

STIFEL FINANCIAL CORP
Form 10-Q
November 06, 2018

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 September 30, 2018

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

Emerging growth company

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

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

The number of shares outstanding of the registrant’s common stock, \$0.15 par value per share, as of the close of business on November 1, 2018, was 72,011,806.

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 September 30, 2018 (unaudited) and December 31, 2017</u>	3
<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and September 30, 2017 (unaudited)</u>	5
<u>Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and September 30, 2017 (unaudited)</u>	6
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and September 30, 2017 (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>	48
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	77
<u>Item 4. Controls and Procedures</u>	80

PART II – OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	80
<u>Item 1A. Risk Factors</u>	80
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	81
<u>Item 6. Exhibits</u>	82
<u>Signatures</u>	83

2

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STIFEL FINANCIAL CORP.

Consolidated Statements of Financial Condition

(in thousands)	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Cash and cash equivalents	\$694,302	\$696,283
Cash segregated for regulatory purposes	21,585	90,802
Receivables:		
Brokerage clients, net	1,466,664	1,384,096
Brokers, dealers, and clearing organizations	646,120	459,107
Securities purchased under agreements to resell	622,361	512,220
Financial instruments owned, at fair value	1,162,732	1,143,684
Available-for-sale securities, at fair value	3,349,607	3,773,508
Held-to-maturity securities, at amortized cost	4,565,453	3,698,098
Loans held for sale, at lower of cost or market	262,063	226,068
Bank loans, net	8,253,989	6,947,759
Investments, at fair value	79,170	111,379
Fixed assets, net	297,846	155,120
Goodwill	1,025,714	968,834
Intangible assets, net	118,923	109,627
Loans and advances to financial advisors and other employees, net	383,477	378,124
Deferred tax assets, net	116,880	105,152
Other assets	693,162	624,092
Total Assets	\$23,760,048	\$21,383,953

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Financial Condition (continued)

	September 30, 2018 (Unaudited)	December 31, 2017
(in thousands, except share and per share amounts)		
Liabilities and Shareholders' Equity		
Payables:		
Brokerage clients	\$627,745	\$828,206
Brokers, dealers, and clearing organizations	928,132	276,302
Drafts	91,639	107,043
Securities sold under agreements to repurchase	495,484	233,704
Bank deposits	14,502,952	13,411,935
Financial instruments sold, but not yet purchased, at fair value	911,374	778,863
Accrued compensation	379,453	493,973
Accounts payable and accrued expenses	374,456	308,911
Federal Home Loan Bank advances	1,064,000	745,000
Borrowings	140,030	256,000
Senior notes	1,015,714	1,014,940
Debentures to Stifel Financial Capital Trusts	67,500	67,500
Total liabilities	20,598,479	18,522,377
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 74,441,001		
and 71,636,986 shares, respectively	11,166	10,746
Additional paid-in-capital	1,873,232	1,733,348
Retained earnings	1,265,536	1,033,526
Accumulated other comprehensive loss	(59,389)	(26,736)
	3,240,545	2,900,884
Treasury stock, at cost, 1,435,882 and 772,302 shares, respectively	(78,976)	(39,308)
Total Shareholders' Equity	3,161,569	2,861,576
Total Liabilities and Shareholders' Equity	\$23,760,048	\$21,383,953

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Operations

(Unaudited)

(in thousands, except per share amounts)	Three Months Ended		Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
Revenues:				
Commissions	\$ 158,016	\$ 162,612	\$ 490,693	\$ 510,150
Principal transactions	83,152	87,010	269,918	299,570
Investment banking	169,012	181,904	506,437	494,017
Asset management and service fees	200,743	179,848	596,112	515,501
Interest	169,760	117,862	461,915	327,766
Other income	6,127	9,558	18,557	25,508
Total revenues	786,810	738,794	2,343,632	2,172,512
Interest expense	48,468	17,625	112,200	50,165
Net revenues	738,342	721,169	2,231,432	2,122,347
Non-interest expenses:				
Compensation and benefits	422,324	448,410	1,322,387	1,338,673
Occupancy and equipment rental	54,035	57,427	165,226	167,864
Communications and office supplies	33,330	34,650	103,468	102,686
Commissions and floor brokerage	11,338	11,232	30,798	33,187
Other operating expenses	76,785	61,311	231,122	209,581
Total non-interest expenses	597,812	613,030	1,853,001	1,851,991
Income from operations before income tax expense	140,530	108,139	378,431	270,356
Provision for income taxes	36,672	41,603	98,525	85,497
Net income	103,858	66,536	279,906	184,859
Preferred dividends	2,343	2,343	7,031	7,031
Net income available to common shareholders	\$ 101,515	\$ 64,193	\$ 272,875	\$ 177,828
Earnings per common share:				
Basic	\$ 1.41	\$ 0.94	\$ 3.80	\$ 2.60
Diluted	\$ 1.25	\$ 0.79	\$ 3.35	\$ 2.21
Weighted-average number of common shares outstanding:				
Basic	71,919	68,522	71,824	68,488
Diluted	81,484	80,881	81,425	80,562
Cash dividends declared per common share	\$ 0.12	\$ 0.10	\$ 0.36	\$ 0.10

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Comprehensive Income

(Unaudited)

(in thousands)	Three Months		Nine Months Ended	
	Ended September 30, 2018	2017	September 30, 2018	2017
Net income	\$ 103,858	\$ 66,536	\$ 279,906	\$ 184,859
Other comprehensive income/(loss), net of tax: ⁽¹⁾ ⁽⁴⁾				
Changes in unrealized gains/(losses) on available-for-sale securities ⁽²⁾	(3,138)	4,736	(28,065)	12,283
Amortization of losses of securities transferred to held-to-maturity from available-for-sale	—	439	—	1,348
Changes in unrealized gains/(losses) on cash flow hedging instruments ⁽³⁾	(1,523)	183	1,895	698
Foreign currency translation adjustment	(1,336)	2,644	(3,434)	7,178
Total other comprehensive income/(loss), net of tax	(5,997)	8,002	(29,604)	21,507
Comprehensive income	\$ 97,861	\$ 74,538	\$ 250,302	\$ 206,366

⁽¹⁾Net of tax benefit of \$2.1 million and tax expense of \$5.0 million for the three months ended September 30, 2018 and 2017, respectively. Net of tax benefit of \$10.4 million and tax expense of \$13.5 million for the nine months ended September 30, 2018 and 2017, respectively.

⁽²⁾There were no reclassifications to earnings during the three and nine months ended September 30, 2018 and 2017, respectively.

⁽³⁾Amounts are net of reclassifications to earnings of gains of \$1.5 million and \$0.7 million for the three months ended September 30, 2018 and 2017, respectively. Amounts are net of reclassifications to earnings of gains of \$3.3 million and losses of \$0.8 million for the nine months ended September 30, 2018 and 2017, respectively.

⁽⁴⁾The adoption of ASU 2018-02 on January 1, 2018 resulted in a reclassification of \$3.0 million to retained earnings related to cash flow hedges and investment portfolio risk. The reclassification is reflected in the activity for the nine months ended September 30, 2018. See Note 2 for further details.

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	Nine Months Ended	
	September 30, 2018	2017
Cash Flows From Operating Activities:		
Net income	\$279,906	\$184,859
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:		
Depreciation and amortization	20,503	26,976
Amortization of loans and advances to financial advisors and other employees	61,783	69,393
Amortization of premium on investment portfolio	18,714	11,248
Provision for loan losses and allowance for loans and advances to financial advisors and other employees	13,980	19,025
Amortization of intangible assets	8,741	9,092
Deferred income taxes	718	14,875
Stock-based compensation	75,382	81,613
(Gains)/losses on sale of investments	10,442	(2,888)
Other, net	(86,576)	2,377
Decrease/(increase) in operating assets, net of assets acquired:		
Receivables:		
Brokerage clients	(82,568)	125,905
Brokers, dealers, and clearing organizations	(187,013)	689,648
Securities purchased under agreements to resell	(110,141)	(209,747)
Financial instruments owned, including those pledged	(19,048)	(139,205)
Loans originated as held for sale	(1,099,187)	(1,152,654)
Proceeds from mortgages held for sale	1,051,789	1,194,709
Loans and advances to financial advisors and other employees	(67,872)	(46,699)
Other assets	31,543	(77,373)
Increase/(decrease) in operating liabilities, net of liabilities assumed:		
Payables:		
Brokerage clients	(200,461)	(94,594)
Brokers, dealers, and clearing organizations	180,463	63,554
Drafts	(15,404)	(17,089)
Financial instruments sold, but not yet purchased	132,511	50,291
Other liabilities and accrued expenses	(66,290)	91,896
Net cash provided by/(used in) operating activities	\$ (48,085)	\$ 895,212

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Consolidated Statements of Cash Flows (continued)

(Unaudited)

(in thousands)	Nine Months Ended	
	September 30, 2018	2017
Cash Flows From Investing Activities:		
Proceeds from:		
Maturities and principal paydowns of available-for-sale securities	\$763,982	\$850,102
Calls and principal paydowns of held-to-maturity securities	443,295	193,140
Sale or maturity of investments	24,345	25,394
Increase in bank loans, net	(810,798)	(1,202,124)
Payments for:		
Purchase of available-for-sale securities	(331,657)	(1,350,033)
Purchase of held-to-maturity securities	(1,313,587)	(712,450)
Purchase of investments	(7,578)	(1,592)
Purchase of fixed assets	(18,271)	(21,153)
Acquisitions, net of cash received	599	(6,743)
Net cash used in investing activities	(1,249,670)	(2,225,459)
Cash Flows From Financing Activities:		
Repayments of borrowings, net	(257,197)	(299,000)
Proceeds from Federal Home Loan Bank advances, net	309,050	290,000
Payment of contingent consideration	(11,909)	(13,328)
Increase/(decrease) in securities sold under agreements to repurchase	261,780	(113,150)
Increase in bank deposits, net	590,000	1,356,478
Increase/(decrease) in securities loaned	471,367	(166,901)
Tax payments related to shares withheld for stock-based compensation plans	(39,815)	(76,242)
Proceeds from stock option exercises	2,278	—
Repurchase of common stock	(62,514)	(12,998)
Cash dividends on preferred stock	(7,031)	(7,031)
Cash dividends paid to common stock and equity-award holders	(26,023)	(6,835)
Net cash provided by financing activities	1,229,986	950,993
Effect of exchange rate changes on cash	(3,429)	7,178
Decrease in cash, cash equivalents, and cash segregated for regulatory purposes	(71,198)	(372,076)
Cash, cash equivalents, and cash segregated for regulatory purposes at beginning of period	787,085	986,167
Cash, cash equivalents, and cash segregated for regulatory purposes at end of period	\$715,887	\$614,091
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds	\$27,280	\$18,591
Cash paid for interest	111,832	49,901
Noncash financing activities:		
Unit grants, net of forfeitures	119,051	55,941
Issuance of common stock for acquisitions	110,671	9,352

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

The following presents cash, cash equivalents, and cash restricted for regulatory purposes for the periods presented (in thousands):

	September 30, 2018	December 31, 2017	September 30, 2017
Cash and cash equivalents	\$ 694,302	\$ 696,283	\$ 588,916
Cash segregated for regulatory purposes	21,585	90,802	25,175
Total cash, cash equivalents, and cash segregated for regulatory purposes	\$ 715,887	\$ 787,085	\$ 614,091

See accompanying Notes to Consolidated Financial Statements.

STIFEL FINANCIAL CORP.

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 1 – Nature of Operations, Basis of Presentation, and Summary of Significant Accounting Policies

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 March 19, 2018, the Company completed the acquisition of Ziegler Wealth Management (“Ziegler”), a privately held investment bank, capital markets and proprietary investments firm that has 55 private client advisors in five states that manage approximately \$5 billion in client assets. Ziegler provides its clients with capital raising, strategic advisory services, equity and fixed income sales & trading and research. The acquisition was funded with cash from operations. See Note 8 in the notes to consolidated financial statements for more details.

On August 31, 2018, the Company completed the acquisition of Business Bancshares, Inc. (“BBI”) and its wholly owned subsidiary, The Business Bank of St. Louis, a full-service banking facility with approximately \$600.0 million in assets that operates from a single location. Upon the closing of the transaction, the Business Bank of St. Louis was renamed “Stifel Bank” and Business Bancshares, Inc. was renamed “Stifel Bancorp, Inc.” Stifel Bancorp, Inc. (“Stifel Bancorp”) is the holding company for Stifel Bank & Trust, Stifel Bank, and their wholly owned subsidiaries. We issued approximately 2.0 million shares for acquisition of BBI. See Note 8 in the notes to consolidated financial statements for more details.

Pro forma information is not presented, because the acquisition is not considered to be material, as defined by the SEC. The results of operations of Ziegler and Stifel Bancorp have been included in our results prospectively from the date of acquisition.

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 Bancorp. 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, 2017 on file with the SEC.

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

Summary of Significant Accounting Policies

For a detailed discussion about the Company's significant accounting policies, see Note 2, Summary of Significant Accounting Policies, in our consolidated financial statements included in Part II, Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2017.

Other than the following, there were no significant changes made to the Company's significant accounting policies. The accounting policy changes are attributable to the adoption of the Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (the "new revenue standard" or "ASU 2014-09") on January 1, 2018. These revenue recognition policy updates are applied prospectively in our consolidated financial statements from January 1, 2018. Reported financial information for the historical comparable period was not revised and continues to be reported under the accounting standards in effect during the historical periods.

The new revenue standard primarily impacts the following revenue recognition and presentation accounting policies of our company:

Investment Banking Revenues

Advisory fees from mergers and acquisitions engagements are recognized at a point in time when the related transaction is completed, as the performance obligation is to successfully broker a specific transaction.

Advisory expenses are deferred only to the extent they are explicitly reimbursable by the client and the related revenue is recognized at a point in time. All other investment banking advisory related expenses are expensed as incurred.

Underwriting expenses are recognized as non-interest expense in the consolidated statements of operations and any expense reimbursements are recognized as investment banking revenues. See Note 2, New Accounting Pronouncements, and Note 17, Revenues from Contracts with Customers, for further information.

NOTE 2 – New Accounting Pronouncements

Recently Adopted Accounting Guidance

Comprehensive Income

In February 2018, the FASB issued ASU 2018-02, “Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income” that provides for the reclassification from accumulated other comprehensive income to retained earnings for stranded effects resulting from the Tax Cuts and Jobs Act of 2017. The accounting update is effective for fiscal years beginning after December 15, 2018 and early adoption is permitted. We early adopted the guidance in the update on January 1, 2018. The adoption of the accounting update resulted in a reclassification adjustment of \$3.0 million related to cash flow hedges and investment portfolio credit risk in our consolidated financial statements.

Statement of Cash Flows

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230) – Restricted Cash,” which adds or clarifies guidance on the classification and presentation of restricted cash in the statement of cash flows. The accounting update is effective for fiscal years beginning after December 15, 2017. We adopted the guidance in the update on January 1, 2018. The adoption of the accounting update did not have a material impact on our consolidated statement of cash flows. Upon adoption of the accounting update, we recorded a decrease of \$48.1 million in net cash provided by operating activities for the nine months ended September 30, 2017 related to reclassifying the changes in our cash segregated for regulatory purposes and restricted cash balance from operating activities to the cash and cash equivalent balances within the consolidated statements of cash flows.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments,” which amends and clarifies the current guidance to reduce diversity in practice of the classification of certain cash receipts and payments in the consolidated statements of cash flows. The accounting update is effective for fiscal years beginning after December 31, 2017. We adopted the guidance in the update on January 1, 2018. The adoption of the accounting update did not have a material impact on our consolidated statements of cash flows.

Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – 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 accounting update also amends certain disclosure requirements associated with the fair value of financial instruments. The accounting update is effective for fiscal years beginning after December 15, 2017. We adopted the guidance in the update on January 1, 2018. The adoption of the accounting update did not have a material impact on our consolidated financial statements.

Revenue Recognition

Effective January 1, 2018, the Company adopted ASU 2014-09, which provides accounting guidance on the recognition of revenues from contracts and requires gross presentation of certain costs that were previously offset against revenue. This change was applied prospectively from January 1, 2018 and there is no impact on our previously presented results. The adoption of the new revenue standard resulted in a reduction of beginning retained earnings of \$3.9 million after-tax as a cumulative effect of adoption of an accounting change.

The impact of adoption is primarily related to investment banking revenues that were previously recognized in prior periods, which are now being deferred under the new revenue standard.

With the adoption of the new revenue recognition standard on January 1, 2018, capital raising and advisory fee revenues are no longer presented net of the related out-of-pocket deal expenses. As a result, capital raising and advisory fee revenues and other operating expenses are higher in the first nine months of 2018 by an identical \$25.9 million, with no impact to net income.

The scope of the accounting update does not apply to revenue associated with financial instruments, and as a result, will not have an impact on the elements of our consolidated statements of operations most closely associated with financial instruments, including principal transaction revenues, interest income, and interest expense.

The new revenue standard primarily impacts the following revenue recognition and presentation accounting policies:

Advisory fees from mergers and acquisitions engagements are recognized at a point in time when the related transaction is completed, as the performance obligation is to successfully broker a specific transaction.

Advisory expenses had historically been deferred until reimbursed by the client, the related fee revenue was recognized or the engagement was otherwise concluded. Under the new revenue standard, expenses are deferred only to the extent they are explicitly reimbursable by the client and the related revenue has been recognized. All other investment banking advisory related expenses, including expenses incurred related to restructuring assignments, are expensed as incurred.

Underwriting expenses had historically been recorded net of client reimbursements and/or netted against revenues. Under the new revenue standard, all investment banking expenses will be recognized as non-interest expense in the consolidated statements of operations and any expense reimbursements will be recognized as investment banking revenues (i.e., expenses are no longer recorded net of client reimbursements and are not netted against revenues).

Recently Issued Accounting Guidance

Derivatives and Hedging

In August 2017, the FASB issued ASU 2017-12, “Derivatives and Hedging (Topic 815) – Targeted Improvements to Accounting for Hedging Activities,” which amends the hedge accounting recognition and presentation requirements. The accounting update improves the transparency and understandability of information conveyed to financial statement users by better aligning companies’ hedging relationship to their existing risk management strategies, simplifies the application of hedge accounting and increases transparency regarding the scope and results of hedging program. The accounting update is effective for fiscal years beginning after December 15, 2018 (January 1, 2019 for our company) and early adoption is permitted. We are currently evaluating the impact of the accounting update, but the adoption is not expected to have a material impact on our consolidated financial statements.

Callable Debt Securities

In March 2017, the FASB issued ASU 2017-08, “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities,” which shortens the amortization period for the premium on certain callable debt securities to the earliest call date. The amendments are applicable to any purchased individual debt security with an explicit and non-contingent call feature that is callable at a fixed price on a preset date. The accounting update is effective for fiscal years beginning after December 15, 2018 (January 1, 2019 for our company) under a modified retrospective approach and early adoption is permitted. We are evaluating the impact the adoption of this new guidance will have on our consolidated financial statements.

Goodwill Impairment Testing

In January 2017, the FASB issued ASU 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 accounting update, 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. The accounting update is effective for annual or any interim impairment tests in fiscal years beginning after December 15, 2019 (January 1, 2020 for our company) and early adoption is permitted. We are currently evaluating the impact of the accounting update, but the adoption is not expected to have a material impact on our consolidated financial statements.

Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” This accounting update impacts the impairment model for certain financial assets measured at amortized cost by requiring a current expected credit loss (“CECL”) methodology to estimate expected credit losses over the entire life of the financial asset, recorded at inception or purchase. CECL will replace the loss model currently applicable to bank loans, held-to-maturity securities, and other receivables carried at amortized cost.

The accounting update also eliminates the concept of other-than-temporary impairment for available-for-sale securities. Impairments on available-for-sale securities will be required to be recognized in earnings through an allowance, when the fair value is less than amortized cost and a credit loss exists or the securities are expected to be sold before recovery of amortized cost. Under the accounting update, there may be an ability to determine there are no expected credit losses in certain circumstances, e.g., based on collateral arrangements for lending and financing transactions or based on the credit quality of the borrower or issuer.

Overall, the amendments in this accounting update are expected to accelerate the recognition of credit losses for portfolios where CECL models will be applied. The accounting update is effective for fiscal years beginning after December 15, 2019 (January 1, 2020 for our company) with early adoption permitted as of January 1, 2019. We are currently evaluating the impact of the accounting update, but the adoption is not expected to have a material impact on our consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases – (Topic 842)” that requires for leases longer than one year, a lessee recognize in the statements of financial condition a right-of-use asset, representing the right to use the underlying asset for the lease term, and a lease liability, representing the liability to make lease payments. The accounting update also requires that for finance leases, a lessee recognize interest expense on the lease liability, separately from the amortization of the right-of-use asset in the statements of earnings, while for operating leases, such amounts should be recognized as a combined expense. In addition, this accounting update requires expanded disclosures about the nature and terms of lease agreements.

The accounting update is effective for fiscal years beginning after December 15, 2018 (January 1, 2019 for our company) under a modified retrospective approach and early adoption is permitted. The Company’s implementation efforts include reviewing existing leases and service contracts, which may include embedded leases. Upon adoption, our company expects a gross up on its consolidated statements of financial condition upon recognition of the right-of-use assets and lease liabilities and does not expect the amount of the gross up to have a material impact on its financial condition.

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

Amounts receivable from brokers, dealers, and clearing organizations at September 30, 2018 and December 31, 2017, included (in thousands):

	September 30, 2018	December 31, 2017
Receivables from clearing organizations	\$ 440,154	\$ 270,285
Deposits paid for securities borrowed	170,165	132,776
Securities failed to deliver	35,801	56,046
	\$ 646,120	\$ 459,107

Amounts payable to brokers, dealers, and clearing organizations at September 30, 2018 and December 31, 2017, included (in thousands):

	September 30, 2018	December 31, 2017
Deposits received from securities loaned	\$ 691,150	\$ 219,782
Payable to clearing organizations	201,510	27,223
Securities failed to receive	35,472	29,297
	\$ 928,132	\$ 276,302

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 and equity securities infrequently traded, state and municipal securities, sovereign debt, 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. No securities with unobservable pricing inputs are reported in Level 3.

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.

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):

	September 30, 2018	
	Fair value of investments	Unfunded commitments
Money market funds	\$ 18,696	\$ —
Mutual funds	10,506	—
Private equity funds	3,394	1,535
Partnership interests	4,405	1,324
Total	\$ 37,001	\$ 2,859

	December 31, 2017	
	Fair value of investments	Unfunded commitments
Money market funds	\$ 77,441	\$ —
Mutual funds	11,748	—
Private equity funds	7,677	1,825
Partnership interests	5,124	1,330
Total	\$ 101,990	\$ 3,155

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 sovereign debt.

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 September 30, 2018, are presented below (in thousands):

	September 30, 2018			
	Total	Level 1	Level 2	Level 3
Financial instruments owned:				
U.S. government securities	\$36,214	\$36,214	\$—	\$—
U.S. government agency securities	167,886	—	167,886	—
Mortgage-backed securities:				
Agency	380,044	—	380,044	—
Non-agency	23,747	—	23,746	1
Asset-backed securities	29,806	—	29,451	355
Corporate securities:				
Fixed income securities	290,627	262	290,365	—
Equity securities	69,205	68,892	212	101
Sovereign debt	15,996	—	15,996	—
State and municipal securities	149,207	—	149,207	—
Total financial instruments owned	1,162,732	105,368	1,056,907	457
Available-for-sale securities:				
U.S. government agency securities	5,165	516	4,649	—
State and municipal securities	68,876	—	68,876	—
Mortgage-backed securities:				
Agency	250,808	—	250,808	—
Commercial	68,823	—	68,823	—
Non-agency	1,269	—	1,269	—
Corporate fixed income securities	1,177,315	—	1,177,315	—
Asset-backed securities	1,777,351	—	1,777,351	—
Total available-for-sale securities	3,349,607	516	3,349,091	—
Investments:				
Corporate equity securities	42,495	42,495	—	—
Auction rate securities:				
Equity securities	16,525	—	—	16,525
Municipal securities	799	—	—	799
Other	1,046	—	189	857
Investments in funds measured at NAV	18,305			
Total investments	79,170	42,495	189	18,181
Cash equivalents measured at NAV	18,696			
Derivative contracts ⁽¹⁾	11,117		11,117	
	\$4,621,322	\$ 148,379	\$4,417,304	\$ 18,638

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

September 30, 2018

	Total	Level 1	Level 2	Level 3
Liabilities:				
Financial instruments sold, but not yet purchased:				
U.S. government securities	\$512,275	\$512,275	\$—	\$ —
Mortgage-backed securities:				
Agency	95,312	—	95,312	—
Corporate securities:				
Fixed income securities	213,335	96	213,239	—
Equity securities	78,895	78,895	—	—
Sovereign debt	11,557	—	11,557	—
Total financial instruments sold, but not yet purchased	\$911,374	\$591,266	\$320,108	\$ —

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2017, are presented below (in thousands):

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Financial instruments owned:				
U.S. government securities	\$13,466	\$13,466	\$—	\$—
U.S. government agency securities	147,223	—	147,223	—
Mortgage-backed securities:				
Agency	302,445	—	302,445	—
Non-agency	29,356	—	29,355	1
Asset-backed securities	76,752	—	76,395	357
Corporate securities:				
Fixed income securities	325,471	362	324,867	242
Equity securities	46,802	46,411	138	253
Sovereign debt	32,470	—	32,470	—
State and municipal securities	169,699	—	169,699	—
Total financial instruments owned	1,143,684	60,239	1,082,592	853
Available-for-sale securities:				
U.S. government agency securities	4,983	516	4,467	—
State and municipal securities	70,559	—	70,559	—
Mortgage-backed securities:				
Agency	305,530	—	305,530	—
Commercial	72,488	—	72,488	—
Non-agency	1,568	—	1,568	—
Corporate fixed income securities	1,211,442	—	1,211,442	—
Asset-backed securities	2,106,938	—	2,106,938	—
Total available-for-sale securities	3,773,508	516	3,772,992	—
Investments:				
Corporate equity securities	49,978	49,978	—	—
Auction rate securities:				
Equity securities	34,789	—	—	34,789
Municipal securities	846	—	—	846
Other	1,217	—	360	857
Investments measured at NAV	24,549			
Total investments	111,379	49,978	360	36,492
Cash equivalents measured at NAV	77,441			
Derivative contracts ⁽¹⁾	7,995	—	7,995	—
	\$5,114,007	\$110,733	\$4,863,939	\$37,345

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

December 31, 2017

	Total	Level 1	Level 2	Level 3
Liabilities:				
Financial instruments sold, but not yet purchased:				
U.S. government securities	\$442,402	\$442,402	\$—	\$ —
U.S. government agency securities	10,348	—	10,348	—
Mortgage-backed securities:				
Agency	86,612	—	86,612	—
Corporate securities:				
Fixed income securities	180,755	—	180,755	—
Equity securities	38,510	38,070	440	—
Sovereign debt	20,236	—	20,236	—
Total financial instruments sold, but not yet purchased	\$778,863	\$480,472	\$298,391	\$ —

The following table summarizes the changes in fair value associated with Level 3 financial instruments during the three months ended September 30, 2018 (in thousands):

	Three Months Ended September 30, 2018					
	Financial instruments owned			Investments		
	Mortgage-					
	Backed			Auction Rate		
Securities			Securities	Auction Rate		
—		Equity	—	Securities —		
	Asset-Backed					
	Non-Securities	Securities	Equity	Municipal	Other	
Balance at June 30, 2018	\$1	\$ 355	\$ 123	\$25,303	\$ 846	\$ 857
Unrealized gains/(losses):						
Included in changes in net assets ⁽¹⁾	—	—	—	997	3	—
Realized gains/(losses) ⁽¹⁾	—	—	(22)	—	—	—
Purchases	—	—	—	—	—	—
Sales	—	—	—	—	—	—
Redemptions	—	—	—	(9,775)	(50)	—
Transfers:						
Into Level 3	—	—	—	—	—	—
Out of Level 3	—	—	—	—	—	—
Net change	—	—	(22)	(8,778)	(47)	—
Balance at September 30, 2018	\$1	\$ 355	\$ 101	\$16,525	\$ 799	\$ 857

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

The following table summarizes the change in fair value associated with Level 3 financial instruments during the nine months ended September 30, 2018 (in thousands):

	Nine Months Ended September 30, 2018						
	Financial instruments owned			Investments			
	Mortgage-						
	Backed			Auction Rate			
Securities			Securities	Auction Rate			
—		Fixed	Equity	—	Securities —		
	Asset-Backed	Income					
	Non-Securities	Securities	Securities	Equity	Municipal	Other	
Balance at December 31, 2017	\$1	\$ 357	\$ 242	\$ 253	\$34,789	\$ 846	\$ 857
Unrealized gains/(losses):							
Included in changes in net assets ⁽¹⁾	—	3	—	(130)	1,086	3	—

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Realized gains/(losses) ⁽¹⁾	—	—	—	(22)	—	—	—
Purchases	—	—	—	—	—	—	—
Sales	—	—	—	—	—	—	—
Redemptions	—	(5)	(242)	—	(19,350)	(50)	—
Transfers:							
Into Level 3	—	—	—	—	—	—	—
Out of Level 3	—	—	—	—	—	—	—
Net change	—	(2)	(242)	(152)	(18,264)	(47)	—
Balance at September 30, 2018	\$1	\$ 355	\$ —	\$ 101	\$16,525	\$ 799	\$ 857

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

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 in unrealized gains/(losses) recorded in earnings for the three and nine months ended September 30, 2018, relating to Level 3 assets still held at September 30, 2018, 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 September 30, 2018.

	Valuation technique	Unobservable input	Range	Weighted average
Investments:				
Auction rate securities:				
Equity securities	Discounted cash flow	Discount rate	0.6% - 6.5%	3.8%
		Workout period	2-3 years	2.4 years
Municipal securities	Discounted cash flow	Discount rate	0.5% - 9.9%	3.2%
		Workout period	1-4 years	2.0 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 no transfers of financial assets from Level 2 to Level 1 during the three months ended September 30, 2018. There were \$0.6 million of transfers of financial assets from Level 2 to Level 1 during the nine months ended September 30, 2018. There were \$0.1 million and \$0.7 million of transfers of financial assets from Level 1 to Level 2 during the three and nine months ended September 30, 2018, respectively, primarily related to corporate fixed income securities for which there were low volumes of recent trade activity observed. There were no transfers into or out of Level 3 during the nine months ended September 30, 2018.

Fair Value of Financial Instruments

The following reflects the fair value of financial instruments as of September 30, 2018 and December 31, 2017, whether or not recognized in the consolidated statements of financial condition at fair value (in thousands).

	September 30, 2018		December 31, 2017	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$694,302	\$694,302	\$696,283	\$696,283
Cash segregated for regulatory purposes	21,585	21,585	90,802	90,802
Securities purchased under agreements to resell	622,361	622,361	512,220	512,220
Financial instruments owned	1,162,732	1,162,732	1,143,684	1,143,684
Available-for-sale securities	3,349,607	3,349,607	3,773,508	3,773,508
Held-to-maturity securities	4,565,453	4,506,385	3,698,098	3,710,478
Loans held for sale	262,063	262,063	226,068	226,068
Bank loans	8,253,989	8,330,974	6,947,759	6,953,328
Investments	79,170	79,170	111,379	111,379
Derivative contracts ⁽¹⁾	11,117	11,117	7,995	7,995
Financial liabilities:				
Securities sold under agreements to repurchase	\$495,484	\$495,484	\$233,704	\$233,704
Bank deposits	14,502,952	13,711,447	13,411,935	12,702,746
Financial instruments sold, but not yet purchased	911,374	911,374	778,863	778,863
Federal Home Loan Bank advances	1,064,000	1,064,000	745,000	745,000
Borrowings	140,030	140,030	256,000	256,000
Senior notes	1,015,714	1,012,374	1,014,940	1,044,768
Debentures to Stifel Financial Capital Trusts	67,500	68,839	67,500	64,962

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

The following table presents the estimated fair values of financial instruments not measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Cash	\$675,606	\$675,606	\$—	\$—
Cash segregated for regulatory purposes	21,585	21,585	—	—
Securities purchased under agreements to resell	622,361	586,829	35,532	—
Held-to-maturity securities	4,506,385	—	4,345,021	161,364
Loans held for sale	262,063	—	262,063	—
Bank loans	8,330,974	—	8,330,974	—
Financial liabilities:				

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Securities sold under agreements to repurchase	\$495,484	\$126,378	\$369,106	\$—
Bank deposits	13,711,447	—	13,711,447	—
Federal Home Loan Bank advances	1,064,000	1,064,000	—	—
Borrowings	140,030	140,030	—	—
Senior notes	1,012,374	1,012,374	—	—
Debentures to Stifel Financial Capital Trusts	68,839	—	—	68,839

19

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Cash	\$618,842	\$618,842	\$—	\$—
Cash segregated for regulatory purposes	90,802	90,802	—	—
Securities purchased under agreements to resell	512,220	428,740	83,480	—
Held-to-maturity securities	3,710,478	—	3,517,781	192,697
Loans held for sale	226,068	—	226,068	—
Bank loans	6,953,328	—	6,953,328	—
Financial liabilities:				
Securities sold under agreements to repurchase	\$233,704	\$92,278	\$141,426	\$—
Bank deposits	12,702,746	—	12,702,746	—
Federal Home Loan Bank advances	745,000	745,000	—	—
Borrowings	256,000	256,000	—	—
Senior notes	1,044,768	1,044,768	—	—
Debentures to Stifel Financial Capital Trusts	64,962	—	—	64,962

The following, as supplemented by the discussion above, describes the valuation techniques used in estimating the fair value of our financial instruments as of September 30, 2018 and December 31, 2017.

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 September 30, 2018 and December 31, 2017 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 September 30, 2018 and December 31, 2017 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 Bancorp'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 September 30, 2018 and December 31, 2017 are as follows (in thousands):

	September 30, 2018	December 31, 2017
Financial instruments owned:		
U.S. government securities	\$36,214	\$13,466
U.S. government agency securities	167,886	147,223
Mortgage-backed securities:		
Agency	380,044	302,445
Non-agency	23,747	29,356
Asset-backed securities	29,806	76,752
Corporate securities:		
Fixed income securities	290,627	325,471
Equity securities	69,205	46,802
Sovereign debt	15,996	32,470
State and municipal securities	149,207	169,699
	\$1,162,732	\$1,143,684

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Financial instruments sold, but not yet purchased:		
U.S. government securities	\$512,275	\$442,402
U.S. government agency securities	—	10,348
Mortgage-backed securities:		
Agency	95,312	86,612
Corporate securities:		
Fixed income securities	213,335	180,755
Equity securities	78,895	38,510
Sovereign debt	11,557	20,236
	\$911,374	\$778,863

At September 30, 2018 and December 31, 2017, financial instruments owned in the amount of \$534.6 million and \$810.3 million, respectively, were pledged as collateral for our repurchase agreements and short-term borrowings. 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 September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018			
	Gross		Gross	
	Amortized	Unrealized	Unrealized	Estimated
	Cost	Gains ⁽¹⁾	Losses ⁽¹⁾	Fair Value
Available-for-sale securities				
U.S. government agency securities	\$ 5,226	\$ —	\$ (61)	\$ 5,165
State and municipal securities	73,253	—	(4,377)	68,876
Mortgage-backed securities:				
Agency	256,120	29	(5,341)	250,808
Commercial	74,698	8	(5,883)	68,823
Non-agency	1,281	—	(12)	1,269
Corporate fixed income securities	1,200,498	2,542	(25,725)	1,177,315
Asset-backed securities	1,782,052	3,109	(7,810)	1,777,351
	\$ 3,393,128	\$ 5,688	\$ (49,209)	\$ 3,349,607
Held-to-maturity securities ⁽²⁾				
Mortgage-backed securities:				
Agency	\$ 1,244,582	\$ —	\$ (48,907)	\$ 1,195,675
Commercial	55,351	—	(343)	55,008
Asset-backed securities	3,265,520	4,940	(14,758)	3,255,702
	\$ 4,565,453	\$ 4,940	\$ (64,008)	\$ 4,506,385
	December 31, 2017			
	Gross		Gross	
	Amortized	Unrealized	Unrealized	Estimated
	Cost	Gains ⁽¹⁾	Losses ⁽¹⁾	Fair Value
Available-for-sale securities				

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

U.S. government agency securities	\$ 5,022	\$ —	\$ (39)	\$ 4,983
State and municipal securities	74,691	—	(4,132)	70,559
Mortgage-backed securities:				
Agency	308,409	102	(2,981)	305,530
Commercial	75,548	28	(3,088)	72,488
Non-agency	1,568	—	—	1,568
Corporate fixed income securities	1,213,262	3,832	(5,652)	1,211,442
Asset-backed securities	2,098,958	12,877	(4,897)	2,106,938
	\$ 3,777,458	\$ 16,839	\$ (20,789)	\$ 3,773,508
Held-to-maturity securities ⁽²⁾				
Mortgage-backed securities:				
Agency	\$ 1,334,833	\$ 13,621	\$ (16,208)	\$ 1,332,246
Commercial	58,971	1,313	—	60,284
Asset-backed securities	2,264,283	15,526	(1,862)	2,277,947
Corporate fixed income securities	40,011	27	(37)	40,001
	\$ 3,698,098	\$ 30,487	\$ (18,107)	\$ 3,710,478

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

⁽²⁾ 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 nine months ended September 30, 2018, we received proceeds of \$55.4 million from the sale of available-for-sale securities, which resulted in a realized loss of \$0.4 million. There were no sales of available-for-sale securities during the three months ended September 30, 2017. For the nine months ended September 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.

During the three months ended September 30, 2018 and September 30, 2017, unrealized losses, net of deferred taxes, of \$3.1 million and unrealized gains, net of deferred taxes of \$4.7 million were recorded in accumulated other comprehensive loss in the consolidated statements of financial condition. During the nine months ended September 30, 2018 and September 30, 2017, unrealized losses, net of deferred taxes, of \$28.1 million and unrealized gains, net of deferred taxes, of \$12.3 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.

	September 30, 2018			
	Available-for-sale securities		Held-to-maturity securities	
	Amortized	Estimated	Amortized	Estimated
	Cost	Fair Value	Cost	Fair Value
Debt securities				
Within one year	\$37,338	\$37,275	\$—	\$—
After one year through three years	380,761	372,133	—	—
After three years through five years	351,855	345,895	—	—
After five years through ten years	698,866	689,934	478,024	478,491
After ten years	1,592,209	1,583,470	2,787,496	2,777,211
Mortgage-backed securities				
After one year through three years	163	163	55,351	55,008
After three years through five years	1,360	1,365	—	—
After five years through ten years	6,242	6,194	180,433	173,389
After ten years	324,334	313,178	1,064,149	1,022,286
	\$3,393,128	\$3,349,607	\$4,565,453	\$4,506,385

The maturities of our available-for-sale (fair value) and held-to-maturity (amortized cost) securities at September 30, 2018, are as follows (in thousands):

	Within	5-10		After 10	Total
	1	Year	Years	Years	
Available-for-sale: ⁽¹⁾					

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

U.S. government agency securities	\$1,657	\$3,508	\$—	\$—	\$5,165
State and municipal securities	395	—	18,272	50,209	68,876
Mortgage-backed securities:					
Agency	—	1,528	6,194	243,086	250,808
Commercial	—	—	—	68,823	68,823
Non-agency	—	—	—	1,269	1,269
Corporate fixed income securities	35,223	714,520	427,572	—	1,177,315
Asset-backed securities	—	—	244,090	1,533,261	1,777,351
	\$37,275	\$719,556	\$696,128	\$1,896,648	\$3,349,607
Held-to-maturity:					
Mortgage-backed securities:					
Agency	\$—	\$—	\$180,433	\$1,064,149	\$1,244,582
Commercial	—	55,351	—	—	55,351
Asset-backed securities	—	—	478,024	2,787,496	3,265,520
	\$—	\$55,351	\$658,457	\$3,851,645	\$4,565,453

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

23

At September 30, 2018 and December 31, 2017, securities of \$2.0 billion and \$2.2 billion, respectively, were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit obtained to secure public deposits. At September 30, 2018 and December 31, 2017, securities of \$2.1 billion and \$2.0 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 September 30, 2018 (in thousands):

	Less than 12 months		12 months or more		Total	
	Gross		Gross		Gross	
	Unrealized Estimated		Unrealized Estimated		Unrealized Estimated	
	Losses	Fair Value	Losses	Fair Value	Losses	Fair Value
Available-for-sale securities						
U.S. government securities	\$(61)	\$5,040	\$—	\$—	\$(61)	\$5,040
State and municipal securities	—	—	(4,377)	68,481	(4,377)	68,481
Mortgage-backed securities:						
Agency	(731)	40,606	(4,610)	188,110	(5,341)	228,716
Commercial	—	—	(5,883)	67,841	(5,883)	67,841
Non-agency	(12)	1,261	—	—	(12)	1,261
Corporate fixed income securities	(14,053)	565,671	(11,672)	310,351	(25,725)	876,022
Asset-backed securities	(7,810)	517,276	—	—	(7,810)	517,276
	\$(22,667)	\$1,129,854	\$(26,542)	\$634,783	\$(49,209)	\$1,764,637
Held-to-maturity securities						
Mortgage-backed securities:						
Agency	\$(11,804)	\$556,381	\$(37,103)	\$639,295	\$(48,907)	\$1,195,676
Commercial	(343)	55,008	—	—	(343)	55,008
Asset-backed securities	(12,298)	1,675,810	(2,460)	42,507	(14,758)	1,718,317
	\$(24,445)	\$2,287,199	\$(39,563)	\$681,802	\$(64,008)	\$2,969,001

At September 30, 2018, the amortized cost of 232 securities classified as available for sale exceeded their fair value by \$49.2 million, of which \$26.5 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 September 30, 2018, was \$1.8 billion, which was 52.7% of our available-for-sale portfolio.

At September 30, 2018, the carrying value of 152 securities held to maturity exceeded their fair value by \$64.0 million, of which \$39.6 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 nine months ended September 30, 2018 and 2017.

We believe the gross unrealized losses of \$113.2 million related to our investment portfolio, as of September 30, 2018, 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.

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

Other. Other loans include consumer, credit card, and indirect lending.

The following table presents the balance and associated percentage of each major loan category in our bank loan portfolio at September 30, 2018 and December 31, 2017 (in thousands, except percentages):

	September 30, 2018		December 31, 2017	
	Balance	Percent	Balance	Percent
Commercial and industrial	\$3,127,435	37.5 %	\$2,437,938	34.8 %
Residential real estate	2,792,269	33.5	2,593,576	37.0
Securities-based loans	1,836,450	22.0	1,819,206	25.9
Commercial real estate	328,814	3.9	116,258	1.7
Construction and land	120,969	1.4	7,896	0.1
Home equity lines of credit	29,118	0.3	15,039	0.2
Other	109,571	1.4	24,508	0.3
Gross bank loans	8,344,626	100.0 %	7,014,421	100.0 %
Unamortized loan premium/(discount), net	(13,419)		788	
Loans in process	(2,755)		(856)	
Unamortized loan fees, net	6,237		872	
Allowance for loan losses	(80,700)		(67,466)	
Bank loans, net	\$8,253,989		\$6,947,759	

At September 30, 2018 and December 31, 2017, Stifel Bancorp had loans outstanding to its executive officers, directors, and their affiliates in the amount of \$4.0 million and \$4.0 million, respectively, and loans outstanding to other Stifel Financial Corp. executive officers, directors, and their affiliates in the amount of \$25.2 million and \$8.4 million, respectively.

At September 30, 2018 and December 31, 2017, we had loans held for sale of \$262.1 million and \$226.1 million, respectively. For the three months ended September 30, 2018 and 2017, we recognized gains of \$2.6 million and \$3.2 million, respectively, from the sale of originated loans, net of fees and costs. For the nine months ended September 30, 2018 and 2017, we recognized gains of \$7.8 million and \$9.4 million, respectively, from the sale of originated loans, net of fees and costs.

The following table details activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2018 (in thousands).

	Three Months Ended September 30, 2018				
	Beginning				Ending
	Balance	Provision	Charge-offs	Recoveries	Balance
Commercial and industrial	\$59,572	\$ 5,008	\$ —	\$ —	\$64,580
Residential real estate	9,328	1,165	—	—	10,493
Securities-based loans	1,928	(5)	—	—	1,923
Commercial real estate	1,672	90	—	—	1,762
Construction and land	303	600	—	—	903
Home equity lines of credit	229	—	—	—	229
Other	13	(3)	—	1	11
Qualitative	730	69	—	—	799
	\$73,775	\$ 6,924	\$ —	\$ 1	\$80,700

	Nine Months Ended September 30, 2018				
	Beginning				Ending
	Balance	Provision	Charge-offs	Recoveries	Balance
Commercial and industrial	\$54,474	\$ 10,118	\$ (12)	\$ —	\$64,580
Residential real estate	8,430	2,063	—	—	10,493
Securities-based loans	2,088	(165)	—	—	1,923
Commercial real estate	1,520	242	—	—	1,762
Construction and land	100	803	—	—	903
Home equity lines of credit	162	65	—	2	229
Other	16	(5)	(2)	2	11
Qualitative	676	123	—	—	799
	\$67,466	\$ 13,244	\$ (14)	\$ 4	\$80,700

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at September 30, 2018 (in thousands):

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually		Total	Individually		Total
	Evaluated	Evaluated for		Evaluated	Evaluated for	
	Impairment	Impairment	Impairment	Impairment	Total	
Commercial and industrial	\$8,677	\$ 55,903	\$64,580	\$23,630	\$ 3,103,805	\$3,127,435
Residential real estate	24	10,469	10,493	328	2,791,941	2,792,269
Securities-based loans	—	1,923	1,923	—	1,836,450	1,836,450

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Commercial real estate	—	1,762	1,762	—	328,814	328,814
Construction and land	—	903	903	—	120,969	120,969
Home equity lines of credit	—	229	229	231	28,887	29,118
Other	—	11	11	58	109,513	109,571
Qualitative	—	799	799	—	—	—
	\$8,701	\$ 71,999	\$80,700	\$24,247	\$ 8,320,379	\$8,344,626

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 nine months ended September 30, 2017 (in thousands).

	Three Months Ended September 30, 2017					Ending Balance
	Beginning					
	Balance	Provision	Charge-offs	Recoveries	Balance	
Commercial and industrial	\$40,805	\$ 6,312	\$ —	\$ 35		\$47,152
Residential real estate	5,569	1,566	—	—		7,135
Securities-based loans	3,600	(288)	—	—		3,312
Commercial real estate	932	95	—	—		1,027
Home equity lines of credit	283	(13)	—	1		271
Construction and land	224	9	—	—		233
Other	105	(3)	—	1		103
Qualitative	2,684	312	—	—		2,996
	\$54,202	\$ 7,990	\$ —	\$ 37		\$62,229

	Nine Months Ended September 30, 2017					Ending Balance
	Beginning					
	Balance	Provision	Charge-offs	Recoveries	Balance	
Commercial and industrial	\$35,127	\$ 12,239	\$ (250)	\$ 36		\$47,152
Residential real estate	2,660	4,475	—	—		7,135
Securities-based loans	3,094	218	—	—		3,312
Commercial real estate	1,363	2,367	(2,703)	—		1,027
Home equity lines of credit	371	(102)	—	2		271
Construction and land	232	1	—	—		233
Other	129	(27)	—	1		103
Qualitative	2,187	809	—	—		2,996
	\$45,163	\$ 19,980	\$ (2,953)	\$ 39		\$62,229

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at December 31, 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	\$ 8,406	\$8,430	\$171	\$ 2,593,405	\$2,593,576

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Commercial and industrial	9,059	45,415	54,474	28,856	2,409,082	2,437,938
Securities-based loans	—	2,088	2,088	—	1,819,206	1,819,206
Commercial real estate	—	1,520	1,520	—	116,258	116,258
Home equity lines of credit	20	142	162	184	14,855	15,039
Construction and land	—	100	100	—	7,896	7,896
Other	2	14	16	2	24,506	24,508
Qualitative	—	676	676	—	—	—
	\$9,105	\$ 58,361	\$67,466	\$29,213	\$ 6,985,208	\$7,014,421

In determining the amount of our allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions. If our assumptions prove to be incorrect, our current allowance may not be sufficient to cover future loan losses and we may experience significant increases to our provision.

There are two components of the allowance for loan losses: the inherent allowance component and the specific allowance component.

The inherent allowance component of the allowance for loan losses is used to estimate the probable losses inherent in the loan portfolio and includes non-homogeneous loans that have not been identified as impaired and portfolios of smaller balance homogeneous loans. The Company maintains methodologies by loan product for calculating an allowance for loan losses that

estimates the inherent losses in the loan portfolio. Qualitative and environmental factors such as economic and business conditions, nature and volume of the portfolio and lending terms, and volume and severity of past due loans may also be considered in the calculations. The allowance for loan losses is maintained at a level reasonable to ensure that it can adequately absorb the estimated probable losses inherent in the portfolio.

The specific allowance component of the allowance for loan losses is used to estimate probable losses for non-homogeneous exposures, including loans modified in a Troubled Debt Restructuring (“TDR”), which have been specifically identified for impairment analysis by the Company and determined to be impaired. At September 30, 2018, we had \$24.2 million of impaired loans, net of discounts, which included \$9.1 million in troubled debt restructurings. The specific allowance on impaired loans at September 30, 2018 was \$8.7 million. At December 31, 2017, we had \$29.2 million of impaired loans, net of discounts, which included \$9.1 million in troubled debt restructurings. The specific allowance on impaired loans at December 31, 2017 was \$9.1 million. The gross interest income related to impaired loans, which would have been recorded, had these loans been current in accordance with their original terms, and the interest income recognized on these loans during the three and nine months ended September 30, 2018 and 2017, were insignificant to the consolidated financial statements.

The tables below present loans that were individually evaluated for impairment by portfolio segment at September 30, 2018 and December 31, 2017, including the average recorded investment balance for the year to date period presented (in thousands):

	September 30, 2018					
	Unpaid	Recorded	Recorded			
	Contractual	Investment	Investment	Total	Average	
	Principal	with No	with	Recorded	Related	Recorded
	Balance	Allowance	Allowance	Investment	Allowance	Investment
Commercial and industrial	\$23,630	\$ 196	\$ 23,434	\$ 23,630	\$ 8,677	\$ 23,783
Residential real estate	353	80	248	328	24	355
Home equity lines of credit	231	184	47	231	—	236
Other	731	26	32	58	—	60
Total	\$24,945	\$ 486	\$ 23,761	\$ 24,247	\$ 8,701	\$ 24,434

	December 31, 2017					
	Unpaid	Recorded	Recorded			
	Contractual	Investment	Investment	Total	Average	
	Principal	with No	with	Recorded	Related	Recorded
	Balance	Allowance	Allowance	Investment	Allowance	Investment
Commercial and industrial	\$28,856	\$ 5,211	\$ 23,645	\$ 28,856	\$ 9,059	\$ 30,277
Home equity lines of credit	184	—	184	184	20	300
Residential real estate	171	—	171	171	24	174
Other	677	—	2	2	2	5

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Total	\$29,888	\$ 5,211	\$ 24,002	\$ 29,213	\$ 9,105	\$ 30,756
-------	----------	----------	-----------	-----------	----------	-----------

The following table presents the aging of the recorded investment in past due loans at September 30, 2018 and December 31, 2017 by portfolio segment (in thousands):

	As of September 30, 2018				
	30 – 89				
	Days				
	Past Due	90 or More Days Past Due	Total Past Due	Current Balance	Total
Commercial and industrial	\$—	\$ 14,656	\$ 14,656	\$3,112,779	\$3,127,435
Residential real estate	3,745	184	3,929	2,788,340	2,792,269
Securities-based loans	—	—	—	1,836,450	1,836,450
Commercial real estate	—	—	—	328,814	328,814
Construction and land	—	—	—	120,969	120,969
Home equity lines of credit	47	—	47	29,071	29,118
Other	—	67	67	109,504	109,571
Total	\$3,792	\$ 14,907	\$ 18,699	\$8,325,927	\$8,344,626

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

	As of September 30, 2018*		
	Non-Accrued	Restructured	Total
Commercial and industrial	\$ 14,694	\$ 8,936	\$ 23,630
Residential real estate	159	169	328
Home equity lines of credit	231	—	231
Other	58	—	58
Total	\$ 15,142	\$ 9,105	\$ 24,247

*There were no loans past due 90 days and still accruing interest at September 30, 2018.

	As of December 31, 2017					
	30 – 89 Days					
	Past Due	90 or More Days Past Due	Total Past Due	Current Balance	Total	
Residential real estate	\$ 7,892	\$ —	\$ 7,892	\$ 2,585,684	\$ 2,593,576	
Commercial and industrial	11,883	—	11,883	2,426,055	2,437,938	
Securities-based loans	—	—	—	1,819,206	1,819,206	
Commercial real estate	—	—	—	116,258	116,258	
Home equity lines of credit	184	—	184	14,855	15,039	
Construction and land	—	—	—	7,896	7,896	
Other	2	—	2	24,506	24,508	
Total	\$ 19,961	\$ —	\$ 19,961	\$ 6,994,460	\$ 7,014,421	

	As of December 31, 2017*		
	Non-Accrued	Restructured	Total
Commercial and industrial	\$ 19,904	\$ 8,952	\$ 28,856
Home equity lines of credit	184	—	184
Residential real estate	—	171	171
Other	2	—	2
Total	\$ 20,090	\$ 9,123	\$ 29,213

*There were no loans past due 90 days and still accruing interest at December 31, 2017.

Credit quality indicators

Loans meet the definition of Pass when they are performing and do not demonstrate adverse characteristics that are likely to result in a credit loss. A loan is determined to be impaired when principal or interest becomes 90 days past due or when collection becomes uncertain. At the time a loan is determined to be impaired, the accrual of interest and amortization of deferred loan origination fees is discontinued (“non-accrual status”), and any accrued and unpaid interest income is reversed.

We closely monitor economic conditions and loan performance trends to manage and evaluate our exposure to credit risk. Trends in delinquency ratios are an indicator, among other considerations, of credit risk within our loan portfolio. The level of nonperforming assets represents another indicator of the potential for future credit losses. Accordingly, key metrics we track and use in evaluating the credit quality of our loan portfolio include delinquency and nonperforming asset rates, as well as charge-off rates and our internal risk ratings of the loan portfolio. In general, we are a secured lender. At September 30, 2018 and December 31, 2017, 98.6% and 97.2% of our loan portfolio was collateralized, respectively. Collateral is required in accordance with the normal credit evaluation process based upon the creditworthiness of the customer and the credit risk associated with the particular transaction. The Company uses the following definitions for risk ratings:

Pass. A credit exposure rated pass has a continued expectation of timely repayment, all obligations of the borrower are current, and the obligor complies with material terms and conditions of the lending agreement.

Special Mention. Extensions of credit that have potential weakness that deserve management's close attention, and if left uncorrected may, at some future date, result in the deterioration of the repayment prospects or collateral position.

Substandard. Obligor has a well-defined weakness that jeopardizes the repayment of the debt and has a high probability of payment default with the distinct possibility that the Company will sustain some loss if noted deficiencies are not corrected.

Doubtful. Inherent weakness in the exposure makes the collection or repayment in full, based on existing facts, conditions and circumstances, highly improbable, and the amount of loss is uncertain.

Doubtful loans are considered impaired. Substandard loans are regularly reviewed for impairment. When a loan is impaired the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or as a practical expedient, the observable market price of the loan or the fair value of the collateral if the loan is collateral dependent.

Based on the most recent analysis performed, the risk category of our loan portfolio was as follows: (in thousands):

	As of September 30, 2018				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	\$3,069,237	\$ 34,488	\$ 23,710	\$ —	\$3,127,435
Residential real estate	2,791,627	394	248	—	2,792,269
Securities-based loans	1,836,450	—	—	—	1,836,450
Commercial real estate	328,814	—	—	—	328,814
Construction and land	120,969	—	—	—	120,969
Home equity lines of credit	28,887	—	231	—	29,118
Other	109,513	—	47	11	109,571
Total	\$8,285,497	\$ 34,882	\$ 24,236	\$ 11	\$8,344,626

	As of December 31, 2017				
	Pass	Special Mention	Substandard	Doubtful	Total
Residential real estate	\$2,593,096	\$ 309	\$ 171	\$ —	\$2,593,576
Commercial and industrial	2,385,152	22,443	30,343	—	2,437,938
Securities-based loans	1,819,206	—	—	—	1,819,206
Commercial real estate	116,258	—	—	—	116,258
Home equity lines of credit	14,855	—	184	—	15,039
Construction and land	7,896	—	—	—	7,896
Other	24,506	—	2	—	24,508
Total	\$6,960,969	\$ 22,752	\$ 30,700	\$ —	\$7,014,421

NOTE 8 – Goodwill and Intangible Assets

The carrying amount of goodwill and intangible assets attributable to each of our reporting segments is presented in the following table (in thousands):

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

	December			September
	31, 2017	Adjustments	Write-off	30, 2018
Goodwill				
Global Wealth Management	\$276,477	\$ 54,969	\$ —	\$331,446
Institutional Group	692,357	1,911	—	694,268
	\$968,834	\$ 56,880	\$ —	\$1,025,714

	December			September
	31, 2017	Net Additions	Amortization	30, 2018
Intangible assets				
Global Wealth Management	\$44,525	\$ 17,180	\$ (3,662)	\$58,043
Institutional Group	65,102	857	(5,079)	60,880
	\$109,627	\$ 18,037	\$ (8,741)	\$118,923

On March 19, 2018, the Company completed the acquisition of Ziegler. The acquisition was accounted for under the acquisition method of accounting in accordance with ASC 805, "Business Combinations." Accordingly, goodwill was measured as the excess of

the acquisition-date fair value of the consideration transferred over the amount of acquisition-date identifiable assets acquired net of assumed liabilities. We recorded \$19.0 million of goodwill in the consolidated statement of financial condition, which has been allocated to our company's Global Wealth Management and Institutional Group segments. Identifiable intangible assets purchased by our company consisted of customer relationships and non-compete agreements with an acquisition-date fair value of \$9.5 million. See Note 1 in the notes to our consolidated financial statements for additional information regarding the acquisition of Ziegler.

The goodwill represents the value expected from the synergies created through the operational enhancement benefits that will result from the integration of the Ziegler business and of the hired financial advisors and the conversion of the customer accounts to our platform. Goodwill is expected to be deductible for federal income tax purposes.

On August 31, 2018, the Company completed the acquisition of Business Bancshares, Inc. ("BBI"). The acquisition was accounted for under the acquisition method of accounting in accordance with ASC 805, "Business Combinations." Accordingly, goodwill was measured as the excess of the acquisition-date fair value of the consideration transferred over the amount of acquisition-date identifiable assets acquired net of assumed liabilities. We recorded \$46.4 million of goodwill and intangibles in the consolidated statement of financial condition, which has been allocated to our company's Global Wealth Management segment. The allocation of the purchase price of BBI is preliminary and will be finalized upon completion of the analysis of the fair values of the net assets of BBI as of the acquisition date and the identified intangible assets. The final goodwill recorded on the consolidated statement of financial condition may differ from that reflected herein as a result of future measurement period adjustments and the recording of identified intangible assets. See Note 1 in the notes to our consolidated financial statements for additional information regarding the acquisition of BBI.

The goodwill represents the value expected from the synergies created through the operational enhancement benefits that will result from the integration of the BBI business and its customer base.

Amortizable intangible assets consist of acquired customer relationships, trade name, investment banking backlog, and non-compete agreements that are amortized over their contractual or determined useful lives. Intangible assets subject to amortization as of September 30, 2018 and December 31, 2017 were as follows (in thousands):

	September 30, 2018		December 31, 2017	
	Gross		Gross	
	Carrying	Accumulated	Carrying	Accumulated
	Value	Amortization	Value	Amortization
Customer relationships	\$ 156,240	\$ 62,822	\$ 146,986	\$ 55,809
Trade name	24,713	11,373	24,713	10,228
Non-compete agreements	2,603	1,388	2,598	1,202
Investment banking backlog	1,431	1,214	1,419	968
Estimated BBI intangibles ⁽¹⁾	8,615	—	—	—
	\$ 193,602	\$ 76,797	\$ 175,716	\$ 68,207

⁽¹⁾ See discussion regarding the allocation of the estimated goodwill and intangibles recorded for the BBI acquisition.

Amortization expense related to intangible assets was \$3.0 million and \$2.9 million for the three months ended September 30, 2018 and 2017, respectively. Amortization expense related to intangible assets was \$8.7 million and \$9.1 million for the nine months ended September 30, 2018 and 2017, respectively. Amortization expense is included in other operating expenses in the consolidated statements of operations.

The weighted-average remaining lives of the following intangible assets at September 30, 2018, are: customer relationships, 10.7 years; trade name, 9.7 years; non-compete agreements, 8.8 years; and BBI intangibles, 5.0 years. As of September 30, 2018, we expect amortization expense in future periods to be as follows (in thousands):

Fiscal year	
Remainder of 2018	\$3,382
2019	12,974
2020	12,757
2021	12,258
2022	11,798
Thereafter	63,636
	\$116,805

NOTE 9 – Borrowings and Federal Home Loan Bank Advances

Our short-term financing is generally obtained through short-term bank line financing on an uncommitted, secured basis, securities lending arrangements, advances from the Federal Home Loan Bank, term loans, and committed bank line financing on an unsecured basis. We borrow from various banks on a demand basis with company-owned and customer securities pledged as collateral. The value of customer-owned securities used as collateral is not reflected in the consolidated statements of financial condition.

Our uncommitted secured lines of credit at September 30, 2018, totaled \$1.0 billion with six banks and are dependent on having appropriate collateral, as determined by the bank agreements, to secure an advance under the line. The availability of our uncommitted lines is subject to approval by the individual banks each time an advance is requested and may be denied. Our peak daily borrowing on our uncommitted secured lines was \$391.0 million during the nine months ended September 30, 2018. There are no compensating balance requirements under these arrangements. Any borrowings on secured lines of credit are generally utilized to finance certain fixed income securities. At September 30, 2018, we had no outstanding balances on our uncommitted secured lines of credit.

The Federal Home Loan advances of \$1.1 billion as of September 30, 2018 are floating-rate advances. The weighted average interest rates on these advances during the three and nine months ended September 30, 2018 was 1.65% and 1.52%, respectively. The advances are secured by Stifel Bancorp's residential mortgage loan portfolio and investment portfolio. The interest rates reset on a daily basis. Stifel Bancorp has the option to prepay these advances without penalty on the interest reset date.

Our committed bank line financing at September 30, 2018, consisted of a \$200.0 million revolving credit facility. The credit facility expires in March 2020. The applicable interest rate under the revolving credit facility is calculated as a per annum rate equal to the London Interbank Offered Rate ("LIBOR") plus 1.75%, as defined in the revolving credit facility. At September 30, 2018, we had no advances on our revolving credit facility and were in compliance with all covenants.

In June 2018, Stifel, our broker-dealer subsidiary, entered into a 364-day Credit Agreement ("Stifel Credit Facility") with a maturity date of June 2019 in which the lenders are a number of financial institutions. This committed unsecured borrowing facility provides for maximum borrowings of up to \$250.0 million at variable rates of interest. At September 30, 2018, we had no advances on the Stifel Credit Facility and were in compliance with all covenants.

As of September 30, 2018, a subsidiary of Stifel Bancorp was a party to two Notes. The Notes mature in 2043. The Notes bear interest contractually at fixed rates as per the Note Purchase Agreement. The outstanding balance on the Notes at September 30, 2018 was \$134.8 million and is included in borrowings in the consolidated statements of financial condition.

NOTE 10 – Senior Notes

The following table summarizes our senior notes as of September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018	December 31, 2017
4.250% senior notes, due 2024 ⁽¹⁾	\$500,000	\$500,000
3.50% senior notes, due 2020 ⁽²⁾	300,000	300,000
5.20% senior notes, due 2047 ⁽³⁾	225,000	225,000
	1,025,000	1,025,000
Debt issuance costs, net	(9,286)	(10,060)
	\$1,015,714	\$1,014,940

⁽¹⁾In July 2014, we sold in a registered underwritten public offering, \$300.0 million in aggregate principal amount of 4.250% senior notes due July 2024. Interest on these senior notes is payable semi-annually in arrears. We may redeem the notes in whole or in part, at our option, at a redemption price equal to 100% of their principal amount, plus a “make-whole” premium and accrued and unpaid interest, if any, to the date of redemption. In July 2016, we issued an additional \$200.0 million in aggregate principal amount of 4.25% senior notes due 2024.

⁽²⁾In December 2015, we sold in a registered underwritten public offering, \$300.0 million in aggregate principal amount of 3.50% senior notes due December 2020. Interest on these senior notes is payable semi-annually in arrears. We may redeem the notes in whole or in part, at our option, at a redemption price equal to 100% of their principal amount, plus a “make-whole” premium and accrued and unpaid interest, if any, to the date of redemption.

32

(3) In October 2017, we completed the pricing of a registered underwritten public offering of \$200.0 million in aggregate principal amount of 5.20% senior notes due October 2047. Interest on the senior notes is payable quarterly in arrears on January 15, April 15, July 15, and October 15. On or after October 15, 2022, we may redeem some or all of the senior notes at any time at a redemption price equal to 100% of the principal amount of the notes being redeemed plus accrued interest thereon to the redemption date. On October 27, 2017, we completed the sale of an additional \$25.0 million aggregate principal amount of Notes pursuant to the over-allotment option. Our senior notes mature as follows, based upon contractual terms (in thousands):

2018	\$—
2019	—
2020	300,000
2021	—
2022	—
Thereafter	725,000
	\$ 1,025,000

NOTE 11 – Bank Deposits

Deposits consist of money market and savings accounts, certificates of deposit, and demand deposits. Deposits at September 30, 2018 and December 31, 2017 were as follows (in thousands):

	September 30, 2018	December 31, 2017
Money market and savings accounts	\$ 11,950,269	\$ 13,219,675
Certificates of deposit	1,970,318	1,575
Demand deposits (interest-bearing)	465,366	184,829
Demand deposits (non-interest-bearing)	116,999	5,856
	\$ 14,502,952	\$ 13,411,935

The weighted-average interest rate on deposits was 0.49% and 0.10% at September 30, 2018 and December 31, 2017, respectively.

Scheduled maturities of certificates of deposit at September 30, 2018 and December 31, 2017 were as follows (in thousands):

	September 30, 2018	December 31, 2017
Certificates of deposit, less than \$100:		
Within one year	\$5,617	\$ 438
One to three years	544	148
Three to five years	127	—
	\$6,288	\$ 586
Certificates of deposit, \$100 and greater:		
Within one year	\$1,740,855	\$ 651
One to three years	193,185	338
Three to five years	29,990	—
	1,964,030	989
	\$1,970,318	\$ 1,575

At September 30, 2018 and December 31, 2017, the amount of deposits includes related party deposits, primarily interest-bearing and time deposits of executive officers, directors, and their affiliates of \$3.8 million and \$0.2 million, respectively. Brokerage customers' deposits were \$13.6 billion and \$13.4 billion, respectively.

NOTE 12 – Derivative Instruments and Hedging Activities

We use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps generally involve the exchange of fixed and variable rate interest payments between two parties, based on a common notional principal amount and maturity date with

no exchange of underlying principal amounts. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for our company making fixed payments. Our policy is not to offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral arising from derivative instruments recognized at fair value executed with the same counterparty under master netting arrangements.

The following table provides the notional values and fair values of our derivative instruments as of September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018 Balance Sheet		
	Notional Value		Fair Value
Asset Derivatives			
Cash flow interest rate contracts	\$540,000	Other assets	\$11,117

	December 31, 2017 Balance Sheet		
	Notional Value		Fair Value
Asset Derivatives			
Cash flow interest rate contracts	\$540,000	Other assets	\$7,995

Cash Flow Hedges

We have entered into interest rate swap agreements that effectively modify our exposure to interest rate risk by converting floating rate debt to a fixed rate debt. The swaps have an average remaining life of 1.3 years.

Any unrealized gains or losses related to cash flow hedging instruments are reclassified from accumulated other comprehensive loss into earnings in the same period the hedged forecasted transaction affects earnings and are recorded in interest expense on the accompanying consolidated statements of operations. The ineffective portion of the cash flow hedging instruments is recorded in other income or other operating expense.

Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on our variable rate deposits. During the next twelve months, we estimate that \$4.9 million will be reclassified as interest income.

The following table shows the effect of our company's derivative instruments in the consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017 (in thousands):

Three Months Ended September 30, 2018			
Gain/(Loss)	Location of	Gain/(Loss)	Location of

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

	Recognized in	Location of Loss	Reclassified From OCI Into Income	Loss Recognized in OCI (Ineffectiveness)	Recognized Due to Ineffectiveness (Ineffectiveness)
Cash flow interest rate contracts	\$ (603)	Interest expense	\$ 1,504	Interest expense	\$ —

Three Months Ended September 30, 2017

	Location of Gain/(Loss)	Location of Loss	Gain/(Loss) Recognized	Loss Recognized in OCI	Gain/(Loss) Recognized Due to Ineffectiveness
Cash flow interest rate contracts	\$ 928	Interest expense	\$ 724	Interest expense	\$ —

Nine Months Ended September 30, 2018				
Gain/(Loss)	Location of		Location of	
	Loss	Gain/(Loss)	Loss	Loss
Recognized	Reclassified		Recognized in	
in	From OCI	From OCI	OCI	Due to
	(Effectiveness)	Income	Into Income	(Ineffectiveness)
Cash flow interest rate contracts	\$ (5,823)	Interest expense	\$ 3,262	Interest expense \$ —

Nine Months Ended September 30, 2017				
Gain/(Loss)	Location of		Location of	
	Loss	Gain/(Loss)	Loss	Loss
Recognized	Reclassified		Recognized in	
in	From OCI	From OCI	OCI	Due to
	(Effectiveness)	Income	Into Income	(Ineffectiveness)
Cash flow interest rate contracts	\$ 3,504	Interest expense	\$ (810)	Interest expense \$ —

We maintain a risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings caused by interest rate volatility. Our goal is to manage sensitivity to changes in rates by hedging the maturity characteristics of variable rate affiliated deposits, thereby limiting the impact on earnings. By using derivative instruments, we are exposed to credit and market risk on those derivative positions. We manage the market risk associated with interest rate contracts by establishing and monitoring limits as to the types and degree of risk that may be undertaken. Credit risk is equal to the extent of the fair value gain in a derivative if the counterparty fails to perform. When the fair value of a derivative contract is positive, this generally indicates that the counterparty owes our company and, therefore, creates a repayment risk for our company. When the fair value of a derivative contract is negative, we owe the counterparty and, therefore, have no repayment risk. See Note 4 in the notes to our consolidated financial statements for further discussion on how we determine the fair value of our financial instruments. We minimize the credit (or repayment) risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically by senior management.

Credit Risk-Related Contingency Features

We have agreements with our derivative counterparties containing provisions where if we default on any of our indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then we could also be declared in default on our derivative obligations.

We have agreements with certain of our derivative counterparties that contain provisions where if our shareholders' equity declines below a specified threshold or if we fail to maintain a specified minimum shareholders' equity, then we could be declared in default on our derivative obligations.

Certain of our agreements with our derivative counterparties contain provisions where if a specified event or condition occurs that materially changes our creditworthiness in an adverse manner, we may be required to fully collateralize our obligations under the derivative instrument.

Regulatory Capital-Related Contingency Features

Certain of our derivative instruments contain provisions that require us to maintain our capital adequacy requirements. If we were to lose our status as "adequately capitalized," we would be in violation of those provisions, and the counterparties of the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions.

Counterparty Risk

In the event of counterparty default, our economic loss may be higher than the uncollateralized exposure of our derivatives if we were not able to replace the defaulted derivatives in a timely fashion. We monitor the risk that our uncollateralized exposure to each of our counterparties for interest rate swaps will increase under certain adverse market conditions by performing periodic market stress tests. These tests evaluate the potential additional uncollateralized exposure we would have to each of these derivative counterparties assuming changes in the level of market rates over a brief time period.

NOTE 13 – Disclosures About Offsetting Assets and Liabilities

The following table provides information about financial assets and derivative assets that are subject to offset as of September 30, 2018 and December 31, 2017 (in thousands):

				Gross amounts not offset		
				in the Statement of		
				Financial Condition		
	Gross	Net				
	Amounts	Amounts				
	Gross	Offset in	Presented in			
	Amounts of	the Statement	the Statement			
	Recognized	of Financial	of Financial	Amounts	Net	
	Assets	Condition	Condition	available	Available	Amount
				for offset	collateral	
As of September 30, 2018:						
Securities borrowing ⁽¹⁾	\$ 170,165	\$ —	\$ 170,165	\$(47,974)	\$(110,088)	\$12,103
Reverse repurchase agreements ⁽²⁾	622,361	—	622,361	(261,773)	(356,842)	3,746
Cash flow interest rate contracts	11,117	—	11,117	—	—	11,117
	\$ 803,643	\$ —	\$ 803,643	\$(309,747)	\$(466,930)	\$26,966
As of December 31, 2017:						
Securities borrowing ⁽¹⁾	\$ 132,776	\$ —	\$ 132,776	\$(78,474)	\$(37,248)	\$17,054
Reverse repurchase agreements ⁽²⁾	512,220	—	512,220	(233,624)	(266,008)	12,588
Cash flow interest rate contracts	7,995	—	7,995	—	—	7,995
	\$ 652,991	\$ —	\$ 652,991	\$(312,098)	\$(303,256)	\$37,637

⁽¹⁾Securities borrowing transactions are included in receivables from brokers, dealers, and clearing organizations on the consolidated statements of financial condition. See Note 3 in the notes to consolidated financial statements for additional information on receivables from brokers, dealers, and clearing organizations.

⁽²⁾Collateral received includes securities received by our company from the counterparty. These securities are not included on the consolidated statements of financial condition unless there is an event of default. The fair value of securities pledged as collateral was \$621.5 million and \$509.4 million at September 30, 2018 and December 31, 2017, respectively.

The following table provides information about financial liabilities and derivative liabilities that are subject to offset as of September 30, 2018 and December 31, 2017 (in thousands):

	Gross amounts not offset		in the Statement of Financial Condition			
	Gross Amounts	Net Amounts				
	Gross Amounts of Recognized Liabilities	Offset in the Statement of Financial Condition	Presented in the Statement of Financial Condition	Amounts available for offset	Collateral Pledged	Net Amount
As of September 30, 2018:						
Securities lending ⁽³⁾	\$(691,150)	\$ —	\$(691,150)	\$47,974	\$616,157	\$(27,019)
Repurchase agreements ⁽⁴⁾	(495,484)	—	(495,484)	261,773	233,711	—
	\$(1,186,634)	\$ —	\$(1,186,634)	\$309,747	\$849,868	\$(27,019)
As of December 31, 2017:						
Securities lending ⁽³⁾	\$(219,782)	\$ —	\$(219,782)	\$78,474	\$133,772	\$(7,536)
Repurchase agreements ⁽⁴⁾	(233,704)	—	(233,704)	233,624	80	—
	\$(453,486)	\$ —	\$(453,486)	\$312,098	\$133,852	\$(7,536)

- (3) Securities lending transactions are included in payables to brokers, dealers, and clearing organizations on the consolidated statements of financial condition. See Note 3 in the notes to consolidated financial statements for additional information on payables to brokers, dealers, and clearing organizations.
- (4) Collateral pledged includes the fair value of securities pledged by our company to the counter party. These securities are included on the consolidated statements of financial condition unless we default. Collateral pledged by our company to the counter party includes U.S. government agency securities, U.S. government securities, and corporate fixed income securities with market values of \$522.4 million and \$241.4 million at September 30, 2018 and December 31, 2017, respectively.

NOTE 14 – Commitments, Guarantees, and Contingencies

Broker-Dealer Commitments and Guarantees

In the normal course of business, we enter into underwriting commitments. Settlement of transactions relating to such underwriting commitments, which were open at September 30, 2018, had no material effect on the consolidated financial statements.

We also provide guarantees to securities clearinghouses and exchanges under their standard membership agreement, which requires members to guarantee the performance of other members. Under the agreement, if another member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet shortfalls. Our liability under these agreements is not quantifiable and may exceed the cash and securities we have posted as collateral. However, the potential requirement for us to make payments under these arrangements is considered remote. Accordingly, no liability has been recognized for these arrangements.

Other Commitments

In the ordinary course of business, Stifel Bancorp has commitments to extend credit in the form of commitments to originate loans, standby letters of credit, and lines of credit. See Note 20 in the notes to consolidated financial statements for further details.

Concentration of Credit Risk

We provide investment, capital-raising, and related services to a diverse group of domestic customers, including governments, corporations, and institutional and individual investors. Our exposure to credit risk associated with the non-performance of customers in fulfilling their contractual obligations pursuant to securities transactions can be directly impacted by volatile securities markets, credit markets, and regulatory changes. This exposure is measured on an individual customer basis and on a group basis for customers that share similar attributes. To reduce the potential for risk concentrations, counterparty credit limits have been implemented for certain products and are continually monitored in light of changing customer and market conditions. As of September 30, 2018 and December 31, 2017, we did not have significant concentrations of credit risk with any one customer or counterparty, or any group of customers or counterparties.

NOTE 15 – Legal Proceedings

Our company and its subsidiaries are named in and subject to various proceedings and claims arising primarily from our securities business activities, including lawsuits, arbitration claims, class actions, and regulatory matters. Some of these claims seek substantial compensatory, punitive, or indeterminate damages. Our company and its subsidiaries are also involved in other reviews, investigations, and proceedings by governmental and self-regulatory organizations regarding our business, which may result in adverse judgments, settlements, fines, penalties, injunctions, and other relief. We are contesting allegations in these claims, and we believe that there are meritorious defenses in each of these lawsuits, arbitrations, and regulatory investigations. In view of the number and diversity of claims against our company, the number of jurisdictions in which litigation is pending, and the inherent difficulty of predicting the outcome of litigation and other claims, we cannot state with certainty what the eventual outcome of pending litigation or other claims will be.

We have established reserves for potential losses that are probable and reasonably estimable that may result from pending and potential legal actions, investigations, and regulatory proceedings. In many cases, however, it is inherently difficult to determine whether any loss is probable or reasonably possible or to estimate the amount or range of any potential loss, particularly where proceedings may be in relatively early stages or where plaintiffs are seeking substantial or indeterminate damages. Matters frequently need to be more developed before a loss or range of loss can reasonably be estimated.

In our opinion, based on currently available information, review with outside legal counsel, and consideration of amounts provided for in our consolidated financial statements with respect to these matters, the ultimate resolution of these matters will not have a material adverse impact on our financial position and results of operations. However, resolution of one or more of these matters may have a material effect on the results of operations in any future period, depending upon the ultimate resolution of those matters and depending upon the level of income for such period. For matters where a reserve has not been established and for which we believe a loss is

reasonably possible, as well as for matters where a reserve has been recorded but for which an exposure to loss in excess of the amount accrued is reasonably possible, based on currently available information, we believe that such losses will not have a material effect on our consolidated financial statements.

NOTE 16 – Regulatory Capital Requirements

We operate in a highly regulated environment and are subject to capital requirements, which may limit distributions to our company from its subsidiaries. Distributions from our broker-dealer subsidiaries are subject to net capital rules. A broker-dealer that fails to comply with the SEC’s Uniform Net Capital Rule (Rule 15c3-1) may be subject to disciplinary actions by the SEC and self-regulatory organizations, such as FINRA, including censures, fines, suspension, or expulsion. Stifel has chosen to calculate its net capital under the alternative method, which prescribes that their net capital shall not be less than the greater of \$1.0 million or two percent of aggregate debit balances (primarily receivables from customers) computed in accordance with the SEC’s Customer Protection Rule (Rule 15c3-3). Our other broker-dealer subsidiaries calculate their net capital under the aggregate indebtedness method, whereby their aggregate indebtedness may not be greater than fifteen times their net capital (as defined).

At September 30, 2018, Stifel had net capital of \$355.9 million, which was 20.0% of aggregate debit items and \$320.4 million in excess of its minimum required net capital. At September 30, 2018, all of our other broker-dealer subsidiaries’ net capital exceeded the minimum net capital required under the SEC rule.

Our international subsidiary is subject to the regulatory supervision and requirements of the Financial Conduct Authority (“FCA”) in the United Kingdom. At September 30, 2018, our international subsidiary’s capital and reserves were in excess of the financial resources requirement under the rules of the FCA.

Our company, as a bank holding company, Stifel Bank & Trust, and Stifel Bank (“bank subsidiaries”) are subject to various regulatory capital requirements administered by the Federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our company’s and its bank subsidiaries’ financial results. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, our company and its bank subsidiaries must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our company’s and its bank subsidiaries’ capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Our company and its bank subsidiaries are subject to Basel III. Under the Basel III rules, the quantity and quality of regulatory capital increased, a capital conservation buffer was established, selected changes were made to the calculation of risk-weighted assets, and a new ratio, common equity Tier 1 was introduced, all of which are applicable to both our company and its bank subsidiaries. Various aspects of Basel III will be subject to multi-year transition periods through December 31, 2018.

Our company and its bank subsidiaries are required to maintain minimum amounts and ratios of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), Tier 1 capital to average assets (as defined), and under rules defined in Basel III, Common equity Tier 1 capital to risk-weighted assets. Our company and its bank subsidiaries each calculate these ratios in order to assess compliance with both regulatory requirements and their internal capital policies. At current capital levels, our company and its bank subsidiaries are each categorized as “well capitalized” under the regulatory framework for prompt corrective action.

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

To be categorized as “well capitalized,” our company and its bank subsidiaries must maintain total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the tables below (in thousands, except ratios).

Stifel Financial Corp. – Federal Reserve Capital Amounts
September 30, 2018

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity tier 1 capital	\$1,931,840	16.7 %	\$521,580	4.5 %	\$753,393	6.5 %
Tier 1 capital	2,081,840	18.0 %	695,439	6.0 %	927,252	8.0 %
Total capital	2,232,951	19.3 %	927,252	8.0 %	1,159,066	10.0 %
Tier 1 leverage	2,081,840	9.6 %	864,465	4.0 %	1,080,581	5.0 %

Stifel Bank & Trust – Federal Reserve Capital Amounts
September 30, 2018

	Actual		Adequacy Purposes		Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity tier 1 capital	\$1,142,936	14.2 %	\$361,454	4.5 %	\$522,100	6.5 %
Tier 1 capital	1,142,936	14.2 %	481,939	6.0 %	642,585	8.0 %
Total capital	1,223,636	15.2 %	642,585	8.0 %	803,231	10.0 %
Tier 1 leverage	1,142,936	7.0 %	651,837	4.0 %	814,797	5.0 %

Stifel Bank – Federal Reserve Capital Amounts
September 30, 2018

	Actual		Adequacy Purposes		Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity tier 1 capital	\$75,385	13.8 %	\$24,666	4.5 %	\$35,629	6.5 %
Tier 1 capital	75,385	13.8 %	32,888	6.0 %	43,851	8.0 %
Total capital	82,246	15.0 %	43,851	8.0 %	54,814	10.0 %
Tier 1 leverage	75,385	12.5 %	24,137	4.0 %	30,171	5.0 %

NOTE 17 – Revenues from Contracts with Customers

The following table presents the Company's total revenues separated between revenues from contracts with customers and other sources of revenues for the three and nine months ended September 30, 2018 (in thousands):

Three Months Ended September	Nine Months Ended September
------------------------------	-----------------------------

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

	30, 2018	30, 2018
Revenues from contracts with customers:		
Commissions	\$ 158,016	\$490,693
Investment banking	169,012	506,437
Asset management and service fees	200,743	596,112
Other	4,394	11,908
Total revenue from contracts with customers	532,165	1,605,150
Other sources of revenue:		
Interest	169,760	461,915
Principal transactions	83,152	269,918
Other	1,733	6,649
Total revenues	\$ 786,810	\$2,343,632

Revenue from contracts with customers is recognized when, or as, we satisfy our performance obligations by transferring the promised goods or services to the customers. A good or service is transferred to a customer when, or as, the customer obtains control of that good or service. A performance obligation may be satisfied over time or at a point in time. Revenue from a performance obligation satisfied over time is recognized by measuring our progress in satisfying the performance obligation in a manner that depicts the transfer of the goods or services to the customer. Revenue from a performance obligation satisfied at a point in time is recognized at the point in time that we determine the customer obtains control over the promised good or service. The amount of revenue recognized reflects the consideration we expect to be entitled to in exchange for those promised goods or services (i.e., the “transaction price”). In determining the transaction price, we consider multiple factors, including the effects of variable consideration. Variable consideration is included in the transaction price only to the extent it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainties with respect to the amount are resolved. In determining when to include variable consideration in the transaction price, we consider the range of possible outcomes, the predictive value of our past experiences, the time period of when uncertainties expect to be resolved and the amount of consideration that is susceptible to factors outside of our influence, such as market volatility or the judgment and actions of third parties.

The following provides detailed information on the recognition of our revenues from contracts with customers:

Commissions. We earn commission revenue by executing, settling, and clearing transactions for clients primarily in OTC and listed equity securities, insurance products, and options. Trade execution and clearing and custody services, when provided together, represent a single performance obligation as the services are not separately identifiable in the context of the contract. Commission revenues associated with combined trade execution and clearing and custody services, as well as trade execution services on a standalone basis, are recognized at a point in time on trade-date. Commission revenues are generally paid on settlement date and we record a receivable between trade-date and payment on settlement date.

Investment Banking. We provide our clients with a full range of capital markets and financial advisory services. Capital markets services include underwriting and placement agent services in both the equity and debt capital markets, including private equity placements, initial public offerings, follow-on offerings, underwriting and distributing public and private debt.

Capital raising revenues are recognized at a point in time on trade-date, as the client obtains the control and benefit of the capital markets offering at that point. Costs associated with capital raising transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded, and are recorded on a gross basis within other operating expenses in the consolidated statements of operations as we are acting as a principal in the arrangement. Any expenses reimbursed by our clients are recognized as investment banking revenues.

Revenues from financial advisory services primarily consist of fees generated in connection with merger, acquisition and restructuring transactions. Advisory fees from mergers and acquisitions engagements are recognized at a point in time when the related transaction is completed, as the performance obligation is to successfully broker a specific transaction. Fees received prior to the completion of the transaction are deferred within accounts payable and accrued expenses on the consolidated statements of financial condition. Advisory fees from restructuring engagements are recognized over time using a time elapsed measure of progress as our clients simultaneously receive and consume the benefits of those services as they are provided. A significant portion of the fees we receive for our advisory services are considered variable as they are contingent upon a future event (e.g., completion of a transaction or third party emergence from bankruptcy) and are excluded from the transaction price until the uncertainty associated with the variable consideration is subsequently resolved, which is expected to occur upon achievement of the specified milestone. Payment for advisory services are generally due promptly upon completion of a specified milestone or, for retainer fees, periodically over the course of the engagement. We recognize a receivable between the date of completion of the milestone and payment by the customer. Expenses associated with investment banking advisory engagements are deferred only to the extent they are explicitly reimbursable by the client and the related revenue is recognized upon completion of services. All other investment banking advisory related expenses, including expenses incurred related to restructuring assignments, are expensed as incurred. All investment banking advisory expenses are recognized within other operating expenses on the consolidated statements of operations and any expenses reimbursed by our clients are recognized as investment banking revenues.

Asset Management Fees. We earn management and performance fees in connection with investment advisory services provided to institutional and individual clients. Investment advisory fees are charged based on the value of assets in fee-based accounts and are affected by changes in the balances of client assets due to market fluctuations and levels of net new client assets. Fees are charged either in advance based on fixed rates applied to the value of the customers' account at the beginning of the period or periodically based on contracted rates and account performance. Contracts can be terminated at any time with no incremental payments due to our company upon termination. If the contract is terminated by the customer fees are prorated for the period and fees charged for the post termination period are refundable to the customer.

Disaggregation of Revenue

The following tables present the Company's revenues from contracts with customers by reportable segment disaggregated by major business activity and primary geographic regions for the three and nine months ended September 30, 2018 (in thousands):

40

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

	Three Months Ended September 30, 2018 ⁽¹⁾		
	Global		
	Wealth Management	Institutional Group	Total
Major business activity:			
Commissions	\$ 117,795	\$ 40,220	\$ 158,015
Investment banking - capital raising	7,722	85,553	93,275
Investment banking - advisory fees	—	75,717	75,717
Asset management	200,735	8	200,743
Other	4,394	—	4,394
Total	330,646	201,498	532,144
Primary Geographic Region:			
United States	330,646	172,382	503,028
Europe	—	28,197	28,197
Other	—	919	919
	\$ 330,646	\$ 201,498	\$ 532,144
	Nine Months Ended September 30, 2018 ⁽¹⁾		
	Global		
	Wealth Management	Institutional Group	Total
Major business activity:			
Commissions	\$ 355,129	\$ 135,563	\$ 490,692
Investment banking - capital raising	23,378	222,666	246,044
Investment banking - advisory fees	81	260,312	260,393
Asset management	596,081	31	596,112
Other	11,908	—	11,908
Total	986,577	618,572	1,605,149
Primary Geographic Region:			
United States	986,577	522,147	1,508,724
Europe	—	92,029	92,029
Other	—	4,396	4,396
	\$ 986,577	\$ 618,572	\$ 1,605,149

⁽¹⁾ Excludes revenue included in the Other segment.

See Note 21 for further break-out of revenues by geography.

Information on Remaining Performance Obligations and Revenue Recognized from Past Performance

We do not disclose information about remaining performance obligations pertaining to contracts that have an original expected duration of one year or less. The transaction price allocated to remaining unsatisfied or partially unsatisfied performance obligations with an original expected duration exceeding one year was not material at September 30, 2018. Investment banking advisory fees that are contingent upon completion of a specific milestone and fees associated with certain distribution services are also excluded as the fees are considered variable and not included in

the transaction price at September 30, 2018.

Contract Balances

The timing of our revenue recognition may differ from the timing of payment by our customers. We record a receivable when revenue is recognized prior to payment and we have an unconditional right to payment. Alternatively, when payment precedes the provision of the related services, we record deferred revenue until the performance obligations are satisfied.

We had receivables related to revenues from contracts with customers of \$146.7 million and \$96.0 million at September 30, 2018 and December 31, 2017, respectively. We had no significant impairments related to these receivables during the three months ended September 30, 2018.

Our deferred revenue primarily relates to retainer fees received in investment banking advisory engagements where the performance obligation has not yet been satisfied. Deferred revenue at September 30, 2018 was \$10.2 million.

NOTE 18 – Interest Income and Interest Expense

The components of interest income and interest expense are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Interest income:				
Bank loans, net	\$78,766	\$54,006	\$210,790	\$147,495
Investment securities	66,825	48,072	185,263	136,123
Margin balances	13,066	9,919	36,322	27,124
Financial instruments owned	5,733	4,371	15,645	12,953
Other	5,370	1,494	13,895	4,071
	\$169,760	\$117,862	\$461,915	\$327,766
Interest expense:				
Bank deposits	\$25,856	\$4,770	\$49,329	\$8,424
Senior notes	11,248	8,655	33,488	24,935
Federal Home Loan Bank advances	4,232	1,255	10,579	5,771
Other	7,132	2,945	18,804	11,035
	\$48,468	\$17,625	\$112,200	\$50,165

NOTE 19 – Employee Incentive, Deferred Compensation, and Retirement Plans

We maintain several incentive stock award plans that provide for the granting of stock options, stock appreciation rights, restricted stock, performance award, stock units and debentures to our employees. We are permitted to issue new shares under all stock award plans approved by shareholders or to reissue our treasury shares. Awards under our company's incentive stock award plans are granted at market value at the date of grant. The awards generally vest ratably over a one- to ten-year vesting period.

All stock-based compensation plans are administered by the Compensation Committee of the Board of Directors ("Compensation Committee"), which has the authority to interpret the plans, determine to whom awards may be granted under the plans, and determine the terms of each award. According to these plans, we are authorized to grant an additional 5.3 million shares at September 30, 2018.

Stock-based compensation expense included in compensation and benefits expense in the consolidated statements of operations for our company's incentive stock award plans was \$31.7 million and \$32.5 million for the three months ended September 30, 2018 and 2017, respectively, and \$82.5 million and \$98.1 million for the nine months ended September 30, 2018 and 2017, respectively.

Restricted Stock Units and Restricted Stock Awards

A restricted stock unit represents the right to receive a share of common stock from our company at a designated time in the future without cash payment by the employee and is issued in lieu of cash incentive, principally for deferred compensation and employee retention plans. The restricted stock units vest on an annual basis over the next one to ten

years and are distributable, if vested, at future specified dates. Our Company grants Performance-based Restricted Stock Units ("PRSUs") to its executive officers. Under the terms of the grants, the number of PRSUs that will vest and convert to shares will be based on the Company's achievement of the pre-determined performance objectives during the performance period. Any resulting delivery of shares for PRSUs granted as part of compensation will occur after four years for 80% of the earned award, and in the fifth year for the remaining 20% of the earned award. The number of shares converted has the potential to range from 0% to 200% based on how the Company performs during the performance period. Restricted stock awards are restricted as to sale or disposition. These restrictions lapse over the next one to five years. Compensation expense is amortized over the service period based on the fair value of the award on the grant date. The Company's pre-determined performance objectives must be met for the awards to vest. Employees forfeit unvested share units upon termination of employment with a corresponding reversal of compensation expense. Certain restricted share units may continue to vest under certain circumstances as described in the Wealth Accumulation Plan (the "Plan"). At September 30, 2018, the total number of restricted stock units and restricted stock awards outstanding was 16.6 million, of which 12.9 million were unvested. At September 30, 2018, the total number of PRSUs was 0.6 million, of which all were unvested.

At September 30, 2018, there was unrecognized compensation cost for stock units of approximately \$292.2 million, which is expected to be recognized over a weighted-average period of 2.9 years.

Deferred Compensation Plans

The Plan is provided to certain revenue producers, officers, and key administrative employees, whereby a certain percentage of their incentive compensation is deferred as defined by the Plan into company stock units and debentures. Participants may elect to defer a portion of their incentive compensation. Deferred awards generally vest over a one- to ten-year period and are distributable upon vesting or at future specified dates. Deferred compensation costs are amortized on a straight-line basis over the vesting period. Elective deferrals are 100% vested.

Additionally, the Plan allows Stifel's financial advisors who achieve certain levels of production the option to defer a certain percentage of their gross commissions. As stipulated by the Plan, the financial advisors will defer 5% of their gross commissions. The mandatory deferral will be split evenly between company restricted stock units and a company fixed-rate cash debenture. They have the option to defer an additional 1% of gross commissions into company stock units with a 25% matching contribution.

In addition, certain financial advisors, upon joining our company, may receive company stock units in lieu of transition cash payments. Deferred compensation related to these awards generally vests over a one- to eight-year period. Deferred compensation costs are amortized on a straight-line basis over the deferral period.

Profit Sharing Plan

Eligible employees of our company who have met certain service requirements may participate in the Stifel Financial Corp. Profit Sharing 401(k) Plan (the "401(k) Plan"). Employees are permitted within limitations imposed by tax law to make pre-tax contributions to the 401(k) Plan. We may match certain employee contributions or make additional contributions to the 401(k) Plan at our discretion. Our contributions to the 401(k) Plan were \$3.4 million and \$1.8 million for the three months ended September 30, 2018 and 2017, respectively and \$10.1 million and \$5.5 million for the nine months ended September 30, 2018 and 2017, respectively.

NOTE 20 – Off-Balance Sheet Credit Risk

In the normal course of business, we execute, settle, and finance customer and proprietary securities transactions. These activities expose our company to off-balance sheet risk in the event that customers or other parties fail to satisfy their obligations.

In accordance with industry practice, securities transactions generally settle within two business days after trade date. Should a customer or broker fail to deliver cash or securities as agreed, we may be required to purchase or sell securities at unfavorable market prices.

We borrow and lend securities to facilitate the settlement process and finance transactions, utilizing customer margin securities held as collateral. We monitor the adequacy of collateral levels on a daily basis. We periodically borrow from banks on a collateralized basis, utilizing firm and customer margin securities in compliance with SEC rules. Should the counterparty fail to return customer securities pledged, we are subject to the risk of acquiring the securities at prevailing market prices in order to satisfy our customer obligations. We control our exposure to credit risk by continually monitoring our counterparties' positions, and where deemed necessary, we may require a deposit of additional collateral and/or a reduction or diversification of positions. Our company sells securities it does not currently own (short sales) and is obligated to subsequently purchase such securities at prevailing market prices. We

are exposed to risk of loss if securities prices increase prior to closing the transactions. We control our exposure to price risk from short sales through daily review and setting position and trading limits.

We manage our risks associated with the aforementioned transactions through position and credit limits and the continuous monitoring of collateral. Additional collateral is required from customers and other counterparties when appropriate.

We have accepted collateral in connection with resale agreements, securities borrowed transactions, and customer margin loans. Under many agreements, we are permitted to sell or repledge these securities held as collateral and use these securities to enter into securities lending arrangements or to deliver to counterparties to cover short positions. At September 30, 2018 and December 31, 2017, the fair value of securities accepted as collateral where we are permitted to sell or repledge the securities was \$2.7 billion and \$2.4 billion, respectively, and the fair value of the collateral that had been sold or repledged was \$495.5 million and \$233.7 million, respectively.

We enter into interest rate derivative contracts to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. Our derivative financial instruments are principally used to manage differences in the amount, timing, and duration of our known or expected cash payments related to certain variable-rate affiliated deposits. Interest rate swaps designated as cash flow hedges involve the receipt of variable-

rate amounts from a counterparty in exchange for us making fixed-rate payments. Our interest rate hedging strategies may not work in all market environments and, as a result, may not be effective in mitigating interest rate risk.

Derivatives' notional contract amounts are not reflected as assets or liabilities in the consolidated statements of financial condition. Rather, the market or fair value of the derivative transactions are reported in the consolidated statements of financial condition as other assets or accounts payable and accrued expenses, as applicable.

For a complete discussion of our activities related to derivative instruments, see Note 12 in the notes to consolidated financial statements.

In the ordinary course of business, Stifel Bancorp has commitments to originate loans, standby letters of credit, and lines of credit. Commitments to originate loans are agreements to lend to a customer as long as there is no violation of any condition established by the contract. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash commitments. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if necessary, is based on the credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, commercial real estate, and residential real estate.

At September 30, 2018 and December 31, 2017, Stifel Bancorp had outstanding commitments to originate loans aggregating \$205.7 million and \$160.2 million, respectively. The commitments extended over varying periods of time, with all commitments at September 30, 2018, scheduled to be disbursed in the following three months.

Through Stifel Bancorp, in the normal course of business, we originate residential mortgage loans and sell them to investors. We may be required to repurchase mortgage loans that have been sold to investors in the event there are breaches of certain representations and warranties contained within the sales agreements. We may be required to repurchase mortgage loans that were sold to investors in the event that there was inadequate underwriting or fraud, or in the event that the loans become delinquent shortly after they are originated. We also may be required to indemnify certain purchasers and others against losses they incur in the event of breaches of representations and warranties and in various other circumstances, and the amount of such losses could exceed the repurchase amount of the related loans. Consequently, we may be exposed to credit risk associated with sold loans.

Standby letters of credit are irrevocable conditional commitments issued by Stifel Bancorp to guarantee the performance of a customer to a third party. Financial standby letters of credit are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. Performance standby letters of credit are issued to guarantee performance of certain customers under non-financial contractual obligations. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. Should Stifel Bancorp be obligated to perform under the standby letters of credit, it may seek recourse from the customer for reimbursement of amounts paid. At September 30, 2018 and December 31, 2017, Stifel Bancorp had outstanding letters of credit totaling \$27.9 million and \$82.5 million, respectively. A majority of the standby letters of credit commitments at September 30, 2018, have expiration terms that are less than one year.

Lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Lines of credit generally have fixed expiration dates. Stifel Bancorp uses the same credit policies in granting lines of credit as it does for on-balance sheet instruments. At September 30, 2018 and December 31, 2017, Stifel Bancorp had granted unused lines of credit to commercial and consumer borrowers aggregating \$769.5 million and \$590.5 million, respectively.

NOTE 21 – Segment Reporting

We currently operate through the following three business segments: Global Wealth Management, Institutional Group, and various corporate activities combined in the Other segment.

Our Global Wealth Management segment consists of two businesses, the Private Client Group and Stifel Bancorp, Inc. The Private Client Group includes branch offices and independent contractor offices of our broker-dealer subsidiaries located throughout the United States. These branches provide securities brokerage services, including the sale of equities, mutual funds, fixed income products, and insurance, as well as offering banking products to their clients through our bank subsidiaries, which provide residential, consumer, and commercial lending, as well as FDIC-insured deposit accounts to customers of our broker-dealer subsidiaries and to the general public.

The Institutional Group segment includes institutional sales and trading. It provides securities brokerage, trading, and research services to institutions, with an emphasis on the sale of equity and fixed income products. This segment also includes the management

of and participation in underwritings for both corporate and public finance (exclusive of sales credits generated through the private client group, which are included in the Global Wealth Management segment), merger and acquisition, and financial advisory services.

The Other segment includes interest income from stock borrow activities, unallocated interest expense, interest income and gains and losses from investments held, amortization of stock-based awards, and all unallocated overhead cost associated with the execution of orders; processing of securities transactions; custody of client securities; receipt, identification, and delivery of funds and securities; compliance with regulatory and legal requirements; internal financial accounting and controls; and general administration and acquisition charges.

Information concerning operations in these segments of business for the three and nine months ended September 30, 2018 and 2017 is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
Net revenues: ⁽¹⁾				
Global Wealth Management	\$498,161	\$453,558	\$1,481,063	\$1,348,280
Institutional Group	245,952	264,747	768,855	778,367
Other	(5,771)	2,864	(18,486)	(4,300)
	\$738,342	\$721,169	\$2,231,432	\$2,122,347
Income/(loss) before income taxes:				
Global Wealth Management	\$183,377	\$161,756	\$548,043	\$457,045
Institutional Group	34,305	51,717	114,899	144,481
Other	(77,152)	(105,334)	(284,511)	(331,170)
	\$140,530	\$108,139	\$378,431	\$270,356

⁽¹⁾No individual client accounted for more than 10 percent of total net revenues for the three and nine months ended September 30, 2018 or 2017.

The following table presents our company's total assets on a segment basis at September 30, 2018 and December 31, 2017 (in thousands):

	September	December
	30, 2018	31, 2017
Global Wealth Management	\$19,874,154	\$17,717,617
Institutional Group	3,511,720	3,313,304
Other	374,174	353,032
	\$23,760,048	\$21,383,953

We have operations in the United States, United Kingdom, Europe, and Asia. The Company's foreign operations are conducted through its wholly owned subsidiary, SNEL. Substantially all long-lived assets are located in the United

States.

Revenues, classified by the major geographic areas in which they are earned for the three and nine months ended September 30, 2018 and 2017, were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
United States	\$703,746	\$680,505	\$2,113,039	\$2,017,999
United Kingdom	32,623	38,103	109,482	95,393
Other	1,973	2,561	8,911	8,955
	\$738,342	\$721,169	\$2,231,432	\$2,122,347

NOTE 22 – Earnings Per Share (“EPS”)

Basic EPS is computed by dividing earnings available to common shareholders by the weighted-average number of common shares outstanding. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were

exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Diluted earnings per share include dilutive stock options and stock units under the treasury stock method.

The following table sets forth the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2018 and 2017 (in thousands, except per share data):

	Three Months		Nine Months Ended	
	Ended September 30, 2018	2017	September 30, 2018	2017
Net income	\$103,858	\$66,536	\$279,906	\$184,859
Preferred dividends	2,343	2,343	7,031	7,031
Net income available to common shareholders	\$101,515	\$64,193	\$272,875	\$177,828
Shares for basic and diluted calculation:				
Average shares used in basic computation	71,919	68,522	71,824	68,488
Dilutive effect of stock options and units ⁽¹⁾	9,565	12,359	9,601	12,074
Average shares used in diluted computation	81,484	80,881	81,425	80,562
Earnings per common share:				
Basic	\$1.41	\$0.94	\$3.80	\$2.60
Diluted	\$1.25	\$0.79	\$3.35	\$2.21

⁽¹⁾Diluted earnings per share is computed on the basis of the weighted-average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. For the three and nine months ended September 30, 2018 and 2017, the anti-dilutive effect from restricted stock units was immaterial.

Cash Dividends

During the three and nine months ended September 30, 2018, we declared and paid cash dividends of \$0.12 and \$0.36 per common share. During the three and nine months ended September 30, 2017, we declared and paid cash dividends of \$0.10 per common share.

NOTE 23 – Shareholders' Equity

Share Repurchase Program

We have an ongoing authorization from the Board of Directors to repurchase our common stock in the open market or in negotiated transactions. At September 30, 2018, the maximum number of shares that may yet be purchased under this plan was 6.0 million. The repurchase program has no expiration date. These purchases may be made on the open market or in privately negotiated transactions, depending upon market conditions and other factors. Repurchased shares may be used to meet obligations under our employee benefit plans and for general corporate purposes. During the three months ended September 30, 2018, we repurchased \$16.6 million, or 0.3 million shares using existing Board

authorizations at an average price of \$53.93 per share to meet obligations under our company's employee benefit plans and for general corporate purposes. During the nine months ended September 30, 2018, we repurchased \$62.5 million, or 1.1 million shares using existing Board authorizations at an average price of \$55.66 per share to meet obligations under our company's employee benefit plans and for general corporate purposes. There were no share repurchases during the three months ended September 30, 2017. During the nine months ended September 30, 2017, we repurchased \$13.0 million, or 0.3 million shares using existing Board authorizations at an average price of \$43.83 per share to meet obligations under our company's employee benefit plans and for general corporate purposes.

Issuance of Common Stock

On August 31, 2018, we issued approximately 2.0 million shares for acquisition of Business Bancshares, Inc.

During the nine months ended September 30, 2018, we issued 4.8 million shares, of which 1.1 million shares were reissued from treasury. Share issuances were primarily a result of the acquisition of Business Bancshares, Inc. and the vesting and exercise transactions under our incentive stock award plans.

NOTE 24 – Variable Interest Entities

Our company's involvement with VIEs is limited to entities used as investment vehicles and private equity funds, the establishment of Stifel Financial Capital Trusts, and our issuance of a convertible promissory note.

We have formed several non-consolidated investment funds with third-party investors that are typically organized as limited liability companies (“LLCs”) or limited partnerships. These partnerships and LLCs have assets of \$233.4 million at September 30, 2018. For those funds where we act as the general partner, our company’s economic interest is generally limited to management fee arrangements as stipulated by the fund operating agreements. We have generally provided the third-party investors with rights to terminate the funds or to remove us as the general partner. Management fee revenue earned by our company was insignificant during the three and nine months ended September 30, 2018 and 2017. In addition, our direct investment interest in these entities is insignificant at September 30, 2018 and December 31, 2017.

Thomas Weisel Capital Management LLC, a subsidiary of our company, acts as the general partner of a series of investment funds in venture capital and fund of funds and manages investment funds that are active buyers of secondary interests in private equity funds, as well as portfolios of direct interests in venture-backed companies. These partnerships have combined assets of \$285.5 million at September 30, 2018. We hold variable interests in these funds as a result of our company’s rights to receive management fees. Our company’s investment in and additional capital commitments to the private equity funds are also considered variable interests. The additional capital commitments are subject to call at a later date and are limited in amount. Our exposure to loss is limited to our investments in, advances and commitments to, and receivables due from these funds, and that exposure is insignificant at September 30, 2018. Management fee revenue earned by our company was insignificant during the three and nine months ended September 30, 2018 and 2017.

For the entities noted above that were determined to be VIEs, we have concluded that we are not the primary beneficiary, and therefore, we are not required to consolidate these entities. Additionally, for certain other entities, we reviewed other relevant accounting guidance, which states the general partner in a limited partnership is presumed to control that limited partnership. The presumption may be overcome if the limited partners have either: (1) the substantive ability to dissolve the limited partnership or otherwise remove the general partner without cause, or (2) substantive participating rights, which provide the limited partners with the ability to effectively participate in significant decisions that would be expected to be made in the ordinary course of the limited partnership’s business and thereby preclude the general partner from exercising unilateral control over the partnership. If the criteria are not met, the consolidation of the partnership or limited liability company is required. Based on our evaluation of these entities, we determined that these entities do not require consolidation.

Debenture to Stifel Financial Capital Trusts

We have completed private placements of cumulative trust preferred securities through Stifel Financial Capital Trust II, Stifel Financial Capital Trust III, and Stifel Financial Capital Trust IV (collectively, the “Trusts”). The Trusts are non-consolidated wholly owned business trust subsidiaries of our company and were established for the limited purpose of issuing trust securities to third parties and lending the proceeds to our company.

The trust preferred securities represent an indirect interest in junior subordinated debentures purchased from our company by the Trusts, and we effectively provide for the full and unconditional guarantee of the securities issued by the Trusts. We make timely payments of interest to the Trusts as required by contractual obligations, which are sufficient to cover payments due on the securities issued by the Trusts, and believe that it is unlikely that any circumstances would occur that would make it necessary for our company to make payments related to these Trusts other than those required under the terms of the debenture agreements and the trust preferred securities agreements. The Trusts were determined to be VIEs because the holders of the equity investment at risk do not have adequate decision-making ability over the Trust’s activities. Our investment in the Trusts is not a variable interest, because equity interests are variable interests only to the extent that the investment is considered to be at risk. Because our investment was funded by the Trusts, it is not considered to be at risk.

NOTE 25 – Subsequent Events

We evaluate subsequent events that have occurred after the balance sheet date but before the financial statements are issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) non-recognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Based on the evaluation, we did not identify any recognized subsequent events that would have required adjustment to the consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of the financial condition and results of operations of our company should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017, and the accompanying consolidated financial statements and notes thereto contained in this Quarterly Report on Form 10-Q.

Certain statements in this report may be considered forward-looking. Statements that are not historical or current facts, including statements about beliefs and expectations, are forward-looking statements. These forward-looking statements cover, among other things, statements made about general economic and market conditions, the investment banking industry, our objectives and results, and also may include our belief regarding the effect of various legal proceedings, management expectations, our liquidity and funding sources, counterparty credit risk, or other similar matters. Forward-looking statements involve inherent risks and uncertainties, and important factors could cause actual results to differ materially from those anticipated, including those factors discussed below under "External Factors Impacting Our Business" as well as the factors identified under "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017, as updated in our subsequent reports filed with the SEC. These reports are available at our web site at www.stifel.com and at the SEC web site at www.sec.gov.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. In addition, our past results of operations do not necessarily indicate our future results. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update them in light of new information or future events, unless we are obligated to do so under federal securities laws.

Unless otherwise indicated, the terms "we," "us," "our" or "our company" in this report refer to Stifel Financial Corp. and its wholly owned subsidiaries.

Executive Summary

We operate as a financial services and bank holding company. We have built a diversified business serving private clients, institutional investors, and investment banking clients located across the United States and in Europe. Our principal activities are: (i) private client services, including securities transaction and financial planning services; (ii) institutional equity and fixed income sales, trading and research, and municipal finance; (iii) investment banking services, including mergers and acquisitions, public offerings, and private placements; and (iv) retail and commercial banking, including personal and commercial lending programs. 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.

Our core philosophy is based upon a tradition of trust, understanding, and studied advice. We attract and retain experienced professionals by fostering a culture of entrepreneurial, long-term thinking. We provide our private, institutional and corporate clients quality, personalized service, with the theory that if we place clients' needs first, both our clients and our company will prosper. Our unwavering client and employee focus have earned us a reputation as one of the leading brokerage and investment banking firms off Wall Street. We have grown our business both organically and through opportunistic acquisitions.

We plan to maintain our focus on revenue growth with a continued appreciation for the development of quality client relationships. Within our private client business, our efforts will be focused on recruiting experienced financial advisors with established client relationships. Within our capital markets business, our focus continues to be on

providing quality client management and product diversification. In executing our growth strategy, we will continue to seek out opportunities that allow us to take advantage of the consolidation among middle-market firms, whereby allowing us to increase market share in our Global Wealth Management and Institutional Group businesses.

Our ability to attract and retain highly skilled and productive employees is critical to the success of our business. Accordingly, compensation and benefits comprise the largest component of our expenses, and our performance is dependent upon our ability to attract, develop and retain highly skilled employees who are motivated and committed to providing the highest quality of service and guidance to our clients.

On March 19, 2018, the Company completed the acquisition of Ziegler Wealth Management (“Ziegler”), a privately held investment bank, capital markets and proprietary investments firm that has 55 private client advisors in five states that manage approximately \$5 billion in client assets. Ziegler provides its clients with capital raising, strategic advisory services, equity and fixed income sales & trading and research. The acquisition was funded with cash from operations.

On August 31, 2018, the Company completed the acquisition of Business Bancshares, Inc. (“BBI”) and its wholly owned subsidiary, The Business Bank of St. Louis, a full-service banking facility with approximately \$600.0 million in assets that operates from a single location. Upon the closing of the transaction, the Business Bank of St. Louis was renamed “Stifel Bank” and Business Bancshares, Inc. was renamed “Stifel Bancorp, Inc.” Stifel Bancorp, Inc. (“Stifel Bancorp”) is the holding company for Stifel Bank & Trust, and its wholly owned subsidiaries, and Stifel Bank. Under the terms of the merger agreement, each outstanding share of BBI common stock (except for shares of BBI common stock held by BBI as treasury stock) were converted into the right to receive 0.705 shares of our company’s common stock, with fractional shares settled with cash. We issued approximately 2.0 million shares for acquisition of BBI.

Results for the three and nine months ended September 30, 2018

For the three months ended September 30, 2018, net revenues increased 2.4% to \$738.3 million from \$721.2 million during the comparable period in 2017. Net income available to common shareholders increased 58.1% to a record \$101.5 million, or \$1.25 per diluted common share for the three months ended September 30, 2018, compared to \$64.2 million, or \$0.79 per diluted common share during the comparable period in 2017.

For the nine months ended September 30, 2018, net revenues increased 5.1% to \$2.2 billion compared to \$2.1 billion during the comparable period in 2017. Net income available to common shareholders increased 53.4% to \$272.9 million, or \$3.35 per diluted common share for the nine months ended September 30, 2018, compared to \$177.8 million, or \$2.21 per diluted common share during the comparable period in 2017.

Our revenue growth for the three months ended September 30, 2018 was primarily attributable to higher net interest income as a result of an increase in interest-earning assets at Stifel Bancorp; the growth in asset management and service fees as a result of increased assets under management; and an increase in capital raising revenue; partially offset by a decrease in advisory fees and lower brokerage revenues.

Our revenue growth for the nine months ended September 30, 2018 was primarily attributable to the growth in asset management and service fees as a result of increased assets under management; higher net interest income as a result of an increase in interest-earning assets at Stifel Bancorp and an increase in advisory fees; partially offset by a decrease in brokerage revenues and capital raising revenues.

External Factors Impacting our Business

Performance in the financial services industry in which we operate is highly correlated to the overall strength of economic conditions and financial market activity. Overall market conditions are a product of many factors, which are beyond our control and mostly unpredictable. These factors may affect the financial decisions made by investors, including their level of participation in the financial markets. In turn, these decisions may affect our business results. With respect to financial market activity, our profitability is sensitive to a variety of factors, including the demand for investment banking services as reflected by the number and size of equity and debt financings and merger and acquisition transactions, the volatility of the equity and fixed income markets, the level and shape of various yield curves, the volume and value of trading in securities, and the value of our customers’ assets under management. The municipal underwriting market is challenging as state and local governments reduce their debt levels. Investors are showing a lack of demand for longer-dated municipals and are reluctant to take on credit or liquidity risks.

Our overall financial results continue to be highly and directly correlated to the direction and activity levels of the United States equity and fixed income markets. At September 30, 2018, the Dow Jones Industrial Average, NASDAQ, and S&P 500 closed 7.0%, 16.6% and 9.0% higher than their December 31, 2017 closing prices, respectively.

As a participant in the financial services industry, we are subject to complicated and extensive regulation of our business. The recent economic and political environment has led to legislative and regulatory initiatives, both enacted and proposed, that could substantially intensify the regulation of the financial services industry and may significantly impact us.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2018 Compared with Three Months Ended September 30, 2017

The following table presents consolidated financial information for the periods indicated (in thousands, except percentages):

	Three Months Ended September 30,			As a Percentage of Net Revenues For the Three Months Ended September 30,	
	2018	2017	Change %	2018	2017
Revenues:					
Commissions	\$158,016	\$162,612	(2.8)	21.4 %	22.5 %
Principal transactions	83,152	87,010	(4.4)	11.3	12.1
Brokerage revenues	241,168	249,622	(3.4)	32.7	34.6
Investment banking	169,012	181,904	(7.1)	22.9	25.2
Asset management and service fees	200,743	179,848	11.6	27.2	24.9
Interest	169,760	117,862	44.0	23.0	16.3
Other income	6,127	9,558	(35.9)	0.8	1.4
Total revenues	786,810	738,794	6.5	106.6	102.4
Interest expense	48,468	17,625	175.0	6.6	2.4
Net revenues	738,342	721,169	2.4	100.0	100.0
Non-interest expenses:					
Compensation and benefits	422,324	448,410	(5.8)	57.2	62.2
Occupancy and equipment rental	54,035	57,427	(5.9)	7.3	8.0
Communication and office supplies	33,330	34,650	(3.8)	4.5	4.8
Commissions and floor brokerage	11,338	11,232	0.9	1.5	1.6
Other operating expenses	76,785	61,311	25.2	10.5	8.4
Total non-interest expenses	597,812	613,030	(2.5)	81.0	85.0
Income before income taxes	140,530	108,139	30.0	19.0	15.0
Provision for income taxes	36,672	41,603	(11.9)	5.0	5.8
Net Income	103,858	66,536	56.1	14.0	9.2
Preferred dividends	2,343	2,343	—	0.3	0.3
Net income available to common shareholders	\$101,515	\$64,193	58.1	13.7 %	8.9 %

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Nine months Ended September 30, 2018 Compared with Nine months Ended September 30, 2017

The following table presents consolidated financial information for the periods indicated (in thousands, except percentages):

	Nine Months Ended September 30,			As a Percentage of Net Revenues For the Nine Months Ended September 30,	
	2018	2017	Change	2018	2017
			%	%	%
Revenues:					
Commissions	\$490,693	\$510,150	(3.8)	22.0 %	24.0 %
Principal transactions	269,918	299,570	(9.9)	12.1	14.2
Brokerage revenues	760,611	809,720	(6.1)	34.1	38.2
Investment banking	506,437	494,017	2.5	22.7	23.3
Asset management and service fees	596,112	515,501	15.6	26.7	24.3
Interest	461,915	327,766	40.9	20.7	15.4
Other income	18,557	25,508	(27.3)	0.8	1.2
Total revenues	2,343,632	2,172,512	7.9	105.0	102.4
Interest expense	112,200	50,165	123.7	5.0	2.4
Net revenues	2,231,432	2,122,347	5.1	100.0	100.0
Non-interest expenses:					
Compensation and benefits	1,322,387	1,338,673	(1.2)	59.3	63.1
Occupancy and equipment rental	165,226	167,864	(1.6)	7.4	7.9
Communication and office supplies	103,468	102,686	0.8	4.6	4.8
Commissions and floor brokerage	30,798	33,187	(7.2)	1.4	1.6
Other operating expenses	231,122	209,581	10.3	10.4	9.9
Total non-interest expenses	1,853,001	1,851,991	0.1	83.1	87.3
Income before income taxes	378,431	270,356	40.0	16.9	12.7
Provision for income taxes	98,525	85,497	15.2	4.4	4.0
Net Income	279,906	184,859	51.4	12.5	8.7
Preferred dividends	7,031	7,031	—	0.3	0.3
Net income available to common shareholders	\$272,875	\$177,828	53.4	12.2 %	8.4 %

NET REVENUES

The following table presents consolidated net revenues for the periods indicated (in thousands, except percentages):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
			%	%	%	%
Net revenues:						
Commissions	\$158,016	\$162,612	(2.8)	\$490,693	\$510,150	(3.8)
Principal transactions	83,152	87,010	(4.4)	269,918	299,570	(9.9)

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Brokerage revenues	241,168	249,622	(3.4)	760,611	809,720	(6.1)
Capital raising	93,295	79,922	16.7	246,044	256,638	(4.1)
Advisory fees	75,717	101,982	(25.8)	260,393	237,379	9.7
Investment banking	169,012	181,904	(7.1)	506,437	494,017	2.5
Asset management and service fees	200,743	179,848	11.6	596,112	515,501	15.6
Net interest	121,292	100,237	21.0	349,715	277,601	26.0
Other income	6,127	9,558	(35.9)	18,557	25,508	(27.3)
Total net revenues	\$738,342	\$721,169	2.4	\$2,231,432	\$2,122,347	5.1

Commissions – Commission revenues are primarily generated from agency transactions in OTC and listed equity securities, insurance products and options. In addition, commission revenues also include distribution fees for promoting and distributing mutual funds.

For the three months ended September 30, 2018, commission revenues decreased 2.8% to \$158.0 million from \$162.6 million in the comparable period in 2017. For the nine months ended September 30, 2018, commission revenues decreased 3.8% to \$490.7 million from \$510.2 million in the comparable period in 2017. The decrease is primarily attributable to a decrease in trading volumes from the comparable periods in 2017.

Principal transactions – Principal transaction revenues are gains and losses on secondary trading, principally fixed income brokerage revenues.

For the three months ended September 30, 2018, principal transactions revenues decreased 4.4% to \$83.2 million from \$87.0 million in the comparable period in 2017. For the nine months ended September 30, 2018, principal transactions revenues decreased 9.9% to \$269.9 million from \$299.6 million in the comparable period in 2017. The decrease is primarily attributable to lower institutional fixed income brokerage revenues, as the industry continues to face systematic issues, including the impact of passive investing and the increase in electronic trading.

Investment banking – Investment banking revenues include: (i) capital raising revenues representing fees earned from the underwriting of debt and equity securities, and (ii) advisory fees related to corporate debt and equity offerings, municipal debt offerings, merger and acquisitions, private placements and other investment banking advisory fees. Investment banking revenues were positively impacted by the adoption of the new revenue recognition standard in 2018 that requires gross presentation of certain costs that were previously offset against investment banking revenues.

For the three months ended September 30, 2018, investment banking revenues decreased 7.1% to \$169.0 million from \$181.9 million in the comparable period in 2017.

Capital raising revenues increased 16.7% to \$93.3 million for the three months ended September 30, 2018 from \$79.9 million in the comparable period in 2017. For the three months ended September 30, 2018, equity capital raising revenues increased 60.0% to \$66.5 million from \$41.6 million in the comparable period in 2017. For the three months ended September 30, 2018, fixed income capital raising revenues decreased 30.2% to \$26.8 million from \$38.3 million in the comparable period in 2017.

Advisory fee revenues decreased 25.8% to \$75.7 million for the three months ended September 30, 2018 from \$102.0 million in the comparable period in 2017.

For the nine months ended September 30, 2018, investment banking revenues increased 2.5% to \$506.4 million from \$494.0 million in the comparable period in 2017.

Capital raising revenues decreased 4.1% to \$246.0 million for the nine months ended September 30, 2018 from \$256.6 million in the comparable period in 2017. For the nine months ended September 30, 2018, equity capital raising revenues increased 19.9% to \$172.8 million from \$144.2 million in the comparable period in 2017. For the nine months ended September 30, 2018, fixed income capital raising revenues decreased 34.9% to \$73.2 million from \$112.4 million in the comparable period in 2017.

Advisory fee revenues increased 9.7% to \$260.4 million for the nine months ended September 30, 2018 from \$237.4 million in the comparable period in 2017. The increase is primarily attributable to an increase in the number of advisory transactions over the comparable period in 2017, including growth in our fund placement business.

Asset management and service fees – Asset management and service fees include fees for asset-based financial services provided to individuals and institutional clients. Investment advisory fees are charged based on the value of assets in fee-based accounts. Asset management and service fees are affected by changes in the balances of client assets due to market fluctuations and levels of net new client assets.

For the three months ended September 30, 2018, asset management and service fee revenues increased 11.6% to \$200.7 million from \$179.8 million in the comparable period in 2017. For the nine months ended September 30, 2018, asset management and service fee revenues increased 15.6% to \$596.1 million from \$515.5 million in the comparable period in 2017. The increase is primarily a result of an increase in the number of fee-based accounts, an increase in

fees earned on client cash balances, and an increase of interest rates on fees earned on client cash over the comparable periods in 2017. See “Asset management and service fees” in the Global Wealth Management segment discussion for information on the changes in asset management and service fees revenues.

Other income – For the three months ended September 30, 2018, other income decreased 35.9% to \$6.1 million from \$9.6 million during the comparable period in 2017. For the nine months ended September 30, 2018, other income decreased 27.3% to \$18.6 million from \$25.5 million during the comparable period in 2017. Other income primarily includes investment gains and losses and loan origination fees. The decrease is primarily attributable to an increase in investment losses over the comparable periods in 2017.

NET INTEREST INCOME

The following tables present average balance data and operating interest revenue and expense data, as well as related interest yields for the periods indicated (in thousands, except rates):

	Three Months Ended			September 30, 2017			
	September 30, 2018			September 30, 2017			
	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate	
Interest-earning assets:							
Interest-bearing cash and federal funds sold							
	\$387,771	\$2,275	2.35 %	\$775,156	\$2,090	1.08 %	
Financial instruments owned	1,171,440	5,733	1.96 %	1,569,744	4,371	1.11 %	
Margin balances	1,323,964	13,066	3.95 %	1,240,582	9,919	3.20 %	
Investment portfolio	8,004,215	66,825	3.34 %	6,920,316	48,072	2.78 %	
Loans	8,111,469	78,766	3.88 %	6,610,602	54,006	3.27 %	
Other interest-bearing assets	747,427	3,095	1.66 %	667,064	(596)	(0.36 %)	
Total interest-earning assets/interest income	\$19,746,286	\$169,760	3.44 %	\$17,783,464	\$117,862	2.65 %	
Interest-bearing liabilities:							
Short-term borrowings							
	\$35,251	\$255	2.89 %	\$128,821	\$683	2.12 %	
Stock loan	497,081	2,022	1.63 %	365,932	801	0.88 %	
Senior notes (Stifel Financial)	1,015,714	11,248	4.43 %	800,000	8,655	4.33 %	
Stifel Capital Trusts	67,500	715	4.24 %	67,500	504	2.99 %	
Deposits	14,003,177	25,856	0.74 %	12,405,791	4,770	0.15 %	
FHLB	1,028,789	4,232	1.65 %	796,033	1,255	0.63 %	
Other interest-bearing liabilities	1,027,141	4,140	1.61 %	936,247	957	0.41 %	
Total interest-bearing liabilities/interest expense	\$17,674,653	48,468	1.10 %	\$15,500,324	17,625	0.45 %	
Net interest income/margin		\$121,292	2.46 %		\$100,237	2.25 %	

	Nine Months Ended			September 30, 2017			
	September 30, 2018			September 30, 2017			
	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate	
Interest-earning assets:							
Interest-bearing cash and federal funds sold							
	\$391,421	\$5,807	1.98 %	\$683,042	\$4,186	0.82 %	
Financial instruments owned	1,181,295	15,645	1.77 %	1,175,800	12,953	1.47 %	
Margin balances	1,303,902	36,322	3.71 %	1,255,269	27,124	2.88 %	
Investment portfolio	7,751,000	185,263	3.19 %	6,597,177	136,123	2.75 %	
Loans	7,622,413	210,790	3.69 %	6,290,932	147,495	3.13 %	
Other interest-bearing assets	775,449	8,088	1.39 %	662,436	(115)	(0.02 %)	
	\$19,025,480	\$461,915	3.24 %	\$16,664,656	\$327,766	2.62 %	

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Total interest-earning assets/interest income								
Interest-bearing liabilities:								
Short-term borrowings	\$99,037	\$1,868	2.51	%	\$159,103	\$2,176	1.82	%
Stock loan	434,538	5,771	1.77	%	350,816	2,853	1.08	%
Senior notes (Stifel Financial)	1,015,714	33,488	4.40	%	800,000	24,935	4.16	%
Stifel Capital Trusts	67,500	2,014	3.98	%	67,500	1,473	2.91	%
Deposits	13,529,200	49,329	0.49	%	11,810,425	8,424	0.10	%
FHLB	925,075	10,579	1.52	%	773,648	5,771	0.99	%
Other interest-bearing liabilities	1,010,782	9,151	1.21	%	1,022,891	4,533	0.59	%
Total interest-bearing liabilities/interest expense	\$17,081,846	112,200	0.88	%	\$14,984,383	50,165	0.45	%
Net interest income/margin		\$349,715	2.45	%		\$277,601	2.22	%

53

Net interest income – Net interest income is the difference between interest earned on interest-earning assets and interest paid on funding sources. Net interest income is affected by changes in the volume and mix of these assets and liabilities, as well as by fluctuations in interest rates and portfolio management strategies. For the three months ended September 30, 2018, net interest income increased to \$121.3 million from \$100.2 million during the comparable period in 2017. For the nine months ended September 30, 2018, net interest income increased to \$349.7 million from \$277.6 million during the comparable period in 2017.

For the three months ended September 30, 2018, interest revenue increased 44.0% to \$169.8 million from \$117.9 million in the comparable period in 2017, principally as a result of an increase in interest revenue generated from the interest-earning assets of Stifel Bancorp and higher margin interest income. The average interest-earning assets of Stifel Bancorp increased to \$16.2 billion during the three months ended September 30, 2018 compared to \$13.9 billion during the comparable period in 2017 at average interest rates of 3.61% and 2.98%, respectively.

For the nine months ended September 30, 2018, interest revenue increased 40.9% to \$461.9 million from \$327.8 million in the comparable period in 2017, principally as a result of an increase in interest revenue generated from the interest-earning assets of Stifel Bancorp and higher margin interest income. The average interest-earning assets of Stifel Bancorp increased to \$15.5 billion during the nine months ended September 30, 2018 compared to \$13.2 billion during the comparable period in 2017 at average interest rates of 3.43% and 2.89%, respectively.

For the three months ended September 30, 2018, interest expense increased 175.0% to \$48.5 million from \$17.6 million during the comparable period in 2017. For the nine months ended September 30, 2018, interest expense increased 123.7% to \$112.2 million from \$50.2 million in the comparable period in 2017. The increase is primarily attributable to an increase in interest-bearing liabilities at Stifel Bancorp (deposits and FHLB advances) and the issuance of 5.20% senior notes in October 2017.

NON-INTEREST EXPENSES

The following table presents consolidated non-interest expenses for the periods indicated (in thousands, except percentages):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	% Change	2018	2017	% Change
Non-interest expenses:						
Compensation and benefits	\$422,324	\$448,410	(5.8)	\$1,322,387	\$1,338,673	(1.2)
Occupancy and equipment rental	54,035	57,427	(5.9)	165,226	167,864	(1.6)
Communications and office supplies	33,330	34,650	(3.8)	103,468	102,686	0.8
Commissions and floor brokerage	11,338	11,232	0.9	30,798	33,187	(7.2)
Other operating expenses	76,785	61,311	25.2	231,122	209,581	10.3
Total non-interest expenses	\$597,812	\$613,030	(2.5)	\$1,853,001	\$1,851,991	0.1

Compensation and benefits – Compensation and benefits expenses, which are the largest component of our expenses, include salaries, bonuses, transition pay, benefits, amortization of stock-based compensation, employment taxes and other employee-related costs. A significant portion of compensation expense is comprised of production-based variable compensation, including discretionary bonuses, which fluctuates in proportion to the level of business activity, increasing with higher revenues and operating profits. Other compensation costs, including base salaries, stock-based compensation amortization, and benefits, are more fixed in nature.

For the three months ended September 30, 2018, compensation and benefits expense decreased 5.8% to \$422.3 million from \$448.4 million during the comparable period in 2017. For the nine months ended September 30, 2018, compensation and benefits expense decreased 1.2% to \$1.32 billion from \$1.34 billion during the comparable period in 2017.

Compensation and benefits expense as a percentage of net revenues was 57.2% and 59.3% for the three and nine months ended September 30, 2018, respectively, compared to 62.2% and 63.1% for the three and nine months ended September 30, 2017, respectively. The decrease is primarily attributable to growth of our higher margin businesses and the acceleration of compensation expense in the prior year related to actions taken in response to US Tax Reform.

Occupancy and equipment rental – For the three months ended September 30, 2018, occupancy and equipment rental expense decreased 5.9% to \$54.0 million from \$57.4 million during the comparable period in 2017. For the nine months ended September 30, 2018, occupancy and equipment rental expense decreased 1.6% to \$165.2 million from \$167.9 million during the comparable period in 2017.

Communications and office supplies – Communications expense includes costs for telecommunication and data communication, primarily for obtaining third-party market data information. For the three months ended September 30, 2018, communications and office supplies expense decreased 3.8% to \$33.3 million from \$34.7 million during the comparable period in 2017. For the nine months ended September 30, 2018, communications and office supplies expense increased 0.8% to \$103.5 million from \$102.7 million during the comparable period in 2017. The increase is primarily attributable to an increase in communication and quote and office supplies.

Commissions and floor brokerage – For the three months ended September 30, 2018, commissions and floor brokerage expense increased 0.9% to \$11.3 million from \$11.2 million during the comparable period in 2017. For the nine months ended September 30, 2018, commissions and floor brokerage expense decreased 7.2% to \$30.8 million from \$33.2 million during the comparable period in 2017. The decrease is primarily attributable to a decrease in trading volumes.

Other operating expenses – Other operating expenses primarily include license and registration fees, litigation-related expenses, which consist of amounts we reserve and/or pay out related to legal and regulatory matters, travel and entertainment, promotional expenses and expenses for professional services.

For the three months ended September 30, 2018, other operating expenses increased 25.2% to \$76.8 million from \$61.3 million during the comparable period in 2017. The increase is primarily attributable to the adoption of the new revenue standard that requires gross presentation of certain costs that were previously offset against revenue that added approximately \$9.7 million to other operating expenses for during three months ended September 30, 2018; and an increase in professional fees, subscriptions, and advertising expense, partially offset by a decrease in the provision for loan losses and FDIC insurance.

For the nine months ended September 30, 2018, other operating expenses increased 10.3% to \$231.1 million from \$209.6 million during the comparable period in 2017. The increase is primarily attributable to the adoption of the new revenue recognition standard that requires gross presentation of certain costs that were previously offset against revenue that added \$25.9 million to other operating expenses for the nine months ended September 30, 2018; and an increase in professional fees, travel costs, subscriptions, and advertising expense, partially offset by a decrease in the provision for loan losses and FDIC insurance.

Provision for income taxes – For the three and nine months ended September 30, 2018, our provision for income taxes was \$36.7 million and \$98.5 million, representing an effective tax rate of 26.1% and 26.0%, respectively, compared to \$41.6 million and \$85.5 million for the comparable periods in 2017, representing an effective tax rate of 38.5% and 31.6%, respectively. The provision for income taxes for the three and nine months ended September 30, 2018 was primarily impacted by the tax reform enacted in the fourth quarter of 2017 that, among other things, lowered the federal corporate income tax rate from 35% to 21%.

SEGMENT ANALYSIS

Our reportable segments include Global Wealth Management, Institutional Group, and Other.

Our Global Wealth Management segment consists of two businesses, the Private Client Group and Stifel Bancorp, Inc. The Private Client Group includes branch offices and independent contractor offices of our broker-dealer subsidiaries located throughout the United States. These branches provide securities brokerage services, including the sale of equities, mutual funds, fixed income products, and insurance, as well as offering banking products to their private clients through our bank subsidiaries, which provide residential, consumer, and commercial lending, as well as Federal Depository Insurance Corporation (“FDIC”)-insured deposit accounts to customers of our broker-dealer subsidiaries and to the general public.

The Institutional Group segment includes institutional sales and trading. It provides securities brokerage, trading, and research services to institutions with an emphasis on the sale of equity and fixed income products. This segment also includes the management of and participation in underwritings for both corporate and public finance (exclusive of sales credits generated through the private client group, which are included in the Global Wealth Management segment), merger and acquisition, and financial advisory services.

The Other segment includes interest income from stock borrow activities, unallocated interest expense, interest income and gains and losses from investments held, amortization of stock-based awards, and all unallocated overhead cost associated with the execution of orders; processing of securities transactions; custody of client securities; receipt, identification, and delivery of funds and securities; compliance with regulatory and legal requirements; internal financial accounting and controls; and general administration and acquisition charges.

We evaluate the performance of our segments and allocate resources to them based on various factors, including prospects for growth, return on investment, and return on revenues.

Results of Operations – Global Wealth Management

Three Months Ended September 30, 2018 Compared with Three Months Ended September 30, 2017

The following table presents consolidated financial information for the Global Wealth Management segment for the periods indicated (in thousands, except percentages):

	Three Months Ended September 30,			As a Percentage of Net Revenues For the Three Months Ended September 30,	
	2018	2017	Change %	2018	2017
Revenues:					
Commissions	\$ 117,795	\$ 115,410	2.1	23.6 %	25.4 %
Principal transactions	41,023	42,924	(4.4)	8.3	9.5
Brokerage revenues	158,818	158,334	0.3	31.9	34.9
Asset management and service fees	200,735	179,830	11.6	40.3	39.6
Investment banking	7,722	9,072	(14.9)	1.6	2.0
Interest	161,133	116,014	38.9	32.3	25.6
Other income	3,545	3,491	1.5	0.7	0.8
Total revenues	531,953	466,741	14.0	106.8	102.9
Interest expense	33,792	13,183	156.3	6.8	2.9
Net revenues	498,161	453,558	9.8	100.0	100.0
Non-interest expenses:					
Compensation and benefits	241,713	222,621	8.6	48.5	49.1
Occupancy and equipment rental	26,428	24,770	6.7	5.3	5.5
Communication and office supplies	14,593	13,876	5.2	2.9	3.1
Commissions and floor brokerage	4,884	4,978	(1.9)	1.0	1.1
Other operating expenses	27,166	25,557	6.3	5.5	5.5
Total non-interest expenses	314,784	291,802	7.9	63.2	64.3
Income before income taxes	\$ 183,377	\$ 161,756	13.4	36.8 %	35.7 %

	September 30,	
	2018	2017
Branch offices (actual)	368	356
Financial advisors (actual)	2,194	2,136
Independent contractors (actual)	104	116

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Nine months Ended September 30, 2018 Compared with Nine months Ended September 30, 2017

The following table presents consolidated financial information for the Global Wealth Management segment for the periods indicated (in thousands, except percentages):

	Nine Months Ended September 30,			As a Percentage of Net Revenues For the Nine Months Ended September 30,	
	2018	2017	Change	2018	2017
Revenues:					
Commissions	\$355,129	\$356,331	(0.3)	24.0 %	26.4 %
Principal transactions	125,713	141,582	(11.2)	8.5	10.5
Brokerage revenues	480,842	497,913	(3.4)	32.5	36.9
Asset management and service fees	596,081	515,383	15.7	40.2	38.2
Investment banking	23,459	31,567	(25.7)	1.6	2.3
Interest	440,252	321,152	37.1	29.7	23.8
Other income	9,898	15,193	(34.9)	0.7	1.2
Total revenues	1,550,532	1,381,208	12.3	104.7	102.4
Interest expense	69,469	32,928	111.0	4.7	2.4
Net revenues	1,481,063	1,348,280	9.8	100.0	100.0
Non-interest expenses:					
Compensation and benefits	721,352	680,250	6.0	48.7	50.5
Occupancy and equipment rental	78,082	76,396	2.2	5.3	5.7
Communication and office supplies	46,315	42,113	10.0	3.1	3.1
Commissions and floor brokerage	13,797	14,857	(7.1)	0.9	1.1
Other operating expenses	73,474	77,619	(5.3)	5.0	5.7
Total non-interest expenses	933,020	891,235	4.7	63.0	66.1
Income before income taxes	\$548,043	\$457,045	19.9	37.0 %	33.9 %

NET REVENUES

For the three months ended September 30, 2018, Global Wealth Management net revenues increased 9.8% to a record \$498.2 million from \$453.6 million for the comparable period in 2017. For the nine months ended September 30, 2018, Global Wealth Management net revenues increased 9.8% to \$1.5 billion from \$1.3 billion for the comparable period in 2017. The increase in net revenues over the comparable periods in 2017 is primarily attributable to an increase in net interest income and growth in asset management and service fees; partially offset by a decrease in investment banking revenues. . Net revenues for the nine months ended September 30, 2018 have been negatively impacted by a decrease in brokerage revenues from the comparable period in 2017.

Commissions – For the three months ended September 30, 2018, commission revenues increased 2.1% to \$117.8 million from \$115.4 million in the comparable period in 2017. For the nine months ended September 30, 2018, commission revenues decreased 0.3% to \$355.1 million from \$356.3 million in the comparable period in 2017.

Principal transactions – For the three months ended September 30, 2018, principal transactions revenues decreased 4.4% to \$41.0 million from \$42.9 million in the comparable period in 2017. For the nine months ended September 30,

2018, principal transactions revenues decreased 11.2% to \$125.7 million from \$141.6 million in the comparable period in 2017.

Brokerage revenues - For the three months ended September 30, 2018, brokerage revenues increased 0.3% to \$158.8 million from \$158.3 million in the comparable period in 2017. For the nine months ended September 30, 2018, brokerage revenues decreased 3.4% to \$480.8 million from \$497.9 million in the comparable period in 2017. Brokerage revenues were impacted by continued migration of client activity from brokerage to asset management activities.

Asset management and service fees – For the three months ended September 30, 2018, asset management and service fees increased 11.6% to \$200.7 million from \$179.8 million in the comparable period in 2017. For the nine months ended September 30, 2018, asset management and service fees increased 15.7% to \$596.1 million from \$515.4 million in the comparable period in 2017. The increase is primarily a result of continued migration to fee-based accounts and our continued expansion in the asset management business.

Fee-based account revenues, which are included within asset management and service fee revenues, are primarily billed based on asset values at the beginning of the period. The value of assets in fee-based accounts including Asset Management at September 30, 2018 increased 15.7% to \$96.0 billion from \$83.0 billion at September 30, 2017.

Investment banking – Investment banking, which represents sales credits for investment banking underwritings, decreased 14.9% to \$7.7 million for the three months ended September 30, 2018 from \$9.1 million during the comparable period in 2017. For the nine months ended September 30, 2018, investment banking revenues decreased 25.7% to \$23.5 million from \$31.6 million during the comparable period in 2017. See “Investment banking” in the Institutional Group segment discussion for information on the changes in net revenues.

Interest revenue – For the three months ended September 30, 2018, interest revenue increased 38.9% to \$161.1 million from \$116.0 million in the comparable period in 2017. For the nine months ended September 30, 2018, interest revenue increased 37.1% to \$440.3 million from \$321.2 million during the comparable period in 2017. The increase is primarily due to a growth of interest-earning assets at Stifel Bancorp, and an increase in the weighted-average yield. See “Net Interest Income – Stifel Bancorp” below for a further discussion of the changes in net interest revenues.

Other income – For the three months ended September 30, 2018, other income of \$3.5 million was consistent with the comparable period in 2017. For the nine months ended September 30, 2018, other income decreased 34.9% to \$9.9 million from \$15.2 million during the comparable period in 2017.

Interest expense – For the three months ended September 30, 2018, interest expense increased 156.3% to \$33.8 million from \$13.2 million during the comparable period in 2017. For the nine months ended September 30, 2018, interest expense increased 111.0% to \$69.5 million from \$32.9 million during the comparable period in 2017. The increase in interest expense is primarily attributable to an increase in interest-earning liabilities at Stifel Bancorp from the comparable periods in 2017.

NET INTEREST INCOME – STIFEL BANCORP

The following tables present average balance data and operating interest revenue and expense data for Stifel Bancorp, as well as related interest yields for the periods indicated (in thousands, except rates):

	Three Months Ended September 30, 2018			Three Months Ended September 30, 2017		
	Average Balance	Interest Income/Expense	Average Interest Rate	Average Balance	Interest Income/Expense	Average Interest Rate
Assets:						
Interest-bearing cash and federal funds sold	\$29,383	\$151	2.06 %	\$296,358	\$916	1.24 %
U.S. government agencies	6,733	25	1.49	—	—	—
U.S. Treasuries	1,900	7	1.47	—	—	—
State and political subdivisions:						
Non-taxable ⁽¹⁾	73,226	364	1.99	74,974	431	2.30
Mortgage-backed securities	1,668,433	9,098	2.18	1,876,477	10,012	2.13
Corporate bonds	1,286,710	9,173	2.85	1,037,866	6,095	2.35
Asset-backed securities	4,967,213	48,158	3.88	3,930,999	31,534	3.21
Federal Home Loan Bank ("FHLB") and other capital stock	73,863	773	4.19	62,398	563	3.61
Loans ⁽²⁾						
Securities-based loans	1,848,213	18,202	3.94	1,740,510	13,466	3.09
Commercial and industrial	2,950,203	34,071	4.62	2,275,826	22,510	3.96
Residential real estate	2,753,661	19,812	2.88	2,296,033	15,244	2.66
Commercial real estate	192,355	2,395	4.98	72,422	735	4.06
Home equity lines of credit	24,118	290	4.81	14,709	151	4.11
Construction and land	64,200	857	5.34	17,516	177	4.04
Other	54,200	679	5.01	40,342	406	4.03
Loans held for sale	224,519	2,460	4.38	153,244	1,317	3.44
Total interest-earning assets ⁽³⁾	\$16,218,930	\$146,515	3.61 %	\$13,889,674	\$103,557	2.98 %
Cash and due from banks	14,944			11,958		
Other non interest-earning assets	144,687			304,732		
Total assets	\$16,378,561			\$14,206,364		
Liabilities and stockholder's equity:						
Deposits:						
Money market	\$11,980,962	\$15,877	0.53 %	\$12,182,061	\$4,683	0.15 %
Demand deposits	478,486	1,722	1.44	221,463	73	0.13
Time deposits	1,535,836	8,221	2.14	2,264	14	2.47
Savings	7,893	36	1.82	3	—	—
FHLB advances	1,028,789	4,232	1.65	796,033	1,255	0.63
Other borrowings	28,129	223	3.17	16,236	232	5.72
Total interest-bearing liabilities ⁽³⁾	15,060,095	30,311	0.81 %	13,218,060	6,257	0.19 %
Non-interest-bearing liabilities	79,424			15,120		
Other non-interest bearing liabilities	99,557			28,235		
Total liabilities	15,239,076			13,261,415		
Stockholder's equity	1,139,485			944,949		

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Total liabilities and stockholder's equity	\$16,378,561			\$14,206,364		
Net interest income/spread		\$116,204	2.80 %		\$97,300	2.79 %
Net interest margin			2.87 %			2.80 %

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

(2) Loans on non-accrual status are included in average balances.

(3) See Net Interest Income table included in "Results of Operations" for additional information on our company's average balances and operating interest and expenses.

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

The following tables present average balance data and operating interest revenue and expense data for Stifel Bancorp, as well as related interest yields for the periods indicated (in thousands, except rates):

	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017			
	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate	
Assets:							
Interest-bearing cash and federal funds sold	\$29,383	\$420	1.91	% \$269,697	\$2,010	0.99	%
U.S. government agencies	2,269	25	1.47	—	—	—	
U.S. Treasuries	640	7	1.46	—	—	—	
State and political subdivisions:							
Non-taxable ⁽¹⁾	73,635	981	1.78	75,170	1,786	3.17	
Mortgage-backed securities	1,699,462	27,741	2.18	1,947,488	31,617	2.16	
Corporate bonds	1,275,929	26,004	2.72	945,731	16,221	2.29	
Asset-backed securities	4,699,065	130,505	3.70	3,628,788	86,499	3.18	
Federal Home Loan Bank ("FHLB") and other capital stock	68,783	2,042	3.96	60,404	1,219	2.69	
Loans ⁽²⁾							
Securities-based loans	1,826,920	50,694	3.70	1,719,323	36,709	2.85	
Commercial and industrial	2,673,867	89,563	4.47	1,985,159	57,798	3.88	
Residential real estate	2,688,638	56,869	2.82	2,271,763	44,864	2.63	
Commercial real estate	133,874	4,507	4.49	75,214	2,072	3.67	
Home equity lines of credit	18,537	643	4.62	14,926	415	3.71	
Construction and land	31,064	1,181	5.07	15,674	447	3.80	
Other	34,487	1,178	4.55	42,538	1,367	4.28	
Loans held for sale	215,026	6,155	3.82	166,335	3,823	3.06	
Total interest-earning assets ⁽³⁾	\$15,471,579	\$398,515	3.43	% \$13,218,210	\$286,847	2.89	%
Cash and due from banks	15,544			13,259			
Other non interest-earning assets	217,332			348,465			
Total assets	\$15,704,455			\$13,579,934			
Liabilities and stockholder's equity:							
Deposits:							
Money market	\$12,452,063	\$35,096	0.38	% \$11,606,471	\$8,255	0.09	%
Demand deposits	360,358	2,917	1.08	200,954	123	0.08	
Time deposits	699,603	11,060	2.11	2,996	46	2.05	
Savings	17,176	256	1.99	4	—	—	
FHLB advances	925,075	10,579	1.52	773,648	5,771	0.99	
Other borrowings	20,166	576	3.81	16,261	538	4.41	
Total interest-bearing liabilities ⁽³⁾	14,474,441	60,484	0.56	% 12,600,334	14,733	0.16	%
Non-interest-bearing liabilities	49,502			13,608			
Other non-interest bearing liabilities	69,135			25,960			
Total liabilities	14,593,078			12,639,902			
Stockholder's equity	1,111,377			940,032			
Total liabilities and stockholder's equity	\$15,704,455			\$13,579,934			
Net interest income/spread		\$338,031	2.87	%	\$272,114	2.73	%
Net interest margin			2.91	%		2.74	%

(1)

Due to immaterial amount of income recognized on tax-exempt securities, yields were not calculated on a tax equivalent basis.

(2) Loans on non-accrual status are included in average balances.

(3) See Net Interest Income table included in "Results of Operations" for additional information on our company's average balances and operating interest and expenses.

60

The following table sets forth an analysis of the effect on net interest income of volume and rate changes for the three and nine month periods ended September 30, 2018 compared to the three and nine month periods ended September 30, 2017 (in thousands):

	Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017			Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Interest-bearing cash and federal funds sold	\$(3,261)	\$2,496	\$(765)	\$(3,208)	\$1,618	\$(1,590)
U.S. government agencies	13	12	25	13	12	25
U.S. Treasuries	4	3	7	4	3	7
State and political - non-taxable	(10)	(57)	(67)	(36)	(769)	(805)
Mortgage-backed securities	(1,141)	227	(914)	(4,051)	175	(3,876)
Corporate bonds	1,626	1,452	3,078	6,356	3,427	9,783
Asset-backed securities	9,280	7,344	16,624	28,212	15,794	44,006
FHLB and other capital stock	113	97	210	188	635	823
Loans						
Securities-based loans	875	3,861	4,736	2,416	11,569	13,985
Commercial and industrial	7,384	4,177	11,561	22,156	9,609	31,765
Residential real estate	3,217	1,351	4,568	8,654	3,351	12,005
Commercial real estate	1,461	199	1,660	1,896	539	2,435
Home equity lines of credit	110	29	139	113	115	228
Construction and land	608	72	680	548	186	734
Other	159	114	273	(284)	95	(189)
Loans held for sale	718	425	1,143	1,268	1,064	2,332
	\$21,156	\$21,802	\$42,958	\$64,245	\$47,423	\$111,668
Interest expense:						
Deposits:						
Money market	\$(77)	\$11,271	\$11,194	\$644	\$26,197	\$26,841
Demand deposits	171	1,478	1,649	169	2,625	2,794
Time deposits	8,208	(1)	8,207	11,012	2	11,014
Savings	35	1	36	254	2	256
FHLB advances	459	2,518	2,977	1,292	3,516	4,808
Other borrowings	508	(517)	(9)	88	(50)	38
	\$9,304	\$14,750	\$24,054	\$13,459	\$32,292	\$45,751

Increases and decreases in interest revenue and interest expense result from changes in average balances (volume) of interest-earning bank assets and liabilities, as well as changes in average interest rates. The effect of changes in volume is determined by multiplying the change in volume by the previous year's average yield/cost. Similarly, the effect of rate changes is calculated by multiplying the change in average yield/cost by the previous year's volume. Changes applicable to both volume and rate have been allocated proportionately.

Net interest income – Net interest income is the difference between interest earned on interest-earning assets and interest paid on funding sources. Net interest income is affected by changes in the volume and mix of these assets and liabilities, as well as by fluctuations in interest rates and portfolio management strategies.

For the three months ended September 30, 2018, interest revenue of \$146.5 million was generated from average interest-earning assets of \$16.2 billion at an average interest rate of 3.61%. Interest revenue of \$103.6 million for the comparable period in 2017 was generated from average interest-earning assets of \$13.9 billion at an average interest rate of 2.98%.

For the nine months ended September 30, 2018, interest revenue of \$398.5 million was generated from average interest-earning assets of \$15.5 billion at an average interest rate of 3.43%. Interest revenue of \$286.8 million for the comparable period in 2017 was generated from average interest-earning assets of \$13.2 billion at an average interest rate of 2.89%.

Interest expense represents interest on customer money market accounts, interest on time deposits, Federal Home Loan Bank advances, and other interest expense. The average balance of interest-bearing liabilities during the three months ended September 30, 2018 was \$15.1 billion at an average interest rate of 0.81%. The average balance of interest-bearing liabilities for the comparable period in 2017 was \$13.2 billion at an average interest rate of 0.19%. The average balance of interest-bearing liabilities during the nine months ended September 30, 2018 was \$14.5 billion at an average interest rate of 0.56%. The average balance of interest-bearing liabilities for the comparable period in 2017 was \$12.6 billion at an average interest rate of 0.16%.

The growth in Stifel Bancorp has been primarily funded by the growth in deposits associated with brokerage customers of Stifel. At September 30, 2018, the balance of Stifel brokerage customer deposits at Stifel Bancorp was \$13.6 billion compared to \$12.9 billion at September 30, 2017.

See “Net Interest Income – Stifel Bancorp” above for more information regarding average balances, interest income and expense, and average interest rate yields.

NON-INTEREST EXPENSES

For the three months ended September 30, 2018, Global Wealth Management non-interest expenses increased 7.9% to \$314.8 million from \$291.8 million for the comparable period in 2017. For the nine months ended September 30, 2018, Global Wealth Management non-interest expenses increased 4.7% to \$933.0 million from \$891.2 million for the comparable period in 2017.

Compensation and benefits – For the three months ended September 30, 2018, compensation and benefits expense increased 8.6% to \$241.7 million from \$222.6 million during the comparable period in 2017. For the nine months ended September 30, 2018, compensation and benefits expense increased 6.0% to \$721.4 million from \$680.3 million during the comparable period in 2017. The increase is principally due to increased variable compensation. Compensation and benefits expense as a percentage of net revenues was 48.5% and 48.7% for the three and nine months ended September 30, 2018, respectively, compared to 49.1% and 50.5% for the comparable periods in 2017, respectively.

Occupancy and equipment rental – For the three months ended September 30, 2018, occupancy and equipment rental expense increased 6.7% to \$26.4 million from \$24.8 million during the comparable period in 2017. For the nine months ended September 30, 2018, occupancy and equipment rental expense increased 2.2% to \$78.1 million from \$76.4 million during the comparable period in 2017. The increase is primarily attributable an increase in locations over the comparable period in 2017.

Communications and office supplies – For the three months ended September 30, 2018, communications and office supplies expense increased 5.2% to \$14.6 million from \$13.9 million during the comparable period in 2017. For the nine months ended September 30, 2018, communications and office supplies expense increased 10.0% to \$46.3 million from \$42.1 million during the comparable period in 2017. The increase is primarily attributable to higher communication expenses associated with the growth of the business.

Commissions and floor brokerage – For the three months ended September 30, 2018, commissions and floor brokerage expense decreased 1.9% to \$4.9 million from \$5.0 million during the comparable period in 2017. For the nine months ended September 30, 2018, commissions and floor brokerage expense decreased 7.1% to \$13.8 million from \$14.9 million during the comparable period in 2017. The decrease is primarily attributable to lower clearing expenses.

Other operating expenses – For the three months ended September 30, 2018, other operating expenses increased 6.3% to \$27.2 million from \$25.6 million during the comparable period in 2017. For the nine months ended September 30,

2018, other operating expenses decreased 5.3% to \$73.5 million from \$77.6 million during the comparable period in 2017. The decrease in other operating expenses from the comparable period in 2017 is primarily attributable to a decrease in the provision for loan losses and insurance expense, partially offset by higher advertising costs, travel expenses, and professional fees.

INCOME BEFORE INCOME TAXES

For the three months ended September 30, 2018, income before income taxes increased 13.4% to a \$183.4 million from \$161.8 million during the comparable period in 2017. For the nine months ended September 30, 2018, income before income taxes increased 19.9% to a record \$548.0 million from \$457.0 million during the comparable period in 2017.

Profit margins (income before income taxes as a percent of net revenues) have increased to 36.8% and 37.0% for the three and nine months ended September 30, 2018 from 35.7% and 33.9% during the comparable periods in 2017. The increase in profit margins from the comparable periods in 2017 is primarily due to the growth of our higher margin businesses.

Results of Operations – Institutional Group

Three Months Ended September 30, 2018 Compared with Three Months Ended September 30, 2017

The following table presents consolidated financial information for the Institutional Group segment for the periods indicated (in thousands, except percentages):

	Three Months Ended September 30,			As a Percentage of Net Revenues For the Three Months Ended September 30,	
	2018	2017	Change %	2018	2017
Revenues:					
Commissions	\$40,220	\$47,202	(14.8)	16.4 %	17.8 %
Principal transactions	42,130	44,086	(4.4)	17.1	16.7
Brokerage revenues	82,350	91,288	(9.8)	33.5	34.5
Capital raising	85,553	70,850	20.8	34.8	26.8
Advisory fees	75,717	101,982	(25.8)	30.8	38.5
Investment banking	161,270	172,832	(6.7)	65.6	65.3
Interest	5,183	3,550	46.0	2.1	1.3
Other income	2,477	1,194	107.5	1.0	0.5
Total revenues	251,280	268,864	(6.5)	102.2	101.6
Interest expense	5,328	4,117	29.4	2.2	1.6
Net revenues	245,952	264,747	(7.1)	100.0	100.0
Non-interest expenses:					
Compensation and benefits	146,187	158,926	(8.0)	59.4	60.0
Occupancy and equipment rental	11,763	11,902	(1.2)	4.8	4.5
Communication and office supplies	15,789	14,717	7.3	6.4	5.6
Commissions and floor brokerage	6,453	6,254	3.2	2.6	2.4
Other operating expenses	31,455	21,231	48.2	12.9	8.0
Total non-interest expenses	211,647	213,030	(0.6)	86.1	80.5
Income before income taxes	\$34,305	\$51,717	(33.7)	13.9 %	19.5 %

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

Nine months Ended September 30, 2018 Compared with Nine months Ended September 30, 2017

The following table presents consolidated financial information for the Institutional Group segment for the periods indicated (in thousands, except percentages):

	Nine Months Ended September 30,			As a Percentage of Net Revenues For the Nine Months Ended September 30,	
	2018	2017	Change %	2018	2017
Revenues:					
Commissions	\$ 135,563	\$ 153,819	(11.9)	17.6 %	19.8 %
Principal transactions	144,206	157,988	(8.7)	18.8	20.3
Brokerage revenues	279,769	311,807	(10.3)	36.4	40.1
Capital raising	222,666	225,071	(1.1)	29.0	28.9
Advisory fees	260,312	237,379	9.7	33.8	30.5
Investment banking	482,978	462,450	4.4	62.8	59.4
Interest	13,880	11,095	25.1	1.8	1.4
Other income	6,583	4,621	42.5	0.9	0.6
Total revenues	783,210	789,973	(0.9)	101.9	101.5
Interest expense	14,355	11,606	23.7	1.9	1.5
Net revenues	768,855	778,367	(1.2)	100.0	100.0
Non-interest expenses:					
Compensation and benefits	455,515	467,098	(2.5)	59.2	60.0
Occupancy and equipment rental	35,269	35,546	(0.8)	4.6	4.6
Communication and office supplies	51,292	45,627	12.4	6.7	5.9
Commissions and floor brokerage	17,001	18,330	(7.3)	2.2	2.4
Other operating expenses	94,879	67,285	41.0	12.4	8.5
Total non-interest expenses	653,956	633,886	3.2	85.1	81.4
Income before income taxes	\$ 114,899	\$ 144,481	(20.5)	14.9 %	18.6 %

NET REVENUES

For the three months ended September 30, 2018, Institutional Group net revenues decreased 7.1% to \$246.0 million from \$264.7 million for the comparable period in 2017. For the nine months ended September 30, 2018, Institutional Group net revenues decreased 1.2% to \$768.9 million from \$778.4 million during the comparable period in 2017.

The decrease in net revenues over the comparable periods in 2017 was primarily attributable to a decrease in fixed income and equity brokerage revenues.

Commissions – For the three months ended September 30, 2018, commission revenues decreased 14.8% to \$40.2 million from \$47.2 million in the comparable period in 2017. For the nine months ended September 30, 2018, commission revenues decreased 11.9% to \$135.6 million from \$153.8 million in the comparable period in 2017.

Principal transactions – For the three months ended September 30, 2018, principal transactions revenues decreased 4.4% to \$42.1 million from \$44.1 million in the comparable period in 2017. For the nine months ended September 30,

2018, principal transaction revenues decreased 8.7% to \$144.2 million from \$158.0 million in the comparable period in 2017.

Brokerage revenues – For the three months ended September 30, 2018, institutional brokerage revenues decreased 9.8% to \$82.4 million from \$91.3 million in the comparable period in 2017. For the nine months ended September 30, 2018, institutional brokerage revenues decreased 10.3% to \$279.8 million from \$311.8 million in the comparable period in 2017. Brokerage revenues were impacted by lower market volatility and continued migration from active to passive management strategies.

For the three months ended September 30, 2018, fixed income institutional brokerage revenues decreased 16.6% to \$38.4 million from \$46.1 million in the comparable period in 2017. For the nine months ended September 30, 2018, fixed income brokerage revenues decreased 12.0% to \$142.5 million from \$161.9 million in the comparable period in 2017. The decrease is primarily attributable to lower fixed income trading volumes from the comparable period in 2017.

For the three months ended September 30, 2018, equity institutional brokerage revenues decreased 2.9% to \$43.9 million from \$45.2 million during the comparable period in 2017. For the nine months ended September 30, 2018, equity brokerage revenues decreased 8.4% to \$137.3 million from \$149.9 million during the comparable period in 2017. The decrease is primarily attributable to reduced market volatility and continued migration from active to passive management strategies.

Investment banking – For the three months ended September 30, 2018, investment banking revenues decreased 6.7% to \$161.3 million from \$172.8 million during the comparable period in 2017. The decrease is primarily attributable to lower advisory fees and fixed income capital raising revenues, partially offset by an increase in equity capital raising revenues over the comparable period in 2017. For the nine months ended September 30, 2018, investment banking revenues increased 4.4% to \$483.0 million from \$462.5 million during the comparable period in 2017. The increase is primarily attributable to an increase in advisory fee revenues and equity capital raising revenues, partially offset by a decrease in fixed income capital raising revenues. Investment banking revenues were positively impacted by the adoption of the new revenue recognition standard in 2018 that requires gross presentation of certain costs that were previously offset against investment banking revenues.

For the three months ended September 30, 2018, capital raising revenues increased 20.8% to \$85.6 million from \$70.9 million in the comparable period in 2017. For the nine months ended September 30, 2018, capital raising revenues decreased 1.1% to \$222.7 million from \$225.1 million in the comparable period in 2017.

For the three months ended September 30, 2018, equity capital raising revenues increased 50.2% to \$65.0 million from \$43.3 million during the comparable period in 2017. For the nine months ended September 30, 2018, equity capital raising revenues increased 29.5% to \$161.8 million from \$124.9 million during the comparable period in 2017. The increase was primarily attributable to the adoption of the new revenue recognition standard in 2018 and an increase in the average fees per deal over the comparable periods in 2017.

For the three months ended September 30, 2018, fixed income capital raising revenues decreased 25.5% to \$20.6 million from \$27.6 million during the comparable period in 2017. For the nine months ended September 30, 2018, fixed income capital raising revenues decreased 39.2% to \$60.9 million from \$100.2 million during the comparable period in 2017. The decrease is primarily attributable to a decrease in the municipal bond origination business.

For the three months ended September 30, 2018, advisory fee revenues decreased 25.8% to \$75.7 million from \$102.0 million in the comparable period in 2017. The decrease is primarily attributable to a decline in the number of advisory transactions from the comparable period in 2017, partially offset by the growth in our fund placement business.

For the nine months ended September 30, 2018, advisory fees increased 9.7% to \$260.3 million from \$237.4 million in the comparable period in 2017. The increase is primarily attributable to an increase in the number of advisory transactions over the comparable period in 2017, including growth in our fund placement business.

Interest – For the three months ended September 30, 2018, interest increased 46.0% to \$5.2 million from \$3.6 million in the comparable period in 2017. For the nine months ended September 30, 2018, interest increased 25.1% to \$13.9 million from \$11.1 million during the comparable period in 2017.

Other income – For the three months ended September 30, 2018, other income increased 107.5% to \$2.5 million from \$1.2 million in the comparable period in 2017. For the nine months ended September 30, 2018, other income increased 42.5% to \$6.6 million from \$4.6 million during the comparable period in 2017.

Interest expense – For the three months ended September 30, 2018, interest expense increased 29.4% to \$5.3 million from \$4.1 million in the comparable period in 2017. For the nine months ended September 30, 2018, interest expense

increased 23.7% to \$14.4 million from \$11.6 million in the comparable period in 2017.

NON-INTEREST EXPENSES

For the three months ended September 30, 2018, Institutional Group non-interest expenses decreased 0.6% to \$211.6 million from \$213.0 million for the comparable period in 2017. For the nine months ended September 30, 2018, Institutional Group non-interest expenses increased 3.2% to \$654.0 million from \$633.9 million during the comparable period in 2017.

Compensation and benefits – For the three months ended September 30, 2018, compensation and benefits expense decreased 8.0% to \$146.2 million from \$158.9 million during the comparable period in 2017. For the nine months ended September 30, 2018, compensation and benefits expense decreased 2.5% to \$455.5 million from \$467.1 million during the comparable period in 2017.

Compensation and benefits expense as a percentage of net revenues was 59.4% and 59.2% for the three and nine months ended September 30, 2018, respectively, compared to 60.0% and 60.0% for comparable periods in 2017, respectively.

Occupancy and equipment rental – For the three months ended September 30, 2018, occupancy and equipment rental expense decreased 1.2% to \$11.8 million from \$11.9 million during the comparable period in 2017. For the nine months ended September 30, 2018, occupancy and equipment rental expense decreased 0.8% to \$35.3 million from \$35.5 million during the comparable period in 2017.

Communications and office supplies – For the three months ended September 30, 2018, communications and office supplies expense increased 7.3% to \$15.8 million from \$14.7 million during the comparable period in 2017. For the nine months ended September 30, 2018, communications and office supplies expense increased 12.4% to \$51.3 million from \$45.6 million during the comparable period in 2017. The increase is primarily attributable to an increase in communication and quote equipment expense.

Commissions and floor brokerage – For the three months ended September 30, 2018, commissions and floor brokerage expense increased 3.2% to \$6.5 million from \$6.3 million during the comparable period in 2017. The increase is primarily attributable to higher clearing expense, partially offset by lower electronic execution pricing. For the nine months ended September 30, 2018, commissions and floor brokerage expense decreased 7.3% to \$17.0 million from \$18.3 million during the comparable period in 2017. The decrease is primarily attributable to lower electronic execution pricing.

Other operating expenses – For the three months ended September 30, 2018, other operating expenses increased 48.2% to \$31.5 million from \$21.2 million during the comparable period in 2017. The increase is primarily attributable to the adoption of the new revenue recognition standard that requires gross presentation of certain costs that were previously offset against revenue that added approximately \$9.7 million to other operating expenses and an increase in professional fees; partially offset by a decrease in travel costs.

For the nine months ended September 30, 2018, other operating expenses increased 41.0% to \$94.9 million from \$67.3 million during the comparable period in 2017. The increase for the nine months ended September 30, 2018 over the comparable period in 2017 is primarily due to the previously disclosed adoption of the new revenue recognition standard that added approximately \$25.9 million to other operating expenses and an increase in travel costs and professional fees.

INCOME BEFORE INCOME TAXES

For the three months ended September 30, 2018, income before income taxes for the Institutional Group segment decreased 33.7% to \$34.3 million from \$51.7 million during the comparable period in 2017. For the nine months ended September 30, 2018, income before income taxes for the Institutional Group segment decreased 20.5% to \$114.9 million from \$144.5 million during the comparable period in 2017.

Profit margins (income before income taxes as a percentage of net revenues) have decreased to 13.9% for the three months ended September 30, 2018 from 19.5% during the comparable period in 2017 as a result of lower revenues in the third quarter of 2018.

Profit margins (income before income taxes as a percentage of net revenues) have decreased to 14.9% for nine months ended September 30, 2018 from 18.6% during the comparable period in 2017 as a result of an increase in expenses and lower revenues.

Results of Operations – Other Segment

Three and Nine months Ended September 30, 2018 Compared with Three and Nine months Ended September 30, 2017

The following table presents consolidated financial information for the Other segment for the periods presented (in thousands, except percentages):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	% Change	2018	2017	% Change
Net revenues	\$(5,771)	\$2,864	(301.5)	\$(18,486)	\$(4,300)	(329.9)
Non-interest expenses:						
Compensation and benefits	34,425	66,862	(48.5)	145,521	191,324	(23.9)
Other operating expenses	36,956	41,336	(10.6)	120,504	135,546	(11.1)
Total non-interest expenses	71,381	108,198	(34.0)	266,025	326,870	(18.6)
Loss before income taxes	\$(77,152)	\$(105,334)	(26.8)%	\$(284,511)	\$(331,170)	(14.1)%

The other segment includes expenses related to the Company's acquisition strategy and the investments made in the Company's infrastructure and control environment.

The expenses relating to the Company's acquisition strategy, which are included in the other segment, consists of stock-based compensation and operating costs from our various acquisitions. The following shows the expenses that are part of the other segment related to acquisitions.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	% Change	2018	2017	% Change
Non-interest expenses:						
Compensation and benefits	\$5,475	\$8,056	(32.0)	\$13,289	\$30,368	(56.2)
Other operating expenses	6,051	4,725	28.1	26,966	36,899	(26.9)
Total non-interest expenses	\$11,526	\$12,781	(9.8)%	\$40,255	\$67,267	(40.2)%

The expenses not associated with acquisition-related activities in the other segment are as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	% Change	2018	2017	% Change
Non-interest expenses:						
Compensation and benefits	\$28,950	\$58,806	(50.8)	\$132,232	\$160,956	(17.8)
Other operating expenses	30,905	36,611	(15.6)	93,538	98,647	(5.2)
Total non-interest expenses	\$59,855	\$95,417	(37.3)%	\$225,770	\$259,603	(13.0)%

Non-interest expenses for the three months ended September 30, 2018 decreased 37.3% from the comparable period in 2017. The decrease consisted of a 50.8% decrease in compensation and benefits and a 15.6% decrease in other operating expenses. Non-interest expenses for the nine months ended September 30, 2018 decreased 13.0% from the comparable period in 2017. The decrease consisted of a 17.8% decrease in compensation and benefits and a 5.2% decrease in other operating expenses.

Analysis of Financial Condition

Our company's consolidated statements of financial condition consist primarily of cash and cash equivalents, receivables, financial instruments owned, bank loans, investments, goodwill, loans and advances to financial advisors, bank deposits, and payables. As of September 30, 2018, our total assets increased 11.1% to \$23.8 billion from \$21.4 billion at December 31, 2017. Our broker-dealer subsidiary's gross assets and liabilities, including financial instruments owned, stock loan/borrow, receivables and payables from/to brokers, dealers, and clearing organizations and clients, fluctuate with our business levels and overall market conditions.

As of September 30, 2018, our liabilities were comprised primarily of deposits of \$14.5 billion at Stifel Bancorp, senior notes, net of debt issuance costs, of \$1.0 billion, Federal Home Loan Bank advances of \$1.1 billion, payables to customers of \$627.7 million at our broker-dealer subsidiaries, accounts payable and accrued expenses of \$374.5 million, accrued employee compensation of \$379.5 million, borrowings of \$140.0 million, and trust preferred securities of \$67.5 million. To meet our obligations to clients and operating needs, we had \$694.3 million in cash and cash equivalents and \$8.5 billion in loans (including loans held for sale) at Stifel Bancorp at September 30, 2018. We also had highly liquid assets consisting of held-to-maturity securities of \$4.6 billion, available-for-sale securities of \$3.3 billion, client brokerage receivables of \$1.5 billion, and financial instruments of \$1.2 billion.

Cash Flow

Cash, cash equivalents, and restricted cash decreased \$71.2 million to \$715.9 million at September 30, 2018, from \$787.1 million at December 31, 2017. Operating activities used \$48.1 million of cash primarily due to an increase in operating assets during the nine months ended September 30, 2018. Investing activities used cash of \$1.2 billion due to the growth of our investment portfolio, growth of the loan portfolio, business acquisitions, and fixed asset purchases, partially offset by proceeds from the sale and maturity of securities in our investment portfolio and the sale of investments. Financing activities provided cash of \$1.2 billion principally due to an increase in bank deposits, securities loaned, and securities sold under agreements to repurchase, partially offset by repurchases of our common stock, tax payments related to shares withheld for our stock-based compensation plans, and dividends paid on our common and preferred stock.

Liquidity and Capital Resources

The Company's senior management establishes the liquidity and capital policies of our company. The Company's senior management reviews business performance relative to these policies, monitors the availability of alternative sources of financing, and oversees the liquidity and interest rate sensitivity of our company's asset and liability position.

Our assets, consisting mainly of cash or assets readily convertible into cash, are our principal source of liquidity. The liquid nature of these assets provides for flexibility in managing and financing the projected operating needs of the business. These assets are financed primarily by our equity capital, corporate debt, debentures to trusts, client credit balances, short-term bank loans, proceeds from securities lending, and other payables. We currently finance our client accounts and firm trading positions through ordinary course borrowings at floating interest rates from various banks on a demand basis, securities lending, and repurchase agreements, with company-owned and client securities pledged as collateral. Changes in securities market volumes, related client borrowing demands, underwriting activity, and levels of securities inventory affect the amount of our financing requirements.

Our bank assets consist principally of available-for-sale and held-to-maturity securities, retained loans, and cash and cash equivalents. Stifel Bancorp's current liquidity needs are generally met through deposits from brokerage clients and equity capital. We monitor the liquidity of our bank subsidiaries daily to ensure its ability to meet customer deposit withdrawals, maintain reserve requirements, and support asset growth.

As of September 30, 2018, we had \$23.8 billion in assets, \$11.1 billion of which consisted of cash or assets readily convertible into cash as follows (in thousands, except average days to conversion):

	September 30, 2018	December 31, 2017	Average Conversion
Cash and cash equivalents	\$694,302	\$696,283	
Receivables from brokers, dealers, and clearing organizations	646,120	459,107	5 days
Securities purchased under agreements to resell	622,361	512,220	1 day
Financial instruments owned at fair value	1,162,275	1,142,831	3 days
Available-for-sale securities at fair value	3,349,607	3,773,508	4 days
Held-to-maturity securities at amortized cost	4,564,453	3,698,098	3 days
Investments	59,819	85,613	10 days
Total cash and assets readily convertible to cash	\$11,098,937	\$10,367,660	

As of September 30, 2018 and December 31, 2017, the amount of collateral by asset class is as follows (in thousands):

	September 30, 2018		December 31, 2017	
	Contractual	Contingent	Contractual	Contingent
Cash and cash equivalents	\$69,082	\$—	\$44,883	\$—
Financial instruments owned at fair value	495,484	497,720	233,704	529,425
Available-for-sale securities at fair value	—	4,029,174	—	4,259,700
	\$564,566	\$4,526,894	\$278,587	\$4,789,125

Capital Management

We have an ongoing authorization from the Board of Directors to repurchase our common stock in the open market or in negotiated transactions. At September 30, 2018, the maximum number of shares that may yet be purchased under this plan was 6.0 million.

Liquidity Risk Management

Our businesses are diverse, and our liquidity needs are determined by many factors, including market movements, collateral requirements, and client commitments, all of which can change dramatically in a difficult funding environment. During a liquidity crisis, credit-sensitive funding, including unsecured debt and some types of secured financing agreements, may be unavailable, and the terms (e.g., interest rates, collateral provisions, and tenor) or availability of other types of secured financing may change. We manage liquidity risk by diversifying our funding sources across products and among individual counterparties within those products.

As a holding company, whereby all of our operations are conducted through our subsidiaries, our cash flow and our ability to service our debt, including the notes, depend upon the earnings of our subsidiaries. Our subsidiaries are separate and distinct legal entities. Our subsidiaries have no obligation to pay any amounts due on the notes or to provide us with funds to pay our obligations, whether by dividends, distributions, loans, or other payments.

Our liquidity requirements may change in the event we need to raise more funds than anticipated to increase inventory positions, support more rapid expansion, develop new or enhanced services and products, acquire technologies, or respond to other unanticipated liquidity requirements. We primarily rely on financing activities and distributions from our subsidiaries for funds to implement our business and growth strategies and repurchase our shares. Net capital rules, restrictions under our borrowing arrangements of our

subsidiaries, as well as the earnings, financial condition, and cash requirements of our subsidiaries, may each limit distributions to us from our subsidiaries.

The availability of outside financing, including access to the capital markets and bank lending, depends on a variety of factors, such as market conditions, the general availability of credit, the volume of trading activities, the overall availability of credit to the financial services sector, and our credit rating. Our cost and availability of funding may be adversely affected by illiquid credit markets and wider credit spreads. As a result of any future concerns about the stability of the markets generally and the strength of counterparties specifically, lenders may from time to time curtail, or even cease to provide, funding to borrowers.

Our liquidity management policies are designed to mitigate the potential risk that we may be unable to access adequate financing to service our financial obligations without material business impact. The principal elements of our liquidity management framework are: (a) daily monitoring of our liquidity needs at the holding company and significant subsidiary level, (b) stress testing the liquidity positions of Stifel and our bank subsidiaries, and (c) diversification of our funding sources.

Monitoring of liquidity – Senior management establishes our liquidity and capital policies. These policies include senior management’s review of short- and long-term cash flow forecasts, review of monthly capital expenditures, the monitoring of the availability of alternative sources of financing, and the daily monitoring of liquidity in our significant subsidiaries. Our decisions on the allocation of capital to our business units consider, among other factors, projected profitability and cash flow, risk, and impact on future liquidity needs. Our treasury department assists in evaluating, monitoring, and controlling the impact that our business activities have on our financial condition, liquidity, and capital structure as well as maintains our relationships with various lenders. The objectives of these policies are to support the successful execution of our business strategies while ensuring ongoing and sufficient liquidity.

Liquidity stress testing (Firm-wide) –A liquidity stress test model is maintained by the Company that measures liquidity outflows across multiple scenarios at the major operating subsidiaries and details the corresponding impact to our holding company and the overall consolidated firm. Liquidity stress tests are utilized to ensure that current exposures are consistent with the Company’s established liquidity risk tolerance and, more specifically, to identify and quantify sources of potential liquidity strain. Further, the stress tests are utilized to analyze possible impacts on the Company’s cash flows, liquidity position, profitability, and solvency. The outflows are modeled over a 30-day liquidity stress timeframe and include the impact of idiosyncratic and macro-economic stress events.

The assumptions utilized in the Company’s liquidity stress tests include, but are not limited to, the following:

- ◆ No government support
- ◆ No access to equity and unsecured debt markets within the stress horizon
- ◆ Higher haircuts and significantly lower availability of secured funding
- ◆ Additional collateral that would be required by trading counter-parties, certain exchanges, and clearing organizations related to credit rating downgrades
- ◆ Additional collateral that would be required due to collateral substitution, collateral disputes, and uncalled collateral
- ◆ Drawdowns on unfunded commitments provided to third parties
- ◆ Client cash withdrawals and reduction in customer short positions that fund long positions
- ◆ Return of securities borrowed on an uncollateralized basis
- ◆ Maturity roll-off of outstanding letters of credit with no further issuance

At September 30, 2018, the Company maintained sufficient liquidity to meet current and contingent funding obligations as modeled in its liquidity stress test model.

Liquidity stress testing (Stifel Bancorp) – Our bank subsidiaries perform three primary stress tests on their liquidity position. These stress tests are based on the following company-specific stresses: (1) the amount of deposit run-off that they could withstand over a one-month period of time based on their on-balance sheet liquidity and available credit, (2) the ability to fund operations if all available credit were to be drawn immediately, with no additional available credit, and (3) the ability to fund operations under a regulatory prompt corrective action. The goal of these stress tests is to determine their ability to fund continuing operations under significant pressures on both assets and liabilities.

Under all stress tests, our bank subsidiaries consider cash and highly liquid investments as available to meet liquidity needs. In their analysis, our bank subsidiaries consider agency mortgage-backed securities, corporate bonds, and commercial mortgage-backed securities as highly liquid. In addition to being able to be readily financed at modest haircut levels, our bank subsidiaries estimate that each of the individual securities within each of the asset classes described above could be sold into the market and converted into cash within three business days under normal market conditions, assuming that the entire portfolio of a given asset class was not simultaneously liquidated. At September 30, 2018, available cash and highly liquid investments comprised approximately 17% of Stifel Bancorp's assets, which was well in excess of its internal target.

In addition to these stress tests, management performs a daily liquidity review. The daily analysis provides management with all major fluctuations in liquidity. The analysis also tracks the proportion of deposits that Stifel Bancorp is sweeping from its affiliated broker-dealer, Stifel. On a monthly basis, liquidity key performance indicators and compliance with liquidity policy limits are reported to the Board of Directors. Our banking subsidiaries have not violated any internal liquidity policy limits.

Funding Sources

The Company pursues a strategy of diversification of secured and unsecured funding sources (by product and by investor) and attempts to ensure that the tenor of the Company's liabilities equals or exceeds the expected holding period of the assets being financed. The Company funds its balance sheet through diverse sources. These sources may include the Company's equity capital, long-term debt, repurchase agreements, securities lending, deposits, committed and uncommitted credit facilities, Federal Home Loan Bank advances, and federal funds agreements.

Cash and Cash Equivalents – We held \$694.3 million of cash and cash equivalents at September 30, 2018, compared to \$696.3 million at December 31, 2017. Cash and cash equivalents provide immediate sources of funds to meet our liquidity needs.

Securities Available-for-Sale – We held \$3.3 billion in available-for-sale investment securities at September 30, 2018, compared to \$3.8 billion at December 31, 2017. As of September 30, 2018, the weighted-average life of the investment securities portfolio was approximately 1.6 years. These investment securities provide increased liquidity and flexibility to support our company's funding requirements.

We monitor the available-for-sale investment portfolio for other-than-temporary impairment based on a number of criteria, including the size of the unrealized loss position, the duration for which the security has been in a loss position, credit rating, the nature of the investments, and current market conditions. For debt securities, we also consider any intent to sell the security and the likelihood we will be required to sell the security before its anticipated recovery. We continually monitor the ratings of our security holdings and conduct regular reviews of our credit-sensitive assets.

Deposits – Deposits have become one of our largest funding sources. Deposits provide a stable, low-cost source of funds that we utilize to fund loan and asset growth and to diversify funding sources. We have continued to expand our deposit-gathering efforts through our existing private client network and through expansion. These channels offer a broad set of deposit products that include demand deposits, money market deposits, and certificates of deposit ("CDs").

As of September 30, 2018, we had \$14.5 billion in deposits compared to \$13.4 billion at December 31, 2017. The growth in deposits is primarily attributable to the increase in brokerage deposits held by our bank subsidiaries. Our core deposits are comprised of non-interest-bearing deposits, money market deposit accounts, savings accounts, and CDs.

Short-term borrowings – Our short-term financing is generally obtained through short-term bank line financing on an uncommitted, secured basis, securities lending arrangements, advances from the Federal Home Loan Bank, term loans, and committed bank line financing on an unsecured basis. We borrow from various banks on a demand basis with company-owned and customer securities pledged as collateral. The value of customer-owned securities used as collateral is not reflected in the consolidated statements of financial condition. We also have unsecured, committed bank lines available.

Our uncommitted secured lines of credit at September 30, 2018, totaled \$1.0 billion with six banks and are dependent on having appropriate collateral, as determined by the bank agreements, to secure an advance under the line. The availability of our uncommitted lines is subject to approval by the individual banks each time an advance is requested and may be denied. Our peak daily borrowing on our uncommitted secured lines was \$391.0 million during the nine months ended September 30, 2018. There are no compensating balance requirements under these arrangements. Any borrowings on secured lines of credit are generally utilized to finance certain fixed income securities. At September 30, 2018, we had no outstanding balances on our uncommitted secured lines of credit.

The Federal Home Loan advances of \$1.1 billion as of September 30, 2018 are floating-rate advances. The weighted average interest rates during the three and nine months ended September 30, 2018 on these advances is 1.65% and 1.52%, respectively. The advances

are secured by Stifel Bancorp's residential mortgage loan portfolio and investment portfolio. The interest rates reset on a daily basis. Stifel Bancorp has the option to prepay these advances without penalty on the interest reset date.

Unsecured short-term borrowings – On April 26, 2017, we amended our existing Credit Agreement, whereby increasing our revolving credit facility to \$200.0 million. The credit facility expires in March 2020. The applicable interest rate under the revolving credit facility is calculated as a per annum rate equal to LIBOR plus 2.00%, as defined.

We can draw upon this line as long as certain restrictive covenants are maintained. Under our amended and restatement Credit Agreement, we are required to maintain compliance with a minimum consolidated tangible net worth covenant, as defined, and a maximum consolidated total capitalization ratio covenant, as defined. In addition, Stifel, our broker-dealer subsidiary, is required to maintain compliance with a minimum regulatory excess net capital covenant, as defined, and our bank subsidiaries are required to maintain their status as well-capitalized, as defined.

Our revolving credit facility contains customary events of default, including, without limitation, payment defaults, breaches of representations and warranties, covenant defaults, cross-defaults to similar obligations, certain events of bankruptcy and insolvency, and judgment defaults. At September 30, 2018, we had no advances on our revolving credit facility and were in compliance with all covenants.

In June 2018, Stifel, our broker-dealer subsidiary, entered into a 364-day, Credit Agreement (“Stifel Credit Facility”) with a maturity date of June 2019 in which the lenders are a number of financial institutions. This committed unsecured borrowing facility provides for maximum borrowings of up to \$250.0 million at variable rates of interest.

Under the Stifel Credit Facility, Stifel is required to maintain compliance with a minimum consolidated tangible net worth covenant, as defined, and to maintain compliance with a minimum regulatory excess net capital covenant, as defined.

The Stifel Credit Facility contains customary events of default, including, without limitation, payment defaults, breaches of representations and warranties, covenant defaults, cross-defaults to similar obligations, certain events of bankruptcy and insolvency, and judgment defaults. At September 30, 2018, there were no advances on the Stifel Credit Facility and we were in compliance with all covenants.

Federal Home Loan Bank Advances and other secured financing – Stifel Bancorp has borrowing capacity with the Federal Home Loan Bank of \$4.0 billion at September 30, 2018 and \$59.5 million in federal funds agreements, for the purpose of purchasing short-term funds should additional liquidity be needed. At September 30, 2018, outstanding FHLB advances were \$1.1 billion. Stifel Bancorp is eligible to participate in the Fed's discount window program; however, Stifel Bancorp does not view borrowings from the Fed as a primary means of funding. The credit available in this program is subject to periodic review, may be terminated or reduced at the discretion of the Fed, and is secured by securities. Stifel Bancorp has borrowing capacity of \$2.1 billion with the Fed's discount window at September 30, 2018. Stifel Bancorp receives overnight funds from excess cash held in Stifel brokerage accounts, which are deposited into a money market account. These balances totaled \$13.6 billion at September 30, 2018.

Public Offering of Senior Notes –On July 15, 2014, we sold in a registered underwritten public offering, \$300.0 million in aggregate principal amount of 4.250% senior notes due July 2024 (the “2014 Notes”). Interest on the 2014 Notes is payable semi-annually in arrears. We may redeem the 2014 Notes in whole or in part, at our option, at a redemption price equal to 100% of their principal amount, plus a “make-whole” premium and accrued and unpaid interest, if any, to the date of redemption. In July 2014, we received a BBB- rating on the 2014 Notes.

On December 1, 2015, we sold in a registered underwritten public offering, \$300.0 million in aggregate principal amount of 3.50% senior notes due December 2020 (the “December 2015 Notes”). Interest on the December 2015 Notes is payable semi-annually in arrears. We may redeem the December 2015 Notes in whole or in part, at our option, at a redemption price equal to 100% of their principal amount, plus a “make-whole” premium and accrued and unpaid interest, if any, to the date of redemption. In December 2015, we received a BBB- rating on the 2015 Notes.

On July 11, 2016, the Company completed the pricing of an additional \$200.0 million in aggregate principal amount of the Company’s 2014 Notes. The 2014 Notes mature in July 2024 and bear interest at 4.250%, payable semi-annually in arrears in January and July.

On October 4, 2017, we completed the pricing of a registered underwritten public offering of \$200.0 million in aggregate principal amount of 5.20% senior notes due October 2047. Interest on the senior notes is payable quarterly in arrears on January 15, April 15, July 15, and October 15. On or after October 15, 2022, we may redeem some or all of the senior notes at any time at a redemption price equal to 100% of the principal amount of the notes being redeemed plus accrued interest thereon to the redemption date. On

October 27, 2017, we completed the sale of an additional \$25.0 million aggregate principal amount of Notes pursuant to the over-allotment option. In October 2017, we received a BBB- rating on the 2017 Notes.

Credit Rating

We believe our current rating depends upon a number of factors, including industry dynamics, operating and economic environment, operating results, operating margins, earnings trends and volatility, balance sheet composition, liquidity and liquidity management, our capital structure, our overall risk management, business diversification, and our market share and competitive position in the markets in which we operate. Deteriorations in any of these factors could impact our credit rating. A reduction in our credit rating could adversely affect our liquidity and competitive position, increase our incremental borrowing costs, limit our access to the capital markets, or trigger our obligations under certain financial agreements. As such, we may not be able to successfully obtain additional outside financing to fund our operations on favorable terms, or at all.

We believe our existing assets, most of which are liquid in nature, together with the funds from operations, available informal short-term credit arrangements, and our ability to raise additional capital will provide sufficient resources to meet our present and anticipated financing needs.

Use of Capital Resources

On March 19, 2018, the Company completed the acquisition of Ziegler, a privately held investment bank, capital markets and proprietary investments firm that has 55 private client advisors in five states that manage approximately \$5 billion in client assets. Ziegler provides its clients with capital raising, strategic advisory services, equity and fixed income sales & trading and research. The acquisition was funded with cash from operations.

On August 31, 2018, the Company completed the acquisition of Business Bancshares, Inc. (“BBI”) and its wholly owned subsidiary, The Business Bank of St. Louis, a full-service banking facility with approximately \$600.0 million in assets that operates from a single location. Upon the closing of the transaction, the Business Bank of St. Louis was renamed “Stifel Bank” and Business Bancshares, Inc. was renamed “Stifel Bancorp, Inc.” Stifel Bancorp, Inc. (“Stifel Bancorp”) is the holding company for Stifel Bank & Trust, and its wholly owned subsidiaries, and Stifel Bank. Under the terms of the merger agreement, each outstanding share of BBI common stock (except for shares of BBI common stock held by BBI as treasury stock) were converted into the right to receive 0.705 shares of our company’s common stock, with fractional shares settled with cash. We issued approximately 2.0 million shares for acquisition of BBI.

We have paid \$67.9 million in the form of upfront notes to financial advisors for transition pay during the nine months ended September 30, 2018. As we continue to take advantage of the opportunities created by market displacement and as competition for skilled professionals in the industry increases, we may decide to devote more significant resources to attracting and retaining qualified personnel.

We utilize transition pay, principally in the form of upfront demand notes, to aid financial advisors, who have elected to join our firm, to supplement their lost compensation while transitioning their customers’ accounts to the Stifel platform. The initial value of the notes is determined primarily by the financial advisors’ trailing production and assets under management. These notes are generally forgiven over a five- to ten-year period based on production. The future estimated amortization expense of the upfront notes, assuming current-year production levels and static growth for the remaining three months in 2018, and the years ended December 31, 2019, 2020, 2021, 2022, and thereafter are \$22.8 million, \$78.6 million, \$61.9 million, \$51.4 million, \$45.5 million, and \$111.1 million, respectively. These estimates could change if we continue to grow our business through expansion or experience increased production levels.

We maintain several incentive stock award plans that provide for the granting of stock options, stock appreciation rights, restricted stock, performance awards, and stock units to our employees. Historically, we have granted stock units to our employees as part of our retention program. In response to the Tax Legislation that was enacted in December 2017, the Company offered certain employees the opportunity to participate in the conversion of certain restricted stock units into restricted stock pursuant to a Modification Award Agreement. A restricted stock unit or restricted stock award represents the right to receive a share of common stock from our company at a designated time in the future without cash payment by the employee and is issued in lieu of cash incentive, principally for deferred compensation and employee retention plans. The restricted stock units or restricted stock awards generally vest over the next one to ten years after issuance and are distributed at predetermined future payable dates once vesting occurs. At September 30, 2018, the total number of stock units and restricted stock awards outstanding was 16.6 million, of which 12.9 million were unvested. At September 30, 2018, the total number of performance-based restricted stock units was 0.6 million, of which all were unvested. At September 30, 2018, there was unrecognized compensation cost for stock units of approximately \$292.2 million, which is expected to be recognized over a weighted-average period of 2.9 years.

The future estimated compensation expense of the unvested units, assuming current year forfeiture levels and static growth for the remaining three months in 2018, and the years ended December 31, 2019, 2020, 2021, 2022, and thereafter are \$21.4 million, \$74.3 million, \$67.3 million, \$52.7 million, \$40.2 million, and \$36.3 million, respectively. These estimates could change if our forfeitures change from historical levels.

Net Capital Requirements – We operate in a highly regulated environment and are subject to capital requirements, which may limit distributions to our company from our subsidiaries. Distributions from our broker-dealer subsidiaries are subject to net capital rules. These subsidiaries have historically operated in excess of minimum net capital requirements. However, if distributions were to be limited in the future due to the failure of our subsidiaries to comply with the net capital rules or a change in the net capital rules, it could have a material and adverse effect to our company by limiting our operations that require intensive use of capital, such as underwriting or trading activities, or limit our ability to implement our business and growth strategies, pay interest on and repay the principal of our debt, and/or repurchase our common stock. Our non-broker-dealer subsidiaries, Stifel Bank & Trust and Stifel Bank, are also subject to various regulatory capital requirements administered by the federal banking agencies. Our broker-dealer subsidiaries and our bank subsidiaries have consistently operated in excess of their capital adequacy requirements.

At September 30, 2018, Stifel had net capital of \$355.9 million, which was 20.0% of aggregate debit items and \$320.4 million in excess of its minimum required net capital. At September 30, 2018, all of our other broker-dealer subsidiaries' net capital exceeded the minimum net capital required under the SEC rule. At September 30, 2018, our international subsidiary's capital and reserves were in excess of the financial resources requirement under the rules of the FCA. At September 30, 2018, our bank subsidiaries were considered well capitalized under the regulatory framework for prompt corrective action. See Note 16 of the Notes to Consolidated Financial Statements for details of our regulatory capital requirements.

Critical Accounting Policies and Estimates

In preparing our consolidated financial statements in accordance with U.S. generally accepted accounting principles and pursuant to the rules and regulations of the SEC, we make assumptions, judgments, and estimates that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosures of contingent assets and liabilities. We base our assumptions, judgments, and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis, we evaluate our assumptions, judgments, and estimates. We also discuss our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

We believe that the assumptions, judgments, and estimates involved in the accounting policies described below have the greatest potential impact on our consolidated financial statements. These areas are key components of our results of operations and are based on complex rules that require us to make assumptions, judgments, and estimates, so we consider these to be our critical accounting policies. Historically, our assumptions, judgments, and estimates relative to our critical accounting policies and estimates have not differed materially from actual results.

For a full description of these and other accounting policies, see Note 2 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2017, as well as Note 2 of the Notes to Consolidated Financial Statements in this Form 10-Q.

Valuation of Financial Instruments

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

Trading securities owned and pledged and trading securities sold, but not yet purchased, are carried at fair value on the consolidated statements of financial condition, with unrealized gains and losses reflected on the consolidated statements of operations.

The fair value of a financial instrument is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, or an exit price. The degree of judgment used in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices in active markets generally have more pricing observability and less judgment used in measuring fair value. Conversely, financial instruments rarely traded or not quoted have less pricing observability and are measured at fair value using valuation models that require more judgment. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction, and overall market conditions generally.

When available, we use observable market prices, observable market parameters, or broker or dealer quotes (bid and ask prices) to derive the fair value of financial instruments. In the case of financial instruments transacted on recognized exchanges, the observable market prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded.

A substantial percentage of the fair value of our trading securities and other investments owned, trading securities pledged as collateral, and trading securities sold, but not yet purchased, are based on observable market prices, observable market parameters, or derived from broker or dealer prices. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing or market parameters in a product may be used to derive a price without requiring significant judgment. In certain markets, observable market prices or market parameters are not available for all products, and fair value is determined using techniques appropriate for each particular product. These techniques involve some degree of judgment.

For investments in illiquid or privately held securities that do not have readily determinable fair values, the determination of fair value requires us to estimate the value of the securities using the best information available. Among the factors we consider in determining the fair value of investments are the cost of the investment, terms and liquidity, developments since the acquisition of the investment, the sales price of recently issued securities, the financial condition and operating results of the issuer, earnings trends and consistency of operating cash flows, the long-term business potential of the issuer, the quoted market price of securities with similar quality and yield that are publicly traded, and other factors generally pertinent to the valuation of investments. In instances where a security is subject to transfer restrictions, the value of the security is based primarily on the quoted price of a similar security without restriction but may be reduced by an amount estimated to reflect such restrictions. The fair value of these investments is subject to a high degree of volatility and may be susceptible to significant fluctuation in the near term, and the differences could be material.

We have categorized our financial instruments measured at fair value into a three-level classification in accordance with Topic 820, "Fair Value Measurement and Disclosures." Fair value measurements of financial instruments that use quoted prices in active markets for identical assets or liabilities are generally categorized as Level 1, and fair value measurements of financial instruments that have no direct observable levels are generally categorized as Level 3. All other fair value measurements of financial instruments that do not fall within the Level 1 or Level 3 classification are considered Level 2. The lowest level input that is significant to the fair value measurement of a financial instrument is used to categorize the instrument and reflects the judgment of management.

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. We have identified Level 3 financial instruments to include certain asset-backed securities, consisting of collateral loan obligation securities, that have experienced low volumes of executed transactions, certain corporate bonds and equity securities where there was less frequent or nominal market activity and auction rate securities for which the market has been dislocated and largely ceased to function. Our Level 3 asset-backed securities are valued using cash flow models that utilize unobservable inputs. Level 3 corporate bonds are valued using prices from comparable securities. Equity securities with unobservable inputs are valued using management's best estimate of fair value, where the inputs require significant management judgment. Auction rate securities are valued based upon our expectations of issuer redemptions and using internal models.

Contingencies

We are involved in various pending and potential legal proceedings related to our business, including litigation, arbitration, and regulatory proceedings. Some of these matters involve claims for substantial amounts, including

claims for punitive damages. We have, after consultation with outside legal counsel and consideration of facts currently known by management, recorded estimated losses in accordance with Topic 450 (“Topic 450”), “Contingencies,” to the extent that claims are probable of loss and the amount of the loss can be reasonably estimated. The determination of these reserve amounts requires us to use significant judgment, and our final liabilities may ultimately be materially different. This determination is inherently subjective, as it requires estimates that are subject to potentially significant revision as more information becomes available and due to subsequent events. In making these determinations, we consider many factors, including, but not limited to, the loss and damages sought by the plaintiff or claimant, the basis and validity of the claim, the likelihood of a successful defense against the claim, and the potential for, and magnitude of, damages or settlements from such pending and potential litigation and arbitration proceedings, and fines and penalties or orders from regulatory agencies. See Item I, “Legal Proceedings,” in Part II of this report for information on our legal, regulatory, and arbitration proceedings.

Allowance for Loan Losses

We regularly review the loan portfolio and have established an allowance for loan losses for inherent losses estimated to have occurred in the loan portfolio through a provision for loan losses charged to income. In providing for the allowance for loan losses, we consider historical loss experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s

ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement, will not be collectible. Factors considered in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. We determine the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Once a loan is determined to be impaired, when principal or interest becomes 90 days past due or when collection becomes uncertain, the accrual of interest and amortization of deferred loan origination fees is discontinued ("non-accrual status"), and any accrued and unpaid interest income is reversed. Loans placed on non-accrual status are returned to accrual status when all delinquent principal and interest payments are collected and the collectability of future principal and interest payments is reasonably assured. Loan losses are charged against the allowance when we believe the uncollectibility of a loan balance is certain. Subsequent recoveries, if any, are credited to the allowance for loan loss.

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, we do not separately identify individual consumer and residential loans for impairment measurements. Impairment is measured on a loan-by-loan basis for non-homogeneous loans, and a specific allowance is established for individual loans determined to be impaired. Impairment is measured by comparing the carrying value of the impaired loan to the present value of its expected cash flow discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent.

Derivative Instruments and Hedging Activities

Our derivative instruments are carried on the consolidated statement of financial condition at fair value. We utilize these derivative instruments to minimize significant unplanned fluctuations in earnings caused by interest rate volatility. Our company's goal is to manage sensitivity to changes in rates by offsetting the repricing or maturity characteristics of certain assets and liabilities, thereby limiting the impact on earnings. The use of derivative instruments does expose our company to credit and market risk. We manage credit risk through strict counterparty credit risk limits and/or collateralization agreements. At inception, we determine if a derivative instrument meets the criteria for hedge accounting under Topic 815, "Derivatives and Hedging." Ongoing effectiveness evaluations are made for instruments that are designated and qualify as hedges. If the derivative does not qualify for hedge accounting, no assessment of effectiveness is needed.

Income Taxes

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 ("Tax Legislation") was signed into law making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, the transition of U.S international taxation from a worldwide tax system to a territorial system, and a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings as of December 31, 2017.

In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), which allows us to record provisional amounts during a measurement period not to extend beyond one year of the enactment date.

The provision for income taxes and related tax reserves is based on our consideration of known liabilities and tax contingencies for multiple taxing authorities. Known liabilities are amounts that will appear on current tax returns, amounts that have been agreed to in revenue agent revisions as the result of examinations by the taxing authorities, and amounts that will follow from such examinations but affect years other than those being examined. Tax contingencies are liabilities that might arise from a successful challenge by the taxing authorities taking a contrary position or interpretation regarding the application of tax law to our tax return filings. Factors considered in estimating our liability are results of tax audits, historical experience, and consultation with tax attorneys and other experts.

Topic 740 (“Topic 740”), “Income Taxes,” clarifies the accounting for uncertainty in income taxes recognized in an entity’s financial statements and prescribed recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, Topic 740 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

Goodwill and Intangible Assets

Under the provisions of Topic 805, “Business Combinations,” we record all assets and liabilities acquired in purchase acquisitions, including goodwill and other intangible assets, at fair value. Determining the fair value of assets and liabilities requires certain estimates.

Goodwill for certain acquisitions is deductible for tax purposes. The amortization of goodwill for tax purposes creates a cash tax savings due to a reduction in the current taxes payable. We have recorded cash tax savings for the nine months ending September 30, 2018 of \$4.4 million, and anticipate cumulative future cash savings of \$52.2 million as of result of the tax amortization of goodwill.

In accordance with Topic 350, “Intangibles – Goodwill and Other,” indefinite-life intangible assets and goodwill are not amortized. Rather, they are subject to impairment testing on an annual basis, or more often if events or circumstances indicate there may be impairment. This test involves assigning tangible assets and liabilities as well as identified intangible assets and goodwill to reporting units and comparing the fair value of each reporting unit to its carrying amount. If the fair value is less than the carrying amount, a further test is required to measure the amount of the impairment. We have elected to test for goodwill impairment in the third quarter of each calendar year.

We test goodwill for impairment on an annual basis and on an interim basis when certain events or circumstances exist. We test for impairment at the reporting unit level, which is generally at the level of or one level below our company’s business segments. For both the annual and interim tests, we have the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, we determine it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then performing the two-step impairment test is not required. However, if we conclude otherwise, we are then required to perform the first step of the two-step impairment test. Goodwill impairment is determined by comparing the estimated fair value of a reporting unit with its respective carrying value. If the estimated fair value exceeds the carrying value, goodwill at the reporting unit level is not deemed to be impaired. If the estimated fair value is below carrying value, however, further analysis is required to determine the amount of the impairment. Additionally, if the carrying value of a reporting unit is zero or a negative value and it is determined that it is more likely than not the goodwill is impaired, further analysis is required. The estimated fair values of the reporting units are derived based on valuation techniques we believe market participants would use for each of the reporting units. Our annual goodwill impairment testing was completed as of October 1, 2017, with no impairment identified.

The goodwill impairment test requires us to make judgments in determining what assumptions to use in the calculation. Assumptions, judgments, and estimates about future cash flows and discount rates are complex and often subjective. They can be affected by a variety of factors, including, among others, economic trends and market conditions, changes in revenue growth trends or business strategies, unanticipated competition, discount rates, technology, or government regulations. In assessing the fair value of our reporting units, the volatile nature of the securities markets and industry requires us to consider the business and market cycle and assess the stage of the cycle in estimating the timing and extent of future cash flows. In addition to discounted cash flows, we consider other information, such as public market comparables and multiples of recent mergers and acquisitions of similar businesses. Although we believe the assumptions, judgments, and estimates we have made in the past have been reasonable and appropriate, different assumptions, judgments, and estimates could materially affect our reported financial results.

Identifiable intangible assets, which are amortized over their estimated useful lives, are tested for potential impairment whenever events or changes in circumstances suggest that the carrying value of an asset or asset group may not be fully recoverable.

Recent Accounting Pronouncements

See Note 2 of the Notes to Consolidated Financial Statements for information regarding the effect of new accounting pronouncements on our consolidated financial statements.

Off-Balance Sheet Arrangements

Information concerning our off-balance sheet arrangements is included in Note 20 of the Notes to Consolidated Financial Statements. Such information is hereby incorporated by reference.

Contractual Obligations

Our contractual obligations have not materially changed from those reported in our Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Risk Management

Risks are an inherent part of our business and activities. Management of these risks is critical to our soundness and profitability. Risk management at our company is a multi-faceted process that requires communication, judgment, and knowledge of financial products and markets. Our senior management group takes an active role in the risk management process and requires our business units to assist in the identification, assessment, monitoring, and control of various risks. The principal risks involved in our business activities are: market (interest rates and equity prices), credit, operational, and regulatory and legal.

We have adopted policies and procedures concerning Enterprise Risk Management. The Risk Management/Corporate Governance Committee of the Board of Directors, in exercising its oversight of management's activities, conducts periodic reviews and discussions with management regarding the guidelines and policies governing the processes by which risk assessment and risk management are handled.

Market Risk

The potential for changes in the value of financial instruments owned by our company resulting from changes in interest rates and equity prices is referred to as "market risk." Market risk is inherent to financial instruments, and accordingly, the scope of our market risk management procedures includes all market risk-sensitive financial instruments.

We trade tax-exempt and taxable debt obligations, including U.S. treasury bills, notes, and bonds; U.S. government agency and municipal notes and bonds; bank certificates of deposit; mortgage-backed securities; and corporate obligations. We are also an active market maker in over-the-counter equity securities. In connection with these activities, we may maintain inventories in order to ensure availability and to facilitate customer transactions.

Changes in value of our financial instruments may result from fluctuations in interest rates, credit ratings, equity prices, and the correlation among these factors, along with the level of volatility.

We manage our trading businesses by product and have established trading departments that have responsibility for each product. The trading inventories are managed with a view toward facilitating client transactions, considering the risk and profitability of each inventory position. Position limits in trading inventory accounts are established by our Enterprise Risk Management department and monitored on a daily basis within the business units. We monitor inventory levels and results of the trading departments, as well as inventory aging, pricing, concentration, securities ratings, and risk sensitivities.

We are also exposed to market risk based on our other investing activities. These investments consist of investments in private equity partnerships, start-up companies, venture capital investments, and zero coupon U.S. government securities and are included under the caption "Investments" on the consolidated statements of financial condition.

Interest Rate Risk

We are exposed to interest rate risk as a result of maintaining inventories of interest rate-sensitive financial instruments and from changes in the interest rates on our interest-earning assets (including client loans, stock borrow activities, investments, inventories, and resale agreements) and our funding sources (including client cash balances, FHLB advances, stock lending activities, bank borrowings, and repurchase agreements), which finance these assets. The collateral underlying financial instruments at the broker-dealer is repriced daily, thus requiring collateral to be

delivered as necessary. Interest rates on client balances and stock borrow and lending produce a positive spread to our company, with the rates generally fluctuating in parallel.

We manage our inventory exposure to interest rate risk by setting and monitoring limits and, where feasible, hedging with offsetting positions in securities with similar interest rate risk characteristics. While a significant portion of our securities inventories have contractual maturities in excess of five years, these inventories, on average, turn over several times per year.

Additionally, we monitor, on a daily basis, the Value-at-Risk (“VaR”) in our trading portfolios using a ten-day horizon and report VaR at a 99% confidence level. VaR is a statistical technique used to estimate the probability of portfolio losses based on the statistical analysis of historical price trends and volatility. This model assumes that historical changes in market conditions are representative of future changes, and trading losses on any given day could exceed the reported VaR by significant amounts in unusually volatile markets. Further, the model involves a number of assumptions and inputs. While we believe that the assumptions and inputs we use in our risk model are reasonable, different assumptions and inputs could produce materially different VaR estimates.

The following table sets forth the high, low, and daily average VaR for our trading portfolios during the nine months ended September 30, 2018, and the daily VaR at September 30, 2018 and December 31, 2017 (in thousands):

	Nine Months Ended September 30, 2018			VAR Calculation at September	
	High	Low	Daily Average	30, 2018	December 31, 2017
Daily VaR	\$7,281	\$2,422	\$ 4,447	\$4,765	\$ 5,636

Stifel Bancorp's interest rate risk is principally associated with changes in market interest rates related to residential, consumer, and commercial lending activities, as well as FDIC-insured deposit accounts to customers of our broker-dealer subsidiaries and to the general public.

Our primary emphasis in interest rate risk management for Stifel Bancorp is the matching of assets and liabilities of similar cash flow and repricing time frames. This matching of assets and liabilities reduces exposure to interest rate movements and aids in stabilizing positive interest spreads. Stifel Bancorp has established limits for acceptable interest rate risk and acceptable portfolio value risk. To ensure that Stifel Bancorp is within the limits established for net interest margin, an analysis of net interest margin based on various shifts in interest rates is prepared each quarter and presented to Stifel Bancorp's Board of Directors. Stifel Bancorp utilizes a third-party model to analyze the available data.

The following table illustrates the estimated change in net interest margin at September 30, 2018, based on shifts in interest rates of up to positive 200 basis points and negative 200 basis points:

Hypothetical change in interest rates	Projected change in net interest margin
+200	7.1 %
+100	3.4
0	—
-100	(3.3)
-200	(21.0)

The following GAP Analysis table indicates Stifel Bancorp's interest rate sensitivity position at September 30, 2018 (in thousands):

Repricing Opportunities		
0-6 Months	1-5 Years	5+ Years

Edgar Filing: STIFEL FINANCIAL CORP - Form 10-Q

7-12
Months

Interest-earning assets:				
Loans	\$5,667,104	\$254,746	\$2,027,797	\$695,997
Securities	5,475,377	236,531	1,232,395	1,078,919
Interest-bearing cash	94,007	—	—	—
	\$11,236,488	\$491,277	\$3,260,192	\$1,774,916
Interest-bearing liabilities:				
Transaction accounts and savings	\$12,435,567	\$—	\$—	\$—
Certificates of deposit	1,339,057	409,532	223,800	—
Borrowings	814,000	—	250,000	149,280
	\$14,588,624	\$409,532	\$473,800	\$149,280
GAP	(3,352,136)	81,745	2,786,392	1,625,636
Cumulative GAP	\$(3,352,136)	\$(3,270,391)	\$(483,999)	\$1,141,637

We maintain a risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings caused by interest rate volatility. Our goal is to manage sensitivity to changes in rates by hedging the maturity characteristics of Fed funds-based affiliated deposits, thereby limiting the impact on earnings. By using derivative instruments, we are exposed to credit and market risk on those derivative positions. We manage the market risk associated with interest rate contracts by establishing and monitoring limits as to the types and degree of risk that may be undertaken. Our interest rate hedging strategies may not work in all market environments and, as a result, may not be effective in mitigating interest rate risk.

Equity Price Risk

We are exposed to equity price risk as a consequence of making markets in equity securities. We attempt to reduce the risk of loss inherent in our inventory of equity securities by monitoring those security positions constantly throughout each day.

Our equity securities inventories are repriced on a regular basis, and there are no unrecorded gains or losses. Our activities as a dealer are client-driven, with the objective of meeting clients' needs while earning a positive spread.

Credit Risk

We are engaged in various trading and brokerage activities, with the counterparties primarily being broker-dealers. In the event counterparties do not fulfill their obligations, we may be exposed to risk. The risk of default depends on the creditworthiness of the counterparty or issuer of the instrument. We manage this risk by imposing and monitoring position limits for each counterparty, monitoring trading counterparties, conducting regular credit reviews of financial counterparties, reviewing security concentrations, holding and marking to market collateral on certain transactions, and conducting business through clearing organizations, which guarantee performance.

Our client activities involve the execution, settlement, and financing of various transactions on behalf of our clients. Client activities are transacted on either a cash or margin basis. Credit exposure associated with our private client business consists primarily of customer margin accounts, which are monitored daily and are collateralized. We monitor exposure to industry sectors and individual securities and perform analyses on a regular basis in connection with our margin lending activities. We adjust our margin requirements if we believe our risk exposure is not appropriate based on market conditions.

We have accepted collateral in connection with resale agreements, securities borrowed transactions, and customer margin loans. Under many agreements, we are permitted to sell or repledge these securities held as collateral and use these securities to enter into securities lending arrangements or to deliver to counterparties to cover short positions. At September 30, 2018, the fair value of securities accepted as collateral where we are permitted to sell or repledge the securities was \$2.7 billion, and the fair value of the collateral that had been sold or repledged was \$495.5 million.

By using derivative instruments, we are exposed to credit and market risk on those derivative positions. Credit risk is equal to the fair value gain in a derivative, if the counterparty fails to perform. When the fair value of a derivative contract is positive, this generally indicates that the counterparty owes our company and, therefore, creates a repayment risk for our company. When the fair value of a derivative contract is negative, we owe the counterparty and, therefore, have no repayment risk. We minimize the credit (or repayment) risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically by senior management.

Stifel Bancorp extends credit to individual and commercial borrowers through a variety of loan products, including residential and commercial mortgage loans, home equity loans, construction loans, and non-real-estate commercial and consumer loans. Bank loans are generally collateralized by real estate, real property, or other assets of the borrower. Stifel Bancorp's loan policy includes criteria to adequately underwrite, document, monitor, and manage credit risk. Underwriting requires reviewing and documenting the fundamental characteristics of credit, including character, capacity to service the debt, capital, conditions, and collateral. Benchmark capital and coverage ratios are utilized, which include liquidity, debt service coverage, credit, working capital, and capital to asset ratios. Lending limits are established to include individual, collective, committee, and board authority. Monitoring credit risk is accomplished through defined loan review procedures, including frequency and scope.

We are subject to concentration risk if we hold large positions, extend large loans to, or have large commitments with a single counterparty, borrower, or group of similar counterparties or borrowers (i.e., in the same industry). Securities purchased under agreements to resell consist of securities issued by the U.S. government or its agencies. Receivables from and payables to clients and stock borrow and lending activities, both with a large number of clients and counterparties, and any potential concentration is carefully monitored. Stock borrow and lending activities are executed under master netting agreements, which gives our company right of offset in the event of counterparty default. Inventory and investment positions taken and commitments made, including underwritings, may involve exposure to individual issuers and businesses. We seek to limit this risk through careful review of counterparties and borrowers and the use of limits established by our senior management group, taking into consideration factors including the financial strength of the counterparty, the size of the position or commitment, the expected duration of the position or commitment, and other positions or commitments outstanding.

Operational Risk

Operational risk generally refers to the risk of loss resulting from our operations, including, but not limited to, improper or unauthorized execution and processing of transactions, deficiencies in our technology or financial operating systems, and inadequacies or breaches in our control processes. We operate different businesses in diverse markets and are reliant on the ability of our employees and systems to process a large number of transactions. These risks are less direct than credit and market risk, but managing them is critical, particularly in a rapidly changing environment with increasing transaction volumes. In the event of a breakdown or improper operation of systems or improper action by employees, we could suffer financial loss, regulatory sanctions, and damage to our reputation. In order to mitigate and control operational risk, we have developed policies and procedures that are designed to identify and manage operational risk at appropriate levels throughout the organization and within such departments as Accounting, Operations, Information Technology, Legal, Compliance, and Internal Audit. These control mechanisms attempt to ensure that operational policies and procedures are being followed and that our various businesses are operating within established corporate policies and limits. Business continuity plans exist for critical systems, and redundancies are built into the systems as deemed appropriate.

Regulatory and Legal Risk

Legal risk includes the risk of private client group customer claims for sales practice violations. While these claims may not be the result of any wrongdoing, we do, at a minimum, incur costs associated with investigating and defending against such claims. See further discussion on our legal reserves policy under “Critical Accounting Policies and Estimates” in Item 2, Part I and “Legal Proceedings” in Item 1, Part II of this report. In addition, we are subject to potentially sizable adverse legal judgments or arbitration awards, and fines, penalties, and other sanctions for non-compliance with applicable legal and regulatory requirements. We are generally subject to extensive regulation by the SEC, FINRA, and state securities regulators in the different jurisdictions in which we conduct business. As a bank holding company, we are subject to regulation by the Federal Reserve. Our bank subsidiaries are subject to regulation by the FDIC. As a result, we are subject to a risk of loss resulting from failure to comply with banking laws. Our international subsidiary, SNEL, is subject to the regulatory supervision and requirements of the FCA in the United Kingdom. We have comprehensive procedures addressing issues such as regulatory capital requirements, sales and trading practices, use of and safekeeping of customer funds, the extension of credit, including margin loans, collection activities, money laundering, and record keeping. We act as an underwriter or selling group member in both equity and fixed income product offerings. Particularly when acting as lead or co-lead manager, we have potential legal exposure to claims relating to these securities offerings. To manage this exposure, a committee of senior executives review proposed underwriting commitments to assess the quality of the offering and the adequacy of due diligence investigation.

Our company, as a bank and financial holding company, is subject to regulation, including capital requirements, by the Federal Reserve. Stifel Bancorp is subject to various regulatory capital requirements administered by the Federal Deposit Insurance Corporation (“FDIC”) and state banking authorities. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our company's and Stifel Bancorp's financial statements.

ITEM 4. CONTROLS AND PROCEDURES

Our disclosure controls and procedures are designed to, among other things, provide reasonable assurance that material information, both financial and non-financial, and other information required under the securities laws to be disclosed is accumulated and communicated to senior management, including the Chief Executive Officer and Chief Financial Officer, on a timely basis. Under the direction of the Chief Executive Officer and Chief Financial Officer, management has evaluated our disclosure controls and procedures as of September 30, 2018 and has concluded that

the disclosure controls and procedures were adequate and effective as of such date.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Please see our discussion set forth under Item 3. “Legal Proceedings” in our Annual Report on Form 10-K for the year ended December 31, 2017 and Item 1. “Financial Statements” in our Form 10-Q for the quarter ended September 30, 2018.

ITEM 1A. RISK FACTORS

The discussion of our business and operations should be read together with the risk factors contained in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC. These risk factors describe various risks and uncertainties to which we are or may become subject. These risks and uncertainties have the potential to affect our business, financial condition, results of operations, cash flows, strategies or prospects in a material and adverse manner.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no unregistered sales of equity securities during the quarter ended September 30, 2018. The following table sets forth information with respect to purchases made by or on behalf of Stifel Financial Corp. or any “affiliated purchaser” (as defined in Rule 10b-10(a)(3) under the Securities Exchange Act of 1934, as amended), of our common stock during the quarter ended September 30, 2018.

	Total Number of Shares Purchased	Average Price Paid per share	Total Number of Shares as Part of Publically Announced Plans	Maximum Number of Shares That May Yet be Purchased Under the Plan or Program
July 1 - 31, 2018	77,391	\$ 53.09	77,391	6,240,235
August 1 - 31, 2018	190,150	54.20	190,150	6,050,085
September 1 - 30, 2018	40,864	54.23	40,864	6,009,221
	308,405	\$ 53.93	308,405	

We have an ongoing authorization from the Board of Directors to repurchase our common stock in the open market or in negotiated transactions. At September 30, 2018, the maximum number of shares that may yet be purchased under this plan was 6.0 million.

ITEM 6. EXHIBITS

Exhibit No.	Description
11.1	<u>Statement Re: Computation of per Share Earnings (The calculation of per share earnings is included in Part I, Item 1 in the Notes to Consolidated Financial Statements (Earnings Per Share) and is omitted here in accordance with Section (b)(11) of Item 601 of Regulation S-K).</u>
31.1	<u>Rule 13a-14(a) Certification of Chief Executive Officer.</u>
31.2	<u>Rule 13a-14(a) Certification of Chief Financial Officer.</u>
32.1	<u>Section 1350 Certification of Chief Executive Officer.*</u>
32.2	<u>Section 1350 Certification of Chief Financial Officer.*</u>
101.INS	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Consolidated Statements of Financial Condition as of September 30, 2018 and December 31, 2017; (ii) Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and 2017; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017; (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017; and (vi) Notes to Consolidated Financial Statements.

*The certifications attached as Exhibits 32.1 and 32.2 that accompany this Quarterly Report on Form 10-Q, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Stifel Financial Corp. under the Securities Act of 1933, as amended, or the Securities Act of 1934, as amended, whether made before or after the date of this Form 10-Q, irrespective of any general incorporation language contained in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

STIFEL FINANCIAL CORP.

/s/ Ronald J. Kruszewski
Ronald J. Kruszewski

Chairman of the Board and

Chief Executive Officer

/s/ James M. Marischen
James M. Marischen

Chief Financial Officer

Date: November 6, 2018