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

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

FORM 10-K
(Mark One)

S ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended March 31, 2013
or
£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number
1-8529

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

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

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

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.	Yes	S	No	£
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.	Yes	£	No	S

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

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

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

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

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

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

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PART I
ITEM 1. BUSINESS.
General
Legg Mason is a global asset management company. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other pooled investment vehicles. We offer these products and services directly and through various financial intermediaries. We provide our asset management services through a number of asset managers, each of which generally markets its products and services under its own brand name and, in many cases, distributes retail products and services through a centralized retail distribution network.
Legg Mason, Inc. was incorporated in Maryland in 1981 to serve as a holding company for its various subsidiaries. The predecessor companies to Legg Mason trace back to Legg & Co., a Maryland-based broker-dealer formed in 1899. Our subsequent growth occurred primarily through internal expansion and the acquisition of asset management and broker-dealer firms. In December 2005, Legg Mason completed a transaction in which it sold its primary broker-dealer businesses to concentrate on the asset management industry.

Additional information about Legg Mason is available on our website at http://www.leggmason.com. We make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and our proxy statements. Investors can find this information under the “Investor Relations” section of our website. These reports are available through our website as soon as reasonably practicable after we electronically file the material with, or furnish it to, the Securities and Exchange Commission (“SEC”). In addition, the Legg Mason, Inc. Corporate Governance Principles, our Code of Conduct for all employees and directors and the charters for the committees of our Board of Directors are also available on our corporate website at http://www.leggmason.com under the “About Us - Corporate Governance” section. A copy of any of these materials may also be obtained, free of charge, by sending a written request to Corporate Secretary, Legg Mason, Inc., 100 International Drive, Baltimore, MD 21202. As required, and within the time frames required, by the SEC or the New York Stock Exchange (“NYSE”), we will post on our website any amendments to the Code of Conduct and any waiver of the Code of Conduct applicable to any executive officer, director, chief financial officer, principal accounting officer or controller. The information on our website is not incorporated by reference into this Report.
Unless the context otherwise requires, all references in this Report to “we,” “us,” “our” and “Legg Mason” include Legg Mason, Inc. and its predecessors and subsidiaries, and the term “asset managers” refers to the asset management businesses operated by our subsidiaries. References to “fiscal year 2013” or other fiscal years refer to the 12-month period ended March 31st of the year specified.
Business Developments During the Fiscal Year Ended March 31, 2013
During fiscal year 2013, in addition to the normal course operation of our business, we changed our Chief Executive Officer ("CEO") and reorganized our executive management team to more closely align it with our key strategic priorities, adopted a capital management plan to restructure and reduce our debt and continue to manage our balance sheet to return capital to shareholders, completed the acquisition of a leading European based fund-of-hedge funds manager, and entered into a transaction to better align the interests of one of our affiliate managers with those of our shareholders by providing an equity interest in one of our asset managers to the management of that manager.

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

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

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

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

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

Business Overview

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

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

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

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

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

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

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

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

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

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

Asset Managers

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

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

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

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

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

Permal Group, Ltd. is a leading global funds-of-hedge funds management firm. With its headquarters in London and other offices in New York City, Boston, Dubai, Paris, Tokyo, Hong Kong, Shanghai, Singapore and Nassau, Permal manages products which include both directional and absolute return strategies, and are available through multi-manager and single manager funds, separately managed accounts and structured products sponsored by several large financial institutions. Permal selects from among thousands of investment managers and investment firms in designing portfolios that are intended to meet a wide variety of specific investment objectives, including global, regional, class and sector specific offerings. In managing its directional offerings, Permal's objective is to participate significantly in strong markets, preserve capital in down or volatile markets and outperform market indices over a full market cycle with reduced risk and volatility. In managing its absolute return strategies, Permal seeks to achieve positive investment returns in all market conditions with low correlation to the overall equity markets. During fiscal year 2013, we acquired the Fauchier Partners business, which is being combined with the business of Permal. As of March 31, 2013, Permal managed assets with a value of $21.3 billion.

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

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

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

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

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

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

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

Legg Mason Poland engages in portfolio management, servicing and distribution of both separate account management services and local funds in Poland. Based in Warsaw, the firm provides portfolio management services primarily for equity assets to institutions, including corporate pension plans and insurance companies, and, through funds distributed through banks and insurance companies and individual investors. As of March 31, 2013, Legg Mason Poland managed assets with a value of $1.0 billion.

United States Mutual Funds

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

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

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

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

International Funds

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

Retail Separately Managed Account Programs

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

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

In addition to distributing funds, the wholesalers in our global distribution operations also support our retail separately managed account program services. These services are provided through programs sponsored by Morgan Stanley Wealth Management's retail business, as well as other financial institutions.
Outside of our global distribution group, each of our United States asset managers has its own marketing group that distributes its separate account management services to institutions or high net worth individuals and families. The institutional marketing groups distribute asset management services to potential clients, both directly and through consultants. Consultants play a large role in the institutional asset management business by helping clients select and retain asset managers. Institutional asset management clients and their consultants tend to be highly sophisticated and investment performance-driven. The high net worth individual marketing groups distribute asset management services for high net worth families and individuals both directly to clients and indirectly through financial intermediaries.

International Distribution
The international distributors within our global distribution group offer our investment management services to individual and institutional investors across Asia, Europe and the Americas. These distributors operate out of distribution offices in 16 cities in 14 countries and are the sole distributors of our cross border funds globally and our international local funds in their respective countries. The goal of our international distributors is to be a global partner for firms that utilize or distribute asset management products around the world, but also to be viewed as a local partner through an understanding of the nuances and needs of each local market that they cover. These distributors seek to develop deep distribution relationships with retail banks, private banks, asset managers, fund platforms, pension plans and insurance plans. Our international distribution offices also work with our asset managers on a case-by-case basis to take advantage of preferences for local distributors or to meet regulatory requirements in distributing products and services into their local markets.
Legg Mason Investments is the largest business component within our international distribution group. It is responsible for the distribution and servicing of cross border and local fund ranges across Europe, the Americas and Asia. Legg Mason Investments has offices in locations including London, Paris, Milan, Geneva, Frankfurt, Madrid, Singapore, Hong Kong, Taipei, Miami, Santiago and New York. Our distribution efforts are not limited to the locations where we have offices, as Legg Mason Investments distributes cross border funds in more than 30 countries

around the world. This global presence provides Legg Mason Investments with the capabilities to provide a platform of sales, service, marketing and products that can cater to the different distribution dynamics in each of the three regions that it covers. Client coverage is local, coordinated across regions, and encompasses multiple distribution channels including broker-dealers, funds-of-funds, asset managers, independent financial advisers, banks, fund platforms, insurance companies and other distribution partners. The extent to which each channel takes precedence in any one market is governed by local market dynamics.

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

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

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

Employees

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

Competition

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

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

Regulation

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

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

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

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

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

Net Capital Requirements

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

ITEM 1A. RISK FACTORS.

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

Risks Related to our Asset Management Business

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The asset management industry has experienced from time to time the entry of many new firms, as well as significant consolidation as numerous asset management firms have either been acquired by other financial services firms or ceased operations. In many cases, this has resulted in firms with greater financial resources than we have. In addition, a number of heavily capitalized companies, including commercial banks and foreign entities have made investments in and acquired asset management firms. Access to mutual fund distribution channels has also become increasingly competitive. All of these factors could make it more difficult for us to compete, and no assurance can be given that we will be successful in competing and growing our assets under management and business. If clients and potential clients decide to use the services of competitors, it could reduce our revenues and growth rate, and if our revenues decrease without a commensurate reduction in our expenses, our net income will be reduced. In this regard, there are a number of asset classes and product types that are not well covered by our current products and services. When these asset classes or products are in favor with investors, we will miss the opportunity to gain the assets under management that are being invested in these assets and face the risk of our managed assets being withdrawn in favor of competitors who provide services covering these classes or products. For example, to the extent there is a trend in the asset management business in favor of passive products such as index and exchange- traded funds, it favors our competitors who provide those products over active managers like our asset managers. In addition, our asset managers are not typically the lowest cost provider of asset management services. To the extent that we compete on the basis of price in any of our businesses, we may not be able to maintain our current fee structure in that business, which could adversely affect our revenues and net income.

In the retail separately managed account program business, there has been a trend toward more open programs that involve more asset managers who provide only investment models which the financial institution sponsor's employees use to allocate assets. A number of the programs for which we provide services have followed this trend, and additional programs could do so in the future. This trend could result in assets under management retention issues due to additional competition within the programs, particularly for products with performance issues, and reduced management fees, which are typical results of providing investment models rather than advisory services.

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

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

Approximately 21% of our assets under management as of March 31, 2013, consisted of assets in money market funds. Money market funds seek to preserve a stable net asset value. The money market funds our asset managers manage have always maintained this stable net asset value. However, there is no guarantee that this stable net asset value will be achieved in the future. Market conditions could lead to severe liquidity or security pricing issues, which could impact their net asset values. If the net asset value of a money market fund managed by our asset managers were to fall below its stable net asset value, we would likely experience significant redemptions in assets under management and reputational harm, which could have a material adverse effect on our revenues or net income.

If a money market fund's stable net asset value comes under pressure, we may elect, as we have done in the past, to provide credit, liquidity, or other support to the fund. We may also elect to provide similar or other support, including by providing liquidity to a fund, to other products we manage for any number of reasons. We are not legally required to support any money market fund or other product and there can be no assurance that any support would be sufficient to avoid an adverse impact on any product or investors in any product. A decision to provide support may arise from factors specific to our products or from industry-wide factors. If we elect to provide support, we could incur losses from the support we provide and incur additional costs, including financing costs, in connection with the support. These losses and additional costs could be material, and could adversely affect our earnings. If we were to take such actions we may also restrict our corporate assets, limiting our flexibility to use these assets for other purposes, and may be required to raise additional capital.

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

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

The Soundness of Other Financial Institutions Could Adversely Affect our Business

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

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

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

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

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

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

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

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

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Risks Related to our Company

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

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

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

The level of our indebtedness could:

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

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

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

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

We May Engage in Strategic Transactions That Could Create Risks

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

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

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

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

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

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

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

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

Loss of Key Personnel Could Harm our Business

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

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

Our Business is Subject to Numerous Operational Risks

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

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

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

We May Incur Charges Related to Leased Facilities

We continue to be exposed to the risk of incurring charges related to subleases or vacant space for several of our leased offices. As of March 31, 2013, our future commitments from third parties under non-cancellable subleases were approximately $152 million, which in total, net of reserves, effectively offsets obligations under our leases for the properties. As part of an evaluation of our real estate needs, we abandoned certain leased real estate during fiscal year 2013, and are pursuing sub-tenants for that space. As of March 31, 2013, our total future lease commitments for office space that we vacated and are seeking to sublease was approximately $76 million, of which we reserved approximately $29 million through lease charges to our earnings during the fiscal year ended March 31, 2013. Under generally accepted accounting principles, at the time a sublease is entered into or space is deemed permanently abandoned, we must incur a charge equal to the present value of the amount by which the commitments under the lease exceeds the amount due, or amount expected to be received, under a sublease. As a result, in a period of declining commercial lease markets, we are exposed to the risk of incurring charges relating to any premises we are seeking to sublease resulting from longer periods to identify sub-tenants and reduced market rent rates leading to new sub-tenants paying less in rent than we are paying under our lease. Also, if a sub-tenant defaults on its sublease, we would likely incur a charge for the rent that we will incur during the period that we expect would be required to sublease the premises and any reduction in rent that current market rent rates lead us to expect a new sub-tenant will pay. This risk is underscored by the fact that one sub-tenant represents approximately half of the future sublease rent commitments described above. There can be no assurance that we will not recognize additional lease-related charges, which may be material to our results of operations.

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

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

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

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

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

Our Deferred Tax Assets May Not Be Fully Realizable

As of March 31, 2013, we had approximately $771 million in U.S. federal deferred tax assets, which represent tax benefits that we expect to realize in future periods. Under accounting rules, we are required to recognize a charge to earnings to reduce our deferred tax assets if it is determined that any future tax benefits are not likely to be realized before they expire. Deferred tax assets generated in U.S. jurisdictions resulting from net operating losses generally expire 20 years after they are generated. Those resulting from foreign tax credits generally expire 10 years after they are generated. In order to realize these future tax benefits, we estimate that we must generate approximately $4.2 billion in future U.S. earnings, approximately $332 million of which must be in the form of foreign source income, before the benefits expire. There can be no assurances that we will achieve this level of earnings before some portion of these tax benefits expires. In addition, our belief that we will likely be able to realize these future tax benefits is based in part upon our estimates of the timing of other differences in revenue and expense recognition between tax returns and financial statements and our understanding of the application of tax regulations, which may prove to be incorrect for any number of reasons, including future changes in tax or accounting regulations. If we are required to recognize a charge to earnings to reduce our deferred tax assets, the charge may be material to our earnings or financial condition.

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

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

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

Legal and Regulatory Risks

Regulatory Matters May Negatively Affect our Business and Results of Operations

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

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

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

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

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

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

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

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS.
None.
ITEM 2. PROPERTIES.
We lease all of our office space. Our headquarters and certain other functions are located in an office building in Baltimore, Maryland, in which we currently hold under lease approximately 372,000 square feet, of which approximately 82,000 square feet has been subleased to third parties.
Our asset managers and other subsidiaries are housed in office buildings in 32 cities in 19 countries around the world. The largest of the leases include:

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

See Note 8 of Notes to Consolidated Financial Statements in Item 8 of this Report for a discussion of our lease obligations.
ITEM 3. LEGAL PROCEEDINGS.
Our current and former subsidiaries have been the subject of customer complaints and have also been named as defendants in various legal actions arising primarily from securities brokerage, asset management and investment banking activities, including certain class actions, which primarily allege violations of securities laws and seek unspecified damages, which could be substantial. For example, we are aware of litigation against certain underwriters of offerings in which one or more of our former subsidiaries was a participant, but where the former subsidiary is not now a defendant. In these latter cases, it is possible that we may be called upon to contribute to settlements or judgments. In the normal course of our business, our current and former subsidiaries have also received subpoenas and are currently involved in governmental and self-regulatory agency inquiries, investigations and, from time to time, proceedings involving asset management activities. In the 2005 transaction with Citigroup, we transferred to Citigroup the subsidiaries that constituted our private client brokerage and capital markets businesses, thus transferring the entities that would have primary liability for most of the customer complaint, litigation and regulatory liabilities and proceedings arising from those businesses. However, as part of that transaction, we agreed to indemnify Citigroup for most customer complaint, litigation and regulatory liabilities of our former private client brokerage and capital markets businesses that result from pre-closing events. In addition, the asset management business we acquired from Citigroup is a defendant in a number of legal actions, including class action litigation, arising from pre-closing asset management activities, some of which seek substantial damages. Under the terms of the transaction agreement with Citigroup, Citigroup has agreed to indemnify us for certain legal matters, including all currently known pre-closing legal matters, of the former CAM business. While the ultimate resolution of any pre-closing matters threatened or pending from our prior brokerage and capital markets businesses or the former CAM business cannot be determined at this time, based on current information and after consultation with legal counsel, management believes that any accrual or range of reasonably possible losses as of March 31, 2013 is not material. While the ultimate resolution of any other threatened or pending litigation and other matters cannot be currently determined, in the opinion of our management, after consultation with legal counsel, due in part to the preliminary nature of certain of these matters, we are currently unable to estimate the amount or range of potential losses from these matters, and our financial condition, results of operations and cash flows could be materially affected during a period in which a matter is ultimately resolved. See Note 8 of Notes to Consolidated Financial Statements in Item 8 of this Report.
ITEM 4. MINE SAFETY DISCLOSURES.

Not Applicable.

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT.

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

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

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

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

PART II

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

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

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

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

Purchases of our Common Stock

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

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

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

(2) Amounts exclude fees.

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

ITEM 6. SELECTED FINANCIAL DATA.

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

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

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

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

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

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

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

EXECUTIVE OVERVIEW

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

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

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

The fees that we charge for our investment services vary based upon factors such as the type of underlying investment product, the amount of assets under management, the asset management affiliate that provides the services, and the type of services (and investment objectives) that are provided. Fees charged for equity asset management services are generally higher than fees charged for fixed income and liquidity asset management services. Accordingly, our revenues and average AUM advisory revenue yields will be affected by the composition of our AUM, with changes in the relative level of equity assets more significantly impacting our revenues and average AUM advisory revenue yields. Average AUM advisory revenue yields are calculated as the ratio of annualized investment advisory fees, excluding performance fees, to average AUM. In addition, in the ordinary course of our business, we may reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. We have in place revenue sharing agreements with most of our asset management affiliates, under which specified percentages of the affiliates' revenues are required to be distributed to us and the balance of the revenues is retained to pay operating expenses, including compensation expenses, but excluding certain expenses and income taxes. Under these agreements, our asset management affiliates retain different percentages of revenues to cover their costs. As such, our Net Income (Loss) Attributable to Legg Mason, Inc., operating margin and compensation as a percentage of operating revenues are impacted based on which affiliates generate our revenues, and a change in AUM at one affiliate can have a dramatically different effect on our revenues and earnings than an equal change at another affiliate. In addition, from time to time we may agree to changes in revenue sharing agreements and other arrangements with our asset management personnel, which may impact our compensation expenses and profitability.

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

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

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

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

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

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

Operating efficiency	Management of expenses
	Restructuring of affiliate arrangements

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

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

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

BUSINESS ENVIRONMENT AND RESULTS OF OPERATIONS

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

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

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

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

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

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

n/m-not meaningful

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

FISCAL 2013 COMPARED WITH FISCAL 2012

Assets Under Management

Our AUM is primarily managed across the following asset classes:

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

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

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

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

AUM at March 31, 2013, was $664.6 billion, an increase of $21.3 billion, or 3%, from March 31, 2012. The increase in AUM was attributable to market performance and other of $34.2 billion, including the negative impact of foreign currency exchange fluctuations of $8.3 billion, and $5.4 billion related to the acquisition of Fauchier Partners Management Limited ("Fauchier"). These increases were offset in part by net client outflows of $11.7 billion and dispositions of $6.6 billion. The dispositions were in liquidity assets which resulted from the amendment of historical Smith Barney brokerage programs providing for investment in liquidity funds that our asset managers manage. Long-term asset classes accounted for the net client outflows, with $20.4 billion and $11.0 billion in equity and fixed income outflows, respectively, partially offset by liquidity inflows of $19.7 billion. Equity outflows were primarily experienced by products managed at Batterymarch Financial Management, Inc. (“Batterymarch”), Royce & Associates (“Royce”), The Permal Group, Ltd. ("Permal"), and Legg Mason Capital Management, LLC ("LMCM"). Due in part to investment performance issues, we have experienced net annual outflows in our equity asset class since fiscal 2007. The majority of fixed income outflows were in products managed by Western Asset Management Company ("Western Asset"), including $6.4 billion in outflows from a single, low fee global sovereign mandate. We expect to continue to experience outflows from this mandate of approximately $500 million per month during fiscal 2014. Fixed income outflows were offset in part by inflows at Brandywine Global Investment Management, LLC ("Brandywine"). We have experienced outflows in our fixed income asset class in all but two quarters since the fourth quarter of fiscal 2008. We generally earn higher fees and profits on equity AUM, and outflows in the equity asset class will more negatively impact our revenues and Net Income (Loss) Attributable to Legg Mason, Inc. than would outflows in other asset classes. We experienced liquidity outflows of approximately $13 billion from a sovereign wealth client during the month ended April 30, 2013, however, we do not expect this outflow to have a material impact on our revenues or net income.

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

AUM by Asset Class

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

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

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

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

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

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

AUM by Distribution Channel

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

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

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

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

Investment Performance

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

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

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

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

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

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

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

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

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

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

Past performance is not indicative of future results. For AUM included in institutional and retail separate accounts and investment funds included in the same strategy as separate accounts, performance comparisons are based on gross-of-fee performance. For investment funds (including fund-of-hedge funds) which are not managed in a separate account format, performance comparisons are based on net-of-fee performance. These performance comparisons do not reflect the actual performance of any specific separate account or investment fund; individual separate account and investment fund performance may differ.

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

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

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

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

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

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

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

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

Business Model Streamlining Initiative

In May 2010, we announced an initiative to streamline our business model to drive increased profitability and growth that primarily involved transitioning certain shared services to our investment affiliates which are closer to the actual client relationships. The initiative resulted in over $140 million in annual cost savings, substantially all of which are cash savings. These cost savings consist of (i) over $80 million in compensation and benefits cost reductions from eliminating positions in certain corporate shared services functions as a result of transitioning such functions to the affiliates, and charging affiliates for other centralized services that will continue to be provided to them without any corresponding adjustment in revenue sharing or other compensation arrangements; (ii) approximately $50 million in non-compensation costs from eliminating and streamlining activities in our corporate and distribution business units, including savings associated with consolidating office space; and (iii) approximately $10 million from our global distribution group sharing in affiliate revenues from retail assets under management without any corresponding adjustment in revenue sharing or other compensation arrangements.

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

RESULTS OF OPERATIONS

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

Operating Revenues

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

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

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

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

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

Operating Expenses

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

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

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

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

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

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

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

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

Occupancy expense increased 11.1% to