investment fund performance may differ.

Certain prior year amounts have been updated to conform to the current year presentation.

(2) Source: Lipper Inc. includes open-end, closed-end, and variable annuity funds. As of March 31, 2012 and 2011, the U.S. long-term mutual fund assets represented in the data accounted for 18% and 17%, respectively, of our total AUM. The performance of our U.S. long-term mutual fund assets is included in the marketed composites.

RESULTS OF OPERATIONS

Operating Revenues

Total operating revenues for the year ended March 31, 2012, were $2.7 billion, a decrease of 4.4% from $2.8 billion in the prior year, primarily due to a 4% decrease in average AUM and a $47.2 million decrease in performance fees. This decrease was offset in part by an increase in average AUM revenue yields, from 34.4 basis points in the year ended March 31, 2011, to 35.2 basis points in the year ended March 31, 2012, resulting from a more favorable average asset mix. The disposition of liquidity AUM related to the Morgan Stanley Wealth Management ("MSWM") relationship resulted in a reduction in operating revenues of $52.3 million, net of related fee waivers, in fiscal 2012, as compared to fiscal 2011, as a significant portion of the management fees generated by these assets were being waived prior to the disposition.

Investment advisory fees from separate accounts decreased $40.1 million, or 4.9%, to $775.5 million. Of this decrease, $25.9 million was primarily the result of lower average equity assets managed by LMCM, Batterymarch, ClearBridge and Legg Mason Investment Counsel & Trust Company ("LMIC"), and $8.0 million was primarily due to the divestiture of a Singapore-based asset manager in fiscal 2011. These decreases were offset in part by an increase of $6.7 million due to higher average fixed income assets managed by Brandywine.

Investment advisory fees from funds remained essentially flat at $1.5 billion for both periods. Higher average equity assets managed by Royce and ClearBridge, and higher average fixed income assets, primarily managed at Western Asset, resulted in an increase of $41.3 million and $41.1 million, respectively. These increases were offset by a decrease of $51.3 million, net of related fee waivers, due to lower average liquidity assets managed at Western Asset, primarily as a result of the previously discussed disposition of liquidity AUM related to our MSWM relationship, as well as a $31.5 million decrease as a result of lower average equity assets managed by LMCM and Permal.

Of our total AUM as of March 31, 2012 and 2011, approximately 6% for each period was in accounts that were eligible to earn performance fees. Performance fees decreased 48.8%, or $47.2 million, to $49.5 million during the year ended March 31, 2012, primarily as a result of lower fees earned on assets managed at Permal and Western Asset, offset slightly by an increase in performance fees earned on assets managed at Brandywine.

Distribution and service fees decreased $38.2 million, or 10.1%, to $341.0 million, primarily due to the disposition of the liquidity AUM related to the MSWM relationship, as well as a decline in average mutual fund AUM subject to distribution and service fees.

Operating Expenses

Total operating expenses for the year ended March 31, 2012, were $2.3 billion, a decrease of 3.1% from $2.4 billion in the prior year. Operating expenses for the year ended March 31, 2012, incurred at the investment management affiliate level comprised approximately 70% of total operating expenses. The remaining operating expenses are comprised of corporate and distribution costs.

The components of total compensation and benefits (in millions) for the years ended March 31 were as follows:

	Years Ended March 31,	
	2012	2011
Salaries and incentives	$895.0	$905.8
Benefits and payroll taxes	196.7	194.7
Transition-related costs	34.6	45.0
Other	18.0	39.9
Total compensation and benefits	$1,144.3	$1,185.4

Total compensation and benefits decreased 3.5% to $1.1 billion;

- Salaries and incentives decreased $10.8 million, primarily due to a $40.6 million decrease in corporate salaries and incentives, primarily resulting from headcount reductions in connection with our business streamlining initiative, and a $40.3 million net decrease in salaries and incentives at revenue-share based affiliates. These decreases were offset in part by an increase in incentives of $51.0 million resulting from changes in an expense reimbursement arrangement with Western Asset, as well as additional costs of $20.5 million associated with market-based compensation increases among retained staff and new employees, primarily in our global distribution group, to support on-going growth initiatives.
- Benefits and payroll taxes increased $2.0 million , primarily due to an $11.2 million increase in non-cash amortization expense associated with certain deferred compensation awards at revenue-share based affiliates. This increase was offset in part by a $9.2 million decrease in corporate benefits expense, primarily due to headcount reductions resulting from our business streamlining initiative.
- Transition-related costs decreased $10.4 million. These costs represent accruals for severance and retention costs related to our business streamlining initiative.
- Other compensation and benefits decreased $21.9 million, primarily due to a decrease in revenue-share based incentive obligations resulting from net market losses on assets invested for seed capital investments and deferred compensation plans, which were offset by corresponding increases in Other non-operating income (expense).

Compensation as a percentage of operating revenues increased to 43.0% from 42.6% in the prior fiscal year, primarily due to the impact of the change in the expense reimbursement arrangement with Western Asset, as well as market-based compensation increases among retained staff and new employees. These increases were offset in part by the impact of lower corporate compensation costs, primarily attributable to our business streamlining initiative, the impact of compensation decreases related to reduced market gains on assets invested for deferred compensation plans and seed capital investments, and the decrease in transition-related compensation.

Distribution and servicing expenses decreased 8.9% to $649.7 million, principally driven by a $41.4 million decrease due to the previously discussed disposition of liquidity AUM related to the MSWM relationship, as well as a $6.9 million decrease in servicing expenses as a result of our business streamlining initiative. A $5.8 million decline in structuring fees related to closed-end fund launches also contributed to the decrease.

Communications and technology expense increased 1.7% to $164.7 million, driven by increases, principally in data processing costs, market data costs, and consulting fees, totaling $12.2 million, primarily due to transition-related costs incurred as a result of our business streamlining initiative. These increases were offset in part by $9.3 million in cost savings as a result of our streamlining changes, including reduced depreciation of technology hardware and software and consulting fees.

Occupancy expense increased 12.3% to $154.8 million, primarily due to a $14.7 million net increase in lease reserves recorded in fiscal 2012, primarily related to permanently abandoning certain office space as part of our business streamlining initiative. In addition, there was a $10.3 million increase as a result of the acceleration of depreciation related to space permanently abandoned in fiscal 2012, also related to our business streamlining initiative. These

increases were offset in part by the impact of the write-off of a $4.1 million real estate escrow deposit in the prior year and a $3.3 million reduction in depreciation on furniture and leasehold improvements, both resulting from our business streamlining initiative.

Amortization of intangibles decreased 14.6% to $19.6 million, primarily due to the full amortization of certain management contracts during fiscal 2012.

Other expenses increased $14.1 million, or 8.0%, to $190.7 million, primarily as a result of an increase in expense reimbursements paid to certain mutual funds during the current year under expense cap arrangements.

Non-Operating Income (Expense)
Interest income increased 24.2% to $11.5 million, driven by higher yields earned on investment balances.

Interest expense decreased 5.0% to $87.6 million, primarily as a result of the retirement of our Equity Units during fiscal 2012, which reduced interest expense by $4.1 million.

Other non-operating income decreased $37.5 million to $22.1 million, primarily as a result of $56.0 million in net market losses on investments in proprietary fund products, which were partially offset by corresponding compensation decreases discussed above, and $11.8 million due to reduced gains on assets invested for deferred compensation plans, which were substantially offset by corresponding compensation decreases described above. These decreases were offset in part by an $11.3 million increase in dividend income, which was partially offset by a corresponding compensation increase under revenue-sharing agreements, a gain of $8.6 million related to an assigned bankruptcy claim, and a gain of $7.5 million on the sale of a small affiliate.

Other non-operating income of CIVs increased $16.6 million to $18.3 million, due to net market gains on investments of certain CIVs.

Income Tax Provision
The provision for income taxes was $72.1 million compared to $119.4 million in the prior year. During fiscal 2012, The U.K. Finance Act 2011 (the "Act") was enacted. The Act reduced the main U.K. corporate income tax rate from 27% to 26% effective April 1, 2011, and to 25% effective April 1, 2012. The impact of the tax rate changes on the revaluation of certain existing deferred tax liabilities resulted in a tax benefit of $18.3 million in the current year. The prior year also included a similar tax benefit of $8.9 million on the revaluation of deferred tax liabilities. In addition, the restructuring of our Australian business, partially offset by adjustments to the net value of certain deferred tax assets, resulted in a net tax benefit of $10.1 million in the current year. The effective tax rate was 23.8% compared to 32.7% in the prior year. Changes in the U.K. tax rate impacted the effective tax rate by 6.0 and 2.5 percentage points in the years ended March 31, 2012 and 2011, respectively. In addition, the restructuring of our Australian business, partially offset by adjustments to the net value of certain deferred tax assets, impacted the effective tax rate by 3.3 percentage points in the current year.

Net Income Attributable to Legg Mason, Inc.
Net Income Attributable to Legg Mason, Inc. for the year ended March 31, 2012, totaled $220.8 million, or $1.54 per diluted share, compared to $253.9 million, or $1.63 per diluted share, in the prior year. The decrease in Net Income was primarily due to an increase in incentive compensation from changes in an expense reimbursement arrangement with Western Asset, the impact of net market losses on proprietary fund products and assets invested for deferred compensation plans which are not offset in compensation and benefits, and the net impact of decreased operating revenues. These decreases were offset in part by the impact of cost savings due to our business streamlining initiative, and the impact of tax benefits associated with the restructuring of a foreign subsidiary and U.K. tax rate changes. These items were previously discussed in "Results of Operations" above.

Supplemental Non-GAAP Financial Information

Adjusted Income decreased to $397.0 million, or $2.77 per diluted share, for the year ended March 31, 2012, from $439.2 million, or $2.83 per diluted share, in the prior year primarily due to the decrease in Net Income, previously discussed, excluding the impact of U.K. tax rate adjustments. Operating Margin, as Adjusted, for the years ended March 31, 2012 and 2011, was 21.3% and 23.2%, respectively.

Adjusted Income

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

	For the Years Ended March 31,	
	2012	2011
Net Income Attributable to Legg Mason, Inc.	$220,817	$253,923
Plus (less):		
Amortization of intangible assets	19,574	22,913
Deferred income taxes on intangible assets:		
Tax amortization benefit	135,830	134,602
U.K. tax rate adjustment	(18,268)	(8,878)
Imputed interest on convertible debt (2.5% senior notes)	39,077	36,688
Adjusted Income	$397,030	$439,248
Net Income per diluted share Attributable to Legg Mason, Inc. common shareholders	$1.54	$1.63
Plus (less):		
Amortization of intangible assets	0.14	0.15
Deferred income taxes on intangible assets:		
Tax amortization benefit	0.95	0.87
U.K. tax rate adjustment	(0.13)	(0.06)
Imputed interest on convertible debt (2.5% senior notes)	0.27	0.24
Adjusted Income per diluted share	$2.77	$2.83

Operating Margin, as Adjusted

The calculation of Operating margin and Operating margin, as adjusted, is as follows (dollars in thousands):

	For the Years Ended March 31,	
	2012	2011
Operating Revenues, GAAP basis	$2,662,574	$2,784,317
Plus (less):		
Operating revenues eliminated upon consolidation of investment vehicles	3,094	4,133
Distribution and servicing expense excluding consolidated investment vehicles	(649,679)	(712,779)
Operating Revenues, as Adjusted	$2,015,989	$2,075,671
Operating Income, GAAP basis	$338,753	$386,808
Plus (less):		
Gains (losses) on deferred compensation and seed investments	13,809	36,274
Transition-related costs	73,066	54,434
Operating income and expenses of consolidated investment vehicles	3,702	4,704
Operating Income, as Adjusted	$429,330	$482,220
Operating Margin, GAAP basis	12.7%	13.9%
Operating Margin, as adjusted	21.3	23.2

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Liquidity and Capital Resources

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

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

Our assets consist primarily of intangible assets, goodwill, cash and cash equivalents, investment securities, and investment advisory and related fee receivables. Our assets have been principally funded by equity capital, long-term debt and the results of our operations. At March 31, 2013, our cash and cash equivalents, total assets, long-term debt and stockholders' equity were $0.9 billion, $7.0 billion, $1.1 billion and $4.8 billion, respectively. Total assets and total liabilities of the CIVs at March 31, 2013, were $285 million and $221 million, respectively.

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

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

	2013		2012		2011	
Cash flows provided by operating activities	$303.3		$496.8		$412.1	
Cash flows provided by/(used in) investing activities	(11.0	)	2.3		(44.4	)
Cash flows used in financing activities	(735.9	)	(481.8	)	(468.5	)
Effect of exchange rate changes	(5.7	)	(10.9	)	10.8	
Net change in cash and cash equivalents	(449.3	)	6.4		(90.0	)
Cash and cash equivalents, beginning of period	1,382.3		1,375.9		1,465.9	
Cash and cash equivalents, end of period	$933.0		$1,382.3		$1,375.9	

Cash inflows provided by operating activities during fiscal 2013 were $303.3 million, primarily related to net sales of trading and other current investments and results of operations, adjusted for non-cash items, offset in part by the allocation of extinguished debt repayment and payments for accrued compensation. Cash outflows used in investing activities during fiscal 2013, were $11.0 million, primarily related to payments related to the acquisition of Fauchier and payments made for fixed assets, offset in part by net activity related to CIVs. Cash outflows used in financing activities during fiscal 2013 were $735.9 million, primarily related to the repayment of long-term debt of $1,049.2 million, the repurchase of 16.2 million shares of our common stock for $425.5 million, the $250.0 million repayment of short-term debt, and dividends paid of $55.3 million, offset in part by the proceeds from the subsequent long-term debt issuances of $1,143.2 million.

Cash inflows provided by operating activities during fiscal 2012 were $496.8 million, primarily related to Net Income, adjusted for non-cash items. Cash inflows provided by investing activities during fiscal 2012, were $2.3 million, primarily related to $20.2 million of net activity related to CIVs and a release of restricted cash required for market hedge arrangements, offset in part by payments made for fixed assets. Cash outflows used in financing activities during fiscal 2012, were $481.8 million, primarily due to the repurchase of 13.6 million shares of our common stock for $400.3 million and dividends paid of $43.6 million.

Cash inflows provided by operating activities during fiscal 2011 were $412.1 million, primarily attributable to Net Income, adjusted for non-cash items. Cash outflows used in investing activities during fiscal 2011 were $44.4 million, primarily attributable to payments made for fixed assets. Cash outflows used in financing activities during fiscal 2011 were $468.5 million, primarily attributable to the repurchase of 14.6 million of our common shares for $445 million.

Financing Transactions

The table below reflects our primary sources of financing (in thousands) as of March 31, 2013:

Type	Total at March 31, 2013	Amount Outstanding at March 31, 2013	2012	Interest Rate	Maturity
5.5% Senior Notes	$650,000	$650,000	N/A	5.50%	May 2019
Five-year Amortizing Term Loan	500,000	500,000	N/A	LIBOR + 1.5%	June 2017
Revolving Credit Agreement	500,000	—	N/A	LIBOR + 1.5% + 0.20% annual commitment fee	June 2017
2.5% Convertible Senior Notes	—	—	$1,127,009	2.50%	Repurchased June 2012
Previous Revolving Credit Agreement	—	—	250,000	LIBOR + 2.625%	Terminated June 2012

During January 2008, we increased our capital base by $1.25 billion through the sale of 2.5% convertible senior notes. The proceeds strengthened our balance sheet and provided additional liquidity that was used for general corporate purposes, including the purchase of structured investment vehicle securities from our liquidity funds. The Notes were repurchased in May 2012, as further discussed below. Prior to the repurchase of the Notes, we were accreting the carrying value of the Notes to the principal amount at maturity using an interest rate of 6.5% (the effective borrowing rate for non-convertible debt at the time of issuance) over its expected life of seven years, resulting in additional interest expense for fiscal 2013, 2012 and 2011, of approximately $5.8 million, $39.1 million and $36.7 million, respectively. In connection with this financing, we entered into economic hedge transactions that increased the effective conversion price of the Notes. These hedge transactions had a net cost to us of $83 million, which we paid from the proceeds of the Notes. These transactions closed on January 31, 2008.

Capital Plan

In May 2012, we announced a capital plan that included refinancing the Notes. The refinancing was effected through the issuance of $650 million of 5.5% senior notes, the net proceeds of which, together with cash on hand and $250 million of remaining borrowing capacity under a then existing revolving credit facility, were used to repurchase all $1.25 billion of the Notes. The terms of the repurchase included the repayment of the Notes at par plus accrued interest, a prepayment fee of $6.3 million, and the issuance of warrants to the holders of the Notes. The warrants provide for the purchase, in the aggregate and subject to adjustment, of 14.2 million shares of our common stock, on a net share settled basis, at an exercise price of $88 per share. The warrants expire in June 2017 and can be settled, at our election, in either shares of common stock or cash.

Also pursuant to the capital plan, in June 2012, we entered into an unsecured credit agreement which provides for an undrawn $500 million revolving credit facility and a $500 million term loan. The proceeds of the term loan were used to repay the $500 million of outstanding borrowings under the previous revolving credit facility, which was then terminated.

The $500 million revolving credit facility may be increased by an aggregate amount up to $250 million, subject to the approval of the lenders, and expires June 2017. This revolving credit facility is available to fund working capital needs and for general corporate purposes. There were no borrowings outstanding under this facility as of March 31, 2013.

The $500 million term loan entered into in conjunction with the unsecured credit agreement noted above can be repaid at any time and is due in four annual installments of $50 million, beginning in June 2013, with the remainder to be repaid at maturity in June 2017.
The $650 million 5.5% senior notes are due May 2019 and were sold at a discount of $6.8 million, which is being amortized to interest expense over the seven-year term.

In connection with the extinguishment of the Notes, the hedge transactions (purchased call options and warrants) executed in connection with the initial issuance of the Notes were also terminated.
The financial covenants under our bank agreements include: maximum net debt to EBITDA ratio of 2.5 to 1 and minimum EBITDA to interest expense ratio of 4.0 to 1. Debt is defined to include all obligations for borrowed money, excluding non-recourse debt of CIVs, and capital leases. Under these net debt covenants, our debt is reduced by the amount of our unrestricted cash in excess of the greater of subsidiary cash or $375 million. EBITDA is defined as consolidated net income (loss) plus/minus tax expense (benefit), interest expense, depreciation and amortization, amortization of intangibles, any extraordinary expense or losses, and any non-cash charges, as defined in the agreements. As of March 31, 2013, our net debt to EBITDA ratio was 1.4 to 1 and EBITDA to interest expense ratio was 11.6 to 1, and, therefore, we have maintained compliance with the applicable covenants. In addition, the 5.5% senior notes are subject to certain nonfinancial covenants, including provisions relating to dispositions of certain assets, which could require a percentage of any related proceeds to be applied to accelerated repayments.
If our net income (loss) significantly declines, or if we spend our available cash, it may impact our ability to maintain compliance with the financial covenants. If we determine that our compliance with these covenants may be under pressure, we may elect to take a number of actions, including reducing our expenses in order to increase our EBITDA, using available cash to repay all or a portion of our outstanding debt subject to these covenants or seeking to negotiate with our lenders to modify the terms or to restructure our debt. We anticipate that we will have available cash to repay our bank debt, should it be necessary. Using available cash to repay indebtedness would make the cash unavailable for other uses and might affect the liquidity discussions and conclusions above. Entering into any modification or restructuring of our debt would likely result in additional fees or interest payments.

Our outstanding bank debt agreement is currently impacted by the ratings of two rating agencies. The interest rate and annual commitment fee on our revolving line of credit is based on the higher credit rating of the two rating agencies. In June 2011, our rating by one of these agencies was downgraded one notch below the other. Should the other agency downgrade our rating, absent an upgrade from the former agency, our interest costs will rise modestly. In addition, under the terms of the 5.5% senior notes, the interest rate paid on these notes will increase modestly if our credit ratings are reduced below investment grade.

Also in connection with the capital plan, our board of directors authorized $1.0 billion for additional purchases of our common stock, $730 million of which remained available as of March 31, 2013, and the completion of the purchase of the then remaining $155 million of our common stock previously authorized, which occurred in the quarter ended June 30, 2012. The capital plan authorizes using up to 65% of cash generated from future operations, beginning in fiscal 2013, to purchase shares of our common stock.

Other Transactions
On March 13, 2013, we completed the acquisition of all of the outstanding share capital of Fauchier, a leading European based manager of funds-of-hedge funds, from BNP Paribas Investment Partners, S.A. The transaction included an initial cash payment of $63.4 million, which was funded from existing cash resources. In addition, contingent consideration of up to approximately $23.0 million and approximately $30.0 million, utilizing exchange rates as of March 31, 2013, may be due on the second and fourth anniversaries of closing, respectively, dependent on achieving certain financial targets and subject to a catch up adjustment. The contingent consideration liability had an acquisition date fair value of approximately $21.6 million.

In May 2010, we terminated the exchangeable share arrangement related to the acquisition of Legg Mason Canada Inc., in accordance with its terms. In this transaction, 1.1 million shares, representing all remaining outstanding exchangeable shares, were exchanged for shares of our common stock on a one-for-one basis.

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

respective capital adequacy requirements during the periods presented.

See Notes 2 and 6 of Notes to Consolidated Financial Statements for additional information related to the Fauchier acquisition and our capital plan, respectively.

Future Outlook

We expect that over the next 12 months cash generated from our operating activities will be adequate to support our operating and investing cash needs, and planned share repurchases. We currently intend to utilize our other available resources for any number of potential activities, including, but not limited to, seed capital investments in new products, repurchase of shares of our common stock, acquisitions, repayment of outstanding debt, or payment of increased dividends.

As described above, we currently project that our cash flows from operating activities will be sufficient to fund our liquidity needs. As of March 31, 2013, we had over $550 million in cash and cash equivalents in excess of our working capital requirements. As previously discussed, and in accordance with our capital plan, we intend to utilize up to 65% of cash generated from future operations to purchase shares of our common stock. We do not currently expect to raise additional debt or equity financing over the next 12 months. However, there can be no assurances of these expectations as our projections could prove to be incorrect, events may occur that require additional liquidity, such as an acquisition opportunity or an opportunity to refinance indebtedness, or market conditions might significantly worsen, affecting our results of operations and generation of available cash. If these events result in our operations and available cash being insufficient to fund liquidity needs, we would likely seek to manage our available resources by taking actions such as reducing future share repurchases, additional cost-cutting, reducing our expected expenditures on investments, selling assets (such as investment securities), repatriating earnings from foreign subsidiaries, or modifying arrangements with our affiliates and/or employees. Should these types of actions prove insufficient, or should a large acquisition or refinancing opportunity arise, we may seek to raise additional equity or debt.

At March 31, 2013, our total cash and cash equivalents of $933 million included $415 million held by foreign subsidiaries. Some of the amounts held by foreign subsidiaries may be subject to material repatriation tax effects. During the year ended March 31, 2013, we repatriated approximately $390 million of foreign cash and we plan to repatriate up to another $325 million over the next several years, in order to increase our cash available in the U.S. for general corporate purposes. We anticipate an incremental tax cost of approximately $18 million with respect to this repatriation and have adjusted our tax reserve accordingly. No further repatriation of accumulated prior period foreign earnings is currently planned. However, if circumstances change, we will provide for and pay any applicable additional U.S. taxes in connection with repatriation of these funds. It is not practical at this time to determine the income tax liability that would result from any further repatriation of accumulated foreign earnings.

Credit and Liquidity Risk

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

Off-Balance Sheet Arrangements

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

Contractual and Contingent Obligations

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

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

	2014	2015	2016	2017	2018	Thereafter	Total
Contractual Obligations							
Long-term borrowings by contract maturity[1]	$50.4	$50.5	$50.0	$50.0	$300.0	$650.0	$1,150.9
Interest on long-term borrowings and credit facility commitment fees[1]	44.9	43.9	43.0	42.2	37.2	53.6	264.8
Minimum rental and service commitments	132.5	121.2	106.6	95.3	86.7	422.6	964.9
Total Contractual Obligations	227.8	215.6	199.6	187.5	423.9	1,126.2	2,380.6
Contingent Obligation							
Payments related to business acquisition[2]	—	23.0	—	30.0	—	—	53.0
Total Contractual and Contingent Obligations[3][4][5][6]	$227.8	$238.6	$199.6	$217.5	$423.9	$1,126.2	$2,433.6

(1) Excludes long-term borrowings of the consolidated CLO of $207.8 million and interest on these long-term borrowings, as applicable.

(2) The amount of contingent payments reflected for any year represents the maximum amount that could be payable, using exchange rates as of
March 31, 2013, at the earliest possible date under the terms of the business purchase agreement. The contingent obligation had an acquisition date fair value of $21.6 million.

(3) The table above does not include approximately $37.4 million in capital commitments to investment partnerships in which Legg Mason is a limited partner. These obligations will be funded, as required, through the end of the commitment periods through fiscal 2021.

(4) The table above does not include amounts for uncertain tax positions of $51.5 million (net of the federal benefit for state tax liabilities), because the timing of any related cash outflows cannot be reliably estimated.

(5) The table above does not include redeemable noncontrolling interests, primarily related to CIVs, of $21.0 million, because the timing of any related cash outflows cannot be reliably estimated.

(6) The table above excludes commitments arising from any potential awards under the proposed Permal management equity plan for its key employees.

MARKET RISK

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

Revenues and Net Income (Loss)

The majority of our revenue is calculated from the market value of our AUM. Accordingly, a decline in the value of the underlying securities will cause our AUM, and thus our revenues, to decrease. In addition, our fixed income and liquidity AUM are subject to the impact of interest rate fluctuations, as rising interest rates may tend to reduce the market value of bonds held in various mutual fund portfolios or separately managed accounts. In the ordinary course of our business, we may also reduce or waive investment management fees, or limit total expenses, on certain

products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. Performance fees may be earned on certain investment advisory contracts for exceeding performance benchmarks, and strong markets tend to increase these fees. Declines in market values of AUM will result in reduced fee revenues and net income. We generally earn higher fees on equity assets than fees charged for fixed income and liquidity assets. Declines in market values of AUM in this asset class will disproportionately impact our revenues. In addition, under revenue sharing agreements, certain of our affiliates retain different percentages of revenues to cover their costs, including compensation. Our net income (loss), profit margin and compensation as a percentage of operating revenues are impacted based on which affiliates generate our revenues, and a change in AUM at one subsidiary can have a dramatically different effect on our revenues and earnings than an equal change at another subsidiary.

Trading and Non-Trading Assets

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

Trading and other current investments, excluding CIVs, at March 31, 2013 and 2012, subject to risk of security price fluctuations are summarized (in thousands) below.

	2013	2012
Investment securities, excluding CIVs:		
Trading investments relating to long-term incentive compensation plans	$86,583	$111,257
Trading proprietary fund products and other investments	228,156	222,585
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments	56,341	78,277
Total current investments, excluding CIVs	$371,080	$412,119

Approximately $39.2 million and $80.0 million of trading and other current investments related to long-term incentive compensation plans as of March 31, 2013 and 2012, respectively, have offsetting liabilities such that fluctuation in the market value of these assets and the related liabilities will not have a material effect on our net income (loss) or liquidity. However, it will have an impact on our compensation expense with a corresponding offset in other non-operating income (expense). Trading and other current investments of $91.1 million and $86.2 million at March 31, 2013 and 2012, respectively, relate to other long-term incentive plans for which the related liabilities do not completely offset due to vesting provisions. Therefore, fluctuations in the market value of these trading investments will impact our compensation expense, non-operating income (expense) and net income (loss).

Approximately $240.8 million and $245.9 million of trading and other current investments at March 31, 2013 and 2012, respectively, are investments in proprietary fund products and other investments for which fluctuations in market value will impact our non-operating income (expense). Of these amounts, the fluctuations in market value of approximately $13.8 million and $12.6 million of proprietary fund products as of March 31, 2013 and 2012, respectively, have offsetting compensation expense under revenue share agreements. The fluctuations in market value of approximately $71.9 million and $11.8 million in proprietary fund products as of March 31, 2013 and 2012, respectively, are substantially offset by gains (losses) on market hedges and therefore do not materially impact Net Income (Loss) Attributable to Legg Mason, Inc. Investments in proprietary fund products are not liquidated before the related fund establishes a track record, has other investors, or a decision is made to no longer pursue the strategy.

Non-trading assets, excluding CIVs, at March 31, 2013 and 2012, subject to risk of security price fluctuations are summarized (in thousands) below.

	2013	2012
Investment securities, excluding CIVs:		
Available-for-sale	$12,400	$11,913
Investments in partnerships, LLCs and other	31,143	34,965
Equity method investments in partnerships and LLCs	68,780	169,201
Other investments	99	112
Total non-trading assets, excluding CIVs	$112,422	$216,191

Equity method investments in partnerships and LLCs at March 31, 2012, included approximately $89.3 million of investments related to our involvement with the PPIP. Fluctuations in the market value of these investments had offsetting compensation expense under revenue-sharing agreements. Our investments related to the PPIP were fully redeemed during fiscal 2013, upon liquidation of the fund.

Investment securities of CIVs totaled $24.8 million and $31.6 million as of March 31, 2013 and 2012, respectively, and investments of CIVs totaled $210.6 million and $294.9 million as of March 31, 2013 and 2012, respectively. As of March 31, 2013 and 2012, we held equity investments in the CIVs of $39.1 million and $38.9 million, respectively. Fluctuations in the market value of investments of CIVs in excess of our equity investment will not impact Net Income (Loss) Attributable

to Legg Mason, Inc. However, it may have an impact on other non-operating income (expense) of CIVs with a corresponding offset in Net income (loss) attributable to non-controlling interests.

Valuation of trading and non-trading investments is described below within Critical Accounting Policies under the heading "Valuation of Financial Instruments." See Notes 1 and 14 of Notes to Consolidated Financial Statements for further discussion of derivatives.

The following is a summary of the effect of a 10% increase or decrease in the market values of our financial instruments subject to market valuation risks at March 31, 2013:

	Carrying Value	Fair Value Assuming a 10% Increase[1]	Fair Value Assuming a 10% Decrease[1]
Investment securities, excluding CIVs:			
Trading investments relating to long-term incentive compensation plans	$86,583	$95,241	$77,925
Trading proprietary fund products and other investments	228,156	250,972	205,340
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments	56,341	61,975	50,707
Total current investments, excluding CIVs	371,080	408,188	333,972
Investments in CIVs	39,056	42,962	35,150
Available-for-sale investments	12,400	13,640	11,160
Investments in partnerships, LLCs and other	31,143	34,257	28,029
Equity method investments in partnerships and LLCs	68,780	75,658	61,902
Other investments	99	109	89
Total investments subject to market risk	$522,558	$574,814	$470,302

(1) Gains and losses related to certain investments in deferred compensation plans and proprietary fund products are directly offset by a corresponding adjustment to compensation expense and related liability. In addition, investments in proprietary fund products of approximately $71.9 million have been economically hedged to limit market risk. As a result, a 10% increase or decrease in the unrealized market value of our financial instruments subject to market valuation risks would result in a $33.1 million increase or decrease in our pre-tax earnings as of March 31, 2013.

Also, as of March 31, 2013 and 2012, cash and cash equivalents included $485.8 million and $893.7 million, respectively, of money market funds.

Foreign Exchange Sensitivity

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

Interest Rate Risk

Exposure to interest rate changes on our outstanding debt is partially mitigated as our $650 million of 5.5% senior notes are at fixed interest rates. At March 31, 2013, approximately $500 million of our outstanding floating rate debt

is subject to fluctuations in interest rates and will have an impact on our non-operating income (loss) and net income (loss). As of March 31, 2013, we estimate that a 1% change in interest rates would result in a net annual change to interest expense of $5 million. See Note 6 of Notes to Consolidated Financial Statements for additional disclosures regarding debt.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

Consolidation

Effective April 1, 2010, we adopted revised accounting guidance, Accounting Standards Codification ("ASC") Topic 810, "Consolidation," (Statement of Financial Accounting Standards No. 167, "Amendments to Financial Accounting Standards Board Interpretation No. 46(R)") ("SFAS No. 167"), relating to the consolidation of variable interest entities ("VIEs") which includes a new approach for determining who should consolidate a VIE, changes to when it is necessary to reassess who should consolidate a VIE, and changes in the assessment of which entities are VIEs. The application of the revised accounting guidance has been deferred for certain investment funds, including money market funds. Investment funds that qualify for the deferral continue to be assessed for consolidation under prior guidance, Financial Accounting Standards Board Interpretation No. 46(R), "Consolidation of Variable Interest Entities — an interpretation of ARB No. 51" ("FIN 46(R)").

In the normal course of our business, we sponsor and are the manager of various types of investment vehicles. Certain of these investment vehicles are considered to be VIEs while others are considered to be voting rights entities ("VREs") subject to traditional consolidation concepts based on ownership rights. For our services, we are entitled to receive management fees and may be eligible, under certain circumstances, to receive additional subordinate management fees or other incentive fees. Our exposure to risk in these entities is generally limited to any equity investment we have made or are required to make and any earned but uncollected management fees. Uncollected management fees from these VIEs were not material at March 31, 2013. We have not issued any investment performance guarantees to these VIEs, VREs or their investors. Investment vehicles that are considered VREs are consolidated if we have a controlling financial interest in the investment vehicle, absent substantive investor rights to replace the manager of the entity (kick-out rights).

Financial Accounting Standards Board Interpretation No. 46(R) (Accounting Standards Update 2010-10, "Amendments to Statement 167 for Certain Investment Funds")

For most sponsored investment funds, including money market funds, we determine whether we are the primary beneficiary of a VIE if we absorb a majority of the VIE's expected losses, or receive a majority of the VIE's expected residual returns, if any. Our determination of expected residual returns excludes gross fees paid to a decision maker if certain criteria are met. In determining whether we are the primary beneficiary of a VIE, we consider both qualitative and quantitative factors such as the voting rights of the equity holders, economic participation of all parties, including how fees are earned and paid to us, related party ownership, guarantees and implied relationships. In determining the primary beneficiary, we must make assumptions and estimates about, among other things, the future performance of the underlying assets held by the VIE, including investment returns, cash flows, and credit and interest rate risks. In determining whether a VIE is significant for disclosure purposes, we consider the same factors used for determination of the primary beneficiary.

Statement of Financial Accounting Standards No. 167 (Accounting Standards Codification Topic 810, "Consolidation")

We sponsor and are the manager for collateralized debt obligation entities ("CDOs") and CLOs that do not qualify for the deferral, and are assessed under the revised accounting guidance, as follows. We determine whether we have a variable interest in a VIE by considering if, among other things, we have the obligation to absorb losses, or the right to receive benefits, that are expected to be significant to the VIE. We consider the management fee structure, including the seniority level of our fees, the current and expected economic performance of the entity, as well as other provisions included in the governing documents that might restrict or guarantee an expected loss or residual return. If we have a significant variable interest, we determine whether we are the primary beneficiary of the VIE if we have both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and the obligation to absorb losses, or the right to receive benefits, that potentially could be significant to the VIE.

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

Legg Mason must consolidate any VIE for which it is deemed to be the primary beneficiary.

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

Revenue Recognition

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

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

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

Valuation processes for AUM are dependent on the nature of the assets and any contractual provisions with our clients. Equity securities under management for which market quotations are available are usually valued at the last reported sales price or official closing price on the primary market or exchange on which they trade. Debt securities under management are usually valued at bid, or the mean between the last quoted bid and asked prices, provided by independent pricing services that are based on transactions in debt obligations, quotations from bond dealers, market transactions in comparable securities and various other relationships between securities. Short-term debt obligations are generally valued at amortized cost, which is designed to approximate fair value. The vast majority of our AUM is valued based on data from third parties such as independent pricing services, fund accounting agents, custodians and brokers. This varies slightly from time to time based upon the underlying composition of the asset class (equity, fixed income and liquidity) as well as the actual underlying securities in the portfolio within each asset class. Regardless of the valuation process or pricing source, we have established controls reasonably designed to assess the reasonableness of the prices provided. Where market prices are not readily available, or are determined not to reflect fair value, value may be determined in accordance with established valuation procedures based on, among other things, unobservable inputs. Management fees on AUM where fair values are based on unobservable inputs are not material. As of March 31, 2013, equity, fixed income and liquidity AUM values aggregated $161.8 billion, $365.1 billion and $137.7 billion, respectively.

As the vast majority of our AUM is valued by independent pricing services based upon observable market prices or inputs, we believe market risk is the most significant risk underlying the value of our AUM. Economic events and financial market turmoil have increased market price volatility; however, the valuation of the vast majority of the securities held by our funds and in separate accounts continues to be derived from readily available market price quotations. As of March 31, 2013, less than 1% of total AUM is valued based on unobservable inputs.

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

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

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

For investments in illiquid or privately-held securities for which market prices or quotations are not readily available, the determination of fair value requires us to estimate the value of the securities using a variety of methods and resources, including the most current available financial information for the investment and the industry. As of March 31, 2013 and 2012, excluding investments in CIVs, we owned approximately $0.1 million and $11.9 million, respectively, of financial investments that were valued on our assumptions or estimates and unobservable inputs.

At March 31, 2013 and 2012, we also have approximately $99.9 million and $204.2 million, respectively, of other investments, such as investment partnerships, that are included in Other noncurrent assets on the Consolidated Balance Sheets, of which approximately $68.8 million and $169.2 million, respectively, are accounted for under the equity method. The remainder is accounted for under the cost method, which considers if factors indicate there may be an impairment in the value of these investments. In addition, as of March 31, 2013 and 2012, we had $56.3 million and $78.3 million, respectively, of equity method investments that are included in Investment securities on the Consolidated Balance Sheets.

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

non-performance.

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

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

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

Level 2 — Financial instruments for which prices are quoted for similar assets and liabilities in active markets; prices are quoted for identical or similar assets in inactive markets; or prices are based on observable inputs, other than quoted prices, such as models or other valuation methodologies. For us, this category may include repurchase agreements, fixed income securities and certain proprietary fund products. This category also includes CLO loans and derivative liabilities of a CIV.

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

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

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

The fair values of CLO loans and bonds are determined based on prices from well-recognized third-party pricing services that utilize available market data and are therefore classified as Level 2. Legg Mason has established controls designed to assess the reasonableness of the prices provided. The fair value of CLO debt is valued using a discounted cash flow methodology. Inputs used to determine the expected cash flows include assumptions about forecasted default and recovery rates that a market participant would use in determining the fair value of the CLO's underlying collateral assets. Given the significance of the unobservable inputs to the fair value measurement, the CLO debt valuation is classified as Level 3.

Exchange traded options are valued using the last sale price or in the absence of a sale, the last offering price. Options traded over the counter are valued using dealer supplied valuations. Options are classified as Level 1. Futures contracts are valued at the last settlement price at the end of each day on the exchange upon which they are traded and are classified as Level 1. Index and single name credit default swaps and interest rate swaps previously held were valued based on valuations furnished by pricing services and classified as Level 2.

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

As of March 31, 2013, approximately 2% of total assets (10% of financial assets measured at fair value) and 9% of total liabilities meet the definition of Level 3. Excluding the assets and liabilities of CIVs, approximately 1% of total assets (8% of financial assets measured at fair value) and no liabilities meet the definition of Level 3.

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

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

Intangible Assets and Goodwill

Balances as of March 31, 2013, are as follows (in thousands):

Amortizable asset management contracts	$22,327
Indefinite-life intangible assets	3,102,435
Trade names	52,800
Goodwill	1,269,165
	$4,446,727

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

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

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

Given the relative significance of our intangible assets and goodwill to our consolidated financial statements, on a quarterly basis we consider if triggering events have occurred that may indicate a significant change in fair values. Triggering events may include significant adverse changes in our business, legal or regulatory environment, loss of key personnel, significant business dispositions, or other events, including changes in economic arrangements with our affiliates that will impact future operating results. If a triggering event has occurred, we perform tests, which include critical reviews of all significant assumptions, to determine if any intangible assets or goodwill are impaired. At a minimum, we perform these tests for indefinite-life intangible assets and goodwill annually at December 31.

We performed an impairment test of the Permal funds-of-hedge funds contracts indefinite-life intangible asset as of December 12, 2012, because a modification of our employment contracts and other arrangements with the management of Permal that was completed on that day constituted a triggering event. Our test indicated that the funds-of-hedge funds contracts asset was impaired, thereby triggering impairment tests of our other indefinite-life intangible assets and goodwill. As a result of these impairment tests, updated through our annual test date of December 31, 2012, our Permal funds-of-hedge funds contracts and trade name indefinite-life intangible assets and our domestic mutual fund contracts indefinite-life intangible assets were each determined to be partially impaired, resulting in aggregate pre-tax operating charges of $734 million. Neither goodwill nor any other intangible assets were deemed to be impaired. Details of our intangible assets and goodwill and the related impairment tests follow.

No impairment in the value of amortizable intangible assets was recognized during the year ended March 31, 2013, as our estimates of the related future cash flows exceeded the asset carrying values. We also determined that no triggering events had occurred as of March 31, 2013, therefore, no additional indefinite-life intangible asset and

goodwill impairment testing was necessary.

Amortizable Intangible Assets

Intangible assets subject to amortization are considered for impairment at each reporting period using an undiscounted cash flow analysis. Significant assumptions used in assessing the recoverability of management contract intangible assets include projected cash flows generated by the contracts and the remaining lives of the contracts. Projected cash flows are based on fees generated by current AUM for the applicable contracts. Contracts are generally assumed to turnover evenly throughout the life of the intangible asset. The remaining life of the asset is based upon factors such as average client retention and

client turnover rates. If the amortization periods are not appropriate, the expected lives are adjusted and the impact on the fair value is assessed. Actual cash flows in any one period may vary from the projected cash flows without resulting in an impairment charge because a variance in any one period must be considered in conjunction with other assumptions that impact projected cash flows.

The estimated remaining useful lives of amortizable intangible assets currently range from one to six years with a weighted-average life of approximately 2.8 years.

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

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

Contracts that are managed and operated as a single unit, such as contracts within the same family of funds, are reviewed in aggregate and are considered interchangeable because investors can transfer between funds with limited restrictions. Similarly, cash flows generated by new funds added to the fund group are included when determining the fair value of the intangible asset.

Projected cash flows are based on annualized cash flows for the applicable contracts projected forward 40 years, assuming annual cash flow growth from estimated net client flows and projected market performance. To estimate the projected cash flows, projected growth rates by affiliate are used to project their assets under management. Cash flow growth rates consider estimates of both AUM flows and market expectations by asset class (equity, fixed income and liquidity) and by investment manager based upon, among other things, historical experience and expectations of future market and investment performance from internal and external sources. Currently, our market growth assumptions are 6% for equity, 3% for fixed income, and 0% for liquidity products, with a general assumption of 2% organic growth for all products, subject to exceptions for organic growth in near-term periods.

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

We believe our growth assumptions are reasonable given our consideration of multiple inputs, including internal and external sources, although our assumptions are subject to change based on fluctuations in our actual results and market

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

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

Discount rates are based on appropriately weighted estimated costs of debt and equity capital using a market participant perspective. We estimate the cost of debt based on published debt rates. We estimate the cost of equity capital based on the Capital Asset Pricing Model, which considers the risk-free interest rate, peer-group betas, and company and equity risk premiums. The equity risk is further adjusted to consider the relative risk associated with each Legg Mason indefinite-life intangible asset and our reporting unit. The discount rates are also calibrated based on an assessment of relevant market values. Continued market uncertainty and the resulting impact on Legg Mason's stock price and our search for a permanent CEO, which was ongoing during our impairment testing process, increase the relative risk associated with all aspects of our business, resulting in higher discount rates in the current year for our evaluation of each of Legg Mason's indefinite-life intangible assets and the reporting unit.

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

The Permal funds-of-hedge funds contracts of $626 million account for approximately 20% of our indefinite-life intangible assets. As noted above, the modification of employment contracts and other arrangements with the management of Permal constituted a triggering event as of December 12, 2012. Further, Permal has experienced recent outflows and increased risk associated with its business. The past several years have seen declines in the traditional high net worth client fund-of-hedge funds business, Permal's historical focus, which Permal has offset to some extent with new institutional business. As a result of these factors, actual results generally compare unfavorably to the growth assumptions for the Permal funds-of-hedge funds contracts used in the asset impairment testing at December 31, 2011 and 2010. As a result, in our December 2012 testing, the near-term growth assumptions for these contracts were reduced, which, together with the impact of decreased margins in near-years resulting from the modifications of the employment arrangements, led to decreased projected cash flows from the business. Further, fund-of-hedge fund managers are subject to unique market and regulatory influences, adding additional uncertainty to our estimates.

Based upon our projected discounted cash flow analyses, the carrying value of the Permal funds-of-hedge funds contracts asset exceeded its fair value, resulting in impairment charges of $321 million for the excess. Cash flows on the Permal funds-of-hedge funds contracts are assumed to have an average annual growth rate of approximately 8%. However, given current experience, projected cash flows reflect no net AUM flows trending to moderate inflows in years 1 and 2, respectively. The projected cash flows from the Permal funds-of-hedge funds contracts are discounted at 16.0%, reflecting the Permal and Legg Mason specific factors noted above.

Investment performance, including its expected impact on future asset flows, is a significant factor in our growth projections for the Permal funds-of-hedge funds contracts. Our market performance projections are supported by the fact that Permal's two largest funds that comprise over half of the contracts asset AUM have 10-year average returns exceeding 6%. Our market projections are further supported by industry statistics.

The domestic mutual fund contracts acquired in the Citigroup Asset Management ("CAM") transaction of $2,106 million account for approximately 65% of our indefinite-life intangible assets. As of December 31, 2012, approximately $127 billion of AUM, primarily managed by ClearBridge and Western Asset, are associated with this asset, with approximately 40% in long-term fixed income AUM and 30% in each of equity AUM and liquidity AUM. Although our domestic mutual fund contracts overall have maintained strong recent market performance, previously disclosed uncertainties regarding market conditions and asset flows and more recent assessments of related risk, including risks related to potential regulatory changes in the liquidity business, are reflected in our projected discounted cash flow analyses. As a result of the impact of these factors on our projected discounted cash flow analyses, the related carrying value exceeded its fair value, resulting in an impairment charge of $396 million for the excess. For our impairment test, cash flows from the domestic mutual fund contracts are assumed to have annual growth rates that average approximately 6%, but given current uncertainties, reflect

no net AUM flows trending to moderate inflows in years 1 and 2, respectively. Projected cash flows of the domestic mutual fund contracts are discounted at 14.5%, reflecting the business and Legg Mason specific factors noted above.

We believe that investment performance also has a significant influence on our domestic mutual fund contract long-term flows, and that recent improvements in performance will favorably impact our flows, as long as performance is strong. In aggregate, 76% of our domestic mutual fund long-term AUM was in funds that had outpaced their three-year Lipper category average at December 31, 2012, the date through which the testing was completed, which compares to 33% at September 30, 2008. Generally, there tends to be a four to five-year lag before improved investment performance results in increased asset flows.

In addition, we believe a recent reorganization of our distribution platform, which provides an improved focus on the growth of our business, has also favorably impacted our flows. The improvement in investment performance has assisted distribution personnel in selling more products. As a result of improved performance and the reorganization of the distribution platform, our U.S. distribution group had net inflows for the nine months through September 30, 2012, with the quarter ended June 30, 2012 having the highest net inflows since March 2007. Year-to-date results generally compare slightly favorably to the growth assumptions related to the domestic mutual fund contracts asset impairment testing at December 31, 2011. In the past several years, however, such actual to projection comparisons are less favorable, and flows in the last several months have been less consistent and are considered in our current estimates.

Trade names account for 2% of indefinite-life intangible assets and are primarily related to Permal. We tested these intangible assets using assumptions similar to those described above for indefinite-life contracts. The Permal trade name carrying value exceeded its estimated fair value, resulting in a $17 million impairment for the excess. The resulting fair value of the other trade name significantly exceeded the related carrying amount.

Goodwill

Goodwill is evaluated at the reporting unit level and is considered for impairment when the carrying amount of the reporting unit exceeds the implied fair value of the reporting unit. In estimating the implied fair value of the reporting unit, we use valuation techniques based on discounted projected cash flows and EBITDA multiples, similar to techniques employed in analyzing the purchase price of an acquisition. In December 2010, we announced a realignment of our executive management team, which during fiscal 2012, resulted in the combination of our Americas and International divisions into one operating segment, Global Asset Management. Internal management reporting has been modified consistent with this realignment such that discrete financial information regularly received by the chief operating decision maker, our Chief Executive Officer, is at the consolidated Global Asset Management business level. As a result, the former Americas and International operating segments are no longer our reporting units, and subsequently, goodwill is recorded and evaluated at one Global Asset Management reporting unit level. Our Global Asset Management reporting unit consists of the operating businesses of our asset management affiliates and our centralized global distribution operations. In our most recent impairment testing process, all consolidated assets and liabilities were allocated to our single Global Asset Management reporting unit, except deferred tax assets arising from net operating losses not related to any assets or liabilities of the reporting unit. Similarly, the projected operating results of the reporting unit include our holding company corporate costs and overhead, including costs associated with executive management, finance, human resources, legal and compliance, internal audit and other central corporate functions.

Goodwill principally originated from the acquisitions of CAM, Permal and Royce. The value of the reporting unit is based in part, on projected consolidated net cash flows, including all cash flows of assets managed in our mutual funds, closed-end funds and other proprietary funds, in addition to separate account assets of our managers.

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

Actual cash flows in any one period may vary from the projected cash flows without resulting in an impairment charge because a variance in any one period must be considered in conjunction with other assumptions that impact projected cash flows. For the reporting unit discounted projected cash flow analysis, projected cash flows, on an aggregate basis across all asset classes, are assumed to have an average annual growth rate of approximately 8%.

Discount rates are based on appropriately weighted estimated costs of debt using a market participant perspective, also consistent with the methodology discussed above for indefinite-life intangible assets. For our impairment test during the quarter ended December 31, 2012, the projected cash flows were discounted at 15.0% to determine their present value, reflecting the company/asset specific factors noted above.

We also perform a market-based valuation of our reporting unit value, which applies an average of EBITDA multiples paid in change of control transactions for peer companies to our EBITDA. The observed average EBITDA multiple utilized was 9.5x, from ten asset management transactions dated October 2009 through December 2012. The results of our two estimates of value for the reporting unit (the discounted cash flow and EBITDA multiple analyses) are compared and any significant difference is assessed to determine the reasonableness of each value and whether any adjustment to either result is warranted. Once the values are accepted, the appropriately weighted average of the two reporting unit valuations (the discounted cash flow and EBITDA multiple analyses) is used as the implied fair value of our Global Asset Management reporting unit, which at December 31, 2012, exceeds the carrying value by approximately $660 million. Considering the relative merits of the details involved in each valuation process, we used an equal weighting of the two values for the December 2012 testing.

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

In calculating our market capitalization for these purposes, market volatility can have a significant impact on our capitalization, and if appropriate, we may consider the average market prices of our stock for a period of up to two months before the test date to determine market capitalization. A control premium arises from the fact that in an acquisition, there is typically a premium paid over current market prices of publicly traded companies that relates to the ability to control the operations of an acquired company. Further, assessments of control premiums in the asset management industry are difficult because many acquisitions involve privately held companies, or involve only portions of a public company, such that no control premium can be calculated. Asset manager transactions are often valued on EBITDA multiples which, absent unusual circumstances, have generally been consistently priced in a range of 8x to 13x EBITDA over the past several years.

Recent market evidence regarding control premiums suggests values of 11% to 99% as realistic and common, and we believe such premiums to be a reasonable range of estimation for our equity value. Our market evidence is from a published source for the two years ended December 31, 2011 and includes 56 transactions from the banking and finance and brokerage and investment consulting industry groups with an average control premium value of 43%. As noted above, control premium values specific to public asset manager transactions are limited. However, since 2000, 17 public asset manager transactions available to us had control premium values ranging from 20% to 154%, and averaged 55%. We consider the specific circumstances of our company to determine whether there are specific differences for our situation that make these market control premiums not applicable. We also exclude from our consideration outlying values and transactions with known unique circumstances. Based on our analysis and consideration, we believe the implied control premium of 48% determined by our reporting unit value estimation at December 31, 2012, is reasonable in relation to the range of observed relevant market control premium values. Subsequent to our December 31, 2012 analysis, the market price of Legg Mason common stock has appreciated by more than 20% as of March 31, 2013, which would reduce our implied control premium assuming all other values remain constant.

Stock-Based Compensation

Our stock-based compensation plans include stock options, employee stock purchase plans, market-based performance share awards, restricted stock awards and deferred compensation payable in stock. Under our stock compensation plans, we issue equity awards to directors, officers, and key employees.

In accordance with the applicable accounting guidance, compensation expense for the years ended March 31, 2013, 2012 and 2011, includes compensation cost for all non-vested share-based awards at their grant date fair value amortized over the respective vesting periods on the straight-line method. Also, under the accounting guidance, cash flows related to income tax deductions in excess of or less than the stock-based compensation expense are classified as financing cash flows.

We granted 1.0 million, 0.8 million, and 0.7 million stock options in fiscal 2013, 2012 and 2011, respectively. For additional information on share-based compensation, see Note 11 of Notes to Consolidated Financial Statements.

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

Income Taxes

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

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

Substantially all of our deferred tax assets relate to U.S. and U.K. taxing jurisdictions. As of March 31, 2013, U.S. federal deferred tax assets aggregated $771 million, realization of which is expected to require $4.2 billion of future U.S. earnings, approximately $332 million of which must be in the form of foreign source income. Deferred tax assets generated in U.S. jurisdictions resulting from net operating losses generally expire 20 years after they are generated and those resulting from foreign tax credits generally expire 10 years after they are generated. Based on estimates of future taxable income, using assumptions consistent with those used in our goodwill impairment testing, it is more likely than not that current federal tax benefits relating to net operating losses are realizable and no valuation allowance is necessary at this time. With respect to those resulting from foreign tax credits, it is more likely than not that tax benefits relating to the utilization of $36.3 million foreign tax credits as credits will not be realized and an additional valuation allowance of $17.1 million was recorded in fiscal 2013 with respect thereto. In addition, a valuation allowance was established in prior years for the substantial portion of our deferred tax assets relating to U.K. taxing jurisdictions. While tax planning may enhance our positions, the realization of current tax benefits is not dependent on any significant tax strategies.

As of March 31, 2013, U.S. state deferred tax assets aggregated $173 million. Due to state tax planning which will allow for the utilization of net operating losses generated in certain jurisdictions, we recognized a net valuation allowance release of $2.0 million during fiscal 2013. Due to the uncertainty of future state apportionment factors and future effective state tax rates, the value of state net operating loss benefits ultimately realized may vary.

A net valuation allowance release of $3.5 million in fiscal 2013 primarily related to the full release of the valuation allowance on deferred tax assets related to Australia and Singapore offset by an establishment of a valuation

allowance against certain U.K. deferred tax assets. To the extent our analysis of the realization of deferred tax assets relies on deferred tax liabilities, we have considered the timing, nature and jurisdiction of reversals, as well as, future increases relating to the tax amortization of goodwill and indefinite-life intangible assets. In the event we determine all or any portion of our deferred tax assets that are not already subject to a valuation allowance are not realizable, we will be required to establish a valuation allowance by a charge to the income tax provision in the period in which that determination is made. Depending on the facts and circumstances, the charge could be material to our earnings.

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

RECENT ACCOUNTING DEVELOPMENTS

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

FORWARD-LOOKING STATEMENTS

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

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

Our future revenues may fluctuate due to numerous factors, such as: the total value and composition of our AUM; the mix of our AUM among our affiliates; the revenue yield of our AUM; the volatility and general level of securities prices and interest rates; the relative investment performance of company-sponsored investment funds and other asset management products both in absolute terms and relative to competing offerings and market indices; investor sentiment and confidence; general economic conditions; our ability to maintain investment management and administrative fees at current levels; competitive conditions in our business; the ability to attract and retain key personnel and the effects of acquisitions, including prior acquisitions. Our future operating results are also dependent upon the level of operating expenses, which are subject to fluctuation for the following or other reasons: variations in the level of compensation expense incurred as a result of changes in the number of total employees, competitive factors, changes in the percentages of revenues paid as compensation or other reasons; variations in expenses and capital costs, including depreciation, amortization and other non-cash charges incurred by us to maintain our administrative infrastructure; unanticipated costs that may be incurred by Legg Mason from time to time to protect client goodwill, to otherwise support investment products or in connection with litigation or regulatory proceedings; and the effects of acquisitions and dispositions.

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

EFFECTS OF INFLATION

The rate of inflation can directly affect various expenses, including employee compensation, communications and technology and occupancy, which may not be readily recoverable in charges for services provided by us. Further, to

the extent inflation adversely affects the securities markets, it may impact revenues and recorded intangible asset and goodwill values. See discussion of "Market Risks — Revenues and Net Income" and "Critical Accounting Policies — Intangible Assets and Goodwill" previously discussed.

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

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

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

The effectiveness of Legg Mason's internal control over financial reporting as of March 31, 2013, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing herein, which expresses an unqualified opinion on the effectiveness of Legg Mason's internal control over financial reporting as of March 31, 2013.

Joseph A. Sullivan
President, Chief Executive Officer and Director

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

REPORT OF INDEPENDENT
REGISTERED PUBLIC ACCOUNTING FIRM

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income (loss), comprehensive income (loss), changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Legg Mason, Inc. and its subsidiaries ("the Company") at March 31, 2013 and March 31, 2012, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2013, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

Baltimore, Maryland
May 24, 2013

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CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	March 31, 2013	2012
ASSETS		
Current Assets		
Cash and cash equivalents	$933,036	$1,382,263
Cash and cash equivalents of consolidated investment vehicles	46,541	26,139
Restricted cash	8,812	2,167
Receivables:		
Investment advisory and related fees	350,726	333,777
Other	72,392	100,060
Investment securities	371,080	412,119
Investment securities of consolidated investment vehicles	24,792	31,575
Deferred income taxes	85,257	117,391
Other	48,239	51,977
Other assets of consolidated investment vehicles	1,987	326
Total Current Assets	1,942,862	2,457,794
Fixed assets, net	201,819	239,411
Intangible assets, net	3,177,562	3,856,866
Goodwill	1,269,165	1,275,045
Investments of consolidated investment vehicles	210,553	294,853
Deferred income taxes	279,361	142,706
Other	187,274	287,653
Other assets of consolidated investment vehicles	1,064	1,419
Total Assets	$7,269,660	$8,555,747
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Current Liabilities		
Accrued compensation	$351,965	$409,759
Accounts payable and accrued expenses	214,803	195,808
Short-term borrowings	—	250,000
Current portion of long-term debt	50,438	1,278
Other	74,940	114,840
Other current liabilities of consolidated investment vehicles	10,320	4,097
Total Current Liabilities	702,466	975,782
Deferred compensation	56,809	57,339
Deferred income taxes	161,298	242,567
Other	204,446	167,544
Other liabilities of consolidated investment vehicles	2,930	3,872
Long-term debt	1,094,516	1,135,614
Long-term debt of consolidated investment vehicles	207,835	271,707
Total Liabilities	2,430,300	2,854,425

Commitments and Contingencies (Note 8)

Redeemable Noncontrolling Interests	21,009	24,031
Stockholders' Equity		
Common stock, par value $.10; authorized 500,000,000 shares; issued 125,341,361 shares in 2013 and 139,874,034 shares in 2012	12,534	13,987
Additional paid-in capital	3,449,190	3,864,216
Employee stock trust	(32,623)	(32,419)
Deferred compensation employee stock trust	32,623	32,419
Retained earnings	1,304,259	1,715,395
Appropriated retained earnings for consolidated investment vehicle	4,829	12,221
Accumulated other comprehensive income, net	47,539	71,472
Total Stockholders' Equity	4,818,351	5,677,291
Total Liabilities and Stockholders' Equity	$7,269,660	$8,555,747

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(Dollars in thousands, except per share amounts)

	Years Ended March 31,		
	2013	2012	2011
OPERATING REVENUES			
Investment advisory fees:			
Separate accounts	$730,326	$775,534	$815,633
Funds	1,446,066	1,491,325	1,486,615
Performance fees	98,568	49,499	96,661
Distribution and service fees	330,480	340,966	379,161
Other	7,210	5,250	6,247
Total Operating Revenues	2,612,650	2,662,574	2,784,317
OPERATING EXPENSES			
Compensation and benefits	1,188,470	1,109,671	1,140,305
Transition-related compensation	—	34,638	45,048
Total Compensation and benefits	1,188,470	1,144,309	1,185,353
Distribution and servicing	600,644	649,739	712,839
Communications and technology	149,645	164,712	161,969
Occupancy	171,941	154,816	137,861
Amortization of intangible assets	14,019	19,574	22,913
Impairment of intangible assets	734,000	—	—
Other	188,430	190,671	176,574
Total Operating Expenses	3,047,149	2,323,821	2,397,509
OPERATING INCOME (LOSS)	(434,499)	338,753	386,808
OTHER NON-OPERATING INCOME (EXPENSE)			
Interest income	7,590	11,481	9,246
Interest expense	(62,919)	(87,584)	(92,157)
Other income (expense), net, including $68,975 debt extinguishment loss in 2013	(17,958)	22,097	59,596
Other non-operating income (loss) of consolidated investment vehicles, net	(2,821)	18,336	1,704
Total Other Non-Operating Income (Expense)	(76,108)	(35,670)	(21,611)
INCOME (LOSS) BEFORE INCOME TAX PROVISION (BENEFIT)	(510,607)	303,083	365,197
Income tax provision (benefit)	(150,859)	72,052	119,434
NET INCOME (LOSS)	(359,748)	231,031	245,763
Less: Net income (loss) attributable to noncontrolling interests	(6,421)	10,214	(8,160)
NET INCOME (LOSS) ATTRIBUTABLE TO LEGG MASON, INC.	$(353,327)	$220,817	$253,923
NET INCOME (LOSS) PER SHARE ATTRIBUTABLE TO LEGG MASON, INC. COMMON SHAREHOLDERS			
Basic	$(2.65)	$1.54	$1.63
Diluted	$(2.65)	$1.54	$1.63

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Dollars in thousands)

	Years Ended March 31,		
	2013	2012	2011
NET INCOME (LOSS)	$(359,748)	$231,031	$245,763
Other comprehensive income (loss):			
Foreign currency translation adjustment	(23,945)	(22,098)	35,159
Unrealized gains (losses) on investment securities:			
Unrealized holding gains (losses), net of tax provision (benefit) of $(1), $132 and $(22), respectively	(1)	198	(33)
Reclassification adjustment for losses included in net income (loss)	13	11	8
Net unrealized gains (losses) on investment securities	12	209	(25)
Total other comprehensive income (loss)	(23,933)	(21,889)	35,134
COMPREHENSIVE INCOME (LOSS)	(383,681)	209,142	280,897
Less: Comprehensive income (loss) attributable to noncontrolling interests	(6,421)	10,214	(8,160)
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO LEGG MASON, INC.	$(377,260)	$198,928	$289,057

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands)

	Years Ended March 31,		
	2013	2012	2011
COMMON STOCK			
Beginning balance	$13,987	$15,022	$16,144
Stock options and other stock-based compensation	8	17	64
Deferred compensation employee stock trust	8	7	7
Deferred compensation, net	192	124	152
Exchangeable shares	—	—	110
Equity Units exchanged	—	183	—
Employee tax withholdings by net share transactions	(41)	(6)	—
Shares repurchased and retired	(1,620)	(1,360)	(1,455)
Ending balance	12,534	13,987	15,022
SHARES EXCHANGEABLE INTO COMMON STOCK			
Beginning balance	—	—	2,760
Exchanges	—	—	(2,760)
Ending balance	—	—	—
ADDITIONAL PAID-IN CAPITAL			
Beginning balance	3,864,216	4,111,095	4,447,612
Stock options and other stock-based compensation	5,198	16,508	31,674
Deferred compensation employee stock trust	1,803	2,020	2,673
Deferred compensation, net	44,246	32,193	34,619
Exchangeable shares	—	—	2,650
Equity Units exchanged	—	102,831	35,877
Employee tax withholdings by net share transactions	(11,303)	(1,525)	—
Shares repurchased and retired	(423,855)	(398,906)	(444,010)
Allocation from 2.5% Convertible Senior Notes repurchase, net of tax	(31,115)	—	—
Ending balance	3,449,190	3,864,216	4,111,095
EMPLOYEE STOCK TRUST			
Beginning balance	(32,419)	(34,466)	(33,095)
Shares issued to plans	(1,811)	(2,027)	(2,136)
Distributions and forfeitures	1,607	4,074	765
Ending balance	(32,623)	(32,419)	(34,466)
DEFERRED COMPENSATION EMPLOYEE STOCK TRUST			
Beginning balance	32,419	34,466	33,095
Shares issued to plans	1,811	2,027	2,136
Distributions and forfeitures	(1,607)	(4,074)	(765)
Ending balance	32,623	32,419	34,466
RETAINED EARNINGS			
Beginning balance	1,715,395	1,539,984	1,316,981
Net income (loss) attributable to Legg Mason, Inc.	(353,327)	220,817	253,923
Dividends declared	(57,809)	(45,406)	(30,920)
Ending balance	1,304,259	1,715,395	1,539,984

APPROPRIATED RETAINED EARNINGS FOR CONSOLIDATED INVESTMENT VEHICLE			
Beginning balance	12,221	10,922	—
Cumulative effect of change in accounting principle	—	—	24,666
Net income (loss) reclassified to appropriated retained earnings	(7,392)	1,299	(13,744)
Ending balance	4,829	12,221	10,922
ACCUMULATED OTHER COMPREHENSIVE INCOME, NET			
Beginning balance	71,472	93,361	58,227
Net unrealized holding gains (losses) on investment securities	12	209	(25)
Foreign currency translation adjustment	(23,945)	(22,098)	35,159
Ending balance	47,539	71,472	93,361
TOTAL STOCKHOLDERS' EQUITY	$4,818,351	$5,677,291	$5,770,384

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Years Ended March 31,		
	2013	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income (Loss)	$(359,748)	$231,031	$245,763
2.5% Convertible Senior Notes:			
Allocation of repurchase payment	(216,038)	—	—
Loss on extinguishment	68,975	—	—
Adjustments to reconcile Net Income (Loss) to net cash provided by operations:			
Impairment of intangible assets	734,000	—	—
Depreciation and amortization	87,848	93,795	102,748
Imputed interest for 2.5% Convertible Senior Notes	5,839	39,077	36,688
Accretion and amortization of securities discounts and premiums, net	3,295	4,552	4,539
Stock-based compensation	58,983	48,735	56,245
Net gains on investments	(43,684)	(1,714)	(58,851)
Net losses (gains) of consolidated investment vehicles	5,358	(6,711)	3,959
Deferred income taxes	(157,355)	49,192	80,272
Other	1,725	(12,191)	5,393
Decrease (increase) in assets:			
Investment advisory and related fees receivable	(11,045)	31,790	(13,794)
Net sales (purchases) of trading and other current investments	189,347	(40,020)	(55,540)
Other receivables	(9,712)	1,432	1,962
Other assets	(1,605)	1,810	(20,923)
Other assets of consolidated investment vehicles	(14,378)	53,720	25,880
Increase (decrease) in liabilities:			
Accrued compensation	(54,964)	42,763	75,970
Deferred compensation	(530)	(35,148)	(44,825)
Accounts payable and accrued expenses	8,690	(11,147)	(251)
Other liabilities	3,112	28,135	(49,954)
Other liabilities of consolidated investment vehicles	5,219	(22,332)	16,859
CASH PROVIDED BY OPERATING ACTIVITIES	303,332	496,769	412,140
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for fixed assets	(38,351)	(31,822)	(32,904)
Business acquisition, net of cash acquired	(55,277)	—	—
Proceeds from sale of assets	—	3,060	—
Change in restricted cash	(7,245)	11,221	—
Purchases of investment securities	(5,787)	(6,493)	(8,430)
Proceeds from sales and maturities of investment securities	5,272	6,197	9,077
Purchases of investments by consolidated investment vehicles	(98,374)	(141,727)	(173,261)
Proceeds from sales and maturities of investments by consolidated investment vehicles	188,739	161,894	161,047
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	$(11,023)	$2,330	$(44,471)

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(Dollars in thousands)

	Years Ended March 31,		
	2013	2012	2011
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of short-term borrowings	$(250,000)	$—	$—
Third-party distribution financing, net	—	—	(1,639)
Repayment of 2.5% Convertible Senior Notes, net of operating allocation	(1,040,212)	(1,014)	(3,515)
Repayment of long-term debt	(9,006)	—	—
Repayment of long-term debt of consolidated investment vehicles	(75,561)	—	—
Proceeds from issuance of long-term debt	1,143,246	—	—
Debt issuance costs	(10,289)	—	—
Issuance of common stock	1,986	4,538	14,440
Repurchase of common stock, including net shares	(436,818)	(401,797)	(445,465)
Dividends paid	(55,250)	(43,602)	(26,813)
Net repayments of consolidated investment vehicles	—	(18,309)	(7,025)
Net (redemptions/distributions paid to)/subscriptions received from noncontrolling interest holders	(3,993)	(21,596)	1,551
CASH USED IN FINANCING ACTIVITIES	(735,897)	(481,780)	(468,466)
EFFECT OF EXCHANGE RATES ON CASH	(5,639)	(10,974)	10,827
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(449,227)	6,345	(89,970)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,382,263	1,375,918	1,465,888
CASH AND CASH EQUIVALENTS AT END OF YEAR	$933,036	$1,382,263	$1,375,918
SUPPLEMENTAL DISCLOSURE			
Cash paid for:			
Income taxes, net of refunds of $(2,313), $(12,034), and $(12,090), respectively	$32,318	$24,552	$39,524
Interest	40,262	41,039	46,620

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts or unless otherwise noted)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

Where appropriate, prior years financial statement amounts reflect reclassifications of certain less significant items to conform to the current year presentation.

All references to fiscal 2013, 2012 or 2011, refer to Legg Mason's fiscal year ended March 31 of that year.

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

Consolidation
Legg Mason applies Accounting Standards Codification ("ASC") Topic 810, "Consolidation," (Statement of Financial Accounting Standards No. 167, "Amendments to Financial Accounting Standards Board Interpretation No. 46(R)") ("SFAS No. 167"), relating to the consolidation of VIEs, which includes guidance for determining who should consolidate a VIE, when it is necessary to reassess who should consolidate a VIE, and for the assessment of which entities are VIEs. However, certain investment funds, including money market funds, qualify for a deferral of the application of SFAS No. 167 and continue to be assessed for consolidation under prior guidance, ASC Topic 810, "Consolidation," (Financial Accounting Standards Board Interpretation No. 46(R), "Consolidation of Variable Interest Entities — an interpretation of ARB No. 51") ("FIN 46(R)").

In the normal course of its business, Legg Mason sponsors and is the manager of various types of investment vehicles. Certain of these investment vehicles are considered to be VIEs while others are considered to be voting rights entities ("VREs") subject to traditional consolidation concepts based on ownership rights. For its services, Legg Mason is entitled to receive management fees and may be eligible, under certain circumstances, to receive additional subordinate management fees or other incentive fees. Legg Mason did not sell or transfer assets to any of the VIEs or VREs. Legg Mason's exposure to risk in these entities is generally limited to any equity investment it has made or is required to make and any earned but uncollected management fees. Uncollected management fees from these VIEs were not material at March 31, 2013 and 2012. Legg Mason has not issued any investment performance guarantees to these VIEs, VREs or their investors. Investment vehicles that are considered VREs are consolidated if Legg Mason has a controlling financial interest in the investment vehicle, absent substantive investor rights to replace the manager

of the entity (kick-out rights).

Financial Accounting Standards Board Interpretation No. 46(R) (Accounting Standards Update 2010-10, "Amendments to Statement 167 for Certain Investment Funds")
For most sponsored investment funds, including money market funds, which qualify for the deferral of the revised accounting guidance, Legg Mason determines it is the primary beneficiary of a VIE if it absorbs a majority of the VIE's expected losses, or receives a majority of the VIE's expected residual returns, if any. Legg Mason's determination of expected residual returns excludes gross fees paid to a decision maker. It is unlikely that Legg Mason will be the primary beneficiary for VIEs created to manage assets for clients which qualify for the deferral unless Legg Mason's ownership interest in the VIE, including interests of related parties, is substantial, unless Legg Mason may earn significant performance fees from the VIE or unless Legg Mason is considered to have a material implied variable interest. In determining whether it is the primary beneficiary of a VIE which qualifies for the deferral, Legg Mason considers both qualitative and quantitative factors such as the voting rights of the equity holders, economic participation of all parties, including how fees are earned and paid to Legg Mason, related party ownership, guarantees and implied relationships. In determining the primary beneficiary, Legg Mason must make assumptions and estimates about, among other things, the future performance of the underlying assets held by the VIE, including investment returns, cash flows, and credit and interest rate risks. In determining whether a VIE is significant for disclosure purposes, Legg Mason considers the same factors used for determination of the primary beneficiary.

Statement of Financial Accounting Standards No. 167 (Accounting Standards Codification Topic 810, "Consolidation")
Legg Mason sponsors and is the manager for collateralized debt obligation entities ("CDOs") and collateralized loan obligations ("CLOs") that do not qualify for the deferral, and are assessed under the revised accounting guidance, as follows. Legg Mason determines whether it has a variable interest in a VIE by considering if, among other things, it has the obligation to absorb losses, or the right to receive benefits, that are expected to be significant to the VIE. Legg Mason also considers the management fee structure, including the seniority level of its fees, the current and expected economic performance of the entity, as well as other provisions included in the governing documents that might restrict or guarantee an expected loss or residual return. If Legg Mason has a significant variable interest, it determines it is the primary beneficiary of the VIE if it has both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and the obligation to absorb losses, or the right to receive benefits, that potentially could be significant to the VIE.

In evaluating whether it has the obligation to absorb losses, or the right to receive benefits, that potentially could be significant to the VIE, Legg Mason considers factors regarding the design, terms, and characteristics of the investment vehicles, including, but not limited to, the following qualitative factors: if Legg Mason has involvement with the investment vehicle beyond providing management services; if Legg Mason holds equity or debt interests in the investment vehicle; if Legg Mason has transferred any assets to the investment vehicle; if the potential aggregate fees in future periods are insignificant relative to the potential cash flows of the investment vehicle; and if the variability of the expected fees in relation to the potential cash flows of the investment vehicle is more than insignificant.

Under both the revised accounting guidance and prior guidance, Legg Mason must consolidate VIEs for which it is deemed to be the primary beneficiary. As of March 31, 2013 and 2012, Legg Mason's Consolidated Balance Sheets reflect $224,193 and $291,853, respectively, in assets, and $207,835 and $271,707, respectively, in debt issued by a CLO, despite the fact that the assets cannot be used by Legg Mason, nor is Legg Mason obligated for the debt. The consolidation of the CLO had no impact on Net Income Attributable to Legg Mason, Inc.'s common shareholders. See Note 17 for additional information related to the application of the amended VIE consolidation model and the required disclosures.

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

Restricted Cash

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

Financial Instruments
Substantially all financial instruments are reflected in the financial statements at fair value or amounts that approximate fair value, except Legg Mason's long-term debt.

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

Legg Mason also holds debt and marketable equity investments which are classified as available-for-sale, held-to-maturity or trading. Debt and marketable equity securities classified as available-for-sale are reported at fair value and resulting unrealized gains and losses are reflected in stockholders' equity, noncontrolling interests, and comprehensive income (loss), net of applicable income taxes. Debt securities, for which there is positive intent and ability to hold to maturity, are classified as held-to-maturity and are recorded at amortized cost. Amortization of discount or premium is recorded under the interest method and is included in interest income. Certain investment securities, including those held by consolidated investment vehicles ("CIVs"), are classified as trading securities. These investments are recorded at fair value and unrealized gains and losses are included in current period earnings. Realized gains and losses for all investments are included in current period earnings.

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

Legg Mason evaluates its non-trading investment securities for "other-than-temporary" impairment. Impairment may exist when the fair value of an investment security has been below the adjusted cost for an extended period of time. If an "other-than-temporary" impairment is determined to exist, the amount of impairment that relates to credit losses is recognized as a charge to income. As of March 31, 2013, 2012 and 2011, the amount of temporary unrealized losses for investment securities not recognized in income was not material.

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

In addition to the financial instruments described above and the derivative instruments and CLO loans, bonds and debt, described below, other financial instruments that are carried at fair value or amounts that approximate fair value

include Cash and cash equivalents and Short-term borrowings. The fair values of Long-term debt at March 31, 2013 and 2012, aggregated $1,206,166 and $1,214,245, respectively. The carrying value of the five-year term loan approximates fair value because the debt is a credit facility with a variable interest rate based on a short-term rate. These fair values were estimated using publicly quoted market prices or discounted cash flow analyses, as appropriate, and were classified as Level 2 in the fair value hierarchy as described below.

Derivative Instruments
The fair values of derivative instruments are recorded as assets or liabilities on the Consolidated Balance Sheets. Legg Mason has used foreign exchange forwards and interest rate swaps to hedge the risk of movement in exchange rates or interest rates on financial assets on a limited basis. Also, Legg Mason has used futures contracts on index funds to hedge the market risk of certain seed capital investments. In addition, certain CIVs use derivative instruments. However, there is no risk to Legg Mason in relation to the derivative assets and liabilities of the CIVs in excess of its investment in the funds, if any.

Legg Mason has not designated any financial instruments for hedge accounting, as defined in the accounting literature, during the periods presented. The gains or losses on derivative instruments not designated for hedge accounting are included as Other income (expense) or Other non-operating income (expense) in the Consolidated Statements of Income (Loss), with the exception of gains and losses on derivative instruments of CIVs, which are recorded as Other non-operating income (expense) of consolidated investment vehicles, net, in the Consolidated Statements of Income (Loss).

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

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

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

Legg Mason's financial instruments are measured and reported at fair value and are classified and disclosed in one of the following categories:

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

Level 2 — Financial instruments for which: prices are quoted for similar assets and liabilities in active markets; prices are quoted for identical or similar assets in inactive markets; or prices are based on observable inputs, other than quoted prices, such as models or other valuation methodologies. For Legg Mason, this category may include repurchase agreements, fixed income securities, and certain proprietary fund products. This category also includes CLO loans and derivative liabilities of a CIV.

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

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

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

The fair values of CLO loans and bonds are determined based on prices from well-recognized third-party pricing services that utilize available market data and are therefore classified as Level 2. Legg Mason has established controls designed to assess the reasonableness of the prices provided. The fair value of CLO debt is valued using a discounted cash flow methodology. Inputs used to determine the expected cash flows include assumptions about forecasted default and recovery rates that a market participant would use in determining the fair value of the CLO's underlying collateral assets. Given the significance of the unobservable inputs to the fair value measurement, the CLO debt valuation is classified as Level 3.

Exchange traded options are valued using the last sale price or, in the absence of a sale, the last offering price. Options traded over the counter are valued using dealer supplied valuations. Options are classified as Level 1. Futures contracts are valued at the last settlement price at the end of each day on the exchange upon which they are traded and are classified as Level 1.

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

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

See Note 3 for additional information regarding fair value measurements.

Fair Value Option

Legg Mason has elected the fair value option for certain eligible assets and liabilities, including corporate loans and debt, of a CLO it is consolidating (see Note 17). Management believes that the use of the fair value option eliminates certain timing differences and better matches the changes in fair value of assets and liabilities related to the CLO. Unrealized gains and losses on assets and liabilities for which the fair value option has been elected are reported in earnings. The decision to elect the fair value option is determined on an instrument by instrument basis, must be applied to an entire instrument, and is irrevocable once elected. Assets and liabilities which are measured at fair value pursuant to the fair value option are included in the assets and liabilities of consolidated investment vehicles in the Consolidated Balance Sheets. At this time, the Company has not elected to apply the fair value option to any of its other financial instruments.

Appropriated Retained Earnings

Upon the election of the fair value option for eligible assets and liabilities of the CLO described above, Legg Mason recorded a cumulative effect adjustment to Appropriated retained earnings for consolidated investment vehicle on the Consolidated Balance Sheets equal to the difference between the fair values of the CLO's assets and liabilities. This difference is recorded as "Appropriated retained earnings" because the investors in the CLO, not Legg Mason shareholders, will ultimately realize any benefits or losses associated with the CLO. Changes in the fair values of the

CLO assets and liabilities are recorded as Net income (loss) attributable to noncontrolling interests in the Consolidated Statements of Income (Loss) and Appropriated retained earnings for consolidated investment vehicle in the Consolidated Balance Sheets.

Fixed Assets

Fixed assets primarily consist of equipment, software and leasehold improvements. Equipment consists primarily of communications and technology hardware and furniture and fixtures. Software includes both purchased software and internally developed software. Fixed assets are reported at cost, net of accumulated depreciation and amortization. Depreciation and amortization are determined by use of the straight-line method. Equipment is depreciated over the estimated useful lives of the assets, generally ranging from three to eight years. Software is amortized over the estimated useful lives of the assets, which are generally three years. Leasehold improvements are amortized or depreciated over the initial term of the lease unless options to extend are likely to be exercised. Maintenance and repair costs are expensed as incurred.

Internally developed software is reviewed periodically to determine if there is a change in the useful life, or if an impairment in value may exist. If impairment is deemed to exist, the asset is written down to its fair value or is written off if the asset is determined to no longer have any value.

Intangible Assets and Goodwill

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

Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. Indefinite-life intangible assets and goodwill are not amortized for book purposes. Given the relative significance of intangible assets and goodwill to the Company's consolidated financial statements, on a quarterly basis Legg Mason considers if triggering events have occurred that may indicate that the fair values have declined below their respective carrying amounts. Triggering events may include significant adverse changes in the Company's business, legal or regulatory environment, loss of key personnel, significant business dispositions, or other events, including changes in economic arrangements with our affiliates that will impact future operating results. If a triggering event has occurred, the Company will perform tests, which include critical reviews of all significant assumptions, to determine if any intangible assets or goodwill are impaired. At a minimum, the Company performs these tests annually at December 31, for indefinite-life intangible assets and goodwill, considering factors such as projected cash flows and revenue multiples, to determine whether the value of the assets is impaired and the indefinite-life assumptions are appropriate. If an asset is impaired, the difference between the value of the asset reflected on the financial statements and its current fair value is recognized as an expense in the period in which the impairment is determined. The fair values of intangible assets subject to amortization are reviewed at each reporting period using an undiscounted cash flow analysis. For intangible assets with indefinite lives, fair value is determined from a market participant's perspective based on projected discounted cash flows, which take into consideration estimates of future fees, profit margins, growth rates, taxes, and discount rates. Goodwill is evaluated at the reporting unit level, and is considered for impairment when the carrying value of the reporting unit exceeds the implied fair value of the reporting unit. In estimating the fair value of the reporting unit, Legg Mason uses valuation techniques principally based on discounted projected cash flows and EBITDA multiples, similar to techniques employed in analyzing the purchase price of an acquisition. Goodwill is deemed to be recoverable at the reporting unit level, which is also the operating segment level that Legg Mason defines as the Global Asset Management segment. This results from the fact that the chief operating decision maker, Legg Mason's Chief Executive Officer, regularly receives discrete financial information at the consolidated Global Asset Management business level and does not regularly receive discrete financial information, such as operating results, at any lower level, such as the asset management affiliate level. Prior to fiscal 2012, Legg Mason's reporting units were its Americas and International divisions. Allocations of goodwill for management restructures, acquisitions and dispositions are based on relative fair values of the respective businesses restructured, added to or sold from the divisions.

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

Translation of Foreign Currencies

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

Investment Advisory Fees

Legg Mason earns investment advisory fees on assets in separately managed accounts, investment funds, and other products managed for Legg Mason's clients. These fees are primarily based on predetermined percentages of the market value of the assets under management ("AUM"), are recognized over the period in which services are performed and may be billed in advance of the period earned based on AUM at the beginning of the billing period in accordance with the related advisory contracts. Revenue associated with advance billings is deferred and included in Other (current) liabilities in the Consolidated Balance Sheets and is recognized over the period earned. Performance fees may be earned on certain investment advisory contracts for exceeding performance benchmarks on a relative or absolute basis, depending on the product, and are recognized at the end of the performance measurement period. Accordingly, neither advanced billings nor performance fees are subject to reversal. The largest portion of performance fees are earned based on 12-month performance periods that end in differing quarters during the year, with a portion also based on quarterly performance periods. Of Legg Mason's total AUM at each period ended as of March 31, 2013, 2012 and 2011, approximately 6% was in accounts that were eligible to earn performance fees.

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

Distribution and Service Fees Revenue and Expense

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

Deferred Sales Commissions

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

Management periodically tests the deferred sales commission asset for impairment by reviewing the changes in value of the related shares, the relevant market conditions and other events and circumstances that may indicate an impairment in value has occurred. If these factors indicate an impairment in value, management compares the carrying value to the estimated undiscounted cash flows expected to be generated by the asset over its remaining life. If management determines that the deferred sales commission asset is not fully recoverable, the asset will be deemed impaired and a loss will be recorded in the amount by which the recorded amount of the asset exceeds its estimated fair value. For the years ended March 31, 2013, 2012 and 2011, no impairment charges were recorded. Deferred sales commissions, included in Other non-current assets in the Consolidated Balance Sheets, were $8,259 and $9,510 at March 31, 2013 and 2012, respectively.

Income Taxes

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the financial statements. Deferred income tax assets are subject to a valuation

allowance if, in management's opinion, it is more likely than not that these benefits will not be realized. Legg Mason's deferred income taxes principally relate to net operating loss and other carryforward benefits, business combinations, amortization of intangible assets and accrued compensation.

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

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

See Note 7 for additional information regarding income taxes.

Loss Contingencies
Legg Mason accrues estimates for loss contingencies related to legal actions, investigations, and proceedings, exclusive of legal fees, when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated.

Stock-Based Compensation
Legg Mason's stock-based compensation includes stock options, employee stock purchase plans, restricted stock awards, market-based performance shares payable in common stock and deferred compensation payable in stock. Under its stock compensation plans, Legg Mason issues equity awards to directors, officers, and other key employees.

In accordance with the applicable accounting guidance, compensation expense includes costs for all non-vested share-based awards at their grant date fair value amortized over the respective vesting periods on the straight-line method. Legg Mason determines the fair value of stock options using the Black-Scholes option-pricing model, with the exception of market-based performance grants, which would be valued with a Monte Carlo option-pricing model. See Note 11 for additional information regarding stock-based compensation.

Earnings Per Share
Basic earnings per share attributable to Legg Mason, Inc. common shareholders ("EPS") is calculated by dividing Net Income (Loss) Attributable to Legg Mason, Inc. by the weighted-average number of shares outstanding. The calculation of weighted-average shares includes common shares, shares exchangeable into common stock and certain unvested share-based payment awards that are considered participating securities because they contain nonforfeitable rights to dividends. Diluted EPS is similar to basic EPS, but adjusts for the effect of potential common shares unless they are antidilutive. For periods with a net loss, potential common shares are considered antidilutive. See Note 12 for additional discussion of EPS.

Restructuring Costs
In May 2010, Legg Mason's management committed to a plan to streamline its business model as further described in Note 15. The streamlining initiative was completed as of March 31, 2012. The costs associated with this initiative primarily related to employee termination benefits, incentives to retain employees during the transition period, charges for consolidating leased office space, and contract termination costs. Termination benefits, including severance and retention incentives, were recorded as Transition-related compensation in the Consolidated Statements of Income (Loss). These compensation items required employees to provide future service and were therefore expensed ratably over the required service period. Contract termination and other costs were expensed when incurred.

Capital Plan
In May 2012, Legg Mason implemented a capital plan for the refinancing/restructuring of debt, the completion of the existing share repurchase authorization, and the authorization of further share repurchases. As a result, Net Income (Loss) Attributable to Legg Mason, Inc. for the year ended March 31, 2013, includes a pre-tax loss on debt extinguishment of $68,975 and a net reduction in outstanding debt obligations of $350,000. See Notes 6 and 12 for further details.

Other Developments
On December 12, 2012, the Company modified its employment and other arrangements with the management of its investment management affiliate The Permal Group, Ltd ("Permal"). These modifications included the Company

investing in the Permal business in part by sharing certain compensation and other costs that result in lower margins from the business at current revenue levels in exchange for higher margins at significantly increased revenue levels. In addition, the Company and Permal are engaged in implementing a profits interest management equity plan for key employees that will entitle them to participate in 15% of the future growth in value of the Permal business.

Noncontrolling Interests

Noncontrolling interests related to CIVs are classified as redeemable noncontrolling interests if investors in these funds may request withdrawals at any time. There are no nonredeemable noncontrolling interests as of March 31, 2013, 2012 and 2011. As noted above, Net income (loss) attributable to noncontrolling interests in the Consolidated Statements of Income (Loss) also includes Net income (loss) reclassified to appropriated retained earnings for consolidated investment vehicle in the Consolidated Balance Sheets.

Net income (loss) attributable to noncontrolling interests for the years ended March 31, 2013, 2012 and 2011, included the following amounts:

	2013	2012	2011
Net income attributable to redeemable noncontrolling interests	$971	$8,915	$5,584
Net Income (loss) reclassified to appropriated retained earnings for consolidated investment vehicle	(7,392)	1,299	(13,744)
Total	$(6,421)	$10,214	$(8,160)

Redeemable noncontrolling interests as of and for the years ended March 31, 2013, 2012 and 2011, included the following amounts:

	2013	2012	2011
Balance, beginning of period	$24,031	$36,712	$29,577
Net income attributable to redeemable noncontrolling interests	971	8,915	5,584
Net (redemptions/distributions paid to)/subscriptions received from noncontrolling interest holders	(3,993)	(21,596)	1,551
Balance, end of period	$21,009	$24,031	$36,712

Recent Accounting Developments

In December 2011, the Financial Accounting Standards Board ("FASB") updated the guidance on disclosures for offsetting assets and liabilities to require both gross and net information about instruments and transactions, including derivatives, repurchase and reverse repurchase and other arrangements that are eligible for offset in the balance sheet. The disclosures will be effective for Legg Mason in fiscal 2014, and are not expected to have a material impact on Legg Mason's consolidated financial statements.

In July 2012, the FASB updated the guidance on the annual indefinite-lived intangible asset tests for impairment. The update permits companies to assess qualitative factors to determine if it is more likely than not that the fair value of the intangible asset is less than its carrying amount as a basis for determining whether it is necessary to perform the currently required quantitative fair value assessment. This update will be effective for Legg Mason in fiscal 2014. This update is not expected to have a material effect on Legg Mason's recorded indefinite-lived assets, and Legg Mason is still evaluating its adoption.

In January 2013, the FASB updated the guidance on a parent's accounting for a cumulative translation adjustment upon the sale, transfer, or liquidation of a foreign subsidiary entity. The update states that a cumulative translation adjustment should be released into earnings only if an entity ceases to have a controlling financial interest in a foreign subsidiary or a group of assets within a foreign subsidiary, and the sale or transfer results in the complete or substantially complete liquidation of the foreign entity. This update will be effective for Legg Mason in fiscal 2014. This update is not expected to have a material effect on Legg Mason's cumulative translation adjustment and Legg Mason is still evaluating the impact of its adoption.

2. ACQUISITIONS

On March 13, 2013, Permal, a wholly-owned subsidiary of Legg Mason, completed the acquisition of all of the outstanding share capital of Fauchier Partners Management, Limited ("Fauchier"), a leading European based manager

of funds-of-hedge funds, from BNP Paribas Investment Partners, S.A. in accordance with a Sale and Purchase Agreement ("SPA") entered into in December 2012. This transaction significantly expands Permal's institutional business, creating a global institutional capability across geographies and client profiles. At the time of acquisition Fauchier managed assets of approximately $5,400,000.

The initial purchase price was a cash payment of $63,433, which was funded from existing cash resources. In addition, contingent consideration of up to approximately $23,000 and approximately $30,000, using exchange rates as of March 31, 2013, may be due on the second and fourth anniversaries of closing, respectively, dependent on achieving certain financial targets and subject to a catch up adjustment. The contingent consideration liability established at closing had an acquisition date fair value of $21,566, which represents the present value of the contingent consideration expected to be paid and is included in Other liabilities in the Consolidated Balance Sheet. Any changes in estimates for the fair value of the contingent consideration will be recorded as Other non-operating income (loss) in the Consolidated Statements of Income (Loss).

A summary of the fair values of the assets acquired and liabilities assumed are as follows:

Cash [1]	$8,156	
Receivables [1]	12,174	
Amortizable asset management contracts	2,865	
Indefinite-life fund management contracts	65,126	
Goodwill [1]	28,983	
Other current liabilities, net [1]	(16,667	)
Contingent consideration	(21,566	)
Deferred tax liability	(15,638	)
Total net assets acquired	$63,433	

(1) Subject to adjustment for amounts ultimately realized, as provided for in the SPA

The fair value of the amortizable asset management contracts are being amortized over a period of 6 years. None of the acquired intangible assets or goodwill are deductible for local tax purposes.

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

	Projected Cash Flow Growth Rates	Discount Rate
Indefinite-life fund management contracts	(35)% to 11% (weighted-average - 6%)	16.0%
	Projected Revenue Growth Rates	
Contingent consideration	(23)% to 3% (weighted-average - (6)%)	2.0%

The Company has not presented pro forma combined results of operations for this acquisition because the results of operations as reported in the accompanying Consolidated Statements of Income would not have been materially different. The post-acquisition financial results of Fauchier included in Legg Mason's consolidated financial results for the year ended March 31, 2013 were not significant. Legg Mason incurred acquisition costs of $1,380, which is included in Other operating expenses in the Consolidated Statement of Income (Loss).

3. INVESTMENTS AND FAIR VALUES OF ASSETS AND LIABILITIES

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

Legg Mason has investments in debt and equity securities that are generally classified as trading as described in Note 1. Investments as of March 31, 2013 and 2012, are as follows:

	2013	2012
Investment securities:		
Current investments	$371,080	$412,119
Available-for-sale	12,400	11,913
Other[1]	99	112
Total	$383,579	$424,144

(1) Includes investments in private equity securities that do not have readily determinable fair values.

The net unrealized and realized gain (loss) for investment securities classified as trading was $18,260, $(6,063) and $28,355 for fiscal 2013, 2012 and 2011, respectively.

Legg Mason's available-for-sale investments consist of mortgage backed securities, U.S. government and agency securities and equity securities. Gross unrealized gains and (losses) for investments classified as available-for-sale were $230 and $(188), respectively, as of March 31, 2013, and $551 and $(184), respectively, as of March 31, 2012.

Legg Mason uses the specific identification method to determine the cost of a security sold and the amount reclassified from accumulated other comprehensive income into earnings. The proceeds and gross realized gains and losses from sales and maturities of available-for-sale investments are as follows:

	Years Ended March 31,		
	2013	2012	2011
Available-for-sale:			
Proceeds	$5,272	$6,197	$4,012
Gross realized gains	22	6	7
Gross realized losses	(43)	(25)	(19)

Legg Mason had no investments classified as held-to-maturity as of March 31, 2013 and 2012.

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

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Value as of March 31, 2013
Assets:				
Cash equivalents[1]:				
Money market funds	$485,776	$—	$—	$485,776
Time deposits and other	—	177,471	—	177,471
Total cash equivalents	485,776	177,471	—	663,247
Current investments:				
Trading investments relating to long-term incentive compensation plans[2]	86,583	—	—	86,583
Trading proprietary fund products and other investments[3]	158,846	69,064	246	228,156
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[4][5]	12,600	43,741	—	56,341
Total current investments	258,029	112,805	246	371,080
Available-for-sale investment securities[6]	2,034	10,354	12	12,400
Investments in partnerships, LLCs and other[6]	761	2,620	27,762	31,143
Equity method investments in partnerships and LLCs[4][6]	1,518	924	66,338	68,780
Derivative assets:				
Currency and market hedges	1,939	—	—	1,939
Other investments[6]	—	—	99	99
	$750,057	$304,174	$94,457	$1,148,688
Liabilities:				
Derivative liabilities:				
Currency and market hedges	$(781)	$—	$—	$(781)

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	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Value as of March 31, 2012
Assets:				
Cash equivalents[1]:				
Money market funds	$893,738	$—	$—	$893,738
Time deposits	—	88,289	—	88,289
Total cash equivalents	893,738	88,289	—	982,027
Current investments:				
Trading investments relating to long-term incentive compensation plans[2]	111,257	—	—	111,257
Trading proprietary fund products and other investments[3]	143,002	79,583	—	222,585
Equity method investments relating to long-term incentive compensation plans, proprietary fund products and other investments[4][5]	11,565	54,934	11,778	78,277
Total current investments	265,824	134,517	11,778	412,119
Available-for-sale investment securities[6]	2,091	9,810	12	11,913
Investments in partnerships, LLCs and other[6]	851	5,351	28,763	34,965
Equity method investments in partnerships and LLCs[4][6]	1,415	1,348	166,438	169,201
Derivative assets:				
Currency and market hedges	84	—	—	84
Other investments[6]	—	—	112	112
	$1,164,003	$239,315	$207,103	$1,610,421
Liabilities:				
Derivative liabilities:				
Currency and market hedges	$(886)	$—	$—	$(886)

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

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

(3) Trading proprietary fund products and other investments primarily represent mutual funds that are invested approximately 49% and 51% in equity and debt securities, respectively, as of March 31, 2013, and were invested approximately 52% and 48% in equity and debt securities, respectively, as of March 31, 2012.

(4) Substantially all of Legg Mason's equity method investments are investment companies which record their underlying investments at fair value. Fair value is measured using Legg Mason's share of the investee's underlying net income or loss, which is predominately representative of fair value adjustments in the investments held by the equity method investee.

(5) Includes investments under the equity method (which approximates fair value) relating to long-term incentive compensation plans of $43,741 and $54,934 as of March 31, 2013 and March 31, 2012, respectively, and proprietary fund products and other investments of $12,600 and $23,343 as of March 31, 2013 and March 31, 2012, respectively, which are classified as Investment securities on the Consolidated Balance Sheets.

(6) Amounts are included in Other non-current assets on the Consolidated Balance Sheets for each of the periods presented.

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

The changes in financial assets measured at fair value using significant unobservable inputs (Level 3) for the years ended March 31, 2013 and 2012, are presented in the tables below:

	Value as of March 31, 2012	Purchases	Sales	Redemptions/ Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of March 31, 2013
Assets:							
Trading proprietary fund products and other investments	$—	$246	$—	$—	$—	$—	$246
Equity method investments in proprietary fund products	11,778	—	—	(11,705)	—	(73)	—
Investments in partnerships, LLCs and other	28,763	—	(970)	(1,014)	—	983	27,762
Equity method investments in partnerships and LLCs	166,438	2,827	(2,268)	(117,411)	—	16,752	66,338
Other investments	124	—	—	—	—	(13)	111
	$207,103	$3,073	$(3,238)	$(130,130)	$—	$17,649	$94,457

	Value as of March 31, 2011	Purchases	Sales	Settlements/ Other	Transfers	Realized and unrealized gains/(losses), net	Value as of March 31, 2012
Assets:							
Trading proprietary fund products and other investments	$11,378	$—	$(11,906)	$—	$—	$ 528	$—
Equity method investments in proprietary fund products	12,167	—	—	—	—	(389)	11,778
Investments in partnerships, LLCs and other	22,167	6,932	—	(578)	—	242	28,763
Equity method investments in partnerships and LLCs	153,931	25,883	(6,387)	(14,168)	—	7,179	166,438
	282	—	—	(159)	—	1	124

Other investments	$199,925	$32,815	$(18,293)	$(14,905)	$—	$ 7,561	$207,103

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Realized and unrealized gains and losses recorded for Level 3 investments are included in Other Non-Operating Income (Expense) on the Consolidated Statements of Income (Loss). The change in unrealized gains (losses) for Level 3 investments still held at the reporting date was $(1,229) and $5,495 for the years ended March 31, 2013 and 2012, respectively.

There were no significant transfers between Level 1 and Level 2 during the years ended March 31, 2013 and 2012.

As a practical expedient, Legg Mason relies on the NAV of certain investments as their fair value. The NAVs that have been provided by the investees have been derived from the fair values of the underlying investments as of the respective reporting dates. The following table summarizes, as of March 31, 2013, the nature of these investments and any related liquidation restrictions or other factors which may impact the ultimate value realized:

		Fair Value Determined Using NAV				As of March 31, 2013	
Category of Investment	Investment Strategy	March 31, 2013		March 31, 2012		Unfunded Commitments	Remaining Term
Funds-of-hedge funds	Global macro, fixed income, long/short equity, natural resources, systematic, emerging market, European hedge	$38,811	(1)	$51,251	(2)	n/a	n/a
Hedge funds	Fixed income - developed market, event driven, fixed income - hedge, relative value arbitrage, European hedge	24,716		25,460		$20,000	n/a
Private equity funds	Long/short equity	23,763	(3)	27,927	(3)	5,235	Up to 7 years
Private fund(4)	Fixed income, residential and commercial mortgage-backed securities	—		89,323		n/a	n/a
Other	Various	2,408		2,450		n/a	Various (5)
Total		$89,698	(6)	$196,411	(6)	$25,235	

n/a-not applicable

(1) 49% monthly redemption; 51% quarterly redemption, of which 38% is subject to two-year lock-up, which expires in June 2013.

(2) 63% monthly redemption; 37% quarterly redemption, of which 36% is subject to two-year lock-up, which expires in June 2013.

(3) Liquidations are expected over the remaining term.

(4) Legg Mason's investment was fully redeemed in the quarter ended December 31, 2012 upon liquidation of the fund.

(5) Of this balance, 4% has a remaining term of less than one year and 96% has a remaining term of 20 years.

(6) Comprised of approximately 32% and 68% of Level 2 and Level 3 assets, respectively, as of March 31, 2013 and 13% and 87% of Level 2 and Level 3 assets, respectively, as of March 31, 2012.

There are no current plans to sell any of these investments held as of March 31, 2013.

4. FIXED ASSETS

The following table reflects the components of fixed assets as of March 31:

	2013	2012
Equipment	$152,065	$155,173
Software	227,739	205,760

Leasehold improvements	222,260	242,566
Total cost	602,064	603,499
Less: accumulated depreciation and amortization	(400,245)	(364,088)
Fixed assets, net	$201,819	$239,411

Depreciation and amortization expense related to fixed assets was $73,829, $74,221 and $79,835 for fiscal 2013, 2012 and 2011, respectively, and includes accelerated depreciation and amortization of $21,020 in fiscal 2013, related to an initiative to reduce space requirements, and $10,256 in fiscal 2012, related to our business streamlining initiative.

5. INTANGIBLE ASSETS AND GOODWILL

Goodwill and indefinite-life intangible assets are not amortized, and the values of identifiable intangible assets are amortized over their useful lives, unless the assets are determined to have indefinite useful lives. Goodwill and indefinite-life intangible assets are analyzed to determine if the fair value of the assets exceeds the book value. Intangible assets subject to amortization are considered for impairment at each reporting period. If the fair value is less than the book value, Legg Mason will record an impairment charge.

The following table reflects the components of intangible assets as of:

	March 31, 2013	March 31, 2012
Amortizable asset management contracts		
Cost	$208,651	$206,411
Accumulated amortization	(186,324)	(172,974)
Net	22,327	33,437
Indefinite–life intangible assets		
U.S. domestic mutual fund management contracts	2,106,351	2,502,351
Permal/Fauchier funds-of-hedge fund management contracts	692,133	947,000
Other fund management contracts	303,951	304,278
Trade names	52,800	69,800
	3,155,235	3,823,429
Intangible assets, net	$3,177,562	$3,856,866

As part of Legg Mason's annual impairment testing process, and considering aspects of the modifications to Permal compensation and other related arrangements discussed in Note 1, on December 12, 2012, and as updated through December 31, 2012, the Company concluded that the carrying value of two significant indefinite-life fund management contract intangible assets and a trade name asset exceeded their respective fair values, and the assets were impaired by an aggregate amount of $734,000. The impairment charges resulted from a number of trends and factors, including (i) a decrease in near-term margin projections; (ii) an increase in the rate used to discount projected future cash flows primarily due to company specific factors including continued market and regulatory influences, continued stock price uncertainty and the search for a permanent Chief Executive Officer, which was ongoing during the impairment testing process; (iii) recent outflows and related reductions in assets under management; and (iv) a reduction in near-term projected growth rates. These changes resulted in a reduction of the projected cash flows and Legg Mason's overall assessment of fair value of the assets, such that the domestic mutual fund management contracts asset, Permal funds-of-hedge fund management contracts asset, and Permal trade name declined below their carrying values, and accordingly were impaired by $396,000, $321,000, and $17,000, respectively.

Management estimated the fair values of these assets based upon discounted cash flow analyses using unobservable market data inputs, which are Level 3 measurements. The significant assumptions used in these cash flow analyses included projected cash flows and discount rates, summarized as follows:

	Projected Cash Flow Growth Rates		
	Range	Weighted-Average	Discount Rates
Domestic mutual funds contracts asset	3% to 9%	6%	14.5%
Permal funds-of-hedge funds contracts and trade name assets	(1)% to 17%	8%	16.0%

Projected cash flow growth rates for these assets are most dependent on product investment performance, client AUM flows, and market conditions. Discount rates are influenced by changes in market conditions, as well as interest rates and other factors. Decreases in the projected cash flow growth rates and/or increases in the discount rates could result in lower fair value measurements and potential additional impairments that could be material.

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There were no impairments to other indefinite-life intangible assets, amortizable management contracts intangible assets, or goodwill, as of December 31, 2012. Legg Mason also determined that no triggering events occurred as of March 31, 2013 that would require further impairment testing.

Changes in indefinite-life intangible assets, other than the impairments noted above and the Fauchier business acquisition further discussed in Note 2, relate to the impact of foreign currency translation.

As of March 31, 2013, amortizable asset management contracts are being amortized over a weighted-average remaining life of 2.8 years.

Estimated amortization expense for each of the next five fiscal years is as follows:

2014	$12,320
2015	3,405
2016	3,148
2017	2,484
2018	485
Thereafter	485
Total	$22,327

The change in the carrying value of goodwill is summarized below:

	Gross Book Value	Accumulated Impairment	Net Book Value
Balance as of March 31, 2011	$2,473,552	$(1,161,900)	$1,311,652
Impact of excess tax basis amortization	(21,694)	—	(21,694)
Other, including changes in foreign exchange rates	(14,913)	—	(14,913)
Balance as of March 31, 2012	$2,436,945	$(1,161,900)	$1,275,045
Impact of excess tax basis amortization	(21,573)	—	(21,573)
Business acquisition (see Note 2)	28,983	—	28,983
Other, including changes in foreign exchange rates	(13,290)	—	(13,290)
Balance as of March 31, 2013	$2,431,065	$(1,161,900)	$1,269,165

Legg Mason also recognizes the tax benefit of the amortization of excess tax basis related to the Citigroup Asset Management ("CAM") acquisition. In accordance with accounting guidance for income taxes, the tax benefit is recorded as a reduction of goodwill and deferred tax liabilities as the benefit is realized.

6. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

The disclosures below include details of Legg Mason's debt, excluding the debt of CIVs. See Note 17, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the debt of CIVs.

The accreted value of long-term debt consists of the following:

	March 31, 2013			March 31, 2012
	Current Accreted Value	Unamortized Discount	Maturity Amount	Accreted Value
5.5% senior notes	$644,077	$5,923	$650,000	$—
Five-year amortizing term loan	500,000	—	500,000	—
Other term loans	877	—	877	9,883
2.5% convertible senior notes	—	—	—	1,127,009

Subtotal	1,144,954	5,923	1,150,877	1,136,892
Less: current portion	50,438	—	50,438	1,278
Total	$1,094,516	$5,923	$1,100,439	$1,135,614

In January 2008, Legg Mason sold $1,250,000 of 2.5% Convertible Senior Notes (the "Notes") due 2015. In May 2012, Legg Mason announced a capital plan that included the refinancing of the Notes, as further discussed below. The refinancing was effected through the issuance of $650,000 of 5.5% senior notes, the net proceeds of which, together with cash on hand and $250,000 of additional borrowing under a then existing revolving credit facility, were used to repurchase the entire $1,250,000 face amount of the Notes.

Also, pursuant to the capital plan, in June 2012, Legg Mason entered into an unsecured credit agreement which provides for an undrawn $500,000 revolving credit facility and a $500,000 term loan, also further discussed below. The proceeds of the term loan were used to repay the $500,000 of outstanding borrowings under the previous revolving credit facility, which was then terminated. As of March 31, 2012, there was $250,000 outstanding under the previous revolving credit facility, which had a then effective interest rate of 2.9%.

The $500,000 revolving credit facility may be increased by an aggregate amount of up to $250,000, subject to the approval of the lenders, and expires in June 2017. The revolving credit facility has an interest rate of LIBOR plus 150 basis points and an annual commitment fee of 20 basis points. The interest rate may change in the future based on changes in Legg Mason's credit ratings. This revolving credit facility is available to fund working capital needs and for general corporate purposes. There were no borrowings outstanding under this facility as of March 31, 2013.

The revolving credit facility and term loan have standard financial covenants, including a maximum net debt to EBITDA ratio (as defined in the documents) of 2.5 to 1 and minimum EBITDA to interest ratio (as defined in the documents) of 4.0 to 1. As of March 31, 2013, Legg Mason's net debt to EBITDA ratio was 1.4 to 1 and EBITDA to interest expense ratio was 11.6 to 1, and therefore, Legg Mason has maintained compliance with the applicable covenants.

Five-year Amortizing Term Loan

The $500,000 term loan entered into in conjunction with the unsecured credit agreement noted above can be repaid at any time and will be due in four annual installments of $50,000, beginning in June 2013, with the remainder to be repaid at maturity in June 2017. The term loan bears interest at LIBOR plus 150 basis points, which may change in the future based on changes in Legg Mason's credit ratings. The effective interest rate as of March 31, 2013 was 1.7%.

5.5% Senior Notes

The $650,000 5.5% Senior Notes (the "Senior Notes") due May 2019, were sold at a discount of $6,754, which is being amortized to interest expense over the seven-year term. The Senior Notes are subject to certain nonfinancial covenants, including provisions relating to dispositions of certain assets, which could require a percentage of any related proceeds to be applied to accelerated repayments. The Senior Notes can be redeemed at any time prior to their scheduled maturity, in part or in aggregate, at the greater of the related principal amount at that time or the sum of the remaining scheduled payments discounted at the Treasury rate (as defined) plus 0.50%, together with any related accrued and unpaid interest. In February 2013, the Senior Notes were registered to trade in public markets, consistent with the terms of a registration rights agreement signed in connection with the issuance. In addition, under the terms of the 5.5% senior notes, the interest rate paid on these notes will increase modestly if Legg Mason's credit ratings are reduced below investment grade.

2.5% Convertible Senior Notes and Related Hedge Transactions

Prior to the repurchase of the Notes in May 2012, as previously discussed, Legg Mason was accreting the carrying value of the Notes to the principal amount at maturity using an interest rate of 6.5% (the effective borrowing rate for non-convertible debt at the time of issuance) over its expected life of seven years, resulting in interest expense of $5,839, $39,077 and $36,688 for the years ended March 31, 2013, 2012 and 2011, respectively. The Notes were convertible, if certain conditions were met, at an initial conversion rate of 11.3636 shares of Legg Mason common stock per one thousand dollar principal amount of Notes (equivalent to a conversion price of approximately $88 per share), or a maximum of 14,205 shares, subject to adjustment. Unconverted notes would mature at par in January 2015. Upon conversion of a one thousand dollar principal amount note, the holder would receive cash in an amount equal to one thousand dollars or, if less, the conversion value of the note. If the conversion value exceeded the principal amount of the Note at conversion, Legg Mason would also deliver, at its election, cash or common stock or a combination of cash and common stock for the conversion value in excess of one thousand dollars.

In connection with the sale of the Notes, in January 2008, Legg Mason entered into convertible note hedge transactions with respect to its common stock (the “Purchased Call Options”) with financial institution counterparties (“Hedge Providers”). The Purchased Call Options were exercisable solely in connection with any conversions of the Notes in the event that the market value per share of Legg Mason common stock at the time of exercise was greater than the exercise price of the

Purchased Call Options, which was equal to the $88 conversion price of the Notes, subject to adjustment. Simultaneously, in separate transactions Legg Mason also sold to the Hedge Providers warrants to purchase, in the aggregate and subject to adjustment, 14,205 shares of common stock on a net share-settled basis at an exercise price of $107.46 per share of common stock. The Purchased Call Options and warrants were not part of the terms of the Notes and did not affect the holders' rights under the Notes. These hedging transactions had a net cost of approximately $83,000, which was paid from the proceeds of the Notes and recorded as a reduction of additional paid-in capital. These transactions effectively increased the conversion price of the Notes to $107.46 per share of common stock. Legg Mason had contractual rights, and, at execution of the related agreements, had the ability to settle its obligations under the conversion feature of the Notes, the Purchased Call Options and warrants, with Legg Mason common stock. Accordingly, these transactions were accounted for as equity, with no subsequent adjustment for changes in the value of these obligations.

The terms of the repurchase of the Notes in May 2012 noted above included their repayment at par plus accrued interest, a prepayment fee of $6,250, and a non-cash exchange of warrants (the “Warrants”) to the holders of the Notes that replicated and extended the contingent conversion feature of the Notes. The cash payment of $1,256,250 to repurchase the Notes was allocated between their liability and equity components based on a liability fair value of $1,193,971, determined using a then current market interest rate of 4.1%, resulting in a loss on debt extinguishment of $68,975, including $7,851 of accelerated deferred issue costs. The remaining balance of the cash payment was allocated to the equity component of the Notes for a $62,279 reduction of additional paid-in capital, offset by related tax benefits of $31,446. The $1,193,971 amount of cash repurchase payment allocated to the liability component of the Notes upon their extinguishment exceeds the initial allocated value at issuance of $977,933, requiring the Consolidated Statements of Cash Flows for the year ended March 31, 2013 to include an allocation of the $216,038 excess to operating activities.

The Warrants issued to the holders of the Notes in connection with the repurchase of the Notes provide for the purchase, in the aggregate and subject to adjustment, of 14,205 shares of Legg Mason common stock, on a net share settled basis, at an exercise price of $88 per share. Upon exercise of the Warrants, Legg Mason will be required to deliver to the holders of the Warrants, at its election, either shares of its common stock or cash, in an amount based on the excess of the market price per share of its common stock over the exercise price of the Warrants. The Warrants expire in July 2017. Legg Mason has had the option to settle its obligations under the Warrants with Legg Mason common stock. Accordingly, the Warrants are accounted for as equity.

In connection with the extinguishment of the Notes, the hedge transactions (Purchased Call Options and warrants) executed in connection with the initial issuance of the Notes were also terminated.

Other Term Loans

In fiscal 2006, a subsidiary of Legg Mason entered into a $12,803 term loan agreement to finance an aircraft. The outstanding balance at March 31, 2012 was $8,568 and was paid in full during fiscal 2013.

As of March 31, 2013, the aggregate maturities of long-term debt, based on their contractual terms, are as follows:

2014	$50,438
2015	50,439
2016	50,000
2017	50,000
2018	300,000
Thereafter	650,000
Total	$1,150,877

7. INCOME TAXES

The components of income (loss) before income tax provision (benefit) are as follows:

	2013	2012	2011
Domestic	$(264,342)	$257,866	$230,334
Foreign	(246,265)	45,217	134,863

Total	$(510,607)	$303,083	$365,197

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The components of income tax expense (benefit) are as follows:

	2013	2012	2011
Federal	$(74,185)	$54,179	$75,290
Foreign	(85,677)	(7,850)	18,788
State and local	9,003	25,723	25,356
Total income tax provision (benefit)	$(150,859)	$72,052	$119,434
Current	$6,496	$22,860	$39,162
Deferred	(157,355)	49,192	80,272
Total income tax provision (benefit)	$(150,859)	$72,052	$119,434

A reconciliation of the difference between the effective income tax (benefit) rate and the statutory federal income tax (benefit) rate is as follows:

	2013	2012	2011
Tax provision (benefit) at statutory U.S. federal income tax rate	(35.0)%	35.0%	35.0%
State income taxes, net of federal income tax benefit[(1)]	1.5	5.4	4.9
Effect of foreign tax rates[(1)]	3.8	(1.8)	(5.4)
Effect of loss on Australian restructuring	—	(6.0)	—
Changes in U.K. tax rates on deferred tax assets and liabilities	(3.5)	(6.0)	(2.5)
Net (income) loss attributable to noncontrolling interests	0.5	(0.8)	0.8
Other, net[(1)]	3.2	(2.0)	(0.1)
Effective income tax (benefit) rate	(29.5)%	23.8%	32.7%

(1) State income taxes include changes in valuation allowances, net of the impact on deferred tax assets of changes in state apportionment factors and planning strategies. The effect of foreign tax rates also includes changes in valuation allowances. Other includes changes in federal valuation allowances. See schedule below for the change in valuation allowances by jurisdiction.

During the quarter ended September 30, 2010, the U.K. Finance (No. 2) Act 2010 was enacted, which reduced the main U.K. corporate tax rate from 28% to 27%. In July 2011, The U.K. Finance Act 2011 (the "Act") was enacted. The Act further reduced the main U.K. corporate tax rate from 27% to 26% effective April 1, 2011, and from 26% to 25% effective April 1, 2012. In July 2012, The U.K. Finance Act 2012 was enacted, further reducing the main U.K. corporate tax rate to 24% effective April 1, 2012 and 23% effective April 1, 2013. The reductions in the U.K. corporate tax rate resulted in tax benefits of $18,075, $18,268 and $8,878, recognized in fiscal 2013, 2012 and 2011, respectively, as a result of the revaluation of deferred tax assets and liabilities at the new rates. In addition, during the year ended March 31, 2012, Legg Mason recorded $18,254 of tax benefits related to a restructuring of our Australian business.

Deferred income taxes are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the Consolidated Balance Sheets. These temporary differences result in taxable or deductible amounts in future years. A summary of Legg Mason's deferred tax assets and liabilities are as follows:

	2013	2012
DEFERRED TAX ASSETS		
Accrued compensation and benefits	$107,411	$125,797
Accrued expenses	73,181	62,410
Operating loss carryforwards	449,806	397,013
Capital loss carryforwards	41,256	46,244
Convertible debt obligations	—	4,951
Foreign tax credit carryforward	115,819	59,871
Federal benefit of uncertain tax positions	21,165	17,602
Mutual fund launch costs	24,324	14,476
Net unrealized losses from investments	4,447	5,327
Other	5,086	18,119
Deferred tax assets	842,495	751,810
Valuation allowance	(115,815)	(102,722)
Deferred tax assets after valuation allowance	$726,680	$649,088

	2013	2012
DEFERRED TAX LIABILITIES		
Basis differences, principally for intangible assets and goodwill	$134,873	$196,611
Depreciation and amortization	386,959	431,280
Other	1,528	3,667
Deferred tax liabilities	523,360	631,558
Net deferred tax asset	$203,320	$17,530

Certain tax benefits associated with Legg Mason's employee stock plans are recorded directly in Stockholders' Equity. No tax benefit was recorded to equity in fiscal 2013, 2012 or 2011, due to the net operating loss position of the Company. As of March 31, 2013, an additional $6,700 of net operating loss will be recognized as an increase in Stockholders' Equity when ultimately realized.

In connection with the completion and filing of its fiscal 2010 federal tax return in December 2010, Legg Mason recorded a net additional tax benefit of approximately $36,000 in fiscal 2011 with respect to the Equity Unit extinguishment that occurred in fiscal 2010. The tax benefit increased Additional paid-in capital in a manner consistent with the fiscal 2010 allocation of the extinguishment payment.

Legg Mason has various loss carryforwards that may provide future tax benefits. Related valuation allowances are established in accordance with accounting guidance for income taxes, if it is management's opinion that it is more likely than not that these benefits will not be realized. Substantially all of Legg Mason's deferred tax assets relate to U.S. and U.K. taxing jurisdictions. As of March 31, 2013, U.S. federal deferred tax assets aggregated $770,933, realization of which is expected to require approximately $4,200,000 of future U.S. earnings, approximately $331,606 of which must be in the form of foreign source income. Based on estimates of future taxable income, using assumptions consistent with those used in Legg Mason's goodwill impairment testing, it is more likely than not that current federal tax benefits relating to net operating losses are realizable and no valuation allowance is necessary at this time. With respect to those resulting from foreign tax credits, it is more likely than not that tax benefits relating to the utilization of $36,319 of foreign tax credits as credits will not be realized and an additional valuation allowance of $17,066 was provided in fiscal 2013. In addition, a valuation allowance was established in prior years for the

substantial portion of our deferred tax assets relating to U.K. taxing jurisdictions. While tax planning may enhance Legg Mason's tax positions, the realization of these current tax benefits is not dependent on any significant tax strategies.

As of March 31, 2013, U.S. state deferred tax assets aggregated approximately $172,704. Due to state tax planning which will allow for the utilization of NOLs generated in certain jurisdictions the Company recognized a net valuation allowance release of $2,046. Due to the uncertainty of future state apportionment factors and future effective state tax rates, the value of state net operating loss benefits ultimately realized may vary.

A net valuation allowance release of approximately $3,500 in fiscal 2013 was primarily related to the full release of the valuation allowance on deferred tax assets related to Australia and Singapore offset by an establishment of a valuation allowance against certain U.K. deferred tax assets. To the extent the analysis of the realization of deferred tax assets relies on deferred tax liabilities, Legg Mason has considered the timing, nature and jurisdiction of reversals, as well as, future increases relating to the tax amortization of goodwill and indefinite-life intangible assets.

The following deferred tax assets and valuation allowances relating to carryforwards have been recorded at March 31, 2013 and 2012, respectively.

	2013	2012	Expires Beginning after Fiscal Year
Deferred tax assets			
U.S. federal net operating losses	$266,659	$219,984	2029
U.S. federal capital losses	74	74	2015
U.S. federal foreign tax credits	115,819	59,871	2015
U.S. charitable contributions	5,401	4,709	2013
U.S. state net operating losses [1,2]	161,136	151,762	2015
U.S. state capital losses	34,960	39,046	2015
Non-U.S. net operating losses	22,011	26,704	2027
Non-U.S. capital losses	6,222	7,124	n/a
Total deferred tax assets for carryforwards	$612,282	$509,274	
Valuation allowances			
U.S. federal capital losses	$74	74	
U.S. federal foreign tax credits	23,608	6,542	
U.S. charitable contributions	1,597	—	
U.S. state net operating losses	25,951	23,911	
U.S. state capital losses	34,960	39,046	
Non-U.S. net operating losses	15,899	22,956	
Non-U.S. capital losses	6,222	7,124	
Valuation allowances for carryforwards	108,311	99,653	
Non-U.S. other deferred assets	7,504	3,069	
Total valuation allowances	$115,815	$102,722	

(1) Substantially all of the U.S. state net operating losses carryforward through fiscal 2029.

(2) Due to potential for change in the factors relating to apportionment of income to various states, the Company's effective state tax rates are subject to fluctuation which will impact the value of the Company's deferred tax assets, including net operating losses, and could have a material impact on the future effective tax rate of the Company.

Legg Mason had total gross unrecognized tax benefits of approximately $72,650, $90,831 and $77,653 as of March 31, 2013, 2012 and 2011, respectively. Of these totals, approximately $46,340, $62,400 and $53,500, respectively, (net of the federal benefit for state tax liabilities) are the amounts of unrecognized benefits which, if recognized, would favorably impact future income tax provisions and effective tax rates. During fiscal 2013, as a result of the expiration of statutes of limitation and the completion of tax authority examinations, unrecognized benefits of $16,842 were realized.

A reconciliation of the beginning and ending amount of unrecognized gross tax benefits for the years ended March 31, 2013, 2012 and 2011, is as follows:

	2013	2012	2011
Balance, beginning of year	$90,831	$77,653	$51,027
Additions based on tax positions related to the current year	11,726	9,822	1,361
Additions for tax positions of prior years	8,439	10,668	34,959
Reductions for tax positions of prior years	(13,083)	(3,575)	(6,107)
Decreases related to settlements with taxing authorities	(25,205)	(3,185)	(2,667)
Expiration of statutes of limitations	(58)	(552)	(920)
Balance, end of year	$72,650	$90,831	$77,653

Although management cannot predict with any degree of certainty the timing of ultimate resolution of matters under review by various taxing jurisdictions, it is reasonably possible that the Company's gross unrecognized tax benefits balance may change within the next twelve months by up to $11,400 as a result of the expiration of statutes of limitation and the completion of tax authorities' exams.

The Company accrues interest related to unrecognized tax benefits in interest expense and recognizes penalties in other operating expense. During the years ended March 31, 2013, 2012 and 2011, the Company recognized approximately $5,500, $1,300, and $3,000, respectively, which was substantially all interest. At March 31, 2013, 2012 and 2011, Legg Mason had approximately $14,000, $10,000, and $9,000, respectively, accrued for interest and penalties on tax contingencies in the Consolidated Balance Sheets.

Legg Mason is under examination by the Internal Revenue Service, the Inland Revenue Service, and other tax authorities in various states. The following tax years remain open to income tax examination for each of the more significant jurisdictions where Legg Mason is subject to income taxes: after fiscal 2009 for U.S. federal; after fiscal 2012 for the United Kingdom; after fiscal 2004 for the state of California; after fiscal 2005 for the state of New York; and after fiscal 2009 for the states of Connecticut, Maryland and Massachusetts. The Company does not anticipate making any significant cash payments with the settlement of these audits in excess of amounts that have been reserved.

During the year ended March 31, 2013, Legg Mason repatriated approximately $394,000 of foreign cash, and plans to repatriate up to another $325,000, over the next several years in order to make the cash available in the U.S. for general corporate purposes. Legg Mason anticipates an incremental tax cost of approximately $18,000 with respect to this repatriation and has adjusted the tax reserve accordingly. No further repatriation of accumulated prior period foreign earnings is currently planned. However, if circumstances change, Legg Mason will provide for and pay any applicable additional U.S. taxes in connection with repatriation of these funds. It is not practical at this time to determine the income tax liability that would result from any further repatriation of accumulated foreign earnings.

Except as noted above, Legg Mason intends to permanently reinvest cumulative undistributed earnings of its non-U.S. subsidiaries in non-U.S. operations. Accordingly, no U.S. federal income taxes have been provided for the undistributed earnings to the extent that they are permanently reinvested in Legg Mason's non-U.S. operations. It is not practical at this time to determine the income tax liability that would result upon repatriation of the earnings.

8. COMMITMENTS AND CONTINGENCIES

Legg Mason leases office facilities and equipment under non-cancelable operating leases, and also has multi-year agreements for certain services. These leases and service agreements expire on varying dates through fiscal 2026. Certain leases provide for renewal options and contain escalation clauses providing for increased rentals based upon maintenance, utility and tax increases.

As of March 31, 2013, the minimum annual aggregate rentals under operating leases and service agreements are as follows:

2014	$132,524
2015	121,176
2016	106,623
2017	95,369
2018	86,669
Thereafter	422,581
Total	$964,942

The minimum rental commitments shown above have not been reduced by $151,664 for minimum sublease rentals to be received in the future under non-cancelable subleases, of which approximately half is due from one counterparty. If a sub-tenant defaults on a sublease, Legg Mason may incur operating charges to adjust the existing liability of $31,321 to reflect expected future sublease rentals at reduced amounts, as a result of the current commercial real estate market.

The above minimum rental commitments include $877,807 in real estate and equipment leases and $87,135 in service and maintenance agreements.

Included in the table above is $75,894 in commitments related to space that has been vacated, but for which subleases are being pursued. A lease liability was adjusted in fiscal 2013 and 2012, to reflect the present value of the excess existing lease obligations over the estimated sublease income and related costs, including any newly vacated or subleased space. The lease liability takes into consideration various assumptions, including the amount of time it will take to secure a sublease agreement and prevailing rental rates in the applicable real estate markets. As of March 31, 2013, the liability related to vacant space for which a sublease is being pursued aggregated $35,592, but is subject to adjustment based on circumstances in the real estate markets that may require a change in assumptions or the actual terms of a sublease that is ultimately secured. In addition to accelerated depreciation and amortization discussed in Note 4, these and other related costs incurred during fiscal 2013, driven by an initiative to reduce space requirements, and during fiscal 2012, related to the business streamlining initiative, aggregated $28,788 and $13,375, respectively, and are included in Occupancy expense in the Consolidated Statements of Income.

The following table reflects rental expense under all operating leases and servicing agreements.

	2013	2012	2011
Rental expense	$138,488	$140,285	$137,072
Less: sublease income	14,750	14,310	10,848
Net rent expense	$123,738	$125,975	$126,224

Legg Mason recognizes rent expense ratably over the lease period based upon the aggregate lease payments. The lease period is determined as the original lease term without renewals, unless and until the exercise of lease renewal options is reasonably assured, and also includes any period provided by the landlord as a "free rent" period. Aggregate lease payments include all rental payments specified in the contract, including contractual rent increases, and are reduced by any lease incentives received from the landlord, including those used for tenant improvements.

As of March 31, 2013 and 2012, Legg Mason had commitments to invest approximately $37,410 and $36,653, respectively, in limited partnerships that make private investments. These commitments are expected to be funded as required through the end of the respective investment periods ranging through fiscal 2021.

In connection with the acquisition of Fauchier, as further discussed in Note 2, contingent consideration of up to approximately $23,000 and approximately $30,000, using exchange rates as of March 31, 2013, may be due on the

second and fourth anniversaries of closing, respectively, which is dependent upon the achievement of certain financial targets and subject to a catch up adjustment. The contingent consideration liability had an acquisition date fair value of $21,566.

In the normal course of business, Legg Mason enters into contracts that contain a variety of representations and warranties and that provide general indemnifications, which are not considered financial guarantees by relevant accounting guidance.

Legg Mason’s maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against Legg Mason that have not yet occurred.

Legg Mason has been the subject of customer complaints and has also been named as a defendant in various legal actions arising primarily from securities brokerage, asset management and investment banking activities, including certain class actions, which primarily allege violations of securities laws and seek unspecified damages, which could be substantial. In the normal course of its business, Legg Mason has also received subpoenas and is currently involved in governmental and self-regulatory agency inquiries, investigations and, from time to time, proceedings involving asset management activities. In accordance with guidance for accounting for contingencies, Legg Mason has established provisions for estimated losses from pending complaints, legal actions, investigations and proceedings when it is probable that a loss has been incurred and a reasonable estimate of loss can be made.

In a transaction with Citigroup in December 2005, Legg Mason transferred to Citigroup the subsidiaries that constituted its Private Client/Capital Markets ("PC/CM") businesses, thus transferring the entities that would have primary liability for most of the customer complaint, litigation and regulatory liabilities and proceedings arising from those businesses. However, as part of that transaction, Legg Mason agreed to indemnify Citigroup for most customer complaint, litigation and regulatory liabilities of Legg Mason's former PC/CM businesses that result from pre-closing events. While the ultimate resolution of these matters cannot be determined based on current information, after consultation with legal counsel, management believes that any accrual or range of reasonably possible losses as of March 31, 2013 and 2012, is not material. Similarly, although Citigroup transferred to Legg Mason the entities that would be primarily liable for most customer complaint, litigation and regulatory liabilities and proceedings of the CAM business, Citigroup has agreed to indemnify Legg Mason for most customer complaint, litigation and regulatory liabilities of the CAM business that result from pre-closing events.

One of Legg Mason's asset management subsidiaries was named as the defendant in a lawsuit filed by a former institutional client in late August 2011. The complaint alleges breach of contract and breach of fiduciary duty arising from investments in the former client's account allegedly being inconsistent with the account's objectives, and seeks damages in excess of $90,000. Legg Mason believes that the claims are without merit and intends to defend the matter vigorously. Discovery in the case is ongoing, and a pretrial conference is currently scheduled for October 2013. Because of the continued preliminary status of the matter, Legg Mason cannot estimate the possible loss or range of loss from this matter, if any. In addition, although Legg Mason believes that this matter would likely be covered by insurance policies that may substantially mitigate the amount of any eventual loss, as is not unusual with litigation at this point in the process, there can be no assurance the action will not have a material effect on Legg Mason's financial position, results of operations or cash flows.

Additionally, there are two matters subject to regulatory investigations involving one of Legg Mason's asset management subsidiaries regarding its compliance with applicable legal requirements with respect to investments made for certain client accounts. Legg Mason is continuing discussions to resolve the matters, subsequent to the fiscal year-end. As a result of these discussions, Legg Mason has agreed in principle, subject to agreement on final terms and documentation, to settle these two matters for approximately $20,000, which was accrued as of March 31, 2013, the majority of which is covered by expected insurance proceeds. Any ultimate loss on these matters beyond amounts covered by insurance policies will be substantially mitigated by reductions in compensation under revenue share arrangements.

Other than the specific matters discussed above, Legg Mason cannot estimate the reasonably possible loss or range of loss associated with matters of litigation, including those described above as customer complaints, legal actions, inquiries, proceedings and investigations. The inability to provide a reasonably possible amount or range of losses is not because there is uncertainty as to the ultimate outcome of a matter, but because liability and damage issues have not developed to the point where Legg Mason can conclude that there is both a reasonable possibility of a loss and a

meaningful amount or range of possible losses. There are numerous aspects to customer complaints, legal actions, inquiries, proceedings and investigations that prevent Legg Mason from estimating a related amount or range of reasonably possible losses. These aspects include, among other things, the nature of the matters; that significant relevant facts are not known, are uncertain or are in dispute; and that damages sought are not specified, are uncertain, unsupportable or unexplained. In addition, for legal actions, discovery may not yet have started, may not be complete or may not be conclusive, and meaningful settlement discussions may not have occurred. Further, for regulatory matters, investigations may run their course without any clear indication of wrongdoing or fault until their conclusion.

In management's opinion, an adequate accrual has been made as of March 31, 2013, to provide for any probable losses that may arise from matters for which the Company could reasonably estimate an amount. Legg Mason's financial condition,

results of operations and cash flows could be materially affected during a period in which a matter is ultimately resolved. In addition, the ultimate costs of litigation-related charges can vary significantly from period-to-period, depending on factors such as market conditions, the size and volume of customer complaints and claims, including class action suits, and recoveries from indemnification, contribution or insurance reimbursement.

As of March 31, 2013 and 2012, Legg Mason's liability for losses and contingencies was $20,300 and $200, respectively. During fiscal 2013, 2012 and 2011, Legg Mason recorded litigation related charges of approximately $5,200, $1,000, and $2,500, respectively (net of recoveries of $15,200 in fiscal 2013). During fiscal 2013, 2012 and 2011, the liability was reduced for settlement payments of approximately $300, $1,300, and $23,500, respectively.

9. EMPLOYEE BENEFITS

Legg Mason, through its subsidiaries, maintains various defined contribution plans covering substantially all employees. Through these plans, Legg Mason can make two types of discretionary contributions. One is a profit sharing contribution to eligible Plan participants based on a percentage of qualified compensation and the other is a match of employee 401(k) contributions. Matches range from 50% to 100% of employee 401(k) contributions, up to a maximum of the lesser of up to 6% of employee compensation or a specified amount up to $15 per year. Corporate profit sharing and matching contributions, together with contributions made under subsidiary plans, totaled $25,868, $22,336 and $22,739 in fiscal 2013, 2012 and 2011, respectively. In addition, employees can make voluntary contributions under certain plans.

10. CAPITAL STOCK

At March 31, 2013, the authorized numbers of common and preferred shares were 500,000 and 4,000, respectively. At March 31, 2013 and 2012, there were 11,948 and 13,932 shares of common stock, respectively, reserved for issuance under Legg Mason's equity plans. As of March 31, 2010, 1,099 common shares were reserved for exchangeable shares issued in connection with the acquisition of Legg Mason Canada Inc. Exchangeable shares were exchangeable at any time by the holder on a one-for-one basis into shares of Legg Mason's common stock and were included in basic shares outstanding. In May 2010, all outstanding exchangeable shares were converted into shares of Legg Mason common stock.

In May 2012, as part of a capital plan, Legg Mason's Board of Directors authorized $1,000,000 for additional purchases of Legg Mason common stock, as well as the completion of the repurchase of the then remaining approximate $155,000 of Legg Mason common stock previously authorized. There is no expiration date attached to this new authorization. During fiscal 2013, Legg Mason purchased and retired 16,199 shares of its common stock for $425,475 through open market purchases, which completed the repurchase of its common stock under the previous authorization, and began purchases under the new authorization. During fiscal 2012, Legg Mason purchased and retired 13,597 shares of its common stock for $400,266 through open market purchases. The remaining balance of the authorized stock buyback is approximately $730,000.

In May 2008, Legg Mason issued $1,150,000 of Equity Units, each unit consisting of a 5% interest in one thousand dollar principal amount of senior notes due June 30, 2021, and a purchase contract committing the holder to purchase shares of Legg Mason's common stock by June 30, 2011. During fiscal 2010, Legg Mason issued approximately 18,596 shares through the Equity Unit tender offer in exchange for 91% of the outstanding Equity Units. During fiscal 2012, Legg Mason issued 1,830 shares of Legg Mason common stock upon the exercise of the purchase contracts from the remaining Equity Units and the senior notes from the Equity Units were retired in a remarketing.

As discussed in Note 6, warrants issued in connection with the repurchase of the Notes could result in the issuance of a maximum of 14,205 shares of Legg Mason common stock, subject to adjustment, if certain conditions are met.

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Changes in common stock and shares exchangeable into common stock for the three years ended March 31, 2013, 2012 and 2011, respectively, are as follows:

	Years Ended March 31,		
	2013	2012	2011
COMMON STOCK			
Beginning balance	139,874	150,219	161,439
Shares issued for:			
Stock option exercises and other stock-based compensation	80	172	638
Deferred compensation trust	71	68	75
Deferred compensation	1,925	1,246	1,520
Exchangeable shares	—	—	1,099
Shares repurchased and retired	(16,199)	(13,597)	(14,552)
Net share transactions	(410)	(64)	—
Equity Units exchange	—	1,830	—
Ending balance	125,341	139,874	150,219
SHARES EXCHANGEABLE INTO COMMON STOCK			
Beginning balance	—	—	1,099
Exchanges	—	—	(1,099)
Ending balance	—	—	—

Dividends declared per share were $0.44, $0.32 and $0.20 for fiscal 2013, 2012 and 2011, respectively. Dividends declared but not paid at March 31, 2013, 2012 and 2011, were $14,185, $11,493 and $8,990, respectively, and are included in Other current liabilities.

11. STOCK-BASED COMPENSATION

Legg Mason's stock-based compensation includes stock options, employee stock purchase plans, restricted stock awards and units, market-based performance shares payable in common stock, and deferred compensation payable in stock. Effective July 26, 2011, the number of shares authorized to be issued under Legg Mason's active equity incentive stock plan was increased by 6,500 to 41,500. Shares available for issuance under the active equity incentive stock plan as of March 31, 2013, were 11,273. Options under Legg Mason’s employee stock plans have been granted at prices not less than 100% of the fair market value. Options are generally exercisable in equal increments over four to five years and expire within eight to ten years from the date of grant.

Compensation expense relating to stock options for the years ended March 31, 2013, 2012, and 2011 was $10,979, $14,076, and $19,926, respectively. The related income tax benefit for the years ended March 31, 2013, 2012, and 2011 was $4,293, $5,539, and $7,718, respectively.

Stock option transactions under Legg Mason's equity incentive plans during the years ended March 31, 2013, 2012 and 2011, respectively, are summarized below:

	Number of Shares	Weighted-Average Exercise Price Per Share
Options outstanding at March 31, 2010	6,054	$57.75
Granted	729	33.12
Exercised	(634)	21.85
Canceled/forfeited	(730)	48.94
Options outstanding at March 31, 2011	5,419	59.82
Granted	810	33.99
Exercised	(117)	25.32
Canceled/forfeited	(488)	48.80
Options outstanding at March 31, 2012	5,624	57.78
Granted	966	23.72
Exercised	(25)	21.80
Canceled/forfeited	(1,204)	51.87
Options outstanding at March 31, 2013	5,361	$53.13

The total intrinsic value of options exercised during the years ended March 31, 2013, 2012 and 2011, was $168, $398, and $6,977, respectively. At March 31, 2013, the aggregate intrinsic value of options outstanding was $12,649.

The following information summarizes Legg Mason's stock options outstanding at March 31, 2013:

Exercise Price Range	Option Shares Outstanding	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Life (in years)
$ 12.65 - $ 25.00	971	$23.03	6.8
25.01 - 35.00	2,649	31.86	4.7
35.01 - 94.00	84	61.02	0.3
94.01 - 100.00	462	95.14	1.3
100.01 - 134.97	1,195	107.98	1.1
	5,361		

At March 31, 2013, 2012 and 2011, options were exercisable on 3,254, 3,334, and 2,860 shares, respectively, and the weighted-average exercise prices were $69.07, $73.60, and $77.20, respectively. Stock options exercisable at March 31, 2013, have a weighted-average remaining contractual life of 2.6 years. At March 31, 2013, the aggregate intrinsic value of options exercisable was $3,555.

The following information summarizes Legg Mason's stock options exercisable at March 31, 2013:

Exercise Price Range	Option Shares Exercisable	Weighted-Average Exercise Price Per Share
$ 12.65 - $ 25.00	81	$17.32
25.01 - 35.00	1,432	31.59
35.01 - 94.00	84	61.02
94.01 - 100.00	462	95.14
100.01 - 134.97	1,195	107.98
	3,254	

The following information summarizes unvested stock options under Legg Mason's equity incentive plans for the year ended March 31, 2013:

	Number of Shares	Weighted-Average Grant Date Fair Value
Shares unvested at March 31, 2012	2,290	$14.00
Granted	966	9.47
Vested	(874)	15.17
Canceled/forfeited	(275)	12.35
Shares unvested at March 31, 2013	2,107	$11.65

Unamortized compensation cost related to unvested options at March 31, 2013, was $17,167 and is expected to be recognized over a weighted-average period of 1.6 years.
Cash received from exercises of stock options under Legg Mason's equity incentive plans was $660, $2,851, and $12,094 for the years ended March 31, 2013, 2012 and 2011, respectively. The tax benefit expected to be realized for the tax deductions from these option exercises totaled $45, $47, and $2,645 for the years ended March 31, 2013, 2012 and 2011, respectively.

The weighted-average fair value of stock option grants during the years ended March 31, 2013, 2012 and 2011, using the Black-Scholes option pricing model, was $9.47 and $13.13, and $14.32 per share, respectively.

The following weighted-average assumptions were used in the model for grants in fiscal 2013, 2012, and 2011:

	2013	2012	2011
Expected dividend yield	1.44 %	1.39 %	1.39 %
Risk-free interest rate	0.81 %	1.95 %	2.37 %
Expected volatility	51.80 %	47.16 %	52.64 %
Expected life (in years)	5.02	5.12	5.18

Legg Mason uses an equally weighted combination of both implied and historical volatility to measure expected volatility for calculating Black-Scholes option values.

Legg Mason has a qualified Employee Stock Purchase Plan covering substantially all U.S. employees. Shares of common stock are purchased in the open market on behalf of participating employees, subject to a 4,500 total share limit under the plan. Purchases are made through payroll deductions and Legg Mason provides a 10% contribution towards purchases, which is charged to earnings. During the fiscal years ended March 31, 2013, 2012 and 2011, approximately 107, 107, and 102 shares, respectively, were purchased in the open market on behalf of participating employees. In fiscal 2013, 2012 and 2011, Legg Mason recognized $238, $267, and $286, respectively, in compensation expense related to the stock purchase plan.

On January 28, 2008, the Legg Mason Compensation Committee approved grants to senior officers of 120 market-based performance shares. During fiscal 2013 the remaining 100 shares from this award were forfeited resulting in no outstanding balance as of March 31, 2013.

Restricted stock and restricted stock unit transactions during the years ended March 31, 2013, 2012 and 2011, respectively, are summarized below:

	Number of Shares		Weighted-Average Grant Date Value
Unvested shares at March 31, 2010	1,605		$34.80
Granted	1,867		33.02
Vested	(617	)	38.62
Canceled/forfeited	(218	)	30.42
Unvested shares at March 31, 2011	2,637		33.01
Granted	1,370		33.48
Vested	(1,075	)	31.49
Canceled/forfeited	(59	)	32.68
Unvested shares at March 31, 2012	2,873		33.83
Granted	2,185		24.04
Vested	(1,177	)	31.22
Canceled/forfeited	(143	)	58.30
Unvested shares at March 31, 2013	3,738		$27.99

The restricted stock and restricted stock unit awards were non-cash transactions. In fiscal 2013, 2012 and 2011, Legg Mason recognized $46,351, $32,826, and $35,770, respectively, in compensation expense and related tax benefits of $17,697, $12,705, and $13,854, respectively, for restricted stock and restricted stock unit awards. Unamortized compensation cost related to unvested restricted stock and restricted stock unit awards for 3,738 shares not yet recognized at March 31, 2013, was $66,854 and is expected to be recognized over a weighted-average period of 1.6 years.

In connection with the change in Legg Mason's Chief Executive Officer in September 2012, 325 shares of restricted stock were granted to certain executives and key employees, with an aggregate value of $8,400. In March 2013, the vesting of 85 of these shares was accelerated. The remaining shares vest on March 31, 2014. Compensation expense for the year ended March 31, 2013 includes approximately $6,400 of accelerated stock-based net compensation costs associated with the departure of three Legg Mason executive officers during fiscal 2013, of which $1,400 relates to the accelerated vesting of shares in March 2013.

Legg Mason also has an equity plan for non-employee directors. Under the equity plan, directors may elect to receive shares of stock or restricted stock units. Prior to a July 19, 2007 amendment to the Plan, directors could also elect to receive stock options. Options granted under the old plan are immediately exercisable at a price equal to the market value of the shares on the date of grant and have a term of not more than ten years. In fiscal 2013, 2012 and 2011, Legg Mason recognized expense of $1,250, $1,375, and $1,425, respectively, for awards under this plan. Shares, options, and restricted stock units issuable under the equity plan are limited to 625 shares in aggregate, of which 328 shares were issued under the plan as of March 31, 2013. As of March 31, 2013, 2012 and 2011 non-employee directors held 112, 184 and 220, stock options, respectively, which are included in the outstanding options presented in the table above. As of March 31, 2013, 2012 and 2011 non-employee directors held 91, 74 and 62 restricted stock units, respectively, which vest on the grant date and are, therefore, not included in the unvested shares of restricted stock and restricted stock units in the table above. During the years ended March 31, 2013 and 2012, non-employee directors did not exercise any stock options and no restricted stock units were distributed. During the year ended March 31, 2011, non-employee directors exercised 9 stock options. In the fiscal year ended March 31, 2011, 7 restricted stock units were distributed for non-employee directors. During the years ended March 31, 2013, 2012 and 2011 non-employee directors were granted 17, 12 and 17 restricted stock units and 35, 31 and 31 shares of common stock, respectively. In the fiscal years ended March 31, 2013, 2012 and 2011, there were 72, 36 and 59 stock options canceled or forfeited, respectively.

During fiscal 2012, Legg Mason established a long-term incentive plan (the "LTIP") under its equity incentive plan, which provides an additional element of compensation that is based on performance. Under the LTIP, executive officers were granted cash value performance units in the June 2011 quarter and the September 2012 quarter that will vest at the end of their performance periods on March 31, 2014 and March 31, 2015, respectively, based upon Legg Mason's cumulative

adjusted earnings per share over the respective periods. Awards granted under the LTIP may be settled in cash and/or shares of Legg Mason common stock, at the discretion of Legg Mason. The estimated payout amounts of the awards, if any, are expensed over the future vesting periods based on a probability assessment of the expected outcome under the LTIP provisions.

Deferred compensation payable in shares of Legg Mason common stock has been granted to certain employees in an elective plan. The vesting in the plan is immediate and the plan provides for discounts of up to 10% on contributions and dividends. There are 378 additional shares reserved for future issuance under the plan. In fiscal 2013, 2012 and 2011, Legg Mason recognized $165, $191, and $263, respectively, in compensation expense related to this plan. During fiscal 2013, 2012 and 2011, Legg Mason issued 71, 68, and 77 shares, respectively, under the plan with a weighted-average fair value per share at the grant date of $23.07, $27.05, and $28.38, respectively.
Legg Mason has issued shares in connection with certain deferred compensation plans that are held in rabbi trusts. Assets of rabbi trusts are consolidated with those of the employer, and the value of the employer's stock held in the rabbi trusts is classified in stockholders' equity and accounted for in a manner similar to treasury stock. Therefore, the shares Legg Mason has issued to its rabbi trusts and the corresponding liability related to the deferred compensation plans are presented as components of stockholders' equity as Employee stock trust and Deferred compensation employee stock trust, respectively. Shares held by the trusts at March 31, 2013, 2012 and 2011, were 726, 690 and 706, respectively.
As part of the Company's streamlining initiative, as further discussed in Note 15, the employment of certain recipients of stock option and restricted stock awards has been terminated. The termination benefits extended to these employees included accelerated vesting of any portion of their equity incentive awards that would not have vested by January 1, 2012, under the original terms of the awards. During fiscal 2011, the portion of the awards subject to accelerated vesting was revalued and was expensed over the new vesting period, the impact of which is included above. Also in connection with the restructuring initiative, the departure of an executive officer in December 2010 resulted in the accelerated vesting of a portion of certain equity incentive awards, the impact of which is also included above.

In May 2013, Legg Mason awarded options to purchase 500 shares of Legg Mason, Inc. common stock at an exercise price of $31.46 to its President and Chief Executive Officer. The award had a grant date fair value of $5,525 and is subject to vesting requirements, the majority of which contain market-based hurdles, as well as a requirement that certain shares received upon exercise are retained for a two year period.

12. EARNINGS PER SHARE

Basic EPS is calculated by dividing Net Income (Loss) Attributable to Legg Mason, Inc. by the weighted-average number of shares outstanding. The calculation of weighted-average shares includes common shares and unvested restricted shares deemed to be participating securities. Diluted EPS is similar to basic EPS, but adjusts for the effect of potentially issuable common shares, except when inclusion is antidilutive. For periods where a net loss attributable to Legg Mason, Inc. is reported, the inclusion of potentially issuable common shares will decrease the net loss per share. Since this would be antidilutive, such shares are excluded from the calculation.

In May 2012, as part of a capital plan, Legg Mason's Board of Directors authorized $1,000,000 for additional purchases of Legg Mason common stock, as well as the completion of the repurchase of the then remaining approximate $155,000 of Legg Mason common stock previously authorized. The capital plan authorizes using up to 65% of cash generated from future operations, beginning in fiscal 2013, to purchase shares of Legg Mason common stock.

During the years ended March 31, 2013 and 2012, Legg Mason purchased and retired 16,199 and 13,597 shares of its common stock, respectively, for $425,475 and $400,266, through open market purchases. The fiscal 2013 purchases completed the repurchase of its common stock under the previous authorization and includes approximately $270,000 of purchases under the new authorization. During fiscal 2011, Legg Mason purchased and retired 14,552 shares of its

common stock for $445,465, through accelerated share repurchase agreements and open market purchases. These repurchases reduced weighted-average shares outstanding by 8,449, 9,716, and 9,088 shares for the years ended March 31, 2013, 2012, and 2011, respectively. The par value of the shares repurchased is charged to common stock, with the excess of the purchase price over par first charged against additional paid-in capital, with the remaining balance, if any, charged against retained earnings.

During the year ended March 31, 2013 and 2012, Legg Mason issued 2,185 and 1,370 shares of restricted stock, respectively, primarily related to its annual incentive awards and retention awards. Of the shares issued in fiscal 2013 and 2012, 1,807 and 1,153 shares, respectively, are included in weighted-average shares outstanding.

In June 2011, Legg Mason issued 1,830 shares of common stock upon the exercise of purchase contracts on the remaining outstanding Equity Units. Of these shares, 1,380 shares are included in weighted-average shares outstanding for the year ended March 31, 2012.

The following table presents the computations of basic and diluted EPS:

	Years ended March 31		
	2013	2012	2011
Weighted-average basic shares outstanding	133,226	143,292	155,321
Potential common shares:			
Employee stock options	—	57	163
Weighted-average diluted shares	133,226	143,349	155,484
Net income (loss)	$(359,748)	$231,031	$245,763
Less: Net income (loss) attributable to noncontrolling interests	(6,421)	10,214	(8,160)
Net income (loss) attributable to Legg Mason, Inc.	$(353,327)	$220,817	$253,923
Net income (loss) per share attributable to Legg Mason, Inc. common shareholders			
Basic	$(2.65)	$1.54	$1.63
Diluted[(1)]	$(2.65)	$1.54	$1.63

(1) Diluted shares are the same as basic shares for periods with a net loss.

The diluted EPS calculation for the year ended March 31, 2013 excludes 5,730 potential common shares that are antidilutive due to the net loss for the fiscal year. Further, the diluted EPS calculation for the years ended March 31, 2013, 2012 and 2011, excludes any potential common shares issuable under the 2.5% Convertible Senior Notes extinguished in May 2012, or the Warrants exchanged for the Note conversion feature, because the market price of Legg Mason common stock had not exceeded the price at which conversion/exercise would be dilutive using the treasury stock method. Also at March 31, 2012 and 2011, warrants issued in connection with the convertible note hedge transactions associated with the issuance of the 2.5% Convertible Senior Notes are excluded from the calculation of diluted earnings per share because the effect would be antidilutive.

Options to purchase 5,239 and 5,204 shares for the fiscal years ended March 31, 2012 and 2011, respectively, were not included in the computation of diluted earnings per share because the presumed proceeds from exercising such options, including related income tax benefits, exceed the average price of the common shares for the period and therefore the options are deemed antidilutive.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income includes cumulative foreign currency translation adjustments and net of tax, gains and losses on investment securities. The change in the accumulated translation adjustments for fiscal 2013 and 2012, primarily resulted from the impact of changes in the Brazilian real, the Japanese yen, the British pound, the Australian dollar, and the Polish zloty in relation to the U.S. dollar on the net assets of Legg Mason's subsidiaries in Brazil, Japan, the United Kingdom, Australia and Poland, for which the real, the yen, the pound, the Australian dollar, and the zloty are the functional currencies, respectively.

A summary of Legg Mason's accumulated other comprehensive income as of March 31, 2013 and 2012, is as follows:

	2013	2012
Foreign currency translation adjustment	$47,259	$71,204
Unrealized gains on investment securities, net of tax provision of $187 and $179, respectively	280	268
Total	$47,539	$71,472

There were no significant amounts reclassified from Accumulated other comprehensive income to the Consolidated Statements of Income (Loss) for the years ended March 31, 2013, 2012 or 2011.

14. DERIVATIVES AND HEDGING
The disclosures below detail Legg Mason's derivatives and hedging activities excluding the derivatives and hedging activities of CIVs. See Note 17, Variable Interest Entities and Consolidation of Investment Vehicles, for information related to the derivatives and hedging of CIVs.

Legg Mason uses currency forwards to economically hedge the risk of movements in exchange rates, primarily between the U.S. dollar, euro, Japanese yen, Singapore dollar, British pound, Chinese yuan, and South Korean won. In the Consolidated Balance Sheets, Legg Mason nets the fair value of certain foreign currency forwards executed with the same counterparty where Legg Mason has both the legal right and intent to settle the contracts on a net basis.

Legg Mason also uses market hedges on certain seed capital investments by entering into futures contracts to sell index funds that benchmark the hedged seed capital investments. Open futures contracts required cash collateral of $7,131 and $1,919 as of March 31, 2013 and 2012, respectively.

The following table presents the fair values as of March 31, 2013 and 2012, of derivative instruments not designated for accounting purposes as hedging instruments, classified as Other assets and Other liabilities:

	2013		2012	
	Assets	Liabilities	Assets	Liabilities
Currency forward contracts	$1,496	$101	$38	$685
Futures contracts				