

LEGG MASON, INC.
Form 10-K
May 30, 2018
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UNITED STATES
SECURITIES AND EXCHANGE
COMMISSION
Washington, D.C.
20549

FORM 10-K

(Mark
One)

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

For the fiscal year ended March 31, 2018
or

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

For the
transition to
period from

Commission File
Number 1-8529

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

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

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

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

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

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

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

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

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

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

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 [X]
this Form 10-K.

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

Large
accelerated [X] Accelerated
filer []

(Do not check if
a smaller
reporting
company)
Non-accelerated
filer [] Smaller
reporting
company []

Emerging
growth []
company

If an emerging growth company, indicate by check mark if
the registrant has elected not to use the extended transition
period for complying with any
new or revised financial accounting
standards provided pursuant to Yes [] No [X]
Section 13(a) of the Exchange Act.

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

As of September 30, 2017 the aggregate market value of
the registrant's voting stock, consisting of the registrant's
common stock, held by
non-affiliates

was
\$3,333,673,465.

As of May 25, 2018, the number of shares outstanding of
the registrant's common stock was 85,459,843.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its
Annual Meeting of Stockholders to be held on July 31,
2018 are incorporated by
reference
into Part III
of this

Report.

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FORWARD-LOOKING STATEMENTS.

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

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

Our future revenues may fluctuate due to numerous factors, such as: the total value and composition of our AUM; the mix of our AUM among our affiliates, asset classes, investment vehicles, client type and geography; the revenue yield of our AUM; the volatility and general level of securities prices and interest rates; the relative investment performance of company-sponsored investment funds and other asset management products both in absolute terms and relative to competing offerings and market indices; investor sentiment and confidence; general political and 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; the impact, extent and timing of technological changes and the adequacy of intellectual property, information and cyber security protection; and the introduction, withdrawal, success and timing of business initiatives, strategies and acquisitions.

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

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.

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PART I

ITEM 1. BUSINESS.

General

Legg Mason is a global asset management firm that operates through nine independent asset management subsidiaries. Acting through our asset management subsidiaries, each of which generally markets its products and services under its own brand name, we provide investment management and related products and 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.

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. Legg Mason is an independent, publicly traded company, with no single majority shareholder and 90% of its Board of Directors consists of independent directors.

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 “About - Investor Relations - Governance - Corporate Governance”. 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 2018” 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, 2018

The asset management industry continues to experience disruption and challenges, including a shift to lower-fee passively managed products, increased fee pressure (including pressure arising from the shift to lower-fee passive products), regulatory changes, an increasing and changing role of technology in asset management services, the constant introduction of new products and services and the consolidation of financial services firms through mergers and acquisition. During fiscal year 2018, our focus on investing to improve lives and expanding client choice continued to drive strong sales, despite the ongoing trend of investor movement to passive strategies in certain portions of the industry.

During the course of this fiscal year, we expanded our investment offerings in response to demand for choice by:

- offering new next generation products such as multi-asset class solutions and new vehicles, including the launch of six new exchange traded funds (“ETFs”);
- completing a bolt-on acquisition adding new capabilities at Clarion Partners;
- commercializing alternative products offered by our most recently acquired asset managers;

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expanding our Alternative Distribution Strategies and Alternative Product teams with strategic hires; and investing in technology to enhance our capabilities and expand choice for global investors.

During fiscal year 2018, we and our asset managers began to identify and pursue new and different ways to collaborate in order to leverage our combined scale and become more effective and efficient at delivering results for our clients and shareholders. We expect these activities to result in savings, much of which we intend to reinvest in our business.

See “Item 8. Financial Statements and Supplementary Data” for the revenues, net income and assets of Legg Mason, which operates in a single reportable business segment. See Note 5 of Notes to Consolidated Financial Statements in Item 8 of this Report for our revenues generated in, and our long-lived assets (consisting primarily of intangible assets and goodwill) located in, each of the principal geographic regions in which we conduct business. See Note 7 of Notes to Consolidated Financial Statements in Item 8 of this Report for our deferred tax assets in the U.S. and in all other countries, in aggregate.

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. Our corporate structure combines our nine asset managers, each with diverse perspectives and specialized expertise across asset classes and strategies, with a centralized global distribution platform focusing on retail distribution and additional distribution capabilities focused on institutional distribution at each of our asset managers. We help investors globally achieve better financial outcomes by expanding choice across investment strategies, vehicles and investor access through independent investment managers with diverse expertise in equity, fixed income, alternative and liquidity investments. Operating from asset management offices located in the United States, the United Kingdom and a number of other countries worldwide, we deliver our investment capabilities through varied products and vehicles and via multiple points of access, including directly and through various financial intermediaries. Our investment advisory services include discretionary and non-discretionary management of separate investment accounts in numerous investment styles for institutional and individual investors. Our investment products include proprietary mutual funds ranging from money market and other liquidity products to fixed income, equity and alternative funds managed in a wide variety of investment styles. We also offer other domestic and offshore funds to both retail and institutional investors, privately placed real estate funds and funds-of-hedge funds.

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

We earn performance fees under certain investment advisory contracts for exceeding performance benchmarks or hurdle rates. The largest portion of our performance fees is earned based on 12-month performance periods that end in differing quarters during the year, with a portion based on quarterly performance periods. We also earn performance fees on alternative products that are earned at the end of varying investment periods or in multiple-year intervals. For the fiscal years ended March 31, 2018, 2017 and 2016, of our \$3.1 billion, \$2.9 billion and \$2.7 billion in total revenues, \$227.8 million, \$108.3 million and \$42.0 million, respectively represented performance fees. During the

fiscal years ended March 31, 2018 and 2017, \$108.8 million and \$60.8 million, respectively, of these performance fees were earned by Clarion Partners on assets invested with them prior to the closing of our acquisition of Clarion Partners in April 2016 and are passed through as compensation to Clarion Partners' management team pursuant to the terms of the Clarion Partners acquisition agreement. Exclusive of the performance fees passed through as compensation to Clarion Partners' management team, as of March 31, 2018, approximately 7% of our total long-term AUM was in accounts that were eligible to pay performance fees.

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

	Assets Under Management	Equity Assets	% of Total in Equity Assets	Fixed Income Assets	% of Total in Fixed Income Assets	Alternative Assets	% of Total in Alternative Assets	Liquidity Assets	% of Total in Liquidity Assets
2018	\$ 754.1	\$203.0	27 %	\$422.3	56 %	\$ 66.1	9 %	\$ 62.7	8 %
2017	728.4	179.8	25	394.3	54 %	67.9	9	86.4	12
2016	669.6	162.3	24	372.3	56	22.7	3	112.3	17

From time to time, our reported equity, fixed income or alternative assets under management may exclude assets that we are retained to manage on a short-term or temporary basis. Beginning in fiscal year 2017, we began reporting Alternative Assets as part of our AUM classifications. We currently define Alternative Assets as all AUM managed by Clarion Partners, EnTrustPermal, RARE Infrastructure or a small private equity business prior to its sale on March 31, 2017. All prior periods have been revised to present Alternative Assets.

We believe that market conditions and our investment performance are critical elements in our attempts to grow our AUM and business. When securities or real estate markets are increasing, our AUM will tend to increase because of market performance, resulting in additional asset management revenues. Similarly, if we can produce positive investment results and maintain competitive fee levels, our AUM will tend to increase. 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 or real estate markets are weak or declining, or when we have not maintained competitive fee levels or have produced poor investment performance, absolute or relative to benchmarks or peers, it is likely to be more difficult to grow our AUM and business and, in such periods, our AUM and business may decline.

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

We conduct the majority of our business through our asset managers. Our asset managers are individual businesses, each of which generally focuses on a portion of the asset management industry in terms of the types of assets managed (primarily alternatives, 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. As of March 31, 2018, we directly or indirectly owned all of the voting equity of Brandywine Global Investment Management, ClearBridge Investments, Martin Currie, QS Investors and Western Asset Management Company. Clarion Partners is 18% owned by its management team, EnTrustPermal is 35% owned by its chief executive officer, Royce is 19% owned by its management team, and RARE Infrastructure is 15% owned by its management team and 10% owned by a third party. In addition, the management teams at Clarion Partners and ClearBridge Investments each owns non-voting equity interests in the business which provide them with

participation in any increase in the value of the business (subject to appropriate valuation discounts).

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

Asset Managers

Our asset managers provide a wide range of investment advisory services to separately managed account clients, including institutional clients such as pension and other retirement plans, corporations, insurance companies, endowments and foundations and governments, as well as retail clients such as high net worth individuals and families, and retail separately managed account programs. In addition, our asset managers also manage or sub-advise various groups of proprietary and non-proprietary U.S. mutual funds and exchange-traded funds ("ETFs") registered under the Investment Company Act of 1940, as amended, including equity, fixed income, liquidity and balanced funds. Certain of our asset managers also manage or sub-advise numerous international mutual funds that are domiciled and distributed in countries around the globe.

Western Asset Management Company is a leading global fixed income asset manager for institutional clients. Headquartered in Pasadena, California, Western Asset Management's operations include investment operations in New York City, the United Kingdom, Japan, Brazil, Australia and Singapore. Western Asset Management offers a broad range of products spanning the yield curve and encompassing the world's major bond markets, including a suite of limited duration and core products, emerging market and high yield portfolios, municipal portfolios and a variety of sector-oriented and global products. Western Asset Management also sub-advises U.S. mutual funds that are sponsored by third parties. Among the services Western Asset Management provides are management of separate accounts and U.S. mutual funds, one real estate investment trust, closed-end funds, international funds and other structured investment products. As of March 31, 2018, Western Asset Management managed assets with a value of \$ 426.0 billion.

ClearBridge Investments is an equity asset management firm based in New York City that also has offices in Baltimore, Maryland and Wilmington, Delaware. ClearBridge Investments provides asset management services to certain of the equity funds (including balanced funds and closed-end funds) in the Legg Mason Funds, to retail separately managed account programs, to certain of our international funds and, primarily through separate accounts, to institutional clients. ClearBridge Investments also sub-advises U.S. mutual funds that are sponsored by third parties. ClearBridge Investments offers a diverse array of investment styles and disciplines, designed to address a range of investment objectives. Significant ClearBridge Investments investment styles include low volatility, high active shares

and income solutions. In managing assets, ClearBridge Investments generally utilizes a bottoms-up, research intensive, fundamental approach to security selection that seeks to identify companies with the potential to provide solid economic returns relative to their risk-adjusted valuations. As of March 31, 2018, ClearBridge Investments managed assets with a value of \$135.0 billion.

Brandywine Global Investment Management is a global asset management firm headquartered in Philadelphia, Pennsylvania with offices also in the United Kingdom, Canada and Singapore. Brandywine Global Investment Management provides investment advisory services primarily to separately managed accounts for institutional clients in a range of fixed income, including global and international fixed income, and equity investment strategies. Brandywine Global Investment Management also provides investment advisory services to high net worth clients through separately managed account

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programs, including various non-proprietary wrap accounts sponsored by third parties, and also sub-advises U.S. mutual funds that are sponsored by third parties. In addition, Brandywine Global Investment Management manages certain of our proprietary U.S. mutual funds and a number of our international funds. Brandywine Global Investment Management pursues a value investing approach in its management of both equity and fixed income assets. As of March 31, 2018, Brandywine Global Investment Management managed assets with a value of \$76.3 billion.

Clarion Partners is a leading manager of real estate investment funds. Headquartered in New York, the firm has offices in Atlanta, Boston, Dallas, London, Los Angeles, São Paulo, Seattle and Washington, DC and offers a broad range of real estate strategies across the risk/return spectrum to institutional investors. Clarion Partners offers its services through institutional separate accounts and privately placed open-end funds. As of March 31, 2018, Clarion Partners managed assets with a value of \$45.6 billion.

Martin Currie is an international equity specialist headquartered in Edinburgh, Scotland with additional offices in London, England and Melbourne, Australia. It manages active U.S. and international equity portfolios for a global client base of financial institutions, charities, foundations, endowments, pension funds, family offices, government agencies and investment funds. As of March 31, 2018, Martin Currie managed approximately \$18.5 billion in AUM.

Royce is the investment advisor to all of The Royce Funds, a proprietary range of equity U.S. mutual funds and to certain of our international funds. In addition, Royce manages other pooled and separately managed accounts, primarily for institutional clients. Headquartered in New York City, Royce generally invests in smaller company stocks, using a value approach. Royce's stock selection process generally seeks to identify companies with strong balance sheets and the ability to generate free cash flow. Royce pursues securities that are priced below its estimate of the issuer's current worth. As of March 31, 2018, Royce managed assets with a value of \$16.6 billion.

EnTrustPermal is a leading global alternative asset manager specializing in providing investment solutions to public, corporate and multi-employer pension funds, foundations, endowments, sovereign wealth funds, insurance companies, private banks, family offices and high net worth individuals. EnTrustPermal has investment teams located in London, New York City and Paris and additional offices in Dubai, Hong Kong, Singapore and Nassau. As of March 31, 2018, EnTrustPermal managed assets with a value of \$ 16.3 billion.

QS Investors is a customized solutions and global quantitative equities investment firm providing asset management and advisory services to a diverse array of institutional clients. Headquartered in New York City, QS Investors has developed approaches to integrating quantitative and behavioral investment insights and dynamically weighting opportunities in response to changing conditions in the economy and the market. QS Investors offers a broad spectrum of strategies which includes actively managed U.S. and Global equities, Liquid Alternatives, and Customized Solutions. As of March 31, 2018, QS Investors managed approximately \$13.9 billion of AUM.

RARE Infrastructure is a global listed infrastructure investing specialist that manages domestic and international funds in three distinct strategies; RARE Infrastructure Value (a global strategy with a mix between income and capital returns), RARE Emerging Market (purely focused on emerging markets infrastructure) and RARE Infrastructure Income (a global strategy with a focus on distributing yield). Legg Mason holds a 75% ownership interest in the firm, the firm's management team holds a 15% equity stake and a third-party owner holds 10%. Headquartered in Sydney, Australia, RARE Infrastructure had approximately \$4.2 billion in AUM as of March 31, 2018.

United States Funds

Mutual Funds

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

The Legg Mason Funds consist of 110 mutual funds and 28 closed-end funds in the United States, which are managed or sub-advised by Brandywine Global Investment Management, ClearBridge Investments, EnTrustPermal, Martin Currie, RARE Infrastructure, QS Investors and Western Asset Management. The mutual funds and closed-end funds within

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the Legg Mason Funds include 52 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 the closed-end funds within the Legg Mason Funds include 58 funds that offer a wide variety of investment strategies and objectives, including income funds, investment grade funds and municipal securities funds. As of March 31, 2018 and 2017, the Legg Mason Funds included \$149.1 billion and \$147.1 billion in assets, respectively, in their mutual funds and closed-end funds, of which approximately 38% and 37%, respectively, were equity assets, approximately 45% and 40%, respectively, were fixed income assets, and approximately 17% and 23%, respectively, were liquidity assets. As of both March 31, 2018 and 2017, less than 1% of the assets in the Legg Mason funds were alternative assets.

The Royce Funds consist of 17 mutual funds and three closed-end funds, most of which invest primarily in smaller-cap company or micro-cap company stocks using a value approach. The funds differ in their approach to investing in smaller companies and the universe of securities from which they can select. As of March 31, 2018 and 2017, the Royce Funds included \$13.8 billion and \$15.4 billion in assets, respectively, substantially all of which were equity assets. The Royce Funds are distributed through non-affiliated fund supermarkets, Legg Mason Global Distribution, non-affiliated wrap programs, and direct distribution. In addition, two of the portfolios in the Royce Funds are distributed only through insurance companies.

Exchange Traded Funds

The Legg Mason ETFs invest in a wide range of domestic and international equity securities. As of March 31, 2018, Legg Mason's ETF lineup consisted of 13 ETFs with an aggregate AUM of approximately \$815 million. Our ETFs are managed by ClearBridge Investments, Martin Currie, QS Investors, RARE Infrastructure, Royce and Western Asset Management. In fiscal 2019, Legg Mason expects to add to its ETF lineup managed by these and other affiliated asset managers. This lineup will include ETFs utilizing both passive and active management to invest in a wide spectrum of equity securities utilizing numerous investment styles, including broad fixed income and equity exposure, factor, sector exposure, fixed income and traditional security selection.

Private Funds

In addition to our U.S. mutual funds and ETFs, our asset managers sponsor and manage various unregistered, or "private" funds that are made available to qualified U.S. or non-U.S. investors, depending upon the product. Private funds are pooled investment vehicles that are exempt from local regulation and that are typically offered to sophisticated, high net worth investors, corporations, sovereign wealth funds, public pension plans and other pooled investment vehicles. Clarion Partners offers a broad range of privately placed funds invested primarily in equity and debt instruments of five major real estate property types. EnTrustPermal sponsors and manages a number of U.S. and non-U.S.-organized private funds that offer a wide range of alternative strategies. Brandywine Global Investment Management, ClearBridge Investments, Martin Currie, QS Investors, RARE Infrastructure and Western Asset also sponsor and manage a wide range of private fund offerings for qualifying U.S. and non-U.S. investors.

International Funds

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

Investment Management, ClearBridge Investments, EnTrustPermal, QS Investors, Martin Currie, RARE Infrastructure, Royce and Western Asset Management. In the aggregate, we sponsored and managed 202 and 201 of these international funds, respectively at March 31, 2018 and 2017, which at those dates had an aggregate of approximately \$86.8 and \$95.0 billion in assets, respectively, of which approximately 24% and 22%, respectively, were equity assets, approximately 36% and 25%, respectively were fixed income assets, approximately 4% and 3%, respectively, were alternative assets and approximately 36% and 50%, respectively, were liquidity assets. The information above does not include the funds-of-hedge funds sponsored and managed by EnTrustPermal, the Brazil-domiciled funds managed by Western Asset Management or the privately placed real estate

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funds offered by Clarion Partners.

Retail Separately Managed Account Programs

We are a leading provider of asset management services to retail separately managed account programs, commonly known as managed account or wrap programs. These programs typically allow securities brokers or other financial intermediaries to offer their clients the opportunity to choose from a number of asset management services pursuing different investment strategies provided by one or more asset managers, and generally charge an all-inclusive fee that covers asset management, trade execution, asset allocation and custodial and administrative services. We provide investment management services through more than 140 retail separately managed account programs sponsored by various financial institutions.

Distribution

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

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

U.S. Distribution

The U.S. Distribution Group of Legg Mason Global Distribution employs a team of U.S. based sales, marketing and support staff that market, distribute and support our U.S. mutual funds, including the Legg Mason Funds, the Royce Funds, the Clarion Funds and the Legg Mason ETFs. We distribute the Legg Mason Funds directly and through a number of third-party distributors.

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

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

International Distribution

The International Distribution Group of Legg Mason Global Distribution employs a team of sales, marketing and support staff that markets, distributes and supports our international funds to individual and institutional investors across Asia (including Australia and Japan), Europe and the Americas. The International Distribution Group has sales

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

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services into their local markets.

Our distribution efforts are not limited to the locations where we have offices, as the International Distribution Group distributes cross border funds in more than 25 countries around the world. This global presence provides Legg Mason 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 regions that it covers. Client coverage is local, coordinated across regions, and encompasses multiple distribution channels including broker-dealers, funds-of-funds, asset managers, independent financial advisers, banks, fund platforms, insurance companies and other distribution partners. The extent to which each channel takes precedence in any one market is governed by local market dynamics.

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

EnTrustPermal'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 EnTrustPermal's distribution operations as well as through our International Distribution Group. In addition, EnTrustPermal distributes its products and services to U.S. and international institutions through EnTrustPermal's internal distribution teams.

Employees

At March 31, 2018, 2017 and 2016, we had 3,275, 3,338 and 3,066 employees, respectively. None of our employees are covered by a collective bargaining agreement. We consider our relations with our employees to be satisfactory. However, competition for experienced asset management personnel is intense and from time to time we may experience a loss of valuable personnel. We recognize the importance to our business of hiring, training and retaining skilled professionals.

Competition

We are engaged in an extremely competitive business and are subject to substantial competition in all aspects of our business. Our competition includes, with respect to one or more aspects of our business, numerous international and domestic asset management firms and broker-dealers, mutual fund complexes, hedge funds, commercial banks, insurance companies, other investment companies and other financial institutions. Many of these organizations offer products and services that are similar to, or compete with, those we offer, and many of these organizations have substantially more personnel and greater financial resources than we have. Some of these competitors have proprietary products and distribution channels that make it more difficult for us to compete with them. In addition, many of our competitors have long-standing and established relationships with distributors and clients. The principal competitive factors relating to our business are the quality of advice and services provided to investors, the performance records of that advice and service, the reputation of 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 is subject to extensive federal, state and international laws and regulations promulgated by various governments, securities exchanges, central banks and regulatory bodies that are intended to benefit and protect investors in products. In addition, our distribution activities also may be subject to regulation by international and U.S. federal agencies, self-regulatory organizations and securities commissions in those jurisdictions in which we conduct business. Due to the extensive laws and regulations to which we are subject, we must devote substantial time, expense and effort to remaining vigilant about, and addressing, legal and regulatory compliance matters. Moreover, regulatory changes in one jurisdiction often affect our business operations in other jurisdictions.

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

Regulatory Reform

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

U.S. Executive Order

On February 3, 2017, a U.S. presidential executive order (the “Executive Order”) articulated certain core principles for regulating the U.S. financial system and directed the Secretary of the U.S. Department of the Treasury (the “U.S. Treasury”) to report to the President the extent to which existing laws, treaties, rules, regulations and policies promote, support or inhibit the federal regulation of the U.S. financial system in a manner consistent with the core principles. The Treasury has issued three (of an expected four) reports in response to the Executive Order (the “Treasury Reports”), which include a number of recommendations, the majority of which require further legislative or regulatory action in order to be implemented, that may affect our business or operations. The scope and potential impact of any regulatory changes resulting from the Executive Order and the Treasury Reports are unclear and we will continue to monitor the potential impact of the Executive Order on our business.

Dodd-Frank Wall Street Reform and Consumer Protection Act

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was signed into law in the United States. The Dodd-Frank Act requires the adoption of extensive regulations and numerous regulatory decisions, many of which have been adopted and others of which will be forthcoming. We have implemented programs to address certain regulations adopted under Dodd-Frank, as well as financial reforms that have been introduced as part of the SEC’s investment company modernization initiatives. As certain limited aspects of Dodd-Frank and other rules are still being adopted, and the impact of the rules already adopted will become evident over time, it is not yet possible to predict the ultimate effects that the Dodd-Frank Act or subsequent implementing regulations and decisions will have on us.

Systemically Important Financial Institution (“SIFI”) Review

The Financial Stability Oversight Council (“FSOC”) has the authority to designate nonbank financial institutions as SIFIs. FSOC’s most recent statements generally indicate that it is focused on products and activities, rather than designation of entities, in its review of asset managers. The Treasury report on asset management, issued in October

2017, also expressed this view. In addition, in November 2017, Treasury made recommendations concerning the process by which FSOC designates nonbanks as SIFIs, further supporting a products and activities approach to addressing risks in asset management. If we are designated as a SIFI, we could become subject to direct supervision by the Federal Reserve System.

Both the Financial Stability Board (“FSB”), working with the International Organization of Securities Commissions (“IOSCO”), and FSOC, are considering potential systemic risk related to asset management and are currently focused on a products and activities approach in their review of asset managers. In January 2017, the FSB announced its Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities, which concentrates primarily

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on products and activities and includes 14 recommendations largely focused on liquidity in open-end funds, leverage in funds, operational risk, and securities lending, certain of which IOSCO is expected to engage on in the future. The FSB has indicated that it may develop criteria for designation of nonbank non-insurers in the future to address “residual risks”. Any measures applied in relation to a global systemically important financial institution (“G-SIFI”) designation from the FSB would need to be implemented through existing regulatory processes and procedures by relevant national authorities.

If we or any other asset manager were designated a SIFI or G-SIFI, we could become subject to enhanced prudential, capital, supervisory and other requirements, such as risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, concentration limits, a contingent capital requirement, enhanced public disclosures, short-term debt limits and overall risk management requirements. Requirements such as these, which were designed to regulate banking institutions, would likely need to be modified to be applicable to an asset manager. No proposals have been made indicating how such measures would be adapted for asset managers.

Securities and Exchange Commission Review of Asset Managers and Mutual Funds

Our business may also be impacted by additional regulatory initiatives by the SEC. In October 2016, the SEC adopted new rules (as well as amendments to existing rules) to modernize the reporting and disclosure of information by registered investment companies, including (i) new monthly and annual reporting requirements for certain U.S. registered funds; (ii) enhanced reporting regimes for investment advisers; and (iii) implementing liquidity risk management programs for ETFs and open-end funds, other than money market funds. In February 2018 the SEC extended the compliance deadlines for certain provisions of the rules, although the original December 1, 2018 deadline for other provisions still applies. The rules will increase our public reporting and disclosure requirements, which could be costly. Any additional SEC oversight relating to the above, or the introduction of any new reporting, disclosure or control requirements could expose us to additional compliance costs and may require us to change how we operate our business.

Regulation of Exchange-Traded Funds

As part of a focus on financial stability issues and due to the significant growth of this product class over the last few years, regulators globally are examining the potential risks in ETFs, including risks related to transparency, liquidity and structural resiliency. There can be no assurance that structural or regulatory reforms, including potential rulemaking by the SEC, will be implemented in a manner favorable to us, or at all. Depending on the outcome of this renewed regulatory analysis, or any associated structural reforms, ETF products may become subject to increased regulatory scrutiny or restrictions, which may require us to incur additional compliance and reporting expenses and adversely affect our business.

Regulation of Swaps and Derivatives

The SEC, the Internal Revenue Service (“IRS”) and the Commodity Futures Trading Commission (“CFTC”) each continue to review the use of futures, swaps and other derivatives. Such reviews could result in regulations that further limit the use of such products by mutual funds. If adopted, these limitations could require us to change certain mutual fund business practices or to register additional entities with the CFTC, which could result in additional costs and/or restrictions. In December 2015, the SEC proposed a new rule governing the use of derivatives and other financial commitment transactions by investment companies that, if enacted, would represent a fundamental change in the nature of the SEC's regulations governing the use of derivatives and other financial commitment transactions by investment companies. While not on the SEC's current agenda for finalization, this proposal has the potential to require us to change or restrict certain investment strategies or practices and incur additional costs.

We also report certain information about several of our private funds to the SEC and certain information to the CFTC, under systemic risk reporting requirements adopted by both agencies. These reporting obligations have required, and will continue to require, investments in people and systems to assure timely and accurate reporting. The rules and regulations applicable to offshore funds, accounts and counterparties will require us to build and implement new compliance monitoring procedures to address the enhanced level of oversight to which we will be subject. These rule changes also introduce new requirements for centrally clearing certain swap, and eventually security-based swap, transactions and for executing certain swap, and eventually security-based swap, transactions on or through CFTC or SEC-registered trading venues. Jurisdictions outside the United States in which we operate also have adopted and implemented, or are in the process of considering, adopting or implementing more pervasive regulation of many elements of the financial services industry, which could further impact us and the broader markets. This includes the implementation of mandated central clearing of

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swaps in the European Union (“EU”) and the implementation of trade reporting, documentation, central clearing and other requirements in various jurisdictions globally.

SEC’s Proposals to Enhance Protections for Retail Investors

In April 2018, the SEC issued several proposals designed to enhance protections for retail investors in their relationships with financial professionals, including broker-dealers and investment advisers, with respect to both retirement and non-retirement accounts. The issuance of the SEC’s proposals followed a decision handed down in March 2018 by the U.S. Fifth Circuit Court of Appeals invalidating the U.S. Department of Labor’s “fiduciary rule” and related prohibited transaction class exemptions that had taken effect in June 2017. The most significant of the SEC’s proposals is a proposed “best interest” standard of conduct for broker-dealers and their representatives that would enhance the current “suitability” standard to which broker-dealers are subject by imposing an explicit care obligation and additional disclosure and conflict of interest mitigation or elimination requirements on broker-dealers that make securities recommendations to retail investors. The SEC’s proposed “best interest” standard contains certain elements that are comparable to some of the core principles that were reflected in the Department of Labor’s fiduciary rule and related exemptions. In addition to the proposed “best interest” standard for broker-dealers, the SEC has proposed an “interpretation” highlighting the fiduciary duties owed to clients by financial professionals who serve in an investment advisory capacity with respect to client accounts. We and our asset managers may be adversely impacted by the SEC’s regulatory initiatives in the retail investment space to the extent that they lead to changes in investment preferences on the part of financial intermediaries and investors and increased pressure on product fees and expenses.

Alternative Investment Fund Managers Directive

Our European business is impacted by the EU Alternative Investment Fund Managers Directive (“AIFMD”), which became effective on July 21, 2011. The AIFMD regulates managers of, and service providers to, a broad range of alternative investment funds (“AIFs”) domiciled within and (depending on the precise circumstances) outside the EU. The AIFMD also regulates the marketing of all AIFs inside the European Economic Area (“EEA”). The AIFMD is being implemented in stages, which run through 2018. Compliance with the AIFMD’s requirements restrict alternative investment fund marketing and impose additional compliance and disclosure obligations regarding remuneration, capital requirements, leverage, valuation, stakes in EU companies, depositaries, the domicile of custodians and liquidity management on us. We have incurred, and expect to continue to incur, additional expenses related to satisfying these new compliance and disclosure obligations and the associated risk management and reporting requirements.

MiFID II

We are subject to numerous regulatory reform initiatives in Europe. The United Kingdom and other European jurisdictions in which we operate have implemented through national legislation the Markets in Financial Instruments Directive (“MiFID”), which focused primarily on equities, to encourage trading across all asset classes to migrate onto open and transparent markets. MiFID II, which came into effect in January 2018, builds upon many of the initiatives introduced through MiFID. MiFID II has significant and wide-ranging impacts on EU securities and derivatives markets, including (i) enhanced investor protection and governance standards, (ii) prescriptive rules regarding the ability of asset management firms to receive and pay for investment research relating to all asset classes, (iii) rules on the identification and monitoring of target markets for MiFID financial instruments by MiFID investment firms who manufacture and/or distribute such instruments, (iv) enhanced regulation of algorithmic trading, (v) the movement of trading in certain shares and derivatives on to regulated execution venues, (vi) the extension of pre- and post-trade transparency requirements to wider categories of financial instruments, (vii) restrictions on the use of so-called dark pool trading, (viii) the creation of a new type of trading venue called the Organized Trading Facility for non-equity financial instruments, (ix) new commodity derivative position limits and reporting requirements, (x) a move away

from vertical silos in execution, clearing and settlement, (xi) an enhanced role for the European Securities and Markets Authority (“ESMA”) in supervising EU securities and derivatives markets and (xii) new requirements regarding non-EU investment firms’ access to EU financial market.

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The United Kingdom has implemented rules regarding retail distribution review (the “RDR”) aimed at enhancing consumer protections, overhauling mutual fund fee structures and increasing professionalism in the retail investment sector. In order to achieve this, RDR requires advisory firms to explicitly disclose and separately charge clients for their services and clearly describe their services as either independent or restricted. It also requires individual advisers to adhere to consistent professional standards, including a code of ethics. Similarly, MiFID II contains a ban on certain advisers recovering commissions and other nonmonetary benefits from fund managers. These rules, if implemented, may lead to changes to the fees and commissions we are able to charge to our clients, as well as to our client servicing and distribution models.

Undertakings for Collective Investment in Transferable Securities

The EU has adopted directives on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (“UCITS”) with respect to depositary functions, remuneration policies and sanctions. UCITS V, which came into effect in March 2016 with further measures implemented in October 2016, seeks to align the depositary regime, remuneration rules and sanctioning powers of regulators under UCITS with the requirements of the AIFMD. In addition, ESMA guidelines include rules relating to collateral management requirements for UCITS funds concerning collateral received in the context of derivatives using Efficient Portfolio Management (“EPM”) techniques (including securities lending) and over-the-counter derivative transactions. These rules required us to make a series of changes to collateral management arrangements applicable to the EPM of UCITS fund ranges and cause us to incur additional expenses associated with risk management and reporting requirements.

Revised EU Capital Requirements

EU regulators are considering how to design an appropriate capital regime for non-systemically important investment firms as the current regime is based upon banking requirements and has not been materially modified for asset managers. In December 2017, the European Commission published a legislative proposal addressed to the European Parliament and Council for a new Directive and new Regulation on prudential requirements for MiFID investment firms. The new legislative package is currently expected to come into effect in 2020 following agreement between the European Council and Parliament. Once implemented, any new requirements could result in significant changes to the methodology used to determine the amount of regulatory capital that we are required to hold in the EU.

Revised Retail Consumer Disclosure Requirements

EU legislators have introduced a new “Key Information Document” (“KID”), which is applicable where a retail consumer is sold Packaged Retail and Insurance-based Investment Products (“PRIIPs”) and which came into effect in January 2018. The KID must include specific information on costs, risks and performance. We are required to produce a KID for each fund in scope, as well as to make information available to distribution partners who sell these funds in the EU.

British Exit from the European Union

The United Kingdom (“U.K.”) held a referendum in June 2016 in which voters approved an exit from the EU (“Brexit”), which resulted in significant volatility in several international markets. On March 29, 2017, the U.K. delivered notice under Article 50 of the Lisbon Treaty of its intent to leave the EU, beginning a two-year negotiation period for the U.K. and the 27 remaining members of the EU to reach agreement on the terms of the exit. On March 23, 2018, the UK and the EU leaders endorsed a 21-month transition period beginning on March 29, 2019 and ending on December 31, 2020 and adopted negotiating guidelines on the future EU-UK relationship. In general terms, this would preserve the current passporting regime within the EEA for UK fund and asset managers (such as Legg Mason) and products

(such as UCITS funds) for a transitional period. However, the terms of this transitional arrangement will not become legally binding unless by March 29, 2019, a formal withdrawal agreement between the UK and the EEA has been negotiated in full and agreed, ratified by the European Parliament and the European Council; and ratified by the UK (which is likely to require an Act of Parliament).

While the U.K. and the EU have agreed in principle to the terms of the transition period, the outcome of the negotiations between the U.K. and the EU and the long-term consequences of the resulting negotiations are uncertain. As a result of Brexit, we may incur additional costs due to having to locate more activities within the EU. There could also be changes to UK and EU immigration policies as a result of Brexit, which could lead to restrictions on the free movement

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of investment and support staff between the UK and the EU. We will continue to monitor the potential impact of Brexit on our business operations and financial condition.

Existing U.S. Regulation

The SEC is the federal agency charged with administration of the federal securities laws. Our U.S. asset managers are registered as investment advisers with the SEC, as are several of our international asset managers, and are also required to make notice filings in certain states. We and certain of our affiliates are also currently subject to regulation by the SEC, the Department of Labor (the “DOL”), the Federal Reserve, the Financial Industry Regulatory Authority (“FINRA”), the National Futures Association (“NFA”), the CFTC and other government agencies and regulatory bodies. Certain of our affiliates are also subject to various anti-terrorist financing, privacy, anti-money laundering regulations and economic sanctions laws and regulations established by various agencies.

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

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

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

In addition, our asset managers also may be subject to the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), and related regulations, particularly insofar as they act as a “fiduciary” or “investment manager” under ERISA with respect to benefit plan clients. ERISA imposes duties on persons who are fiduciaries of ERISA plan clients, and ERISA and related provisions of the Internal Revenue Code prohibit certain transactions involving the assets of ERISA plan and Individual Retirement Account (“IRA”) clients and certain transactions by the fiduciaries (and several other related parties) to such clients. In April 2016, the Department of Labor, which administers ERISA, issued a final fiduciary rule expanding the circumstances in which advice furnished to retirement investors will be treated as fiduciary in nature as well as related prohibited transaction class exemptions. The substantive provisions of

the rule began to apply in June 2017. However, the applicability date of many conditions of the prohibited transaction exemptions accompanying the rule has been delayed until July 2019, while the DOL continues its re-examination of the rule and the prohibited transaction exemptions. The fiduciary rule and exemptions are focused on financial intermediaries who provide advice to institutional and retail retirement plan clients, including the third-party distributors who market and sell Legg Mason Funds and separately managed account program services, and mandate increased disclosure of financial intermediary compensation and mitigation of conflicts of interest. We and our asset managers may be adversely impacted by the fiduciary rule and exemptions to the extent that they lead to changes in financial intermediary and retirement plan investment preferences and increased pressure on product fees and expenses.

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In October 2016, the SEC adopted a new rule (and amendments to existing rules) designed to promote effective liquidity risk management throughout the open-end fund industry, thereby reducing the risk that funds will be unable to meet redemption obligations and mitigating dilution of the interests of fund shareholders. The amendments also seek to enhance disclosure regarding fund liquidity and redemption practices. New rule 22e-4 will require each registered open-end fund, including open-end ETFs (but not including money market funds), to establish a liquidity risk management program. The Commission also adopted amendments to existing rule 22c-1 to permit a fund, under certain circumstances, to use “swing pricing,” the process of adjusting the NAV of a fund’s shares to effectively pass on the costs stemming from shareholder purchase or redemption activity to the shareholders associated with that activity. The funds are required to comply with rule 22e-4 beginning on December 1, 2018. The SEC delayed the effective date of the amendments that will permit funds to use swing pricing until November 2018 to provide funds, intermediaries and service providers time to work through operational issues. The potential impact of the new and amended rules on the funds and/or our business is unclear.

Existing International Regulation

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

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

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

The EU has adopted directives on the coordination of laws, regulations and administrative provisions relating to undertakings for UCITS with respect to depositary functions, remuneration policies and sanctions. UCITS are capable

of being freely marketed throughout the EU with a single authorization in a member state - so-called passporting. UCITS V covers a range of matters relating to UCITS including the fund structure and domicile of UCITS, service providers to UCITS and marketing arrangements, and seeks to align the depositary regime, remuneration rules and sanctioning powers of regulators under UCITS with the requirements of the AIFMD. In addition, ESMA guidelines include rules relating to collateral management requirements for UCITS funds concerning collateral received in the context of derivatives using Efficient Portfolio Management (“EPM”) techniques (including securities lending) and over-the-counter derivative transactions. These rules required us to make a series of changes to collateral management arrangements applicable to the EPM of UCITS fund ranges and cause us to incur additional expenses associated with risk management and reporting requirements.

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Certain of our affiliates are subject to an EU regulation on OTC derivatives, central counterparties and trade repositories, which was adopted in August 2012 and which requires (i) the central clearing of standardized OTC derivatives,

(ii) the application of risk-mitigation techniques to non-centrally cleared OTC derivatives and (iii) the reporting of all derivative contracts from February 2014.

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

Net Capital Requirements

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

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ITEM 1A. RISK FACTORS.

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

Risks Related to our Asset Management Business

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

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

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

If our revenues decline without a commensurate reduction in our expenses, our net income will be reduced. From time to time, several of our asset managers have generated poor investment performance, on a relative basis or an absolute basis, in certain products or accounts that they managed, which contributed to a significant reduction in their AUM and revenues and a reduction in performance fees, and some of our asset managers currently face these issues. We face periodic performance issues with certain of our products, and there is typically a lag before improvements in investment performance produce a positive effect on asset flows. In addition, recently the asset management industry has experienced a weakening in the correlation between strong investment performance and increased asset flows. There can be no assurances as to when, or if, investment performance issues will cease to negatively influence our AUM and revenues.

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

Our investment advisory and administrative contracts are generally terminable at will or upon relatively short notice, and investors in the mutual funds that we manage may redeem their investments in the funds at any time without prior notice. Institutional and individual clients can terminate their relationships with us, reduce the aggregate amount of AUM, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, changes in investment preferences of clients, changes in our reputation in the marketplace, changes in management or control of clients or third-party distributors with whom we have relationships, loss of key investment management or other personnel and financial market performance. In addition, there has been a trend of investors shifting to alternative, passive, and smart beta strategies. As a result, core equities and fixed income portfolios are declining as a share of global AUM. In addition, in a declining securities market, the pace of mutual fund redemptions and withdrawal of assets from other accounts could accelerate. Poor investment performance generally or relative to other investment management firms tends to result in decreased purchases of fund shares, increased redemptions of fund shares, and the loss of institutional or individual accounts.

We have experienced net outflows of equity AUM for the last 13 fiscal years due in part to investment performance issues. During fiscal years 2018 and 2017, we had \$22.6 billion and \$28.9 billion of net client outflows, respectively, primarily in liquidity assets in both years.

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 many segments of the asset management industry and there is fee pressure in many portions of the active equity and fixed income industry, driven in part by inflows into low-fee passive asset management products. In addition, in the ordinary course of our business, we

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

Our AUM can generate very different revenues per dollar of managed assets based on factors such as the type of asset managed (alternative assets and equity assets generally produce greater revenues than fixed income assets), the type of client (institutional clients generally pay lower fees than other clients), the type of asset management product or service provided and the fee schedule of the asset manager providing the service. A shift in the mix of our AUM from higher revenue- generating assets to lower revenue-generating assets may result in a decrease in our revenues even if our aggregate level of AUM remains unchanged or increases. A decrease in our revenues, without a commensurate reduction in expenses, will reduce our net income.

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

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

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

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

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

There are often substantial fluctuations in price levels in the securities markets. These fluctuations can occur on a daily basis and over longer periods as a result of a variety of factors, including national and international economic and

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political events, broad trends in business and finance, and interest rate movements. Reduced securities market prices generally may result in reduced revenues from lower levels of AUM and loss or reduction in advisory, incentive and performance fees. Periods of reduced market prices may adversely affect our profitability because fixed costs remain relatively unchanged. Because we operate in one industry, the business cycles of our asset managers may occur contemporaneously. Consequently, the effect of an economic downturn may have a magnified negative effect on our business.

In addition, as of March 31, 2018, a substantial portion of our invested assets consisted of securities and other seed capital investments. A decline in the value of alternatives, equity or fixed income 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 may adversely affect the net asset values of our AUM. In addition, in a rising interest rate environment, institutional investors may shift liquidity assets that we manage in pooled investment vehicles to direct investments in the types of assets in which the pooled vehicles invest in order to realize higher yields than those available in money market and other products or strategies holding lower-yielding instruments. Furthermore, increases in interest rates may result in reduced prices in equity markets. Conversely, decreases in interest rates could lead to outflows in fixed income or liquidity assets that we manage as investors seek higher yields. Any of these effects could lower our AUM and revenues and, if our revenues decline without a commensurate reduction in our expenses, our net income will be reduced.

The low interest rate environment experienced in recent years adversely affected the yields of money market funds, which are based on the income from the underlying securities less the operating costs of the funds. When short-term interest rates are at or near zero, the operating expenses of money market funds may become greater than the income from the underlying securities, which reduces the yield of the money market funds to very low or negative levels. In addition, bank deposits may become more attractive to investors and money market funds could experience redemptions, which could decrease our revenues and net income. During the previous four fiscal years, we voluntarily waived certain fees or assumed expenses of money market funds for competitive reasons, such as to maintain competitive yields, which reduced our advisory fee income and net income. The actual amount of fees waived was dependent on a number of variables including, among others, changes in the net assets held by our money market funds, changes in market yields, changes in the expense levels of the funds, and our willingness to voluntarily continue such fee waivers. These fee waivers for competitive reasons resulted in approximately \$22 million in reduced investment advisory revenues in fiscal year 2017. Given the current higher interest rate environment, fee waivers for competitive reasons did not continue into fiscal year 2018.

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 based on a number of factors including: investment performance, the level of fees charged, the quality and diversity of services and products provided, name recognition and reputation, and the ability to develop new investment strategies and products to meet the changing needs of investors. The introduction of new technologies, as well as regulatory changes, have altered the competitive landscape for asset managers, which may lead to fee compression or require us to spend more to modify or adapt our product offerings to attract and retain customers and remain competitive with products and services offered by other financial institutions, technology companies, trading, advisory or asset management firms. 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 competitors seek to expand market share in many of the products and services we offer. If our competitors successfully expand their market share to the detriment of our market share, our revenues and profitability could be adversely affected. 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.

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

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

Failure to Properly Address the Increased Transformative Pressures Affecting the Asset Management Industry Could Negatively Impact our Business

The asset management industry is facing transformative pressures and trends from a variety of different sources including:

• Increased fee pressure;

• Increased demand from clients and distributors for client engagement and value-added services;

• Divergent central bank monetary policies between the U.S Federal Reserve and the central banks of other developed economies;

• A continued shift away from core equities and fixed income strategies and towards alternative, passive, and smart beta strategies;

• A trend towards institutions developing fewer relationships and partners and reducing the number of investment managers they work with;

• Increased regulatory activity and scrutiny of many aspects of the asset management industry, including transparency/unbundling of fees, inducements, conflicts of interest, capital, liquidity, solvency, leverage, operational risk management, controls and compensation;

Addressing the key emerging markets in the world, such as China and India, which often have populations with different needs, preferences and horizons than the more developed U.S. and European markets; and
• Advances in technology and increasing client interest in interacting digitally with their investment portfolios.

As a result of the trends and pressures discussed above, the asset management industry is facing an increased level of disruption. If we are unable to adapt our strategy and business to adequately address these trends and pressures listed above, we may be unable to satisfactorily meet client needs, our competitive position may weaken and our business results and operations may be adversely affected.

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

Approximately 5% of our AUM as of March 31, 2018, consisted of assets in government or retail money market funds. Money market funds seek to preserve a stable net asset value. While the SEC has implemented rules requiring any institutional prime money market fund and any institutional municipal (or tax-exempt) money market fund that is registered under the Investment Company Act of 1940 to utilize market-based valuations to calculate a floating NAV, government and retail money market funds can continue using current pricing and accounting methods to seek to maintain a stable NAV. Market conditions could lead to severe liquidity or security pricing issues, which could impact the NAV of money market funds. If the NAV of a money market fund managed by our asset managers were to fall below its stable net asset value, we would likely experience significant redemptions in AUM and reputational harm, which could have a material adverse effect on our revenues or net income.

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

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

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

The Soundness of Other Financial Institutions Could Adversely Affect our Business

Volatility in the markets has highlighted the interconnection of the global markets and demonstrated how the deteriorating financial condition of one institution may materially and adversely impact the performance of other institutions. Legg Mason, and the funds and accounts that we manage, have exposure to many different industries and counterparties, and routinely execute 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, 2018, approximately 11% of our long-term AUM was in accounts or products that are eligible to earn performance fees. Performance fees earned on historic AUM in place as of the closing of the acquisition of Clarion Partners on April 13, 2016 are fully passed through to the Clarion Partners management team, per the terms of the acquisition agreement. We expect the pass through to phase out approximately five years post-closing. Exclusive of these performance fees, approximately 7% of our long-term AUM was in accounts that were performance fee eligible as of March 31, 2018. We earned \$227.8 million, \$108.3 million and \$42.0

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million in performance fees during fiscal years 2018, 2017 and 2016, respectively. Of the \$227.8 million in performance fees earned during fiscal year 2018, \$108.8 million was passed through to the Clarion Partners management team. An increase or decrease in performance fees, or in performance-based fee arrangements with our clients, could create greater fluctuations in our revenues.

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

Our ability to market and distribute mutual funds and certain other investment products that we manage is significantly dependent on access to third-party financial intermediaries that distribute these products. These distributors are generally not contractually required to distribute our products, and typically offer their clients various investment products and services, including proprietary products and services, in addition to and in competition with our products and services. Relying on third-party distributors also exposes us to the risk of increasing costs of distribution, as we compensate them for selling our products and services in amounts that are agreed between them and us but which, in many cases, are largely determined by the distributor. There has been a recent trend of increasing fees paid to certain distributors in the asset management business, and certain of our distribution costs have increased as a result. 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. 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

EnTrustPermal operates a portion of its business in the international funds-of-hedge funds business, which is subject to a number of regulatory authorities and requirements in different jurisdictions. The funds-of-hedge funds business typically involves clients being charged fees on two levels - at the funds-of-funds level and at the underlying funds level. These fees may include management fees and performance fees. There can be no assurance that EnTrustPermal will not be forced to change its fee structures by competitive or other pressures or that EnTrustPermal's fee structures will not hamper its growth. The funds-of-hedge funds industry has been under significant pressure in recent years and has seen significant outflows. There can be no assurance that this pressure will not continue. In addition, EnTrustPermal may generate significant performance fees from time to time, which could increase the volatility of our revenues. See "Performance-Based Fee Arrangements May Increase the Volatility of our Revenues."

Risks Related to our Company

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

At March 31, 2018, on a consolidated basis, we had approximately \$2.3 billion in total indebtedness, and total stockholders' equity of \$3.9 billion, and our goodwill and other intangible assets were \$1.9 billion and \$3.8 billion, respectively. We also have an additional \$374.5 million of borrowing capacity available under our revolving credit facility. As a result of this substantial indebtedness, we are currently required to use a portion of our cash flow to service interest on our debt, which will limit the cash flow available for other business opportunities. In addition, these servicing obligations will increase in the future as the principal payments on this debt become due or if we incur additional indebtedness.

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

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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 the amount of unrestricted cash in excess of the greater of subsidiary cash or \$300M, the lesser of 50% of the aggregate amount of our seed capital investments or \$125M, and an amount equal to 50% of our hybrid capital securities) to Consolidated EBITDA (as defined therein) not exceed (a) 3.5 to 1 at any time during the period from January 1, 2017, through and including March 31, 2018, and (b) 3 to 1 at any other time., and (ii) our ratio of Consolidated EBITDA to total cash interest payments on certain Indebtedness (as defined therein) exceeds 4.0 to 1);

limit cash flow available for general corporate purposes due to the ongoing cash flow requirements for debt service;

limit our flexibility, including our ability to react to competitive and other changes in the industry and economic conditions; and

place us at a competitive disadvantage compared to our competitors that have less debt.

As of March 31, 2018, under the terms of our bank credit agreement our ratio of net debt to Consolidated EBITDA was 2.5 to 1 and our ratio of Consolidated EBITDA to interest expense was 6.2 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.

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

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

We May Engage in Strategic Transactions That Could Create Risks

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

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

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

potential disputes with counterparties.

Acquisitions, related transactions and completed acquisitions 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.

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

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

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

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

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

Loss of Key Personnel Could Harm our Business

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

Our Business is Subject to Numerous Operational Risks

We face numerous operational risks related to our business on a day-to-day basis. Among other things, we must be able to consistently and reliably obtain securities pricing information, process trading activity, process client and investor transactions and provide reports and other customer service to our clients, investors and distributors. Failure to keep current and accurate books and records can render us subject to disciplinary action by governmental and self-regulatory authorities, as well as to claims by our clients. A portion of our software is licensed from and supported by outside vendors upon whom we rely to prevent operating system failure. A suspension or termination of these licenses or the related support, upgrades and maintenance could cause system delays or interruption. If any of our financial, portfolio accounting or other data processing systems, or the systems of third parties on whom we rely, do not operate properly or are disabled or if there are other shortcomings or failures in our internal processes, people or systems, or those of third parties on whom we rely, we

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could suffer an impairment to our liquidity, a financial loss, a disruption of our businesses, liability to clients, regulatory problems or damage to our reputation. These systems may fail to operate properly or become disabled as a result of events that are wholly or partially beyond our control, including a disruption of electrical or communications services or our inability to occupy one or more offices. In addition, our operations are dependent upon information from, and communications with, third parties, and operational problems at third parties may adversely affect our ability to carry on our business.

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

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

Our operations rely on the effectiveness of our information and cyber security policies, procedures and capabilities to provide secure processing, storage and transmission of confidential and other information in our computer systems, networks and mobile devices and on the computer systems, networks and mobile devices of third parties on which we rely. Although we take protective measures and endeavor to modify them as circumstances warrant, our computer systems, software, networks and mobile devices, and those of third parties on whom we rely, may be vulnerable to cyber-attacks, sabotage, unauthorized access, computer viruses, worms or other malicious code, phishing scams and other events that have a security impact. In addition, our interconnectivity with third-party vendors, advisors, central agents, exchanges, clearing houses and other financial institutions may be adversely affected if any of them are subject to a successful cyber-attack or other information security event. While we collaborate with clients, vendors and other third parties to develop secure transmission capabilities and protect against cyber-attacks, we cannot ensure that we or any third parties has all appropriate controls in place to protect the confidentiality of such information. In addition, our increased use of mobile and cloud technologies could heighten these and other operational risks and any failure by mobile technology and cloud service providers to adequately safeguard their systems and prevent cyber-attacks, could disrupt our operations and result in misappropriation, corruption or loss of personal, confidential or proprietary information.

An externally caused information security incident, such as a hacker attack, virus or worm, or an internally caused issue, such as failure to control access to sensitive systems, could materially interrupt business operations or cause disclosure or modification of sensitive or confidential client or competitive information and could result in material financial loss, loss of competitive position, regulatory actions, breach of client contracts, reputational harm or legal liability.

There have been a number of recent highly publicized cases involving financial services and consumer-based companies reporting the unauthorized disclosure of client or customer information, as well as cyber-attacks involving

the dissemination, theft and destruction of corporate information or other assets, as a result of failure to follow procedures by employees or contractors or as a result of actions by third parties, including actions by terrorist organizations and hostile foreign governments. We have been the target of attempted cyber-attacks and must monitor and develop our systems to protect our technology infrastructure and data from misappropriation or corruption, as the failure to do so could disrupt our operations and adversely affect our business. Although we take protective measures and endeavors to strengthen our computer systems, software, technology assets and networks to prevent and address potential cyber-attacks, there can be no assurance that any of these measures prove effective.

Any information security incident or cyber-attack against us or third parties with whom we are connected, including any interception, mishandling or misuse of personal, confidential or proprietary information, could result in material financial

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loss, loss of competitive position, regulatory fines and/or sanctions, breach of client contracts, reputational harm or legal liability, which, in turn, may cause our revenue and earnings to decline.

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, 2018, our future commitments from third parties under non-cancellable subleases were approximately \$113 million, which in total, net of reserves, effectively offsets obligations under our leases for the properties. As of March 31, 2018, our total future lease commitments for office space that we vacated and are seeking to sublease were approximately \$9 million, all of which was reserved through lease charges to our earnings in prior fiscal years. 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. There can be no assurance that we will not recognize additional lease-related charges, which may be material to our results of operations.

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

Determining goodwill and intangible assets, and evaluating them for impairment, requires significant management estimates and judgment, including estimating value and assessing life in connection with the allocation of purchase price in the acquisition creating them. Our goodwill and intangible assets may become impaired as a result of any number of factors, including losses of investment management contracts or declines in the value of managed assets. Any impairment of goodwill or intangibles could have a material adverse effect on our results of operations. For example, during the quarter ended December 31, 2017, we incurred an impairment charge associated with our combined EnTrustPermal indefinite-life fund management contracts asset of \$195 million; and, during the quarter ended June 30, 2017, we incurred impairment charges associated with our RARE Infrastructure amortizable management contracts asset and trade name asset of \$32 million and \$2 million, respectively. Changes in the assumptions underlying projected cash flows from the assets or reporting unit, resulting from market conditions, reduced AUM or other factors, could result in an impairment of any of these assets.

There can be no assurances that continued market uncertainty or asset outflows, or other factors, including the regulatory matter discussed in Note 18 of Notes to the Consolidated Financial Statements, will not produce additional impairments. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates - Intangible Assets and Goodwill” and “Note 18 of Notes to the Consolidated Financial Statements.”

Our Deferred Tax Assets May Not Be Fully Realizable

As of March 31, 2018, we had approximately \$551 million in U.S. federal deferred tax assets, which represent tax benefits that we expect to realize in future periods. Under accounting rules, we are required to recognize a charge to earnings to reduce our deferred tax assets if it is determined that any future tax benefits are not likely to be realized before they expire. Deferred tax assets generated in U.S. jurisdictions resulting from net operating losses generally expire 20 years after they are generated. Those resulting from foreign tax credits generally expire 10 years after they are generated. In order to realize these future tax benefits, we estimate that we must generate approximately \$3.8

billion in future U.S. earnings, of which \$1.3 billion must be foreign sourced earnings, before the benefits expire. There can be no assurances that we will achieve this level of earnings before some portion of these tax benefits expires. In addition, our belief that we will likely be able to realize these future tax benefits is based in part upon our estimates of the timing of other differences in revenue and expense recognition between tax returns and financial statements, certain planning strategies and our understanding of the application of tax regulations and ability to implement certain tax planning strategies, which may be revised to incorporate future changes in tax or accounting regulations. In addition, the value of our deferred tax assets is based on enacted corporate tax rates for future periods. Legislative changes related to these rates would require a measurement of our deferred tax assets in the period of enactment. On December 22, 2017, the U.S. government enacted a comprehensive tax legislation, H.R.1 “An Act to

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Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018” (the “Tax Law”). The Tax Law makes broad and complex changes to the U.S. tax code, including, a lower corporate rate that resulted in a reduction of the value of our tax shield, which is our estimate of the future value of our tax benefits.

Our estimates and assumptions do not contemplate certain possible future changes in the ownership of Legg Mason stock, which, under the U.S. Internal Revenue Code (the “Code”), could limit our utilization of net operating loss and foreign tax credit benefits. Under the relevant Code provisions, an “ownership change” occurs if there is a cumulative net increase in the aggregate ownership of Legg Mason stock by “5% shareholders” (as defined in the Code) of more than 50 percent of the total outstanding shares of Legg Mason stock during a rolling three-year period. An ownership change would prospectively establish an annual limitation on the amount of pre-change net operating loss and foreign tax credit carryforwards we could utilize to reduce our tax liability. The amount of the limitation would generally equal the amount of our market capitalization immediately prior to the ownership change multiplied by the long-term tax-exempt interest rate in effect at that time. Such an ownership change would impact the timing or amount of net operating loss or foreign tax credit benefits we ultimately realize before they expire. If we are required to recognize a charge to earnings to reduce our deferred tax assets, the charge may be material to our earnings or financial condition.

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, 2018, our total liquid assets, which include cash, cash equivalents and certain current investment securities, were \$942 million. These liquid assets included approximately \$368 million of cash and investments held by our foreign subsidiaries, some of which, if repatriated, may be subject to material tax effects.

In addition, we are exposed to certain risks related to the different currencies in which we transact and the home jurisdictions of certain securities in which our AUM is invested. Uncertainties regarding developments in those jurisdictions can produce volatility in global financial markets and adversely impact our results of operations. This may impact the levels and composition of our AUM and also negatively impact investor sentiment, which could result in reduced or negative flows. In addition, because the U.K. Pound Sterling and the Euro are the currency used in certain aspects of our business, any weakening of the U.K. Pound Sterling or Euro relative to the U.S. Dollar could negatively impact our reported financial results.

Despite controls and other actions reasonably designed to mitigate these risks, our international operations expose us to risks arising from Legg Mason's potential responsibility for actions of third party agents and other representatives of our business operating outside our primary jurisdictions of operation. Our foreign business operations are also subject to the following risks:

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

Legal and Regulatory Risks

Regulatory Matters May Negatively Affect our Business and Results of Operations

Our business is subject to regulation by various regulatory authorities around the world that are charged with protecting the interests of our clients. We could be subject to civil liability, criminal liability, or sanction, including revocation of our subsidiaries' registrations as investment advisers, revocation of the licenses of our employees, censures, fines, or temporary suspension or permanent bar from conducting business, if we violate such laws or regulations. Any such liability or sanction could have a material adverse effect on our financial condition, results of operations, reputation, and business prospects. In addition, the regulatory environment in which we operate frequently changes and has seen significant increased

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regulation in recent years. Our profitability could be materially and adversely affected by modification of the rules and regulations that impact the business and financial communities in general, including changes to the laws governing taxation, antitrust regulation and electronic commerce. In particular, we have incurred, and will continue to incur, significant additional costs as a result of regulatory changes affecting U.S. mutual funds, changes to European mutual fund regulation and recent changes to data privacy regulation in the U.K. and the EU come into effect in May 2018.

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

Instances of criminal activity and fraud by participants in the asset management industry, disclosures of trading and other abuses by participants in the financial services industry and significant governmental intervention and investment in the financial markets and financial firms have led the U.S. government and regulators to increase the rules and regulations governing, and oversight of, the U.S. financial system. This activity has resulted in changes to the laws and regulations governing the asset management industry and more aggressive enforcement of the existing laws and regulations. The ongoing revisions to the laws and regulations governing our business 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, Regulatory Proceedings and Tax Disputes, Which May Result in Liability That Could Increase our Expenses and Reduce our Net Income

Many aspects of our business involve substantial risks of liability. In the normal course of business, our asset managers are from time to time named as defendants or co-defendants in lawsuits, or are involved in disputes that involve the threat of lawsuits, seeking substantial damages. We are also involved from time to time in governmental and self-regulatory organization investigations and proceedings, including the regulatory matter discussed in "Item 3 - Legal Proceedings" and Note 18 of Notes to Consolidated Financial Statements and the regulatory proceedings discussed in Note 8 of Notes to Consolidated Financial Statements. No assurances can be given as to how this existing regulatory matter, or any other regulatory matter, might be resolved or the effect it may have on us or our business. Any such resolution is subject to the final review and approval of the DOJ, the SEC Commissioners and Legg Mason's Board of Directors. In addition, we are involved in a tax dispute in Brazil arising from matters relating to the tax deductibility of goodwill amortization with respect to the Brazilian business of our subsidiary, Western Asset Management. The assessments that were subject to the dispute for the years 2007 and 2008 were withdrawn after we received a favorable ruling in administrative court. The assessments for the years 2009 through 2010 were recently upheld by the judgment of the same level administrative court (but by a different panel) that overruled the assessments for the previous period. We are in the process of appealing this result. The net amount of tax, interest and penalty at issue in the years subject to our appeal is over \$15 million. Additionally, new assessments were issued for the years 2011 through 2014 and the net amount at issue in those years is over \$28 million. It may take another three to five years or longer to achieve final resolution of this matter as it potentially could go through multiple levels of appeal. During that time, the current \$43 million amount in dispute could increase due to additional interest accruals. While there can be no assurance of the timing or outcome of this dispute, or that we will receive additional favorable judgments in connection with this matter, we and our local advisors continue to believe that our tax position is correct, and it is more likely than not that we will not be required to pay the taxes in question or any related interest and penalties.

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

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

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

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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 346,000 square feet, of which approximately 161,000 square feet has been subleased to third parties.

Our asset managers and other subsidiaries are housed in office buildings in 39 cities in 17 countries around the world. The largest of the leases include:

- ClearBridge Investments, Western Asset Management and our distribution and administrative services subsidiaries currently occupy approximately 130,000 square feet in an office building located in New York, New York in which we hold under lease approximately 193,000 square feet. The remaining 63,000 square feet has been subleased to a third party;
- Western Asset Management's headquarters is housed in an office building in Pasadena, California in which we occupy approximately 190,000 square feet and for which we are seeking tenants to sublease 9,300 square feet of the space; and our distribution and administrative services subsidiaries occupy approximately 79,000 square feet in an office building located in Stamford, Connecticut in which we hold under lease approximately 137,000 square feet. 58,000 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 asset management, securities brokerage and investment banking activities, including certain class actions, which primarily allege violations of securities laws and seek unspecified damages, which could be substantial. In the normal course of our business, our current and former subsidiaries have also received subpoenas and are currently involved in governmental and self-regulatory agency inquiries, investigations and, from time to time, proceedings. While the ultimate resolution of any threatened or pending litigation, regulatory investigations and other matters cannot be currently determined, in the opinion of our management, after consultation with legal counsel, due in part to the preliminary nature of certain of these matters, we are currently unable to estimate the amount or range of potential losses from these matters, and our financial condition, results of operations and cash flows could be materially affected during a period in which a matter is ultimately resolved. See Note 8 of Notes to Consolidated Financial Statements in Item 8 of this Report.

We expect that we will shortly complete negotiations with both the U.S. Department of Justice ("DOJ") and the SEC staff to resolve a Foreign Corrupt Practices Act investigation concerning the activities of our former Permal business in connection with managing assets of Libyan governmental entities in structures established by a third-party financial institution. Those investments were made in calendar years 2005 to 2007 and all were terminated no later than 2012. The matter does not relate to any of our or our affiliates' current business activities or client relationships and has focused on the actions of former employees of Permal who left that firm four or more years ago. Based on discussions to date, we believe that any resolution of this matter will not result in restrictions on our or our affiliates' ongoing business activities. We have accrued a \$67 million charge to earnings for this matter in the year ended March 31, 2018, representing our current estimated liability for the settlement of the matter. This accrual reflects in part the net revenues of approximately \$31 million earned by our former Permal business from managing assets of Libyan governmental entities. Any such resolution, including the actual amount of the payments required to ultimately settle

this matter, which are uncertain and may be higher than the amounts we have currently accrued, are subject to the final review and approval of the DOJ, the SEC Commissioners and our Board of Directors.

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ITEM 4. MINE SAFETY DISCLOSURES.

Not Applicable.

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT.

Information (not included in our definitive proxy statement for the 2018 Annual Meeting of Stockholders) regarding certain of our executive officers is as follows:

Frances Cashman, age 57, was appointed Global Head of Marketing and Communications in May 2017. Ms. Cashman is responsible for Legg Mason's communications, marketing, digital experience and brand. Ms. Cashman joined Legg Mason in 1995 and except for a brief period at Stifel Nicholas from 2005 to 2010, has served in a variety of sales management roles for Legg Mason, including, most recently, Co-Head of US Sales.

Thomas K. Hoops, age 53, was appointed Executive Vice President and Head of Business and Product Development in January 2014. From March 2000 through January 2014, Mr. Hoops held a variety of positions at Wells Fargo Corporation and its predecessors, most recently as Head of Affiliated Managers at Wells Fargo Asset Management. Prior to joining Wells Fargo / Wachovia, he was a Managing Director at a boutique investment bank which specialized in M&A advisory services for emerging growth and middle-market companies and their owners. He began his career as a credit analyst at First Union National Bank in Charlotte.

Terence Johnson, age 45, 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.

John Kenney, age 53, was appointed Global Head of Affiliate Strategic Initiatives in April 2015. Mr. Kenney is a member of the board of directors of each of Legg Mason's asset managers and provides ongoing strategic support and guidance on business development and operating issues. From 2002 until 2005, Mr. Kenney served in a variety of sales and sales management roles at Legg Mason, including as Managing Director, Co-National Sales Manager of the Legg Mason Fixed Income Capital Markets Group, the capital markets business sold by Legg Mason in 2005. He rejoined Legg Mason in 2011, serving in a variety of roles, including as a Managing Director in Legg Mason's Corporate Strategy and Business Development Group and as the chief executive officer and head of Legg Mason Global Asset Allocation.

Patricia Lattin, age 53, was appointed Head of Global Human Resources in January 2009 and Chief Human Resources Officer in June 2017. Ms. Lattin oversees Legg Mason's Human Resources department and leads the firm's efforts in Corporate Social Responsibility and Philanthropy. Ms Lattin joined Legg Mason in 1997 and has served in a variety of positions in Legg Mason's Human Resources department, including Head of Employee Relations, Director of Human Resources Administration which included Director of Benefits and Director of Employment.

Thomas C. Merchant, age 50, 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.

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Peter H. Nachtwey, age 62, was elected Chief Financial Officer and Senior Executive Vice President of Legg Mason in January 2011 when he joined the firm. From July 2007 through December 2010, Mr. Nachtwey served as Chief Financial Officer of The Carlyle Group, an alternative investment management firm, where he had responsibility for all of the financial and a number of the operational functions at the firm. Prior to The Carlyle Group, Mr. Nachtwey spent more than 25 years at Deloitte & Touche, LLP, an accounting firm, most recently as Managing Partner of the Investment Management practice.

Ursula Schliessler, age 59, was appointed Chief Administrative Officer and elected Executive Vice President in April 2015. Ms. Schliessler oversees Legg Mason's technology, global data solutions, real estate, risk management, internal audit and global fund operations and strategic project management. Prior to her appointment as Chief Administrative Officer, Ms. Schliessler served as Head of Global Distribution Business Management for Legg Mason, managing day to day operations and aligning strategic initiatives to support the growth of Legg Mason's retail business. Ms. Schliessler has been in senior roles with Legg Mason or predecessor firms since 1988, with a brief interruption between 2007 and 2010.

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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, 2018, there were approximately 1,300 holders of record of Legg Mason common stock. Information with respect to our dividends and stock prices is as follows:

	Quarter ended			
	Mar. 31	Dec. 31	Sept. 30	June 30
Fiscal Year 2018				
Cash dividend declared per share	\$0.28	\$0.28	\$0.28	\$0.28
Stock price range:				
High	\$47.13	\$42.43	\$42.08	\$40.82
Low	37.05	37.15	36.24	35.34
Fiscal Year 2017				
Cash dividend declared per share	\$0.22	\$0.22	\$0.22	\$0.22
Stock price range:				
High	\$38.99	\$34.35	\$35.09	\$35.83
Low	30.22	28.10	27.62	27.54

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 24, 2018, our Board of Directors declared a regular, quarterly dividend of \$0.34 per share, increasing the regular, quarterly dividend paid on shares of our common stock by 21%.

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, 2018:

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, 2018 Through January 31, 2018	1,713	\$42.19	—	\$ —
February 1, 2018 Through February 28, 2018	397	42.97	—	—
March 1, 2018 Through March 31, 2018	1,636	42.97	—	—
Total	3,746	\$42.61	—	—

(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) As of March 31, 2018, further purchases of our common stock have not been authorized.

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ITEM 6. SELECTED FINANCIAL DATA.

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

	Years ended March 31,					
	2018 ⁽¹⁾	2017	2016	2015	2014	
OPERATING RESULTS						
Operating Revenues	\$3,140,322	\$2,886,902	\$2,660,844	\$2,819,106	\$2,741,757	
Operating expenses, excluding impairment	2,587,321	2,429,659	2,239,013	2,320,887	2,310,864	
Impairment of intangible assets and goodwill	229,000	35,000	371,000	—	—	
Operating Income	324,001	422,243	50,831	498,219	430,893	
Non-operating expense, net, including \$107,074 debt extinguishment loss in July 2014	(99,942)	(64,694)	(68,806)	(136,114)	(13,726)	
Non-operating income (expense) of consolidated investment vehicles, net	9,781	13,329	(7,243)	5,888	2,474	
Income (Loss) before Income Tax Provision (Benefit)	233,840	370,878	(25,218)	367,993	419,641	
Income tax provision (benefit)	(102,510)	84,175	7,692	125,284	137,805	
Net Income (Loss)	336,350	286,703	(32,910)	242,709	281,836	
Less: Net income (loss) attributable to noncontrolling interests	51,275	59,447	(7,878)	5,629	(2,948)	
Net Income (Loss) Attributable to Legg Mason, Inc.	\$285,075	\$227,256	\$(25,032)	\$237,080	\$284,784	
PER SHARE						
Net Income (Loss) per Share Attributable to Legg Mason, Inc. Shareholders:						
Basic	\$3.03	\$2.19	\$(0.25)	\$2.06	\$2.34	
Diluted	\$3.01	\$2.18	\$(0.25)	\$2.04	\$2.33	
Weighted-Average Number of Shares Outstanding: ⁽²⁾						
Basic	90,734	100,580	107,406	112,019	121,941	
Diluted	91,194	100,799	107,406	113,246	122,383	
Dividends Declared	\$1.12	\$0.88	\$0.80	\$0.64	\$0.52	
BALANCE SHEET						
Total Assets	\$8,152,534	\$8,290,415	\$7,520,446	\$7,064,834	\$7,103,203	
Long-term debt, net	2,221,810	2,221,867	1,740,985	1,048,946	1,031,118	
Total Stockholders' Equity Attributable to Legg Mason, Inc.	3,824,405	3,983,374	4,213,563	4,484,901	4,724,724	
FINANCIAL RATIOS AND OTHER DATA						
Operating Margin	10.3	% 14.6	% 1.9	% 17.7	% 15.7	%
Operating Margin, as Adjusted ⁽³⁾	24.6	% 19.7	% 18.6	% 23.0	% 22.0	%
Cash provided by operating activities	\$492,936	\$539,772	\$454,451	\$568,118	\$437,324	
Adjusted EBITDA ⁽⁴⁾	637,228	560,240	561,432	658,262	581,462	
Total debt to total capital ⁽⁵⁾	38.4	% 36.2	% 29.9	% 19.1	% 18.0	%
Assets under management (in millions)	\$754,131	\$728,406	\$669,615	\$702,724	\$701,774	
Full-time employees	3,275	3,338	3,066	2,982	2,843	

(1)

In connection with the regulatory matter discussed in Subsequent Event, Note 18 of the Notes to Consolidated Financial Statements, we have accrued a charge to earnings of approximately \$67 million, or \$0.71 per diluted share, in fiscal 2018. This charge became probable and estimable after the date on which Legg Mason issued its preliminary financial results for the quarter and fiscal year ended March 31, 2018, and the financial statements and other financial information in this Report serve to update all preliminary financial results.

(2) Excludes weighted-average unvested restricted shares deemed to be participating securities for the years ended March 31, 2018, 2017, 2016, and 2015. Basic and diluted shares are the same for periods with a Net Loss Attributable to Legg Mason, Inc. See Note 12 of Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplemental Data.

(3) Operating Margin, as Adjusted, is a non-GAAP performance measure we calculate by dividing (i) Operating Income, adjusted to exclude the impact on compensation expense of gains or losses on investments made to fund deferred compensation plans, the impact on compensation expense of gains or losses on seed capital investments by our affiliates under revenue sharing agreements, amortization related to intangible assets, income (loss) of consolidated investment vehicles, the impact of fair value adjustments of contingent consideration liabilities, if any, unusual and other non-core charges (including the regulatory matter discussed in Subsequent Event, Note 18 of Notes to Consolidated Financial Statements), 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, and less performance fees that are passed through as compensation expense or net income (loss) attributable to noncontrolling interests, 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. Adjusted EBITDA is a non-GAAP liquidity measure we define as cash provided by (used in) operating activities plus (minus) interest expense, net of accretion and amortization of debt discounts and premiums, current income (4) tax expense (benefit), the net change in assets and liabilities, net (income) loss attributable to noncontrolling interests, net gains (losses) on consolidated investment vehicles, and other. See Supplemental Non-GAAP Information in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (5) Calculated based on total gross debt as a percentage of total capital (total stockholders' equity attributable to Legg Mason, Inc. plus total gross debt) as of March 31.

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

EXECUTIVE OVERVIEW

Legg Mason, Inc., a holding company, together with its subsidiaries (collectively, "Legg Mason"), is a global asset management firm. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other investment vehicles. We offer these products and services directly and through various financial intermediaries. We have operations principally in the U.S. and the U.K. and also have offices in Australia, Bahamas, Brazil, Canada, Chile, China, Dubai, France, Germany, Italy, Japan, Singapore, Spain, Switzerland and Taiwan. All references to fiscal 2018, 2017 or 2016, refer to our fiscal year ended March 31 of that year. Terms such as "we," "us," "our," and "Company" refer to Legg Mason.

Our operating revenues primarily consist of investment advisory fees from funds and separate accounts, and distribution and service fees. Investment advisory fees are generally calculated as a percentage of the assets of the investment portfolios that we manage. In addition, performance fees may be earned under certain investment advisory contracts for exceeding performance benchmarks or hurdle rates. The largest portion of our performance fees is earned based on 12-month performance periods that end in differing quarters during the year, with a portion based on quarterly performance periods. We also earn performance fees on alternative products that lock at the end of varying investment periods or in multiple-year intervals. Per the terms of certain more recent acquisitions, performance fees earned on pre-close assets under management ("AUM") of the acquired entities are fully passed through as compensation expense or net income (loss) attributable to noncontrolling interests, and therefore have no impact on Net Income (Loss) Attributable to Legg Mason, Inc. Distribution and service fees are received for distributing investment products and services, for providing other support services to investment portfolios, or for providing non-discretionary advisory services for assets under advisement ("AUA"), 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 AUA and the related 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 changes from period to period primarily due to inflows and outflows of client assets and market performance as well as changes in foreign exchange rates. Client decisions to increase or decrease their assets under our management, and decisions by potential clients to utilize our services, may be based on one or more of a number of factors. These factors include our reputation in the marketplace, the investment performance (both absolute and relative to benchmarks or competitive products) of our products and services, the fees we charge for our investment services, the client or potential client's situation, including investment objectives, liquidity needs, investment horizon and amount of assets managed, our relationships with distributors and the external economic environment, including market conditions.

The fees that we charge for our investment services vary based upon factors such as the type of underlying investment product, the amount of AUM, the asset management affiliate that provides the services, and the type of services (and investment objectives) that are provided. In general, fees earned for asset management services are highest for alternative assets, followed by equity assets, fixed income assets and liquidity assets. Accordingly, our revenues and average operating revenue yields will be affected by the composition of our AUM, with changes in the relative level of alternative and equity assets typically more significantly impacting our revenues and average operating revenue yields. Average operating revenue yields are calculated as the ratio of annualized total operating revenue, less performance fees, to average AUM. In addition, in the ordinary course of our business, we may reduce or waive investment management fees or total expenses, on certain products or services for particular time periods to limit fund expenses, or for other reasons, and to help retain or increase managed assets. Our industry continues to be impacted by disruption and challenges, with continued migration from active to passive strategies (which tend to have lower fees), which, together with regulatory reform, continue to put pressure on fees.

We have revenue sharing arrangements in place with certain of our asset management affiliates, under which specified percentages of the affiliates' revenues are required to be distributed to us and the balance of the revenues is retained by the affiliates to pay their operating expenses, including compensation expenses, but excluding certain expenses and income taxes. Under these revenue-sharing arrangements, our asset management affiliates retain different percentages of revenues to cover their costs. Other affiliates operate under budget processes with varying margin targets. As such, our Net Income (Loss) Attributable to Legg Mason, Inc., operating margin and compensation as a percentage of operating revenues are impacted based on which affiliates and products generate our AUM, and a change in AUM at one affiliate or with respect

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

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

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

The financial services business in which we are engaged is extremely competitive. Our competition includes numerous global, national, regional and local asset management firms, commercial banks, insurance companies, and other financial services companies. The industry continues to experience disruption and challenges, including a shift to lower-fee passively managed products, increased fee pressure (including pressure arising from the shift to lower fee passive products), the increased role of technology in asset management services, the constant introduction of new products and services, and the consolidation of financial services firms through mergers and acquisitions. The asset management industry is also subject to extensive and evolving regulation under federal, state, and foreign laws. Like most firms, we have been and will continue to be impacted by regulatory and legislative changes. Responding to these changes and keeping abreast of regulatory developments, has required, and will continue to require, us to incur costs that impact our profitability. For a further discussion of factors that may affect our results of operations, refer to Item 1A. Risk Factors included herein.

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Our strategy is to expand client choice. We focus our strategic operating priorities on the four primary areas listed below. Management considers these strategic priorities when evaluating our operating performance and financial condition. Consistent with this approach, we have also presented in the table below initiatives on which management currently focuses in evaluating our performance and financial condition.

Strategic Priorities	Initiatives
-Products	- Create an innovative portfolio of investment products and promote revenue growth by developing new products and product vehicles and leveraging the capabilities of our affiliates - Identify and execute strategic acquisitions to strengthen our affiliates and increase product offerings
-Performance	- Deliver compelling and consistent performance against both relevant benchmarks and the products and services of our competitors
-Distribution	- Continue to maintain and enhance our top tier distribution function with the capability to offer solutions to relevant investment challenges and grow market share worldwide - Develop alternative and innovative distribution approaches for expanded client access
-Productivity	- Operate with a high level of effectiveness and improve ongoing efficiency - Align economic relationships with affiliate management teams, including retained affiliate management equity and the implementation of affiliate management equity plan agreements

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

During fiscal 2018, we expanded our investment offerings in response to demand for choice by:

- offering new next generation products such as multi-asset solutions and new vehicles, including the launch of six new exchange traded funds (“ETFs”);
- completing a bolt-on acquisition adding new capabilities at Clarion Partners;
- commercializing alternative products offered by our most recently acquired asset managers;
- expanding our Alternative Distribution Strategies and Alternative Product teams with strategic hires; and
- investing in technology to enhance our capabilities and expand choice for global investors.

As investor interest has trended away from traditional mutual funds, we intend to continue to focus on increasing our ETF, alternative, separately managed account, and multi-asset solutions product offerings during fiscal 2019.

Net Income Attributable to Legg Mason, Inc. for the year ended March 31, 2018, was \$285.1 million, or \$3.01 per diluted share, compared to \$227.3 million, or \$2.18 per diluted share for the year ended March 31, 2017. The increase in Net Income Attributable to Legg Mason, Inc. was largely the result of a \$213.7 million, or \$2.26 per diluted share, one-time, net non-cash provisional tax benefit related to H.R. 1 "An Act to Provide for the Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018" (the "Tax Law"), which was enacted on December 22, 2017. The years ended March 31, 2018 and 2017, also included impairment charges related to intangible assets of \$229.0 million, or \$1.96 per diluted share, and \$35.0 million, or \$0.26 per diluted share, respectively; and adjustments to decrease the fair value of contingent consideration liabilities by \$31.3 million, or \$0.33 per diluted share, and \$39.5 million, or \$0.36 per diluted share, respectively. The year ended March 31, 2018,

included transition-related costs of \$7.0 million, or \$0.05 per diluted share, associated with the combination of The Permal Group ("Permal") with EnTrust Capital ("EnTrust"), while the year ended March 31, 2017, included \$75.1 million, or \$0.48 per diluted share, of acquisition and transition-related costs, primarily associated with the acquisitions of Clarion Partners and EnTrust, and the combination of Permal with EnTrust. These items are more fully discussed below.

In addition, in connection with the regulatory matter discussed in Subsequent Event, Note 18 of Notes to the Consolidated Financial Statements, we have accrued a charge to earnings of approximately \$67.0 million, or \$0.71 per diluted share, in

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fiscal year 2018. This charge became probable and estimable after the date on which Legg Mason issued its preliminary financial results for the quarter and fiscal year ended March 31, 2018 and the financial statements and other financial information in this Report serves to update such preliminary financial results.

Average AUM and total revenues increased by approximately 5% and 9%, respectively, in fiscal 2018 as compared to fiscal 2017, as further discussed below.

Total AUM increased during the year ended March 31, 2018, primarily due to the positive impact of market performance and other, which includes the reclassification, effective April 1, 2017, of certain assets which were previously classified as AUA to AUM due to a change in our policy on classification of AUA and AUM, as further discussed below, and net client inflows in fixed income AUM. These increases were offset in part by net client outflows in liquidity, equity, and alternative AUM.

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

BUSINESS ENVIRONMENT AND RESULTS OF OPERATIONS

During fiscal 2018, U.S. equity markets increased significantly, largely due to continued growth in corporate earnings and an expanding economy. International equity markets also improved, due to signs of economic growth and accommodative monetary policy.

Our industry continues to be impacted by disruption and competition, with continued migration from active to passive strategies, which, together with regulatory reform, continues to put pressure on fees, and is contributing to the consolidation of products and managers on distribution platforms. These factors continue to create significant flow challenges for active managers like ourselves.

All three major U.S. equity market indices increased significantly during both fiscal 2018 and fiscal 2017, after decreasing slightly during fiscal 2016. Bond indices increased in both fiscal 2018 and fiscal 2016, and were mixed in fiscal 2017, as illustrated in the table below:

Indices ⁽¹⁾	% Change for the year ended March 31:		
	2018	2017	2016
Dow Jones Industrial Average ⁽²⁾	16.7%	16.8 %	(0.5)%
S&P 500 ⁽²⁾	11.8%	14.7 %	(0.4)%
NASDAQ Composite Index ⁽²⁾	19.5%	21.4 %	(0.6)%
Barclays Capital U.S. Aggregate Bond Index	1.2 %	0.4 %	2.0 %
Barclays Capital Global Aggregate Bond Index	7.0 %	(1.9)%	4.6 %

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

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

In December 2015, the Federal Reserve Board increased the target federal funds rate for the first time since 2006, from 0.25% to 0.50%. During fiscal 2017, the target federal funds rate was increased from 0.50% to 1.00%, and during fiscal 2018 it was increased from 1.00% to 1.75%. While the economic outlook for the U.S. has remained positive in recent years, it has been impacted by increased uncertainty. The financial environment in which we operate continues to reflect a heightened level of sensitivity and continued pressure on our fees as we move into fiscal 2019.

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

	Percentage of Operating Revenues			Period to Period Change ⁽¹⁾	
	Years Ended March 31,			2018	2017
	2018	2017	2016	Compared to 2017	Compared to 2016
Operating Revenues					
Investment advisory fees:					
Separate accounts	32.5 %	32.0 %	31.0 %	10 %	12 %
Funds	49.8	51.3	53.0	6	5
Performance fees	7.3	3.8	1.6	n/m	n/m
Distribution and service fees	10.3	12.7	14.3	(12)	(4)
Other	0.1	0.2	0.1	6	n/m
Total Operating Revenues	100.0	100.0	100.0	9	8
Operating Expenses					
Compensation and benefits	47.8	47.6	44.1	9	17
Transition-related compensation	0.2	1.0	1.2	(79)	(15)
Total Compensation and Benefits	48.0	48.6	45.3	8	16
Distribution and servicing	15.6	17.3	20.5	(2)	(9)
Communications and technology	6.8	7.2	7.4	2	6
Occupancy	3.2	3.9	4.6	(11)	(7)
Amortization of intangible assets	0.8	0.9	0.2	6	n/m
Impairment charges	7.3	1.2	13.9	n/m	(91)
Contingent consideration fair value adjustments	(1.0)	(1.4)	(1.3)	(21)	18
Other	9.0	7.7	7.4	29	12
Total Operating Expenses	89.7	85.4	98.0	14	(6)
Operating Income	10.3	14.6	2.0	(23)	n/m
Non-Operating Income (Expense)					
Interest income	0.2	0.2	0.2	4	21
Interest expense	(3.8)	(3.9)	(1.8)	4	n/m
Other income (expense), net	0.4	1.4	(1.0)	(74)	n/m
Non-operating income (expense) of consolidated investment vehicles, net	0.3	0.5	(0.3)	(26)	n/m
Total Non-Operating Income (Expense)	(2.9)	(1.8)	(2.9)	75	(32)
Income (Loss) before Income Tax Provision (Benefit)	7.4	12.8	(0.9)	(37)	n/m
Income tax provision (benefit)	(3.3)	2.9	0.3	n/m	n/m
Net Income (Loss)	10.7	9.9	(1.2)	17	n/m
Less: Net income (loss) attributable to noncontrolling interests	1.6	2.0	(0.3)	(14)	n/m
Net Income (Loss) Attributable to Legg Mason, Inc.	9.1 %	7.9 %	(0.9)%	25	n/m

n/m - not meaningful

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

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ASSETS UNDER MANAGEMENT AND ASSETS UNDER ADVISEMENT

Assets Under Management

Our AUM is primarily managed across the following asset classes and strategies:

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

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

	2018	2017	2016
Beginning of period	\$728.4	\$669.6	\$702.7
Net client cash flows			
Investment funds, excluding liquidity funds: ⁽¹⁾			
Subscriptions	65.2	64.0	50.3
Redemptions	(56.5)	(65.4)	(62.3)
Long-term separate account flows, net ⁽²⁾	(7.0)	(0.2)	0.8
Total long-term flows	1.7	(1.6)	(11.2)
Liquidity fund flows, net	(25.5)	(27.8)	(15.1)
Liquidity separate account flows, net	1.2	0.5	0.2
Total liquidity flows	(24.3)	(27.3)	(14.9)
Total net client cash flows	(22.6)	(28.9)	(26.1)
Realizations ⁽³⁾	(2.6)	—	—
Market performance and other ⁽⁴⁾	45.7	42.7	(15.3)
Impact of foreign exchange	5.4	(1.3)	1.4
Acquisitions (dispositions), net ⁽⁵⁾	(0.2)	46.3	6.9
End of period ⁽²⁾	\$754.1	\$728.4	\$669.6

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

As further discussed below, due to a change in our policy on classification of AUA and AUM effective April 1, 2017, AUM as of March 31, 2018 includes \$23.8 billion of assets which were previously included in AUA.

Comparable AUA as of March 31, 2017 and 2016, was \$16.0 billion and \$10.5 billion, respectively. Long-term (2) separate account flows, net, for the year ended March 31, 2018, includes \$5.1 billion of net inflows related to this AUM. Net inflows related to the comparable AUA were \$3.5 billion and \$2.1 billion for the years ended March 31, 2017 and 2016, respectively, and are excluded from the table above. See "Assets Under Advisement" below for additional information regarding AUA.

(3) Realizations represent investment manager-driven distributions primarily related to the sale of assets. Realizations are specific to our alternative managers and do not include client-driven distributions (e.g. client requested redemptions, liquidations or asset transfers). Prior to April 1, 2017, realizations were reported as net client cash

flows.

(4) For the year ended March 31, 2018, other includes the reclassification, effective April 1, 2017, of \$16.0 billion of certain assets which were previously included in AUA to AUM. For the year ended March 31, 2018, other also includes the reinvestment of dividends and a \$(3.7) billion reconciliation to previously reported amounts. For the years ended March 31, 2017 and 2016, other primarily includes the reinvestment of dividends.

(5) Includes \$41.5 billion and \$9.6 billion related to the acquisitions of Clarion Partners and EnTrust, respectively, offset in part by \$4.8 billion related to the disposition of two small investment managers and our share of a joint venture during the year ended March 31, 2017; and \$6.8 billion and \$0.1 billion related to the acquisitions of RARE Infrastructure and PK Investments, LLP ("PK Investments"), respectively, during the year ended March 31, 2016.

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AUM at March 31, 2018 was \$754.1 billion, an increase of \$25.7 billion, or 4%, compared to March 31, 2017. Total net client outflows were \$22.6 billion, comprised of \$24.3 billion of net client outflows from the liquidity asset class, offset in part by \$1.7 billion of net client inflows into long-term asset classes. Long-term asset net inflows were comprised of fixed income net inflows of \$9.4 billion, and were offset in part by equity net outflows of \$6.7 billion and alternative net outflows of \$1.0 billion. Fixed income net inflows were primarily into products managed by Western Asset Management Company ("Western Asset") and Brandywine Global Investment Management ("Brandywine"), offset in part by net outflows in products managed by QS Investors. Equity net outflows were primarily from products managed by QS Investors, Royce, and Brandywine, offset in part by equity net inflows in products managed by Martin Currie. Alternative net outflows were primarily in products managed by EnTrustPermal and RARE Infrastructure, offset in part by net inflows in products managed by Clarion Partners. We generally earn higher fees and profits on alternative and equity AUM, and outflows in those asset classes will more negatively impact our revenues and Net Income (Loss) Attributable to Legg Mason, Inc. than would outflows in the fixed income or liquidity asset classes. Market performance and other was \$45.7 billion, \$16.0 billion of which relates to the reclassification, effective April 1, 2017, of certain assets which were previously classified as AUA to AUM due to a change in our policy on classification of AUA and AUM. See "Assets Under Advisement" below for additional information regarding AUA. The positive impact of foreign currency exchange rate fluctuations was \$5.4 billion.

During fiscal 2018, we began to separately report realizations. Realizations are investment manager driven distributions primarily related to the sale of assets. Realizations are specific to our alternative managers and do not include client-driven distributions (e.g. requested redemptions, liquidations, or asset transfers). Realizations for the year ended March 31, 2018, were \$2.6 billion. Realizations of \$1.3 billion were included in net client cash flows for the year ended March 31, 2017 and there were no realizations for the year ended March 31, 2016.

AUM at March 31, 2017 was \$728.4 billion, an increase of \$58.8 billion, or 9%, compared to March 31, 2016. Total net client outflows were \$28.9 billion, consisting of net client outflows from the liquidity and long-term asset classes of \$27.3 billion and \$1.6 billion, respectively. Long-term asset net outflows were comprised of alternative and equity net outflows of \$7.2 billion and \$5.2 billion, respectively, partially offset by fixed income net inflows of \$10.8 billion. Alternative net outflows were primarily in products managed by EnTrustPermal and RARE Infrastructure. Equity net outflows were primarily in products managed by Royce, QS Investors and Brandywine, offset in part by equity net inflows at Martin Currie. Fixed income net inflows were primarily in products managed by Western Asset, offset in part by fixed income net outflows at Brandywine. Market performance and other was \$42.7 billion and the negative impact of foreign currency exchange rate fluctuations was \$1.3 billion. Acquisitions (dispositions), net, totaled \$46.3 billion, and included \$41.5 billion related to the acquisition of Clarion Partners in April 2016 and \$9.6 billion related to the acquisition of EnTrust in May 2016, offset in part by \$4.8 billion related to the disposition of two small investment managers and our portion of a joint venture.

Our investment advisory and administrative contracts are generally terminable at will or upon relatively short notice, and investors in the mutual funds and other vehicles that we manage may redeem their investments in the funds or vehicles 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.

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AUM by Asset Class

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

	2018	% of Total	2017	% of Total	2016	% of Total	% Change 2018 Compared to 2017		% Change 2017 Compared to 2016	
Equity	\$203.0	27 %	\$179.8	25 %	\$162.3	24 %	13 %	11 %		
Fixed Income	422.3	56	394.3	54	372.3	56	7	6		
Alternative	66.1	9	67.9	9	22.7	3	(3)	n/m		
Total long-term assets	691.4	92	642.0	88	557.3	83	8	15		
Liquidity	62.7	8	86.4	12	112.3	17	(27)	(23)		
Total	\$754.1	100%	\$728.4	100%	\$669.6	100%	4	9		

n/m - not meaningful

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

	2018	% of Total	2017	% of Total	2016	% of Total	% Change 2018 Compared to 2017		% Change 2017 Compared to 2016	
Equity	\$200.5	26 %	\$167.6	23 %	\$173.4	25 %	20 %	(3)%		
Fixed Income	412.0	55	386.5	54	367.2	54	7	5		
Alternative	66.3	9	66.9	9	21.1	3	(1)	n/m		
Total long-term assets	678.8	90	621.0	86	561.7	82	9	11		
Liquidity	75.6	10	99.2	14	123.1	18	(24)	(19)		
Total	\$754.4	100%	\$720.2	100%	\$684.8	100%	5	5		

n/m - not meaningful

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The component changes in our AUM by asset class (in billions) for the fiscal years ended March 31, 2018, 2017 and 2016, were as follows:

	Equity	Fixed Income	Alternative	Total Long-Term	Liquidity	Total
March 31, 2015	\$186.2	\$370.1	\$ 19.2	\$ 575.5	\$ 127.2	\$702.7
Investment funds, excluding liquidity funds: ⁽¹⁾						
Subscriptions	21.8	27.4	1.1	50.3	—	50.3
Redemptions	(34.4)	(25.2)	(2.7)	(62.3)	—	(62.3)
Separate account flows, net	2.9	(1.8)	(0.3)	0.8	0.2	1.0
Liquidity fund flows, net	—	—	—	—	(15.1)	(15.1)
Net client cash flows	(9.7)	0.4	(1.9)	(11.2)	(14.9)	(26.1)
Market performance and other ⁽²⁾	(14.2)	0.6	(1.8)	(15.4)	0.1	(15.3)
Impact of foreign exchange	(0.1)	1.2	0.4	1.5	(0.1)	1.4
Acquisitions ⁽³⁾	0.1	—	6.8	6.9	—	6.9
March 31, 2016	162.3	372.3	22.7	557.3	112.3	669.6
Investment funds, excluding liquidity funds: ⁽¹⁾						
Subscriptions	27.0	30.8	6.2	64.0	—	64.0
Redemptions	(27.0)	(28.6)	(9.8)	(65.4)	—	(65.4)
Separate account flows, net	(5.2)	8.6	(3.6)	(0.2)	0.5	0.3
Liquidity fund flows, net	—	—	—	—	(27.8)	(27.8)
Net client cash flows	(5.2)	10.8	(7.2)	(1.6)	(27.3)	(28.9)
Market performance and other ⁽²⁾	25.4	12.5	3.7	41.6	1.1	42.7
Impact of foreign exchange	(0.7)	(0.9)	(0.2)	(1.8)	0.5	(1.3)
Acquisitions (dispositions), net ⁽³⁾	(2.0)	(0.4)	48.9	46.5	(0.2)	46.3
March 31, 2017	179.8	394.3	67.9	642.0	86.4	728.4
Investment funds, excluding liquidity funds: ⁽¹⁾						
Subscriptions	22.6	36.3	6.3	65.2	—	65.2
Redemptions	(27.2)	(23.5)	(5.8)	(56.5)	—	(56.5)
Separate account flows, net ⁽²⁾	(2.1)	(3.4)	(1.5)	(7.0)	1.2	(5.8)
Liquidity fund flows, net	—	—	—	—	(25.5)	(25.5)
Net client cash flows	(6.7)	9.4	(1.0)	1.7	(24.3)	(22.6)
Realizations ⁽⁴⁾	—	—	(2.6)	(2.6)	—	(2.6)
Market performance and other ⁽²⁾	28.9	14.5	1.5	44.9	0.8	45.7
Impact of foreign exchange	1.3	4.1	0.2	5.6	(0.2)	5.4
Acquisitions (dispositions), net ⁽³⁾	(0.3)	—	0.1	(0.2)	—	(0.2)
March 31, 2018	\$203.0	\$422.3	\$ 66.1	\$ 691.4	\$ 62.7	\$754.1

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

For the year ended March 31, 2018, other includes the reclassification, effective April 1, 2017, of \$12.1 billion and \$3.9 billion of certain equity and fixed income assets, respectively, which were previously included in AUA to

(2) AUM. Equity and fixed income separate account flows, net, for the year ended March 31, 2018, include \$3.2 billion and \$1.9 billion, respectively, of net inflows related to this AUM. For the year ended March 31, 2018, other also includes the reinvestment of dividends and a \$(3.7) billion reconciliation to previously reported amounts. For the years ended March 31, 2017 and 2016, other primarily includes the reinvestment of dividends.

(3) Includes \$41.5 billion and \$9.6 billion related to the acquisitions of Clarion Partners and EnTrust, respectively, offset in part by \$4.8 billion related to the disposition of two small investment managers and our portion of a joint venture during the year ended March 31, 2017; and \$6.8 billion and \$0.1 billion related to the acquisitions of RARE Infrastructure and PK Investments, respectively, during the year ended March 31, 2016.

(4)

Realizations represent investment manager-driven distributions primarily related to the sale of assets. Realizations are specific to our alternative managers and do not include client-driven distributions (e.g. client requested redemptions, liquidations or asset transfers). Prior to April 1, 2017, realizations were reported in net client cash flows.

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AUM by Distribution Channel

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

The component changes in our AUM by distribution channel (in billions) for the years ended March 31, 2018, 2017 and 2016, were as follows:

	Global Distribution ⁽¹⁾	Affiliate/Other	Total
March 31, 2015	\$ 270.0	\$ 432.7	\$702.7
Net client cash flows, excluding liquidity funds	(3.5)	(7.5)	(11.0)
Liquidity fund flows, net	—	(15.1)	(15.1)
Net client cash flows	(3.5)	(22.6)	(26.1)
Market performance and other	(13.1)	(2.2)	(15.3)
Impact of foreign exchange	1.2	0.2	1.4
Acquisitions	—	6.9	⁽²⁾ 6.9
March 31, 2016	254.6	415.0	669.6
Net client cash flows, excluding liquidity funds	8.9	(10.0)	(1.1)
Liquidity fund flows, net	—	(27.8)	(27.8)
Net client cash flows	8.9	(37.8)	(28.9)
Market performance and other	22.7	20.0	42.7
Impact of foreign exchange	(0.6)	(0.7)	(1.3)
Acquisitions (dispositions), net	—	46.3	⁽²⁾ 46.3
March 31, 2017	285.6	442.8	728.4
Net client cash flows, excluding liquidity funds	15.8	(12.9)	2.9
Liquidity fund flows, net	—	(25.5)	(25.5)
Net client cash flows	15.8	(38.4)	(22.6)
Realizations ⁽³⁾	—	(2.6)	(2.6)
Market performance and other ⁽⁴⁾	29.4	16.3	45.7
Impact of foreign exchange	2.7	2.7	5.4
Acquisitions (dispositions), net	—	(0.2)	(0.2)
March 31, 2018	\$ 333.5	\$ 420.6	\$754.1

Excludes \$15.9 billion, \$10.3 billion, and \$8.2 billion of AUA as of March 31, 2017, 2016, and 2015, respectively.

(1) Net client cash flows for the years ended March 31, 2017 and 2016, excludes \$3.5 billion and \$2.1 billion of AUA net inflows, respectively. Effective April 1, 2017, a significant portion of these assets were reclassified from AUA to AUM. Accordingly, \$23.8 billion of assets which were previously included in AUA are included in AUM as of March 31, 2018, and net client cash flows for the year ended March 31, 2018, include \$5.1 billion of net inflows related to this AUM.

(2) Includes \$41.5 billion and \$9.6 billion related to the acquisitions of Clarion Partners and EnTrust, respectively, offset in part by \$4.8 billion related to the disposition of two small investment managers and our share of a joint venture during the year ended March 31, 2017; and \$6.8 billion and \$0.1 billion related to the acquisitions of RARE Infrastructure and PK Investments, respectively, during the year ended March 31, 2016.

(3) Realizations represent investment manager-driven distributions primarily related to the sale of assets. Realizations are specific to our alternative managers and do not include client-driven distributions (e.g. client requested redemptions, liquidations or asset transfers). Prior to April 1, 2017, realizations were reported as net client cash

flows.

Other includes the reclassification, effective April 1, 2017, of \$16.0 billion of certain assets which were previously (4)included in AUA to AUM due to a change in our policy on classification of AUA and AUM. Other also includes the reinvestment of dividends and a \$(3.7) billion reconciliation to previously reported amounts.

Operating Revenue Yield

Our overall operating revenue yield, less performance fees, across all asset classes and distribution channels was 39 basis points for each of the years ended March 31, 2018 and 2017, and 38 basis points for the year ended March 31, 2016. Fees for managing alternative and equity assets are generally higher, with alternative assets averaging 65 basis points, 73 basis points and 105 basis points for the years ended March 31, 2018, 2017, and 2016, respectively, and equity assets averaging

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63 basis points, 67 basis points and 70 basis points for the years ended March 31, 2018, 2017, and 2016, respectively. The average fee rate for managing alternative assets declined over the last year due to a shift in the mix of assets from higher fee to lower fee products, and declined in the prior year due to the acquisitions of Clarion Partners in April 2016, EnTrust in May 2016, and RARE Infrastructure in October 2015, whose products typically earn lower average fees than our legacy alternative asset products. The average fee rate for managing equity assets has declined over the last year primarily due to the previously discussed reclassification of certain assets from AUA to AUM, as this increased the AUM denominator without a corresponding increase in operating revenue. In addition, the average fee rate for managing equity assets has declined over the last five years due to a shift in the mix of equity assets from higher fee equity products to lower fee equity products and lower fees earned on certain existing products. This compares to fees for fixed income assets, which averaged approximately 27 basis points for each of the years ended March 31, 2018 and 2017, and 29 basis points for the year ended March 31, 2016, and liquidity assets, which averaged approximately 13 basis points, 12 basis points and 9 basis points for the years ended March 31, 2018, 2017 and 2016, respectively. The average fee rate for managing liquidity increased over the last three years due to a reduction in fee waivers. Equity assets are primarily managed by ClearBridge, Royce, Brandywine, QS Investors, and Martin Currie; alternative assets are managed by Clarion Partners, EnTrustPermal, and RARE Infrastructure; fixed income assets are primarily managed by Western Asset and Brandywine; and liquidity assets are managed by Western Asset. Fee rates for assets distributed through Legg Mason Global Distribution, which are predominately retail in nature, averaged 45 basis points for each of the years ended March 31, 2018 and 2017, and 48 basis points for the year ended March 31, 2016, while fee rates for assets distributed through the Affiliate/Other channel averaged approximately 34 basis points, 35 basis points, and 32 basis points for the years ended March 31, 2018, 2017, and 2016, respectively.

Investment Performance

Overall investment performance of our AUM for the years ended March 31, 2018, 2017 and 2016, was mixed compared to relevant benchmarks.

Year ended March 31, 2018

For the year ended March 31, 2018, U.S. equity indices produced strong positive returns. The best performing index was the NASDAQ, which returned 19.5%, while the lowest performing index was the S&P 400, which returned 11.0%. These positive returns reflect the growth of corporate earnings and an expanding economy.

In the fixed income markets, the Federal Reserve raised its target rate by 0.25% in each of June 2017, December 2017 and March 2018, continuing the Federal Reserve's steps to tighten monetary policy. Expectations of future Federal Reserve interest rate increases were expanded to include two additional rate increases in calendar year 2018 and three increases in calendar year 2019. These expectations resulted in the yield curve continuing to flatten over the fiscal year as short-term yields increased more than long-term yields.

The best performing fixed income sector for the year ended March 31, 2018, was high yield bonds as measured by the Barclays U.S. High Yield Index, which returned 3.8%. The lowest performing fixed income sector for the year ended March 31, 2018, was U.S. Government bonds, as measured by the Barclays U.S. Government Index, which returned 0.4%.

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Year ended March 31, 2017

For the year ended March 31, 2017, U.S. equity indices produced positive returns. The best performing was the Russell 2000, which returned 26.2%. These returns were achieved in a volatile economic environment defined by the decision of the U.K. to leave the European Union and the newly elected President in the U.S.

In the fixed income markets, the Federal Reserve raised its target rate by 0.25% in both December 2016 and March 2017, continuing the Federal Reserve's steps toward monetary policy normalization. This resulted in the yield curve continuing to flatten over the fiscal year as many long-dated yields declined.

The best performing fixed income sector for the year ended March 31, 2017, was high yield bonds as measured by the Barclays U.S. High Yield Index, which returned 16.4%. The lowest performing fixed income sector for the year ended March 31, 2017, was U.S. Government bonds, as measured by the Barclays U.S. Government Index, which declined 1.3%.

Year ended March 31, 2016

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

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

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

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The following table presents a summary of the percentages of our AUM by strategy⁽¹⁾ that outpaced their respective benchmarks as of March 31, 2018, 2017 and 2016, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2018				As of March 31, 2017				As of March 31, 2016			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total (includes liquidity)	72	% 72	% 75	% 85	% 79	% 71	% 80	% 88	% 48	% 66	% 86	% 82
Equity:												
Large cap	22	% 33	% 43	% 77	% 70	% 27	% 62	% 95	% 44	% 23	% 86	% 68
Small cap	65	% 69	% 29	% 36	% 35	% 19	% 19	% 51	% 70	% 19	% 30	% 63
Total equity (includes other equity)	29	% 43	% 44	% 73	% 58	% 33	% 61	% 88	% 53	% 31	% 76	% 68
Fixed income:												
U.S. taxable	95	% 88	% 88	% 88	% 94	% 86	% 87	% 84	% 31	% 78	% 87	% 79
U.S. tax-exempt	100	% 100	% 100	% 100	% 100	% 100	% 100	% 100	% 100	% 0	% 100	% 100
Global taxable	74	% 68	% 71	% 93	% 75	% 69	% 75	% 88	% 11	% 75	% 85	% 84
Total fixed income	88	% 82	% 83	% 90	% 89	% 82	% 84	% 86	% 29	% 72	% 87	% 82
Alternative	68	% 65	% 92	% 61	% 45	% 84	% 88	% 65	% 20	% 42	% 55	% 96

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, 2018, 2017 and 2016, for the trailing 1-year, 3-year, 5-year, and 10-year periods:

	As of March 31, 2018				As of March 31, 2017				As of March 31, 2016			
	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year	1-year	3-year	5-year	10-year
Total (excludes liquidity)	58	% 64	% 63	% 68	% 65	% 63	% 70	% 78	% 48	% 61	% 72	% 65
Equity:												
Large cap	19	% 51	% 47	% 48	% 60	% 62	% 81	% 82	% 47	% 69	% 89	% 52
Small cap												