LEGG MASON INC
Form 10-K
May 27, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2011

or

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

For the transition period from to

Commission File Number 1-8529

LEGG MASON, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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

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

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

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

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

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

As of September 30, 2010 the aggregate market value of the registrant's voting stock, consisting of the registrant's common stock, held by non-affiliates was $4,250,549,977.

As of May 20th, 2011, the number of shares outstanding of the registrant's common stock was 148,776,428.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its Annual Meeting of Stockholders to be held on July 26, 2011 are incorporated by reference into Part III of this Report.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I

ITEM 1. BUSINESS.

General

Legg Mason is a global asset management company. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other pooled investment vehicles. We offer these products and services directly and through various financial intermediaries. We operate our business as two divisions: Americas and International. Within each division, we provide services through a number of asset managers, each of which generally markets its products and services under its own brand name and, in many cases, distributes retail products and services through a centralized retail distribution network.

Legg Mason, Inc. was incorporated in Maryland in 1981 to serve as a holding company for its various subsidiaries. The predecessor companies to Legg Mason trace back to Legg & Co., a Maryland-based broker-dealer formed in 1899. Our subsequent growth has occurred primarily through internal expansion and the acquisition of asset management and broker-dealer firms. In December 2005, Legg Mason completed a transaction in which it sold its primary broker-dealer businesses to concentrate on the asset management industry.

Additional information about Legg Mason is available on our website at *http://www.leggmason.com*. We make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and our proxy statements. Investors can find this information under the "Investor Relations" section of our website. These reports are available through our website as soon as reasonably practicable after we electronically file the material with, or furnish it to, the Securities and Exchange Commission ("SEC"). In addition, the Legg Mason, Inc. Corporate Governance Principles, our Code of Conduct for all employees and directors and the charters for the committees of our Board of Directors are also available on our corporate website at *http://www.leggmason.com* under the "About Us Corporate Governance" section. A copy of any of these materials may also be obtained, free of charge, by sending a written request to Corporate Secretary, Legg Mason, Inc., 100 International Drive, Baltimore, MD 21202. As required, and within the time frames required, by the SEC or the New York Stock Exchange ("NYSE"), we will post on our website any amendments to the Code of Conduct and any waiver of the Code of Conduct applicable to any executive officer, director, chief financial officer, principal accounting officer or controller. The information on our website is not incorporated by reference into this Report.

Unless the context otherwise requires, all references in this Report to "we," "us," "our" and "Legg Mason" include Legg Mason, Inc. and its predecessors and subsidiaries, and the term "asset managers" refers to the asset management businesses operated by our subsidiaries. References to "fiscal year 2011" or other fiscal years refer to the 12-month period ended March 31st of the year specified.

Business Developments During the Fiscal Year Ended March 31, 2011

During fiscal year 2011, in addition to the normal course operation of our business, we launched a business model streamlining initiative, reorganized and realigned our executive management team and improved our earnings. In May 2010, we launched the streamlining initiative that we expect will drive increased profitability and growth while transitioning certain shared services, such as information technology services, to our investment managers, who are closer to the actual client relationships, without any corresponding change to their revenue sharing or other compensation arrangements. The initiative involves headcount reductions in operations, technology and other administrative areas at the corporate level, which may be partially offset by headcount increases at the asset managers, and will ultimately enable us to eliminate a portion of the corporate office space that was dedicated to our operations and technology employees. The plan is projected to result in annual costs savings of approximately $130 million to $150 million, which we expect to achieve on a run rate basis by the fourth quarter of fiscal year 2012, which is when we expect the plan to be substantially complete.

During fiscal year 2011, we reorganized and realigned our executive management team. During the fiscal year, two executive officers left the company, we hired Peter Nachtwey as Chief Financial Officer, and Thomas Lemke, our

Table of Contents

General Counsel, joined the senior executive team. In December 2010, we announced a realignment of the responsibilities of our executive team to better align with our growth strategy and the changes in the team members. We expect that this management realignment will lead to the elimination of our two division structure during fiscal year 2012. However, as of March 31, 2011, we continued to operate our business through two divisions.

During fiscal year 2011, we experienced a 24% growth in our net income as compared to fiscal year 2010. Our financial results were significantly helped by strong equity and fixed income markets during the year. Those strong markets contributed to $56.3 billion in market appreciation increases to our assets under management during the year. We also experienced $61 billion in outflows from our assets under management during the fiscal year, which is 25% lower than the outflows experienced in the prior fiscal year. During the fiscal year, our assets under management shifted in favor of higher yielding assets, with equity assets increasing to 28% of our total managed assets at March 31, 2011 from 25.4% at March 31, 2010. In addition, we continued to manage our balance sheet during the fiscal year, resulting in approximately $1 billion in available cash at the end of the fiscal year despite our repurchasing 14.6 million shares of our common stock during the fiscal year at a cost of $445 million.

See "Item 8. Financial Statements and Supplementary Data" for the revenues, net income and assets of the company, which operates in a single reportable business segment. See Note 17 of Notes to Consolidated Financial Statements in Item 8 of this Report for our revenues generated in, and our long-lived assets (consisting of intangible assets and goodwill) located in, each of the principal geographic areas in which we conduct business. See Note 8 of Notes to Consolidated Financial Statements in Item 8 of this Report for our deferred tax assets in the U.S. and in all other countries, in aggregate.

Business Overview

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

Our subsidiary asset managers primarily earn revenues by charging fees for managing the investment assets of clients. Fees are typically calculated as a percentage of the value of assets under management and vary with the type of account managed, the amount of assets in the account, the asset manager and the type of client. Accordingly, the fee income of each of our asset managers will typically increase or decrease as its average assets under management increases or decreases. We may also earn performance fees from certain accounts if the investment performance of the assets in the account meets or exceeds a specified benchmark during a measurement period. For the fiscal years ended March 31, 2011, 2010 and 2009, $96.7 million, $71.5 million and $17.4 million, respectively, of our $2.4 billion, $2.3 billion and $2.9 billion in total investment advisory revenues represented performance fee revenues. Increases in assets under management generally result from inflows of additional assets from new and existing clients and from appreciation in the value of client assets (including investment income earned on client assets). Conversely, decreases in assets under management generally result from client redemptions and withdrawals and from depreciation in the value of client assets. Our assets under management may also increase as a result of business acquisitions, or decrease as a result of dispositions.

Table of Contents

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

	Assets Under Management	Equity Assets	% of Total in Equity Assets	Fixed Income Assets	% of Total in Fixed Income Assets	Liquidity Assets	% of Total in Liquidity Assets
2011	$ 677.6	$ 189.6	28.0%	$ 356.6	52.6%	$ 131.4	19.4%
2010	684.5	173.8	25.4	364.3	53.2	146.4	21.4
2009	632.4	126.9	20.1	357.6	56.5	147.9	23.4

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

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

We conduct our business primarily through 13 asset managers. Our asset managers are individual businesses, each of which generally focuses on a portion of the asset management industry in terms of the types of assets managed (primarily equity or fixed income), the types of products and services offered, the investment styles utilized, the distribution channels used, and the types and geographic locations of its clients. Each asset manager is housed in one or more different subsidiaries, all of the voting equity of which is directly or indirectly owned by Legg Mason. Each of our asset managers is generally operated as a separate business, in many cases with certain distribution functions being provided by the parent company and other affiliates, that typically markets its products and services under its own brand name. Consistent with this approach, we have in place revenue sharing agreements with certain of our asset managers, Bartlett & Co., Batterymarch Financial Management, Brandywine Global Asset Management, Legg Mason Capital Management, Permal Group, Private Capital Management, Royce & Associates, and Western Asset Management Company and/or certain of their key officers. Pursuant to these revenue sharing agreements, a specified percentage of the asset manager's revenues (or, in certain cases, revenues net of certain third party distribution expenses) is required to be distributed to us and the balance of the revenues (or net revenues) is retained to pay operating expenses, including salaries and bonuses, with specific compensation allocations being determined by the asset manager's management, subject to corporate management approval in certain cases, but excluding certain non-cash expenses such as amortization of acquired intangible assets and excluding income taxes. Although, without renegotiation, the revenue sharing agreements impede our ability to increase our profit margins from these businesses, we believe the agreements are important because they help us retain and attract talented employees and provide management of the businesses with incentives to (i) grow the asset managers' revenues, since management is able to participate in the revenue growth through the portion that is retained; and (ii) control operating expenses, which will increase the portion of the revenues retained that is available to fund growth initiatives and for incentive compensation.

Table of Contents

We operate our business, based on how we manage and distribute our products, as two divisions: Americas and International. Each division includes our fund families that are domiciled in the region and our separate account management and distribution operations that are located in the region. One of our asset managers, Western Asset Management Company, has significant business both within the United States and internationally, and thus its operations are divided between the divisions. Within a division, we allocate all separate account management operations of the asset managers that are located in the applicable region to that division, regardless of whether they serve clients located in other regions. For example, while many of our Americas managers provide separate account management services to clients located outside the United States, we include these operations in the Americas division.

Our assets under management by division (in billions) as of March 31 of each of the three years indicated below were as follows:

	2011	2010	2009
Americas	$ 476.8	$ 475.8	$ 446.7
International	200.8	208.7	185.7
Total	$ 677.6	$ 684.5	$ 632.4

Americas includes all assets, other than international fund assets, managed by the asset managers in this division and all assets in our U.S.-domiciled funds. International includes all assets, other than U.S. fund assets, managed by the managers in this division and all assets in our international funds.

For the fiscal years ended March 31, 2011, 2010 and 2009, our aggregate operating revenues were $2.8 billion, $2.6 billion and $3.4 billion, respectively. Our operating revenues by division (in millions) in each of those fiscal years were as follows:

	2011	2010	2009
Americas	$ 1,917.9	$ 1,864.2	$ 2,290.5
International	866.4	770.7	1,066.9
Total	$ 2,784.3	$ 2,634.9	$ 3,357.4

In reporting our operating revenues by division, we include in each division all revenues of the asset managers within the division, except that revenues earned for providing investment advisory services to proprietary funds are included in the division containing the funds. Revenues of Western Asset Management are divided so that the revenues from its U.S. separate account management operations are attributed to Americas and the revenues of its international separate account management operations are attributed to International.

Americas Division

Our Americas division includes the separate account management operations of our U.S.-based asset managers and our mutual, closed-end and other proprietary fund operations, and distribution operations that are located in the United States. The asset managers in this division provide a wide range of separate account investment management services to institutional clients, including pension and other retirement plans, corporations, insurance companies, endowments and foundations and governments, and to high net worth individuals and families. This division also sponsors and manages various groups of U.S. mutual funds, including the Legg Mason Funds, The Royce Funds and the Western Asset Funds, and provides investment advisory services to a number of retail separately managed account programs. For the fiscal years ended March 31, 2011, 2010 and 2009, our Americas division generated aggregate revenues of $1.9 billion, $1.9 billion and $2.3 billion, respectively.

As of March 31, 2011 and 2010, our Americas division managed assets with a value of $476.8 billion and $475.8 billion, respectively. As of March 31, 2011, 61% of the assets managed by this division were fixed income and liquidity assets managed by Western Asset Management. Of the assets managed by this division at March 31, 2011,

Table of Contents

approximately 49% were in institutional separate accounts, approximately 42% were in funds and approximately 9% were in retail or high net worth separately managed accounts.

Asset Managers in this Division

Western Asset Management Company is a leading global fixed income asset manager for institutional clients. Western Asset operates globally; its U.S. operations are assigned to this division and its international operations are part of the International division. Headquartered in Pasadena, California, Western Asset's U.S. operations also include investment operations in New York City. Western Asset offers a broad range of products spanning the yield curve and encompassing the world's major bond markets, including a suite of limited duration and core products, emerging market and high yield portfolios, municipal portfolios and a variety of sector-oriented and global products. Among the services Western Asset provides are management of separate accounts and management of mutual funds, closed-end funds and other structured investment products. As of March 31, 2011, Western Asset's U.S. operations managed assets with a value of $289 billion.

ClearBridge Advisors is an equity asset management firm based in New York, New York that also has an office in San Francisco, California. ClearBridge Advisors provides asset management services to 29 of the equity funds (including balanced funds and closed-end funds) in the Legg Mason Funds, to retail separately managed account programs and, primarily through separate accounts, to institutional clients. ClearBridge also sub-advises domestic mutual funds that are sponsored by third parties. ClearBridge offers a diverse array of investment styles and disciplines, designed to address a range of investment objectives. Significant ClearBridge investment styles include large-cap growth and core equity management. In managing assets, ClearBridge generally utilizes a bottom-up, primary research intensive, fundamental approach to security selection that seeks to identify companies with the potential to provide solid economic returns relative to their risk-adjusted valuations. As of March 31, 2011, ClearBridge managed assets with a value of $57 billion.

Global Currents Investment Management, a manager of international and global equity portfolios, was combined with ClearBridge and currently operates as a division of ClearBridge. As of March 31, 2011, the Global Currents division, which is based in Wilmington, Delaware, managed assets with a value of $4 billion.

Royce & Associates is investment advisor to all of The Royce Funds. In addition, Royce & Associates manages other pooled and separate accounts, primarily institutional. Headquartered in New York City, Royce & Associates generally invests in smaller company stocks, using a value approach. Royce & Associates' stock selection process generally seeks to identify companies with strong balance sheets and the ability to generate free cash flow. Royce & Associates pursues securities that are priced below its estimate of the company's current worth. As of March 31, 2011, Royce & Associates managed assets with a value of $43 billion.

Brandywine Global Investment Management manages equity and fixed income, including global and international fixed income, portfolios for institutional and, through wrap accounts, high net worth individual clients. Brandywine, based in Philadelphia, Pennsylvania, pursues a value investing approach in its management of both equity and fixed income assets. As of March 31, 2011, Brandywine managed assets with a value of $31 billion.

Batterymarch Financial Management manages U.S., international and emerging markets equity portfolios for institutional clients. Based in Boston, Massachusetts, Batterymarch primarily uses a quantitative approach to asset management. The firm's investment process for U.S. and international portfolios, other than emerging market portfolios, is designed to enhance the fundamental investment disciplines by using quantitative tools to process fundamental data. As of March 31, 2011, Batterymarch managed assets with a value of $22 billion.

Legg Mason Capital Management is an equity asset management business based in Baltimore, Maryland that manages both institutional separate accounts and mutual funds. Legg Mason Capital Management manages eight Legg Mason Funds, and also sub-advises the mutual fund managed by the joint venture described below and investment products sponsored by our other subsidiaries. Applying the principles of value investing, Legg Mason Capital Management's investment process uses a variety of techniques to develop an estimate of the worth of a business over the long term. The objective is to identify companies where the intrinsic value of the business is significantly higher than the

Table of Contents

current market value. As of March 31, 2011, Legg Mason Capital Management managed assets with a value of $14 billion.

We and one of our employees each own 50% of a consolidated joint venture subsidiary that serves as investment manager of one equity fund, Legg Mason Opportunity Trust, within the Legg Mason Funds family. We include all of the assets managed by this joint venture, $1.8 billion at March 31, 2011 in our assets under management.

Legg Mason Investment Counsel & Trust Company, National Association is a national banking association with authority to exercise trust powers. Headquartered in Baltimore, Maryland, Legg Mason Investment Counsel & Trust Company provides services as a trustee for trusts established by our individual and employee benefit plan clients and manages fixed income and equity assets. Legg Mason Investment Counsel, LLC, a subsidiary of Legg Mason Investment Counsel & Trust, manages equity, fixed income and balanced portfolios for high net worth individual and institutional clients and several of our proprietary mutual funds. Legg Mason Investment Counsel is headquartered in Baltimore, Maryland and operates out of offices in New York City, Cincinnati, Philadelphia, and Bryn Mawr, Pennsylvania. As of March 31, 2011, Legg Mason Investment Counsel & Trust Company, including its subsidiaries, managed assets with a value of $10 billion.

Legg Mason Investment Counsel & Trust Company had a second subsidiary asset manager, Barrett Associates, that had assets under management of $1.3 billion as of March 31, 2011, which was sold in April 2011.

Bartlett & Co. manages balanced, equity and fixed income portfolios for high net worth individual and institutional clients and follows a value investment philosophy. Bartlett is based in Cincinnati, Ohio. Bartlett's research and stock selection criteria emphasize a variety of fundamental factors, and Bartlett seeks to invest in companies that generally possess some combination of the following characteristics: financial strength, potential for growth of earnings and dividends, attractive profitability characteristics, sustainable competitive advantage and shareholder-oriented management. As of March 31, 2011, Bartlett managed assets with a value of $3 billion.

Private Capital Management manages equity assets for high net worth individuals and families, institutions, endowments and foundations in separate accounts and through limited partnerships. Based in Naples, Florida, Private Capital Management's value-focused investment philosophy leads to an effort to build an all-cap portfolio consisting primarily of securities of mid-cap companies that possess several basic elements, including significant free cash flow, a substantial resource base and a management team with the ability to correct problems. As of March 31, 2011, Private Capital Management managed assets with a value of $2 billion.

In addition to these asset managers, three of our International managers, Esemplia Emerging Markets, Permal Group and Western Asset Management's international operations, also manage funds in the Legg Mason Funds family that are part of the Americas division.

United States Mutual Funds and Retail Separately Managed Account Programs

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

The Legg Mason Funds consist of 122 mutual funds and 24 closed-end funds in the United States, almost all of which are managed by our subsidiary asset managers. The mutual and closed-end funds within the Legg Mason Funds include 70 equity funds (including balanced funds) that invest in a wide spectrum of equity securities utilizing numerous investment styles, including large-and mid-cap growth funds and international funds. The fixed income and liquidity mutual funds and closed-end funds within the Legg Mason Funds include 76 funds that offer a similarly wide variety of investment strategies and objectives, including income funds, investment grade funds and municipal securities funds. Many of our asset managers provide investment advisory services to the Legg Mason Funds. As of March 31, 2011 and 2010, the Legg Mason Funds included $142.7 billion and $148.9 billion in assets, respectively, in their mutual funds and closed-end funds, of which approximately 27% and 25%, respectively, were equity assets,

Table of Contents

approximately 18% and 16%, respectively, were fixed income assets and approximately 55% and 59%, respectively, were liquidity assets.

The Royce Funds consist of 32 mutual funds and three closed-end funds, most of which invest primarily in smaller-cap company stocks using a value approach. The funds differ in their approaches to investing in smaller or micro-cap companies and the universe of securities from which they can select. As of March 31, 2011 and 2010, The Royce Funds included $41.7 billion and $32.2 billion in assets, respectively, substantially all of which were equity assets. The Royce Funds are distributed through non-affiliated fund supermarkets, our centralized funds distribution operations, non-affiliated wrap programs, and direct distribution. In addition, two of the portfolios in The Royce Funds are distributed only through insurance companies.

Our mutual funds business also includes the Western Asset Funds, a proprietary family of 10 mutual funds that are marketed primarily to institutional investors and retirement plans through our institutional funds marketing group. Western Asset Management Company manages these funds using a team approach under the supervision of Western Asset's investment committee. The funds primarily invest in fixed income securities. As of March 31, 2011 and 2010, the Western Asset Funds included $14.1 billion and $15.2 billion in assets, respectively.

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

Distribution

Our funds distribution groups distribute and support our U.S. mutual funds, closed-end funds and retail separately managed account program business. In general, our fund distributors are housed in separate subsidiaries from our asset managers.

Our Americas division includes our U.S. mutual fund support and distribution operations. These operations support and distribute the Legg Mason Funds, The Royce Funds and the Western Asset Funds, and include our mutual fund wholesalers and our institutional funds marketing group. Our mutual fund wholesalers distribute the Legg Mason Funds through a number of third-party distributors. Historically, many of the Legg Mason Funds were principally distributed through the retail brokerage business of Citigroup. While we have worked to diversify our distributors, the retail business created by the merger of Morgan Stanley's brokerage and Citigroup's Smith Barney brokerage remains the primary distributor of the Legg Mason Funds. Other than the previously announced transfer of liquidity assets, we are not able to predict the long-term effect of the merger of those two businesses on our ability to continue to successfully distribute our funds through them, or the costs of doing so. Our institutional funds marketing group distributes institutional share classes of the Legg Mason Funds and the Western Asset Funds to institutional clients and also distributes variable annuity sub-advisory services provided by our asset managers to insurance companies. Our institutional liquidity funds are primarily distributed by Western Asset's distributors. In addition to our centralized funds distribution group, Royce & Associates' distributors also distribute The Royce Funds.

In addition to distributing funds, our wholesalers also support our retail separately managed account program services. These services are provided through programs sponsored by Morgan Stanley Smith Barney's retail business, as well as other financial institutions.

Each of the asset managers in this division has its own marketing groups that distribute its separate account management services to institutions or high net worth individuals and families. The institutional marketing groups distribute asset management services to potential clients, both directly and through consultants. Consultants play a large role in the institutional asset management business by helping clients select and retain asset managers. Institutional asset management clients and their consultants tend to be highly sophisticated and investment performance-driven. The high

Table of Contents

net worth individual marketing groups distribute asset management services for high net worth families and individuals both directly to clients and indirectly through financial intermediaries.

International Division

Our International division includes the separate account management operations of our asset managers that are based outside the United States, our non-U.S.-domiciled fund operations and our international distribution operations. The asset managers in this division provide a wide range of separate account investment management services primarily to institutional clients and provide asset management services to the funds that we sponsor. This division also contains our funds-of-hedge funds business, which sponsors and manages funds that invest in numerous hedge funds. In addition, this division sponsors proprietary equity, fixed income, liquidity and balanced funds that are domiciled and distributed in countries around the globe. For the fiscal years ended March 31, 2011, 2010 and 2009, this division generated revenues of $866 million, $771 million and $1.1 billion, respectively.

As of March 31, 2011 and 2010, our International division managed assets with a value of $200.8 billion and $208.7 billion, respectively. Approximately 80% of the assets managed by this division as of March 31, 2011 were in fixed income or liquidity accounts managed by Western Asset and approximately 10% were in funds-of-hedge funds managed by Permal.

Asset Managers in this Division

Western Asset Management Company has asset management offices in the United Kingdom, Japan, Brazil, Australia and Singapore. Western Asset's international fixed income business includes management of liquidity products and Asian, Australian, Japanese, Brazilian, European, Canadian and United Kingdom local currency fixed income securities. As of March 31, 2011, Western Asset's international operations managed assets with a value of $165.9 billion.

Permal Group Ltd. is a leading global funds-of-hedge funds management firm. Permal's products include both directional and absolute return strategies, and are available through multi-manager and single manager funds, separately managed accounts and structured products sponsored by several large financial institutions. Permal selects from among thousands of investment managers and investment firms in designing portfolios that are intended to meet a wide variety of specific investment objectives, including global, regional, class and sector specific offerings. In managing its directional offerings, Permal's objective is to participate significantly in strong markets, preserve capital in down or volatile markets and outperform market indices over a full market cycle with reduced risk and volatility. In managing its absolute return strategies, Permal seeks to achieve positive investment returns in all market conditions with low correlation to the overall equity markets. As of March 31, 2011, Permal managed assets with a value of $19.9 billion.

Esemplia Emerging Markets is an emerging markets equities investment manager. Headquartered in London and with an office in Hong Kong, Esemplia offers a range of portfolio management strategies, including core long only and alpha extension portfolios, to institutional investors around the world, including pension funds and sovereign wealth funds. Esemplia has a disciplined, systematic and fundamental-based investment process with an integrated, top-down (via country strategy) and bottom-up (via stock and sector) equity security selection process. As of March 31, 2011, Esemplia managed assets with a value of $5.8 billion.

Legg Mason's business in Poland engages in portfolio management, servicing and distribution of both separate account management services and local funds in Poland. Based in Warsaw, the firm provides portfolio management services for primarily equity assets to institutions, including corporate pension plans and insurance companies, and, through funds distributed through banks and insurance companies, individual investors. As of March 31, 2011, Legg Mason's Poland business managed assets with a value of $1.3 billion.

Legg Mason Australian Equities is an Australian asset management business that offers Australian equity products, Australian property trusts and asset allocation products. Based in Melbourne, the firm follows a fundamental, intrinsic value approach to portfolio management and its guiding philosophy is a belief that in-depth research can generate superior long-term investment performance. As of March 31, 2011, Legg Mason Australian Equities managed assets with a value of $863 million.

Table of Contents

During fiscal year 2011, we sold Congruix Investment Management, a Singapore-based Asian equity manager that was part of this division.

In addition to these asset managers, a number of our Americas asset managers also provide investment management services to the funds that are part of the International division. These managers include Batterymarch Financial Management, Brandywine Global, ClearBridge, Legg Mason Capital Management, Private Capital Management and Royce & Associates.

International Funds

Our International division manages, supports and distributes numerous proprietary funds across a wide array of global fixed income, liquidity and equity investment strategies. Our international funds include a broad range of cross border funds that are domiciled in Ireland and Luxembourg and are sold in a number of countries across Asia, Europe and Latin America. These funds also include local fund ranges that are available for distribution in the United Kingdom, Australia, Japan, Singapore, Poland, Hong Kong and Canada. In addition, our international funds include funds-of-hedge funds managed by Permal that are sold to non-U.S. investors. Other than the funds-of-hedge funds, all of our international funds are distributed and serviced by Legg Mason's international distribution group, as discussed below. Our international funds include equity, fixed income, liquidity, balanced and funds-of-hedge funds that are primarily managed or sub-advised by Batterymarch Financial Management, Brandywine Global, ClearBridge, Esemplia, Legg Mason Capital Management, Permal, Private Capital Management, Royce & Associates and Western Asset Management. In aggregate, we sponsor and manage more than 260 of these international funds, which, as of March 31, 2011 and 2010, had an aggregate of approximately $103.6 billion and $95.3 billion in assets, respectively.

Distribution

Our international distribution group offers our investment management services to individual and institutional investors across Asia, Europe and the Americas. This group operates out of distribution offices in 19 cities in 15 countries and is the sole distributor of our cross border funds globally and our international local funds in their respective countries. The goal of our international distributors is to be a global partner for firms that utilize or distribute asset management products around the world, but also to be viewed as a local partner through an understanding of the nuances and needs of each local market that they cover. These distributors seek to develop deep distribution relationships with retail banks, private banks, asset managers, fund platforms, pension plans and insurance plans. Our international distribution offices also work with our asset managers on a case-by-case basis to take advantage of preferences for local distributors or to meet regulatory requirements in distributing products and services into their local markets.

Legg Mason Investments is the largest business component within our international distribution group. It is responsible for the distribution and servicing of cross border and local fund ranges across Europe, the Americas and Asia. Legg Mason Investments has offices in locations including London, Paris, Milan, Frankfurt, Madrid, Singapore, Hong Kong, Taipei, Miami, Santiago and New York. These office locations understate the global nature of our distribution efforts, as Legg Mason Investments distributes cross border funds in more than 25 countries around the world, and works with our distribution operations in Japan and Canada to explore opportunities to sell cross border funds in those locations. This global presence provides Legg Mason Investments with the capabilities to provide a platform of sales, service, marketing and product that can cater to the different distribution dynamics in each of the three regions that it covers. Client coverage is local, coordinated across regions, and encompasses multiple distribution channels including fund-of-fund buyers, private banks, fund platforms, insurance companies, intermediaries and distribution partners. The extent to which each channel takes precedence in any one market is governed by local market dynamics.

Legg Mason Australia Distribution is primarily responsible for the distribution in Australia of pooled investment vehicles sub-managed by Legg Mason Australian Equities and several of our other asset managers. These distribution operations are run from offices in Melbourne and Sydney, and seek to distribute products primarily to retail investors, pension plans, retail-offer funds, fund-of-fund managers, insurance companies, and government funds/agencies.

Table of Contents

Legg Mason Canada distributes Legg Mason-managed products in Canada and also services and is responsible for investment oversight of balanced accounts and Canadian domiciled pooled investment vehicles that are sub-advised by our asset managers. Legg Mason Canada operates from offices in Toronto and Montreal, and primarily distributes products to pension plans, endowments, foundations, banks and mutual fund companies (for sub-advisory services) and separately managed account programs.

Legg Mason Japan is responsible for the distribution of domestic investment funds, cross border funds and institutional separate accounts in Japan. Its primary market is the retail market which includes retail banks, private banks, asset managers, fund platforms and insurance companies. Legg Mason Japan also provides support services for our cross border funds.

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

Permal's products and services are sold primarily outside the United States to non-U.S. high net worth investors through a network of financial intermediaries. Permal's relationships with its financial intermediaries have resulted in wide international distribution of Permal's products and services.

Employees

At March 31, 2011, 2010 and 2009, we had 3,395, 3,550 and 3,890 employees, respectively. Under our streamlining initiative, we expect to reduce our corporate work force by approximately 325 positions by January 1, 2012. None of our employees is covered by a collective bargaining agreement. We consider our relations with our employees to be satisfactory. However, competition for experienced asset management personnel is intense and from time to time we may experience a loss of valuable personnel. We recognize the importance to our business of hiring, training and retaining skilled professionals.

Competition

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

Competition in our business periodically has been affected by significant developments in the asset management industry. See "Item 1A. Risk Factors Competition in the Asset Management Industry Could Reduce our Revenues and Net Income."

Regulation

The asset management industry in the United States is subject to extensive regulation under both federal and state securities and other laws. The SEC is the federal agency charged with administration of the federal securities laws. Our distribution activities also may be subject to regulation by federal agencies, self-regulatory organizations and state securities commissions in those states in which we conduct business. In addition, asset management firms are subject to regulation by various foreign governments, securities exchanges, central banks and regulatory bodies, particularly in those countries where they have established offices. Due to the extensive laws and regulations to which we are subject,

Table of Contents

we must devote substantial time, expense and effort to remaining current on, and addressing, legal and regulatory compliance issues.

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

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

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

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

Table of Contents

Net Capital Requirements

Our broker-dealer subsidiaries are subject to net capital rules that mandate that they maintain certain levels of capital. In addition, certain of our subsidiaries that operate outside the United States are subject to net capital or liquidity requirements in the jurisdictions in which they operate. For example, in addition to requirements in other jurisdictions, our United Kingdom-based subsidiaries and our Singapore-based subsidiaries are subject to the net capital requirements of the Financial Services Authority and the Monetary Authority of Singapore, respectively.

ITEM 1A. RISK FACTORS.

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

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

At March 31, 2011, on a consolidated basis, we had approximately $1.5 billion in total indebtedness, excluding debt of consolidated investment vehicles for which we are not responsible, and total stockholders' equity of $5.8 billion, and our goodwill and other intangible assets were $1.3 billion and $3.9 billion, respectively. As of March 31, 2011, we had $265 million of additional borrowing capacity available under our various credit agreements, subject to certain conditions and compliance with the covenants in our outstanding indebtedness. As a result of this substantial indebtedness, we are required to use a significant portion of our cash flow to service principal and interest on our debt, which will limit the cash flow available for other business opportunities. In addition, these servicing obligations would increase in the future if we incur additional indebtedness.

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

The level of our indebtedness could:

- limit our ability to obtain additional debt financing in the future or to borrow under our existing credit facilities (our principal bank debt facilities require that (i) our ratio of net debt (total debt less unrestricted cash in excess of working capital) to Consolidated EBITDA (as defined therein) not exceed 2.5 to 1 and (ii) our ratio of Consolidated EBITDA to total cash interest payments on certain Indebtedness (as defined therein) exceeds 4 to 1 while another debt facility prevents us from incurring additional debt, with certain exceptions, if our total debt to Consolidated EBITDA (as defined therein) exceeds 2.5 to 1);

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

- limit our flexibility, including our ability to react to competitive and other changes in the industry and economic conditions and our ability to provide support, should we elect to do so, to funds that our subsidiaries manage; and

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

As of March 31, 2011, under the terms of our bank credit agreements our ratio of net debt to Consolidated EBITDA was 1.1 and our ratio of Consolidated EBITDA to interest expense was 12.9, and, therefore, Legg Mason was in compliance with its bank financial covenants. If our net income significantly declines for any reason, it may be difficult to remain in compliance with these covenants. Similarly, to the extent that we spend our available cash for purposes other than repaying debt or acquiring businesses that increase our EBITDA, we will increase our net debt to Consolidated EBITDA ratio. Although there are actions that we may take if our financial covenant compliance becomes an issue, there can be no assurance that Legg Mason will remain in compliance with its bank debt covenants. We

Table of Contents

anticipate that we will have available cash to repay all or a portion of our bank debt, should it be necessary. In addition, under the terms of the debt to Consolidated EBITDA ratio covenant that we entered into in connection with the issuance of the 2.5% senior convertible notes, we may not, with certain exceptions, incur additional debt at any time when the ratio exceeds 2.5. As of March 31, 2011, the ratio was 2.6 and thus the only new debt we could have incurred would be as allowed by the covenant exceptions.

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

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

Approximately 19% of our assets under management as of March 31, 2011 consisted of assets in money market funds. Money market funds seek to preserve a stable net asset value. The money market funds our asset managers manage have always maintained this stable net asset value. However, there is no guarantee that this stable net asset value will be achieved in the future. Market conditions could lead to severe liquidity or security pricing issues, which could impact their net asset values. If the net asset value of a money market fund managed by our asset managers were to fall below its stable net asset value, we would likely experience significant redemptions in assets under management and reputational harm, which could have a material adverse effect on our revenues or net income.

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

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

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

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

In addition, in the ordinary course of our business we may reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. For example, during fiscal years 2010 and 2011, we voluntarily waived certain fees from or assumed certain expenses of money market funds for competitive reasons. If our revenues decline without a commensurate reduction in our expenses, our net income will be reduced. During fiscal years 2008 through 2010, several of our key equity and fixed income asset managers generated poor investment performance, on a relative basis or an absolute basis, in certain products or accounts that they managed. These investment performance issues contributed to a significant reduction in their assets under management and revenues and a reduction in performance fees. Although our overall investment performance improved significantly in fiscal year 2010 and was mixed during fiscal year 2011, there is typically a lag before improvements in investment performance produce a positive effect on

Table of Contents

asset flows. There can be no assurances as to when investment performance issues will cease to influence our assets under management and revenues.

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

Our investment advisory and administrative contracts are generally terminable at will or upon relatively short notice, and investors in the mutual funds that we manage may redeem their investments in the funds at any time without prior notice. Institutional and individual clients can terminate their relationships with us, reduce the aggregate amount of assets under management, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, changes in investment preferences of clients, changes in our reputation in the marketplace, changes in management or control of clients or third-party distributors with whom we have relationships, loss of key investment management or other personnel and financial market performance. This risk is underscored by the fact that we have one international client that represents approximately 5% of our total assets under management (although it generates less than 2% of our operating revenues). In addition, in a declining securities market, the pace of mutual fund redemptions and withdrawal of assets from other accounts could accelerate. Poor investment performance generally or relative to other investment management firms tends to result in decreased purchases of fund shares, increased redemptions of fund shares, and the loss of institutional or individual accounts. Due in part to investment performance issues, we have experienced net outflows of equity and fixed income assets under management for the last five and three fiscal years, respectively. While the rate of outflows decreased in fiscal year 2011, there can be no assurances as to when, or if, the flows will reverse. During fiscal years 2011 and 2010 we had $61.1 billion and $82.0 billion, respectively, in aggregate net client outflows. The fiscal year 2011 outflows included $37.0 billion in fixed income asset outflows, $15.9 billion in liquidity asset outflows and $8.2 billion in equity asset outflows.

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

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

Our assets under management can generate very different revenues per dollar of managed assets based on factors such as the type of asset managed (equity assets generally produce greater revenues than fixed income assets), the type of client (institutional clients generally pay lower fees than other clients), the type of asset management product or service provided and the fee schedule of the asset manager providing the service. A shift in the mix of our assets under management from higher revenue-generating assets to lower revenue-generating assets may result in a decrease in our revenues even if our aggregate level of assets under management remains unchanged or increases. A decrease in our revenues, without a commensurate reduction in expenses, will reduce our net income. We experienced such a shift in the mix of our assets under management during fiscal years 2009 and 2008. While this trend reversed during fiscal year 2010 and fiscal year 2011, during which our equity assets under management increased from $173.8 billion (25% of our total assets under management) on March 31, 2010 to $189.6 billion (28% of our total assets under management) on March 31, 2011, there can be no assurance that this reversal will continue.

We May Not Receive the Benefits that we Expect from our Initiative to Streamline our Business Model

On May 10, 2010, we announced an initiative to streamline our business model to increase operating efficiency and overall profitability and growth. This initiative will include transitioning certain support services to our asset

Table of Contents

managers, our Americas distribution group sharing in revenue on retail based assets under management and reductions in our corporate staff. Our ability to realize the projected benefits of the initiative is subject to many risks, and no assurances can be given that we will achieve the expected results. These risks include the possibility that one or more of our asset managers, due to market conditions or for other reasons, does not take on, operationally or financially, some or all of the services that we plan to transition; that market conditions or other factors result in a lower rate of assets under management growth or worse financial results than we currently anticipate; and that we are not able to reduce our corporate costs as much as we currently plan. In addition, we might have to incur higher costs than currently anticipated to complete the initiative, and, for any number of reasons, the initiative might not be completed on the current timetable. Finally, our business is dynamic, and we may elect to incur currently unexpected incremental expenses from time to time to grow and better support our business that would partially offset the benefits of the initiative.

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

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

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

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

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

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

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

We experienced such a decline in the equity and fixed income markets during fiscal year 2009 which contributed to a decline in our assets under management and revenues during the year. While this market decline reversed in fiscal years 2010 and 2011, the markets generally have not returned to their prior levels. If our revenues decline without a commensurate reduction in our expenses, our net income will be reduced.

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

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

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

The current historically low interest rate environment affects the yields of money market funds, which are based on the income from the underlying securities less the operating costs of the funds. With short term interest rates at or near zero, the operating expenses of money market funds may become greater than the income from the underlying securities. During fiscal years 2010 and 2011, we voluntarily waived certain fees or assumed expenses of money market funds for competitive reasons such as to maintain positive yields. These actions have reduced our revenues and net income, and have continued into the present fiscal year.

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

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

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

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

We May Engage in Strategic Transactions That Could Create Risks

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

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

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

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

Regulatory Matters May Negatively Affect our Business and Results of Operations

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

Table of Contents

business prospects. In addition, the regulatory environment in which we operate frequently changes and has seen significant increased regulation in recent years. In particular, we have incurred significant additional costs as a result of regulatory changes affecting U.S. mutual funds and changes to European mutual fund regulation, including the Undertakings for Collective Investments in Transferable Securities Directives (UCITs). We may be adversely affected as a result of new or revised legislation or regulations or by changes in the interpretation or enforcement of existing laws and regulations. For example, we note that the federal government has made, and has proposed further, significant changes to the regulatory structure of the financial services industry. We also note that recommendations for regulatory reform in the liquidity asset management business include the imposition of banking and banking-like regulations on investment advisors, the creation of net capital requirements for investment advisors and changes in the rules governing money market mutual fund net asset value calculations. Any of these revisions could adversely affect our liquidity asset management business and our results of operations. Our business and results of operations can also be adversely affected by federal, state and foreign regulatory issues and proceedings.

Instances of criminal activity and fraud by participants in the asset management industry, disclosures of trading and other abuses by participants in the financial services industry and massive governmental intervention and investment in the financial markets and financial firms have led the U.S. government and regulators to consider increasing the rules and regulations governing, and oversight of, the U.S. financial system. This activity has resulted in changes to the laws and regulations governing the asset management industry and more aggressive enforcement of the existing laws and regulations. These revisions to the laws and regulations are an ongoing process. The cumulative effect of these actions may result in increased expenses, or lower management or other fees, and therefore adversely affect the revenues or profitability of our business.

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

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

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

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

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

Many aspects of our business involve substantial risks of liability. In the normal course of business, our asset managers are from time to time named as defendants or co-defendants in lawsuits, or are involved in disputes that involve the threat of lawsuits, seeking substantial damages. We are also involved from time to time in governmental and self-regulatory organization investigations and proceedings. Similarly, the investment funds that our asset managers manage are subject to actual and threatened lawsuits and governmental and self-regulatory organization investigations and proceedings, any of which could harm the investment returns or reputation of the applicable fund or result in our asset managers being liable to the funds for any resulting damages. There has been an increased incidence of litigation and regulatory investigations in the asset management industry in recent years, including customer claims as well as class action suits seeking substantial damages.

Table of Contents

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

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

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

The asset management contracts under which we manage client assets, including contracts with investment funds, often specify guidelines or contractual requirements that we are obligated to observe in providing asset management services. A failure to comply with these guidelines or requirements could result in damage to our reputation, liability to the client or the client reducing its assets under our management, any of which could cause our revenues and net income to decline.

Loss of Key Personnel Could Harm our Business

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

The Soundness of Other Financial Institutions Could Adversely Affect our Business

Volatility in the markets in the recent past has highlighted the interconnection of the global markets and demonstrated how the deteriorating financial condition of one institution may materially and adversely impact the performance of other institutions. Legg Mason, and the funds and accounts that we manage, has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial industry. We, and the funds and accounts we manage, may be exposed to credit or other risk in the event of a default by a counterparty or client, or in the event of other unrelated systemic failures in the markets.

Table of Contents

Our Business is Subject to Numerous Operational Risks and Risks that we May Incur Charges Related to Leased Facilities

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

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

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

We continue to be exposed to the risk of incurring charges related to subleases or vacant space for several of our leased offices. As of March 31, 2011, our future commitments from third parties under non-cancellable subleases were approximately $149 million, which in total, net of reserves, effectively offsets obligations under our leases for the properties. As of March 31, 2011, our total future lease commitments for office space that we have vacated and are seeking to sublease decreased to approximately $13 million, of which we have previously reserved $7 million through lease charges to our earnings. Under generally accepted accounting principles, at the time a sublease is entered into or space is deemed permanently abandoned, we must incur a charge equal to the present value of the amount by which the commitments under the lease exceeds the amount due, or amount expected to be paid, under a sublease. As a result, in a period of declining commercial lease markets, we are exposed to the risk of incurring charges relating to any premises we are seeking to sublease resulting from longer periods to identify sub-tenants and reduced market rent rates leading to new sub-tenants paying less in rent than we are paying under our lease. In connection with our business model streamlining initiative, we plan to incur transition-related charges for consolidating leased office space and thus abandoning leased properties. We expect that the total transition-related charges will be within our estimates, but no assurances can be given that our estimates will prove correct. Also, if a sub-tenant defaults on its sublease, we would likely incur a charge for the rent that we will incur during the period that we expect would be required to sublease the premises and any reduction in rent that current market rent rates lead us to expect a new sub-tenant will pay. This risk is underscored by the fact that one sub-tenant represents approximately 55% of the future sublease rent commitments described above. There can be no assurance that we will not recognize additional lease-related charges, which may be material to our results of operations.

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

Determining goodwill and intangible assets, and evaluating them for impairment, requires significant management estimates and judgment, including estimating value and assessing life in connection with the allocation of purchase price in the acquisition creating them. Our goodwill and intangible assets may become impaired as a result of any number of factors, including losses of investment management contracts or declines in the value of managed assets. Any impairment of goodwill or intangibles could have a material adverse effect on our results of operations. For example, during the year ended March 31, 2009, we incurred aggregate impairment charges of $1.3 billion ($863 million, net of taxes) relating to goodwill and intangible assets including acquired asset management contracts and trade names. Our $53 million in net amortizable intangible assets represent asset management contracts purchased in several transactions. These assets could become impaired if we experience client attrition at a rate faster than projected or fees charged under the contracts are reduced. The domestic mutual fund contracts acquired in the 2005 acquisition of the Citigroup Asset Management business ("CAM") of $2,502 million and the Permal funds-of-hedge funds contracts of $947 million account for approximately 65% and 25%, respectively, of our indefinite-life intangible assets, while the goodwill in our Americas and International divisions aggregates $1.3 billion. Changes in the assumptions underlying projected cash flows from the assets or reporting units, resulting from market conditions, reduced assets under management or other factors, could result in an impairment of any of these assets. As of December 31, 2010, the date of our most recent annual testing, assuming all other factors remain the same, actual results and changes in assumptions for the domestic mutual fund and Permal fund-of-hedge funds contracts would have to cause our cash flow projections over the long-term to deviate more than 20% and 25%, respectively, from projections or the discount rate would have to increase by about 1.8 and 2.5 percentage points, respectively, for the asset to be deemed impaired. Similarly, assuming all other factors remain the same, actual results and changes in assumptions for the Americas and International divisions would have to cause our cash flow projections over the long-term to decrease approximately 47% and 50%, respectively, from previous projections or the discount rates would have to increase by approximately 5.9 and 7.0 percentage points, respectively, for the goodwill to be deemed impaired. There can be no assurances that market turmoil or asset outflows, or other factors, will not produce an impairment. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations   Critical Accounting Policies and Estimates   Intangible Assets and Goodwill."

Deferred Tax Assets May Not Be Fully Realizable

As of March 31, 2011, we had approximately $683 million in U.S. federal deferred tax assets, which represent tax benefits that we expect to realize in future periods. Under accounting rules, we are required to recognize a charge to earnings to reduce our deferred tax assets if it is determined that any future tax benefits are not likely to be realized before they expire. Deferred tax assets generated in U.S. jurisdictions resulting from net operating losses generally expire 20 years after they are generated. Those resulting from foreign tax credits generally expire 10 years after they are generated. In order to realize these future tax benefits, we estimate that we must generate approximately $4.6 billion in future U.S. earnings, approximately $129 million of which must be in the form of foreign source income, before the benefits expire. There can be no assurances that we will achieve this level of earnings before some portion of these tax benefits expires. In addition, our belief that we will likely be able to realize these future tax benefits is based in part upon our estimates of the timing of other differences in revenue and expense recognition between tax returns and financial statements and our understanding of the application of tax regulations, which may prove to be incorrect for any number of reasons, including future changes in tax or accounting regulations. If we are required to recognize a charge to earnings to reduce our deferred tax assets, the charge may be material to our earnings or financial condition.

Table of Contents

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

A portion of our investment advisory and related fee revenues is derived from performance fees. Our asset managers earn performance fees under certain client agreements if the investment performance in the portfolio meets or exceeds a specified benchmark. If the investment performance does not meet or exceed the investment return benchmark for a particular period, the asset manager will not generate a performance fee for that period and, if the benchmark is based on cumulative returns, the asset manager's ability to earn performance fees in future periods may be impaired. We earned $96.7 million, $71.5 million and $17.4 million in performance fees during fiscal 2011, 2010 and 2009, respectively. Performance fees may become more common in our industry. An increase in performance fees, or in performance-based fee arrangements with our clients, could create greater fluctuations in our revenues.

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

Our asset managers operate in a number of jurisdictions outside of the United States on behalf of international clients. We have offices in numerous countries and many cross border and local proprietary funds that are domiciled outside the United States. Our international operations require us to comply with the legal requirements of various foreign jurisdictions, expose us to the political consequences of operating in foreign jurisdictions and subject us to expropriation risks, expatriation controls and potential adverse tax consequences which, among other things, make it more difficult to repatriate to the United States the cash that we generate outside the U.S. Our foreign business operations are also subject to the following risks:

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

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

Our ability to market and distribute mutual funds and certain other investment products that we manage is significantly dependent on access to third-party financial intermediaries that distribute these products. These distributors are generally not contractually required to distribute our products, and typically offer their clients various investment products and services, including proprietary products and services, in addition to and in competition with our products and services. Relying on third-party distributors also exposes us to the risk of increasing costs of distribution, as we compensate them for selling our products and services in amounts that are agreed between them and us but which, in many cases, are largely determined by the distributor. Many of the funds we manage were historically primarily distributed through Citigroup's retail brokerage business. While we have strived to diversify our distributors, the retail business created by the merger of Morgan Stanley's brokerage and Citigroup's Smith Barney brokerage remains our primary fund distributor. While the third-party distributors are compensated for distributing our products and services, there can be no assurances that we will be successful in distributing our products and services through them. In addition, mergers and other corporate transactions among distributors may affect our distribution relationships. For example, we are not able to predict the long-term effect of the merger of the Smith Barney and Morgan Stanley businesses on our ability to continue to successfully distribute our funds and other products through them, or the costs of doing so. During the quarter ended June 30, 2011, Morgan Stanley Smith Barney amended certain historic Smith Barney brokerage programs providing for investment in liquidity funds that our asset managers manage, which resulted in a $16 billion reduction in our liquidity assets under management. In addition, we expect further amendments to result in an additional $7 billion in liquidity assets under management being transferred over the next 15 months. We are also in negotiations with Morgan Stanley Smith Barney over whether an additional $20 billion in liquidity assets under management that are distributed through the Morgan Stanley Smith Barney business will remain with our managers. If we are unable to distribute our products and services successfully, it will adversely affect our revenues and net income, and any increase in distribution-related expenses could adversely affect our net income.

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

We lease all of our office space. Our headquarters and certain other functions are located in an office building in Baltimore, Maryland, in which we currently hold under lease approximately 372,000 square feet, of which approximately 82,000 square feet has been subleased to third parties.

Our asset managers and other subsidiaries are housed in office buildings in 32 cities in 18 countries around the world. The largest of the leases include:

- ClearBridge Advisors, Western Asset Management Company and our distribution and administrative services subsidiaries currently occupy approximately 130,000 square feet in an office building located in New York, New York in which we hold under lease approximately 193,000 square feet. The remaining 63,000 square feet has been subleased to a third party;

- Our distribution and administrative services subsidiaries occupy approximately 150,000 square feet in an office building located in Stamford, Connecticut; and

- Western Asset Management Company's headquarters is housed in an office building in Pasadena, California in which we occupy approximately 190,000 square feet.

See Note 9 of Notes to Consolidated Financial Statements in Item 8 of this Report for a discussion of our lease obligations.

ITEM 3. LEGAL PROCEEDINGS.

Our current and former subsidiaries are the subject of customer complaints, have been named as defendants or co-defendants in various lawsuits alleging substantial damages and have received subpoenas and are currently involved in certain governmental and self-regulatory organization investigations and proceedings. These proceedings arise primarily from asset management, securities brokerage, and investment banking activities. Some of these proceedings relate to public offerings of securities in which one or more of our prior subsidiaries participated as a member of the underwriting syndicate. We are also aware of litigation against certain underwriters of offerings in which one or more of our former subsidiaries was a participant, but where the former subsidiary is not now a defendant. In these latter cases, it is possible that we may be called upon to contribute to settlements or judgments. In the 2005 transaction with Citigroup, we transferred to Citigroup the subsidiaries that constituted our private client brokerage and capital markets businesses, thus transferring the entities that would have primary liability for most of the customer complaint, litigation and regulatory liabilities and proceedings arising from those businesses. However, as part of that transaction, we agreed to indemnify Citigroup for most customer complaint, litigation and regulatory liabilities of our former private client brokerage and capital markets businesses that result from pre-closing events. In addition, the asset management business we acquired from Citigroup is a defendant in a number of legal actions, including class action litigation, arising from pre-closing asset management activities, some of which seek substantial damages. That business is also involved in

certain regulatory matters related to its business activities prior to the closing. Under the terms of the transaction agreement with Citigroup, Citigroup has agreed to indemnify us for certain legal matters, including all currently known pre-closing legal matters, of the former CAM business. While the ultimate resolution of any pre-closing matters threatened or pending from our prior brokerage and capital markets businesses or the former CAM business can not be determined at this time, based on current information and after consultation with legal counsel, management believes that any accrual or range of reasonably possible losses as of March 31, 2011 is not material. While the ultimate resolution of any other threatened or pending litigation and other matters cannot be currently determined, in the opinion of our management, after consultation with legal counsel, the resolution of these matters will not have a material adverse effect on our financial position. We are currently unable to estimate the potential losses in any one period and, our results of operations and cash flows could be materially affected during a period in which a matter is resolved. See Note 9 of Notes to Consolidated Financial Statements in Item 8 of this Report.

ITEM 4. [REMOVED & RESERVED]

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT.

Information (not included in our definitive proxy statement for the 2011 Annual Meeting of Stockholders) regarding certain of our executive officers is as follows:

Peter H. Nachtwey, age 55, was elected Chief Financial Officer and Senior Executive Vice President of Legg Mason in January 2011 when he joined the firm. From July 2007 through December 2010, Mr. Nachtwey served as Chief Financial Officer of The Carlyle Group, an alternative investment management firm, where he had responsibility for all of the financial and a number of the operational functions at the firm. Prior to The Carlyle Group, Mr. Nachtwey spent more than 25 years at Deloitte and Touche, LLP, an accounting firm, most recently as a Managing Partner of the Investment Management practice.

Ronald R. Dewhurst, age 58, was elected Senior Executive Vice President and Senior Managing Director of Legg Mason in January 2008, was the head of our International division from January 2008 until January 2011 and currently oversees our global investment managers. Mr. Dewhurst served as the Chief Executive Officer of I00F, an investment management company in Australia, from 2004 to 2007. From 1993 to 2002, he held various positions at J.P. Morgan Investment Management and J.P. Morgan Fleming Asset Management, including Head of Asian Equities, Hong Kong; Head of European Equities, London and Head of the Americas, New York. He was also a member of the J.P. Morgan Global Committee for Private Banking and Asset Management.

Thomas P. Lemke, age 56, was elected General Counsel and Senior Vice President of Legg Mason in 2005. Until December 2010, Mr. Lemke was responsible for overseeing our Legal, Compliance and Internal Audit functions. Since December 2010, Mr. Lemke has been responsible for overseeing Legal, Compliance, Internal Audit, Risk Management, Global Fiduciary Platform and U.S. Fund Boards. Prior to joining Legg Mason, Mr. Lemke was a partner at Morgan Lewis, a law firm where he held a senior role in the firm's asset management practice.

Jeffrey A. Nattans, age 44, was elected Senior Vice President of Legg Mason in March 2009 and Executive Vice President in July 2009, previously was responsible for overseeing our Specialized Asset Managers and currently oversees our acquisition and business development activities. Mr. Nattans has been involved in corporate strategy, strategic initiatives, including acquisitions and financings, and the development of Legg Mason's international equity asset management businesses since joining us in 2006. From 1996 to 2006, he served as an investment banker at Goldman, Sachs & Co., a large broker-dealer and investment banking firm.

Joseph A. Sullivan, age 53, was elected Senior Executive Vice President of Legg Mason in September 2008 and until January 2011 was responsible for overseeing our administrative functions as Chief Administrative Officer. Mr. Sullivan currently oversees our global distribution operations. From December 2005 to September 2008 he was responsible for overseeing the fixed income capital markets operations of Stifel Nicolaus, a broker-dealer. From 1993 to December 2005 he oversaw the fixed income capital markets operations of Legg Mason Wood Walker, Legg Mason's broker-dealer subsidiary that was sold in December 2005.

Table of Contents

PART II

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

Shares of Legg Mason, Inc. common stock are listed and traded on the New York Stock Exchange (symbol LM). As of March 31, 2011, there were approximately 1,500 holders of record of Legg Mason common stock. Information with respect to our dividends and stock prices is as follows:

	Quarter ended			
	Mar. 31	Dec. 31	Sept. 30	June 30
Fiscal 2011				
Cash dividend declared per share	$ 0.06	$ 0.06	$ 0.04	$ 0.04
Stock price range:				
High	37.29	37.72	31.04	34.83
Low	32.21	29.68	24.94	27.36
Fiscal 2010				
Cash dividend declared per share	$ 0.03	$ 0.03	$ 0.03	$ 0.03
Stock price range:				
High	31.95	33.70	33.08	26.74
Low	24.00	26.99	22.06	15.53

We expect to continue paying cash dividends. However, the declaration of dividends is subject to the discretion of our Board of Directors. In determining whether to declare dividends, or how much to declare in dividends, our Board will consider factors it deems relevant, which may include our results of operations and financial condition, our financial requirements, general business conditions and the availability of funds from our subsidiaries, including all restrictions on the ability of our subsidiaries to provide funds to us. On May 2, 2011, our Board of Directors declared a regular, quarterly dividend of $.08 per share, increasing the regular, quarterly dividend rate paid on shares of our common stock during the prior fiscal quarter.

Equity Compensation Plan Information

The following table provides information about our equity compensation plans as of March 31, 2011.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by stockholders	6,422,874(1)	$ 59.82(2)	11,759,681(3)(4)
Equity compensation plans not approved by stockholders			

Total	6,422,874(1)	11,759,681(3)(4)

(1) Includes 705,893 shares of Legg Mason Common Stock ("Common Stock") that are held in a trust pending distribution of phantom stock units. The phantom stock units, which are converted into shares of Common Stock on a one-for-one basis upon distribution, were granted to plan participants upon their deferral of compensation or dividends paid on phantom stock units. When amounts are deferred, participants receive a number of phantom stock units equal to the deferred amount divided by 90% to 95% of the fair market value of a share of Common

Table of Contents

Stock. Also includes 75,122 restricted stock units granted to non-employee directors as equity compensation that are converted into shares of Common Stock on a one-for-one basis upon distribution.

(2) Does not include phantom stock units or restricted stock units that will be converted into Common Stock on a one-for-one basis upon distribution at no additional cost, and were granted as described in footnote (1).

(3) In addition, an unlimited number of shares of Common Stock may be issued under the Legg Mason & Co, LLC Deferred Compensation/Phantom Stock Plan upon the distribution of phantom stock units that may be acquired in the future as described in footnote (1).

(4) 8,304,208 of these shares may be issued under our omnibus equity plan as stock options, restricted or unrestricted stock grants or any other form of equity compensation. 392,520 of these shares may be issued under the Legg Mason, Inc. Equity Plan for Non-Employee Directors as grants of stock or restricted stock units. 3,062,953 of these shares may be purchased under our employee stock purchase plan, which acquires the shares that are purchased thereunder in the open market.

Purchases of our Common Stock

The following table sets out information regarding our purchases of Common Stock during the quarter ended March 31, 2011:

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans or programs(1)	(d) Approximate dollar value that may yet be purchased under the plans or programs(1)
January 1, 2011 Through January 31, 2011		$		$ 623,934,899
February 1, 2011 Through February 28, 2011	485,660	35.00	485,660	606,935,893
March 1, 2011 Through March 31, 2011	1,500,842	34.65	1,500,842	554,933,013
Total	1,986,502	$ 34.74	1,986,502	$ 554,933,013

(1) On May 10, 2010, we announced that our Board of Directors replaced a prior stock purchase authorization with a new authorization to purchase up to $1 billion worth of our common stock. There is no expiration date attached to this authorization. We intend to use a portion of our available cash to purchase up to an additional $400 million of our common stock under this authorization during fiscal year 2012, subject to market and our performance, actual cash flows, and other capital needs.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

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

	Years Ended March 31, 2011	2010	2009	2008	2007
OPERATING RESULTS					
Operating revenues	**$ 2,784,317**	$ 2,634,879	$ 3,357,367	$ 4,634,086	$ 4,343,675
Operating expenses, excluding impairment	**2,397,509**	2,313,696	2,718,577	3,432,910	3,315,377
Impairment of goodwill and intangible assets			1,307,970	151,000	
Operating income (loss)	**386,808**	321,183	(669,180)	1,050,176	1,028,298
Other non-operating income (expense)	**(23,315)**	(32,027)	(243,577)	(5,573)	15,556
Other income (expense) of consolidated investment vehicles	**1,704**	17,329	7,796		
Fund support		23,171	(2,283,236)	(607,276)	
Income (loss) from continuing operations before income tax provision (benefit)	**365,197**	329,656	(3,188,197)	437,327	1,043,854
Income tax provision (benefit)	**119,434**	118,676	(1,223,203)	173,496	397,612
Income (loss) from continuing operations	**245,763**	210,980	(1,964,994)	263,831	646,242
Gain on sale of discontinued operations, net of tax[1]					572
Net income (loss)	**245,763**	210,980	(1,964,994)	263,831	646,814
Less: Net income (loss) attributable to noncontrolling interests	**(8,160)**	6,623	2,924	266	(4)
Net income (loss) attributable to Legg Mason, Inc.	**$ 253,923**	$ 204,357	$ (1,967,918)	$ 263,565	$ 646,818

Net income (loss) from continuing operations attributable to Legg Mason, Inc.	**$**	**253,923**	$	204,357	$	(1,967,918)	$	263,565	$	646,246
PER SHARE										
Net income (loss) per share attributable to Legg Mason, Inc. common shareholders:										
Basic	**$**	**1.63**	$	1.33	$	(13.99)	$	1.86	$	4.58
Diluted	**$**	**1.63**	$	1.32	$	(13.99)	$	1.83	$	4.48
Weighted-average shares outstanding:										
Basic		**155,321**		153,715		140,669		142,018		141,112
Diluted(2)		**155,484**		155,362		140,669		143,976		144,386
Dividends declared	**$**	**.20**	$	.12	$	.96	$	.96	$	.81
BALANCE SHEET										
Total assets	**$**	**8,707,756**	$	8,622,632	$	9,232,299	$	11,830,352	$	9,604,488
Long-term debt		**1,201,868**		1,170,334		2,740,190		1,992,231		1,112,624
Total stockholders' equity		**5,770,384**		5,841,724		4,598,625		6,784,641		6,541,490
FINANCIAL RATIOS AND OTHER DATA										
Adjusted income (loss) per diluted share(3)	**$**	**2.83**	$	2.45	$	(8.47)	$	6.11	$	5.86
Operating margin		**13.9%**		12.2%		(19.9)%		22.7%		23.7%
Operating margin, as adjusted(4)		**23.2%**		20.7%		23.9%		35.5%		33.1%
Total debt to total capital(5)		**20.1%**		19.6%		39.4%		26.9%		14.5%
Assets under management *(in millions)*	**$**	**677,646**	$	684,549	$	632,404	$	950,122	$	968,510
Full-time employees		**3,395**		3,550		3,890		4,220		4,030

(1) All attributable to Legg Mason, Inc.

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

(3) Adjusted Income (Loss) (formerly "Cash Income, As Adjusted") is a non-GAAP performance measure. We define Adjusted Income (Loss) as Net Income (Loss) from Continuing Operations Attributable to Legg Mason, Inc., plus amortization and deferred taxes related to intangible assets and goodwill, and imputed interest and tax benefits on contingent convertible debt less deferred income taxes on goodwill and intangible asset impairment, if any. We also adjust for non-core items that are not reflective of our economic performance, such as impairment charges and the impact of tax rate adjustments on certain deferred tax liabilities related to indefinite-life intangible assets and goodwill, and net money market fund support losses (gains). See Supplemental Non-GAAP Information in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(4) Operating margin, as adjusted, is a non-GAAP performance measure we calculate by dividing (i) Operating Income, adjusted to exclude the impact on compensation expense of gains or losses on investments made to fund deferred compensation plans, the impact on compensation expense of gains or losses on seed capital investments by our affiliates under revenue sharing agreements, transition-related costs of streamlining our business model,

income (loss) of consolidated investment vehicles, and impairment charges by (ii) our operating revenues, adjusted to add back net investment advisory fees eliminated upon consolidation of investment vehicles, less distribution and servicing expenses which we use as an approximate measure of revenues that are passed through to third-parties, which we refer to as "adjusted operating revenues." See Supplemental Non-GAAP Information in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

Table of Contents

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

EXECUTIVE OVERVIEW

Legg Mason, Inc., a holding company, with its subsidiaries (which collectively comprise "Legg Mason") is a global asset management firm. Acting through our subsidiaries, we provide investment management and related services to institutional and individual clients, company-sponsored mutual funds and other investment vehicles. We offer these products and services directly and through various financial intermediaries. We have operations principally in the United States of America and the United Kingdom and also have offices in Australia, Bahamas, Brazil, Canada, Chile, China, Dubai, France, Germany, Italy, Japan, Luxembourg, Poland, Singapore, Spain and Taiwan.

We currently operate in one reportable business segment, Asset Management, and manage our business in two divisions or operating segments, Americas and International, which are primarily based on the geographic location of the advisor or the domicile of fund families we manage. The Americas division consists of our U.S.-domiciled fund families, the separate account businesses of our U.S.-based investment affiliates and the domestic distribution organization. Similarly, the International Division consists of our fund complexes, distribution teams and investment affiliates located outside the U.S. In December 2010, we announced a realignment of our executive management team which, among other things, will eliminate the previous separation of the Americas and International divisions into one Global Asset Management business during fiscal 2012. We believe this new structure will allow us to function as a global organization with a single purpose and allow us to focus on future growth opportunities. As of March 31, 2011, there has been no change to the internal executive management reporting and we continued to operate in one reportable business segment, Asset Management, with two divisions, Americas and International.

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

The fees that we charge for our investment services vary based upon factors such as the type of underlying investment product, the amount of assets under management, and the type of services (and investment objectives) that are provided. Fees charged for equity asset management services are generally higher than fees charged for fixed income and liquidity asset management services. Accordingly, our revenues will be affected by the composition of our assets under management. In addition, in the ordinary course of our business, we may reduce or waive investment management fees, or limit total expenses, on certain products or services for particular time periods to manage fund expenses, or for other reasons, and to help retain or increase managed assets. Under revenue sharing agreements, certain of our affiliates retain different percentages of revenues to cover their costs, including compensation. As such, our Net income attributable to Legg Mason, Inc., operating margin and compensation as a percentage of operating revenues are impacted based on which affiliates generate our revenues, and a change in assets under management at one subsidiary can have a dramatically different effect on our revenues and earnings than an equal change at another subsidiary. In addition, from time to time we may agree to changes in revenue sharing agreements and other arrangements with our asset management personnel, which may impact our compensation expenses and profitability.

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

Our financial position and results of operations are materially affected by the overall trends and conditions of the financial markets, particularly in the United States, but increasingly in the other countries in which we operate. Results of any individual period should not be considered representative of future results. Our profitability is sensitive to a variety of factors, including the amount and composition of our assets under management, and the volatility and general level of securities prices and interest rates, among other things. Sustained periods of unfavorable market conditions are likely to affect our profitability adversely. In addition, the diversification of services and products offered, investment performance, access to distribution channels, reputation in the market, attracting and retaining key employees and client relations are significant factors in determining whether we are successful in attracting and retaining clients. The economic downturn of fiscal years 2008 and 2009 contributed to a significant contraction in our business. We have experienced improvement over the past two years, although we have not recovered to pre-downturn levels.

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

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

All references to fiscal 2011, 2010 or 2009 refer to our fiscal year ended March 31 of that year. Terms such as "we," "us," "our," and "Company" refer to Legg Mason.

BUSINESS ENVIRONMENT AND RESULTS OF OPERATIONS

The financial environment globally and in the United States continued to rebound during fiscal 2011, but challenging conditions persisted throughout most of our fiscal year due to uncertainties surrounding the strength of the economic recovery, continued concerns over budget deficits, and high levels of unemployment. The impact of the earthquake that occurred in Japan in March 2011, along with political unrest in the Middle East, have created new uncertainties.

In spite of these global concerns, the markets continued to increase due to steady improvement in consumer confidence, stabilization of still elevated unemployment rates, and improved performance in corporate earnings across many sectors. During fiscal 2011, the Federal Reserve Board held the discount rate at 0.25%, the lowest in history. The financial environment in which we operate continues to be challenging moving into fiscal 2012.

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

	% Change for the year ended March 31,	
Indices[1]	**2011**	**2010**
Dow Jones Industrial Average	**13.48%**	42.68%
S&P 500	**13.37%**	46.57%
NASDAQ Composite Index	**15.98%**	56.87%
Barclays Capital U.S. Aggregate Bond Index	**5.12%**	7.69%
Barclays Capital Global Aggregate Bond Index	**7.15%**	10.23%

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

Table of Contents

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

	Percentage of Operating Revenues Years Ended March 31,			Period to Period Change[1]	
	2011	2010	2009	2011 Compared to 2010	2010 Compared to 2009
Operating Revenues					
Investment advisory fees					
Separate accounts	**29.3%**	30.9%	30.3%	**0.1%**	(19.9)%
Funds	**53.4**	51.9	54.7	**8.7**	(25.5)
Performance fees	**3.5**	2.7	0.5	**35.3**	310.0
Distribution and service fees	**13.6**	14.3	14.2	**1.0**	(21.0)
Other	**0.2**	0.2	0.3	**4.6**	(47.6)
Total operating revenues	**100.0**	100.0	100.0	**5.7**	(21.5)
Operating Expenses					
Compensation and benefits	**41.0**	42.2	33.7	**2.6**	(1.8)
Transition-related compensation	**1.6**			**n/m**	n/m
Total compensation and benefits	**42.6**	42.2	33.7	**6.7**	(1.8)
Distribution and servicing	**25.6**	26.3	28.9	**3.0**	(28.7)
Communications and technology	**5.8**	6.2	5.6	**(0.7)**	(13.4)
Occupancy	**5.0**	6.0	6.2	**(12.2)**	(25.1)
Amortization of intangible assets	**0.8**	0.8	1.1	**0.6**	(37.6)
Impairment of goodwill and intangible assets			39.0	**n/m**	n/m
Other	**6.3**	6.3	5.4	**5.3**	(7.9)
Total operating expenses	**86.1**	87.8	119.9	**3.6**	(42.5)
Operating Income (Loss)	**13.9**	12.2	(19.9)	**20.4**	n/m
Other Income (Expense)					
Interest income	**0.3**	0.3	1.7	**25.7**	(86.9)
Interest expense	**(3.3)**	(4.8)	(5.5)	**(27.0)**	(30.9)
Fund support		0.9	(68.0)	**n/m**	n/m
Other	**2.1**	3.2	(3.5)	**(31.4)**	n/m
Other non-operating income (expense) of consolidated investment vehicles	**0.1**	0.7	0.2	**(90.2)**	n/m
Total other income (expense)	**(0.8)**	0.3	(75.1)	**n/m**	n/m
Income (Loss) before Income Tax Provision (Benefit)	**13.1**	12.5	(95.0)	**10.8**	n/m
Income tax provision (benefit)	**4.3**	4.5	(36.5)	**0.6**	n/m
Net Income (Loss)	**8.8**	8.0	(58.5)	**16.5**	n/m
	(0.3)	0.2	0.1	**n/m**	n/m

Less: Net income (loss) attributable to noncontrolling interest					
Net Income (Loss) Attributable to Legg Mason, Inc.	**9.1%**	7.8%	(58.6)%	**24.3**	n/m

n/m not meaningful

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

Table of Contents

FISCAL 2011 COMPARED WITH FISCAL 2010

Financial Overview

Net income attributable to Legg Mason, Inc. for the year ended March 31, 2011 totaled $253.9 million, or $1.63 per diluted share, compared to $204.4 million, or $1.32 per diluted share, in the prior year. The increase in Net Income was primarily due to the net impact of increased operating revenues, reflecting a more favorable asset mix and increased performance fees, reduced interest expense, and a change in the U.K. tax rate. These increases were offset in part by the impact of transition-related compensation, the impact of gains on fund support recognized in the prior year, and an increase in costs associated with closed-end fund launches. These items are further discussed in "Results of Operations" below. Adjusted Income (see Supplemental Non-GAAP Financial Information) was $439.2 million, or $2.83 per diluted share, compared to $381.3 million, or $2.45 per diluted share, in the prior year. This increase was primarily due to the increase in Net Income, as previously discussed, excluding the impact of the current year U.K. tax rate change and fund support gains in the prior year. Operating margin increased to 13.9% from 12.2% in the prior year. Operating margin, as adjusted (see Supplemental Non-GAAP Financial Information) increased to 23.2% from 20.7% in the prior year.

Assets Under Management

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

	2011	2010
Beginning of period	**$ 684.5**	$ 632.4
Investment funds, excluding liquidity funds[1]		
Subscriptions	**49.5**	38.8
Redemptions	**(44.3)**	(40.2)
Separate account flows, net		