

STIFEL FINANCIAL CORP  
Form 10-Q  
August 08, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended June 30, 2017

OR

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

Commission File Number: 001-09305

STIFEL FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Delaware 43-1273600  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)  
501 N. Broadway, St. Louis, Missouri 63102-2188

(Address of principal executive offices and zip code)

(314) 342-2000

(Registrant's telephone number, including area code)

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Emerging growth company

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

The number of shares outstanding of the registrant’s common stock, \$0.15 par value per share, as of the close of business on August 1, 2017, was 68,309,855.

STIFEL FINANCIAL CORP.

Form 10-Q

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

<u>Item 1. Financial Statements</u>	3
<u>Consolidated Statements of Financial Condition as of June 30, 2017 (unaudited) and December 31, 2016</u>	3
<u>Consolidated Statements of Operations for the three and six months ended June 30, 2017 and June 30, 2016 (unaudited)</u>	5
<u>Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2017 and June 30, 2016 (unaudited)</u>	6
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and June 30, 2016 (unaudited)</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	9
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	47
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	75
<u>Item 4. Controls and Procedures</u>	79

PART II – OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	79
<u>Item 1A. Risk Factors</u>	79
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	79
<u>Item 6. Exhibits</u>	80
<u>Signatures</u>	81

2

---

## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## STIFEL FINANCIAL CORP.

## Consolidated Statements of Financial Condition

(in thousands)	June 30, 2017 (Unaudited)	December 31, 2016
<b>Assets</b>		
Cash and cash equivalents	\$678,054	\$912,932
Cash segregated for regulatory purposes	150	73,235
Receivables:		
Brokerage clients, net	1,364,624	1,415,936
Brokers, dealers, and clearing organizations	358,760	1,024,752
Securities purchased under agreements to resell	478,091	248,588
Financial instruments owned, at fair value	1,063,651	925,045
Available-for-sale securities, at fair value	3,455,373	3,181,313
Held-to-maturity securities, at amortized cost	3,307,970	3,038,405
Loans held for sale, at lower of cost or market	139,676	228,588
Bank loans, net	6,160,093	5,591,190
Investments, at fair value	128,332	133,563
Fixed assets, net	180,584	172,828
Goodwill	969,764	962,282
Intangible assets, net	115,253	116,304
Loans and advances to financial advisors and other employees, net	386,110	396,318
Deferred tax assets, net	133,603	225,453
Other assets	613,487	482,624
<b>Total Assets</b>	<b>\$19,533,575</b>	<b>\$19,129,356</b>

See accompanying Notes to Consolidated Financial Statements.

## STIFEL FINANCIAL CORP.

## Consolidated Statements of Financial Condition (continued)

	June 30, 2017 (Unaudited)	December 31, 2016
(in thousands, except share and per share amounts)		
<b>Liabilities and Shareholders' Equity</b>		
Payables:		
Brokerage clients	\$821,357	\$842,014
Brokers, dealers, and clearing organizations	433,343	523,107
Drafts	59,938	94,451
Securities sold under agreements to repurchase	243,999	268,546
Bank deposits	12,050,474	11,527,483
Financial instruments sold, but not yet purchased, at fair value	705,577	699,032
Accrued compensation	244,731	295,354
Accounts payable and accrued expenses	370,051	400,570
Federal Home Loan Bank advances	790,000	500,000
Borrowings	105,000	377,000
Senior notes	796,296	795,891
Debentures to Stifel Financial Capital Trusts	67,500	67,500
<b>Total liabilities</b>	<b>16,688,266</b>	<b>16,390,948</b>
Shareholders' Equity:		
Preferred stock - \$1 par value; authorized 3,000,000 shares; 6,000 shares issued	150,000	150,000
Common stock - \$0.15 par value; authorized 97,000,000 shares; issued 69,690,846		
and 69,507,842 shares, respectively	10,454	10,426
Additional paid-in-capital	1,784,654	1,840,551
Retained earnings	990,459	876,958
Accumulated other comprehensive loss	(25,537 )	(39,042 )
	2,910,030	2,838,893
Treasury stock, at cost, 1,409,250 and 2,866,492 shares, respectively	(64,721 )	(100,485 )
<b>Total Shareholders' Equity</b>	<b>2,845,309</b>	<b>2,738,408</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$19,533,575</b>	<b>\$19,129,356</b>

See accompanying Notes to Consolidated Financial Statements.

## STIFEL FINANCIAL CORP.

## Consolidated Statements of Operations

(Unaudited)

(in thousands, except per share amounts)	Three Months Ended		Six Months Ended June	
	June 30, 2017	2016	30, 2017	2016
<b>Revenues:</b>				
Commissions	\$ 172,264	\$ 182,104	\$ 347,538	\$ 380,034
Principal transactions	95,703	126,426	212,560	247,374
Investment banking	185,261	133,125	312,113	233,783
Asset management and service fees	172,914	144,567	335,653	289,099
Interest	108,951	65,780	209,904	128,607
Other income	7,198	17,405	15,950	24,595
Total revenues	742,291	669,407	1,433,718	1,303,492
Interest expense	16,644	17,262	32,540	31,373
Net revenues	725,647	652,145	1,401,178	1,272,119
<b>Non-interest expenses:</b>				
Compensation and benefits	453,876	460,023	890,263	871,136
Occupancy and equipment rental	57,892	58,746	110,437	116,002
Communications and office supplies	34,192	37,426	68,036	74,086
Commissions and floor brokerage	11,232	12,145	21,955	23,876
Other operating expenses	85,257	68,012	148,270	127,313
Total non-interest expenses	642,449	636,352	1,238,961	1,212,413
Income from operations before income tax expense	83,198	15,793	162,217	59,706
Provision for income taxes	30,387	6,022	43,894	22,880
Net income	52,811	9,771	118,323	36,826
Preferred dividends	2,344	—	4,688	—
Net income available to common shareholders	\$ 50,467	\$ 9,771	\$ 113,635	\$ 36,826
<b>Earnings per common share:</b>				
Basic	\$ 0.74	\$ 0.15	\$ 1.66	\$ 0.55
Diluted	\$ 0.63	\$ 0.13	\$ 1.41	\$ 0.48
<b>Weighted-average number of common shares outstanding:</b>				
Basic	68,556	66,792	68,471	67,186
Diluted	80,021	75,982	80,391	76,084

See accompanying Notes to Consolidated Financial Statements.



## STIFEL FINANCIAL CORP.

## Consolidated Statements of Comprehensive Income

(Unaudited)

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$52,811	\$9,771	\$118,323	\$36,826
Other comprehensive income/(loss), net of tax: <sup>(1)</sup>				
Changes in unrealized gains on available-for-sale securities <sup>(2)</sup>	3,770	11,449	7,547	10,421
Amortization of losses of securities transferred to held-to-maturity from available-for-sale	385	800	909	1,309
Changes in unrealized gains/(losses) on cash flow hedging instruments <sup>(3)</sup>	(518 )	(3,427 )	515	(8,407 )
Foreign currency translation adjustment	2,240	(5,093 )	4,534	(7,279 )
Total other comprehensive income/(loss), net of tax	5,877	3,729	13,505	(3,956 )
Comprehensive income	\$58,688	\$13,500	\$131,828	\$32,870

<sup>(1)</sup>Net of tax expense of \$3.7 million and \$2.3 million for the three months ended June 30, 2017 and 2016, respectively. Net of tax expense of \$8.5 million and tax benefit of \$2.5 million for the six months ended June 30, 2017 and 2016, respectively.

<sup>(2)</sup>There were no reclassifications to earnings during the three and six months ended June 30, 2017 and 2016, respectively.

<sup>(3)</sup>Amounts are net of reclassifications to earnings of losses of \$0.6 million and \$1.5 million for the three months ended June 30, 2017 and 2016, respectively. Amounts are net of reclassifications to earnings of losses of \$1.5 million and \$2.9 million for the six months ended June 30, 2017 and 2016, respectively.

See accompanying Notes to Consolidated Financial Statements.



## STIFEL FINANCIAL CORP.

## Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	Six Months Ended June 30,	
	2017	2016
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 118,323	\$ 36,826
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:		
Depreciation and amortization	16,649	21,604
Amortization of loans and advances to financial advisors and other employees	46,358	33,079
Amortization of premium on investment portfolio	5,964	4,655
Provision for loan losses and allowance for loans and advances to financial advisors and other employees	10,795	6,579
Amortization of intangible assets	6,246	8,008
Deferred income taxes	87,873	54,651
Tax deficit from stock-based compensation	—	5,197
Stock-based compensation	55,266	94,349
(Gains)/losses on sale of investments	(1,855 )	3,911
Gain on extinguishment of Stifel Financial Capital Trust	—	(5,607 )
Other, net	2,111	864
Decrease/(increase) in operating assets, net of assets acquired:		
Cash segregated for regulatory purposes and restricted cash	73,085	167,593
Receivables:		
Brokerage clients	51,312	133,799
Brokers, dealers, and clearing organizations	666,801	12,396
Securities purchased under agreements to resell	(229,503)	(133,343 )
Financial instruments owned, including those pledged	(137,353)	(337,032 )
Loans originated as held for sale	(749,265)	(1,093,740)
Proceeds from mortgages held for sale	821,115	1,041,457
Loans and advances to financial advisors and other employees	(33,105 )	(47,760 )
Other assets	(118,209)	(149,190 )
Increase/(decrease) in operating liabilities, net of liabilities assumed:		
Payables:		
Brokerage clients	(20,657 )	(36,181 )
Brokers, dealers, and clearing organizations	34,572	4,439
Drafts	(34,513 )	(115,039 )
Financial instruments sold, but not yet purchased	6,545	93,941
Other liabilities and accrued expenses	(67,666 )	(237,486 )
Net cash provided by/(used in) operating activities	\$ 610,889	\$ (432,030 )

See accompanying Notes to Consolidated Financial Statements.



## STIFEL FINANCIAL CORP.

## Consolidated Statements of Cash Flows (continued)

(Unaudited)

(in thousands)	Six Months Ended June	
	2017	2016
<b>Cash Flows From Investing Activities:</b>		
Proceeds from:		
Maturities and principal paydowns of available-for-sale securities	\$ 720,828	\$ 104,660
Calls and principal paydowns of held-to-maturity securities	132,018	93,686
Sale or maturity of investments	8,642	26,150
Increase in bank loans, net	(571,149 )	(1,032,497)
Payments for:		
Purchase of available-for-sale securities	(986,027 )	(927,687 )
Purchase of held-to-maturity securities	(403,250 )	(359,337 )
Purchase of investments	(1,556 )	(5,242 )
Purchase of fixed assets	(16,770 )	(14,159 )
Acquisitions, net of cash received	(9,070 )	(71,924 )
Net cash used in investing activities	(1,126,334)	(2,186,350)
<b>Cash Flows From Financing Activities:</b>		
Proceeds from/(repayments of) borrowings, net	(272,000 )	246,073
Proceeds from Federal Home Loan Bank advances, net	290,000	717,000
Payment of contingent consideration	(11,707 )	—
(Decrease)/increase in securities sold under agreements to repurchase	(24,547 )	38,328
Increase in bank deposits, net	522,991	1,242,863
Increase/(decrease) in securities loaned	(124,336 )	44,008
Tax deficit from stock-based compensation	—	(5,197 )
Restricted stock conversions	(86,682 )	(38,081 )
Proceeds from stock option exercises	—	175
Repurchase of common stock	(12,998 )	(95,116 )
Cash dividends on preferred stock	(4,688 )	—
Extinguishment of Stifel Financial Capital Trust	—	(9,393 )
Net cash provided by financing activities	276,033	2,140,660
Effect of exchange rate changes on cash	4,534	(7,279 )
Decrease in cash and cash equivalents	(234,878 )	(484,999 )
Cash and cash equivalents at beginning of period	912,932	811,019
Cash and cash equivalents at end of period	\$ 678,054	\$ 326,020
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for income taxes, net of refunds	\$ 17,811	\$ 21,211
Cash paid for interest	32,287	30,256
<b>Noncash financing activities:</b>		
Unit grants, net of forfeitures	48,630	131,736
Issuance of common stock for acquisitions	9,352	11,427

See accompanying Notes to Consolidated Financial Statements.

8

---

STIFEL FINANCIAL CORP.

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 1 – Nature of Operations and Basis of Presentation

Nature of Operations

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

On January 3, 2017, the Company completed the acquisition of City Financial Corporation and its wholly owned subsidiary, City Securities Corporation (“City Securities”), an independent investment bank focused primarily on offering wealth management and public finance services across the Midwest. The acquisition was funded with cash from operations and common stock.

Basis of Presentation

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

We have prepared the accompanying unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, we have omitted certain information and footnote disclosures we normally include in our annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles. In management’s opinion, we have made all adjustments (consisting only of normal, recurring adjustments, except as otherwise noted) necessary to fairly present our financial position, results of operations and cash flows. Our interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and the notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2016 on file with the SEC.

Certain amounts from prior periods have been reclassified to conform to the current period’s presentation. During the first quarter of 2017, we adopted Accounting Standards Update (“ASU”) 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. Amounts previously reported for the three and six months ended June 30, 2016 have been restated as required upon adoption of the ASU. See Note 2 for further discussion.

There have been no material changes in our significant accounting policies, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2016, with the exception of the new guidance on stock-based compensation.

NOTE 2 – New Accounting Pronouncements

Recently Adopted Accounting Guidance

Share-Based Payments

In March 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-09, “Improvements to Employee Share-Based Payment Accounting” that requires an entity to record all excess tax benefits and tax deficiencies as an income tax benefit or expense in the income statement. The update no longer requires cash flows related to excess tax benefits to be presented as a financing activity separate from other income tax cash flows. The update also clarifies that all cash payments to taxing authorities made on an employee's behalf for withheld shares should be presented as a financing activity on the statement of cash flows and requires an entity to elect an accounting policy to either estimate the number of forfeitures or account for forfeitures when they occur. The guidance is effective for fiscal years beginning after December 15, 2016 (January 1, 2017 for our company).

We adopted the guidance in the update on January 1, 2017, and during the six months ended June 30, 2017 recognized an excess tax benefit from stock-based compensation of \$17.1 million in the provision for income taxes on the accompanying consolidated

statements of operations (adopted prospectively). Excess tax benefits from stock based compensation are now classified in operating activities on the accompanying consolidated statement of cash flows instead of being separately stated in financing activities for the six months ended June 30, 2017 (adopted prospectively). Cash paid to a tax authority by our company when withholding shares from an employee's award for tax-withholding purposes are now classified as a financing activity in the accompanying consolidated statement of cash flows (adopted retrospectively). We reclassified \$38.1 million from operating activities to financing activities in the accompanying consolidated statement of cash flows for the six months ended June 30, 2016 pertaining to shares withheld from employee awards for tax withholding purposes. Following the adoption of ASU 2016-09, we will continue to estimate forfeitures.

### Goodwill Impairment Testing

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which simplifies the subsequent measurement of goodwill and eliminates Step 2 from the goodwill impairment test. Under the new guidance, the annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount, and an impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendments are to be applied on a prospective basis. The guidance is effective for annual or any interim impairment tests in fiscal years beginning after December 15, 2019 (January 1, 2020 for our company). Early adoption is permitted. We are currently evaluating the effect that the new guidance will have on our consolidated financial statements.

### Statement of Cash Flow – Restricted Cash

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flow - Restricted Cash," which adds or clarifies guidance on the classification and presentation of restricted cash in the statement of cash flows. The ASU is effective for the fiscal year beginning after December 15, 2017 (January 1, 2018 for our Company). Early adoption is permitted. We are currently evaluating the effect that the new guidance will have on our consolidated financial statements.

### Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." For trade receivables, loans, and held-to-maturity debt securities, the current probable loss recognition methodology is being replaced by an expected credit loss model. For available-for-sale debt securities, the recognition model on credit losses is generally unchanged, except the losses will be presented as an adjustable allowance. The guidance is effective for fiscal years beginning after December 15, 2019 (January 1, 2020 for our Company), including interim periods within that reporting period. Early adoption is permitted for annual periods beginning after December 15, 2018. We have been closely monitoring FASB activity related to the new standard. During the second half of 2016, we began developing a plan regarding the evaluation of the potential changes from adopting the new standard on our future financial reporting and disclosures. We expect to adopt the requirements of the new standard in the first quarter of 2020.

### Leases

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



standard. During the second half of 2016, we began developing a plan regarding the evaluation of the potential changes from adopting the new standard on our future financial reporting and disclosures. We also made progress on our contract reviews and detailed policy drafting. Based on our evaluation, we expect to adopt the requirements of the new standard in the first quarter of 2019 and anticipate using the modified retrospective approach.

#### Financial Assets and Financial Liabilities

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

#### Revenue Recognition

In April 2016, the FASB issued ASU No. 2016-10, "Identifying Performance Obligations and Licensing" that amends the revenue guidance in ASU 2014-09 on identifying performance obligations. The effective date of the new guidance will coincide with ASU 2014-09 during the first quarter 2018.

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

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

We have been closely monitoring FASB activity related to the new standard. Our implementation efforts include the identification of revenue within the scope of the guidance, and the potential impact on its consolidated results of operations and disclosures. The current broker dealer industry treatment of netting deal expenses with investment banking revenues, the timing of performance fee recognition related to consolidated alternative asset management entities, and fees received for equity research may be impacted by the new guidance. We are also evaluating whether certain asset management contract costs can be capitalized on the consolidated statements of financial position. We expect to adopt the requirements of the new standard in the first quarter of 2018 and anticipate using the modified retrospective approach.

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

Amounts receivable from brokers, dealers, and clearing organizations at June 30, 2017 and December 31, 2016, included (in thousands):

	June 30, 2017	December 31, 2016
Receivables from clearing organizations	\$ 153,241	\$ 568,373
Deposits paid for securities borrowed	145,285	382,691

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Securities failed to deliver	60,234	73,688
	\$358,760	\$1,024,752

Amounts payable to brokers, dealers, and clearing organizations at June 30, 2017 and December 31, 2016, included (in thousands):

	June 30, 2017	December 31, 2016
Deposits received from securities loaned	\$352,127	\$478,814
Securities failed to receive	50,315	27,882
Payable to clearing organizations	30,901	16,411
	\$433,343	\$523,107

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

NOTE 4 – Fair Value Measurements

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

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

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

#### Financial Instruments Owned and Available-For-Sale Securities

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

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

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

#### Investments

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

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

ARS are valued based upon our expectations of issuer redemptions and using internal discounted cash flow models that utilize unobservable inputs. ARS are reported as Level 3 assets. ARS for which recent market trades were observed that provided transparency into their valuation were classified as Level 2 at June 30, 2017.

Direct investments in private companies, reported as Level 3 assets, may be valued using the market approach and were valued based on an assessment of each underlying investment, incorporating evaluation of additional significant third-party financing, changes in valuations of comparable peer companies, the business environment of the companies, market indices, assumptions relating to appropriate risk adjustments for nonperformance, and legal

restrictions on disposition, among other factors. The fair value derived from the methods used are evaluated and weighted, as appropriate, considering the reasonableness of the range of values indicated. Under the market approach, fair value may be determined by reference to multiples of market-comparable companies or transactions, including earnings before interest, taxes, depreciation, and amortization (“EBITDA”) multiples. For securities utilizing the market comparable companies valuation technique, a significant increase (decrease) in the EBITDA multiple in isolation could result in a significantly higher (lower) fair value measurement.

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

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

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

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

	June 30, 2017	
	Fair value of investments	Unfunded commitments
Partnership interests	\$5,806	\$ 1,348
Mutual funds	12,441	—
Private equity funds	8,673	1,856
Money market funds	16,365	—
Total	\$43,285	\$ 3,204

	December 31, 2016	
	Fair value of investments	Unfunded commitments
Private company investments	\$18,763	\$ 8,526
Partnership interests	15,798	1,822
Mutual funds	11,301	—
Private equity funds	9,310	2,020
Money market funds	35,637	—
Total	\$90,809	\$ 12,368

#### Financial Instruments Sold, But Not Yet Purchased

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

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

## Derivatives

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

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2017, are presented below (in thousands):

	June 30, 2017			
	Total	Level 1	Level 2	Level 3
<b>Financial instruments owned:</b>				
U.S. government securities	\$ 16,924	\$ 16,924	\$—	\$—
U.S. government agency securities	119,703	—	119,703	—
<b>Mortgage-backed securities:</b>				
Agency	313,463	—	313,463	—
Non-agency	54,566	—	54,041	525
<b>Corporate securities:</b>				
Fixed income securities	367,866	7,443	360,167	256
Equity securities	43,671	43,304	—	367
State and municipal securities	147,458	—	147,458	—
<b>Total financial instruments owned</b>	<b>1,063,651</b>	<b>67,671</b>	<b>994,832</b>	<b>1,148</b>
<b>Available-for-sale securities:</b>				
U.S. government agency securities	4,565	199	4,366	—
State and municipal securities	72,382	—	72,382	—
<b>Mortgage-backed securities:</b>				
Agency	319,062	—	319,062	—
Commercial	72,688	—	72,688	—
Non-agency	1,617	—	1,617	—
Corporate fixed income securities	971,131	—	971,131	—
Asset-backed securities	2,013,928	—	2,013,928	—
<b>Total available-for-sale securities</b>	<b>3,455,373</b>	<b>199</b>	<b>3,455,174</b>	<b>—</b>
<b>Investments:</b>				
Corporate equity securities	50,384	50,144	—	240
<b>Auction rate securities:</b>				
Equity securities	48,577	—	13,956	34,621
Municipal securities	841	—	—	841
Other	1,610	—	370	1,240
Investments in funds measured at NAV	26,920			
<b>Total investments</b>	<b>128,332</b>	<b>50,144</b>	<b>14,326</b>	<b>36,942</b>
Cash equivalents measured at NAV	16,365			
Derivative contracts <sup>(1)</sup>	8,442		\$ 8,442	
	\$ 4,672,163	\$ 118,014	\$ 4,472,774	\$ 38,090

<sup>(1)</sup>Included in other assets in the consolidated statements of financial condition.

	June 30, 2017			
	Total	Level 1	Level 2	Level 3



Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Liabilities:				
Financial instruments sold, but not yet purchased:				
U.S. government securities	\$298,832	\$298,832	\$—	\$ —
U.S. government agency securities	1,995	—	1,995	—
Mortgage-backed securities				
Agency	118,458	—	118,458	—
Non-agency	16	—	16	—
Corporate securities:				
Fixed income securities	245,148	317	244,831	—
Equity securities	41,091	41,091	—	—
State and municipal securities	37	—	37	—
Total financial instruments sold, but not yet purchased	705,577	340,240	365,337	—
Derivative contracts <sup>(2)</sup>	939		939	
	\$706,516	\$340,240	\$366,276	\$ —

15

(2)Included in accounts payable and accrued expenses in the consolidated statements of financial condition. Assets and liabilities measured at fair value on a recurring basis as of December 31, 2016, are presented below (in thousands):

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
<b>Financial instruments owned:</b>				
U.S. government securities	\$9,951	\$9,951	\$—	\$—
U.S. government agency securities	89,833	—	89,833	—
<b>Mortgage-backed securities:</b>				
Agency	305,774	—	305,774	—
Non-agency	28,402	—	27,320	1,082
<b>Corporate securities:</b>				
Fixed income securities	299,946	1,944	297,729	273
Equity securities	32,044	31,444	—	600
State and municipal securities	159,095	—	159,095	—
<b>Total financial instruments owned</b>	<b>925,045</b>	<b>43,339</b>	<b>879,751</b>	<b>1,955</b>
<b>Available-for-sale securities:</b>				
U.S. government agency securities	4,197	300	3,897	—
State and municipal securities	72,490	—	72,490	—
<b>Mortgage-backed securities:</b>				
Agency	338,732	—	338,732	—
Commercial	72,773	—	72,773	—
Non-agency	1,892	—	1,892	—
Corporate fixed income securities	823,511	—	823,511	—
Asset-backed securities	1,867,718	—	1,867,718	—
<b>Total available-for-sale securities</b>	<b>3,181,313</b>	<b>300</b>	<b>3,181,013</b>	<b>—</b>
<b>Investments:</b>				
Corporate equity securities	27,247	23,414	—	3,833
<b>Auction rate securities:</b>				
Equity securities	48,689	—	—	48,689
Municipal securities	832	—	—	832
Other	1,623	—	383	1,240
Investments measured at NAV	55,172			
<b>Total investments</b>	<b>133,563</b>	<b>23,414</b>	<b>383</b>	<b>54,594</b>
Cash equivalents measured at NAV	35,637			
Derivative contracts <sup>(1)</sup>	10,390	—	10,390	—
	<b>\$4,285,948</b>	<b>\$67,053</b>	<b>\$4,071,537</b>	<b>\$56,549</b>

(1)Included in other assets in the consolidated statements of financial condition.

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
<b>Liabilities:</b>				
Financial instruments sold, but not yet purchased:				
U.S. government securities	\$362,536	\$362,536	\$—	\$ —
U.S. government agency securities	20,549	—	20,549	—
Mortgage-backed securities				
Agency	94,552	—	94,552	—
Non-agency	1	—	1	—
Corporate securities:				
Fixed income securities	202,968	980	201,988	—
Equity securities	18,395	18,395	—	—
State and municipal securities	31	—	31	—
Total financial instruments sold, but not yet purchased	699,032	381,911	317,121	—
Derivative contracts <sup>(2)</sup>	1,823	—	1,823	—
	\$700,855	\$381,911	\$318,944	\$ —

(2)Included in accounts payable and accrued expenses in the consolidated statements of financial condition. The following table summarizes the changes in fair value associated with Level 3 financial instruments during the three months ended June 30, 2017 (in thousands):

	Three Months Ended June 30, 2017						
	Financial instruments owned			Investments			
	Mortgage-						
	Backed			Auction Rate		Auction Rate	
	Securities			Securities –		Securities –	
	Fixed	Equity	Corporate	Securities –	Securities –		
	Income	Securities	Equity	Municipal	Other		
	Non-Agency	Securities	Securities	Equity			
Balance at March 31, 2017	\$1,019	\$ 267	\$ 583	\$3,833	\$ 49,055	\$ 837	\$1,240
Unrealized gains/(losses):							
Included in changes in net assets <sup>(1)</sup>	(100 )	—	(216 )	—	251	4	—
Included in OCI <sup>(2)</sup>	—	—	—	—	—	—	—
Realized gains/(losses) <sup>(1)</sup>	96	—	—	—	—	—	—
Purchases	—	—	—	—	—	—	—
Sales	(324 )	—	—	—	—	—	—

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Redemptions	(166 )	(11 )	—	—	—	—	—
Transfers:							
Into Level 3	—	—	—	—	—	—	—
Out of Level 3	—	—	—	(3,593)	(14,685 )	—	—
Net change	(494 )	(11 )	(216 )	(3,593)	(14,434 )	4	—
Balance at June 30, 2017	\$525	\$ 256	\$ 367	\$240	\$ 34,621	\$ 841	\$1,240

(1) Realized and unrealized gains/(losses) related to financial instruments owned and investments are reported in other income in the consolidated statements of operations.

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

The following table summarizes the change in fair value associated with Level 3 financial instruments during the six months ended June 30, 2017 (in thousands):

17

Six Months Ended June 30, 2017

Financial instruments owned Investments  
Mortgage-

Backed

Auction Rate Auction Rate

Securities

– Fixed Income Securities – Securities –  
Equity Securities Equity Securities Equity Municipal Other

Balance at December 31, 2016	\$1,082	\$ 273	\$ 600	\$3,833	\$ 48,689	\$ 832	\$1,240
Unrealized gains/(losses):							
Included in changes in net assets <sup>(1)</sup>	(100 )	—	(233 )	—	617	9	—
Included in OCI <sup>(2)</sup>	—	—	—	—	—	—	—
Realized gains/(losses) <sup>(1)</sup>	97	—	—	—	—	—	—
Purchases	—	—	—	—	—	—	—
Sales	(324 )	—	—	—	—	—	—
Redemptions	(230 )	(17 )	—	—	—	—	—
Transfers:							
Into Level 3	—	—	—	—	—	—	—
Out of Level 3	—	—	—	(3,593)	(14,685 )	—	—
Net change	(557 )	(17 )	(233 )	(3,593)	(14,068 )	9	—
Balance at June 30, 2017	\$525	\$ 256	\$ 367	\$240	\$ 34,621	\$ 841	\$1,240

<sup>(1)</sup>Realized and unrealized gains/(losses) related to financial instruments owned and investments are reported in other income in the consolidated statements of operations.

<sup>(2)</sup>Unrealized gains/(losses) related to available-for-sale securities are reported in accumulated other comprehensive loss in the consolidated statements of financial.

The results included in the tables above are only a component of the overall investment strategies of our company. The tables above do not present Level 1 or Level 2 valued assets or liabilities. The changes to our company's Level 3 classified instruments during the six months ended June 30, 2017 were principally a result of transfers out of Level 3 due to market activity that provided transparency into the valuation of these assets. The changes in unrealized gains/(losses) recorded in earnings for the three and six months ended June 30, 2017, relating to Level 3 assets still held at June 30, 2017, were immaterial.

The following table summarizes quantitative information related to the significant unobservable inputs utilized in our company's Level 3 recurring fair value measurements as of June 30, 2017.

	Valuation technique	Unobservable input	Range	Weighted average
Investments:				
Auction rate securities:				
Equity securities	Discounted cash flow	Discount rate	1.2% - 10.5%	5.2%
		Workout period	1 - 3 years	2.2 years
Municipal securities	Discounted cash flow	Discount rate	1.6% - 9.4%	3.9%
		Workout period	1 - 4 years	1.9 years

The fair value of certain Level 3 assets was determined using various methodologies, as appropriate, including third-party pricing vendors and broker quotes. These inputs are evaluated for reasonableness through various procedures, including due diligence reviews of third-party pricing vendors, variance analyses, consideration of current market environment, and other analytical procedures.

The fair value for our auction rate securities was determined using an income approach based on an internally developed discounted cash flow model. The discounted cash flow model utilizes two significant unobservable inputs: discount rate and workout period. The discount rate was calculated using credit spreads of the underlying collateral or similar securities. The workout period was based on an assessment of publicly available information on efforts to re-establish functioning markets for these securities and our company's own redemption

experience. Significant increases in any of these inputs in isolation would result in a significantly lower fair value. On an ongoing basis, management verifies the fair value by reviewing the appropriateness of the discounted cash flow model and its significant inputs.

#### Transfers Within the Fair Value Hierarchy

We assess our financial instruments on a quarterly basis to determine the appropriate classification within the fair value hierarchy. Transfers between fair value classifications occur when there are changes in pricing observability levels. Transfers of financial instruments among the levels are deemed to occur at the beginning of the reporting period. There were \$1.0 million and \$1.1 million of transfers of financial assets from Level 2 to Level 1 during the three and six months ended June 30, 2017, respectively, primarily related to corporate fixed income securities for which market trades were observed that provided transparency into the valuation of these assets. There were \$4.0 million and \$4.4 million of transfers of financial assets from Level 1 to Level 2 during the three and six months ended June 30, 2017, respectively, primarily related to corporate fixed income securities for which there were low volumes of recent trade activity observed. There were no transfers into Level 3 during the six months ended June 30, 2017. There were \$18.3 million of transfers of financial assets out of Level 3 during the three and six months ended June 30, 2017, primarily related to ARS and corporate equity securities for which market trades were observed that provided transparency into the valuation of these assets.

#### Fair Value of Financial Instruments

The following reflects the fair value of financial instruments as of June 30, 2017 and December 31, 2016, whether or not recognized in the consolidated statements of financial condition at fair value (in thousands).

	June 30, 2017		December 31, 2016	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$678,054	\$678,054	\$912,932	\$912,932
Cash segregated for regulatory purposes	150	150	73,235	73,235
Securities purchased under agreements to resell	478,091	478,091	248,588	248,588
Financial instruments owned	1,063,651	1,063,651	925,045	925,045
Available-for-sale securities	3,455,373	3,455,373	3,181,313	3,181,313
Held-to-maturity securities	3,307,970	3,321,880	3,038,405	3,040,554
Loans held for sale	139,676	139,676	228,588	228,588
Bank loans	6,160,093	5,994,527	5,591,190	5,633,804
Investments	128,332	128,332	133,563	133,563
Derivative contracts <sup>(1)</sup>	8,442	8,442	10,390	10,390
<b>Financial liabilities:</b>				
Securities sold under agreements to repurchase	\$243,999	\$243,999	\$268,546	\$268,546
Bank deposits	12,050,474	11,366,970	11,527,483	11,092,185
Financial instruments sold, but not yet purchased	705,577	705,577	699,032	699,032
Derivative contracts <sup>(2)</sup>	939	939	1,823	1,823
Federal Home Loan Bank advances	790,000	790,000	500,000	500,000
Borrowings	105,000	105,000	377,000	377,000

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Senior notes	796,296	811,318	795,891	799,632
Debentures to Stifel Financial Capital Trusts	67,500	50,413	67,500	52,525

(1)Included in other assets in the consolidated statements of financial condition.

(2)Included in accounts payable and accrued expenses in the consolidated statements of financial condition.

19

---



The following table presents the estimated fair values of financial instruments not measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017			
	Total	Level 1	Level 2	Level 3
<b>Financial assets:</b>				
Cash	\$661,689	\$661,689	\$—	\$—
Cash segregated for regulatory purposes	150	150	—	—
Securities purchased under agreements to resell	478,091	478,091	—	—
Held-to-maturity securities	3,321,880	—	3,119,542	202,338
Loans held for sale	139,676	—	139,676	—
Bank loans	5,994,527	—	5,994,527	—
<b>Financial liabilities:</b>				
Securities sold under agreements to repurchase	\$243,999	\$—	\$243,999	\$—
Bank deposits	11,366,970	—	11,366,970	—
Federal Home Loan Bank advances	790,000	790,000	—	—
Borrowings	105,000	105,000	—	—
Senior notes	811,318	811,318	—	—
Debentures to Stifel Financial Capital Trusts	50,413	—	—	50,413

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
<b>Financial assets:</b>				
Cash	\$877,295	\$877,295	\$—	\$—
Cash segregated for regulatory purposes	73,235	73,235	—	—
Securities purchased under agreements to resell	248,588	227,983	20,605	—
Held-to-maturity securities	3,040,554	—	2,830,869	209,685
Loans held for sale	228,588	—	228,588	—
Bank loans	5,633,804	—	5,633,804	—
<b>Financial liabilities:</b>				
Securities sold under agreements to repurchase	\$268,546	\$149,881	\$118,665	\$—
Bank deposits	11,092,185	—	11,092,185	—
Federal Home Loan Bank advances	500,000	500,000	—	—
Borrowings	377,000	377,000	—	—
Senior notes	799,632	799,632	—	—
Debentures to Stifel Financial Capital Trusts	52,525	—	—	52,525

The following, as supplemented by the discussion above, describes the valuation techniques used in estimating the fair value of our financial instruments as of June 30, 2017 and December 31, 2016.

#### Financial Assets

##### Securities Purchased Under Agreements to Resell

Securities purchased under agreements to resell are collateralized financing transactions that are recorded at their contractual amounts plus accrued interest. The carrying values at June 30, 2017 and December 31, 2016 approximate fair value due to their short-term nature.

#### Held-to-Maturity Securities

Securities held to maturity are recorded at amortized cost based on our company's positive intent and ability to hold these securities to maturity. Securities held to maturity include agency mortgage-backed securities, asset-backed securities, consisting of collateralized loan obligation securities and corporate fixed income securities. The estimated fair value, included in the above table, is determined using several factors; however, primary weight is given to discounted cash flow modeling techniques that incorporated an estimated discount rate based upon recent observable debt security issuances with similar characteristics.

### Loans Held for Sale

Loans held for sale consist of fixed-rate and adjustable-rate residential real estate mortgage loans intended for sale. Loans held for sale are stated at lower of cost or market value. Market value is determined based on prevailing market prices for loans with similar characteristics or on sale contract prices.

### Bank Loans

The fair values of mortgage loans and commercial loans were estimated using a discounted cash flow method, a form of the income approach. Discount rates were determined considering rates at which similar portfolios of loans, with similar remaining maturities, would be made and considering liquidity spreads applicable to each loan portfolio based on the secondary market.

### Financial Liabilities

#### Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase are collateralized financing transactions that are recorded at their contractual amounts plus accrued interest. The carrying values at June 30, 2017 and December 31, 2016 approximate fair value due to the short-term nature.

#### Bank Deposits

The fair value of interest-bearing deposits, including certificates of deposits, demand deposits, savings, and checking accounts, was calculated by discounting the future cash flows using discount rates based on the replacement cost of funding of similar structures and terms.

#### Borrowings

The carrying amount of borrowings approximates fair value due to the relative short-term nature of such borrowings. In addition, Stifel Bank's FHLB advances reflect terms that approximate current market rates for similar borrowings.

#### Senior Notes

The fair value of our senior notes is estimated based upon quoted market prices.

#### Debentures to Stifel Financial Capital Trusts

The fair value of our trust preferred securities is based on the discounted value of contractual cash flows. We have assumed a discount rate based on the coupon achieved in our 4.250% senior notes due 2024.

These fair value disclosures represent our best estimates based on relevant market information and information about the financial instruments. Fair value estimates are based on judgments regarding future expected losses, current economic conditions, risk characteristics of the various instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in the above methodologies and assumptions could significantly affect the estimates.



## NOTE 5 – Financial Instruments Owned and Financial Instruments Sold, But Not Yet Purchased

The components of financial instruments owned and financial instruments sold, but not yet purchased, at June 30, 2017 and December 31, 2016 are as follows (in thousands):

	June 30, 2017	December 31, 2016
<b>Financial instruments owned:</b>		
U.S. government securities	\$ 16,924	\$ 9,951
U.S. government agency securities	119,703	89,833
<b>Mortgage-backed securities:</b>		
Agency	313,463	305,774
Non-agency	54,566	28,402
<b>Corporate securities:</b>		
Fixed income securities	367,866	299,946
Equity securities	43,671	32,044
State and municipal securities	147,458	159,095
	\$ 1,063,651	\$ 925,045
<b>Financial instruments sold, but not yet purchased:</b>		
U.S. government securities	\$ 298,832	\$ 362,536
U.S. government agency securities	1,995	20,549
<b>Mortgage-backed securities:</b>		
Agency	118,458	94,552
Non-agency	16	1
<b>Corporate securities:</b>		
Fixed income securities	245,148	202,968
Equity securities	41,091	18,395
State and municipal securities	37	31
	\$ 705,577	\$ 699,032

At June 30, 2017 and December 31, 2016, financial instruments owned in the amount of \$591.6 million and \$992.9 million, respectively, were pledged as collateral for our repurchase agreements and short-term borrowings. Financial instruments owned on a settlement-date basis were \$1.3 billion at December 31, 2016. Our financial instruments owned are presented on a trade-date basis in the consolidated statements of financial condition.

Financial instruments sold, but not yet purchased, represent obligations of our company to deliver the specified security at the contracted price, thereby creating a liability to purchase the security in the market at prevailing prices in future periods. We are obligated to acquire the securities sold short at prevailing market prices in future periods, which may exceed the amount reflected in the consolidated statements of financial condition.



## NOTE 6 – Available-for-Sale and Held-to-Maturity Securities

The following tables provide a summary of the amortized cost and fair values of the available-for-sale securities and held-to-maturity securities at June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017			
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Estimated
	Cost	Gains <sup>(1)</sup>	Losses <sup>(1)</sup>	Fair Value
<b>Available-for-sale securities</b>				
U.S. government agency securities	\$4,584	\$ —	\$(19 )	\$4,565
State and municipal securities	75,685	2	(3,305 )	72,382
<b>Mortgage-backed securities:</b>				
Agency	321,352	131	(2,421 )	319,062
Commercial	76,131	42	(3,485 )	72,688
Non-agency	1,721	—	(104 )	1,617
Corporate fixed income securities	971,867	2,843	(3,579 )	971,131
Asset-backed securities	2,000,561	13,367	—	2,013,928
	\$3,451,901	\$ 16,385	\$(12,913 )	\$3,455,373
<b>Held-to-maturity securities <sup>(2)</sup></b>				
<b>Mortgage-backed securities:</b>				
Agency	\$1,454,314	\$ 16,885	\$(14,474 )	\$1,456,725
Commercial	59,518	2,088	—	61,606
Asset-backed securities	1,754,093	11,405	(2,063 )	1,763,435
Corporate fixed income securities	40,045	69	—	40,114
	\$3,307,970	\$ 30,447	\$(16,537 )	\$3,321,880
	December 31, 2016			
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Estimated
	Cost	Gains <sup>(1)</sup>	Losses <sup>(1)</sup>	Fair Value
<b>Available-for-sale securities</b>				
U.S. government agency securities	\$4,213	\$ 2	\$(18 )	\$4,197
State and municipal securities	76,066	—	(3,576 )	72,490
<b>Mortgage-backed securities:</b>				
Agency	340,738	298	(2,304 )	338,732
Commercial	77,417	59	(4,703 )	72,773
Non-agency	2,032	—	(140 )	1,892
Corporate fixed income securities	830,695	1,418	(8,602 )	823,511
Asset-backed securities	1,858,929	9,857	(1,068 )	1,867,718

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

	\$3,190,090	\$ 11,634	\$ (20,411 )	\$3,181,313
Held-to-maturity securities <sup>(2)</sup>				
Mortgage-backed securities:				
Agency	\$1,567,758	\$ 14,537	\$ (17,037 )	\$1,565,258
Commercial	59,581	1,786	—	61,367
Non-agency	688	—	(13 )	675
Asset-backed securities	1,370,300	6,242	(3,396 )	1,373,146
Corporate fixed income securities	40,078	30	—	40,108
	\$3,038,405	\$ 22,595	\$ (20,446 )	\$3,040,554

<sup>(1)</sup>Unrealized gains/(losses) related to available-for-sale securities are reported in accumulated other comprehensive loss.

<sup>(2)</sup>Held-to-maturity securities are carried in the consolidated statements of financial condition at amortized cost, and the changes in the value of these securities, other than impairment charges, are not reported on the consolidated financial statements.

For the three and six months ended June 30, 2017, we received proceeds of \$87.3 million from the sale of available-for-sale securities, which resulted in realized gains of \$0.4 million. There were no sales of available-for-sale securities during the three and six months ended June 30, 2016.



During the three months ended June 30, 2017 and June 30, 2016, unrealized gains, net of deferred taxes, of \$3.8 million and \$ 11.4 million were recorded in accumulated other comprehensive loss in the consolidated statements of financial condition. During the six months ended June 30, 2017 and June 30, 2016, unrealized gains, net of deferred taxes, of \$7.5 million and \$10.4 million were recorded in accumulated other comprehensive loss in the consolidated statements of financial condition.

The table below summarizes the amortized cost and fair values of debt securities by contractual maturity. Expected maturities may differ significantly from contractual maturities, as issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2017			
	Available-for-sale securities		Held-to-maturity securities	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
<b>Debt securities</b>				
Within one year	\$142,136	\$142,514	\$40,045	\$40,114
After one year through three years	138,597	139,032	—	—
After three years through five years	432,593	432,306	—	—
After five years through ten years	702,630	703,979	335,011	335,513
After ten years	1,636,741	1,644,175	1,419,082	1,427,922
<b>Mortgage-backed securities</b>				
After three years through five years	—	—	59,518	61,606
After five years through ten years	58,618	55,846	162,429	161,038
After ten years	340,586	337,521	1,291,885	1,295,687
	<b>\$3,451,901</b>	<b>\$3,455,373</b>	<b>\$3,307,970</b>	<b>\$3,321,880</b>

The maturities of our available-for-sale (fair value) and held-to-maturity (amortized cost) securities at June 30, 2017, are as follows (in thousands):

	Within 1		After 10		Total
	Year	1-5 Years	5-10 Years	Years	
<b>Available-for-sale: <sup>(1)</sup></b>					
U.S. government agency securities	\$824	\$3,741	\$—	\$—	\$4,565
State and municipal securities	200	375	16,738	55,069	72,382
<b>Mortgage-backed securities:</b>					
Agency	—	—	412	318,650	319,062
Commercial	—	—	55,434	17,254	72,688
Non-agency	—	—	—	1,617	1,617
Corporate fixed income securities	141,490	567,222	262,419	—	971,131
Asset-backed securities	—	—	424,822	1,589,106	2,013,928
	<b>\$142,514</b>	<b>\$571,338</b>	<b>\$759,825</b>	<b>\$1,981,696</b>	<b>\$3,455,373</b>

Held-to-maturity:					
Mortgage-backed securities:					
Agency	\$—	\$—	\$162,429	\$1,291,885	\$1,454,314
Commercial	—	59,518	—	—	59,518
Asset-backed securities	—	—	335,011	1,419,082	1,754,093
Corporate fixed income securities	40,045	—	—	—	40,045
	\$40,045	\$59,518	\$497,440	\$2,710,967	\$3,307,970

<sup>(1)</sup>Due to the immaterial amount of income recognized on tax-exempt securities, yields were not calculated on a tax-equivalent basis.

At June 30, 2017 and December 31, 2016, securities of \$1.9 billion and \$2.0 billion, respectively, were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit obtained to secure public deposits. At June 30, 2017 and December 31, 2016, securities of \$1.9 billion and \$1.7 billion, respectively, were pledged with the Federal Reserve discount window.

The following table shows the gross unrealized losses and fair value of the Company's investment securities with unrealized losses, aggregated by investment category and length of time the individual investment securities have been in continuous unrealized loss positions, at June 30, 2017 (in thousands):

	Less than 12 months		12 months or more		Total	
	Gross		Gross		Gross	
	Estimated		Estimated		Estimated	
	Unrealized	Fair	Unrealized	Fair	Unrealized	Fair
	Losses	Value	Losses	Value	Losses	Value
<b>Available-for-sale securities</b>						
U.S. government securities	\$(19 )	\$4,565	\$—	\$—	\$(19 )	\$4,565
State and municipal securities	(261 )	9,765	(3,044)	60,113	(3,305 )	69,878
<b>Mortgage-backed securities:</b>						
Agency	(604 )	155,073	(1,817)	133,664	(2,421 )	288,737
Commercial	(3,485 )	71,139	—	—	(3,485 )	71,139
Non-agency	—	—	(104 )	1,585	(104 )	1,585
Corporate fixed income securities	(3,579 )	396,324	—	—	(3,579 )	396,324
	\$(7,948 )	\$636,866	\$(4,965)	\$195,362	\$(12,913)	\$832,228
<b>Held-to-maturity securities</b>						
<b>Mortgage-backed securities:</b>						
Agency	\$(14,457)	\$830,887	\$(17 )	\$1,165	\$(14,474)	\$832,052
Asset-backed securities	(312 )	116,997	(1,751)	34,391	(2,063 )	151,388
	\$(14,769)	\$947,884	\$(1,768)	\$35,556	\$(16,537)	\$983,440

At June 30, 2017, the amortized cost of 124 securities classified as available for sale exceeded their fair value by \$12.9 million, of which \$5.0 million related to investment securities that had been in a loss position for 12 months or longer. The total fair value of these investments at June 30, 2017, was \$832.2 million, which was 24.1% of our available-for-sale portfolio.

At June 30, 2017, the carrying value of 45 securities held to maturity exceeded their fair value by \$16.5 million, of which \$1.8 million related to securities held to maturity that have been in a loss position for 12 months or longer. As discussed in more detail below, we conduct periodic reviews of all securities with unrealized losses to assess whether the impairment is other-than-temporary.

#### Other-Than-Temporary Impairment

We evaluate all securities in an unrealized loss position quarterly to assess whether the impairment is other-than-temporary. Our other-than-temporary impairment ("OTTI") assessment is a subjective process requiring the use of judgments and assumptions. There was no credit-related OTTI recognized during the three and six months ended June 30, 2017 and 2016.

We believe the gross unrealized losses of \$29.5 million related to our investment portfolio, as of June 30, 2017, are attributable to issuer-specific credit spreads and changes in market interest rates and asset spreads. We, therefore, do not expect to incur any credit losses related to these securities. In addition, we have no intent to sell these securities with unrealized losses, and it is not more likely than not that we will be required to sell these securities prior to

recovery of the amortized cost. Accordingly, we have concluded that the impairment on these securities is not other-than-temporary.

## NOTE 7 – Bank Loans

Our loan portfolio consists primarily of the following segments:

**Real Estate.** Real estate loans include commercial real estate, residential real estate non-conforming loans, residential real estate conforming loans and home equity lines of credit. The allowance methodology related to real estate loans considers several factors, including, but not limited to, loan-to-value ratio, FICO score, home price index, delinquency status, credit limits, and utilization rates.

**Commercial and industrial (C&I).** C&I loans primarily include commercial and industrial lending used for general corporate purposes, working capital and liquidity, and “event-driven.” “Event-driven” loans support client merger, acquisition or recapitalization activities. C&I lending is structured as revolving lines of credit, letter of credit facilities, term loans and bridge loans. Risk factors considered in determining the allowance for corporate loans include the borrower’s financial strength, seniority of the loan, collateral type, leverage, volatility of collateral value, debt cushion, and covenants.

**Securities-based loans.** Securities-based loans allow clients to borrow money against the value of qualifying securities for any suitable purpose other than purchasing, trading, or carrying securities or refinancing margin debt. The majority of consumer loans are structured as revolving lines of credit and letter of credit facilities and are primarily offered through Stifel’s Pledged Asset (“SPA”) program. The allowance methodology for securities-based lending considers the collateral type underlying the loan, including the liquidity and trading volume of the collateral, position concentration and other borrower specific factors such as personal guarantees.

**Consumer.** Consumer loans allow customers to purchase non-investment goods and services.

**Construction and land.** Short-term loans used to finance the development of a real estate project.

The following table presents the balance and associated percentage of each major loan category in our bank loan portfolio at June 30, 2017 and December 31, 2016 (in thousands, except percentages):

	June 30, 2017		December 31, 2016	
	Balance	Percent	Balance	Percent
Residential real estate	\$2,248,528	36.2 %	\$2,161,400	38.4 %
Commercial and industrial	2,064,052	33.2	1,710,399	30.3
Securities-based loans	1,755,592	28.3	1,614,033	28.6
Commercial real estate	71,517	1.2	78,711	1.4
Consumer	42,666	0.7	45,391	0.8
Home equity lines of credit	14,303	0.2	15,008	0.3
Construction and land	17,155	0.2	12,623	0.2
Gross bank loans	6,213,813	100.0 %	5,637,565	100.0 %
Unamortized loan premium/(discount), net	1,113		858	
Unamortized loan fees, net of loan fees	75		(49)	
Loans in process	(706)		(2,021)	
Allowance for loan losses	(54,202)		(45,163)	
Bank loans, net	\$6,160,093		\$5,591,190	

At June 30, 2017 and December 31, 2016, Stifel Bank had loans outstanding to its executive officers, directors, and their affiliates in the amount of \$3.9 million and \$3.7 million, respectively, and loans outstanding to other Stifel Financial Corp. executive officers, directors, and their affiliates in the amount of \$7.0 million and \$5.6 million, respectively.

At June 30, 2017 and December 31, 2016, we had loans held for sale of \$139.7 million and \$228.6 million, respectively. For the three months ended June 30, 2017 and 2016, we recognized gains of \$3.4 million and \$4.1 million, respectively, from the sale of originated loans, net of fees and costs. For the six months ended June 30, 2017 and 2016, we recognized gains of \$6.2 million and \$6.9 million, respectively, from the sale of originated loans, net of fees and costs.

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

The following table details activity in the allowance for loan losses by portfolio segment for the three and six months ended June 30, 2017 (in thousands).

	Three Months Ended June 30, 2017				Ending Balance
	Beginning				
	Balance	Provision	Charge-offs	Recoveries	
Commercial and industrial	\$38,789	\$ 2,266	\$ (250 )	\$ —	\$40,805
Securities-based loans	3,393	207	—	—	3,600
Consumer	107	(2 )	—	—	105
Residential real estate	4,190	1,379	—	—	5,569
Commercial real estate	1,618	2,017	(2,703 )	—	932
Home equity lines of credit	285	(3 )	—	1	283
Construction and land	437	(213 )	—	—	224
Qualitative	2,479	205	—	—	2,684
	\$51,298	\$ 5,856	\$ (2,953 )	\$ 1	\$54,202

	Six Months Ended June 30, 2017				Ending Balance
	Beginning				
	Balance	Provision	Charge-offs	Recoveries	
Commercial and industrial	\$35,127	\$ 5,928	\$ (250 )	\$ —	\$40,805
Securities-based loans	3,094	506	—	—	3,600
Consumer	129	(24 )	—	—	105
Residential real estate	2,660	2,909	—	—	5,569
Commercial real estate	1,363	2,272	(2,703 )	—	932
Home equity lines of credit	371	(89 )	—	1	283
Construction and land	232	(8 )	—	—	224
Qualitative	2,187	497	—	—	2,684
	\$45,163	\$ 11,991	\$ (2,953 )	\$ 1	\$54,202

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at June 30, 2017 (in thousands):

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually			Individually		
	Collectively			Collectively		
	Evaluated for	Evaluated for	Total	Evaluated for	Evaluated for	Total
	Impairment	Impairment		Impairment	Impairment	
Residential real estate	\$24	\$ 5,545	\$5,569	\$174	\$ 2,248,354	\$2,248,528
Commercial and industrial	2,155	38,650	40,805	13,949	2,050,103	2,064,052
Securities-based loans	—	3,600	3,600	—	1,755,592	1,755,592

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Commercial real estate	—	932	932	—	71,517	71,517
Consumer	4	101	105	4	42,662	42,666
Home equity lines of credit	149	134	283	323	13,980	14,303
Construction and land	—	224	224	—	17,155	17,155
Qualitative	—	2,684	2,684	—	—	—
	\$2,332	\$ 51,870	\$54,202	\$14,450	\$ 6,199,363	\$6,213,813



The following table details activity in the allowance for loan losses by portfolio segment for the three and six months ended June 30, 2016 (in thousands).

	Three Months Ended June 30, 2016				Ending Balance
	Beginning Balance	Provision	Charge-offs	Recoveries	
Commercial and industrial	\$27,700	\$ 2,116	\$ —	\$ —	\$29,816
Securities-based loans	1,605	126	—	—	1,731
Consumer	84	23	—	—	107
Residential real estate	1,330	210	(13 )	2	1,529
Commercial real estate	1,289	(780 )	—	3	512
Home equity lines of credit	267	16	—	—	283
Construction and land	118	26	—	—	144
Qualitative	1,657	87	—	—	1,744
	\$34,050	\$ 1,824	\$ (13 )	\$ 5	\$35,866

	Six Months Ended June 30, 2016				Ending Balance
	Beginning Balance	Provision	Charge-offs	Recoveries	
Commercial and industrial	\$24,748	\$ 5,068	\$ —	\$ —	\$29,816
Securities-based loans	1,607	124	—	—	1,731
Consumer	105	2	—	—	107
Residential real estate	1,241	298	(13 )	3	1,529
Commercial real estate	264	241	—	7	512
Home equity lines of credit	290	(7 )	—	—	283
Construction and land	78	66	—	—	144
Qualitative	1,454	290	—	—	1,744
	\$29,787	\$ 6,082	\$ (13 )		