

LABRANCHE & CO INC
Form 10-K
March 16, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
for the fiscal year 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: 001-15251

LaBRANCHE & CO INC.

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
(State or Other Jurisdiction of

13-4064735
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

33 Whitehall Street, New York, New York 10004

(Address of Principal Executive Offices) (Zip Code)

(212) 425-1144

(Registrant's telephone number, including area code)

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

Title of each Class:
Common Stock, par value \$0.01

Name of each exchange on which registered:
New York Stock Exchange

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

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

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

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 Website, 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 such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Smaller reporting company

(Do not check if a smaller reporting company)

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

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The aggregate market value of the Common Stock held by non-affiliates of the registrant, based upon the last sale price of the Common Stock reported on the New York Stock Exchange on June 30, 2009, was approximately \$150.6 million. Shares of Common Stock beneficially held by each officer and director and by each person who owns 10 percent or more of the outstanding shares of common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

The number of shares of Common Stock outstanding as of March 12, 2010 was 42,947,856.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the registrant's 2010 Annual Meeting of Stockholders to be held on May 18, 2010 are incorporated by reference in this Annual Report on Form 10-K in response to Part II, item 5 and Part III, items 10, 11, 12, 13 and 14.

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LaBranche & Co Inc.

FORM 10-K ANNUAL REPORT

For the Year Ended December 31, 2009

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PART I

This Annual Report on Form 10-K and the documents incorporated by reference contain forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations, estimates and projections about the registrant's industry, management's beliefs and certain assumptions made by management. Words such as anticipates, expects, intends, plans, believes, seeks, estimates, variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict; therefore, actual results may differ materially from those expressed or forecasted in any such forward-looking statements. Unless required by law, the registrant undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. However, readers should carefully review the risk factors set forth herein and in other reports or documents the registrant files from time to time with the Securities and Exchange Commission (the SEC).

Item 1. BUSINESS.

Overview

LaBranche & Co Inc. (we , our , us) is the parent corporation of LaBranche Structured Holdings, Inc.(LSHI), the holding company for a group of entities that are and market-makers in options, futures and exchange-traded funds, or ETFs, traded on various exchanges. LSHI's subsidiaries now generate the majority of the collective revenues of our market-making businesses, which is referred to in this Annual Report as our Market-Making segment. LSHI's subsidiaries are:

LaBranche Structured Products, LLC, a New York limited liability company (LSP);

LaBranche Structured Products Europe Limited, a United Kingdom single member private company (LSPE);

LaBranche Structured Products Hong Kong Limited, a Hong Kong single member private company (LSPH);

LaBranche Structured Products Direct, Inc. (LSPD), a New York corporation; and

LaBranche Structured Products Specialists LLC, a New York limited liability company (LSPS), which is now dormant and is no longer registered with the SEC as a broker-dealer.

LSP is a registered broker-dealer that operates as a market-maker in equity, index and ETF options, ETFs and futures on the NYSE Amex Exchange, the NYSE Arca Exchange, the New York Board of Trade (NYBOT), the Philadelphia Stock Exchange (PHLX), and the Chicago Board Options Exchange® (CBOE). LSPE is a broker-dealer registered with the United Kingdom's Financial Securities Authority and operates primarily as a market-maker for ETFs traded on the London Stock Exchange and the Euroex and Euronext Exchanges. LSPH is a broker-dealer registered with Hong Kong's Securities and Futures Commission and operates as a market-maker for ETFs and engages in hedging transactions in Asia. LSPD is a Financial Industry Regulatory Authority (FINRA) member firm that is authorized to act as an institutional execution firm in derivative and structured products, but currently does not engage in any operations. LSPS, which has been inactive since it ceased operations in October 2007, was a registered broker-dealer and operated as a specialist in ETFs traded on the NYSE.

We are also the parent of LaBranche & Co. LLC, which was one of the oldest and largest designated market-makers (previously called specialists) in equity securities listed on the New York Stock Exchange (NYSE) until January 22, 2010, when we sold the designated market making operations of LaBranche & Co. LLC to Barclays Capital Inc., a division of Barclays Bank PLC (Barclays) for \$25 million plus the value of LaBranche & Co. LLC's net trading inventory.

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LaBranche Financial Services, LLC (LFS), is a FINRA Member Firm that provides securities execution, fixed income and professional trading brokerage services to institutional investors and is also a market-maker in over-the-counter, bulletin board and pink sheet securities.

We are also the sole stockholder of LABDR Services, Inc. (LABDR) and the sole owner of LaBranche & Co. B.V. (BV). LABDR provided disaster recovery services and back-up facilities to other LaBranche subsidiaries until June 2007 when it became inactive. BV represented LaBranche & Co. LLC in European markets and provided client services to LaBranche & Co. LLC 's European listed companies until June 30, 2007, when it ceased operations.

We are a Delaware corporation that was incorporated in June 1999. Our principal executive offices are located at 33 Whitehall Street, New York, New York 10004, and our telephone number is (212) 425-1144. Our Internet address is www.labranche.com. We make available free of charge, on or through the investor relations section of our website, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. These filings also are available on the SEC 's website at www.sec.gov.

Also available on our website are our Corporate Governance Guidelines, our Code of Conduct (applicable to all our directors, officers and employees) and the charters for our Audit Committee, Compensation Committee and Nominating & Corporate Governance Committee. Within the time period required by the SEC and the NYSE, if applicable, we will post any amendment and/or any waiver of our Code of Conduct.

Our business principally operates in two separate segments: the Market-Making segment and the Institutional Brokerage segment. Our Market-Making segment currently includes the operations of LSP, LSPE, LSPH and LSPD (and formerly also included the operations of LaBranche & Co. LLC and LSPS prior to their sale and cessation of business, respectively). As of December 31, 2009, the entities within our Market-Making segment were market-makers on the NYSE (LaBranche & Co. LLC), the NYSE Amex Exchange, the NYSE Arca Exchange, the NYBOT, the PHLX, and the CBOE. Collectively, since the sale of LaBranche & Co. LLC 's designated market maker business, our Market-Making segment is comprised of market makers for 3 futures and 114 ETFs on the NYSE Amex Exchange, PHLX, NYBOT and other exchanges, and are market-makers for ETFs, options and futures on various exchanges.

Our Institutional Brokerage segment currently includes the operations of LFS, which provides securities execution to institutional clients and professional traders. LFS ' central focus is to bring the customer closer to the point of sale and provide price discovery at the highest possible speed and lowest possible cost. LFS also is a market-maker in over-the-counter, bulletin board and pink sheet securities serving as a liquidity provider in those securities. The Institutional Brokerage segment also includes an agency business that trades high-yield debt on behalf of its institutional customers and also acts as agent for our holding company in transactions concerning leveraged loans and commercial loans.

Compensation and related benefits for certain employees and certain company-wide professional fees are allocated to our two principal business segments. However, certain revenues and administrative and corporate overhead expenses, which consist primarily of interest on our public debt, are not specifically allocated to our two principal business segments and thus are treated as other revenues and expenses. A description of our principal business segments is presented below.

Recent Changes to the Capital and Business Structure of LaBranche

We have undergone substantial changes in the first quarter of 2010. On January 22, 2010, we completed the sale of LaBranche & Co. LLC 's designated market maker operations on the NYSE and all of its net designated market maker positions to Barclays. Under the terms of the transaction, we received \$25 million in cash plus the value of LaBranche & Co. LLC 's net trading inventory and we retained all cash and other non-designated market

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maker assets, including our shares of NYSE Euronext, Inc. stock (the NYX shares) and \$76 million in capital that we no longer are required to maintain at LaBranche & Co. LLC in connection with the designated market maker operations.

In addition, on February 15, 2010 (the Redemption Date), we fully redeemed and cancelled all of our remaining outstanding public indebtedness pursuant to the optional redemption provisions of the indenture governing our public debt. On the Redemption Date, all of our remaining note holders were paid 102.75% of the principal amount of their notes, plus accrued and unpaid interest thereon up to the Redemption Date. Therefore, as of February 15, 2010, we have no remaining outstanding public debt, resulting in a reduction of our interest expense by approximately \$21 million per year. On January 22, 2010, we satisfied and discharged the indenture governing our outstanding public debt by irrevocably depositing with U.S. Bank National Association (the Trustee for the indebtedness) cash in an amount sufficient to pay the full amount of the redemption price for the Senior Notes on the Redemption Date, together with irrevocable instructions directing U.S. Bank to apply such funds to the payment of the Senior Notes on the Redemption Date. Thus, as of January 22, 2010, we were no longer obligated or restricted under the indenture governing our public debt.

In addition, on January 29, 2010, we commenced a tender offer to purchase up to 15,000,000 shares of our outstanding common stock, at a price of \$4.60 per share. On March 1, 2010, the tender offer expired and we repurchased an aggregate of 8,539,667 shares of common stock (which was equal to the total number of shares tendered), at a price of \$4.60 per share, for a total tender price of \$39.3 million, constituting the purchase of an aggregate of 16.6% of our shares. The repurchase of the shares tendered, combined with the 10,937,769 shares repurchased by us pursuant to Board-authorized purchases over the past 18 months, have resulted in our repurchasing an aggregate of 19,477,436 shares of our common stock under our repurchase program, which constitutes a repurchase of an aggregate of 31.2% of our outstanding shares of common stock to date under our board-authorized repurchase programs. Upon completion of the tender offer, LaBranche and Co Inc. has approximately 42.9 million shares issued and outstanding. Following completion of the tender offer, we have approximately \$60.7 million in board-authorized repurchases remaining under our repurchase program. Repurchases may be made in open market transactions, privately negotiated transactions, in a tender offer, Dutch auction or otherwise, in compliance with applicable state and federal securities laws. The timing and amounts of any purchases will be based on market conditions and other factors, including price and regulatory requirements.

Following these capital and business transactions, we are a much different company going forward. Our Market Making segment has now shifted its focus solely to providing liquidity in derivative products such as equity, index, ETF and foreign currency options, ETFs and futures, rather than also focusing on the cash-equity securities that were the focus of LaBranche & Co. LLC's specialist and, subsequently, designated market maker business. The derivative products in which we are making markets have not changed materially from historical periods, other than that market-making in these products represent our entire Market-Making segment operations.

In addition, we are no longer hampered by the significant interest expense on our public indebtedness. Historically, the operating expense related to our outstanding debt has been the negative carry to our firm, which was the interest we paid on our outstanding indebtedness, less the interest income we received as a result of having that cash on-hand. Our negative carry prior to the repurchase of all our debt reached a high of approximately \$5.4 million per quarter due to the collapse of the interest rates to between 0% to .25% which has now been eliminated, and now we will have no negative carry. The elimination of this negative carry will enable us to use our capital more efficiently and with greater flexibility. We believe that these events, combined with the \$76 million that was freed up from the net liquid asset requirement of our designated market maker business and the \$25 million in cash proceeds from the sale of our designated market maker business to Barclays has enabled us to restructure, pursuant to the debt and stock repurchases described above, into a more flexible company that is better able to take advantage of opportunities as the financial services industry continues to evolve following the financial crises of 2008 and 2009.

The services offered by our Institutional Brokerage segment have remained relatively unchanged following our capital and business reorganization. Our Institutional Brokerage segment continues to provide execution, fixed income and brokerage services to institutional investors. However, changes in the institutional brokerage

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environment for firms our size and decreased volumes in late 2009 and early 2010 have forced us to take additional initiatives to cut expenses and reduce headcount in order to rationalize the costs and orderflow of these businesses. These expense reductions were made following the hires of additional sales and position traders in 2008 and early 2009 to address what we thought would be opportunities in that environment when traders were leaving bulge bracket firms. However, the perceived opportunities did not fully materialize and our cost structure continued to pose challenges to improving our Institutional Brokerage segment results. Despite these reductions, we believe that we still offer a competitive, high-touch execution platform for our institutional clients and we continue to make markets in over-the-counter and pink sheet securities and focus on our fixed income business that engages in sales and positional trading of bank and credit bank loans. We are also in the process of diversifying our institutional brokerage business to now offer interdealer broker services to our customers in equity and index options. We believe that our institutional brokerage business provides us with the ability to leverage our market trading philosophies and expertise, while meeting the needs of and providing more diverse products to our institutional customers.

Our Market-Making Segment

Our Market-Making Business Model

Our Market-Making segment consists of registered broker-dealers that operate as market makers in equity options, index options, ETF options, foreign exchange options, futures, structured notes and ETFs and engage in hedging and market risk mitigation trading in securities directly related to our market making operations. We have trading operations in both domestic and global securities markets in which our provision of liquidity is necessary and advantageous to the markets in which we operate. Our main goals are to provide liquidity to the markets and to profit from dynamically changing market prices and from quoting at the national best bid and offer, or NBBO, in each case through the use of both technology and human judgment. We believe that our participation in the markets improves market quality and, as a result, lowers trading costs to market participants. Our market-making and liquidity provision activities are performed algorithmically, manually or telephonically by furnishing bona fide competitive bid and offer quotations continuously or regularly upon request and being willing and able to effect transactions at those quotes in marketable quantities. Our manual and telephonic trading is done based on advanced fair value models, which we have proprietarily developed internally.

Our goal is to provide quotations and interact with order flow globally both telephonically with other broker-dealers and through electronic trade messaging and over a scalable platform of market-making algorithms that can interact with all securities markets. We have been in constant transition over the past several years in order to adapt to the evolution of securities markets to electronic platforms, especially since the implementation of Regulation NMS, which became effective in March 2007, and the NYSE's new market model, which commenced in late December 2008, generally providing for electronic trading on national market systems to provide for the fastest possible execution.

We believe our future success will depend, to a great extent, on our technology and our trading personnel. Therefore, we have developed systems that embed pricing and risk parameters to continuously quote hundreds of securities simultaneously across many markets and depend on our automated fair value models and experienced traders to provide competitive bid and ask quotations upon request from other broker-dealers, particularly those with large sized orders in derivative products that cannot obtain competitive liquidity pricing by placing those orders in small sizes over one or more automated markets. Although regulatory requirements that govern some of our market-making have historically prevented us from combining all these activities into one broker-dealer, particularly in light of our former NYSE designated market maker operations, we have developed a capability for fully integrated position trading should the opportunity arise. Due to recent events, including the sale of our designated market maker business, there is less duplication in many of our administrative functions, and we are exploring an initiative to combine broker-dealers in order to achieve capital and operational efficiencies while still complying with regulatory and procedural requirements. We cannot currently estimate the timing or achievability of this potential combination of broker-dealers but we are committed to making our domestic broker/dealer operations more integrated and less silo structured as was required in the past by regulation.

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The focus of our market-making operations has been shifting over the past several years from our traditional auction based specialist model in cash equity securities on the NYSE and AMEX and equity options listed on the AMEX, to a more electronic and diversified approach to being market-makers in a variety of cash equity and derivative securities, such as ETFs, ETF options, index options and futures across many different exchanges. We are in the process of developing and enhancing our market-making operations domestically and abroad, in Europe and Asia. We believe that as markets continue to evolve and develop worldwide and as new securities, such as ETFs continue to develop abroad, the desire for liquidity providers such as us continues to grow. This shift has culminated in the sale of our designated market maker business in January 2010 and we see our continued focus on derivative products market-making as an opportunity for our current and future growth.

Our adaptation to the automation and globalization of derivative securities markets is further evidenced by our January 2005 formation of LSPE to be a market-maker for ETFs traded on the London Stock Exchange, Euroex and Euronext exchanges and our August 2005 formation of LSPH to be a market-maker in ETFs traded in Hong Kong and to conduct hedging transactions in Hong Kong markets related to our market-making activities. LSPE became a registered broker-dealer with the FSA in March 2006, and LSPH registered as a broker-dealer with Hong Kong's SFC in October 2006.

Our international market-making operations have grown since inception and their results have continued to grow in 2009. LSPE experienced significant growth in 2008 and 2009 and continues to contribute significant revenues to our Market-Making segment. LSPE has established new relationships with a number of British and European order providers, and benefitted from a general increase in trading activity. We plan to continue our investment in LSPE and to pursue opportunities in international ETFs and indexes as they arise. The operations of our LSPH subsidiary are still being developed, and we are working toward making LSPH an important part of our market-making activities. Currently, a large portion of the trading that could be done by LSPH is being performed by LSPE due to cost and operational efficiencies, although that may change in the future. LSPH, however, has been developing its own options and ETF market making capabilities and, although we focused more of our attention in 2009 to domestic options market making and the growth of our London subsidiary, LSPE, we intend to grow LSPH in Asia using the same model of operations we used for LSPE in 2008 and 2009. By expanding our market-making presence abroad in Europe and Asia, we believe we are further strengthening and diversifying the product and market base in our Market-Making segment, which will further our strategy of meeting the liquidity provision challenges in an increasingly electronic and global marketplace.

We will continue to seek to leverage our liquidity providing expertise further internationally and are continually striving to enhance current relationships and establish new ones with entities that trade or provide order flow in the Australasian region.

The Evolution of the Specialist and Market-Making Industry

Historically, trading of securities on the NYSE and other listed securities markets was conducted through a process managed by the specialist for each security. Effective December 2008, specialists on the NYSE became DMMs but the role of the DMMs have been essentially the same as the specialist, although the way in which we satisfied our obligations and injected liquidity had become more electronic and required less human intervention prior to the sale of our DMM business in January 2010. On the NYSE, the DMM is a broker-dealer who applies for and, if accepted, is assigned the role to maintain a fair and orderly market in the securities for which it is selected. The number of DMM firms on the NYSE has decreased substantially over the past ten years due to consolidation within the industry, and this consolidation largely occurred before the implementation of the NYSE's new market model. In 2009 and early 2010, there was additional consolidation of DMM firms with the sale of Van der Moolen's specialist business to Lehman Brothers and subsequent sale of Lehman Brothers to Barclays and with Susquehanna Investment Group giving up its DMM business in 2009. In addition, on January 22, 2010, we sold our DMM business to Barclay Capital Inc. for \$25 million. Until we sold our DMM operations to Barclays, our competitors in the NYSE cash equities DMM business were Spear, Leeds & Kellogg Specialists LLC (a division of Goldman Sachs Group), Bank of America Specialists, Kellogg Specialist Group and Barclays.

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On the NYSE Amex Exchange and the ETF portion of the NYSE Arca Exchange (both of which exchanges list the securities formerly traded on the AMEX), specialist firms competed for a listing through an allocation process organized by the NYSE Alternext. An allocation committee of the exchange selects the specialist firm for each security based on specified criteria, giving weight to the desires of the listed company. In the second half of 2008, all of the ETFs that had previously been listed on the NYSE Amex Exchange (formerly, the AMEX), the lead market maker for each ETF listed on the NYSE Arca exchange is chosen either by the exchange or the ETF issuer. In March 2008, LSP sold its equity options specialist operations to another AMEX options specialist for an immaterial amount. Upon completion of this transaction, LSP retained its ETF, ETF option and index option lead market-making operations, as well as all of its current market-making operations.

In addition to normal market making functions, a lead market-maker in ETFs may provide seed money to the ETF by creating ETF shares by purchasing and depositing a group of securities and/or cash into the fund. Due to the evolution of the specialist and market-making functions into more similar roles, there is little difference in the lead market-makers and market-makers for ETFs; thus, the need for seed money has diminished. However, we may still seek to inject seed money into some ETFs when the opportunity arises in order to provide additional services to our ETF issuers, both domestically and internationally.

In connection with the operation of our DMM business prior to the sale in January 2010, the DMM firm's purchase and sale of its DMM securities as principal were based on obligation or inclination. For example, the DMM firm may have been obligated to buy or sell its DMM securities to counter short-term imbalances in the market, thus helping to maintain a fair and orderly market in that stock. At other times, the DMM firm may have been inclined to buy or sell the securities as principal based on market conditions, but in many cases, had to re-enter the market on the opposite side of its last trade in order to bring fairness and continuity to the market. In actively-traded securities, the DMM firm continually bought and sold its securities at varying prices throughout each trading day. The DMM firm's goal and expectation is to profit from small differences in the prices at which it buys and sells these securities. Historically, before specialists became DMMs under the new market model, the specialist firm's trading practices were subject to a relatively large number of restrictions, but a large number of these restrictions were removed under the new market model due to the removal of some of the informational advantages that had existed prior to December 2008. The changes brought on by the new market model had hampered our DMM's profitability in 2009, especially considering the decline in volumes on the NYSE and the significant increase in volumes in off-NYSE electronic marketplaces and so-called dark pools. These market structure changes and increase electronic market competitors were important factors that shaped our decision to sell LaBranche & Co. LLC's DMM business in January 2010. We felt that the market-making opportunities in derivative products represented our best business going forward and to achieve the highest possible stockholder returns.

Currently, and for the foreseeable future, the large bulk of trading on exchanges, by market-makers, is done and will be done electronically and large orders are at times traded telephonically by broker-dealers through upstairs market-makers. As discussed above, our market makers have developed proprietary algorithms to trade in the nearly all-electronic market both by obligation and inclination. Our algorithms are designed to trade in accordance with our obligations as market-maker and also are designed to trade on opportunity in increasing situations where we are allowed to trade by inclination. We also believe we have talented market-makers that provide competitive markets upon request, and that are well capitalized and are ready, willing and able to trade at their quoted prices.

Growth of our Options, Futures and ETFs Market-Making

The recent changes in investor behavior from concentration on individual stocks to alternatives such as sector and index trading, as well as ETFs, also have substantially fueled the growth of trading in options, futures and ETFs. We have continued to increase our focus on our options, futures and ETFs specialist and market making-operations. In 2009, personnel and strategy changes interrupted the growth in our domestic revenue that we had been experiencing generally since 2006. We also experienced increased competition in the domestic

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options and ETF market making business in 2009, which caused fewer opportunities to be available with lower margins and longer durations at times. However, we continued to experience growth with these products in the overseas in the European market. Regardless of our experience domestically, the global structured product marketplace continues to evolve and grow providing opportunity for business expansion within this segment.

Recent Trends in Trading

DMM firms, as the specialists did, generate revenues by providing liquidity with their own capital in their market-making securities. In the electronic marketplaces, DMM firms' revenues generally are significantly impacted by the share volume of trading and volatility on the applicable market, as it was in the former manual specialist models on the NYSE and AMEX. DMM revenues in the NYSE's new market model are also generated by their quoting at the NBBO and order flow that is thereby brought to the NYSE. Market activity historically has tended to be cyclical and trading volumes from 2002 through 2009 have generally evidenced a decline in individual and institutional trading.

Our Market Making segment has now shifted its focus solely to providing liquidity in derivative products such as equity, index, ETF and foreign currency options, ETFs and futures, rather than also focusing on the cash-equity securities that were the focus of LaBranche & Co. LLC's specialist and, subsequently, designated market maker business.

Since 2000, ETFs and other derivative products have grown as an alternative to traditional equity and bond investments. ETFs are share-based investment funds that pool investors' capital and trade on stock exchanges throughout the day at prices determined by the market. ETFs attempt to imitate a stock market index or narrowly defined basket, rather than actively add or remove stocks. As a result, these ETFs offer investors the diversification advantages of a mutual fund, while also possessing certain tax and other advantages of traditional stocks. According to data provided by the Investment Company Institute, ETF assets grew to approximately \$777 billion as of December 31, 2009 from \$642 billion as of December 31, 2008, representing an annual growth rate of approximately 21.0%. Some of the more recognizable ETFs are the Nasdaq 100 Tracking Stock (QQQQ), Standard & Poors Depositary Receipts (SPDRs), Vanguard Index Participation Receipts (VIPERS) and iShares MSCI EAFE Index Fund (EFA). We believe the increase in program trading during this period is at least partially related to the growth in ETFs because hedging trades executed by market makers tend to be done electronically and in small increments. Additionally, related products such as index and ETF options have grown in popularity in connection with risk management, hedging and other opportunities. These products also require the services of a specialist and/or market-maker to maintain liquidity and a fair and continuous market in those securities.

Average daily trading volume on the NYSE decreased to approximately 1.3 billion shares in 2009 (and declined from approximately 1.6 billion in the first quarter of 2009 to approximately 1.1 billion in the fourth quarter of 2009) from approximately 1.5 billion shares in 2008 and 1.6 billion shares in 2007. There were several periods of trading in 2007 and 2006 in which there were significant unilateral market moves upward or downward (*i.e.*, there was very low volatility), causing us to generate poor trading results. In 2008, particularly during the financial crisis and closing or take-overs of large financial institutions, there was a significant increase in trading volumes and volatility, on which our market-making businesses were able to capitalize and during which the importance of liquidity providers in the marketplace was very evident. This period of significant increase in trading volumes and volatility was followed by a period of rapid decline in 2009. Overall, trading volumes worldwide have increased, due primarily to the proliferation of electronic and algorithmic trading and the relative ease and quickness of market access through automated trading models. This trend is further evidenced by the transition of all formerly manual markets, such as the NYSE and AMEX, to trading models that are, essentially, fully electronic. For example, in December 2006, the NYSE launched its HYBRID market. This transition was further developed in the fourth quarter of 2008 when the SEC approved, and the NYSE implemented, its New Market Model. In addition, Electronic Communications Networks, or ECNs, which are trading systems off of exchange floors that automatically match buy and sell orders at specified prices, continued

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to grow in popularity during this period due to their ability to handle large amounts of orders without human intervention. These trading systems, as well as advances in overall trading algorithms and increased speed of market technology, has led to the increases in volumes and worldwide trading activity, while at the same time causing increasing numbers of transactions to be executed in markets other than the primary listed market more quickly than the markets on which the securities were listed. These trends have led to the decline in volume on these historically manual markets. These trends have caused us to adapt our market-making focus to a more diversified base of derivative securities as well as additional equity securities on new and evolving markets such as the CBOE Stock Exchange.

The trading revenues of our Market-Making Segment decreased significantly in 2009, largely to lower volatility and the reduced opportunities of trading on the NYSE and other markets. Additionally, as the volumes captured by the exchange decreased significantly from 2008 to 2009 and due to a significant decline in our options market-making business in the first quarter of 2009, following the departure of our options market-making team in the second and third quarters of 2009, and the challenging environment facing our new options market-making team in the second and third quarters of 2009, this caused lower revenues and higher expenses in our options market-making operations. The dramatic increase in market volatility in the second half of 2008 brought on by extraordinary events in the financial markets, especially in the trading of financial companies, eroded in 2009 and, when combined with lower trading volumes and the challenging options market-making environment in 2009, caused significantly poorer results than we had seen in our Market-Making segment in 2007 and 2008. In the second half of 2008, the CBOE's Volatility Index, or VIX, a key measure of market expectation of near-term volatility and investor sentiment reached record high levels. However, in 2009, the VIX decreased to reflect the cyclical nature of the volatility in the marketplace and the need for liquidity provision declined. In this situation, we believe that the need for market-makers is crucial to the maintenance of continuous markets, and our market-making model is designed to increasingly use our capital to mitigate volatility in the market by adding liquidity. However, in 2009, the VIX decreased to reflect the cyclical nature of the volatility in the marketplace and the need for liquidity provision declined.

Due in large part to the provisions of Regulation NMS and increased electronic trading resulting in trades being shipped to the market or trading system that posts the national best bid and offer, the percentage of trades in NYSE-listed stocks that take place on the NYSE declined to below 30% in 2009. In 2009, 24.9% of trades in NYSE-listed stocks were traded on the NYSE, a decline from approximately 26.2% in 2008. The percentage of trades in NYSE-listed stocks on the floor of the NYSE is affected as follows:

some stocks are listed on multiple exchanges, such as regional exchanges, and trades take place on those exchanges as well as in the over-the-counter market and through alternative trading systems (ATSS), such as BATS and BIDS ;

at times, significant volume in NYSE-listed stocks takes place before and after regular NYSE trading hours, off the NYSE; and

rebates incentivize market participants to trade on other venues.

Technological advances and the implementation of Regulation NMS have contributed to increased trading through ATSS, such as ECNs, and electronic crossing systems. These systems electronically facilitate the matching of buy and sell orders that are entered by their network members. If a match does not occur, some ATSS will forward unfilled orders to other ATSS or to exchanges such as the NYSE. Some of these networks also allow limited negotiation between members to facilitate a match. These ATSS generally limit trades over their systems to their members, who are typically large financial institutions, professional traders or brokerage firms. Additionally, some ATSS are being developed to facilitate trading by retail investors. In April 1999, the SEC ruled that these networks are allowed, and in specified cases are required, to register and become subject to regulation as stock exchanges. It is possible that the presence of these ATSS and other emerging electronic trading systems have contributed to the overall decline in the percentage of equity shares traded on the NYSE over the past six years from approximately 82% to approximately 24.9% in 2009. Notwithstanding the presence of these ATSS and other emerging trading technologies, the NYSE remains a dominant trading marketplace for

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listed securities. It is unclear, however, how ATs and other new technologies, other potential securities market acquisitions, the HYBRID model and Regulation NMS, all as described in Rules Governing Our Specialist and Market-Making Activities (below), will continue to affect the future percentages of trading in listed stocks on the NYSE and the other markets on which we conduct business.

The NYSE's HYBRID market, launched in December 2006, substantially replaced these products with an almost fully electronic market. The changes brought on by the new market model in December 2008 had hampered our DMM's profitability in 2009, especially considering the decline in volumes on the NYSE and the significant increase in volumes in off-NYSE electronic marketplaces and so-called "dark pools." These market structure changes and increase electronic market competitors were important factors that shaped our decision to sell LaBranche & Co. LLC's DMM business in January 2010. We felt that the market-making opportunities in derivative products represented our best business going forward and to achieve the highest possible stockholder returns.

Our Market-Making Operations

Our Market-Making segment revenues, net of interest expense, declined to \$25.3 million in 2009 from \$49.0 million in 2008 and \$98.0 million in 2007. Excluding the gain or loss from the NYSE Euronext, Inc. common stock (the "NYX shares") the revenues, net of interest expense, of our market making segment were \$31.0 million, \$216.3 million, and \$112.6 million, for 2009, 2008 and 2007, respectively. In January 2010, our Company sold the DMM business and related assets which caused the revenues, net of interest expense, of the DMM business to be excluded in the comparative amounts reported. In a supplemental disclosure, the market-making segment is reported with the discontinued operations in segment information. The decline in 2009 was primarily attributable to declines in trading revenue in the domestic options and ETF market-making, NYSE cash equities market-making, and losses on the NYX shares offset by increases in revenues in our European market making activities. In 2008, our overall revenues declined mainly due to the unrealized net loss of \$167.3 million on our NYX shares in 2008 versus the unrealized net loss on the NYX shares of \$14.5 million in 2007.

Prior to the implementation of the NYSE's HYBRID Market in 2006, the cash equities specialist business generated the majority of the revenues of our Market-Making segment, with the revenues from the ETFs, options and future products growing significantly over that same time period. However, since the NYSE's HYBRID Market implementation, the cash equities specialists/market-making revenues have been surpassed by the derivative specialist and market-making activities, which since the third quarter of 2007 has accounted for the majority of our Market-Making segment's total revenues. We significantly reduced costs related to our Market-Making segment in 2009, 2008 and 2007, largely due to a reduction in compensation expense following significant reductions in workforce related to the implementation of a nearly-fully electronic market under the HYBRID Market model and Regulation NMS. On January 22, 2010, we sold the DMM business for \$25 million, which we believe will further significantly lower our expenses, both in terms of compensation expense and in terms of the expenses related to our outstanding indebtedness (and the negative carry related thereto) and in releasing us of the requirement to maintain \$76.0 million in net liquid assets at our DMM business.

In 2008 and 2009, we continued to increase our focus on our market-making operations other than the NYSE cash equities business, and since our sale of the DMM business in January 2010, our focus has shifted entirely to making markets in these derivative products. Our Market-Making segment has been employing less capital more efficiently in its trading activities on more exchanges, and in derivative products and ETFs in order to seek growth opportunities. Our initial acquisition strategy and strategic organic growth from 2000 to 2009 has enabled us to attract products and build relationships in our market-making operations on additional exchanges and in additional countries. A restructuring of certain of our market-making subsidiaries during this period has allowed us to develop our market-making operations across various exchanges and marketplaces. These initiatives have also enabled us to better allocate and deploy our capital, workforce and technology across our operations in order to more efficiently seek out opportunities as they arise. The working capital allocated to this segment, however, has decreased from \$777.8 million at the beginning of 2007 to \$269.5 million at the end of 2009, largely due to the decline in the capital requirements at our DMM business within the Market-Making segment.

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Our Options, Futures and ETFs and Market-Maker Business

As a market maker in options, futures and ETFs, we are responsible for maintaining a fair and orderly market in the trading of those securities. In doing so, we may at times be obligated to trade against the market, adversely impacting the profitability of the trade or creating a position that may not necessarily be desired. To hedge the risk of our derivative positions, we may buy or sell the underlying asset(s). As a market-maker, we also trade these derivative securities as principal out of both obligation and inclination. Our principal competitors in the ETF specialist business were Spear, Leeds & Kellogg Specialists LLC, Bear Wagner Specialists LLC (Bear Wagner became Barclays) and Kellogg Group Specialists LLC. Our options and futures business is not dominated by any one or group of competitors.

As a market-maker in options, ETFs and futures, both domestically and internationally, our Market-Making segment generally engages in a course of dealings that is reasonably calculated to contribute to the maintenance of a fair and orderly market. We also may hedge these positions with the underlying assets or other financial instruments. In our market-making function, we either regularly publish bona fide, competitive bid and offer quotations in our securities on an interdealer quotation system, such as the NYSE Arca Exchange, CBOE, etc., or we furnish bona fide competitive bid and offer quotations to other broker dealers upon their request. We stand ready, willing and able to effect transactions at our quoted prices with those other broker dealers, thereby bringing immediacy and liquidity to the markets when we choose to participate.

In 2002, we began to implement a strategy to diversify our revenues beyond the core NYSE and AMEX cash equities specialist businesses by focusing on non-traditional products such as options, ETFs and futures, both domestically and globally. This was mainly achieved by coupling the LaBranche reputation and relationships with new trading technologies and algorithms to be used in marketplaces outside the NYSE where growth in new products was evident. This strategy largely began with the formation of LSP in June 2002, in which we have conducted our options, ETFs and other derivatives specialist and market-making business activities on the NYSE Arca Exchange, the NYSE Amex Exchange, NYBOT, PHLX, CBOE and other exchanges.

From 2002 through 2006, we expanded our market-making activities to different derivative products as well as to other exchanges, which contributed significantly to our growing balance sheet over this period. In January 2005, we further expanded our market-making activities by forming LSPE to be a market-maker for ETFs traded on the London Stock Exchange, Euroex and Euronext exchanges. In August 2005, we formed LSPH to be a market-maker in ETFs traded in Hong Kong and to conduct hedging transactions in Hong Kong markets related to our market-making activities. LSPE became a registered broker-dealer with the FSA in March 2006, and LSPH registered as a broker-dealer with Hong Kong's SFC in October 2006.

In August and September 2005, we reorganized our options, futures and ETFs specialist and market-making operations under our LSHI holding company subsidiary in order to facilitate the liquidity and working capital management of our non-cash equities specialist and market-making activities. During 2006, our options, futures and ETFs specialist and market-making operations continued to expand our LSPE and LSPH subsidiaries continued start-up activities to commence its market-making activities in London and Hong Kong. In the second quarter of 2009, we sold our options specialist operations on the PHLX to a third party. In addition, in March 2008, LSP sold its equity options specialist operations to another AMEX options specialist to a third party. These transactions essentially caused a discontinuation of our specialist operations in options products, although we are still a lead market maker in some options products on the CBOE and a lead market-maker in several ETFs quoted on the NYSE Arca Exchange.

In 2007 and 2008, in particular, our expansion into new products and increased globalization have given us opportunities which we believe has allowed and will enable us to further diversify our business. Our trading operations in London began yielding positive results in 2007 and that production accelerated in 2008 and 2009 due in part to market volatility and the fact that LSPE provided liquidity on a regular basis to the ETF markets abroad. We believe the further globalization of electronic markets will provide us additional opportunities as a

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liquidity provider and market-maker, and we are continuing to develop trading technologies to enable us to make markets in ETFs and options in Hong Kong through our LSPH subsidiary. The expansion of our derivative product market-making business into the United Kingdom and Hong Kong is evidence of our strong belief that market-making operations are needed and can profit by growing abroad. We believe we are in an opportune position to leverage the electronic trading technologies developed in our domestic operations to continue to make markets in the United Kingdom and Hong Kong. We also believe that the growth of our revenues at LSPE, in the United Kingdom, using our scalable, proprietary market-making technology evidences the fact that our trading philosophy and technology translates well to other global and electronic markets.

During 2009, our domestic index and options market-making activities experienced lower revenues while our ETF market-making activities and European market making activities delivered continued revenue growth. In 2007 and 2008, our index and ETF options market-making and ETF market making activities excelled.

For detailed financial information in connection with our Market-Making segment, please see Management's Discussion and Analysis of Financial Condition and Results of Operations Market-Making Segment Operating Results and Note 16 to the Financial Statements filed herewith.

Our NYSE Equity Designated Market Maker Business (prior to its sale)

Our DMM cash equities business on the NYSE was conducted through our LaBranche & Co. LLC subsidiary. As a DMM in equity securities and rights listed on the NYSE, LaBranche & Co. LLC's role was to maintain, as far as practicable, a fair and orderly market in the securities it has been allocated. The securities allocated to LaBranche & Co. LLC after the new market model was implemented were the same securities that were allocated to it as the specialist for those companies. As a DMM, LaBranche & Co. LLC provided a service to its listed companies, and to the brokers, traders and investors who trade in its DMM stocks. As a result of our commitment to providing high quality market-making services, we developed a solid reputation among our constituencies, including investors, members of the Wall Street community and our listed companies. In January 2010, we sold the DMM business and related assets.

Based on dollar volume and share volume traded of stocks, LaBranche & Co. LLC was one of the largest NYSE DMM firms as of December 31, 2009 and 2008. In addition, LaBranche & Co. LLC acted as the DMM for 200 other NYSE-listed securities (e.g., preferred stocks and derivative securities).

As of December 31, 2009, LaBranche & Co. LLC's listed companies included:

101 of the S&P 500 Index companies;

28 of the S&P 100 Index companies;

8 of the 30 companies comprising the Dow Jones Industrial Average (DJIA). Our DJIA stocks are 3M Co., American Express Company, Chevron, E.I. du Pont de Nemours and Company, Exxon Mobil Corp., Merck & Co. Inc., Kraft Foods and AT&T Inc.; and

121 foreign ADRs, of which 24 are Peoples Republic of China ADRs

Regulation National Market System (Regulation NMS). Regulation NMS became effective in March 2007 for automated trading centers. It has had a significant impact on the regulation of trading on securities exchanges and marketplaces. Specifically, the rule establishes inter-market protection against trade-throughs for all NMS stocks and protection of only those quotations that are immediately accessible through automatic execution, allowing trades to go directly to the market that posts the national best bid and offer. The rule generally does not contain the opt-out exception originally proposed by the SEC, which would have (1) allowed customers (and broker dealers trading for their own accounts) to opt-out of the protections of the rule by providing informed consent to the execution of their orders, on an order-by-order basis, in one market without regard to the possibility of obtaining a better price in another market, and (2) taken into account the differences between the speed of execution in electronic versus manual markets by providing an automated market with the ability to

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trade through a non-automated market at a price up to a certain amount away from the best bid or offer displayed by the non-automated market. The rule also is anticipated to protect the best bids and offers of each exchange and the NASD/FINRA's Alternative Display Facility. We are fully operational under the HYBRID market; therefore, we believe we are in compliance with the provisions of Regulation NMS and will continue to adapt to the NYSE and other markets in order to do so. We currently do not anticipate that Regulation NMS will have a material effect on our business, other than with respect to the effects of the new HYBRID market and other electronic exchanges, as more fully described herein and in Item 1A, Risk Factors below.

The Change from Commissions to Liquidity Provision Payments on the NYSE. In September 2007, the NYSE completed a change in its commission rules for specialists, providing for a monthly liquidity provision payment (the LPP). Formerly the specialist commission, until December 1, 2006, was paid to a specialist for executing limit orders that had been on the book for more than five minutes. In a transition period from December 2006 through August 2007, our NYSE specialist received a specialist allocation pool payment in the amount of \$2.1 million per month. The new LPP system changed the amounts paid to our DMM business for providing liquidity on the NYSE and, in effect, rewarded the DMM for the times they quoted at the NBBO. Until we sold our DMM business on January 22, 2010, the new LPP system involved a two tier fee structure based on (1) the firm's proportional share of 100% of the consolidated tape revenue earned by the NYSE for quoting at the national best bid and offer, and (2) a subjective allocation from the NYSE of the LPP pool which consisted of 25% of the NYSE's listed stock transaction revenue on matched volume. This monthly payment, in the aggregate, was between \$1.3 million to \$2.1 million since implementation.

Reduction in Capital Requirements of the DMM. On February 5, 2008, the SEC approved an NYSE-proposed reduction by 75% in the net liquid asset (NLA) requirements applicable NYSE specialist firms. This reduction became effective immediately and resulted in a reduction of LaBranche & Co. LLC's NLA requirement by approximately \$205.0 million. Upon the completion of the sale of the DMM business in January of 2010, we were released from our remaining \$76 million NLA requirement, thereby freeing up working capital to be used for other corporate purposes.

Emergency Rule Making Under Regulation SHO and conversion to Final Rule. On October 14 and 15, 2008, the SEC Commission adopted a set of interim final temporary rules concerning short selling practices designed to give continued effect to emergency measures taken in September 2008 either banning or significantly restricting the practice of naked short selling, which is selling an equity security short without owning or having borrowed the security. Among other things, the SEC approved amendments to Regulation SHO, adopting Rule 204T, which requires market participants to close out short sales on a T+3 basis, which is within three trading days after the initial sale. Rule 204T of Regulation SHO requires participants of a registered clearing agency (which include broker-dealers) to deliver equity securities for clearance and settlement no later than the close of business on T+3). If there is a failure to deliver securities on the settlement date, then the participant must, by no later than the beginning of regular trading hours on the next following settlement date (or T+4), close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity. A participant who violates this close-out requirement is prohibited from further short sales in the same security unless the shares are not only located but also pre-borrowed. This prohibition applies to all short sales in the same security effected by the participant, not just future sales for the particular naked short seller. The rule is designed to effectively prevent naked short selling by causing broker-dealers to require their short selling customers to pre-borrow, rather than run the risk of a failure to deliver. The new close-out requirement applies to sales of all equity securities. In this respect, it is significantly broader than the current close-out requirement in Regulation SHO, which applies only to threshold securities (defined as securities with large and persistent fails to deliver). The new rule provides limited exceptions for sales attributable to bona fide market-making activities (close-out required by the third settlement date following the fail to deliver) and was converted into a final rule by the SEC in the third quarter of 2009 into Rule 204. We believe that this rule significantly limits our ability to enter short sales, even where our market-making obligations require us to do so, because a failure to cover a short sale by delivering securities of like kind and quantity could prevent us from providing liquidity without first pre-borrowing the security in the future. Since the implementation of New Rule 204, we have been able to use

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the extra three-day period to deliver securities on a naked short sale on a timely basis, but cannot provide assurances that we would not be limited from certain market-making activities in the future due to the new Regulation SHO requirements.

Licenses Required to Operate our DMM Business. In order to allow us to operate our NYSE specialist activities on the NYSE, the NYSE issued trading licenses to all registered broker-dealers wishing to conduct business on the floor of the NYSE. The annual fee for each such license was \$40,000 per license for 2008 and 2009. These trading licenses replaced the trading rights provided by the ownership or lease of an NYSE membership prior to the NYSE/Archipelago merger. Prior to our sale of the DMM business in January 2010, our NYSE DMM business utilized 31 trading licenses. Upon the sale of our DMM business, we no longer require trading licenses, but our Institutional Brokerage segment continues to utilize one NYSE trading license to conduct its agency execution business for institutions and professional traders.

Please see *Regulatory Matters* and *Risk Factors* below for additional information regarding our regulatory environment.

Competition in the Market-Making Industry

Options, Futures and ETFs Market-Makers. Competition in the options futures and ETFs market making business is extremely intense. Although there is not an official allocation process to become a market-maker on the exchanges on which we conduct these market-making activities (since there is not one central market-maker, as on the NYSE), market-makers are based on the strength of their capital base, willingness and ability to furnish competitive bid and offer quotations quickly and effectively, willingness to commit its capital to provide liquidity to the market when other market participants may not be willing or able to do so, and skills in monitoring and managing risk appropriate to its market-making activities. We have many competitors, including, without limitation, Goldman Sachs, Susquehanna Investment Group, Citadel Investment Group and Timber Hill, Knight Trading and Interactive Brokers who provide these market-making services in options, futures and ETFs, and some of these competitors have greater financial resources, relationships and personnel resources than we do.

Cash Equity DMMs. In 2009, the number of cash equities DMM firms on the NYSE was reduced from seven to five. Prior to the sale of our DMM business, we obtained each of our new DMM listings by participating in an allocation process. As part of this process, either the allocation committee or the listing company chooses the DMM. Prior to our sale of the DMM business, we competed with other DMM firms based on a number of factors, including:

the strength of our capital base;

our willingness to commit our own capital and trade for our own account while conducting our DMM operations; and

the ancillary services we offer our allocated companies, such as providing information on the trading activity in their stocks.

Under NYSE Rule 103B, *The Exchange Allocation Policy*, the NYSE Market is granted the right to determine the number and identity of DMM firms from which a new listing issuer may choose, provided the group consists of at least four firms. The NYSE Market and the issuer are provided with the same kind of material with respect to each applicant as was formerly reviewed by the NYSE's Allocation Committee prior to the NYSE/Archipelago merger.

Our Market-Making Segment's Competitive Position

We are committed to providing the highest quality service to our various constituencies. Our competitive position is based on the following factors:

Leading position in the market-making industry. We are a significant market-making firm in options, ETFs and futures on various exchanges, such as the NYSE Amex Exchange, the NYSE Arca

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Exchange, the NYBOT and the CBOE. We have a long-standing reputation as a leading market-making firm. We have grown and diversified our business and improved our services through widely varying market conditions. We have grown our business and reputation in both options and ETFs domestically and abroad as market-makers. We believe that market participants seeking liquidity in these products have come to rely on the reputation of LSP and LSPE as brokers with significant capital resources and the ability to provide liquidity when other market participants have not. This was particularly evident in the European ETF markets in 2008 and 2009 during the global financial crisis in which LSP and LSPE stood ready to provide liquidity at competitive prices.

Diverse and high quality market-making securities. The derivative products in which we are market-makers operate in a variety of industries, including financial services, media, oil and gas, retail, technology and telecommunications. Many of these companies are leaders in their respective fields. They range in market capitalization from some of the smallest to some of the largest and most well-known.

Reputation in industry as effective market-maker and relationships with significant market participants. Over the past several years, we have established and maintained a reputation as a market-making firm that is ready, willing and able to provide liquidity to the market at times when other parties are not willing to do so. We are able to provide quotations quickly upon request when called to do so and stand ready to execute transactions in the size and prices quoted, which has resulted in more order flow being directed to our market-makers. Due to our market-making capabilities and our willingness to provide competitive quotes and liquidity upon request, we have enjoyed excellent relationships with other market participants seeking our liquidity. These capabilities span both domestically and internationally, and we believe these relationships have grown in 2008 and 2009 when other market-makers may not have been willing or able to provide liquidity during the financial market crises of 2008 and 2009.

Ability to deploy capital efficiently. We have employed capital more efficiently in our trading activities on more exchanges, and in derivative products and ETFs, in seeking growth opportunities while maintaining a leadership position in the cash equities specialist market. Due to the sale of the DMM business in 2010, we will no longer have an NLA requirement to the NYSE or SEC going forward. Our initial acquisition strategy and strategic organic growth has enabled us to gather products in our market-making operations on additional exchanges and in additional countries. A restructuring of certain of our options, futures and ETFs market-making subsidiaries has allowed us to develop those operations across various domestic and international exchanges and market places. The organizational structure of our Market-Making segment is intended to enable us to better allocate and deploy our capital, workforce and technology across our operations in order to more efficiently seek out opportunities as they arise. This will be further enhanced as we seek in 2010 to further consolidate our operations in order to create additional efficiencies and flexibility.

Strong trading and technology skills. We utilize our trading and technology skills to actively participate as principal in trading our market-making securities. We significantly improve liquidity in our market-making securities particularly during periods of market volatility. Additionally, as the securities trading marketplace has become more electronic, we have developed electronic trading capabilities which allow us to interact in the fast and more automated markets. Due to our investment in automated quoting technology, which was developed internally through cooperation of our highly experienced traders and technology development personnel, we have the capability to trade almost entirely electronically across multiple markets. Our technology group is also developing more advanced algorithmic models that may be used in electronic trading markets worldwide.

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Our Institutional Brokerage Segment

Recent Trends in Institutional Brokerage Industry

As a result of years of advances in order delivery and execution technology, trading costs for customers across all categories (retail, institutional, etc.) have dropped dramatically. These advances in trading technologies, and the resulting economies afforded the customer, have also engendered an entirely new style of investment management, where algorithms embedded in servers generate, direct and account for orders with minimal human interaction.

In addition, there have arisen a number of non-traditional execution venues that bypass the traditional exchanges and ECNs in which institutions can trade directly with each other without exposing orders to market-wide price verification.

The traditional clearing industry has, over the last few years, consolidated down to a small number of highly capitalized and extremely focused competitors. Mostly owned by or affiliated with large investment or commercial banks, these few top competitors command the dominant share of the fully-disclosed correspondent clearing market. As a result, barriers to entry have risen and the capital expenditures necessary to maintain market share have increased. During the second quarter of 2007, in order to reduce expenses and take advantage of a consolidating clearing marketplace, we outsourced our Institutional Brokerage segment's clearance activities to a major Wall Street firm. We expect that this change will provide cost savings going forward and will also release working capital that we can use for other corporate purposes. LFS has expanded its services to institutional customers to include equities in international markets.

Our Institutional Brokerage Operations

LFS, which is the sole operating entity constituting our Institutional Brokerage segment, provides a range of customized execution services, to a range of institutional and individual clients through our Institutional Execution Group (IEG). IEG provides institutions with highly customized service built around special execution needs. IEG focuses on timely executions with minimal market impact. IEG handles and, through an outsourced clearing relationship with a major Wall Street firm, clears trades on every major domestic stock exchange, with straight-through processing from order origination to trade execution. IEG also provides soft dollar execution and other administrative services to institutional customers. IEG has active relationships with over 300 accounts and is developing its business nationwide.

Commencing in May 2007, following approval by FINRA, LFS commenced principal trading and market-making activities in 500 OTC Bulletin Board and Pink Sheet securities. In 2009, the number of OTC Bulletin Board and Pink Sheet securities in which LFS is authorized to make a market in was increased to 4,000. Currently, LFS makes a market in approximately 1,100 stocks which can grow significantly to up to 4,000 securities due to the increased authorization by FINRA.

Our Institutional Brokerage segment revenues, net of interest expense in 2009 increased to \$30.5 million from \$10.1 million in 2008. Commission and trading revenues increased by \$3.9 million and \$0.3 million, respectively, offset by a \$5.6 million loss in our NYX shares. However, trading and compensation expenses also significantly increased in 2009 in connection with the growth in personnel and new hires by LFS in 2009, as described below.

Beginning in April 2008, we commenced efforts to significantly increase our IEG group's activities and provide our customers with additional products and services to enhance their investment objectives. Some of these services included facilitation trading, in which we provide liquidity on certain customer orders by interacting directly with those orders with our own capital, and corporate access initiatives, in which we provided avenues to the buy side for publicly traded entities. To energize this growth in 2009, we made key hires of sales and position traders that we believed would help us build our Institutional Brokerage business into an operation that meets the needs of today's institutional customers. Due to significant market changes in 2009,

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