STIFEL FINANCIAL CORP
Form 10-Q
May 10, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2016

OR

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

Commission File Number: 001-09305

STIFEL FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

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

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

(Address of principal executive offices and zip code)

(314) 342-2000

(Registrant’s telephone number, including area code)

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

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

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

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

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

The number of shares outstanding of the registrant's common stock, $0.15 par value per share, as of the close of business on May 2, 2016, was 66,472,096.

STIFEL FINANCIAL CORP.

Form 10-Q

TABLE OF CONTENTS


| | |
|---|---|
| PART I – FINANCIAL INFORMATION | |
| Item 1. Financial Statements | 3 |
| Consolidated Statements of Financial Condition as of March 31, 2016 (unaudited) and December 31, 2015 | 3 |
| Consolidated Statements of Operations for the three months ended March 31, 2016 and March 31, 2015 (unaudited) | 5 |
| Consolidated Statements of Comprehensive Income for the three months ended March 31, 2016 and March 31, 2015 (unaudited) | 6 |
| Consolidated Statements of Cash Flows for the three months ended March 31, 2016 and March 31, 2015 (unaudited) | 7 |
| Notes to Consolidated Financial Statements (unaudited) | 9 |
| Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations | 45 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 68 |
| Item 4. Controls and Procedures | 71 |
| PART II – OTHER INFORMATION | |
| Item 1. Legal Proceedings | 71 |
| Item 1A. Risk Factors | 71 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 72 |
| Item 6. Exhibits | 73 |
| Signatures | 74 |

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STIFEL FINANCIAL CORP.

Consolidated Statements of Financial Condition

| (in thousands) | March 31, 2016 (Unaudited) | December 31, 2015 |
|---|---|---|
| Assets | | |
| Cash and cash equivalents | $577,350 | $811,019 |
| Cash segregated for regulatory purposes | 37,051 | 227,727 |
| Receivables: | | |
| Brokerage clients, net | 1,382,362 | 1,599,218 |
| Brokers, dealers, and clearing organizations | 719,790 | 601,831 |
| Securities purchased under agreements to resell | 207,946 | 160,423 |
| Financial instruments owned, at fair value | 1,028,781 | 749,443 |
| Available-for-sale securities, at fair value | 2,125,466 | 1,629,907 |
| Held-to-maturity securities, at amortized cost | 2,028,179 | 1,855,399 |
| Loans held for sale, at lower of cost or market | 132,900 | 189,921 |
| Bank loans, net | 3,467,187 | 3,143,515 |
| Investments, at fair value | 165,424 | 181,017 |
| Fixed assets, net | 182,450 | 181,966 |
| Goodwill | 974,266 | 915,602 |
| Intangible assets, net | 92,922 | 63,177 |
| Loans and advances to financial advisors and other employees, net | 407,403 | 401,293 |
| Deferred tax assets, net | 216,321 | 285,127 |
| Other assets | 467,930 | 329,466 |
| Total Assets | $14,213,728 | $13,326,051 |

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Financial Condition (continued)

| (in thousands, except share and per share amounts) | March 31, 2016 (Unaudited) | December 31, 2015 |
|---|---|---|
| Liabilities and Shareholders' Equity | | |
| Payables: | | |
| Brokerage clients | $1,077,414 | $1,000,422 |
| Brokers, dealers, and clearing organizations | 282,920 | 438,031 |
| Drafts | 74,503 | 183,857 |
| Securities sold under agreements to repurchase | 290,729 | 278,674 |
| Bank deposits | 7,218,100 | 6,638,356 |
| Financial instruments sold, but not yet purchased, at fair value | 674,841 | 521,744 |
| Accrued compensation | 147,203 | 363,791 |
| Accounts payable and accrued expenses | 380,652 | 349,040 |
| Borrowings | 827,581 | 237,084 |
| Senior notes | 740,409 | 740,136 |
| Debentures to Stifel Financial Capital Trusts | 82,500 | 82,500 |
| Total liabilities | 11,796,852 | 10,833,635 |
| Shareholders' Equity: | | |
| Preferred stock - $1 par value; authorized 3,000,000 shares; none issued | — | — |
| Common stock - $0.15 par value; authorized 97,000,000 shares; issued 69,508,281 and 69,507,842 shares, respectively | 10,426 | 10,426 |
| Additional paid-in-capital | 1,733,605 | 1,820,772 |
| Retained earnings | 826,234 | 805,685 |
| Accumulated other comprehensive loss | (47,218) | (39,533) |
| | 2,523,047 | 2,597,350 |
| Treasury stock, at cost, 3,054,716 and 2,483,071 shares, respectively | (106,171) | (104,934) |
| Total Shareholders' Equity | 2,416,876 | 2,492,416 |
| Total Liabilities and Shareholders' Equity | $14,213,728 | $13,326,051 |

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Operations

(Unaudited)

| (in thousands, except per share amounts) | Three Months Ended March 31, 2016 | 2015 |
|---|---|---|
| Revenues: | | |
| Commissions | $197,930 | $180,302 |
| Principal transactions | 120,948 | 100,205 |
| Investment banking | 100,658 | 125,089 |
| Asset management and service fees | 144,532 | 113,869 |
| Interest | 62,786 | 42,736 |
| Other income | 7,231 | 11,800 |
| Total revenues | 634,085 | 574,001 |
| Interest expense | 14,111 | 13,019 |
| Net revenues | 619,974 | 560,982 |
| Non-interest expenses: | | |
| Compensation and benefits | 411,113 | 355,693 |
| Occupancy and equipment rental | 57,255 | 44,170 |
| Communications and office supplies | 36,660 | 29,234 |
| Commissions and floor brokerage | 11,732 | 10,069 |
| Other operating expenses | 59,301 | 51,750 |
| Total non-interest expenses | 576,061 | 490,916 |
| Income from operations before income tax expense | 43,913 | 70,066 |
| Provision for income taxes | 16,858 | 26,969 |
| Net income | $27,055 | $43,097 |
| | | |
| Earnings per common share: | | |
| Basic | $0.40 | $0.62 |
| Diluted | $0.36 | $0.56 |
| Weighted-average number of common shares outstanding: | | |
| Basic | 67,579 | 68,006 |
| Diluted | 76,086 | 77,359 |

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Comprehensive Income

(Unaudited)

| (in thousands) | Three Months Ended March 31, 2016 | 2015 |
|---|---|---|
| Net income | $27,055 | $43,097 |
| Other comprehensive income/(loss), net of tax: [1] | | |
| Changes in unrealized gains/(losses) on available-for-sale securities [2] | (1,028 ) | 6,945 |
| Amortization of losses of securities transferred to held-to-maturity from available-for-sale | 509 | 731 |
| Changes in unrealized losses on cash flow hedging instruments [3] | (4,980 ) | (225 ) |
| Foreign currency translation adjustment | (2,186 ) | (3,978 ) |
| Total other comprehensive income/(loss), net of tax | (7,685 ) | 3,473 |
| Comprehensive income | $19,370 | $46,570 |

(1) Net of tax benefit of $4.7 million and tax expense of $2.4 million for the three months ended March 31, 2016 and 2015, respectively.
(2) There were no reclassifications to earnings of realized gains during the three months ended March 31, 2016 and 2015, respectively.
(3) Amounts are net of reclassifications to earnings of losses of $1.3 million and $1.2 million for the three months ended March 31, 2016 and 2015, respectively.
See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Cash Flows

(Unaudited)

| (in thousands) | Three Months Ended March 31, 2016 | 2015 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net income | $27,055 | $43,097 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization | 10,629 | 7,952 |
| Amortization of loans and advances to financial advisors and other employees | 18,995 | 15,769 |
| Amortization of premium on investment portfolio | 1,622 | 1,192 |
| Provision for loan losses and allowance for loans and advances to financial advisors and other employees | 4,571 | 2,200 |
| Amortization of intangible assets | 2,974 | 1,942 |
| Deferred income taxes | 72,979 | 49,469 |
| Excess tax benefits/(tax deficit) from stock-based compensation | 4,215 | (11,768) |
| Stock-based compensation | 30,450 | 22,356 |
| (Gains)/losses on sale of investments | 3,826 | (5,669) |
| Other, net | (2,524) | 3,382 |
| Decrease/(increase) in operating assets, net of assets acquired: | | |
| Cash segregated for regulatory purposes and restricted cash | 190,676 | 49,519 |
| Receivables: | | |
| Brokerage clients | 216,856 | (58,082) |
| Brokers, dealers, and clearing organizations | (117,959) | 200,414 |
| Securities purchased under agreements to resell | (47,523) | (143,534) |
| Financial instruments owned, including those pledged | (279,338) | (24,309) |
| Loans originated as held for sale | (419,601) | (464,087) |
| Proceeds from mortgages held for sale | 472,886 | 394,751 |
| Loans and advances to financial advisors and other employees | (25,417) | (10,782) |
| Other assets | (133,412) | (32,614) |
| Increase/(decrease) in operating liabilities, net of liabilities assumed: | | |
| Payables: | | |
| Brokerage clients | 76,992 | 10,791 |
| Brokers, dealers, and clearing organizations | (3,792) | (1,624) |
| Drafts | (109,354) | (20,357) |
| Financial instruments sold, but not yet purchased | 153,097 | (42,384) |
| Other liabilities and accrued expenses | (246,487) | (288,049) |
| Net cash used in operating activities | $(97,584) | $(300,425) |

See accompanying Notes to Consolidated Financial Statements.

7

STIFEL FINANCIAL CORP.

Consolidated Statements of Cash Flows (continued)

(Unaudited)

| (in thousands) | Three Months Ended March 31, 2016 | 2015 |
|---|---|---|
| Cash Flows From Investing Activities: | | |
| Proceeds from: | | |
| Maturities and principal paydowns of available-for-sale securities | $31,303 | $72,290 |
| Calls and principal paydowns of held-to-maturity securities | 37,577 | 23,186 |
| Sale or maturity of investments | 12,978 | 35,858 |
| Increase in bank loans, net | (327,931) | (190,183) |
| Payments for: | | |
| Purchase of available-for-sale securities | (529,707) | (199) |
| Purchase of held-to-maturity securities | (210,677) | — |
| Purchase of investments | (1,313) | (19,262) |
| Purchase of fixed assets | (9,270) | (20,996) |
| Acquisitions, net of cash acquired | (68,680) | (961) |
| Net cash used in investing activities | (1,065,720) | (100,267) |
| Cash Flows From Financing Activities: | | |
| Proceeds from borrowings | 238,497 | 20,500 |
| Proceeds from Federal Home Loan Bank advances | 352,000 | — |
| Increase in securities sold under agreements to repurchase | 12,055 | 216,678 |
| Increase in bank deposits, net | 579,744 | 43,959 |
| Increase/(decrease) in securities loaned | (151,319) | 442 |
| Excess tax benefits/(tax deficit) from stock-based compensation | (4,215) | 11,768 |
| Issuance of common stock for stock option exercises | 175 | 200 |
| Repurchase of common stock | (95,116) | — |
| Repayment of senior notes | — | (175,000) |
| Net cash provided by financing activities | 931,821 | 118,547 |
| Effect of exchange rate changes on cash | (2,186) | (3,881) |
| Decrease in cash and cash equivalents | (233,669) | (286,026) |
| Cash and cash equivalents at beginning of period | 811,019 | 689,782 |
| Cash and cash equivalents at end of period | $577,350 | $403,756 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes, net of refunds | $20,061 | $30,936 |
| Cash paid for interest | 13,630 | 10,135 |
| Noncash financing activities: | | |
| Unit grants, net of forfeitures | 98,876 | 53,045 |
| Issuance of common stock for acquisitions | 11,427 | — |
| Shares surrendered into treasury | — | 223 |

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 1 – Nature of Operations and Basis of Presentation

Nature of Operations

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

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

Basis of Presentation

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

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

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

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

NOTE 2 – Recently Issued Accounting Guidance

Share-Based Payments

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

Leases

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

Financial Assets and Financial Liabilities

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

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

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

Interest - Imputation of Interest

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

Revenue Recognition

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

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

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

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

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

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Deposits paid for securities borrowed | $420,417 | $318,105 |
| Receivables from clearing organizations | 221,643 | 260,077 |
| Securities failed to deliver | 77,730 | 23,649 |
| | $719,790 | $601,831 |

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

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Deposits received from securities loaned | $178,347 | $329,670 |
| Securities failed to receive | 71,263 | 16,353 |
| Payable to clearing organizations | 33,310 | 92,008 |
| | $282,920 | $438,031 |

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

NOTE 4 – Fair Value Measurements

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

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

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

Financial Instruments Owned and Available-For-Sale Securities

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

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

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

Investments

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

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

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

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

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

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

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

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

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

| | March 31, 2016 | |
|---|---|---|
| | Fair value of investments | Unfunded commitments |
| Private company investments | $28,106 | $ 13,651 |
| Partnership interests | 21,574 | 1,988 |
| Mutual funds | 20,521 | — |
| Private equity funds | 12,321 | 9,338 |
| Money market funds | 10,377 | — |
| Total | $92,899 | $ 24,977 |

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

Financial Instruments Sold, But Not Yet Purchased

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

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

Derivatives

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

Assets and liabilities measured at fair value on a recurring basis as of March 31, 2016, are presented below (in thousands):

| | March 31, 2016 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Financial instruments owned: | | | | |
| U.S. government securities | $38,165 | $38,165 | $— | $— |
| U.S. government agency securities | 71,900 | — | 71,900 | — |
| Mortgage-backed securities: | | | | |
| Agency | 267,056 | — | 267,056 | — |
| Non-agency | 33,774 | — | 32,341 | 1,433 |
| Corporate securities: | | | | |
| Fixed income securities | 340,946 | 24,873 | 316,073 | — |
| Equity securities | 75,837 | 72,662 | 2,556 | 619 |
| State and municipal securities | 201,103 | — | 201,103 | — |
| Total financial instruments owned | 1,028,781 | 135,700 | 891,029 | 2,052 |
| Available-for-sale securities: | | | | |
| U.S. government agency securities | 1,780 | 101 | 1,679 | — |
| State and municipal securities | 74,105 | — | 74,105 | — |
| Mortgage-backed securities: | | | | |
| Agency | 400,631 | — | 400,631 | — |
| Commercial | 19,565 | — | 19,565 | — |
| Non-agency | 2,283 | — | 2,283 | — |
| Corporate fixed income securities | 541,209 | — | 541,209 | — |
| Asset-backed securities | 1,085,893 | — | 1,085,893 | — |
| Total available-for-sale securities | 2,125,466 | 101 | 2,125,365 | — |
| Investments: | | | | |
| Corporate equity securities | 27,035 | 22,714 | 1,342 | 2,979 |
| Auction rate securities: | | | | |
| Equity securities | 50,864 | — | — | 50,864 |
| Municipal securities | 1,351 | — | — | 1,351 |
| Other [1] | 3,652 | 5 | 2,872 | 775 |
| Investments in funds measured at NAV | | | | |