

FRANKLIN RESOURCES INC  
Form 10-Q  
February 08, 2010

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(MARK ONE)

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

For the quarterly period ended December 31, 2009

OR

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

For the transition period from            to

Commission File Number: 001-09318

**FRANKLIN RESOURCES, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**13-2670991**  
*(I.R.S. Employer  
Identification No.)*

**One Franklin Parkway, San Mateo, CA**  
*(Address of principal executive offices)*

**94403**  
*(Zip Code)*

**(650) 312-2000**

*(Registrant's telephone number, including area code)*

**N/A**

*(Former name, former address and former fiscal year, if changed since last report)*

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  NO

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Outstanding: 228,220,726 shares of common stock, par value \$0.10 per share, of Franklin Resources, Inc. as of January 31, 2010.

**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****FRANKLIN RESOURCES, INC.****Condensed Consolidated Statements of Income****Unaudited**

| <i>(in thousands, except per share data)</i>                     | <b>Three Months Ended<br/>December 31,</b> |                   |
|--|--|-------------------|
|  | <b>2009</b>                                | <b>2008</b>       |
| <b>Operating Revenues</b>  |  |                   |
| Investment management fees                                       | \$ 806,664                                 | \$ 600,274        |
| Underwriting and distribution fees                               | 488,053                                    | 304,929           |
| Shareholder servicing fees                                       | 69,543                                     | 66,342            |
| Consolidated sponsored investment products income, net           | 448  | 1,886             |
| Other, net   | 12,703                                     | (4,101)           |
| <b>Total operating revenues</b>                                  | <b>1,377,411</b>                           | <b>969,330</b>    |
| <b>Operating Expenses</b>  |  |                   |
| Underwriting and distribution                                    | 467,027                                    | 289,529           |
| Compensation and benefits  | 254,312                                    | 244,063           |
| Information systems, technology and occupancy                    | 68,610                                     | 68,598            |
| Advertising and promotion  | 34,848                                     | 24,227            |
| Amortization of deferred sales commissions                       | 46,546                                     | 36,612            |
| Other  | 39,091                                     | 37,937            |
| <b>Total operating expenses</b>                                  | <b>910,434</b>                             | <b>700,966</b>    |
| <b>Operating income</b>  | <b>466,977</b>                             | <b>268,364</b>    |
| <b>Other Income (Expenses)</b>                                   |  |                   |
| Consolidated sponsored investment products gains (losses), net   | 15,072                                     | (47,442)          |
| Investment and other income (losses), net                        | 32,978                                     | (45,022)          |
| Interest expense   | (742)                                      | (1,200)           |
| <b>Other income (expenses), net</b>                              | <b>47,308</b>                              | <b>(93,664)</b>   |
| Income before taxes  | 514,285                                    | 174,700           |
| Taxes on income  | 156,736                                    | 64,771            |
| <b>Net Income</b>  | <b>\$ 357,549</b>                          | <b>\$ 109,929</b> |
| Less: Net income (loss) attributable to noncontrolling interests | 1,946                                      | (10,971)          |
| <b>Net Income attributable to Franklin Resources, Inc.</b>       | <b>\$ 355,603</b>                          | <b>\$ 120,900</b> |
| <b>Earnings per Share</b>  |  |                   |
| Basic  | \$ 1.55                                    | \$ 0.52           |
| Diluted  | \$ 1.54                                    | \$ 0.52           |
| <b>Dividends per Share</b>                                       | <b>\$ 3.22</b>                             | <b>\$ 0.21</b>    |

See Notes to Condensed Consolidated Financial Statements.



**FRANKLIN RESOURCES, INC.****Condensed Consolidated Balance Sheets****Unaudited**

| <i>(in thousands)</i>                            | <b>December 31,<br/>2009</b> | <b>September 30,<br/>2009</b> |
|--|------------------------------|-------------------------------|
| <b>Assets</b>                                    |                              |                               |
| <b>Current Assets</b>                            |                              |                               |
| Cash and cash equivalents                        | \$ 2,753,253                 | \$ 2,982,539                  |
| Receivables                                      | 632,517                      | 581,810                       |
| Investment securities, trading                   | 476,403                      | 502,609                       |
| Investment securities, available-for-sale        | 1,063,711                    | 1,027,287                     |
| Other investments                                | 7,111                        | 51,950                        |
| Deferred taxes                                   | 70,535                       | 67,773                        |
| Prepaid expenses and other                       | 28,098                       | 30,452                        |
| Total current assets                             | 5,031,628                    | 5,244,420                     |
| <b>Banking/Finance Assets</b>                    |                              |                               |
| Cash and cash equivalents                        | 97,055                       | 121,912                       |
| Investment securities, trading                   | 70,667                       | 110,600                       |
| Investment securities, available-for-sale        | 457,589                      | 472,055                       |
| Loans held for sale                              | 13,117                       | 15,711                        |
| Loans receivable, net                            | 362,393                      | 310,504                       |
| Other  | 9,212                        | 8,383                         |
| Total banking/finance assets                     | 1,010,033                    | 1,039,165                     |
| <b>Non-Current Assets</b>                        |                              |                               |
| Investment securities, available-for-sale        | 103,291                      | 108,838                       |
| Investments in equity method investees and other | 399,600                      | 398,995                       |
| Deferred sales commissions                       | 105,050                      | 103,993                       |
| Property and equipment, net                      | 530,926                      | 535,459                       |
| Goodwill   | 1,439,874                    | 1,436,626                     |
| Other intangible assets, net                     | 567,345                      | 567,974                       |
| Other  | 36,382                       | 32,993                        |
| Total non-current assets                         | 3,182,468                    | 3,184,878                     |
| <b>Total Assets</b>                              | <b>\$ 9,224,129</b>          | <b>\$ 9,468,463</b>           |

[Table continued on next page]

See Notes to Condensed Consolidated Financial Statements.

## FRANKLIN RESOURCES, INC.

## Condensed Consolidated Balance Sheets

## Unaudited

[Table continued from previous page]

| <i>(in thousands, except share data)</i>  | December 31,<br>2009 | September 30,<br>2009 |
|---|----------------------|-----------------------|
| <b>Liabilities and Stockholders Equity</b>  |                      |                       |
| <b>Current Liabilities</b>  |                      |                       |
| Compensation and benefits   | \$ 158,819           | \$ 210,789            |
| Commercial paper  | 256,657              | 64,156                |
| Accounts payable and accrued expenses   | 159,905              | 174,525               |
| Commissions   | 240,781              | 219,356               |
| Income taxes  | 128,297              | 28,363                |
| Other   | 26,848               | 28,351                |
| Total current liabilities   | 971,307              | 725,540               |
| <b>Banking/Finance Liabilities</b>  |                      |                       |
| Deposits  | 689,245              | 664,580               |
| Federal Home Loan Bank advances   | 66,000               | 57,000                |
| Other   | 18,613               | 24,653                |
| Total banking/finance liabilities   | 773,858              | 746,233               |
| <b>Non-Current Liabilities</b>  |                      |                       |
| Deferred taxes  | 223,645              | 218,845               |
| Other   | 83,929               | 78,284                |
| Total non-current liabilities   | 307,574              | 297,129               |
| Total liabilities   | 2,052,739            | 1,768,902             |
| <b>Commitments and Contingencies (Note 11)</b>  |                      |                       |
| <b>Redeemable noncontrolling interests</b>  | 34,313               | 65,126                |
| <b>Stockholders Equity</b>  |                      |                       |
| Preferred stock, \$1.00 par value, 1,000,000 shares authorized; none issued   |                      |                       |
| Common stock, \$0.10 par value, 1,000,000,000 shares authorized; 228,205,363 and 229,324,345 shares issued and outstanding, at December 31, 2009 and September 30, 2009 | 22,821               | 22,932                |
| Retained earnings   | 6,986,831            | 7,505,890             |
| Accumulated other comprehensive income  | 125,399              | 103,351               |
| Total Franklin Resources, Inc. stockholders equity  | 7,135,051            | 7,632,173             |
| Nonredeemable noncontrolling interests  | 2,026                | 2,262                 |
| Total stockholders equity   | 7,137,077            | 7,634,435             |
| <b>Total Liabilities and Stockholders Equity</b>  | <b>\$ 9,224,129</b>  | <b>\$ 9,468,463</b>   |

See Notes to Condensed Consolidated Financial Statements.



## FRANKLIN RESOURCES, INC.

## Condensed Consolidated Statements of Cash Flows

## Unaudited

| <i>(in thousands)</i>  | Three Months Ended<br>December 31, |                |
|--|------------------------------------|----------------|
|  | 2009                               | 2008           |
| <b>Net Income</b>  | \$ 357,549                         | \$ 109,929     |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                                    |                |
| Depreciation and amortization  | 66,001                             | 46,680         |
| Stock-based compensation   | 19,619                             | 18,719         |
| Excess tax benefits from stock-based compensation arrangements                           | (9,502)                            | (3,012)        |
| Net (gains) losses on sale of assets   | (1,715)                            | 12,064         |
| Equity in net (income) losses of affiliated companies                                    | (4,150)                            | 25,460         |
| Provision for loan losses  | 1,053                              | 4,102          |
| Other-than-temporary impairment of investments   | 1,462                              | 33,849         |
| Deferred income taxes  | (106)                              | (3,472)        |
| <b>Changes in operating assets and liabilities:</b>                                      |                                    |                |
| (Increase) decrease in receivables, prepaid expenses and other                           | (56,321)                           | 112,161        |
| Principal collected on loans held for sale, net  | 1,668                              | 4,613          |
| Increase in trading securities, net  | (74,237)                           | (33,452)       |
| Advances of deferred sales commissions   | (47,326)                           | (17,303)       |
| Increase (decrease) in income taxes payable  | 114,691                            | (3,093)        |
| Increase (decrease) in commissions payable   | 21,425                             | (61,917)       |
| Decrease in other liabilities  | (19,528)                           | (38,715)       |
| Decrease in accrued compensation and benefits  | (53,508)                           | (164,668)      |
| <b>Net cash provided by operating activities</b>   | <b>317,075</b>                     | <b>41,945</b>  |
| Purchase of investments  | (166,982)                          | (473,937)      |
| Liquidation of investments   | 231,096                            | 671,543        |
| Purchase of banking/finance investments  |                                    | (39,692)       |
| Liquidation of banking/finance investments   | 67,119                             | 9,122          |
| (Increase) decrease in loans receivable  | (52,494)                           | 14,320         |
| Additions of property and equipment, net   | (9,590)                            | (21,784)       |
| Acquisitions of subsidiaries, net of cash acquired                                       |                                    | 533            |
| <b>Net cash provided by investing activities</b>   | <b>69,149</b>                      | <b>160,105</b> |
| Increase in bank deposits, net   | 24,665                             | 206,327        |
| Exercise of common stock options   | 8,303                              | 3,084          |
| Dividends paid on common stock   | (732,970)                          | (46,540)       |
| Purchase of common stock   | (173,996)                          | (40,678)       |
| Excess tax benefits from stock-based compensation arrangements                           | 9,502                              | 3,012          |
| Proceeds from issuance of commercial paper, net  | 192,451                            | 22,815         |
| Proceeds from issuance of debt   | 9,000                              | 49,250         |
| Payments on debt   |                                    | (67,551)       |
| Noncontrolling interests, net  | 22,454                             | 22,352         |
| <b>Net cash (used in) provided by financing activities</b>                               | <b>(640,591)</b>                   | <b>152,071</b> |
| Effect of exchange rate changes on cash and cash equivalents                             | 224                                | (44,876)       |



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|  |                     |                     |
|--|---------------------|---------------------|
| (Decrease) increase in cash and cash equivalents | (254,143)           | 309,245             |
| Cash and cash equivalents, beginning of period   | 3,104,451           | 2,527,552           |
| <b>Cash and Cash Equivalents, End of Period</b>  | <b>\$ 2,850,308</b> | <b>\$ 2,836,797</b> |

[Table continued on next page]

See Notes to Condensed Consolidated Financial Statements.

**FRANKLIN RESOURCES, INC.****Condensed Consolidated Statements of Cash Flows****Unaudited**

[Table continued from previous page]

| <i>(in thousands)</i>   | <b>Three Months Ended</b> |                              |
|---|---------------------------|------------------------------|
|   | <b>2009</b>               | <b>December 31,<br/>2008</b> |
| <b>Components of Cash and Cash Equivalents</b>  |                           |                              |
| Cash and cash equivalents, beginning of period:   |                           |                              |
| Current assets  | \$ 2,982,539              | \$ 2,314,818                 |
| Banking/finance assets  | 121,912                   | 212,734                      |
| <b>Total</b>  | <b>\$ 3,104,451</b>       | <b>\$ 2,527,552</b>          |
| Cash and cash equivalents, end of period:   |                           |                              |
| Current assets  | \$ 2,753,253              | \$ 2,453,127                 |
| Banking/finance assets  | 97,055                    | 383,670                      |
| <b>Total</b>  | <b>\$ 2,850,308</b>       | <b>\$ 2,836,797</b>          |
| <b>Supplemental Disclosure of Non-Cash Information</b>  |                           |                              |
| Change in assets related to the net deconsolidation of certain sponsored investment products      | \$ (63,020)               | \$ (85,196)                  |
| Change in liabilities related to the net deconsolidation of certain sponsored investment products | (6,753)                   | (51,685)                     |
| <b>Supplemental Disclosure of Cash Flow Information</b>   |                           |                              |
| Cash paid for income taxes  | \$ 40,476                 | \$ 64,265                    |
| Cash paid for interest  | 1,707                     | 3,035                        |

See Notes to Condensed Consolidated Financial Statements.

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**FRANKLIN RESOURCES, INC.**

**Notes to Condensed Consolidated Financial Statements**

**December 31, 2009**

**(Unaudited)**

**Note 1 - Basis of Presentation**

The unaudited interim financial statements of Franklin Resources, Inc. ( Franklin ) and its consolidated subsidiaries (collectively, the Company ) included herein have been prepared by the Company in accordance with the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission (the SEC ). Under these rules and regulations, some information and footnote disclosures normally included in financial statements prepared under accounting principles generally accepted in the United States of America have been shortened or omitted. Management believes that all adjustments necessary for a fair statement of the financial position and the results of operations for the periods shown have been made. All adjustments are normal and recurring. These financial statements should be read together with the Company's audited financial statements included in its Form 10-K for the fiscal year ended September 30, 2009 ( fiscal year 2009 ). Certain amounts for the comparative prior fiscal year periods have been reclassified to conform to the financial statement presentation as of and for the period ended December 31, 2009, including those required by the retrospective adoption of new accounting guidance relating to noncontrolling interests and the computation of earnings per share (see Note 2 New Accounting Standards). The Company has evaluated subsequent events through February 8, 2010, which is the date that this Quarterly Report on Form 10-Q is filed with the SEC.

**Note 2 - New Accounting Standards**

The Company adopted the following accounting standards during the three months ended December 31, 2009. There were no significant updates to new accounting standards not yet adopted by the Company as disclosed in its Form 10-K for fiscal year 2009.

In September 2009, the Financial Accounting Standards Board ( FASB ) issued a new standard that permits a reporting entity to measure the fair value of certain alternative investments that do not have a readily determinable fair value on the basis of the investments' net asset value per share or its equivalent. The adoption of the standard had no impact on the Company's consolidated financial statements.

In December 2007, the FASB issued a new standard that establishes accounting and reporting standards for noncontrolling interests in a subsidiary (previously referred to as minority interests) and for the deconsolidation of a subsidiary. The standard clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as a component of equity, separate from the parent's equity, in the consolidated financial statements. In addition, it modifies the presentation of consolidated net income to include the amount attributable to noncontrolling interests. The standard requires retrospective adoption of the presentation and disclosure requirements for existing noncontrolling interests. All other requirements of the standard are applied prospectively. The adoption of the standard did not have a material effect on the Company's consolidated financial position or results of operations, but resulted in changes in financial statement presentation and disclosure for all periods presented. Minority interests have been recharacterized as redeemable noncontrolling interests and classified as temporary equity, if currently redeemable or convertible for cash or other assets at the option of the holder, or otherwise as nonredeemable noncontrolling interests and classified as a component of equity. Additionally, the presentation of consolidated net income was modified to include the amount attributable to noncontrolling interests.

In June 2008, the FASB issued a new standard that specifies that vested share-based payment awards containing nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. All prior period earnings per share data presented must be adjusted retrospectively. The adoption of the standard did not have a material impact on basic or diluted earnings per share.

**Note 3 - Stockholders Equity and Comprehensive Income**

The changes in stockholders equity and redeemable noncontrolling interests for the three months ended December 31, 2009 and 2008 were as follows:

| <i>(in thousands)</i>                                     | Franklin Resources, Inc. |  | Total               | Redeemable               |
|---|--------------------------|--|---------------------|--------------------------|
|   | Stockholders Equity      | Nonredeemable Noncontrolling Interests | Stockholders Equity | Noncontrolling Interests |
| Balance at October 1, 2009                                | \$ 7,632,173             | \$ 2,262                               | \$ 7,634,435        | \$ 65,126                |
| Net income  | 355,603                  | 216                                    | 355,819             | 1,730                    |
| Other comprehensive income                                |                          |  |                     |                          |
| Net unrealized gains on investments, net of tax           | 12,438                   |  | 12,438              |                          |
| Currency translation adjustments                          | 9,447                    |  | 9,447               |                          |
| Net unrealized gains on defined benefit plans, net of tax | 163                      |  | 163                 |                          |
| Cash dividends on common stock                            | (736,926)                |  | (736,926)           |                          |
| Repurchase of common stock                                | (173,996)                |  | (173,996)           |                          |
| Other   | 36,149                   | (452)                                  | 35,697              | (32,543)                 |
| <b>Balance at December 31, 2009</b>                       | <b>\$ 7,135,051</b>      | <b>\$ 2,026</b>                        | <b>\$ 7,137,077</b> | <b>\$ 34,313</b>         |

| <i>(in thousands)</i>                            | Franklin Resources, Inc. |  | Total               | Redeemable               |
|--|--------------------------|--|---------------------|--------------------------|
|  | Stockholders Equity      | Nonredeemable Noncontrolling Interests | Stockholders Equity | Noncontrolling Interests |
| Balance at October 1, 2008                       | \$ 7,074,364             | \$ 29,608                              | \$ 7,103,972        | \$ 47,554                |
| Net income (loss)                                | 120,900                  | (3,922)                                | 116,978             | (7,049)                  |
| Other comprehensive income                       |                          |  |                     |                          |
| Net unrealized losses on investments, net of tax | (7,832)                  |  | (7,832)             |                          |
| Currency translation adjustments                 | (81,999)                 |  | (81,999)            |                          |
| Cash dividends on common stock                   | (48,871)                 |  | (48,871)            |                          |
| Repurchase of common stock                       | (40,678)                 |  | (40,678)            |                          |
| Other  | 22,362                   | (23,220)                               | (858)               | 12,060                   |
| <b>Balance at December 31, 2008</b>              | <b>\$ 7,038,246</b>      | <b>\$ 2,466</b>                        | <b>\$ 7,040,712</b> | <b>\$ 52,565</b>         |

The components of comprehensive income, including amounts attributable to redeemable noncontrolling interests, were as follows:

| <i>(in thousands)</i>  | Three Months Ended December 31, |                  |
|--|---------------------------------|------------------|
|  | 2009                            | 2008             |
| Net income   | \$ 357,549                      | \$ 109,929       |
| Net unrealized gains (losses) on investments, net of tax                   | 12,438                          | (7,832)          |
| Currency translation adjustments   | 9,447                           | (81,999)         |
| Net unrealized gains on defined benefit plans, net of tax                  | 163                             |                  |
| <b>Total Comprehensive Income</b>  | <b>379,597</b>                  | <b>20,098</b>    |
| Less: Comprehensive income (loss) attributable to noncontrolling interests | 1,946                           | (10,971)         |
| <b>Total Comprehensive Income attributable to Franklin Resources, Inc.</b> | <b>\$ 377,651</b>               | <b>\$ 31,069</b> |

**Note 4 - Earnings per Share**

Effective October 1, 2009, the Company retrospectively adopted a new FASB standard that modifies the earnings per share calculation to recognize its nonvested stock awards and nonvested stock unit awards that contain nonforfeitable rights to dividends or dividend equivalents as if they were a separate class of stock. Basic earnings per share is computed on the basis of the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed on the basis of the weighted-average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the two-class method. The nonvested stock awards and nonvested stock unit awards are not included as incremental shares in the diluted earnings per share calculation.

The components of basic and diluted earnings per share were as follows:

| <i>(in thousands, except per share data)</i>                                 | Three Months Ended<br>December 31, |                   |
|--|------------------------------------|-------------------|
|  | 2009                               | 2008              |
| Net Income attributable to Franklin Resources, Inc.                          | \$ 355,603                         | \$ 120,900        |
| Less: Allocation of earnings to nonvested stock awards and stock unit awards | 3,265                              | 860               |
| <b>Net Income Available to Common Stockholders</b>                           | <b>\$ 352,338</b>                  | <b>\$ 120,040</b> |
| Weighted-average shares outstanding - basic                                  | 227,892                            | 231,626           |
| Effect of dilutive common stock options                                      | 1,359                              | 1,062             |
| <b>Weighted-Average Shares Outstanding - Diluted</b>                         | <b>229,251</b>                     | <b>232,688</b>    |
| <b>Earnings per Share</b>  |                                    |                   |
| Basic  | \$ 1.55                            | \$ 0.52           |
| Diluted  | \$ 1.54                            | \$ 0.52           |

**Note 5 - Cash and Cash Equivalents**

The Company discloses cash and cash equivalents as separate components of current assets and banking/finance assets in its condensed consolidated balance sheets. Cash and cash equivalents consisted of the following:

| <i>(in thousands)</i>   | December 31,<br>2009 | September 30,<br>2009 |
|---|----------------------|-----------------------|
| Cash on hand and non-interest-bearing deposits with financial institutions    | \$ 39,276            | \$ 134,508            |
| Interest-bearing deposits with financial institutions                         | 426,482              | 350,483               |
| Federal funds sold  | 18,468               | 5,242                 |
| Sponsored money market funds  | 1,008,706            | 1,407,801             |
| Time deposits, securities of the U.S. Treasury and federal agencies and other | 1,357,376            | 1,206,417             |
| <b>Total</b>  | <b>\$ 2,850,308</b>  | <b>\$ 3,104,451</b>   |

Federal Reserve Board regulations require certain of the Company's banking subsidiaries to maintain reserve and clearing balances on deposits with the Federal Reserve Banks. The required reserve balances were \$6.8 million at December 31, 2009 and \$7.0 million at September 30, 2009. The required clearing balance was \$1.2 million at December 31, 2009 and September 30, 2009.

The Company maintains cash and cash equivalents with financial institutions in various countries, limits the amount of credit exposure with any given financial institution and conducts ongoing evaluations of the creditworthiness of the financial institutions with which it does business.

**Note 6 - Investments**

Investments consisted of the following:

| <i>(in thousands)</i>   | December 31,<br>2009 | September 30,<br>2009 |
|---|----------------------|-----------------------|
| <b>Current</b>  |                      |                       |
| Investment securities, trading                                | \$ 476,403           | \$ 502,609            |
| Investment securities, available-for-sale                     |                      |                       |
| Sponsored investment products                                 | 911,897              | 943,824               |
| U.S. government-sponsored enterprise obligations <sup>1</sup> | 76,000               | 5,200                 |
| Securities of U.S. states and political subdivisions          | 14,124               | 15,118                |
| Securities of the U.S. Treasury and federal agencies          | 52,010               | 50,616                |
| Other equity securities                                       | 9,680                | 12,529                |
| <b>Total investment securities, available-for-sale</b>        | <b>1,063,711</b>     | <b>1,027,287</b>      |
| Other investments <sup>2</sup>                                | 7,111                | 51,950                |
| <b>Total Current</b>  | <b>\$ 1,547,225</b>  | <b>\$ 1,581,846</b>   |
| <b>Banking/Finance</b>  |                      |                       |
| Investment securities, trading                                | \$ 70,667            | \$ 110,600            |
| Investment securities, available-for-sale                     |                      |                       |
| U.S. government-sponsored enterprise obligations <sup>1</sup> | 351,984              | 365,655               |
| Securities of U.S. states and political subdivisions          | 846                  | 852                   |
| Securities of the U.S. Treasury and federal agencies          | 3,415                | 3,566                 |
| Corporate debt securities <sup>3</sup>                        | 101,139              | 101,774               |
| Other equity securities                                       | 205                  | 208                   |
| <b>Total investment securities, available-for-sale</b>        | <b>457,589</b>       | <b>472,055</b>        |
| <b>Total Banking/Finance</b>                                  | <b>\$ 528,256</b>    | <b>\$ 582,655</b>     |
| <b>Non-Current</b>  |                      |                       |
| Investment securities, available-for-sale                     |                      |                       |
| Sponsored investment products                                 | \$ 29,383            | \$ 23,947             |
| Securities of U.S. states and political subdivisions          | 72,727               | 83,838                |
| Other equity securities                                       | 1,181                | 1,053                 |
| <b>Total investment securities, available-for-sale</b>        | <b>103,291</b>       | <b>108,838</b>        |
| Investments in equity method investees and other              | 399,600              | 398,995               |
| <b>Total Non-Current</b>                                      | <b>\$ 502,891</b>    | <b>\$ 507,833</b>     |

<sup>1</sup> At December 31, 2009 and September 30, 2009, U.S. government-sponsored enterprise obligations consisted of \$299.8 million and \$313.0 million of residential mortgage-backed securities and \$128.2 million and \$57.9 million of debentures.

<sup>2</sup> Other investments consist of time deposits with financial institutions having original maturities greater than three months but not exceeding one year from the date of purchase.

<sup>3</sup> Corporate debt securities are insured by the Federal Deposit Insurance Corporation or non-U.S. government agencies.

At December 31, 2009 and September 30, 2009, current investment securities, trading included \$249.3 million and \$277.6 million of securities held by sponsored investment products that were consolidated in the Company's condensed financial statements.

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At December 31, 2009 and September 30, 2009, banking/finance segment investment securities with aggregate carrying values of \$239.2 million and \$245.9 million were pledged as collateral for the ability to borrow from the Federal Reserve Bank, \$95.2 million and \$99.6 million were pledged as collateral for outstanding Federal Home Loan Bank ( FHLB ) borrowings and amounts available in secured FHLB short-term borrowing capacity, and \$1.9 million were pledged as collateral as required by federal and state regulators (see Note 10 Debt). In addition, investment management and related services segment securities with aggregate carrying values of \$5.1 million and \$5.0 million were pledged as collateral at December 31, 2009 and September 30, 2009.



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A summary of the gross unrealized gains and losses relating to investment securities, available-for-sale is as follows:

(in thousands)

|  | Gross Unrealized    |                   |                    |                     |
|--|---------------------|-------------------|--------------------|---------------------|
| as of December 31, 2009                              | Cost Basis          | Gains             | Losses             | Fair Value          |
| Sponsored investment products                        | \$ 851,157          | \$ 111,250        | \$ (21,127)        | \$ 941,280          |
| U.S. government-sponsored enterprise obligations     | 421,370             | 7,052             | (438)              | 427,984             |
| Securities of U.S. states and political subdivisions | 85,113              | 2,755             | (171)              | 87,697              |
| Securities of the U.S. Treasury and federal agencies | 55,448              | 12                | (35)               | 55,425              |
| Corporate debt securities                            | 100,244             | 895               |                    | 101,139             |
| Other equity securities                              | 8,617               | 2,453             | (4)                | 11,066              |
| <b>Total</b>   | <b>\$ 1,521,949</b> | <b>\$ 124,417</b> | <b>\$ (21,775)</b> | <b>\$ 1,624,591</b> |

(in thousands)

|  | Gross Unrealized    |                   |                    |                     |
|--|---------------------|-------------------|--------------------|---------------------|
| as of September 30, 2009                             | Cost Basis          | Gains             | Losses             | Fair Value          |
| Sponsored investment products                        | \$ 890,745          | \$ 94,829         | \$ (17,803)        | \$ 967,771          |
| U.S. government-sponsored enterprise obligations     | 366,540             | 6,566             | (2,251)            | 370,855             |
| Securities of U.S. states and political subdivisions | 96,647              | 3,265             | (104)              | 99,808              |
| Securities of the U.S. Treasury and federal agencies | 54,228              | 20                | (66)               | 54,182              |
| Corporate debt securities                            | 100,272             | 1,502             |                    | 101,774             |
| Other equity securities                              | 11,136              | 2,786             | (132)              | 13,790              |
| <b>Total</b>   | <b>\$ 1,519,568</b> | <b>\$ 108,968</b> | <b>\$ (20,356)</b> | <b>\$ 1,608,180</b> |

The changes in net holding gains (losses) on investment securities, available-for-sale included in accumulated other comprehensive income were \$14.2 million and \$(59.8) million for the three months ended December 31, 2009 and 2008. The tax effects of the net change in unrealized gains (losses) included in accumulated other comprehensive income were \$(1.6) million and \$5.8 million during the three months ended December 31, 2009 and 2008.

The following tables show the gross unrealized losses and fair values of investment securities, available-for-sale with unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

(in thousands)

|   | Less Than 12 Months |                         | 12 Months or Greater |                         | Total            |                         |
|---|---------------------|-------------------------|----------------------|-------------------------|------------------|-------------------------|
| as of December 31, 2009                   | Fair Value          | Gross Unrealized Losses | Fair Value           | Gross Unrealized Losses | Fair Value       | Gross Unrealized Losses |
| <b>Current</b>                            |                     |                         |                      |                         |                  |                         |
| Investment securities, available-for-sale |                     |                         |                      |                         |                  |                         |
| Sponsored investment products             | \$ 38,303           | \$ (19,317)             | \$ 31,822            | \$ (943)                | \$ 70,125        | \$ (20,260)             |
| Other equity securities                   |                     |                         | 30                   | (4)                     | 30               | (4)                     |
| <b>Total Current</b>                      | <b>\$ 38,303</b>    | <b>\$ (19,317)</b>      | <b>\$ 31,852</b>     | <b>\$ (947)</b>         | <b>\$ 70,155</b> | <b>\$ (20,264)</b>      |

Banking/Finance

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|  |           |              |           |              |           |               |                                      |
|--|-----------|--------------|-----------|--------------|-----------|---------------|--------------------------------------|
| Investment securities, available-for-sale            |           |              |           |              |           |               |                                      |
| U.S. government-sponsored enterprise obligations     | \$        |              | \$        | 70,385       | \$        | (438)         | \$ 70,385 \$ (438)                   |
| Securities of the U.S. Treasury and federal agencies |           | 2,119        |           | (22)         |           | 1,296         | (13) 3,415 (35)                      |
| <b>Total Banking/Finance</b>                         | <b>\$</b> | <b>2,119</b> | <b>\$</b> | <b>(22)</b>  | <b>\$</b> | <b>71,681</b> | <b>\$ (451) \$ 73,800 \$ (473)</b>   |
| <b>Non-Current</b>                                   |           |              |           |              |           |               |                                      |
| Investment securities, available-for-sale            |           |              |           |              |           |               |                                      |
| Sponsored investment products                        | \$        | 9,055        | \$        | (234)        | \$        | 34,873        | \$ (633) \$ 43,928 \$ (867)          |
| Securities of U.S. states and political subdivisions |           |              |           |              |           | 3,068         | (171) 3,068 (171)                    |
| <b>Total Non-Current</b>                             | <b>\$</b> | <b>9,055</b> | <b>\$</b> | <b>(234)</b> | <b>\$</b> | <b>37,941</b> | <b>\$ (804) \$ 46,996 \$ (1,038)</b> |

| <i>(in thousands)</i>                                | Less Than 12 Months |  | 12 Months or Greater |  | Total             |  |
|--|---------------------|--|----------------------|--|-------------------|--|
| <b>as of September 30, 2009</b>                      | <b>Fair Value</b>   | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair Value</b>    | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair Value</b> | <b>Gross<br/>Unrealized<br/>Losses</b> |
| <b>Current</b>                                       |                     |  |                      |  |                   |  |
| Investment securities, available-for-sale            |                     |  |                      |  |                   |  |
| Sponsored investment products                        | \$ 89,676           | \$ (15,082)                            | \$ 49,733            | \$ (594)                               | \$ 139,409        | \$ (15,676)                            |
| Other equity securities                              | 782                 | (118)                                  | 28                   | (5)                                    | 810               | (123)                                  |
| <b>Total Current</b>                                 | <b>\$ 90,458</b>    | <b>\$ (15,200)</b>                     | <b>\$ 49,761</b>     | <b>\$ (599)</b>                        | <b>\$ 140,219</b> | <b>\$ (15,799)</b>                     |
| <b>Banking/Finance</b>                               |                     |  |                      |  |                   |  |
| Investment securities, available-for-sale            |                     |  |                      |  |                   |  |
| U.S. government-sponsored enterprise obligations     | \$ 53,717           | \$ (333)                               | \$ 161,236           | \$ (1,918)                             | \$ 214,953        | \$ (2,251)                             |
| Securities of the U.S. Treasury and federal agencies | 2,129               | (36)                                   | 1,437                | (30)                                   | 3,566             | (66)                                   |
| <b>Total Banking/Finance</b>                         | <b>\$ 55,846</b>    | <b>\$ (369)</b>                        | <b>\$ 162,673</b>    | <b>\$ (1,948)</b>                      | <b>\$ 218,519</b> | <b>\$ (2,317)</b>                      |
| <b>Non-Current</b>                                   |                     |  |                      |  |                   |  |
| Investment securities, available-for-sale            |                     |  |                      |  |                   |  |
| Sponsored investment products                        | \$ 15,460           | \$ (2,038)                             | \$ 37,653            | \$ (89)                                | \$ 53,113         | \$ (2,127)                             |
| Securities of U.S. states and political subdivisions |                     |  | 8,618                | (104)                                  | 8,618             | (104)                                  |
| Other equity securities                              |                     |  | 165                  | (9)                                    | 165               | (9)                                    |
| <b>Total Non-Current</b>                             | <b>\$ 15,460</b>    | <b>\$ (2,038)</b>                      | <b>\$ 46,436</b>     | <b>\$ (202)</b>                        | <b>\$ 61,896</b>  | <b>\$ (2,240)</b>                      |

The Company recognized other-than-temporary impairment on available-for-sale investments, primarily related to sponsored investment products, in the amounts of \$1.4 million and \$33.8 million during the three months ended December 31, 2009 and 2008. The Company did not recognize any other-than-temporary impairment of available-for-sale debt securities during the three months ended December 31, 2009 and 2008.

The unrealized losses associated with U.S. government-sponsored enterprise obligations, securities of the U.S. Treasury and federal agencies, and securities of U.S. states and political subdivisions for the three months ended December 31, 2009 were primarily driven by changes in interest rates and were not due to the credit quality of the securities. As a result, the Company concluded that these securities were not other-than-temporarily impaired at December 31, 2009.

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At December 31, 2009, maturities of available-for-sale debt securities were as follows:

| <i>(in thousands)</i>                                       | Cost Basis        | Fair Value        |
|---|-------------------|-------------------|
| <b>U.S. government-sponsored enterprise obligations</b>     |                   |                   |
| Due in one year or less                                     | \$ 75,996         | \$ 76,000         |
| Due after one year through five years                       | 49,713            | 52,151            |
| Due after five years through ten years                      | 14,689            | 15,464            |
| Due after ten years   | 280,972           | 284,369           |
| <b>Total</b>  | <b>\$ 421,370</b> | <b>\$ 427,984</b> |
| <b>Securities of U.S. states and political subdivisions</b> |                   |                   |
| Due in one year or less                                     | \$ 13,924         | \$ 14,125         |
| Due after one year through five years                       | 51,357            | 53,546            |
| Due after five years through ten years                      | 16,528            | 16,891            |
| Due after ten years   | 3,304             | 3,135             |
| <b>Total</b>  | <b>\$ 85,113</b>  | <b>\$ 87,697</b>  |
| <b>Securities of the U.S. Treasury and federal agencies</b> |                   |                   |
| Due in one year or less                                     | \$ 51,998         | \$ 52,010         |
| Due after ten years   | 3,450             | 3,415             |
| <b>Total</b>  | <b>\$ 55,448</b>  | <b>\$ 55,425</b>  |
| <b>Corporate debt securities</b>                            |                   |                   |
| Due after one year through five years                       | \$ 100,244        | \$ 101,139        |
| <b>Total</b>  | <b>\$ 100,244</b> | <b>\$ 101,139</b> |

**Note 7 - Fair Value Measurements**

The Company uses a three-level fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value based on whether the inputs to those valuation techniques are observable or unobservable. The three levels of fair value hierarchy are set forth below. The Company's assessment of the hierarchy level of the assets or liabilities measured at fair value is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

- Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than Level 1 quoted prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs other than quoted prices that are observable or corroborated by observable market data. Level 2 quoted prices are obtained from independent third-party brokers or dealers, including prices derived from model-based valuation techniques for which the significant assumptions are observable in the market or corroborated by observable market data.
- Level 3 Unobservable inputs that are supported by little or no market activity. These inputs require significant management judgment and reflect the Company's estimation of assumptions that market participants would use in pricing the asset or liability. Level 3 valuations are derived primarily from model-based valuation techniques in which one or more significant inputs are unobservable in the market.

The Company records substantially all of its investments at fair value or amounts that approximate fair value. Trading securities and securities available-for-sale are financial instruments recorded at fair value on a recurring basis.



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The table below presents the balances of assets measured at fair value on a recurring basis.

(in thousands)

| as of December 31, 2009                              | Level 1             | Level 2           | Level 3          | Total               |
|--|---------------------|-------------------|------------------|---------------------|
| <b>Current Assets</b>                                |                     |                   |                  |                     |
| Investment securities, trading                       | \$ 362,776          | \$ 111,859        | \$ 1,768         | \$ 476,403          |
| Investment securities, available-for-sale            |                     |                   |                  |                     |
| Sponsored investment products                        | 911,897             |                   |                  | 911,897             |
| U.S. government-sponsored enterprise obligations     |                     | 76,000            |                  | 76,000              |
| Securities of U.S. states and political subdivisions |                     | 14,124            |                  | 14,124              |
| Securities of the U.S. Treasury and federal agencies |                     | 52,010            |                  | 52,010              |
| Other equity securities                              | 5,466               |                   | 4,214            | 9,680               |
| <b>Banking/Finance Assets</b>                        |                     |                   |                  |                     |
| Investment securities, trading                       |                     | 40,162            | 30,505           | 70,667              |
| Investment securities, available-for-sale            |                     |                   |                  |                     |
| U.S. government-sponsored enterprise obligations     |                     | 351,984           |                  | 351,984             |
| Securities of U.S. states and political subdivisions |                     | 846               |                  | 846                 |
| Securities of the U.S. Treasury and federal agencies |                     | 3,415             |                  | 3,415               |
| Corporate debt securities                            |                     | 101,139           |                  | 101,139             |
| Other equity securities                              |                     |                   | 205              | 205                 |
| <b>Non-Current Assets</b>                            |                     |                   |                  |                     |
| Investment securities, available-for-sale            |                     |                   |                  |                     |
| Sponsored investment products                        | 24,486              |                   | 4,897            | 29,383              |
| Securities of U.S. states and political subdivisions |                     | 72,727            |                  | 72,727              |
| Other equity securities                              | 327                 |                   | 854              | 1,181               |
| Life settlement contracts                            |                     |                   | 6,568            | 6,568               |
| <b>Total Assets Measured at Fair Value</b>           | <b>\$ 1,304,952</b> | <b>\$ 824,266</b> | <b>\$ 49,011</b> | <b>\$ 2,178,229</b> |

(in thousands)

| as of September 30, 2009                             | Level 1    | Level 2    | Level 3  | Total      |
|--|------------|------------|----------|------------|
| <b>Current Assets</b>                                |            |            |          |            |
| Investment securities, trading                       | \$ 394,754 | \$ 105,802 | \$ 2,053 | \$ 502,609 |
| Investment securities, available-for-sale            |            |            |          |            |
| Sponsored investment products                        | 943,824    |            |          | 943,824    |
| U.S. government-sponsored enterprise obligations     |            | 5,200      |          | 5,200      |
| Securities of U.S. states and political subdivisions |            | 15,118     |          | 15,118     |
| Securities of the U.S. Treasury and federal agencies |            | 50,616     |          | 50,616     |
| Other equity securities                              | 8,403      |            | 4,126    | 12,529     |
| <b>Banking/Finance Assets</b>                        |            |            |          |            |
| Investment securities, trading                       |            | 81,886     | 28,714   | 110,600    |
| Investment securities, available-for-sale            |            |            |          |            |
| U.S. government-sponsored enterprise obligations     |            | 365,655    |          | 365,655    |
| Securities of U.S. states and political subdivisions |            | 852        |          | 852        |
| Securities of the U.S. Treasury and federal agencies |            | 3,566      |          | 3,566      |
| Corporate debt securities                            |            | 101,774    |          | 101,774    |
| Other equity securities                              |            |            | 208      | 208        |
| <b>Non-Current Assets</b>                            |            |            |          |            |
| Investment securities, available-for-sale            |            |            |          |            |

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|  |                     |                   |                  |                     |
|--|---------------------|-------------------|------------------|---------------------|
| Sponsored investment products                        | 19,837              |                   | 4,110            | 23,947              |
| Securities of U.S. states and political subdivisions |                     | 83,838            |                  | 83,838              |
| Other equity securities                              | 321                 |                   | 732              | 1,053               |
| Life settlement contracts                            |                     |                   | 6,162            | 6,162               |
| <b>Total Assets Measured at Fair Value</b>           | <b>\$ 1,367,139</b> | <b>\$ 814,307</b> | <b>\$ 46,105</b> | <b>\$ 2,227,551</b> |

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The fair values of trading and available-for-sale securities are determined based on valuation techniques using the best information available, and may include quoted market prices, published net asset values of sponsored investment products, independent third-party broker or dealer price quotes, and discounted cash flows or other valuation methods as appropriate for each security type. For a further discussion of the Company's valuation techniques, see Note 1 Significant Accounting Policies in the Company's Form 10-K for fiscal year 2009.

The changes in Level 3 assets measured at fair value on a recurring basis for the three months ended December 31, 2009 and 2008 were as follows.

| <i>(in thousands)</i>   | Securities<br>Held by<br>Consolidated<br>Sponsored<br>Investment<br>Products | Residual<br>Interests<br>from<br>Securitization<br>Transactions | Other <sup>1</sup> | Total            |
|---|--|---|--------------------|------------------|
| Balance at October 1, 2009  | \$ 2,053   | \$ 28,714   | \$ 15,338          | \$ 46,105        |
| Total realized and unrealized gains (losses):   |  |   |                    |                  |
| Included in other, net revenue  |  | 205   |                    | 205              |
| Included in consolidated sponsored investment products losses, net  | (289)  |   |                    | (289)            |
| Included in investments and other income, net   |  |   | 121                | 121              |
| Included in accumulated other comprehensive income  |  |   | 996                | 996              |
| Purchases, sales, and settlements, net  | 4  | 1,586   | 283                | 1,873            |
| <b>Balance at December 31, 2009</b>   | <b>\$ 1,768</b>  | <b>\$ 30,505</b>  | <b>\$ 16,738</b>   | <b>\$ 49,011</b> |
| Change in unrealized gains (losses) included in net income relating to assets still held at December 31, 2009 | \$ (1) <sup>2</sup>  | \$ 205 <sup>3</sup>   | \$                 | \$ 204           |

| <i>(in thousands)</i>   | Securities<br>Held by<br>Consolidated<br>Sponsored<br>Investment<br>Products | Residual<br>Interests<br>from<br>Securitization<br>Transactions | Other <sup>1</sup> | Total            |
|---|--|---|--------------------|------------------|
| Balance at October 1, 2008  | \$ 4,089   | \$ 29,782   | \$ 12,112          | \$ 45,983        |
| Total realized and unrealized gains (losses):   |  |   |                    |                  |
| Included in other, net revenue  |  | (17,703)  |                    | (17,703)         |
| Included in consolidated sponsored investment products losses, net                                    | (960)  |   |                    | (960)            |
| Included in accumulated other comprehensive income  |  |   | 137                | 137              |
| Purchases, sales, and settlements, net  | 3  | 5,403   | (93)               | 5,313            |
| Transfers into Level 3  | 57   |   |                    | 57               |
| <b>Balance at December 31, 2008</b>   | <b>\$ 3,189</b>  | <b>\$ 17,482</b>  | <b>\$ 12,156</b>   | <b>\$ 32,827</b> |
| Change in unrealized losses included in net income relating to assets still held at December 31, 2008 | \$ (962) <sup>2</sup>  | \$ (17,703) <sup>3</sup>  | \$                 | \$ (18,665)      |

<sup>1</sup> Other primarily consists of equity securities and life settlement contracts.

<sup>2</sup> Included in consolidated sponsored investment products gains (losses), net.

<sup>3</sup> Included in other, net revenue.





The following financial instruments were not measured at fair value, but required disclosure of the estimated fair value:

| <i>(in thousands)</i>        | December 31, 2009 |              | September 30, 2009 |              |
|------------------------------|-------------------|--------------|--------------------|--------------|
|                              | Carrying Value    | Fair Value   | Carrying Value     | Fair Value   |
| <b>Financial Assets</b>      |                   |              |                    |              |
| Cash and cash equivalents    | \$ 2,850,308      | \$ 2,850,308 | \$ 3,104,451       | \$ 3,104,451 |
| Other investments            | 7,111             | 7,111        | 51,950             | 51,950       |
| Loans held for sale          | 13,117            | 14,057       | 15,711             | 16,621       |
| Loans receivable, net        | 362,393           | 360,992      | 310,504            | 323,672      |
| <b>Financial Liabilities</b> |                   |              |                    |              |
| Commercial paper             | \$ 256,657        | \$ 256,657   | \$ 64,156          | \$ 64,156    |
| Deposits                     | 689,245           | 692,992      | 664,580            | 667,793      |
| FHLB advances                | 66,000            | 64,490       | 57,000             | 57,026       |

Due to the short-term nature and liquidity of cash and cash equivalents, other investments, commercial paper and deposits with no stated maturities, the carrying values of these financial instruments approximate fair value. The fair values of loans, deposits with stated maturities and FHLB advances are estimated based on discounted cash flows. For a further discussion of the Company's valuation techniques, see Note 1 Significant Accounting Policies in the Company's Form 10-K for fiscal year 2009.

#### Note 8 - Securitization of Loans Held for Sale

From time to time, the Company enters into automobile loan securitization transactions with securitization trusts structured as qualified special purpose entities (the securitization trusts), which then issue asset-backed securities to private investors. The Company records these transactions as sales. The securitization transactions are comprised of prime, non-prime and sub-prime contracts for retail installment sales that are secured by new and used automobiles purchased from motor vehicle dealers. The Company purchases the sale contracts in the ordinary course of business.

When the Company sells automobile loans in a securitization transaction, it retains certain interests. Residual interests, which include interest-only strips receivable and cash on deposit, represent the Company's contractual right to receive excess interest and cash from the pool of securitized loans after the payment of required amounts to holders of the asset-backed securities and certain other costs associated with the securitization. The residual interests are generally fully realizable and subject to limited recourse provisions. Credit enhancements for the securitization trusts require the Company to maintain a certain amount of cash on deposit, which provides protection for the holders of the asset-backed securities against delays in payment and certain losses on the securitized loans. At December 31, 2009 and September 30, 2009, the amounts of cash on deposit were \$44.8 million and \$46.9 million. Discounted values of the cash on deposit were recognized as part of the residual interests. The Company may also retain subordinated securities from securitization transactions, which are senior to the residual interests. The retained interests in securitized assets, including the residual interests and the retained subordinated securities, are recognized as banking/finance trading securities in the condensed consolidated balance sheets. Changes in the fair value of the retained interests were recognized in earnings.

The Company did not enter into any automobile loan securitization transactions during the three months ended December 31, 2009 and 2008. The securitization transactions in which the Company entered into through September 30, 2008 were similar in all material respects. As a result of a securitization transaction that the Company entered into in June 2008, it retained the subordinated securities in addition to the residual interests. The remaining retained subordinated securities held by the Company at December 31, 2009 had a BBB- credit rating from Standard & Poor.

The Company determines the fair value of the retained interests in securitized assets at the date of securitization and at the end of each period (see Note 1 Significant Accounting Policies in the Company's Form 10-K for fiscal year 2009 for a description of fair value methodologies used).

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The following table shows the sensitivity of the retained interests to hypothetical adverse changes in the key economic assumptions used to measure fair value:

| <i>(dollar amounts in thousands)</i>                | December 31,<br>2009 | September 30,<br>2009 |
|---|----------------------|-----------------------|
| <i>Fair value of retained interests</i>             |                      |                       |
| Retained subordinated securities                    | \$ 40,162            | \$ 81,886             |
| Residual interests                                  | 30,505               | 28,714                |
| <b>Total</b>  | <b>\$ 70,667</b>     | <b>\$ 110,600</b>     |
| <i>Excess cash flow discount rate (annual rate)</i> |                      |                       |
|   | 8.3%-11.4%           | 12.2%-14.4%           |
| Impact on fair value of 10% adverse change          | \$ (1,705)           | \$ (4,133)            |
| Impact on fair value of 20% adverse change          | (3,385)              | (8,225)               |
| <i>Cumulative life loss rate</i>                    |                      |                       |
|   | 7.4%                 | 7.4%                  |
| Impact on fair value of 10% adverse change          | \$ (2,743)           | \$ (2,376)            |
| Impact on fair value of 20% adverse change          | (5,429)              | (4,763)               |
| <i>Expected weighted-average life (years)</i>       |                      |                       |
|   | 2.1                  | 2.2                   |
| <i>Prepayment speed (average monthly rate)</i>      |                      |                       |
|   | 1.1%                 | 1.2%                  |
| Impact on fair value of 10% adverse change          | \$ (2,726)           | \$ (2,737)            |
| Impact on fair value of 20% adverse change          | (5,052)              | (5,241)               |

Actual future market conditions may differ materially. Accordingly, this sensitivity analysis should not be considered the Company's projection of future events or losses.

The Company retains servicing responsibilities for automobile loan securitizations and receives annual servicing fees ranging from 1% to 2% of the loans securitized for services that it provides to the securitization trusts. The servicing fees are recognized in other, net revenue in the condensed consolidated statements of income. The Company does not recognize a servicing asset or liability because the benefits of servicing are just adequate to compensate for its servicing responsibilities as the servicing fees are consistent with current market rates that would be charged to compensate a substitute servicer for providing these services.

The following table provides a summary of cash flows received from and paid to securitization trusts.

| <i>(in thousands)</i>   | Three Months Ended<br>December 31, |          |
|---|------------------------------------|----------|
|   | 2009                               | 2008     |
| Servicing fees received   | \$ 2,581                           | \$ 3,786 |
| Cash flows received related to retained subordinated securities | 1,113                              | 1,698    |
| Cash flows received related to residual interests               |                                    | 1,470    |
| Cash paid related to residual interests                         | (550)                              | (5,729)  |

Amounts payable to the trustee related to loan principal and interest collected on behalf of the securitization trusts of \$19.7 million at December 31, 2009 and \$24.1 million at September 30, 2009 were included in other banking/finance liabilities in the condensed consolidated balance sheets.

The Company provides guarantees to cover shortfalls for the securitization trusts in amounts due to the holders of the asset-backed securities if the shortfall exceeds cash on deposit. At December 31, 2009 and September 30, 2009, the maximum potential amounts of future payments related to these guarantees were \$6.9 million and \$7.4 million. The fair value of the guarantees was recognized as banking/finance liabilities in the condensed consolidated balance sheets and was not significant.

During the three months ended December 31, 2009 and 2008, the Company did not provide any financial or other support to the securitization trusts or the holders of the asset-backed securities, other than as described above.

The original amount of loans serviced for the securitization trusts that were still in existence at December 31, 2009 and September 30, 2009 totaled \$1.8 billion. At December 31, 2009 and September 30, 2009, the securitization trusts had 41,087 and 44,221 loans outstanding, and their

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weighted-average annualized interest rate was 10.5% as of the end of each period. Net charge-offs on the securitized loans held by the securitization trusts and the loans that were managed together with them were \$9.0 million and \$12.7 million for the three months ended December 31, 2009 and 2008.

The following table shows further details of the loans serviced by the Company that were held by the securitization trusts and the loans that were managed together with them:

| <i>(dollar amounts in thousands)</i>                                      | December 31,<br>2009 | September 30,<br>2009 |
|---|----------------------|-----------------------|
| Principal amount of loans   |                      |                       |
| Securitized loans   | \$ 489,489           | \$ 551,369            |
| Loans held for sale   | 13,679               | 16,274                |
| Loans receivable  | 81,617               | 85,520                |
| <b>Total</b>  | <b>\$ 584,785</b>    | <b>\$ 653,163</b>     |
| Principal amount of loans 30 days or more past due <sup>1</sup>           | \$ 27,117            | \$ 29,238             |
| Credit quality as a percentage of aggregate outstanding principal balance |                      |                       |
| Prime   | 47.3%                | 47.4%                 |
| Non-prime   | 49.1%                | 49.4%                 |
| Sub-prime   | 3.6%                 | 3.2%                  |

<sup>1</sup> The majority of the balances were related to securitized loans.

#### Note 9 - Goodwill and Other Intangible Assets

Goodwill and other intangible assets have been assigned to one reporting unit, the investment management and related services segment. The changes in the carrying values of goodwill and gross intangible assets were as follows:

| <i>(in thousands)</i>               | Goodwill            | Amortized<br>Intangible<br>Assets | Non-amortized<br>Intangible<br>Assets |
|-------------------------------------|---------------------|-----------------------------------|---------------------------------------|
| Balance at October 1, 2009          | \$ 1,436,626        | \$ 200,952                        | \$ 507,737                            |
| Foreign currency movements          | 3,248               | 134                               | 1,932                                 |
| <b>Balance at December 31, 2009</b> | <b>\$ 1,439,874</b> | <b>\$ 201,086</b>                 | <b>\$ 509,669</b>                     |

Certain of the goodwill and intangible assets are denominated in currencies other than the U.S. dollar; therefore, their gross and net carrying values are subject to foreign currency movements.

Intangible assets were as follows:

*(in thousands)*

| <b>as of December 31, 2009</b>  | Gross Carrying<br>Value | Accumulated<br>Amortization | Net Carrying<br>Value |
|---------------------------------|-------------------------|-----------------------------|-----------------------|
| Amortized intangible assets     |                         |                             |                       |
| Customer base                   | \$ 166,046              | \$ (111,345)                | \$ 54,701             |
| Other                           | 35,040                  | (32,065)                    | 2,975                 |
|                                 | 201,086                 | (143,410)                   | 57,676                |
| Non-amortized intangible assets |                         |                             |                       |
| Management contracts            | 509,669                 |                             | 509,669               |

|              |           |                |           |                  |           |                |
|--------------|-----------|----------------|-----------|------------------|-----------|----------------|
| <b>Total</b> | <b>\$</b> | <b>710,755</b> | <b>\$</b> | <b>(143,410)</b> | <b>\$</b> | <b>567,345</b> |
|--------------|-----------|----------------|-----------|------------------|-----------|----------------|

*(in thousands)*

| <b>as of September 30, 2009</b>        | <b>Gross Carrying<br/>Value</b> | <b>Accumulated<br/>Amortization</b> | <b>Net Carrying<br/>Value</b> |
|--|---------------------------------|-------------------------------------|-------------------------------|
| <b>Amortized intangible assets</b>     |                                 |                                     |                               |
| Customer base                          | \$ 165,915                      | \$ (109,059)                        | \$ 56,856                     |
| Other                                  | 35,037                          | (31,656)                            | 3,381                         |
|  | 200,952                         | (140,715)                           | 60,237                        |
| <b>Non-amortized intangible assets</b> |                                 |                                     |                               |
| Management contracts                   | 507,737                         |                                     | 507,737                       |
| <b>Total</b>                           | <b>\$ 708,689</b>               | <b>\$ (140,715)</b>                 | <b>\$ 567,974</b>             |

The Company completed its most recent annual impairment tests of goodwill and indefinite-lived intangible assets during the quarter ended September 30, 2009, and determined that there was no impairment in the value of these assets as of August 1, 2009. Additionally, no impairment loss in the value of goodwill and indefinite-lived intangible assets was recognized during the three months ended December 31, 2009 and 2008. No impairment loss in the value of intangible assets subject to amortization was recognized during the three months ended December 31, 2009 and 2008 as the estimates of the undiscounted expected cash flows from these assets exceeded the asset carrying values.

Amortization expense related to definite-lived intangible assets was \$2.6 million for the three months ended December 31, 2009 and 2008. The estimated remaining amortization expense related to definite-lived intangible assets as of December 31, 2009 was as follows:

(in thousands)

| For the fiscal years ending September 30, | Amount           |
|---|------------------|
| 2010 (remaining nine months)              | \$ 7,814         |
| 2011                                      | 10,406           |
| 2012                                      | 8,912            |
| 2013                                      | 8,789            |
| 2014                                      | 8,789            |
| Thereafter                                | 12,966           |
| <b>Total</b>                              | <b>\$ 57,676</b> |

#### Note 10 - Debt

Outstanding debt consisted of the following:

| (in thousands)                  | December 31,<br>2009 | September 30,<br>2009 |
|---------------------------------|----------------------|-----------------------|
| <b>Current</b>                  |                      |                       |
| Commercial paper                | \$ 256,657           | \$ 64,156             |
| <b>Banking/Finance</b>          |                      |                       |
| Federal Home Loan Bank advances | 66,000               | 57,000                |
| <b>Total Debt</b>               | <b>\$ 322,657</b>    | <b>\$ 121,156</b>     |

At December 31, 2009, current debt consisted of commercial paper with a total face value of \$256.7 million that was issued at a weighted-average annualized interest rate of 0.20% and matures during the quarter ending March 31, 2010.

The banking/finance segment has financed its automobile lending business primarily through FHLB advances, which had a total outstanding balance of \$66.0 million at December 31, 2009. Approximately \$15.0 million of these advances mature by December 31, 2010, while the remaining \$51.0 million mature between June 2011 and January 2039. These advances had a weighted-average interest rate of 2.93% at December 31, 2009 and are subject to collateralization requirements.

At December 31, 2009, the Company had \$420.0 million in short-term revolving credit available under a five-year credit facility with certain banks and financial institutions expiring on June 9, 2010, \$243.3 million of short-term commercial paper available for issuance under an uncommitted \$500.0 million private placement program, and \$14.3 million available in uncommitted short-term bank lines of credit. The revolving credit facility is available for general corporate purposes, including the support of the Company's commercial paper program. It is subject to various financial covenants, including, but not limited to, minimum requirements related to the Company's interest coverage ratio and maintenance of working capital as well as limitations on capitalization ratio, indebtedness, investments and liens. Interest rates on loans under the revolving credit facility are determined at the time of issuance and depend on the type of loan issued. As of December 31, 2009, there were no amounts outstanding under the revolving credit facility and the Company was in compliance with the financial covenants related to this facility.

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In addition, at December 31, 2009, the banking/finance segment had \$295.0 million available in uncommitted short-term bank lines of credit under the Federal Reserve system, \$229.2 million available in secured Federal Reserve Bank short-term discount window and \$55.6 million available in secured FHLB short-term borrowing capacity (see Note 6 Investments). At December 31, 2009 and September 30, 2009, loans receivable with aggregate carrying values of \$39.4 million and \$30.6 million were pledged as collateral for the ability to obtain FHLB advances.



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**Note 11 - Commitments and Contingencies***Guarantees*

The Company is obligated to cover shortfalls for the automobile loan securitization trusts in amounts due to the holders of the asset-backed securities up to certain levels (see Note 8 – Securitization of Loans Held for Sale).

At December 31, 2009, the banking/finance segment had issued financial standby letters of credit totaling \$6.3 million which beneficiaries would be able to draw upon in the event of non-performance by its customers, primarily in relation to lease and lien obligations of these banking customers. These standby letters of credit were secured by marketable securities with a fair value of \$7.5 million as of December 31, 2009.

*Legal Proceedings*

As previously reported, between 2003 and 2006, following industry-wide market timing and late trading investigations by U.S. and Canadian regulators, and U.S. state government offices, Franklin and certain related parties were named in civil lawsuits in the U.S. and one of Franklin's adviser subsidiaries was named in civil lawsuits in Canada.

In the U.S., the lawsuits were filed against Franklin and certain of its adviser and distributor affiliates, individual Franklin officers and directors, a former Franklin employee, and trustees of certain Franklin Templeton Investments mutual funds (the Funds). In 2004, the lawsuits were consolidated for coordinated proceedings with similar lawsuits against numerous other mutual fund complexes in a multi-district litigation titled *In re Mutual Funds Investment Litigation*, pending in the U.S. District Court for the District of Maryland, Case No. 04-md-15862 (the MDL). Plaintiffs filed consolidated amended complaints in the MDL on September 29, 2004. The three consolidated lawsuits involving the Company include a class action (*Sharkey IRO/IRA v. Franklin Resources, Inc., et al.*, Case No. 04-cv-01310), a derivative action on behalf of the Funds (*McAlvey v. Franklin Resources, Inc., et al.*, Case No. 04-cv-01274), and a derivative action on behalf of Franklin (*Hertz v. Burns, et al.*, Case No. 04-cv-01624) and seek, among other forms of relief, one or more of the following: unspecified monetary damages; punitive damages; removal of Fund trustees, directors, advisers, administrators, and distributors; rescission of management contracts and distribution plans under Rule 12b-1 promulgated under the Investment Company Act of 1940; and attorneys' fees and costs.

On February 25, 2005, the Company-related parties filed motions to dismiss the consolidated amended class action and Fund derivative action complaints. On June 26, 2008, the court issued its order granting in part and denying in part the Company's motion to dismiss the consolidated amended class action complaint. In its order, the court dismissed certain claims, while allowing others under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and under Sections 36(b) and 48(a) of the Investment Company Act of 1940 to remain, and dismissed all class action claims against the named Funds. Pursuant to stipulation, the court also dismissed all claims against certain individual defendants, including the independent trustees to the named Funds, and a former Franklin executive. On September 4, 2009, the court entered as its order the parties' stipulation to dismiss without prejudice the remaining Fund trustee defendants named in the consolidated amended class action complaint. On January 12, 2010, lead plaintiff in the consolidated class action filed a second consolidated amended class action complaint. The Company's motion to dismiss the consolidated fund derivative action remains under submission with the court. In addition, pursuant to stipulation, the derivative action brought on behalf of Franklin has been stayed since 2004.

In Canada, Franklin Templeton Investments Corp. (FTIC), a Franklin subsidiary and the manager of Franklin Templeton Investments' Canadian mutual funds, is named (along with several other non-Franklin affiliated manager defendants) in two market timing lawsuits that are styled as class actions (*Huneault v. AGF Funds, Inc., et al.*, Case No. 500-06-00256-046, filed in the Superior Court for the Province of Quebec, District of Montreal on October 25, 2004, and *Fischer v. IG Investment Management Ltd., et al.*, Case No. 06-CV-307599CP, filed in the Ontario Superior Court of Justice on March 9, 2006). The lawsuits seek, among other forms of relief, one or more of: unspecified monetary damages, punitive damages, an order barring any increase in management fees for a period of two years following judgment, and attorneys' fees and costs. Oral argument on petitioners' motion for authorization to institute a class action in the Huneault lawsuit concluded on May 5, 2009, and the matter is now under submission with the court. Oral argument on plaintiffs' motion for class certification in the Fischer lawsuit concluded in early December 2009, and the court denied plaintiffs' motion on January 12, 2010. Plaintiffs have 30 days to file a notice of appeal.

In addition, Franklin/Templeton Distributors, Inc. (one of Franklin's subsidiaries and the principal underwriter to the Funds), as well as the individual trustees to the Franklin Custodian Funds (the Trust), have been named in a lawsuit brought derivatively on behalf of the Trust, concerning payment of asset-based compensation between July 22, 2005 and the present to broker-dealers that hold Fund shares in brokerage accounts and that are not registered as investment advisers. The lawsuit is captioned *Smith v. Franklin/Templeton Distributors, Inc., et al.*, Case No. CV 09-4775, and was filed in the U.S. District Court for the Northern District of California on October 6, 2009. Specifically, plaintiff is attempting to allege claims under Section 47(b) of the Investment Company Act of 1940, and for breach of fiduciary duty, breach of contract, and waste of Trust assets, and is seeking unspecified monetary damages, declaratory and injunctive relief enjoining further asset-based compensation to such broker-dealers, and attorneys' fees and costs. Defendants filed a motion to dismiss the complaint on January 22, 2010.



Management strongly believes that the claims made in each of the lawsuits identified above are without merit and intends to defend against them vigorously. The Company cannot predict with certainty, however, the eventual outcome of those lawsuits, nor whether they will have a material negative impact on the Company.

The Company is from time to time involved in litigation relating to claims arising in the normal course of business. Management is of the opinion that the ultimate resolution of such claims will not materially affect the Company's business, financial position or results of operations. In management's opinion, an adequate accrual has been made as of December 31, 2009, to provide for any probable losses that may arise from these matters for which the Company could reasonably estimate an amount.

#### *Variable Interest Entities*

The Company's variable interest entities ( VIEs ) primarily include certain sponsored investment products and certain other investment products (collectively, investment products ). The Company's variable interests generally include its equity ownership interest in the investment products and its investment management and related services fees earned from sponsored investment products. Based on its evaluations, the Company believes it was not the primary beneficiary of its VIEs and, as a result, did not consolidate these entities as of and for the quarters ended December 31, 2009 and 2008.

Total assets under management of investment products in which the Company held a variable interest, but was not the primary beneficiary, were approximately \$40.1 billion at December 31, 2009 and \$35.8 billion at September 30, 2009. The carrying values of the Company's equity ownership interest in and investment management and related service fees receivable from these investment products as recorded in the Company's consolidated balance sheets at December 31, 2009 and September 30, 2009 are set forth below. These amounts represent the Company's maximum exposure to loss and do not reflect an estimate of the actual losses.

| <i>(in thousands)</i>                            | December 31,<br>2009 | September 30,<br>2009 |
|--|----------------------|-----------------------|
| <b>Current Assets</b>                            |                      |                       |
| Receivables                                      | \$ 58,681            | \$ 50,088             |
| Investment securities, available-for-sale        | 93,720               | 112,853               |
| <b>Total Current</b>                             | <b>152,401</b>       | <b>162,941</b>        |
| <b>Non-Current Assets</b>                        |                      |                       |
| Investment securities, available-for-sale        | 25,621               | 20,208                |
| Investments in equity method investees and other | 326,061              | 305,024               |
| <b>Total Non-Current</b>                         | <b>351,682</b>       | <b>325,232</b>        |
| <b>Total</b>                                     | <b>\$ 504,083</b>    | <b>\$ 488,173</b>     |

While the Company has no contractual obligation to do so, it routinely makes cash investments in the course of launching sponsored investment products. The Company also may voluntarily elect to provide its sponsored investment products with additional direct or indirect financial support based on its business objectives.

The Company's other VIEs include limited liability partnerships, limited liability companies, and joint ventures. The Company's variable interest generally comprises its equity ownership interest. These investments are recognized as investments in equity method investees because the Company is not the primary beneficiary. The investment carrying values in the Company's consolidated balance sheets related to these VIEs were \$4.1 million at December 31, 2009 and \$14.9 million at September 30, 2009. These amounts represent the Company's maximum exposure to loss. The Company did not provide financial or other support to its other VIEs during the three months ended December 31, 2009.

The joint venture VIEs previously included Lightning Finance Company Limited ( LFL ) and Lightning Asset Finance Limited ( LAFL ), in which the Company held 49% ownership interests at September 30, 2009. The Company liquidated its ownership interests in LFL and LAFL during the three months ended December 31, 2009.

#### *Other Commitments and Contingencies*

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At December 31, 2009, the banking/finance segment had commitments to extend credit in an aggregate amount of \$173.0 million, primarily under credit card lines.

The Company in its role as agent or trustee facilitates the settlement of investor share purchase, redemption, and other transactions with affiliated mutual funds. The Company is appointed by the affiliated mutual funds as agent or trustee to manage, on behalf of the affiliated mutual funds, bank deposit accounts that contain only (i) cash remitted by investors to the affiliated mutual funds for the direct purchase of fund shares, or (ii) cash remitted by the affiliated mutual funds for direct delivery to the

investors for either the proceeds of fund shares liquidated at the investors' direction, or dividends and capital gains earned on fund shares. As of December 31, 2009 and September 30, 2009, the Company held cash of approximately \$371.7 million and \$214.5 million off-balance sheet in agency or trust for investors and the affiliated mutual funds.

At December 31, 2009, there were no changes in other commitments and contingencies that would have a material effect on commitments and contingencies reported in the Company's Form 10-K for fiscal year 2009.

**Note 12 - Stock-Based Compensation**

The Company's stock-based compensation plans include the Amended and Restated Annual Incentive Plan (the "AIP") and the 2002 Universal Stock Incentive Plan, as amended and restated (the "USIP"). Under the terms of the AIP, eligible employees may receive cash, equity awards, and/or cash-settled equity awards generally based on the performance of the Company, its funds and the individual employee. The USIP provides for the issuance of up to 30.0 million shares of the Company's common stock for various stock-related awards to officers, directors and employees. At December 31, 2009, approximately 3.5 million shares were available for grant under the USIP. In addition to stock awards and stock unit awards, the Company may award options and other forms of stock-based compensation to officers, directors and employees under the USIP. The Compensation Committee of the Board of Directors determines the terms and conditions of awards under the AIP and USIP.

*Stock Options*

The following table summarizes stock option activity:

| <i>(in thousands, except weighted-average exercise price)</i> | Shares       | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in Years) | Aggregate Intrinsic Value |
|---|--------------|---------------------------------|--|---------------------------|
| Outstanding at September 30, 2009                             | 2,737        | \$ 37.86                        |  |                           |
| Exercised   | (225)        | 36.69                           |  |                           |
| <b>Outstanding and Exercisable at December 31, 2009</b>       | <b>2,512</b> | <b>\$ 37.97</b>                 | <b>2.5</b>   | <b>\$ 169,284</b>         |

Stock option awards outstanding under the USIP generally have been granted at prices that are either equal to or above the market value of the underlying shares of the Company's common stock on the date of grant, generally vest over three years and expire no later than ten years after the grant date. No stock option awards have been granted under the USIP since November 2004. All stock options were fully vested and all related compensation cost was recognized prior to fiscal year 2008.

Cash received from stock option exercises for the three months ended December 31, 2009 and 2008 was \$8.3 million and \$3.1 million. Income tax benefits from stock option exercises were \$8.7 million and \$3.4 million for the three months ended December 31, 2009 and 2008.

*Stock Awards and Stock Unit Awards*

The fair value of stock awards and stock unit awards granted under the USIP is estimated on the date of grant based on the market price of the underlying shares of the Company's common stock and is amortized to compensation expense on a straight-line basis over the related vesting period, which is generally three to four years. The total number of stock awards and stock unit awards expected to vest is adjusted for estimated forfeitures.

Total unrecognized compensation cost related to nonvested stock awards and stock unit awards, net of estimated forfeitures, was \$127.2 million at December 31, 2009. This cost is expected to be recognized over a remaining weighted-average vesting period of 1.9 years.

The following table summarizes nonvested stock award and stock unit award activity:

*(shares in thousands)*

**Shares**

|   |              | <b>Weighted-<br/>Average Grant-<br/>Date Fair<br/>Value per<br/>Share</b> |
|---|--------------|---|
| Nonvested balance at September 30, 2009       | 954          | \$ 85.21  |
| Granted                                       | 806          | 107.15  |
| Forfeited/cancelled                           | (59)         | 95.49   |
| <b>Nonvested Balance at December 31, 2009</b> | <b>1,701</b> | <b>\$ 95.25</b>   |

The stock awards generally entitle holders to the right to sell the underlying shares of the Company's common stock once the awards vest. Stock unit awards generally entitle holders to receive the underlying shares of common stock once the awards vest.

Certain performance-based long-term stock awards and stock unit awards have been granted to the Company's executive officers and other employees. These awards are equity-based and generally vest over a three-year period based on the achievement of predetermined Company financial performance goals. In the event a performance measure is not achieved at or above a specified threshold level, the portion of the award tied to such performance measure will be forfeited. At December 31, 2009, the balance of nonvested awards was 405.2 thousand and had a weighted-average grant-date fair value of \$107.61 per share.

#### *Employee Stock Investment Plan*

The amended and restated Franklin Resources, Inc. 1998 Employee Stock Investment Plan (the "ESIP"), allows eligible participants to buy shares of the Company's common stock at a discount of its market value on defined dates. The Compensation Committee of the Board of Directors determines the terms and conditions of awards under the ESIP. No shares were issued under the ESIP during the three months ended December 31, 2009. At December 31, 2009, approximately 3.1 million shares were reserved for future issuance under this plan.

Effective August 1, 2008, the terms of the ESIP were amended to allow eligible participants to buy shares of the Company's common stock at 85% of its market value on defined dates and the Company's discretionary match was discontinued with respect to shares purchased under the plan on or after such date.

#### *All Stock-Based Plan Arrangements*

Total stock-based compensation costs of \$19.6 million and \$18.7 million were recognized in the condensed consolidated statements of income for the three months ended December 31, 2009 and 2008. The income tax benefits realized from all stock-based arrangements totaled \$9.3 million and \$2.3 million for the three months ended December 31, 2009 and 2008.

The Company generally does not repurchase shares upon share option exercise or vesting of stock awards and stock unit awards. However, in order to pay taxes due in connection with the vesting of employee and executive officer stock awards and stock unit awards under the ESIP and in connection with the remaining final discretionary match under the ESIP, shares are repurchased using a net stock issuance method.

#### **Note 13 - Common Stock Repurchases**

During the three months ended December 31, 2009, the Company repurchased 1.6 million shares of its common stock at a cost of \$174.0 million. The common stock repurchases made as of December 31, 2009 reduced capital in excess of par value to nil and the excess amount was recognized as a reduction to retained earnings. At December 31, 2009, approximately 8.0 million shares of common stock remained available for repurchase under the stock repurchase program. During the three months ended December 31, 2008, the Company repurchased 0.7 million shares of its common stock at a cost of \$40.7 million. The stock repurchase program is not subject to an expiration date.

#### **Note 14 - Segment Information**

The Company bases its operating segment selection process primarily on services offered. The Company derives substantially all of its operating revenues and net income from providing investment management and related services to its sponsored investment products. This is the Company's primary business activity and operating segment. The Company's investment management and related services are marketed to the public globally under six distinct brand names: Franklin, Templeton, Mutual Series, Bissett, Fiduciary Trust and Darby.

The Company's secondary business activity and operating segment is banking/finance. The banking/finance segment offers selected retail banking and consumer lending services and private banking services to high net-worth clients. Consumer lending and retail banking activities include automobile lending services related to the purchase, securitization, and servicing of retail installment sales contracts originated by independent automobile dealerships, consumer credit and debit cards, real estate equity lines, home equity/mortgage lending, and other consumer lending.

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Financial information for the Company's two operating segments is presented in the table below. Inter-segment transactions are immaterial and excluded from segment income (loss) and assets. Operating revenues of the banking/finance segment are reported net of interest expense, the provision for loan losses and changes in fair value of residual interests from securitization transactions.

(in thousands)

|   | <b>Investment<br/>Management<br/>and Related<br/>Services</b> | <b>Banking/<br/>Finance</b> | <b>Total</b> |
|---|---|-----------------------------|--------------|
| <b>as of and for the three months ended December 31, 2009</b> |   |                             |              |
| Assets  | \$ 8,214,096  | \$ 1,010,033                | \$ 9,224,129 |
| Operating revenues  | 1,366,764   | 10,647                      | 1,377,411    |
| Income before taxes   | 508,400   | 5,885                       | 514,285      |
| <b>for the three months ended December 31, 2008</b>           |   |                             |              |
| Operating revenues  | \$ 975,959  | \$ (6,629)                  | \$ 969,330   |
| Income (losses) before taxes                                  | 208,860   | (34,160)                    | 174,700      |
| <b>as of September 30, 2009</b>                               |   |                             |              |
| Assets  | \$ 8,429,298  | \$ 1,039,165                | \$ 9,468,463 |

Operating revenues of the banking/finance segment included above were as follows:

|   | <b>Three Months Ended<br/>December 31,</b> |                   |
|---|--|-------------------|
|   | <b>2009</b>                                | <b>2008</b>       |
| <i>(in thousands)</i>                                 |  |                   |
| Interest and fees on loans                            | \$ 4,581                                   | \$ 6,053          |
| Interest and dividends on investment securities       | 3,641                                      | 6,976             |
| <b>Total interest income</b>                          | <b>8,222</b>                               | <b>13,029</b>     |
| Interest on deposits                                  | (1,300)                                    | (1,758)           |
| Interest on short-term debt                           | (6)  | (771)             |
| Interest on long-term debt                            | (452)                                      | (410)             |
| <b>Total interest expense</b>                         | <b>(1,758)</b>                             | <b>(2,939)</b>    |
| Net interest income                                   | 6,464                                      | 10,090            |
| Unrealized gains (losses) on trading investments, net | 205  | (17,703)          |
| Other income  | 5,031                                      | 5,086             |
| Provision for loan losses                             | (1,053)                                    | (4,102)           |
| <b>Total</b>  | <b>\$ 10,647</b>                           | <b>\$ (6,629)</b> |

The investment management and related services segment incurs substantially all of the Company's depreciation and amortization costs and expenditures on long-lived assets.



**Note 15 - Other Income (Expenses)**

Other income (expenses) consisted of the following:

| <i>(in thousands)</i>  | Three Months Ended<br>December 31, |                    |
|--|------------------------------------|--------------------|
|  | 2009                               | 2008               |
| <b>Consolidated Sponsored Investment Products Gains (Losses), Net</b>        |                                    |                    |
| Realized gains (losses), net   | \$ 5,056                           | \$ (26,923)        |
| Unrealized gains (losses), net   | 10,016                             | (20,519)           |
| <b>Total</b>   | <b>15,072</b>                      | <b>(47,442)</b>    |
| <b>Investment and Other Income (Losses), Net</b>                             |                                    |                    |
| Dividend income  | 10,548                             | 12,439             |
| Interest income  | 3,581                              | 11,603             |
| Capital gain distributions   | 862                                | 14,222             |
| Other-than-temporary impairment of investment securities, available-for-sale | (1,462)                            | (33,849)           |
| Realized gains on sale of investment securities, available-for-sale          | 2,130                              | 1,833              |
| Realized losses on sale of investment securities, available-for-sale         | (487)                              | (14,115)           |
| Gains (losses) on trading investment securities, net                         | 12,389                             | (26,556)           |
| Income (losses) from investments in equity method investees                  | 4,150                              | (25,460)           |
| Foreign currency exchange (losses) gains, net                                | (1,422)                            | 12,545             |
| Other, net   | 2,689                              | 2,316              |
| <b>Total</b>   | <b>32,978</b>                      | <b>(45,022)</b>    |
| <b>Interest expense</b>  | <b>(742)</b>                       | <b>(1,200)</b>     |
| <b>Other income (expenses), net</b>  | <b>\$ 47,308</b>                   | <b>\$ (93,664)</b> |

Substantially all of the Company's dividend income, capital gain distributions, and realized gains and losses on sale of investment securities, available-for-sale were generated by investments in its sponsored investment products. Interest income was primarily generated by investments in debt securities of the U.S. Treasury and federal agencies and cash equivalents. Proceeds from the sale of investment securities, available-for-sale were \$105.6 million and \$80.3 million for the three months ended December 31, 2009 and 2008.

The Company recognized net gains (losses) on trading investment securities, including securities held by consolidated sponsored investment products, that were still held at December 31, 2009 and 2008 in the amounts of \$10.4 million and \$(46.3) million during the three months ended December 31, 2009 and 2008.

**Note 16 - Banking Regulatory Ratios**

Franklin is a bank holding company and a financial holding company subject to various regulatory capital requirements administered by federal banking agencies, including the Federal Reserve Board. Failure to meet minimum capital requirements can result in certain mandatory, and possibly additional, discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. The Company must meet specific capital adequacy guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain a minimum Tier 1 capital and Tier 1 leverage ratio (as defined in the regulations), as well as minimum Tier 1 and Total risk-based capital ratios (as defined in the regulations). Based on the Company's calculations as of December 31, 2009 and September 30, 2009, it exceeded the applicable capital adequacy requirements as listed below.

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| <i>(dollar amounts in thousands)</i> | <b>December 31,<br/>2009</b> | <b>September 30,<br/>2009</b> | <b>Capital<br/>Adequacy<br/>Minimum</b> |
|--------------------------------------|------------------------------|-------------------------------|---|
| Tier 1 capital                       | \$ 4,996,501                 | \$ 5,495,995                  | N/A                                     |
| Total risk-based capital             | 5,003,150                    | 5,503,022                     | N/A                                     |
| Tier 1 leverage ratio                | 68%                          | 75%                           | 4%                                      |
| Tier 1 risk-based capital ratio      | 97%                          | 97%                           | 4%                                      |
| Total risk-based capital ratio       | 97%                          | 97%                           | 8%                                      |

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Forward-Looking Statements

In this section, we discuss and analyze the results of operations and financial condition of Franklin Resources, Inc. ( "Franklin" ) and its subsidiaries (collectively, the "Company" ). In addition to historical information, we also make statements relating to the future, called forward-looking statements, which are provided under the safe harbor protection of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally written in the future tense and/or are preceded by words such as will , may , could , expect , believe , anticipate , plan , seek , estimate , or other similar words. Moreover, statements that speculate about future events are forward-looking statements. These forward-looking statements involve a number of known and unknown risks, uncertainties and other important factors that could cause actual results and outcomes to differ materially from any future results or outcomes expressed or implied by such forward-looking statements. Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. We caution you therefore against relying on any of these forward-looking statements. They are neither statements of historical fact nor guarantees or assurances of future performance.

You should carefully review the Risk Factors section set forth below and in any more recent filings with the SEC, each of which describes these risks, uncertainties and other important factors in more detail. While forward-looking statements are our best prediction at the time that they are made, you should not rely on them. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. If a circumstance occurs after the date of this Form 10-Q that causes any of our forward-looking statements to be inaccurate, whether as a result of new information, future developments or otherwise, we do not have an obligation, and we undertake no obligation, to announce publicly the change to our expectations, or to make any revisions to our forward-looking statements, unless required by law.

The following discussion should be read in conjunction with our Form 10-K for the fiscal year ended September 30, 2009 filed with the SEC, and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q.

### Overview

We are a global investment management company and derive substantially all of our operating revenues and net income from providing investment management and related services to our retail and institutional mutual funds, unregistered funds, and to institutional, high net-worth and separately-managed accounts and other investment products. Our services include fund administration, shareholder services, transfer agency, underwriting, distribution, custodial, trustee and other fiduciary services. Our sponsored investment products and investment management and related services are distributed or marketed to the public globally under six distinct brand names: Franklin, Templeton, Mutual Series, Bissett, Fiduciary Trust and Darby.

We offer a broad range of sponsored investment products under equity, hybrid, fixed-income and cash management funds and accounts that meet a wide variety of specific investment needs of individual and institutional investors. Cash management funds consist of U.S.-registered money market funds and non-U.S. registered funds with similar investment objectives.

The level of our revenues depends largely on the level and relative mix of assets under management. As noted in the Risk Factors section set forth below, the amount and mix of our assets under management are subject to significant fluctuations and can negatively impact our revenues and income. To a lesser degree, the level of our revenues also depends on the level of mutual fund sales and the number of mutual fund shareholder accounts. The fees charged for our services are based on contracts with our sponsored investment products or our clients. These arrangements could change in the future.

Our secondary business is banking/finance. Our banking/finance group offers retail banking and consumer lending services and private banking services to high net-worth clients. Our consumer lending and retail banking activities include consumer credit and debit cards, real estate equity lines, home equity/mortgage lending, and automobile lending related to the purchase, securitization, and servicing of retail installment sales contracts originated by independent automobile dealerships.

During the first quarter of fiscal year 2010, there was growing optimism that the global economy had emerged from recession and was moving into recovery. Market conditions continued to improve during the quarter, as evidenced by 4% and 6% increases in the MSCI World and S&P 500 indexes. Our results of operations also improved during the quarter consistent with the positive market performance. Our operating income for the quarter increased 21% from the prior quarter and 74% from the same period in the prior fiscal year.

Our total assets under management at December 31, 2009 were \$553.5 billion, 6% higher than they were at September 30, 2009 and 33% higher than they were at December 31, 2008. Simple monthly average assets under management for the first quarter of fiscal year 2010 increased 22%

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from the same period in the prior fiscal year. Market appreciation of \$16.6 billion and positive net new flows of \$14.3 billion during the three months ended December 31, 2009 accounted for the increase in total assets under management for the quarter. Long-term sales activity for the quarter increased 21% from the prior quarter, mainly due to a 45% increase in sales of our global/international taxable fixed-income products.

Uncertainties regarding the economic recovery remain in the foreseeable future. As we confront the challenges of this economic environment, we expect to continue to focus on the investment performance of our sponsored investment products and on providing high quality customer service to our clients. While we are focused on expense management, we will also seek to attract, retain and develop employees and invest strategically in systems and technology that will provide secure, stable environments and economies of scale. We will continue to protect and further our brand recognition while developing and maintaining broker/dealer and client relationships. The success of these and other strategies may be influenced by the factors discussed in the Risk Factors section set forth below.

## RESULTS OF OPERATIONS

| <i>(dollar amounts in millions, except per share data)</i> | Three Months Ended |            | Percent Change |
|--|--------------------|------------|----------------|
|  | December 31,       |            |                |
|  | 2009               | 2008       |                |
| <b>Operating Income</b>                                    | \$ 467.0           | \$ 268.4   | 74%            |
| <b>Net Income attributable to Franklin Resources, Inc.</b> | 355.6              | 120.9      | 194%           |
| <b>Earnings Per Share</b>                                  |                    |            |                |
| Basic  | \$ 1.55            | \$ 0.52    | 198%           |
| Diluted  | 1.54               | 0.52       | 196%           |
| <b>Operating Margin<sup>1</sup></b>                        | <b>34%</b>         | <b>28%</b> |                |

<sup>1</sup> Defined as operating income divided by total operating revenues.

Operating income increased for the three months ended December 31, 2009 as compared to the same period in the prior fiscal year. The increase was primarily due to a \$206.4 million or 34% increase in investment management revenue, which resulted from a 22% increase in simple monthly average assets under management and a higher effective management fee rate.

Net income attributable to Franklin Resources, Inc. increased primarily due to the \$198.6 million increase in operating income and a \$141.0 million increase in other income (expenses), partially offset by a \$92.0 million increase in taxes on income. Other income (expenses) increased for the three months ended December 31, 2009 primarily due to higher investment valuations during the quarter resulting from improved market conditions.

Diluted earnings per share increased consistent with the increase in net income as well as a 1% decrease in diluted average common shares outstanding resulting primarily from the repurchase of shares of our common stock.

## ASSETS UNDER MANAGEMENT

Assets under management by investment objective were as follows:

| <i>(dollar amounts in billions)</i> | December 31,<br>2009 | December 31,<br>2008 | Percent<br>Change |
|-------------------------------------|----------------------|----------------------|-------------------|
| <b>Equity</b>                       |                      |                      |                   |
| Global/international                | \$ 189.5             | \$ 142.6             | 33%               |
| Domestic (U.S.)                     | 66.3                 | 55.2                 | 20%               |
| Total equity                        | 255.8                | 197.8                | 29%               |
| <b>Hybrid</b>                       | 104.0                | 78.8                 | 32%               |
| <b>Fixed-Income</b>                 |                      |                      |                   |
| Tax-free                            | 69.7                 | 56.1                 | 24%               |
| Taxable                             |                      |                      |                   |
| Global/international                | 77.5                 | 45.9                 | 69%               |
| Domestic (U.S.)                     | 40.4                 | 29.8                 | 36%               |
| Total fixed-income                  | 187.6                | 131.8                | 42%               |

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|  |           |              |           |              |            |
|--|-----------|--------------|-----------|--------------|------------|
| <b>Cash Management<sup>1</sup></b>                                   |           | 6.1          | 7.8       | (22)%        |            |
| <b>Total</b>   | <b>\$</b> | <b>553.5</b> | <b>\$</b> | <b>416.2</b> | <b>33%</b> |
| <b>Simple Monthly Average for the Three-Month Period<sup>2</sup></b> | <b>\$</b> | <b>534.9</b> | <b>\$</b> | <b>438.7</b> | <b>22%</b> |

<sup>1</sup> Includes both U.S.-registered money market funds and non-U.S. registered funds with similar investment objectives.

<sup>2</sup> Investment management fees from approximately 54% of our assets under management at December 31, 2009 were calculated using daily average assets under management.

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Assets under management at December 31, 2009 were 33% higher than they were at December 31, 2008, primarily due to market appreciation of \$113.0 billion and positive net new flows of \$27.0 billion during the twelve-month period. The increases occurred in both equity and fixed-income products as improved market conditions led to significant valuation increases, higher sales and lower redemptions. Simple monthly average assets under management, which are generally more indicative of trends in revenue for providing investment management and fund administration services than the year over year change in ending assets under management, increased 22% during the three months ended December 31, 2009, as compared to the same period in the prior fiscal year.

The simple monthly average mix of assets under management is shown below. The change in mix for the three months ended December 31, 2009 as compared to the same period in the prior fiscal year reflects an investor shift to lower risk investments during the prior twelve months.

|                 | Three Months Ended<br>December 31, |             |
|-----------------|------------------------------------|-------------|
|                 | 2009                               | 2008        |
| Equity          | 46%                                | 49%         |
| Hybrid          | 19%                                | 19%         |
| Fixed-income    | 34%                                | 30%         |
| Cash management | 1%                                 | 2%          |
| <b>Total</b>    | <b>100%</b>                        | <b>100%</b> |

Assets under management by sales region were as follows:

| <i>(dollar amounts in billions)</i> | December 31,<br>2009 | Percent<br>of Total | December 31,<br>2008 | Percent<br>of Total |
|-------------------------------------|----------------------|---------------------|----------------------|---------------------|
| United States <sup>1</sup>          | \$ 407.9             | 74%                 | \$ 313.8             | 75%                 |
| Europe <sup>2</sup>                 | 60.8                 | 11%                 | 41.2                 | 10%                 |
| Asia-Pacific <sup>3</sup>           | 52.5                 | 9%                  | 35.9                 | 9%                  |
| Canada                              | 32.3                 | 6%                  | 25.3                 | 6%                  |
| <b>Total</b>                        | <b>\$ 553.5</b>      | <b>100%</b>         | <b>\$ 416.2</b>      | <b>100%</b>         |

<sup>1</sup> Approximately 67% and 69% of our operating revenues originated from U.S. operations in the three months ended December 31, 2009 and 2008.

<sup>2</sup> Europe sales region includes Middle East and Africa.

<sup>3</sup> Asia-Pacific sales region includes Latin America and Australia.

Due to the global nature of our business operations, investment management and related services may be performed in locations unrelated to the sales region.

Components of the change in our assets under management were as follows:

| <i>(dollar amounts in billions)</i> | Three Months Ended<br>December 31, |               | Percent<br>Change |
|-------------------------------------|------------------------------------|---------------|-------------------|
|                                     | 2009                               | 2008          |                   |
| Beginning assets under management   | \$ 523.4                           | \$ 507.3      | 3%                |
| Long-term sales                     | 42.2                               | 27.8          | 52%               |
| Long-term redemptions               | (28.2)                             | (45.1)        | (37)%             |
| Net cash management                 | 0.3                                | (0.9)         | NM                |
| <b>Net new flows</b>                | <b>14.3</b>                        | <b>(18.2)</b> | <b>NM</b>         |
| Reinvested distributions            | 3.7                                | 7.1           | (48)%             |

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|                                       |                 |                 |            |
|---------------------------------------|-----------------|-----------------|------------|
| <b>Net flows</b>                      | <b>18.0</b>     | <b>(11.1)</b>   | <b>NM</b>  |
| Distributions                         | (4.5)           | (9.0)           | (50)%      |
| Appreciation (depreciation) and other | 16.6            | (71.0)          | NM         |
| <b>Ending Assets Under Management</b> | <b>\$ 553.5</b> | <b>\$ 416.2</b> | <b>33%</b> |

Assets under management increased during the three months ended December 31, 2009, resulting from \$16.6 billion of appreciation, primarily in our equity products, and \$14.3 billion of positive net new flows, primarily in our fixed-income products.



## Investment Management Fee Rate

For the three months ended December 31, 2009, our effective investment management fee rate (investment management fees divided by simple monthly average assets under management) increased to 0.603% for the three months ended December 31, 2009 from 0.547% for the same period a year ago. The increase was primarily due to a higher level of global/international assets under management, partially offset by an overall shift in the mix of assets under management from equity products towards fixed-income products. Generally, investment management fees earned on equity products are higher than fees earned on fixed-income products, and fees earned on global/international products are higher than fees earned on domestic (U.S.) products.

## OPERATING REVENUES

The table below presents the percentage change in each revenue category.

| <i>(dollar amounts in millions)</i>                    | Three Months Ended |                 | Percent Change |
|--|--------------------|-----------------|----------------|
|  | December 31,       |                 |                |
|  | 2009               | 2008            |                |
| Investment management fees                             | \$ 806.7           | \$ 600.3        | 34%            |
| Underwriting and distribution fees                     | 488.1              | 304.9           | 60%            |
| Shareholder servicing fees                             | 69.5               | 66.3            | 5%             |
| Consolidated sponsored investment products income, net | 0.4                | 1.9             | (79)%          |
| Other, net   | 12.7               | (4.1)           | NM             |
| <b>Total Operating Revenues</b>                        | <b>\$ 1,377.4</b>  | <b>\$ 969.3</b> | <b>42%</b>     |

## Investment Management Fees

Investment management fees are generally calculated under contractual arrangements with our sponsored investment products and sub-advised accounts as a percentage of the market value of assets under management. Annual rates vary by investment objective and type of services provided.

Investment management fees increased for the three months ended December 31, 2009 primarily due to a 22% increase in simple monthly average assets under management and a higher effective management fee rate for the quarter, as described above.

## Underwriting and Distribution Fees

We earn underwriting fees from the sale of certain classes of sponsored investment products on which investors pay a sales commission at the time of purchase. Sales commissions are reduced or eliminated on some share classes and for some sale transactions depending upon the amount invested and the type of investor. Therefore, underwriting fees will change with the overall level of gross sales, the size of individual transactions, and the relative mix of sales between different share classes and types of investors.

Globally, our mutual funds and certain other products generally pay us distribution fees in return for sales, marketing and distribution efforts on their behalf. Specifically, the majority of U.S.-registered mutual funds, with the exception of certain of our money market mutual funds, have adopted distribution plans (the Plans) under Rule 12b-1 promulgated under the Investment Company Act of 1940, as amended (Rule 12b-1). The Plans permit the mutual funds to bear certain expenses relating to the distribution of their shares, such as expenses for marketing, advertising, printing and sales promotion, subject to the Plans' limitations on amounts. The individual Plans set a percentage limit for Rule 12b-1 expenses based on average daily net assets under management of the mutual fund. Similar arrangements exist for the distribution of our non-U.S. funds and where, generally, the distributor of the funds in the local market arranges for and pays commissions.

We pay a significant portion of underwriting and distribution fees to the financial advisers and other intermediaries who sell our sponsored investment products to the public on our behalf. See the description of underwriting and distribution expenses below.

Overall, underwriting and distribution fees increased for the three months ended December 31, 2009. Underwriting fees increased 127% primarily due to a 172% increase in gross commissionable sales, partially offset by a shift in sales from equity products to fixed-income products, which typically generate lower underwriting fees. Distribution fees increased 36% primarily due to a 22% increase in simple monthly average assets under management, combined with a shift in the mix of assets under management from institutional to retail products, which typically generate higher distribution fees.

**Shareholder Servicing Fees**

We receive shareholder servicing fees as compensation for providing transfer agency services, which include providing customer statements, transaction processing, customer service, and tax reporting. These fees are generally fixed charges per shareholder account that vary with the particular type of fund and the service being rendered. In some instances, we charge

sponsored investment products these fees based on the level of assets under management. In the United States, transfer agency service agreements provide that accounts closed in a calendar year generally remain billable at a reduced rate through the second quarter of the following calendar year. In Canada, such agreements provide that accounts closed in the calendar year remain billable for four months after the end of the calendar year. Accordingly, the level of fees will vary with the change in open accounts and the level of closed accounts that remain billable.

Shareholder servicing fees increased for the three months ended December 31, 2009 primarily due to a favorable currency impact and a 5% increase in simple monthly average billable shareholder accounts during the period. The favorable currency impact mainly resulted from a 14% increase in the value of the Canadian dollar against the U.S. dollar. The account increase was predominantly related to shareholder accounts originated in the United States, which are generally billable at higher rates than in other regions.

#### Consolidated Sponsored Investment Products Income, Net

Consolidated sponsored investment products income, net reflects the net investment income, including dividend and interest income, of sponsored investment products that we consolidate in our financial statements.

Consolidated sponsored investment products income, net decreased for the three months ended December 31, 2009, reflecting investment performance and net asset balances of the specific sponsored investment products that we consolidated during each period and the deconsolidation of certain sponsored investment products during the current quarter.

#### Other, Net

Other, net revenue primarily consists of revenues from the banking/finance segment as well as income from custody services. Banking/finance revenues include interest income on loans, servicing income, and realized and unrealized gains (losses) on residual interests from securitization transactions, and are reduced by interest expense and the provision for loan losses.

Other, net revenue increased for the three months ended December 31, 2009 primarily due to a \$17.7 million loss recognized in the three months ended December 31, 2008 due to a decline in the fair value of retained interests from securitization transactions and a \$3.0 million decrease in provision for loan losses, partially offset by a \$2.1 million decrease in interest income on the retained interests.

#### OPERATING EXPENSES

The table below presents the percentage change in each expense category.

| <i>(dollar amounts in millions)</i>           | Three Months Ended |                   | Percent Change |
|---|--------------------|-------------------|----------------|
|   | December 31, 2009  | December 31, 2008 |                |
| Underwriting and distribution                 | \$ 467.0           | \$ 289.5          | 61%            |
| Compensation and benefits                     | 254.3              | 244.1             | 4%             |
| Information systems, technology and occupancy | 68.6               | 68.6              | 0%             |
| Advertising and promotion                     | 34.8               | 24.2              | 44%            |
| Amortization of deferred sales commissions    | 46.5               | 36.6              | 27%            |
| Other   | 39.2               | 38.0              | 3%             |
| <b>Total Operating Expenses</b>               | <b>\$ 910.4</b>    | <b>\$ 701.0</b>   | <b>30%</b>     |

#### Underwriting and Distribution

Underwriting and distribution expenses include payments to financial advisers and other third parties for providing sales, marketing and distribution services to investors in our sponsored investment products. The increase in underwriting and distribution expenses for the three months ended December 31, 2009 was consistent with the 60% increase in underwriting and distribution revenues during the quarter.

#### Compensation and Benefits

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Compensation and benefit expenses increased for the three months ended December 31, 2009 primarily due to a \$25.7 million increase in variable compensation. The increase in variable compensation was mainly due to higher bonus expense under the Amended and Restated Annual Incentive Compensation Plan ( AIP ), pursuant to which bonus awards are made based on our performance. The increase was partially offset by an \$11.2 million decrease in severance costs related to the 2% reduction in our global workforce announced in October 2008 and a \$4.3 million decrease in salaries, wages and benefits resulting from lower

staffing levels. As of December 31, 2009, we had approximately 7,800 employees, a decrease from approximately 8,600 employees at December 31, 2008.

We continue to place a high emphasis on our pay for performance philosophy. As such, any changes in the underlying performance of our sponsored investment products or changes in the composition of our incentive compensation offerings could have an impact on compensation and benefit expenses going forward. However, in order to attract and retain talented individuals, our level of compensation and benefit expenses may increase more quickly or decrease more slowly than our revenue.

### Information Systems, Technology and Occupancy

Information systems, technology and occupancy costs remained unchanged for the three months ended December 31, 2009. Slightly higher occupancy costs during the period were offset by lower costs incurred for technical consulting.

Details of capitalized information systems and technology costs, which exclude occupancy costs, are shown below.

| <i>(in millions)</i>                       | Three Months Ended<br>December 31, |                |
|--|------------------------------------|----------------|
|  | 2009                               | 2008           |
| Net carrying value at beginning of period  | \$ 65.2                            | \$ 66.5        |
| Additions during period, net of disposals  | 3.9                                | 15.3           |
| Amortization during period                 | (8.3)                              | (7.9)          |
| <b>Net Carrying Value at End of Period</b> | <b>\$ 60.8</b>                     | <b>\$ 73.9</b> |

### Advertising and Promotion

Advertising and promotion expenses increased for the three months ended December 31, 2009 primarily due to an \$11.8 million increase in marketing support payments to intermediaries resulting from higher product sales and assets under management. The increase was partially offset by a \$1.1 million decrease in sales promotion expenses primarily as a result of ongoing global cost reduction initiatives.

We are committed to investing in advertising and promotion in response to changing business conditions, and to advance our products where we see continued or potential new growth opportunities. As a result of potential changes in our strategic marketing campaigns, the level of advertising and promotion expenditures may increase more rapidly, or decrease more slowly, than our revenues.

### Amortization of Deferred Sales Commissions

Certain fund share classes sold globally, including Class C and Class R shares marketed in the United States, are sold without a front-end sales charge to shareholders, although our distribution subsidiaries pay an up-front commission to financial intermediaries on these sales. In addition, certain share classes, such as Class A shares sold in the United States, are sold without a front-end sales charge to shareholders when minimum investment criteria are met, although our distribution subsidiaries pay an up-front commission to financial intermediaries on these sales. We defer all up-front commissions paid by our distribution subsidiaries and amortize them over the periods in which commissions are generally recovered from distribution and service fee revenues and contingent sales charges received from shareholders of the funds upon redemption of their shares. We evaluate deferred commission assets ( DCA ) for recoverability on a periodic basis using undiscounted expected cash flows from the shares of mutual funds sold without a front-end sales charge.

We previously held 49% ownership interests in Lightning Finance Company Limited ( LFL ) and Lightning Asset Finance Limited ( LAFL ). Due to our significant interest in LAFL, we carried on our consolidated balance sheets the DCA generated in the United States and the financing liability for the related future revenue we previously sold to LFL, which was subsequently transferred to LAFL. We repurchased the remaining DCA from LAFL in September 2009 and liquidated our ownership interests in LFL and LAFL during the three months ended December 31, 2009.

Amortization of deferred sales commissions increased for the three months ended December 31, 2009 mainly due to accelerated amortization of the DCA repurchased from LAFL. Higher product sales with up-front commissions, primarily related to U.S. funds, also contributed to the increase.

**Other Operating Expenses**

Other operating expenses primarily consist of professional fees, fund administration services and shareholder servicing fees payable to external parties, corporate travel and entertainment, and other miscellaneous expenses.

Other operating expenses increased for the three months ended December 31, 2009 primarily due to a \$2.1 million increase in fund administration services and shareholder servicing fees payable to external parties, which resulted from higher average assets under management, partially offset by a decrease in litigation costs.

#### Other Income (Expenses)

| <i>(in millions)</i>   | Three Months Ended<br>December 31, |                  |
|--|------------------------------------|------------------|
|  | 2009                               | 2008             |
| Consolidated sponsored investment products gains (losses), net | \$ 15.1                            | \$ (47.5)        |
| Investment and other income (losses), net                      | 33.0                               | (45.0)           |
| Interest expense   | (0.8)                              | (1.2)            |
| <b>Other income (expenses), net</b>                            | <b>\$ 47.3</b>                     | <b>\$ (93.7)</b> |

Other income (expenses) includes net realized and unrealized investment gains (losses) on consolidated sponsored investment products, investment and other income, net and interest expense from our investment management and related services business. Investment and other income, net is comprised primarily of income related to our investments, including interest and dividend income, realized gains and losses on sale of and other-than-temporary impairments of available-for-sale investment securities, income from equity method investees, and foreign currency exchange gains and losses.

Other income (expenses) increased for the three months ended December 31, 2009 primarily due to higher investment valuations resulting from improved market conditions. This resulted in current quarter net gains of \$15.1 million from securities held by our consolidated sponsored investment products and \$12.4 million from trading investments, and income from equity method investees of \$4.1 million, as compared to net losses during the same period in the prior fiscal year of \$47.5 million from securities held by our consolidated sponsored investment products, \$26.6 million from trading investments and \$25.5 million from equity method investees. Also contributing to the increase was a \$32.4 million reduction in other-than-temporary impairments on available-for-sale investment securities.

Our investments in sponsored investment products primarily consist of the initial cash investments made in the course of launching mutual fund and other investment product offerings; however we may also invest in our products for other business reasons. The market conditions that impact our assets under management similarly affect the investment income earned or losses incurred on our sponsored investment product investments.

#### Taxes on Income

As a multi-national corporation, we provide investment management and related services to a wide range of international sponsored investment products, often managed from locations outside the United States. Some of these jurisdictions have lower tax rates than the United States. The mix of pre-tax income (primarily from our investment management and related services business) subject to these lower rates, when aggregated with income originating in the United States, produces a lower overall effective income tax rate than existing U.S. federal and state income tax rates.

Our effective income tax rate was 30.48% for the three months ended December 31, 2009, as compared to 37.08% for the same period in the prior fiscal year. The decrease was primarily due to the release of a valuation allowance for state deferred tax assets and a decrease in foreign income currently taxable in U.S., net of foreign tax credits.

The effective income tax rate for future reporting periods will continue to reflect the relative contributions of non-U.S. earnings that are subject to reduced tax rates and that are not currently included in U.S. taxable income.

**LIQUIDITY AND CAPITAL RESOURCES**

The following table summarizes certain key financial data relating to our liquidity, capital resources and uses of capital.

| <i>(in millions)</i>            | December 31,<br>2009 | September 30,<br>2009 |
|---------------------------------|----------------------|-----------------------|
| <b>Balance Sheet Data</b>       |                      |                       |
| <b>Assets</b>                   |                      |                       |
| Liquid assets                   | \$ 5,529.7           | \$ 5,832.6            |
| Cash and cash equivalents       | 2,850.3              | 3,104.5               |
| <b>Liabilities</b>              |                      |                       |
| <b>Debt</b>                     |                      |                       |
| Commercial paper                | \$ 256.7             | \$ 64.2               |
| Federal Home Loan Bank advances | 66.0                 | 57.0                  |
| <b>Total debt</b>               | <b>\$ 322.7</b>      | <b>\$ 121.2</b>       |

| <i>(in millions)</i>  | Three Months Ended<br>December 31, |         |
|-----------------------|------------------------------------|---------|
|                       | 2009                               | 2008    |
| <b>Cash Flow Data</b> |                                    |         |
| Operating cash flows  | \$ 317.1                           | \$ 41.9 |
| Investing cash flows  | 69.1                               | 160.1   |
| Financing cash flows  | (640.6)                            | 152.1   |
| <i>Liquidity</i>      |                                    |         |

Liquid assets consist of cash and cash equivalents, current receivables, and current and certain other investments (trading, available-for-sale and other). Cash and cash equivalents include cash on hand, non-interest-bearing and interest-bearing deposits with financial institutions, federal funds sold, time deposits, securities of the U.S. Treasury and federal agencies, debt instruments with original maturities of three months or less at the purchase date and other highly liquid investments, including money market funds, which are readily convertible into cash. Cash and cash equivalents at December 31, 2009 decreased primarily due to net cash used in financing activities. At December 31, 2009, the percentages of cash and cash equivalents held by our U.S. and non-U.S. operations were approximately 39% and 61%, as compared to approximately 49% and 51% at September 30, 2009. The percentage of cash and cash equivalents held by our U.S. operations decreased primarily due to dividends paid to our shareholders.

The increase in total debt outstanding during the three months ended December 31, 2009 primarily relates to the issuance of commercial paper in December 2009. We periodically issue commercial paper to meet short-term operational needs.

We experienced an increase in net cash provided by operating activities during the three months ended December 31, 2009, as compared to the same period in the prior fiscal year, primarily due to an increase in net income. Net cash provided by investing activities decreased mainly due to a decrease in liquidation of investments and an increase in loans receivable, partially offset by a decrease in purchase of investments. We experienced financing cash outflows for the three months ended December 31, 2009, as compared to financing cash inflows for the same period in the prior fiscal year, primarily due to an increase in dividends paid on common stock and an increase in common stock repurchases.

*Capital Resources*

We believe that we can meet our present and reasonably foreseeable operating cash needs and future commitments through existing liquid assets, continuing cash flows from operations, borrowing capacity under current credit facilities and the ability to issue debt or equity securities.

At December 31, 2009, our current debt consisted of commercial paper with a total face value of \$256.7 million that was issued at a weighted-average annualized interest rate of 0.20% and matures during the quarter ending March 31, 2010.

The banking/finance segment has financed its automobile lending business primarily through Federal Home Loan Bank ( FHLB ) advances, which had a total outstanding balance of \$66.0 million at December 31, 2009. Approximately \$15.0 million of these advances mature by December 31, 2010, while the remaining \$51.0 million mature between June 2011 and January 2039. These advances had a weighted-average



interest rate of 2.93% at December 31, 2009 and are subject to collateralization requirements.

At December 31, 2009, we had \$420.0 million in short-term revolving credit available under a five-year credit facility with certain banks and financial institutions expiring on June 9, 2010, \$243.3 million of short-term commercial paper available for issuance under an uncommitted \$500.0 million private placement program, and \$14.3 million available in uncommitted short-term bank lines of credit. The revolving credit facility is available for general corporate purposes, including the support of our commercial paper program. It is subject to various financial covenants, including, but not limited to, minimum requirements related to our interest coverage ratio and maintenance of working capital as well as limitations on our capitalization ratio, indebtedness, investments and liens. Interest rates on loans under the revolving credit facility are determined at the time of issuance and depend on the type of loan issued. As of December 31, 2009, there were no amounts outstanding under the revolving credit facility and we were in compliance with the financial covenants related to this facility. In addition, at December 31, 2009, our banking/finance segment had \$295.0 million available in uncommitted short-term bank lines of credit under the Federal Reserve system, \$229.2 million available in secured Federal Reserve Bank short-term discount window and \$55.6 million available in secured FHLB short-term borrowing capacity.

In March 2008, we filed an automatic shelf registration statement with the SEC as a well-known seasoned issuer. Using the shelf registration statement, we may sell, at any time and from time to time, in one or more offerings, our shares of common stock, shares of preferred stock, debt securities, convertible securities, warrants or units.

Our ability to access the capital markets in a timely manner depends on a number of factors, including our credit rating, the condition of the global economy, investors' willingness to purchase our securities, interest rates, credit spreads and the valuation levels of equity markets. If we are unable to access capital markets in a timely manner, our business could be adversely impacted.

#### *Uses of Capital*

We expect that our main uses of cash will be to expand our core business, make strategic acquisitions, acquire shares of our common stock, fund property and equipment purchases, pay operating expenses of the business, enhance technology infrastructure and business processes, pay stockholder dividends and repay and service debt.

On December 18, 2009, our Board of Directors declared a regular quarterly cash dividend of \$0.22 per share which was payable on January 8, 2010 to stockholders of record on December 31, 2009. Additionally, our Board of Directors declared a special cash dividend of \$3.00 per share which was payable on December 31, 2009 to stockholders of record on December 28, 2009.

We maintain a stock repurchase program to manage our equity capital with the objective of maximizing shareholder value. Our stock repurchase program is affected through regular open-market purchases and private transactions in accordance with applicable laws and regulations. During the three months ended December 31, 2009, we repurchased 1.6 million shares of our common stock at a cost of \$174.0 million. The common stock repurchases made as of December 31, 2009 reduced our capital in excess of par value to nil and the excess amount was recognized as a reduction to retained earnings. At December 31, 2009, approximately 8.0 million shares of our common stock remained available for repurchase under our stock repurchase program. Our stock repurchase program is not subject to an expiration date.

The funds that we manage have their own resources available for purposes of providing liquidity to meet shareholder redemptions, including securities that can be sold or provided to investors as in-kind redemptions, and lines of credit. While we have no contractual obligation to do so, we may voluntarily elect to provide the funds with direct or indirect financial support based on our business objectives.

#### **CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS**

Our contractual obligations are summarized in our Form 10-K for the fiscal year ended September 30, 2009. At December 31, 2009, there were no material changes outside the ordinary course in our contractual obligations from September 30, 2009.

We are obligated to cover shortfalls for automobile loan securitization trusts that are structured as qualified special purpose entities in amounts due to holders of asset-backed securities up to certain levels. At December 31, 2009, the maximum potential amount of future payments related to these guarantees was \$6.9 million and the fair value of the guarantees was recognized as banking/finance liabilities in the condensed consolidated balance sheets and was not significant.

At December 31, 2009, the banking/finance operating segment had issued financial standby letters of credit totaling \$6.3 million on which beneficiaries would be able to draw upon in the event of non-performance by our customers, primarily in relation to lease and lien obligations of these banking customers. These standby letters of credit were secured by marketable securities with a fair value of \$7.5 million at December 31, 2009.

#### **OFF-BALANCE SHEET ARRANGEMENTS**

Our banking/finance operating segment periodically enters into automobile loan securitization transactions with qualified special purpose entities, which then issue asset-backed securities to private investors (see Note 8 – Securitization of Loans Held for Sale in the notes to the condensed consolidated financial statements in Item 1 of Part I of this Form 10-Q). Our main objective in entering into these securitization transactions is to obtain financing for automobile loan activities. Securitized loans held by the securitization trusts totaled \$489.5 million at December 31, 2009 and \$551.4 million at September 30, 2009.

In our role as agent or trustee, we facilitate the settlement of investor share purchase, redemption, and other transactions with affiliated mutual funds. We are appointed by the affiliated mutual funds as agent or trustee to manage, on behalf of the affiliated mutual funds, bank deposit accounts that contain only (i) cash remitted by investors to the affiliated mutual funds for the direct purchase of fund shares, or (ii) cash remitted by the affiliated mutual funds for direct delivery to the investors for either the proceeds of fund shares liquidated at the investors' direction, or dividends and capital gains earned on fund shares. As of December 31, 2009 and September 30, 2009, we held cash of approximately \$371.7 million and \$214.5 million off-balance sheet in agency or trust for investors and the affiliated mutual funds.

#### **CRITICAL ACCOUNTING POLICIES**

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America, which require the use of estimates, judgments, and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Actual results may differ from those estimates under different assumptions. Following are updates to our critical accounting policies disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K for the fiscal year ended September 30, 2009.

##### *Fair Value Measurements*

We record substantially all of our investments in the financial statements at fair value or amounts that approximate fair value. We use a three-level fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value based on whether the inputs to those valuation techniques are observable or unobservable.

Level 3 assets represented approximately 2.3% and 2.1% of total assets measured at fair value at December 31, 2009 and September 30, 2009, and Level 3 liabilities measured at fair value were insignificant. There were no transfers into or out of Level 3 during the three months ended December 31, 2009 and immaterial transfers into and no transfers out of Level 3 during the three months ended December 31, 2008.

##### *Goodwill and Other Intangible Assets*

We make significant estimates and assumptions when valuing goodwill and other intangible assets in connection with the initial purchase price allocation of an acquired entity, as well as when evaluating impairment of goodwill and other intangible assets on an ongoing basis.

Goodwill is tested for impairment annually and when an event occurs or circumstances change that more likely than not reduce the fair value of a reporting unit below its carrying value. Indefinite-lived intangible assets are tested for impairment annually and when events or changes in circumstances indicate the assets might be impaired. Impairment is indicated when the carrying value of the intangible asset exceeds its fair value.

We performed our annual impairment tests for goodwill and indefinite-lived intangible assets as of August 1, 2009. We did not recognize any impairment because our estimates of the fair values of our reporting unit and our indefinite-lived assets exceeded their respective carrying values. A hypothetical 500 basis point decline in the assets under management growth rate or a 500 basis point increase in the discount rate would not cause either the investment management and related services reporting unit or the management contracts to fail step one of the impairment tests for goodwill or indefinite-lived intangible assets.

We subsequently monitor the market conditions and their potential impact on the assumptions used in the annual calculations of fair value to determine whether circumstances have changed that would more likely than not reduce the fair value of our reporting unit below its carrying value, or indicate that our indefinite-lived intangible assets might be impaired. We consider, among other things, changes in our assets under management and pre-tax profit margin amounts, which affect our revenue growth rate assumptions, by assessing whether these changes would

impact the reasonableness of the assumptions used in our impairment

test as of August 1, 2009. We also monitor fluctuations of our common stock per share price to evaluate our market capitalization relative to the reporting unit as a whole. Subsequent to August 1, 2009, there were no impairments to goodwill or indefinite-lived intangible assets as we determined no events occurred or circumstances changed that would more likely than not reduce the fair value of the reporting unit below its carrying value, or indicate that our indefinite-lived intangible assets might be impaired.

We test definite-lived intangible assets for impairment quarterly. As of December 31, 2009, approximately 90% of our definite-lived intangible assets related to investment management contracts of Fiduciary Trust Company International ( FTCI ). The undiscounted future cash flow projections for FTCI institutional and high net-worth management contracts exceeded their carrying values by approximately 50% and 5%, respectively. We estimated the undiscounted future cash flows using assets under management growth rates ranging from -6.2% to 6.0% depending on the type of management contracts. The undiscounted future cash flow projections for the other definite-lived intangible assets exceeded their respective carrying values by more than 100%. The assumptions used in our impairment tests for definite-lived intangible assets were developed taking into consideration the ongoing market conditions. As of December 31, 2009, a decline in our assets under management of approximately 5% could cause us to evaluate whether the fair value of our definite-lived intangible assets is below the asset carrying value.

While we believe that our impairment tests and the assumptions used to estimate fair value are reasonable and appropriate, if the assumptions used in our estimates of fair value change in the future, we may be required to record impairment charges or otherwise accelerate amortization expense.

#### *Income Taxes*

We record deferred tax assets and liabilities for temporary differences between the tax basis of assets and liabilities, and the reported amounts in the consolidated financial statements using the statutory tax rates in effect for the year when the reported amount of the asset or liability is recovered or settled, respectively. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying values of deferred tax assets to the amount that is more likely than not to be realized. For each tax position taken or expected to be taken in a tax return, we determine whether it is more likely than not that the position will be sustained upon examination based on the technical merits of the position, including resolution of any related appeals or litigation. A tax position that meets the more likely than not recognition threshold is measured to determine the amount of benefit to recognize. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. We recognize the accrual of interest on uncertain tax positions in interest expense and penalties in other operating expenses.

As a multinational corporation, we operate in various locations outside the United States and generate earnings from our non-U.S. subsidiaries. We indefinitely reinvest the undistributed earnings of our non-U.S. subsidiaries, except for Subpart F income taxed in the U.S., subject to regulatory or contractual repatriation restrictions or contractual repatriation requirements, and the excess net earnings after debt service payments and regulatory capital requirements of our Canadian and U.K. consolidated subsidiaries. Changes to our policy of reinvestment or repatriation of non-U.S. earnings may have a significant effect on our financial condition and results of operations.

#### *Loss Contingencies*

We are involved in various lawsuits and claims encountered in the normal course of business. When such a matter arises and periodically thereafter, we consult with our legal counsel and evaluate the merits of the claims based on the facts available at that time. In management's opinion, an adequate accrual has been made as of December 31, 2009 to provide for probable losses that may arise from these matters for which we could reasonably estimate an amount. See also Note 11 - Commitments and Contingencies in the notes to condensed consolidated financial statements in Item 1 of Part I of this Form 10-Q.

#### **RISK FACTORS**

*Volatility and disruption of the capital and credit markets, and adverse changes in the global economy, may significantly affect our results of operations and may put pressure on our financial results.* The capital and credit markets have experienced substantial volatility and disruption during the past year. Although global market conditions have shown some stabilization and improvement, the decline in global market conditions has in the past resulted in significant decreases in our assets under management, revenues and income, and future declines may negatively impact our performance. Such declines have had and may in the future have an adverse impact on our results of operations. Even if legislative or regulatory initiatives or other efforts successfully stabilize and add liquidity to the financial markets, we may need to modify our business, strategies or operations, and we may be subject to additional constraints or costs in order to satisfy new regulatory requirements or to compete in a changed business environment.

*The amount and mix of our assets under management are subject to significant fluctuations.* Fluctuations in the amount and mix of our assets under management may be attributable in part to market conditions outside of our control that have had, and could continue to have, a negative impact on our revenues and income. We derive the majority of our operating revenues and net income from providing investment management

and related services. The level of our revenues depends largely on the level and

mix of assets under management. Any decrease in the value or amount of our assets under management because of market volatility or other factors negatively impacts our revenues and income. We are subject to an increased risk of asset volatility from changes in the global financial and equity markets. Individual financial and equity markets may be adversely affected by economic, political, financial, or other instabilities that are particular to the country or regions in which a market is located, including without limitation local acts of terrorism, economic crises or other business, social or political crises. Declines in these markets have caused in the past, and would cause in the future, a decline in our revenues and income. Global economic conditions, exacerbated by war or terrorism or financial crises, changes in the equity market place, currency exchange rates, interest rates, inflation rates, the yield curve, defaults by derivative counterparties and other factors that are difficult to predict affect the mix, market values and levels of our assets under management. The funds we manage may be subject to an unanticipated large number of redemptions as a result of such events, causing the funds to sell securities they hold, possibly at a loss, or draw on any available lines of credit to obtain cash to settle these redemptions, or settle in-kind with securities held in the applicable fund. The Company, in its discretion, may also provide financial support to a fund to enable it to maintain sufficient liquidity in such event. Our investment management services revenues are derived primarily from fees based on a percentage of the value of assets under management and vary with the nature of the account or product managed. A decline in the price of stocks or bonds, or in particular market segments, or in the securities market generally, could cause the value and returns on our assets under management to decline, resulting in a decline in our revenues and income. Moreover, changing market conditions may cause a shift in our asset mix between international and U.S. assets, potentially resulting in a decline in our revenue and income depending upon the nature of our assets under management and the level of management fees we earn based on them. Additionally, changing market conditions may cause a shift in our asset mix towards fixed-income products and a related decline in our revenue and income, as we generally derive higher fee revenues and income from equity assets than from fixed-income products we manage. On the other hand, increases in interest rates, in particular if rapid, or high interest rates, as well as any uncertainty in the future direction of interest rates, may have a negative impact on our fixed-income products as rising interest rates or interest rate uncertainty typically decrease the total return on many bond investments due to lower market valuations of existing bonds. Any decrease in the level of our assets under management resulting from price declines, interest rate volatility or uncertainty, increased redemptions or other factors could negatively impact our revenues and income.

*We are subject to extensive and complex, overlapping and frequently changing rules, regulations and legal interpretations.* Our investment management and related services business and our banking/finance business are subject to extensive and complex, overlapping and frequently changing rules, regulations and legal interpretations in the countries in which we operate, including, among others, securities, banking, accounting and tax laws and regulations. Moreover, financial reporting requirements, and the processes, controls and procedures that have been put in place to address them, are often comprehensive and complex. While management has focused attention and resources on our compliance policies, procedures and practices, non-compliance with applicable laws or rules or regulations, conflicts of interest requirements or fiduciary principles, or our inability to keep up with, or adapt to, an ever changing, complex regulatory environment could result in sanctions against us, including fines and censures, injunctive relief, suspension or expulsion from a particular jurisdiction or market or the revocation of licenses, any of which could also adversely affect our reputation, prospects, revenues, and earnings.

We are subject to U.S. federal securities laws, state laws regarding securities fraud, other federal and state laws and rules and regulations of certain regulatory and self-regulatory organizations, including those rules and regulations promulgated by, among others, the SEC, the Financial Industry Regulatory Authority and the New York Stock Exchange. To the extent operations or trading in our securities take place outside the United States, we are subject to regulation by non-U.S. regulations and regulators, such as the U.K. Financial Services Authority, and U.S. regulations and regulators such as the Department of Justice and the SEC with respect to the Foreign Corrupt Practices Act of 1977. Certain of our subsidiaries are registered with the SEC under the Investment Advisers Act of 1940 and many of our funds are registered with the SEC under the Investment Company Act of 1940, both of which impose numerous obligations, as well as detailed operational requirements, on our subsidiaries which are investment advisers to registered investment companies. Our subsidiaries must comply with a myriad of complex and changing U.S. and/or non-U.S. rules and regulations, some of which may conflict, as well as complex tax regimes. Additionally, as we expand our operations, sometimes rapidly, into non-U.S. jurisdictions, the rules and regulations of these non-U.S. jurisdictions become applicable, sometimes with short compliance deadlines, and add further regulatory complexity to our ongoing compliance operations.

In addition, we are a bank holding company and a financial holding company subject to the supervision and regulation of the Federal Reserve Board (the FRB ) and are subject to the restrictions, limitations, or prohibitions of the Bank Holding Company Act of 1956, as amended, and the Gramm-Leach-Bliley Act. The FRB may impose additional limitations or restrictions on our activities, including if the FRB believes that we do not have the appropriate financial and managerial resources to commence or conduct an activity or make an acquisition. Further, our subsidiary, Fiduciary Trust, is subject to extensive regulation, supervision and examination by the Federal Deposit Insurance Corporation and New York State Banking Department, while other subsidiaries are subject to oversight by the Office of Thrift Supervision and various state regulators. The laws and regulations imposed by these regulators generally involve restrictions and requirements in connection with a variety of technical, specialized, and expanding matters and concerns. For example, compliance with anti-money laundering and Know-Your-Customer requirements, both domestically and internationally, and the Bank Secrecy Act has taken on heightened importance with regulators as a result of

efforts to, among other things, limit terrorism. At the same time, there has been increased regulation with respect to the protection of customer privacy and the need to secure sensitive customer information. As we continue to address these requirements or focus on meeting new or expanded ones, we may expend a substantial amount of time and resources, even though our banking/finance business does not constitute our dominant business sector. Any inability to meet these requirements, within the timeframes set by regulators, may subject us to sanctions or other restrictions by the regulators that could impact our broader business. Moreover, being subject to banking regulation may put us at a disadvantage compared to our competitors which are not subject to such requirements.

*Regulatory and legislative actions and reforms have made the regulatory environment in which we operate more costly and future actions and reforms could adversely impact our assets under management, increase costs and negatively impact our profitability and future financial results.* Since 2001, the federal securities laws have been augmented substantially and made significantly more complex by, among other measures, the Sarbanes-Oxley Act of 2002 and the USA Patriot Act of 2001. Moreover, changes in the interpretation or enforcement of existing laws or regulations have directly affected our business. With new laws and changes in interpretation and enforcement of existing requirements, the associated time we must dedicate to, and related costs we must incur in, meeting the regulatory complexities of our business have increased. These outlays have also increased as we expand our business into new jurisdictions. Compliance activities to meet these new legal requirements have required us to expend additional time and resources, and, consequently, we are incurring increased costs of doing business, which potentially negatively impacts our profitability and future financial results. Moreover, any potential accounting or reporting error, whether financial or otherwise, if material, could damage our reputation, adversely affect our ability to conduct business, and decrease revenue and net income. Finally, any regulatory and legislative actions and reforms affecting the mutual fund industry, including compliance initiatives, may negatively impact revenues by increasing our costs of accessing or dealing in the financial markets or by making certain investment offerings less favorable to our customers.

*Changes in tax laws or exposure to additional income tax liabilities could have a material impact on our financial condition, results of operations and liquidity.* We are subject to income taxes as well as non-income based taxes, in both the United States and various foreign jurisdictions and are subject to ongoing tax audits in various jurisdictions. Tax authorities may disagree with certain positions we have taken and assess additional taxes. We regularly assess the likely outcomes of these audits in order to determine the appropriateness of our tax provision. However, there can be no assurance that we will accurately predict the outcomes of these audits, and the actual outcomes of these audits could have a material impact on our net income or financial condition. Changes in tax laws or tax rulings could materially impact our effective tax rate. For example, proposals for fundamental U.S. international tax reform, such as the recent proposal by the Obama administration, if enacted, could have a significant adverse impact on our future results of operations.

*Our ability to maintain the beneficial tax treatment we anticipate with respect to non-U.S. earnings we have repatriated is based on current interpretations of the American Jobs Creation Act of 2004 (the Jobs Act) and permitted use of such amounts in accordance with our domestic reinvestment plan and the Jobs Act.* In September 2006, we completed our planned repatriation into the United States of undistributed earnings of our non-U.S. subsidiaries in accordance with our domestic reinvestment plan and the Jobs Act. However, our ability to maintain the anticipated beneficial tax treatment with respect to these non-U.S. earnings is subject to current interpretations and compliance with the Jobs Act (including Internal Revenue Code Section 965), as well as the rules and regulations promulgated by, among others, the Internal Revenue Service and the United States Treasury Department. Moreover, changes in the interpretation of these rules and regulations may have an effect on our ability to maintain the beneficial tax treatment with respect to our repatriated non-U.S. earnings. Our inability to appropriately use repatriated amounts for permitted purposes or to otherwise satisfy the requirements of our planned repatriation could also have a negative impact on the scope and breadth of our anticipated tax treatment with respect to such amounts.

*Any significant limitation or failure of our software applications, technology or other systems that are critical to our operations could constrain our operations.* We are highly dependent upon the use of various proprietary and third-party software applications and other technology systems to operate our business. We use our technology to, among other things, obtain securities pricing information, process client transactions, and provide reports and other customer services to the clients of the funds we manage. Any inaccuracies, delays, or systems failures in these and other processes could subject us to client dissatisfaction and losses. Although we take protective measures, including measures to effectively secure information through system security technology, our technology systems may still be vulnerable to unauthorized access, computer viruses or other events that have a security impact, such as an authorized employee or vendor inadvertently causing us to release confidential information, which could materially damage our operations or cause the disclosure or modification of sensitive or confidential information. Moreover, loss of confidential customer identification information could harm our reputation and subject us to liability under laws that protect confidential personal data, resulting in increased costs or loss of revenue.

Further, although we take precautions to password protect our laptops and other mobile electronic hardware, if such hardware is stolen, misplaced or left unattended, it may become vulnerable to hacking or other unauthorized use, creating a possible security risk and resulting in potentially costly actions by us. Most of the software applications that we use in our business are licensed from, and supported, upgraded and maintained by, third-party vendors. A suspension or termination of certain of these licenses or the related support, upgrades and maintenance could cause temporary system delays or interruption. In addition, although we





currently outsource to a single third-party vendor the operation of our U.S. data centers, we are revising our operations such that the majority of the services currently performed by the vendor will be performed by us and by a separate third-party vendor in the future. The failure by the current vendor to provide adequate transition support services in connection with the termination and transition of their services, or the failure by us or the new third-party vendor to adequately perform the services performed by the current vendor, could have an adverse impact on our business. Although we have in place certain disaster recovery plans, we may experience system delays and interruptions as a result of natural disasters, power failures, acts of war, and third-party failures. Technology is subject to rapid change and we cannot guarantee that our competitors may not implement more advanced Internet platforms for their products, which could affect our business. Potential system failures or breaches, or advancements in technology, and the cost necessary to address them, could result in material financial loss or costs, regulatory actions, breach of client contracts, reputational harm or legal claims and liability, which in turn could negatively impact our revenues and income.

*Our investment management business operations are complex and a failure to properly perform operational tasks or the misrepresentation of our products and services could have an adverse effect on our revenues and income.* Through our subsidiaries, we provide investment management and related services to funds and institutional, high net-worth and separately-managed accounts (collectively, our sponsored investment products). Our investment management and related services include fund administration, shareholder services, transfer agency, underwriting, distribution, custodial, trustee and other fiduciary services. In order to be competitive, we must properly perform our fund and portfolio administration and related responsibilities, including portfolio recordkeeping and accounting, security pricing, corporate actions, investment restrictions compliance, daily net asset value computations, account reconciliations, and required distributions to fund shareholders. In addition, the intentional or unintentional misrepresentation of our products and services in advertising materials, public relations information or other external communications could adversely affect our reputation and business prospects. Further, certain of our subsidiaries may act as general partner for various investment partnerships, which may subject them to liability for the partnerships' liabilities. If we fail to properly perform and monitor our investment management operations, our business could suffer and our revenues and income could be adversely affected.

*We face risks, and corresponding potential costs and expenses, associated with conducting operations and growing our business in numerous countries.* We sell mutual funds and offer investment management and related services in many different regulatory jurisdictions around the world, and intend to continue to expand our operations internationally. As we do so, we will continue to face challenges to the adequacy of our resources, procedures and controls to consistently and effectively operate our business. In order to remain competitive, we must be proactive and prepared to implement necessary resources when growth opportunities present themselves, whether as a result of a business acquisition or rapidly increasing business activities in particular markets or regions. As we grow, we face a heightened risk that the necessary resources and/or personnel will be unavailable to take full advantage of strategic opportunities when they appear or that strategic decisions can be efficiently implemented. Local regulatory environments may vary widely, as may the adequacy and sophistication of each. Similarly, local distributors, and their policies and practices as well as financial viability, may be inconsistent or less developed or mature. Notwithstanding potential long-term cost savings by increasing certain operations, such as transfer agent and other back-office operations, in countries or regions of the world with lower operating costs, growth of our international operations may involve near-term increases in expenses as well as additional capital costs, such as information, systems and technology costs and costs related to compliance with particular regulatory or other local requirements or needs. Local requirements or needs may also place additional demands on sales and compliance personnel and resources, such as meeting local language requirements, while also integrating personnel into an organization with a single operating language. Finding and hiring additional, well-qualified personnel and crafting and adopting policies, procedures and controls to address local or regional requirements remain a challenge as we expand our operations internationally. Moreover, regulators in non-U.S. jurisdictions could also change their policies or laws in a manner that might restrict or otherwise impede our ability to distribute or register investment products in their respective markets. Any of these local requirements, activities, or needs could increase the costs and expenses we incur in a specific jurisdiction without any corresponding increase in revenues and income from operating in the jurisdiction. In addition, from time to time we enter into international joint ventures in which we may not have control. These investments in joint ventures may involve risks, including the risk that the controlling joint venture partner may have business interests, strategies or goals that are inconsistent with ours, and the risk that business decisions or other actions or omissions of the controlling joint venture partner or the joint venture company may result in harm to our reputation or adversely affect the value of our investment in the joint venture.

*We depend on key personnel and our financial performance could be negatively affected by the loss of their services.* The success of our business will continue to depend upon our key personnel, including our portfolio and fund managers, investment analysts, investment advisers, sales and management personnel and other professionals as well as our executive officers and business unit heads. Competition for qualified, motivated, and highly skilled executives, professionals and other key personnel in the asset management and banking/finance industries remains significant. Our success depends to a substantial degree upon our ability to attract, retain, and motivate qualified individuals, including through competitive compensation packages, and upon the continued contributions of these people. As our business grows, we are likely to need to increase correspondingly the overall number of individuals that we employ. Moreover, in order to retain certain key personnel, we may be required to increase compensation to such individuals, resulting in additional expense without a corresponding increase in potential revenue. We cannot assure you that we will be successful in attracting and retaining qualified individuals, and the departure of key investment



personnel, in particular, if not replaced, could cause us to lose clients, which could have a material adverse effect on our financial condition, results of operations and business prospects.

*Strong competition from numerous and sometimes larger companies with competing offerings and products could limit or reduce sales of our products, potentially resulting in a decline in our market share, revenues and net income.* We compete with numerous asset management companies, mutual fund, stock brokerage, and investment banking firms, insurance companies, banks, savings and loan associations and other financial institutions. Our investment products also compete with products offered by these competitors as well as real estate investment trusts, hedge funds and others. The periodic establishment of new asset management companies and other competitors increases the competition that we face in our business. At the same time, consolidation in the financial services industry has created stronger competitors with greater financial resources and broader distribution channels than our own. Competition is based on various factors, including, among others, business reputation, investment performance, product mix and offerings, service quality and innovation, distribution relationships, and fees charged. Additionally, competing securities broker/dealers whom we rely upon to distribute and sell our mutual funds may also sell their own proprietary funds and investment products, which could limit the distribution of our investment products. To the extent that existing or potential customers, including securities broker/dealers, decide to invest in or distribute the products of our competitors, the sales of our products as well as our market share, revenues and net income could decline. Our ability to attract and retain assets under our management is also dependent on the relative investment performance of our funds and other managed investment portfolios, offering a mix of sponsored investment products that meets investor demand and our ability to maintain our investment management services fees at competitive levels.

*Changes in the third-party distribution and sales channels on which we depend could reduce our revenues and hinder our growth.* We derive nearly all of our fund sales through third-party broker/dealers and other similar investment advisers. Increasing competition for these distribution channels and recent regulatory initiatives have caused our distribution costs to rise and could cause further increases in the future or could otherwise negatively impact the distribution of our products. Higher distribution costs lower our net revenues and earnings. Additionally, recent consolidations in the broker/dealer industry could adversely impact our revenues and earnings. Moreover, if several of the major financial advisers who distribute our products were to cease operations or limit or otherwise end the distribution of our products, it could have a significant adverse impact on our revenues and earnings. There is no assurance we will continue to have access to the third-party broker/dealers and similar investment advisers that currently distribute our products, or continue to have the opportunity to offer all or some of our existing products through them. A failure to maintain strong business relationships with the major investment advisers who currently distribute our products may also impair our distribution and sales operations. Because we use broker/dealers and other similar investment advisers to sell our products, we do not control the ultimate investment recommendations given to clients. Any inability to access and successfully sell our products to clients through third-party distribution channels could have a negative effect on our level of assets under management, related revenues and overall business and financial condition.

*Our increasing focus on international markets as a source of investments and sales of investment products subjects us to increased exchange rate and other risks in connection with earnings and income generated overseas.* While we operate primarily in the United States, we also provide services and earn revenues in The Bahamas, Asia, Canada, Europe, Latin America, Africa, and Australia. As a result, we are subject to foreign exchange risk through our non-U.S. operations. Fluctuations in the exchange rates to the U.S. dollar may affect our financial results from one period to the next. While we have taken steps to reduce our exposure to foreign exchange risk, for example, by denominating a significant amount of our transactions in U.S. dollars, the situation may change in the future as our business continues to grow outside the United States. Appreciation of the U.S. dollar could moderate revenues from managing investment products internationally or could affect relative investment performance of certain funds invested in non-U.S. securities. Separately, management fees that we earn tend to be higher in connection with international assets under management than with U.S. assets under management. Consequently, a downturn in international markets could have a significant effect on our revenues and income. Moreover, as our business grows in non-U.S. markets, any business, economic, social or political unrest affecting these markets, in addition to any direct consequences such as unrest may have on our personnel and facilities located in the affected area, may also have a more lasting impact on the long-term investment climate in these and other areas and, as a result, our assets under management and the corresponding revenues and income that we generate from them may be negatively affected.

*Poor investment performance of our products could affect our sales or reduce the level of assets under management, potentially negatively impacting our revenues and income.* Our investment performance, along with achieving and maintaining superior distribution and client services, is critical to the success of our investment management and related services business. Strong investment performance often stimulates sales of our investment products. Poor investment performance as compared to third-party benchmarks or competitive products could lead to a decrease in sales of investment products we manage and stimulate redemptions from existing products, generally lowering the overall level of assets under management and reducing the management fees we earn. We cannot assure you that past or present investment performance in the investment products we manage will be indicative of future performance. Any poor investment performance may negatively impact our revenues and income.

*We could suffer losses in earnings or revenue if our reputation is harmed. Our reputation is important to the success of our business.* We believe that our Franklin Templeton Investments brand has been, and continues to be, well received both in our



industry and with our clients, reflecting the fact that our brand, like our business, is based in part on trust and confidence. If our reputation is harmed, existing clients may reduce amounts held in, or withdraw entirely from, funds that we advise or funds may terminate their management agreements with us, which could reduce the amount of assets under management and cause us to suffer a corresponding loss in earnings or revenue. Moreover, reputational harm may cause us to lose current employees and we may be unable to continue to attract new ones with similar qualifications, motivations, or skills. If we fail to address, or appear to fail to address, successfully and promptly the underlying causes of any reputational harm, we may be unsuccessful in repairing any existing harm to our reputation and our future business prospects would likely be affected.

*Our future results are dependent upon maintaining an appropriate level of expenses, which is subject to fluctuation.* The level of our expenses is subject to fluctuation and may increase for the following or other reasons: changes in the level and scope of our advertising expenses in response to market conditions; variations in the level of total compensation expense due to, among other things, bonuses, changes in our employee count and mix, and competitive factors; changes in expenses and capital costs, including costs incurred to maintain and enhance our administrative and operating services infrastructure or to cover uninsured losses and an increase in insurance expenses including through the assumption of higher deductibles and/or co-insurance liability.

*Our ability to successfully integrate widely varied business lines can be impeded by systems and other technological limitations.* Our continued success in effectively managing and growing our business depends on our ability to integrate the varied accounting, financial, information, and operational systems of our various businesses on a global basis. Moreover, adapting or developing our existing technology systems to meet our internal needs, as well as client needs, industry demands and new regulatory requirements, is also critical for our business. The constant introduction of new technologies presents new challenges to us. We have an ongoing need to continually upgrade and improve our various technology systems, including our data processing, financial, accounting, and trading systems. Further, we also must be proactive and prepared to implement technology systems when growth opportunities present themselves, whether as a result of a business acquisition or rapidly increasing business activities in particular markets or regions. These needs could present operational issues or require, from time to time, significant capital spending. It also may require us to reevaluate the current value and/or expected useful lives of our technology systems, which could negatively impact our results of operations.

*Our inability to successfully recover should we experience a disaster or other business continuity problem could cause material financial loss, loss of human capital, regulatory actions, reputational harm, or legal liability.* Should we experience a local or regional disaster or other business continuity problem, such as an earthquake, terrorist attack, pandemic or other natural or man-made disaster, our continued success will depend, in part, on the availability of our personnel, our office facilities, and the proper functioning of our computer, telecommunication and other related systems and operations. While our operational size, the diversity of locations from which we operate, and our redundant back-up systems provide us with a strong advantage should we experience a local or regional disaster or other business continuity event, we could still experience near-term operational challenges, in particular depending upon how a local or regional event may affect our human capital across our operations or with regard to particular segments of our operations, such as key executive officers or personnel in our technology group. Moreover, as we grow our operations in new geographic regions, the potential for particular types of natural or man-made disasters, political, economic or infrastructure instabilities, or other country- or region-specific business continuity risks increases. Past disaster recovery efforts have demonstrated that even seemingly localized events may require broader disaster recovery efforts throughout our operations and, consequently, we regularly assess and take steps to improve upon our existing business continuity plans and key management succession. However, a disaster on a significant scale or affecting certain of our key operating areas within or across regions, or our inability to successfully recover should we experience a disaster or other business continuity problem, could materially interrupt our business operations and cause material financial loss, loss of human capital, regulatory actions, reputational harm, or legal liability.

*Certain of the portfolios we manage, including our emerging market portfolios, are vulnerable to significant market-specific political, economic, or other risks, any of which may negatively impact our revenues and income.* Our emerging market portfolios and revenues derived from managing these portfolios are subject to significant risks of loss from political, economic, and diplomatic developments, currency fluctuations, social instability, changes in governmental policies, expropriation, nationalization, asset confiscation and changes in legislation related to foreign ownership. International trading markets, particularly in some emerging market countries, are often smaller, less liquid, less regulated and significantly more volatile than those in the U.S.

*Our revenues, earnings, and income could be adversely affected if the terms of our management agreements are significantly altered or these agreements are terminated by the funds and other sponsored investment products we advise.* Our revenues are dependent on fees earned under investment management and related services agreements that we have with the funds and other sponsored investment products we advise. These revenues could be adversely affected if these agreements are altered significantly or terminated. The decline in revenue that might result from alteration or termination of our investment management services agreements could have a material adverse impact on our earnings or income.

*Regulatory and governmental examinations and/or investigations, civil litigation relating to previously-settled regulatory and governmental investigations, and the legal risks associated with our business, could adversely impact our assets under management, increase costs and negatively impact our profitability and/or our future financial results.* From time to time we may



receive requests for documents or other information from governmental authorities or regulatory bodies or we also may become the subject of governmental or regulatory investigations and/or examinations. Moreover, governmental or regulatory investigations or examinations that have been inactive could become active. We may be obligated, and under our standard form of indemnification agreement with certain officers and directors in some instances, we are obligated, or we may choose, to indemnify directors, officers, or employees against liabilities and expenses they may incur in connection with such matters to the extent permitted under applicable law. In addition, we have been named as a defendant in mutual fund shareholder class action and fund derivative lawsuits, as well as in a corporate derivative lawsuit, that relate to previously settled regulatory and governmental investigations. While management believes that the claims made in these lawsuits are without merit, and intends to defend against them vigorously, litigation typically is an expensive process. Risks associated with legal liability often are difficult to assess or quantify and their existence and magnitude can remain unknown for significant periods of time. Moreover, settlements or judgments against us have the potential of being substantial if we are unsuccessful in settling or otherwise resolving matters early in the process and/or on favorable terms. Eventual exposures from and expenses incurred relating to current and future litigation, investigations, examinations and settlements could adversely impact our assets under management, increase costs and negatively impact our profitability and/or our future financial results. Judgments or findings of wrongdoing by regulatory or governmental authorities or in civil litigation against us could affect our reputation, increase our costs of doing business and/or negatively impact our revenues, any of which could have a material negative impact on our financial results.

*Our ability to meet cash needs depends upon certain factors, including the market value of our assets, operating cash flows and our perceived credit worthiness.* Our ability to meet anticipated cash needs depends upon factors such as the market value of our assets, our operating cash flows and our creditworthiness as perceived by lenders. If we are unable to obtain funds and financing, we may be forced to incur unanticipated costs or revise our business plans. Further, our access to the capital markets depends significantly on our credit ratings. A reduction in our long- or short-term credit ratings could increase our borrowing costs and limit our access to the capital markets. Volatility in the global financing markets may also impact our ability to access the capital markets should we seek to do so, and have an adverse affect on investors' willingness to purchase our securities, interest rates, credit spreads and the valuation levels of equity markets. If we are unable to obtain funds and financing, or access the capital markets in a timely manner, we may be forced to incur unanticipated costs or revise our business plans, and our business could be adversely impacted.

*Diverse and strong competition limits the interest rates that we can charge on consumer loans.* We compete with many types of institutions for consumer loans, certain of which can provide loans at significantly below-market interest rates or, in some cases, zero interest rates in connection with automobile sales. Our inability to compete effectively against these companies or to maintain our relationships with the various automobile dealers through whom we offer consumer loans could limit the growth of our consumer loan business. Economic and credit market downturns could reduce the ability of our customers to repay loans, which could cause losses to our consumer loan portfolio.

*Our business could be negatively affected if we or our banking subsidiaries fail to remain well capitalized, and liquidity needs could affect our banking business.* Our bank and thrift subsidiaries are subject to significant regulation and supervision, which includes minimum regulatory capital standards. Franklin is also subject to minimum regulatory capital standards because it is a bank holding company and financial holding company registered with the FRB under the Bank Holding Company Act of 1956. Franklin and its bank and thrift subsidiaries are currently well capitalized under applicable guidelines. However, our business could be negatively affected if Franklin or its bank or thrift subsidiaries failed to remain well capitalized. For example, because our bank and thrift subsidiaries are well capitalized and we otherwise qualify as a financial holding company, we are permitted to engage in a broader range of activities than are permitted to a bank holding company. Loss of financial holding company status would require that we either cease these broader activities or divest our bank subsidiaries if we desire to continue such activities. The banking regulators are authorized (and sometimes required) to impose a wide range of requirements, conditions, and restrictions on banks, thrifts, and bank holding companies that fail to maintain adequate capital levels. In addition, liquidity needs could affect our banking business, which may be subject to an unanticipated large number of withdrawals as a result of a number of factors, such as changed or unstable economic conditions, adverse trends or events, business closings and lay-offs, rates paid by competitors, general interest rate levels, and returns available to clients on alternative investments. Our banking subsidiaries may be required from time to time to rely on secondary sources of liquidity, such as the sale of investment securities, Federal Home Loan Bank ( FHLB ) advances and federal funds lines to enable them to meet such withdrawal demands. These secondary sources may not be sufficient to meet liquidity needs.

*We are dependent on the earnings of our subsidiaries.* Substantially all of our operations are conducted through our subsidiaries, as a result, our cash flow and our ability to fund operations are dependent upon the earnings of our subsidiaries and the distribution of earnings, loans or other payments by our subsidiaries. Our subsidiaries are separate and distinct legal entities and have no obligation to provide us with funds for our payment obligations, whether by dividends, distributions, loans or other payments. Any payments to us by our subsidiaries could be subject to statutory or contractual restrictions and are contingent upon our subsidiaries' earnings and business considerations.



**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

In the normal course of business, our financial position is subject to market risk, including, but not limited to, potential loss due to changes in the value of financial instruments including those resulting from adverse changes in interest rates, foreign currency exchange rates and market valuation. Financial instruments include, but are not limited to, investment securities, loans, deposits and debt obligations. Management is responsible for managing market risk. Our Enterprise Risk Management Committee is responsible for providing a framework to assist management to identify, assess and manage market and other risks.

We are exposed to changes in interest rates, primarily through our loans, investment in debt securities, deposit liabilities and outstanding debt. We minimize the impact of changes in interest rates related to our investments in debt securities by managing the maturities of these securities, and through diversification. We minimize the impact of changes in interest rates related to our outstanding debt by entering into financing transactions that ensure an appropriate mix of debt at fixed and variable interest rates. In addition, our banking/finance segment monitors the net interest rate margin and the average maturity of interest earning assets, as well as funding sources and, from time to time, we may enter into interest-rate swap agreements to mitigate interest rate exposure arising from the loans receivable portfolio.

At December 31, 2009, we have considered the potential impact of a 2% movement in market interest rates on interest earning assets, net of interest-bearing liabilities of our banking/finance segment, total debt outstanding and our portfolio of debt securities. Based on our analysis, we do not expect that this change would have a material impact on our operating revenues or results of operations in the next twelve months, for each of these categories or in the aggregate.

We are subject to foreign currency exchange risk through our international operations. While we operate primarily in the United States, we also provide services and earn revenues in The Bahamas, Asia-Pacific, Canada, Europe, Latin America and Africa. Our exposure to foreign currency exchange risk is minimized in relation to our results of operations since a significant portion of these revenues are denominated in U.S. dollars. This situation may change in the future as our business continues to grow outside the United States and expenses incurred denominated in foreign currencies increase. Our exposure to foreign currency exchange risk in relation to our condensed consolidated balance sheet mostly relates to cash and cash equivalents and investments that are denominated in foreign currencies, primarily in Euro, Pound Sterling, Indian Rupee and Canadian Dollar. These assets accounted for approximately 13% of the total cash and cash equivalents and investments at December 31, 2009. We do not use derivative financial instruments to manage foreign currency exchange risk exposure. As a result, both positive and negative currency fluctuations against the U.S. dollar may affect our results of operations and accumulated other comprehensive income.

We are exposed to market valuation risks related to securities we hold that are carried at fair value and securities held by sponsored investment products that we consolidate, which are also carried at fair value.

The following table summarizes the effect of a 10% increase or decrease in the carrying values of our financial instruments that are subject to market valuation risks at December 31, 2009.

| <i>(in thousands)</i>                     | Carrying Value      | Carrying Value<br>Assuming a<br>10% Increase | Carrying Value<br>Assuming a<br>10% Decrease |
|---|---------------------|--|--|
| <b>Current</b>                            |                     |  |  |
| Investment securities, trading            | \$ 476,403          | \$ 524,043                                   | \$ 428,763                                   |
| Investment securities, available-for-sale | 1,063,711           | 1,170,082                                    | 957,340                                      |
| <b>Total Current</b>                      | <b>\$ 1,540,114</b> | <b>\$ 1,694,125</b>                          | <b>\$ 1,386,103</b>                          |
| <b>Banking/Finance</b>                    |                     |  |  |
| Investment securities, trading            | \$ 70,667           | \$ 77,734                                    | \$ 63,600                                    |
| Investment securities, available-for-sale | 457,589             | 503,348                                      | 411,830                                      |
| <b>Total Banking/Finance</b>              | <b>\$ 528,256</b>   | <b>\$ 581,082</b>                            | <b>\$ 475,430</b>                            |
| <b>Non-Current</b>                        |                     |  |  |
| Investment securities, available-for-sale | \$ 103,291          | \$ 113,620                                   | \$ 92,962                                    |
| <b>Total</b>                              | <b>\$ 2,171,661</b> | <b>\$ 2,388,827</b>                          | <b>\$ 1,954,495</b>                          |

To mitigate the market valuation risks, we maintain a diversified investment portfolio and, from time to time, we may enter into derivative agreements. Our exposure to these risks is also minimized as we sponsor a broad range of investment products in various global jurisdictions, which allows us to mitigate the impact of changes in any particular market(s) or region(s).

Our cash, cash equivalents and investments portfolio by investment objective at December 31, 2009 was as follows:

| <i>(dollar amounts in thousands)</i>                   | Total<br>Portfolio  | Percent<br>of Total<br>Portfolio | Trading Securities<br>Included in<br>Portfolio | Percent<br>of Total<br>Trading<br>Securities |
|--|---------------------|----------------------------------|--|--|
| <b>Cash and Cash Equivalents</b>                       | <b>\$ 2,850,308</b> | <b>53%</b>                       | <b>\$</b>                                      |  |
| <b>Investment Securities</b>                           |                     |                                  |  |  |
| <b>Equity</b>  |                     |                                  |  |  |
| Domestic (U.S.)  | 89,152              | 2%                               | 43,772   | 8%   |
| Global/international                                   | 327,414             | 6%                               | 157,681  | 29%  |
| <b>Total equity</b>                                    | <b>416,566</b>      | <b>8%</b>                        | <b>201,453</b>                                 | <b>37%</b>                                   |
| <b>Hybrid</b>  | <b>68,484</b>       | <b>1%</b>                        | <b>39,722</b>                                  | <b>7%</b>                                    |
| <b>Fixed-Income</b>                                    |                     |                                  |  |  |
| Tax-free   | 87,721              | 2%                               |  |  |
| Taxable  |                     |                                  |  |  |
| Domestic (U.S.)  | 1,145,225           | 21%                              | 176,053  | 32%  |
| Global/international                                   | 453,665             | 8%                               | 129,842  | 24%  |
| <b>Total fixed-income</b>                              | <b>1,686,611</b>    | <b>31%</b>                       | <b>305,895</b>                                 | <b>56%</b>                                   |
| <b>Total Investment Securities</b>                     | <b>2,171,661</b>    | <b>40%</b>                       | <b>547,070</b>                                 | <b>100%</b>                                  |
| <b>Other<sup>1</sup></b>                               | <b>406,711</b>      | <b>7%</b>                        |  |  |
| <b>Total Cash and Cash Equivalents and Investments</b> | <b>\$ 5,428,680</b> | <b>100%</b>                      | <b>\$ 547,070</b>                              | <b>100%</b>                                  |

<sup>1</sup> Includes investments in equity method investees and other investments.

Investments categorized as investment securities, trading in our condensed consolidated balance sheets include securities held by consolidated sponsored investment products. These securities, which amounted to \$249.3 million at December 31, 2009, are generally assigned a classification in the table presented above based on the investment objective of the consolidated sponsored investment products holding the trading securities. Investment securities, trading also include securities held by our banking/finance operating segment, which amounted to \$70.7 million at December 31, 2009.

#### Item 4. Controls and Procedures.

The Company's management evaluated, with the participation of the Company's principal executive and principal financial officers, the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of December 31, 2009. Based on their evaluation, the Company's principal executive and principal financial officers concluded that the Company's disclosure controls and procedures as of December 31, 2009 were designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in reports filed under the Exchange Act is (i) recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to management, including the principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure.

There has been no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Company's fiscal quarter ended December 31, 2009, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings.**

For a description of our legal proceedings, please see the description of our legal proceedings set forth in the Legal Proceedings section in Note 11 Commitments and Contingencies in the notes to the condensed consolidated financial statements in Item 1 of Part I of this Form 10-Q, which is incorporated herein by reference.

**Item 1A. Risk Factors.**

Our Form 10-K for the fiscal year ended September 30, 2009 includes a detailed discussion of the risk factors applicable to us, which are also set forth under the heading Risk Factors in Item 2 of Part I of this Form 10-Q. There are no material changes from the risk factors as previously disclosed in our Form 10-K for the fiscal year ended September 30, 2009.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

The following table provides information with respect to the shares of Franklin's common stock we repurchased during the three months ended December 31, 2009.

| <b>Period</b>                              | <b>Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>Average Price<br/>Paid per<br/>Share</b> | <b>Total Number of<br/>Shares Purchased<br/>as Part of Publicly<br/>Announced Plans<br/>or Programs</b> | <b>Maximum Number<br/>of Shares that<br/>May Yet Be<br/>Purchased<br/>Under the Plans or<br/>Programs</b> |
|--|---|---|---|---|
| October 1, 2009 through October 31, 2009   | 253,606   | \$ 101.56                                   | 253,606   | 9,331,921   |
| November 1, 2009 through November 30, 2009 | 823,410   | \$ 111.04                                   | 823,410   | 8,508,511   |
| December 1, 2009 through December 31, 2009 | 527,400   | \$ 107.71                                   | 527,400   | 7,981,111   |
| <b>Total</b>                               | <b>1,604,416</b>                                    |   | <b>1,604,416</b>  |   |

Under our stock repurchase program, we can repurchase shares of Franklin's common stock from time to time in the open market and in private transactions in accordance with applicable laws and regulations, including without limitation applicable federal securities laws. From time to time we have announced the existence of and updates to the Company's continuing policy of repurchasing shares of our common stock, including the most recent announcements made in January 2008 and March 2009. At December 31, 2009, approximately 8.0 million shares of our common stock remained available for repurchase under our stock repurchase program. Our stock repurchase program is not subject to an expiration date. There were no unregistered sales of equity securities during the period covered by this report.

**Item 6. Exhibits.**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| Exhibit 3(i)(a)    | Registrant's Certificate of Incorporation, as filed November 28, 1969, incorporated by reference to Exhibit (3)(i) to the Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 1994 (File No. 001-09318) (the 1994 Annual Report).  |
| Exhibit 3(i)(b)    | Registrant's Certificate of Amendment of Certificate of Incorporation, as filed March 1, 1985, incorporated by reference to Exhibit (3)(ii) to the 1994 Annual Report.   |
| Exhibit 3(i)(c)    | Registrant's Certificate of Amendment of Certificate of Incorporation, as filed April 1, 1987, incorporated by reference to Exhibit (3)(iii) to the 1994 Annual Report.  |
| Exhibit 3(i)(d)    | Registrant's Certificate of Amendment of Certificate of Incorporation, as filed February 2, 1994, incorporated by reference to Exhibit (3)(iv) to the 1994 Annual Report.  |
| Exhibit 3(i)(e)    | Registrant's Certificate of Amendment of Certificate of Incorporation, as filed on February 4, 2005, incorporated by reference to Exhibit (3)(i)(e) to the Registrant's Quarterly Report on Form 10-Q for the period ended December 31, 2004 (File No. 001-09318).   |
| Exhibit 3(ii)      | Registrant's Amended and Restated By-laws (as adopted and effective February 4, 2010), incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K filed with the SEC on February 5, 2010 (File No. 001-09318).  |
| Exhibit 31.1       | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).   |
| Exhibit 31.2       | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).   |
| Exhibit 32.1       | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).  |
| Exhibit 32.2       | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).  |
| Exhibit 101        | The following materials from the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2009, formatted in Extensible Business Reporting Language (XBRL), include: (i) the Condensed Consolidated Statements of Income, (ii) the Condensed Consolidated Balance Sheets, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) related notes, tagged as blocks of text (furnished herewith). |

**SIGNATURES**

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

**FRANKLIN RESOURCES, INC.**  
(Registrant)

Date: February 8, 2010

By: /s/ KENNETH A. LEWIS  
**Kenneth A. Lewis**  
**Executive Vice President and Chief Financial Officer**  
**(Duly Authorized Officer and Principal Financial Officer)**

**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| Exhibit 3(i)(a)    | Registrant's Certificate of Incorporation, as filed November 28, 1969, incorporated by reference to Exhibit (3)(i) to the Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 1994 (File No. 001-09318) (the 1994 Annual Report).  |
| Exhibit 3(i)(b)    | Registrant's Certificate of Amendment of Certificate of Incorporation, as filed March 1, 1985, incorporated by reference to Exhibit (3)(ii) to the 1994 Annual Report.   |
| Exhibit 3(i)(c)    | Registrant's Certificate of Amendment of Certificate of Incorporation, as filed April 1, 1987, incorporated by reference to Exhibit (3)(iii) to the 1994 Annual Report.  |
| Exhibit 3(i)(d)    | Registrant's Certificate of Amendment of Certificate of Incorporation, as filed February 2, 1994, incorporated by reference to Exhibit (3)(iv) to the 1994 Annual Report.  |
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