SCHWAB CHARLES CORP
Form 10-Q
November 06, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

Commission File Number: 1-9700

THE CHARLES SCHWAB CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-3025021**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

211 Main Street, San Francisco, CA 94105

(Address of principal executive offices and zip code)

Registrant s telephone number, including area code: (415) 667-7000

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 x 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	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 x

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

1,275,098,321 shares of $.01 par value Common Stock

Outstanding on October 24, 2012

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THE CHARLES SCHWAB CORPORATION

Quarterly Report on Form 10-Q

For the Quarter Ended September 30, 2012

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Part I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Statements of Income

(In millions, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net Revenues				
Asset management and administration fees	$ 524	$ 466	$ 1,504	$ 1,470
Interest revenue	478	487	1,447	1,464
Interest expense	(39)	(44)	(116)	(134)
Net interest revenue	439	443	1,331	1,330
Trading revenue	204	248	666	694
Other	42	45	209	119
Provision for loan losses	(10)	(8)	(14)	(13)
Net impairment losses on securities [(1)]	(3)	(13)	(28)	(22)
Total net revenues	1,196	1,181	3,668	3,578
Expenses Excluding Interest				
Compensation and benefits	442	423	1,353	1,290
Professional services	98	104	287	288
Occupancy and equipment	77	78	233	222
Advertising and market development	49	48	173	159
Communications	53	56	166	166
Depreciation and amortization	50	39	146	107
Class action litigation and regulatory reserve				7
Other	66	73	204	199
Total expenses excluding interest	835	821	2,562	2,438
Income before taxes on income	361	360	1,106	1,140
Taxes on income	114	140	389	439
Net Income	247	220	717	701
Preferred stock dividends	9		23	
Net Income Available to Common Stockholders	$ 238	$ 220	$ 694	$ 701

Weighted-Average Common Shares Outstanding Diluted	1,275	1,229	1,274	1,216
Earnings Per Common Share Basic	$ .19	$ .18	$ .54	$ .58
Earnings Per Common Share Diluted	$ .19	$ .18	$ .54	$ .57

(1) Net impairment losses on securities include total other-than-temporary impairment losses of $1 million and $2 million, net of $(2) million and $(11) million recognized in other comprehensive income, for the three months ended September 30, 2012 and 2011, respectively. Net impairment losses on securities include total other-than-temporary impairment losses of $15 million and $13 million, net of $(13) million and $(9) million recognized in other comprehensive income, for the nine months ended September 30, 2012 and 2011, respectively.

See Notes to Condensed Consolidated Financial Statements.

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THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Statements of Comprehensive Income

(In millions)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net Income	$ 247	$ 220	$ 717	$ 701
Other comprehensive income:				
Change in net unrealized gain on securities available for sale:				
Net unrealized gain	250	4	458	41
Reclassification of impairment charges included in earnings	3	13	28	22
Other reclassifications included in earnings			(1)	1
Income tax effect	(95)	(6)	(181)	(24)
Total other comprehensive income	158	11	304	40
Comprehensive Income	$ 405	$ 231	$ 1,021	$ 741

See Notes to Condensed Consolidated Financial Statements.

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THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Balance Sheets

(In millions, except per share and share amounts)

(Unaudited)

	September 30, 2012	December 31, 2011
Assets		
Cash and cash equivalents	$ 8,523	$ 8,679
Cash and investments segregated and on deposit for regulatory purposes (including resale agreements of $17,843 at September 30, 2012 and $17,899 at December 31, 2011)	25,041	26,034
Receivables from brokers, dealers, and clearing organizations	607	230
Receivables from brokerage clients net	11,914	11,072
Other securities owned at fair value	513	593
Securities available for sale	42,448	33,965
Securities held to maturity (fair value $16,229 at September 30, 2012 and $15,539 at December 31, 2011)	15,612	15,108
Loans to banking clients net	10,102	9,812
Loans held for sale		70
Equipment, office facilities, and property net	672	685
Goodwill	1,159	1,161
Intangible assets net	292	326
Other assets	775	818
Total assets	$ 117,658	$ 108,553
Liabilities and Stockholders Equity		
Deposits from banking clients	$ 68,756	$ 60,854
Payables to brokers, dealers, and clearing organizations	1,445	1,098
Payables to brokerage clients	34,761	35,489
Accrued expenses and other liabilities	1,455	1,397
Long-term debt	1,776	2,001
Total liabilities	108,193	100,839
Stockholders equity:		
Preferred stock $.01 par value per share; aggregate liquidation preference of $885 at September 30, 2012 and $0 at December 31, 2011	864	
Common stock 3 billion shares authorized; $.01 par value per share; 1,487,543,446 shares issued	15	15
Additional paid-in capital	3,890	3,826
Retained earnings	8,442	7,978
Treasury stock, at cost 212,554,662 shares at September 30, 2012 and 216,378,623 shares at December 31, 2011	(4,058)	(4,113)
Accumulated other comprehensive income	312	8
Total stockholders equity	9,465	7,714
Total liabilities and stockholders equity	$ 117,658	$ 108,553

See Notes to Condensed Consolidated Financial Statements.

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THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Statements of Cash Flows

(In millions)

(Unaudited)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Cash Flows from Operating Activities		
Net income	$ 717	$ 701
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	14	13
Net impairment losses on securities	28	22
Stock-based compensation	79	73
Depreciation and amortization	146	107
Premium amortization, net, on securities available for sale and securities held to maturity	163	62
Other	4	(3)
Originations of loans held for sale	(441)	(1,139)
Proceeds from sales of loans held for sale	513	1,251
Net change in:		
Cash and investments segregated and on deposit for regulatory purposes	880	(3,187)
Receivables from brokers, dealers, and clearing organizations	(376)	(111)
Receivables from brokerage clients	(844)	333
Other securities owned	80	(86)
Other assets	19	32
Payables to brokers, dealers, and clearing organizations	84	(242)
Payables to brokerage clients	(619)	4,513
Accrued expenses and other liabilities	(74)	(327)
Net cash provided by operating activities	373	2,012
Cash Flows from Investing Activities		
Purchases of securities available for sale	(19,889)	(10,800)
Proceeds from sales of securities available for sale	1,524	450
Principal payments on securities available for sale	10,546	5,639
Purchases of securities held to maturity	(4,620)	(866)
Principal payments on securities held to maturity	4,012	2,795
Net increase in loans to banking clients	(318)	(997)
Purchase of equipment, office facilities, and property	(107)	(137)
Cash acquired in business acquisition, net of cash paid		84
Other investing activities	10	11
Net cash used for investing activities	(8,842)	(3,821)
Cash Flows from Financing Activities		
Net change in deposits from banking clients	7,902	3,488
Repayment of long-term debt	(207)	(115)
Premium paid on debt exchange	(19)	
Net proceeds from preferred stock offerings	863	

Dividends paid	(252)	(218)
Proceeds from stock options exercised and other	26	89
Other financing activities		10
Net cash provided by financing activities	8,313	3,254
(Decrease) Increase in Cash and Cash Equivalents	(156)	1,445
Cash and Cash Equivalents at Beginning of Period	8,679	4,931
Cash and Cash Equivalents at End of Period	$ 8,523	$ 6,376
Supplemental Cash Flow Information		
Cash paid during the period for:		
Interest	$ 118	$ 127
Income taxes	$ 379	$ 416
Non-cash investing activities:		
Common stock issued and equity awards assumed for business acquisition (See note 3 - Business Acquisition for acquisition of optionsXpress Holdings, Inc.)	$	$ 714
Securities purchased during the period but settled after period end	$ 263	$ 203
Non-cash financing activity:		
Exchange of Senior Notes (See note 6 - Borrowings)	$ 256	$

See Notes to Condensed Consolidated Financial Statements.

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

(Tabular Amounts in Millions, Except Per Share Data, Ratios, or as Noted)

(Unaudited)

1. Introduction and Basis of Presentation

The Charles Schwab Corporation (CSC) is a savings and loan holding company engaged, through its subsidiaries, in securities brokerage, banking, and related financial services. Charles Schwab & Co., Inc. (Schwab) is a securities broker-dealer with over 300 domestic branch offices in 45 states, as well as a branch in each of the Commonwealth of Puerto Rico and London, U.K. In addition, Schwab serves clients in Hong Kong through one of CSC s subsidiaries. Other subsidiaries include Charles Schwab Bank (Schwab Bank), a federal savings bank, and Charles Schwab Investment Management, Inc. (CSIM), the investment advisor for Schwab s proprietary mutual funds, which are referred to as the Schwab Funds®, and for Schwab s exchange-traded funds, which are referred to as the Schwab ETFs .

The accompanying unaudited condensed consolidated financial statements include CSC and its majority-owned subsidiaries (collectively referred to as the Company). Intercompany balances and transactions have been eliminated. These condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States, which require management to make certain estimates and assumptions that affect the reported amounts in the accompanying financial statements. Certain estimates relate to other-than-temporary impairment of securities available for sale and securities held to maturity, valuation of goodwill, allowance for loan losses, and legal reserves. Actual results may differ from those estimates. These condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the periods presented. These adjustments are of a normal recurring nature. Certain prior period amounts have been reclassified to conform to the 2012 presentation. The Company s results for any interim period are not necessarily indicative of results for a full year or any other interim period. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

2. New Accounting Standard

Adoption of New Accounting Standard

Testing Goodwill for Impairment: In September 2011, the Financial Accounting Standards Board issued new guidance allowing companies to consider qualitative factors before performing a quantitative assessment when determining whether goodwill is impaired, which was effective for goodwill impairment tests performed after January 1, 2012. Specifically, there is no longer a requirement to perform the two-step goodwill impairment test unless the entity determines that based on qualitative factors, it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The adoption of this new guidance did not have a material impact on the Company s financial position, results of operations, earnings per common share (EPS), or cash flows.

3. Business Acquisition

On September 1, 2011, the Company completed its acquisition of all of the outstanding common shares of optionsXpress Holdings, Inc. (optionsXpress) for total consideration of $714 million. optionsXpress is an online brokerage firm primarily focused on equity option securities and futures. The optionsXpress® brokerage platform provides active investors and traders trading tools, analytics and education to execute a variety of investment strategies. The combination of optionsXpress and Schwab offers active investors an additional level of service and platform capabilities.

Under the terms of the merger agreement, optionsXpress stockholders received 1.02 shares of the Company s common stock for each share of optionsXpress stock. As a result, the Company issued 59 million shares of the Company s common stock valued at $710 million, based on the closing price of the Company s common stock on September 1, 2011. The Company also assumed optionsXpress stock-based compensation awards valued at $4 million. In allocating the purchase price based on estimated fair values of assets and liabilities assumed as of the acquisition

date, the Company recorded $511 million of goodwill and $285 million of intangible assets. The results of optionsXpress operations have been included in the Company s condensed consolidated statements of income from the date of acquisition. optionsXpress net revenues were

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Notes to Condensed Consolidated Financial Statements

(Tabular Amounts in Millions, Except Per Share Data, Ratios, or as Noted)

(Unaudited)

$42 million and its net loss was not material for the third quarter of 2012. optionsXpress net revenues were $143 million and its net income was $7 million for the first nine months of 2012.

The following table presents pro forma financial information as if optionsXpress had been acquired prior to January 1, 2011. Pro forma net income for the third quarter and first nine months of 2011 were adjusted to exclude $10 million and $12 million, after tax, respectively, of acquisition related costs incurred by the Company in 2011. Additionally, pro forma net income below excludes $15 million, before tax, of acquisition related costs because these costs were incurred by optionsXpress prior to the acquisition date. Pro forma net income also reflects the impact of amortizing purchase accounting adjustments relating to intangible assets, net of tax, of $6 million and $17 million in the third quarter and first nine months of 2011, respectively.

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Net revenues	$ 1,222	$ 3,744
Net income	$ 231	$ 726
Basic EPS	$ .18	$ .57
Diluted EPS	$ .18	$ .57

The pro forma financial information above is presented for illustrative purposes only and is not necessarily indicative of the results that actually would have occurred had the acquisition been completed prior to January 1, 2011, nor is it indicative of the results of operations for future periods.

4. Securities Available for Sale and Securities Held to Maturity

The amortized cost, gross unrealized gains and losses, and fair value of securities available for sale and securities held to maturity are as follows:

September 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
U.S. agency residential mortgage-backed securities	$ 23,298	$ 480	$ 6	$ 23,772
Non-agency residential mortgage-backed securities	856	3	77	782
Corporate debt securities	5,555	56	1	5,610
Certificates of deposit	5,524	14	2	5,536
Commercial paper	449			449
U.S. agency notes	350			350
Asset-backed and other securities	5,916	35	2	5,949
Total securities available for sale	$ 41,948	$ 588	$ 88	$ 42,448
Securities held to maturity:				

U.S. agency residential mortgage-backed securities	$	15,450	$	618	$	1	$	16,067
Other securities		162						162
Total securities held to maturity	$	15,612	$	618	$	1	$	16,229

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Notes to Condensed Consolidated Financial Statements

(Tabular Amounts in Millions, Except Per Share Data, Ratios, or as Noted)

(Unaudited)

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
U.S. agency residential mortgage-backed securities	$ 20,666	$ 269	$ 14	$ 20,921
Non-agency residential mortgage-backed securities	1,130		223	907
Corporate debt securities	3,592	5	26	3,571
Certificates of deposit	3,623	2	3	3,622
Commercial paper	225			225
U.S. agency notes	1,795	5		1,800
Asset-backed and other securities	2,919	7	7	2,919
Total securities available for sale	$ 33,950	$ 288	$ 273	$ 33,965
Securities held to maturity:				
U.S. agency residential mortgage-backed securities	$ 14,770	$ 430	$ 2	$ 15,198
Other securities	338	3		341
Total securities held to maturity	$ 15,108	$ 433	$ 2	$ 15,539

A summary of securities with unrealized losses, aggregated by category and period of continuous unrealized loss, is as follows:

	Less than 12 months		12 months or longer		Total	
September 30, 2012	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. agency residential mortgage-backed securities	$	$	$ 346	$ 6	$ 346	$ 6
Non-agency residential mortgage-backed securities			606	77	606	77
Corporate debt securities	776	1			776	1
Certificates of deposit	698	2			698	2
Asset-backed and other securities			923	2	923	2
Total	$ 1,474	$ 3	$ 1,875	$ 85	$ 3,349	$ 88
Securities held to maturity:						
U.S. agency residential mortgage-backed securities	$ 249	$ 1	$	$	$ 249	$ 1
Total	$ 249	$ 1	$	$	$ 249	$ 1
Total securities with unrealized losses [1]	$ 1,723	$ 4	$ 1,875	$ 85	$ 3,598	$ 89

(1) The number of investment positions with unrealized losses totaled 128 for securities available for sale and 7 for securities held to maturity.

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(Unaudited)

December 31, 2011	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. agency residential mortgage-backed securities	$ 5,551	$ 14	$	$	$ 5,551	$ 14
Non-agency residential mortgage-backed securities	121	8	746	215	867	223
Corporate debt securities	1,888	26			1,888	26
Certificates of deposit	2,158	3			2,158	3
Asset-backed and other securities	1,376	6	152	1	1,528	7
Total	$ 11,094	$ 57	$ 898	$ 216	$ 11,992	$ 273
Securities held to maturity:						
U.S. agency residential mortgage-backed securities	$ 384	$ 2	$	$	$ 384	$ 2
Total	$ 384	$ 2	$	$	$ 384	$ 2
Total securities with unrealized losses [(1)]	$ 11,478	$ 59	$ 898	$ 216	$ 12,376	$ 275

(1) The number of investment positions with unrealized losses totaled 296 for securities available for sale and 3 for securities held to maturity. Unrealized losses in securities available for sale of $88 million as of September 30, 2012, were concentrated in non-agency residential mortgage-backed securities. Included in non-agency residential mortgage-backed securities are securities collateralized by loans that are considered to be Prime (defined as loans to borrowers with a Fair Isaac Corporation credit score of 620 or higher at origination), and Alt-A (defined as Prime loans with reduced documentation at origination). At September 30, 2012, the amortized cost and fair value of Alt-A residential mortgage-backed securities were $326 million and $280 million, respectively.

Certain Alt-A and Prime residential mortgage-backed securities experienced continued credit deterioration in the first nine months of 2012, including increased payment delinquency rates and losses on foreclosures of underlying mortgages. In addition, the Company increased the projected default rates for modified loans in the first quarter of 2012. Based on the Company s cash flow projections, management determined that it does not expect to recover all of the amortized cost of these securities and therefore determined that these securities were other-than-temporarily impaired (OTTI). The Company employs a buy and hold strategy relative to its mortgage-related securities, and does not intend to sell these securities and will not be required to sell these securities before anticipated recovery of the unrealized losses on these securities. Further, the Company has adequate liquidity at September 30, 2012, with cash and cash equivalents totaling $8.5 billion, a loan-to-deposit ratio of 15%, adequate access to short-term borrowing facilities and regulatory capital ratios in excess of well capitalized levels. Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities, the Company recognized an impairment charge equal to the securities expected credit losses of $3 million and $28 million during the third quarter and first nine months of 2012, respectively. The expected credit losses were measured as the difference between the present value of expected cash flows and the amortized cost of the securities. Further deterioration in the performance of the underlying loans in the Company s residential mortgage-backed securities portfolio could result in the recognition of additional impairment charges.

Actual credit losses on the Company s residential mortgage-backed securities were not material during the third quarters or first nine months of 2012 or 2011.

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THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

(Tabular Amounts in Millions, Except Per Share Data, Ratios, or as Noted)

(Unaudited)

The following table is a rollforward of the amount of credit losses recognized in earnings for OTTI securities held by the Company during the period for which a portion of the impairment was recognized in other comprehensive income:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Balance at beginning of period	$ 152	$ 105	$ 127	$ 96
Credit losses recognized into current period earnings on debt securities for which an other-than-temporary impairment was not previously recognized	1	2	6	4
Credit losses recognized into current period earnings on debt securities for which an other-than-temporary impairment was previously recognized	2	11	22	18
Balance at end of period	$ 155	$ 118	$ 155	$ 118

The maturities of securities available for sale and securities held to maturity at September 30, 2012, are as follows:

	Within 1 year	After 1 year through 5 years	After 5 years through 10 years	After 10 years	Total
Securities available for sale:					
U.S. agency residential mortgage-backed securities [(1)]	$	$ 2	$ 4,031	$ 19,739	$ 23,772
Non-agency residential mortgage-backed securities [(1)]			8	774	782
Corporate debt securities	1,015	4,595			5,610
Certificates of deposit	4,030	1,506			5,536
Commercial paper	449				449
U.S. agency notes		100	250		350
Asset-backed and other securities		474	440	5,035	5,949
Total fair value	$ 5,494	$ 6,677	$ 4,729	$ 25,548	$ 42,448
Total amortized cost	$ 5,484	$ 6,617	$ 4,565	$ 25,282	$ 41,948
Securities held to maturity:					
U.S. agency residential mortgage-backed securities [(1)]	$	$	$ 7,049	$ 9,018	$ 16,067
Other securities		162			162
Total fair value	$	$ 162	$ 7,049	$ 9,018	$ 16,229
Total amortized cost	$	$ 162	$ 6,678	$ 8,772	$ 15,612

(1) Residential mortgage-backed securities have been allocated over maturity groupings based on final contractual maturities. Actual maturities will differ from final contractual maturities because borrowers on a certain portion of loans underlying these securities have the right to prepay their obligations.

Proceeds and gross realized gains (losses) from sales of securities available for sale are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Proceeds	$ 201	$	$ 1,524	$ 450
Gross realized gains	$	$	$ 2	$ 1
Gross realized losses	$	$	$	$

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

(Tabular Amounts in Millions, Except Per Share Data, Ratios, or as Noted)

(Unaudited)

5. Loans to Banking Clients and Related Allowance for Loan Losses

The composition of loans to banking clients by loan segment is as follows:

	September 30, 2012	December 31, 2011
Residential real estate mortgages	$ 5,982	$ 5,596
Home equity lines of credit	3,346	3,509
Personal loans secured by securities	807	742
Other	24	19
Total loans to banking clients [(1)]	10,159	9,866
Allowance for loan losses	(57)	(54)
Total loans to banking clients net	$ 10,102	$ 9,812

(1) All loans are evaluated for impairment by loan segment.

The Company records an allowance for loan losses through a charge to earnings based on management s evaluation of probable losses in the existing portfolio. Management reviews the allowance for loan losses quarterly, taking into consideration current economic conditions, the composition of the existing loan portfolio, past loss experience, and risks inherent in the portfolio to ensure that the allowance for loan losses is maintained at an appropriate level.

The methodology to establish an allowance for loan losses utilizes statistical models that estimate prepayments, defaults, and probable losses for the loan segments based on predicted behavior of individual loans within the segments. The methodology considers the effects of borrower behavior and a variety of factors including, but not limited to, interest rates, housing price movements as measured by a housing price index, economic conditions, estimated defaults and foreclosures measured by historical and expected delinquencies, changes in prepayment speeds, loan-to-value (LTV) ratios, past loss experience, estimates of future loss severities, borrower credit risk measured by Fair Isaac Corporation (FICO) scores, and the adequacy of collateral. The methodology also evaluates concentrations in the loan segments, including loan products, year of origination, geographical distribution of collateral, and the portion of borrowers who have other client relationships with the Company.

Probable losses are forecast using a loan-level simulation of the delinquency status of the loans over the term of the loans. The simulation starts with the current relevant risk indicators, including the current delinquent status of each loan, the estimated current LTV ratio of each loan, the term and structure of each loan, current key interest rates including U.S. Treasury and LIBOR rates, and borrower FICO scores. The more significant variables included in the simulation include delinquency roll rates, loss severity, housing prices, and interest rates. Delinquency roll rates (i.e., the rates at which loans transition through delinquency stages and ultimately result in a loss) are estimated from the Company s historical loss experience adjusted for current trends and market information. Further, the delinquency roll rates within the loan-level simulation discussed above are calibrated to match a moving average of the delinquency roll rates actually experienced in the respective first lien residential real estate mortgage loan (First Mortgage) and home equity line of credit (HELOC) portfolios. Loss severity estimates are based on the Company s historical loss experience and market trends. Housing price trends are derived from historical home price indices and econometric forecasts of future home values. Factors affecting the home price index include: housing inventory, unemployment, interest rates, and inflation expectations. Interest rate projections are based on the current term structure of interest rates and historical volatilities to project various possible future interest rate paths. As a result, the current state of house prices, including the decrease in general house prices experienced over the last

several years, as well as the current state of delinquencies unique to the Company s First Mortgage and HELOC portfolios, are considered in the allowance for loan loss methodology.

This methodology results in a loss factor that is applied to the outstanding balances to determine the allowance for loan loss for each loan segment.

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THE CHARLES SCHWAB CORPORATION

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(Unaudited)

Changes in the allowance for loan losses were as follows:

Three Months Ended	**September 30, 2012**			**September 30, 2011**		
	Residential real estate mortgages	**Home equity lines of credit**	**Total**	**Residential real estate mortgages**	**Home equity lines of credit**	**Total**
Balance at beginning of period	$ 34	$ 17	$ 51	$ 34	$ 16	$ 50
Charge-offs	(2)	(3)	(5)	(2)	(3)	(5)
Recoveries	1		1			
Provision for loan losses	2	8	10	6	2	8
Balance at end of period	$ 35	$ 22	$ 57	$ 38	$ 15	$ 53

Nine Months Ended	**September 30, 2012**			**September 30, 2011**		
	Residential real estate mortgages	**Home equity lines of credit**	**Total**	**Residential real estate mortgages**	**Home equity lines of credit**	**Total**
Balance at beginning of period	$ 40	$ 14	$ 54	$ 38	$ 15	$ 53
Charge-offs	(6)	(7)	(13)	(8)	(6)	(14)
Recoveries	2		2		1	1
Provision for loan losses	(1)	15	14	8	5	13
Balance at end of period	$ 35	$ 22	$ 57	$ 38	$ 15	$ 53

Included in the loan portfolio are nonaccrual loans totaling $46 million and $52 million at September 30, 2012 and December 31, 2011, respectively. There were no loans accruing interest that were contractually 90 days or more past due at September 30, 2012 or December 31, 2011. The amount of interest revenue that would have been earned on nonaccrual loans, versus actual interest revenue recognized on these loans, was not material to the Company s results of operations in the first nine months of 2012 or 2011. Nonperforming assets, which include nonaccrual loans and other real estate owned, totaled $50 million and $56 million at September 30, 2012 and December 31, 2011, respectively. The Company considers loan modifications in which it makes an economic concession to a borrower experiencing financial difficulty to be a troubled debt restructuring. Troubled debt restructurings were not material at September 30, 2012 or December 31, 2011.

In the first quarter of 2012, Schwab Bank launched a co-branded loan origination program for Schwab Bank clients (the Program) with Quicken Loans, Inc. (Quicken® Loans®). Pursuant to the Program, Quicken Loans originates and services loans for Schwab Bank clients and Schwab Bank sets the underwriting standards and pricing for those loans it intends to purchase for its portfolio. These underwriting standards are the same standards that Schwab Bank applied previously to its originated loans. The First Mortgage portion of the Program launched in March 2012 and is included in the originated and purchased first mortgages loan class as of September 30, 2012, in the tables below. The HELOC portion of the Program was launched in May 2012. Under the Program, Schwab Bank purchases all HELOC loans to Schwab Bank clients that are originated by Quicken Loans.

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The delinquency aging analysis by loan class is as follows:

September 30, 2012	**Current**	**30-59 days past due**	**60-89 days past due**	**Greater than 90 days**	**Total past due**	**Total loans**
Residential real estate mortgages:						
Originated and purchased first mortgages	$ 5,751	$ 30	$ 3	$ 33	$ 66	$ 5,817
Other purchased first mortgages	160	1		4	5	165
Home equity lines of credit	3,326	8	3	9	20	3,346
Personal loans secured by securities	807					807
Other	24					24
Total loans to banking clients	$ 10,068	$ 39	$ 6	$ 46	$ 91	$ 10,159
December 31, 2011						
Residential real estate mortgages:						
Originated first mortgages	$ 5,380	$ 16	$ 2	$ 39	$ 57	$ 5,437
Purchased first mortgages	152	2		5	7	159
Home equity lines of credit	3,494	5	2	8	15	3,509
Personal loans secured by securities	741	1			1	742
Other	19					19
Total loans to banking clients	$ 9,786	$ 24	$ 4	$ 52	$ 80	$ 9,866

In addition to monitoring delinquency characteristics, the Company monitors the credit quality of residential real estate mortgages and HELOCs by stratifying the portfolios by the year of origination, borrower FICO scores at origination (Origination FICO), updated borrower FICO scores (Updated FICO), LTV ratios at origination (Origination LTV), and estimated current LTV ratios (Estimated Current LTV), as presented in the following tables. Borrowers FICO scores are provided by an independent third party credit reporting service and were last updated in September 2012. The Origination LTV and Estimated Current LTV ratios for a HELOC include any first lien mortgage outstanding on the same property at the time of the HELOC s origination. The Estimated Current LTV for each loan is estimated by reference to a home price appreciation index.

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	Residential real estate mortgages			
September 30, 2012	**Originated and purchased first mortgages**	**Other purchased first mortgages**	**Total**	**Home equity lines of credit**
Year of origination				
Pre-2008	$ 489	$ 57	$ 546	$ 1,220
2008	430	6	436	1,180
2009	354	6	360	362
2010	1,128	14	1,142	270
2011	1,606	62	1,668	214
2012	1,810	20	1,830	100
Total	$ 5,817	$ 165	$ 5,982	$ 3,346
Origination FICO				
< 620	$ 10	$ 1	$ 11	$
620 - 679	96	18	114	24
680 - 739	1,061	40	1,101	643
³740	4,650	106	4,756	2,679
Total	$ 5,817	$ 165	$ 5,982	$ 3,346
Updated FICO				
< 620	$ 56	$ 6	$ 62	$ 47
620 - 679	163	11	174	111
680 - 739	862	39	901	505
³740	4,736	109	4,845	2,683
Total	$ 5,817	$ 165	$ 5,982	$ 3,346
Origination LTV				
£70%	$ 3,807	$ 103	$ 3,910	$ 2,263
>70% - £90%	1,994	55	2,049	1,056
>90% - £100%	16	7	23	27
Total	$ 5,817	$ 165	$ 5,982	$ 3,346

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September 30, 2012	Balance	Weighted Average Updated FICO	Utilization Rate [(1)]	Percent of Loans that are 90+ Days Past Due and Less than 90 Days Past Due but on Nonaccrual Status
Residential real estate mortgages:				
Estimated Current LTV				
£70%	$ 4,024	774	N/A	0.26%
>70% - £90%	1,557	764	N/A	0.41%
>90% - £100%	171	748	N/A	1.31%
>100%	230	748	N/A	1.96%
Total	$ 5,982	769	N/A	0.39%
Home equity lines of credit:				
Estimated Current LTV				
£70%	$ 1,704	775	37%	0.07%
>70% - £90%	1,013	767	47%	0.33%
>90% - £100%	265	762	54%	0.40%
>100%	364	754	61%	0.83%
Total	$ 3,346	769	42%	0.26%

(1) The Utilization Rate is calculated using the outstanding HELOC balance divided by the associated total line of credit.
N/A Not applicable.

	Residential real estate mortgages			
December 31, 2011	Originated first mortgages	Purchased first mortgages	Total	Home equity lines of credit
Year of origination				
Pre-2008	$ 569	$ 60	$ 629	$ 1,306
2008	538	8	546	1,262
2009	553	10	563	412
2010	1,757	17	1,774	311
2011	2,020	64	2,084	218
Total	$ 5,437	$ 159	$ 5,596	$ 3,509
Origination FICO				
<620	$ 9	$ 2	$ 11	$

620 - 679	108	19	127	24
680 - 739	1,030	43	1,073	667
³740	4,290	95	4,385	2,818
Total	$ 5,437	$ 159	$ 5,596	$ 3,509
Updated FICO				
<620	$ 55	$ 7	$ 62	$ 49
620 - 679	162	11	173	112
680 - 739	831	44	875	520
³740	4,389	97	4,486	2,828
Total	$ 5,437	$ 159	$ 5,596	$ 3,509
Origination LTV				
£70%	$ 3,507	$ 91	$ 3,598	$ 2,378
>70% - £90%	1,904	60	1,964	1,091
>90% - £100%	26	8	34	40
Total	$ 5,437	$ 159	$ 5,596	$ 3,509

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December 31, 2011	Balance	Weighted Average Updated FICO	Utilization Rate [1]	Percent of Loans that are 90+ Days Past Due and Less than 90 Days Past Due but on Nonaccrual Status
Residential real estate mortgages:				
Estimated Current LTV				
£70%	$ 3,200	773	N/A	0.27%
>70% - £90%	1,764	766	N/A	0.41%
>90% - £100%	241	758	N/A	1.33%
>100%	391	748	N/A	2.34%
Total	$ 5,596	768	N/A	0.50%
Home equity lines of credit:				
Estimated Current LTV				
£70%	$ 1,561	774	37%	0.09%
>70% - £90%	1,099	769	46%	0.26%
>90% - £100%	328	765	54%	0.16%
>100%	521	755	58%	0.75%
Total	$ 3,509	769	43%	0.25%

(1) The Utilization Rate is calculated using the outstanding HELOC balance divided by the associated total line of credit.
N/A Not applicable.

The Company monitors the credit quality of personal loans secured by securities by reviewing the fair value of collateral to ensure adequate collateralization of at least 100% of the principal amount of the loans. All of these personal loans were fully collateralized by securities with fair values in excess of borrowings at September 30, 2012 and December 31, 2011.

6. Borrowings

Long-term debt including unamortized debt discounts and premiums, where applicable, consists of the following:

	September 30, 2012	December 31, 2011
Senior Notes	$ 1,432	$ 1,450
Senior Medium-Term Notes, Series A	249	249

Finance lease obligation		95		100
Junior Subordinated Notes				202
Total long-term debt	$	1,776	$	2,001

In August 2012, CSC completed an exchange offer with certain eligible holders of its 4.950% Senior Notes due 2014 (Old Senior Notes), whereby Old Senior Notes in an aggregate principal amount of $256 million were exchanged for the same aggregate principal amount of 3.225% Senior Notes due 2022 (New Senior Notes) and cash consideration of $19 million. The New Senior Notes have a fixed interest rate of 3.225% with interest payable semiannually. Pursuant to an exchange and registration rights agreement (Registration Rights Agreement), on October 30, 2012, CSC filed an exchange registration statement with the SEC to allow the holders of the New Senior Notes to exchange such New Senior Notes for an equal principal amount of notes with substantially identical terms, except that they will generally be freely transferable under the Securities Act of 1933. In addition, CSC has agreed pursuant to the Registration Rights Agreement, under certain circumstances, to file a shelf registration statement with the SEC to cover resales of the New Senior Notes.

CSC and Schwab Capital Trust I, a statutory trust formed under the laws of the State of Delaware (Trust), previously closed a public offering of $300 million of the Trust s fixed-to-floating rate trust preferred securities. The proceeds from the sale of

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the trust preferred securities were invested by the Trust in fixed-to-floating rate Junior Subordinated Notes issued by CSC, of which $202 million remained outstanding at August 30, 2012. On August 31, 2012, CSC redeemed all of the outstanding fixed-to-floating rate trust preferred securities issued by the Trust for $207 million. The trust preferred securities were redeemed, along with the common securities issued by the Trust and held by CSC, as a result of the concurrent redemption in whole by CSC of the Junior Subordinated Notes held by the Trust which underlay the trust preferred securities. The redemption price represented 100% of the liquidation amount of each trust preferred security, plus accumulated and unpaid distributions up to and including the redemption date.

Annual maturities on long-term debt outstanding at September 30, 2012, are as follows:

2012	$ 1
2013	6
2014	500
2015	7
2016	7
Thereafter	1,275
Total maturities	1,796
Unamortized discount, net	(20)
Total long-term debt	$ 1,776

7. Commitments and Contingencies

The Company has clients that sell (i.e., write) listed option contracts that are cleared by various clearing houses. The clearing houses establish margin requirements on these transactions. The Company partially satisfies the margin requirements by arranging unsecured standby letter of credit agreements (LOCs), in favor of the clearing houses, which are issued by multiple banks. At September 30, 2012, the aggregate face amount of these LOCs totaled $325 million. In connection with its securities lending activities, Schwab is required to provide collateral to certain brokerage clients. Schwab satisfies the collateral requirements by arranging LOCs in favor of these brokerage clients, which are issued by multiple banks. At September 30, 2012, the aggregate face amount of these LOCs totaled $99 million. There were no funds drawn under any of these LOCs at September 30, 2012.

The Company also provides guarantees to securities clearing houses and exchanges under standard membership agreements, which require members to guarantee the performance of other members. Under the agreements, if another member becomes unable to satisfy its obligations to the clearing houses and exchanges, other members would be required to meet shortfalls. The Company s liability under these arrangements is not quantifiable and may exceed the cash and securities it has posted as collateral. However, the potential requirement for the Company to make payments under these arrangements is remote. Accordingly, no liability has been recognized for these guarantees.

Legal contingencies: The Company is subject to claims and lawsuits in the ordinary course of business, including arbitrations, class actions and other litigation, some of which include claims for substantial or unspecified damages. The Company is also the subject of inquiries, investigations, and proceedings by regulatory and other governmental agencies. In addition, the Company is responding to certain litigation claims brought against former subsidiaries pursuant to indemnities it has provided to purchasers of those entities.

The Company believes it has strong defenses in all significant matters currently pending and is contesting liability and any damages claimed. Nevertheless, some of these matters may result in adverse judgments or awards, including penalties, injunctions or other relief, and the Company may also determine to settle a matter because of the uncertainty and risks of litigation. Described below are certain matters in which there is a reasonable possibility that a material loss could be incurred or where the matter may otherwise be of significant interest to stockholders. With respect to all other pending matters, based on current information and consultation with counsel, it does not appear that the outcome of any such matter could be material to the financial condition, operating results or cash flows of the Company. However, predicting the outcome of a litigation or regulatory matter is inherently difficult, requiring significant judgment and evaluation of various factors,

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including the procedural status of the matter and any recent developments; prior experience and the experience of others in similar cases; available defenses, including potential opportunities to dispose of a case on the merits or procedural grounds before trial (e.g., motions to dismiss or for summary judgment); the progress of fact discovery; the opinions of counsel and experts regarding potential damages; potential opportunities for settlement and the status of any settlement discussions; and potential insurance coverage and indemnification. Often, as in the case of the Auction Rate Securities Regulatory Inquiries and Total Bond Market Fund Litigation matters described below, it is not possible to reasonably estimate potential liability, if any, or a range of potential liability until the matter is closer to resolution - pending, for example, further proceedings, the outcome of key motions or appeals, or discussions among the parties. Numerous issues may have to be developed, such as discovery of important factual matters and determination of threshold legal issues, which may include novel or unsettled questions of law. Reserves are established or adjusted or further disclosure and estimates of potential loss are provided as the matter progresses and more information becomes available.

Auction Rate Securities Regulatory Inquiries: Schwab has been responding to industry wide inquiries from federal and state regulators regarding sales of auction rate securities to clients who were unable to sell their holdings when the normal auction process for those securities froze unexpectedly in February 2008. On August 17, 2009, a civil complaint was filed against Schwab in New York state court by the Attorney General of the State of New York (NYAG) alleging material misrepresentations and omissions by Schwab regarding the risks of auction rate securities, and seeking restitution, disgorgement, penalties and other relief, including repurchase of securities held in client accounts. As reflected in a statement issued August 17, 2009, Schwab has responded that the allegations are without merit, and has been contesting all charges. By order dated October 24, 2011, the court granted Schwab s motion to dismiss the complaint with prejudice. The NYAG has appealed to the Appellate Division, where the case is currently pending.

Total Bond Market Fund Litigation: On August 28, 2008, a class action lawsuit was filed in the U.S. District Court for the Northern District of California on behalf of investors in the Schwab Total Bond Market Fund (Northstar lawsuit). The lawsuit, which alleges violations of state law and federal securities law in connection with the fund s investment policy, names Schwab Investments (registrant and issuer of the fund s shares) and CSIM as defendants. Allegations include that the fund improperly deviated from its stated investment objectives by investing in collateralized mortgage obligations (CMOs) and investing more than 25% of fund assets in CMOs and mortgage-backed securities without obtaining a shareholder vote. Plaintiffs seek unspecified compensatory and rescission damages, unspecified equitable and injunctive relief, costs and attorneys fees. Plaintiffs federal securities law claim and certain of plaintiffs state law claims were dismissed in proceedings before the court and following a successful petition by defendants to the Ninth Circuit Court of Appeals. On August 8, 2011, the court dismissed plaintiffs remaining claims with prejudice. Plaintiffs have again appealed to the Ninth Circuit, where the case is currently pending.

optionsXpress Regulatory Matters: optionsXpress entities and individual employees have been responding to certain pending regulatory matters which predate the Company s acquisition of optionsXpress. On April 16, 2012, optionsXpress, Inc. was charged by the Securities and Exchange Commission (SEC) in an administrative proceeding alleging violations of the firm s close-out obligations under SEC Regulation SHO (short sale delivery rules) in connection with certain customer trading activity. Trial in the administrative proceeding commenced September 5, 2012. The Company disputes the allegations and is contesting the charges. Separately, on April 19, 2012, the SEC instituted an administrative proceeding alleging violations of the broker-dealer registration requirements by an unregistered optionsXpress entity. On September 5, 2012, the administrative law judge hearing the case ruled on summary disposition that applicable registration requirements were violated. Certain other issues, including relief, remain to be determined at trial. The Company continues to dispute the allegations and is contesting the charges. The Company recorded a contingent liability associated with the two separate matters, which was not material at September 30, 2012.

8. Fair Values of Assets and Liabilities

Fair value is defined as the price that would be received to sell an asset or the price paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurement accounting guidance describes the fair value hierarchy for disclosing assets and liabilities measured at fair value based on the inputs used to value them. The fair value hierarchy maximizes the use of observable inputs and

minimizes the use of unobservable inputs. Observable inputs

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are based on market pricing data obtained from sources independent of the Company. A quoted price in an active market provides the most reliable evidence of fair value and is generally used to measure fair value whenever available. Unobservable inputs reflect management s judgment about the assumptions market participants would use in pricing the asset or liability. Where inputs used to measure fair value of an asset or liability are from different levels of the hierarchy, the asset or liability is categorized based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input requires judgment. The fair value hierarchy includes three levels based on the objectivity of the inputs as follows:

Level 1 inputs are quoted prices in active markets as of the measurement date for identical assets or liabilities that the Company has the ability to access. The Company did not transfer any assets or liabilities between Level 1 and Level 2 during the first nine months of 2012, or the year ended December 31, 2011.

Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates, benchmark yields, issuer spreads, new issue data, and collateral performance.

Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. The Company did not have any financial assets or liabilities utilizing Level 3 inputs as of September 30, 2012 or December 31, 2011.

Assets and Liabilities Recorded at Fair Value

The Company s assets recorded at fair value include certain cash equivalents, investments segregated and on deposit for regulatory purposes, other securities owned, and securities available for sale. The Company uses the market and income approaches to determine the fair value of assets and liabilities. When available, the Company uses quoted prices in active markets to measure the fair value of assets. When utilizing market data with a bid-ask spread, the Company uses the price within the bid-ask spread that best represents fair value. When quoted prices do not exist, the Company uses prices obtained from independent third-party pricing services to measure the fair value of investment assets. The Company generally obtains prices from at least three independent pricing sources for assets recorded at fair value and may obtain up to five prices on assets with higher risk of limited observable information, such as non-agency residential mortgage-backed securities. The Company s primary independent pricing service provides prices based on observable trades and discounted cash flows that incorporate observable information such as yields for similar types of securities (a benchmark interest rate plus observable spreads) and weighted-average maturity for the same or similar to-be-issued securities. The Company compares the prices obtained from its primary independent pricing service to the prices obtained from the additional independent pricing services to determine if the price obtained from the primary independent pricing service is reasonable. The Company does not adjust the prices received from independent third-party pricing services unless such prices are inconsistent with the definition of fair value and result in a material difference in the recorded amounts. At September 30, 2012 and December 31, 2011, the Company did not adjust prices received from the primary independent third-party pricing service. Liabilities recorded at fair value were not material, and therefore are not included in the following tables.

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The following tables present the fair value hierarchy for assets measured at fair value:

September 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at Fair Value
Cash equivalents:				
Money market funds	$ 218	$	$	$ 218
Commercial paper		866		866
Total cash equivalents	218	866		1,084
Investments segregated and on deposit for regulatory purposes:				
Certificates of deposit		2,675		2,675
Corporate debt securities		535		535
Total investments segregated and on deposit for regulatory purposes		3,210		3,210
Other securities owned:				
Schwab Funds® money market funds	244			244
Equity and bond mutual funds	183			183
State and municipal debt obligations		55		55
Equity, U.S. Government and corporate debt, and other securities	1	30		31
Total other securities owned	428	85		513
Securities available for sale:				
U.S. agency residential mortgage-backed securities		23,772		23,772
Non-agency residential mortgage-backed securities		782		782
Corporate debt securities		5,610		5,610
Certificates of deposit		5,536		5,536
Commercial paper		449		449
U.S. agency notes		350		350
Asset-backed and other securities		5,949		5,949
Total securities available for sale		42,448		42,448
Total	$ 646	$ 46,609	$	$ 47,255

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December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at Fair Value
Cash equivalents:				
Money market funds	$ 8	$	$	$ 8
Commercial paper		814		814
Total cash equivalents	8	814		822
Investments segregated and on deposit for regulatory purposes:				
Certificates of deposit		2,374		2,374
Corporate debt securities		767		767
U.S. Government securities		650		650
Total investments segregated and on deposit for regulatory purposes		3,791		3,791
Other securities owned:				
Schwab Funds® money market funds	332			332
Equity and bond mutual funds	183			183
State and municipal debt obligations		46		46
Equity, U.S. Government and corporate debt, and other securities	12	20		32
Total other securities owned	527	66		593
Securities available for sale:				
U.S. agency residential mortgage-backed securities		20,921		20,921
Non-agency residential mortgage-backed securities		907		907
Corporate debt securities		3,571		3,571
Certificates of deposit		3,622		3,622
Commercial paper		225		225
U.S. agency notes		1,800		1,800
Asset-backed and other securities		2,919		2,919
Total securities available for sale		33,965		33,965
Total	$ 535	$ 38,636	$	$ 39,171

Financial Instruments Not Recorded at Fair Value

Descriptions of the valuation methodologies and assumptions used to estimate the fair value of financial instruments not recorded at fair value are described below. There were no significant changes in these methodologies or assumptions during the first nine months of 2012.

Cash and cash equivalents, receivables from/payables to brokers, dealers, and clearing organizations, and receivables from/payables to brokerage clients are short-term in nature and accordingly are recorded at amounts that approximate fair value. Cash and cash equivalents

include cash and highly liquid investments with original maturities of three months or less. Receivables from/payables to brokers, dealers, and clearing organizations, and receivables from/payables to brokerage clients are recorded at or near transaction price and historically have been settled or converted to cash at approximately that value.

Cash and investments segregated and on deposit for regulatory purposes include cash and securities purchased under resale agreements. Securities purchased under resale agreements are recorded at par value plus accrued interest. Securities purchased under resale agreements are short-term in nature and are backed by collateral that both exceeds the carrying value of the resale agreement and is highly liquid in nature. Accordingly, the carrying value approximates fair value.

Securities held to maturity include U.S. agency residential mortgage-backed securities and other securities. Securities held to maturity are recorded at amortized cost. The fair value of these securities is obtained using an independent third-party pricing service similar to investment assets recorded at fair value as discussed above.

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Loans to banking clients primarily include adjustable rate residential first-mortgage and HELOC loans. Loans to banking clients are recorded at carrying value net of an allowance for loan losses. The fair value of the Company s loans to banking clients is estimated based on prices obtained from independent third-party pricing services for mortgage-backed securities collateralized by similar types of loans. The Company may adjust the independent third-party prices to account for differences between comparable mortgage-backed securities and loans to banking clients.

Loans held for sale at December 31, 2011, included fixed-rate and adjustable-rate residential first-mortgage loans intended for sale. Loans held for sale were recorded at the lower of cost or fair value. The fair value of the Company s loans held for sale was estimated using quoted market prices for securities backed by similar types of loans.

Other assets Financial instruments included in other assets primarily consist of cost method investments and Federal Home Loan Bank (FHLB) stock, whose carrying values approximate their fair values. FHLB stock is recorded at par, which approximates fair value.

Deposits from banking clients The Company considers the fair value of deposits with no stated maturity, such as deposits from banking clients, to be equal to the amount payable on demand as of the balance sheet date.

Accrued expenses and other liabilities Financial instruments included in accrued expenses and other liabilities consist of drafts payable and certain amounts due under contractual obligations which are short-term in nature and accordingly are recorded at amounts that approximate fair value.

Long-term debt includes Senior Notes, Senior Medium-Term Notes, Series A, and a finance lease obligation. The fair values of the Senior Notes and Senior Medium-Term Notes, Series A, are estimated using indicative non-binding quotes from independent brokers. The Company validates indicative prices for its debt through comparison to other independent non-binding quotes. The finance lease obligation is recorded at carrying value, which approximates fair value. Long-term debt at December 31, 2011, included Junior Subordinated Notes, which were estimated using indicative non-binding quotes from independent brokers.

Firm commitments to extend credit The Company extends credit to banking clients through HELOC and personal loans secured by securities. The Company considers the fair value of these unused commitments to be not material because the interest rates earned on these balances are based on market interest rate indices and reset monthly. Future utilization of HELOC and personal loan commitments will earn a then-current market interest rate. The Company does not charge a fee to maintain a HELOC or personal loan.

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The following table presents the fair value hierarchy for financial instruments not recorded at fair value at September 30, 2012:

	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at Fair Value
Assets:					
Cash and cash equivalents	$ 7,439	$	$ 7,439	$	$ 7,439
Cash and investments segregated and on deposit for regulatory purposes	21,824		21,824		21,824
Receivables from brokers, dealers, and clearing organizations	607		607		607
Receivables from brokerage clients net	11,909		11,909		11,909
Securities held to maturity:					
U.S. agency residential mortgage-backed securities	15,450		16,067		16,067
Other securities	162		162		162
Total securities held to maturity	15,612		16,229		16,229
Loans to banking clients net:					
Residential real estate mortgages	5,947		6,028		6,028
Home equity lines of credit	3,324		3,315		3,315
Personal loans secured by securities	807		807		807
Other	24		24		24
Total loans to banking clients net	10,102		10,174		10,174
Other assets	64		64		64
Total	$ 67,557	$	$ 68,246	$	$ 68,246
Liabilities:					
Deposits from banking clients	$ 68,756	$	$ 68,756	$	$ 68,756
Payables to brokers, dealers, and clearing organizations	1,445		1,445		1,445
Payables to brokerage clients	34,761		34,761		34,761
Accrued expenses and other liabilities	546		546		546
Long-term debt	1,776		1,717		1,717
Total	$ 107,284	$	$ 107,225	$	$ 107,225

The following table presents the Company s fair value estimates for financial instruments not recorded at fair value at December 31, 2011. The table excludes short-term financial assets and liabilities, for which carrying amounts approximate fair value, and financial instruments recorded at fair value.

	Carrying Amount	Fair Value
Financial Assets:		
Securities held to maturity	$ 15,108	$ 15,539
Loans to banking clients net	$ 9,812	$ 9,671
Loans held for sale	$ 70	$ 73
Financial Liabilities:		
Long-term debt	$ 2,001	$ 2,159

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(Unaudited)

9. Preferred Stock

The Company was authorized to issue 9,940,000 shares of preferred stock, $0.01 par value, at both September 30, 2012 and December 31, 2011. There were no shares of preferred stock issued and outstanding at December 31, 2011. The Company s preferred stock issued and outstanding as of September 30, 2012, are as follows:

	Shares Issued and Outstanding (In thousands)	Liquidation Preference Per Share	Liquidation Preference	Carrying Value
Series A	400	$ 1,000	$ 400	$ 394
Series B	485	$ 1,000	485	470
Total Preferred Stock	885		$ 885	$ 864

In June 2012, the Company issued and sold 19,400,000 depositary shares, each representing a 1/40th ownership interest in a share of 6.00% non-cumulative perpetual preferred stock, Series B, equivalent to $25 per depositary share (Series B Preferred Stock). Net proceeds received from the sale were $469 million. The Series B Preferred Stock has no stated maturity and has a fixed dividend rate of 6.00%. Dividends, if declared, will be payable quarterly in arrears. Under the terms of the Series B Preferred Stock, the Company s ability to pay dividends on, make distributions with respect to, or to repurchase, redeem or acquire its common stock or any preferred stock ranking on parity with or junior to the Series B Preferred Stock, is subject to restrictions in the event that the Company does not declare and either pay or set aside a sum sufficient for payment of dividends on the Series B Preferred Stock for the immediately preceding dividend period. The Series B Preferred Stock is redeemable at the Company s option, in whole or in part, on any dividend payment date on or after September 1, 2017, or, in whole but not in part, within 90 days following a regulatory capital treatment event as defined in its Certificate of Designations.

In January 2012, the Company issued and sold 400,000 shares of fixed-to-floating rate non-cumulative perpetual preferred stock, Series A (Series A Preferred Stock). Net proceeds received from the sale were $394 million. The Series A Preferred Stock has no stated maturity and has a fixed dividend rate of 7.000% until February 2022 and a floating rate equal to three-month LIBOR plus 4.820% thereafter. During the fixed rate period, dividends, if declared, will be payable semi-annually in arrears. During the floating rate period, dividends, if declared, will be payable quarterly in arrears. Dividends will not be cumulative. Under the terms of the Series A Preferred Stock, the Company s ability to pay dividends on, make distributions with respect to, or to repurchase, redeem or acquire its common stock or any preferred stock ranking on parity with or junior to the Series A Preferred Stock, is subject to restrictions in the event that the Company does not declare and either pay or set aside a sum sufficient for payment of dividends on the Series A Preferred Stock for the immediately preceding dividend period. The Series A Preferred Stock is redeemable at the Company s option, in whole or in part, on any dividend payment date on or after February 1, 2022, or, in whole but not in part, within 90 days following a regulatory capital treatment event as defined in its Certificate of Designations.

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10. Accumulated Other Comprehensive Income

Accumulated other comprehensive income (loss) represents cumulative gains and losses that are not reflected in earnings. Accumulated other comprehensive income balances were:

	Net unrealized gain on securities available for sale	Other	Total accumulated other comprehensive income
Balance at December 31, 2010	$ 17	$ (1)	$ 16
Other net changes	39	1	40
Balance at September 30, 2011	$ 56	$	$ 56
Balance at December 31, 2011	$ 10	$ (2)	$ 8
Other net changes	303	1	304
Balance at September 30, 2012	$ 313	$ (1)	$ 312

11. Earnings Per Common Share

Basic EPS is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. Dilutive potential common shares include the effect of outstanding stock options and unvested restricted stock awards and units. EPS under the basic and diluted computations is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	$ 247	$ 220	$ 717	$ 701
Preferred stock dividends	(9)		(23)	
Net income available to common stockholders [1]	$ 238	$ 220	$ 694	$ 701
Weighted-average common shares outstanding basic	1,274	1,228	1,273	1,213
Common stock equivalent shares related to stock incentive plans	1	1	1	3
Weighted-average common shares outstanding diluted [2]	1,275	1,229	1,274	1,216

Basic EPS	$	.19	$	.18	$	.54	$	.58
Diluted EPS	$	.19	$	.18	$	.54	$	.57

(1) Net income available to participating securities (unvested restricted shares) was not material for the third quarters or first nine months of 2012 or 2011.

(2) Antidilutive stock options and restricted stock awards excluded from the calculation of diluted EPS totaled 59 million and 50 million shares for the third quarters of 2012 and 2011, respectively, and 61 million and 48 million shares for the first nine months of 2012 and 2011, respectively.

12. Regulatory Requirements

CSC is a savings and loan holding company and Schwab Bank, CSC s depository institution subsidiary, is a federal savings bank. CSC is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve) and Schwab Bank is subject to supervision and regulation by the Office of the Comptroller of the Currency. CSC is currently not subject to specific statutory capital requirements, however CSC is required to serve as a source of strength for Schwab Bank. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act , CSC will be subject to new

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minimum leverage and minimum risk-based capital ratio requirements that will be set by the Federal Reserve that are at least as stringent as the requirements generally applicable to insured depository institutions as of July 21, 2011.

Schwab Bank is required to maintain minimum capital levels as specified in federal banking laws and regulations. Failure to meet the minimum levels could result in certain mandatory, and possibly additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on Schwab Bank. At September 30, 2012, CSC and Schwab Bank met the capital level requirements.

The regulatory capital and ratios for Schwab Bank at September 30, 2012, are as follows:

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Tier 1 Risk-Based Capital	$ 5,584	21.7%	$ 1,031	4.0%	$ 1,547	6.0%
Total Risk-Based Capital	$ 5,639	21.9%	$ 2,062	8.0%	$ 2,578	10.0%
Tier 1 Leverage	$ 5,584	7.5%	$ 2,993	4.0%	$ 3,741	5.0%
Tangible Equity	$ 5,584	7.5%	$ 1,496	2.0%	N/A	

N/A Not applicable.

Based on its regulatory capital ratios at September 30, 2012, Schwab Bank is considered well capitalized (the highest category) pursuant to banking regulatory guidelines. There are no conditions or events since September 30, 2012, that management believes have changed Schwab Bank s capital category.

CSC s principal U.S. broker-dealers are Schwab and optionsXpress, Inc. optionsXpress, Inc. is a wholly-owned subsidiary of optionsXpress. Schwab and optionsXpress, Inc. are both subject to Rule 15c3-1 under the Securities Exchange Act of 1934 (the Uniform Net Capital Rule). Schwab and optionsXpress, Inc. compute net capital under the alternative method permitted by the Uniform Net Capital Rule. This method requires the maintenance of minimum net capital, as defined, of the greater of 2% of aggregate debit balances arising from client transactions or a minimum dollar requirement ($250,000 for Schwab), which is based on the type of business conducted by the broker-dealer. Under the alternative method, a broker-dealer may not repay subordinated borrowings, pay cash dividends, or make any unsecured advances or loans to its parent company or employees if such payment would result in a net capital amount of less than 5% of aggregate debit balances or less than 120% of its minimum dollar requirement.

optionsXpress, Inc. is also subject to Commodity Futures Trading Commission Regulation 1.17 (Reg. 1.17) under the Commodity Exchange Act, which also requires the maintenance of minimum net capital. optionsXpress, Inc., as a futures commission merchant, is required to maintain minimum net capital equal to the greater of its net capital requirement under Reg. 1.17 ($1 million), or the sum of 8% of the total risk margin requirements for all positions carried in client accounts and 8% of the total risk margin requirements for all positions carried in non-client accounts (as defined in Reg. 1.17).

Net capital and net capital requirements for Schwab and optionsXpress, Inc. at September 30, 2012, are as follows:

	Net Capital	% of Aggregate Debit Balances	Minimum Net Capital Required	2% of Aggregate Debit Balances	Net Capital in Excess of Required Net Capital	Net Capital in Excess of 5% of Aggregate Debit Balances
Schwab	$ 1,371	10%	$ 0.250	$ 272	$ 1,099	$ 692
optionsXpress, Inc.	$ 78	33%	$ 1	$ 5	$ 73	$ 66

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13. Segment Information

The Company structures its operating segments according to its clients and the services provided to those clients. The Company s two reportable segments are Investor Services and Institutional Services.

The Company evaluates the performance of its segments on a pre-tax basis, excluding items such as significant nonrecurring gains, impairment charges on non-financial assets, discontinued operations, extraordinary items, and significant restructuring and other charges. Segment assets and liabilities are not used for evaluating segment performance or in deciding how to allocate resources to segments. There are no revenues from transactions with other segments within the Company.

Financial information for the Company s reportable segments is presented in the following table:

	Investor Services		**Institutional Services**		**Unallocated**		**Total**	
Three Months Ended September 30,	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**
Net Revenues:								
Asset management and administration fees	$ 285	$ 254	$ 238	$ 212	$ 1	$	$ 524	$ 466
Net interest revenue	367	377	72	66			439	443
Trading revenue	136	166	69	82	(1)		204	248
Other	22	25	20	19		1	42	45
Provision for loan losses	(9)	(7)	(1)	(1)			(10)	(8)
Net impairment losses on securities	(2)	(12)	(1)	(1)			(3)	(13)
Total net revenues	799	803	397	377		1	1,196	1,181
Expenses Excluding Interest	571	561	264	259		1	835	821
Income before taxes on income	$ 228	$ 242	$ 133	$ 118	$	$	$ 361	$ 360
Taxes on income							114	140
Net Income							$ 247	$ 220

	Investor Services		**Institutional Services**		**Unallocated**		**Total**	
Nine Months Ended September 30,	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**
Net Revenues:								
Asset management and administration fees	$ 816	$ 805	$ 688	$ 665	$	$	$ 1,504	$ 1,470
Net interest revenue	1,117	1,137	214	193			1,331	1,330
Trading revenue	446	462	221	232	(1)		666	694
Other [(1)]	76	61	61	57	72	1	209	119
Provision for loan losses	(12)	(11)	(2)	(2)			(14)	(13)
Net impairment losses on securities	(24)	(20)	(4)	(2)			(28)	(22)

Total net revenues	2,419	2,434	1,178	1,143	71	1	3,668	3,578
Expenses Excluding Interest	1,764	1,662	798	777		(1)	2,562	2,438
Income before taxes on income	$ 655	$ 772	$ 380	$ 366	$ 71	$ 2	$ 1,106	$ 1,140
Taxes on income							389	439
Net Income							$ 717	$ 701

(1) Unallocated amount includes a pre-tax gain of $70 million relating to a confidential resolution of a vendor dispute in the second quarter of 2012.

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

Management of The Charles Schwab Corporation (CSC) and its subsidiaries (collectively referred to as the Company) focuses on several key client activity and financial metrics in evaluating the Company s financial position and operating performance. Results for the third quarters and first nine months of 2012 and 2011 are:

	Three Months Ended September 30,		Percent	Nine Months Ended September 30,		Percent
	2012	2011	Change	2012	2011	Change
Client Activity Metrics:						
Net new client assets [(1)] (in billions)	$ 20.4	$ 86.0	(76%)	$ 75.3	$ 124.4	(39%)
Client assets (in billions, at quarter end)	$ 1,890.4	$ 1,576.4	20%			
Clients daily average trades [(2)] (in thousands)	402.4	475.4	(15%)	438.0	448.3	(2%)
Company Financial Metrics:						
Net revenues	$ 1,196	$ 1,181	1%	$ 3,668	$ 3,578	3%
Expenses excluding interest	835	821	2%	2,562	2,438	5%
Income before taxes on income	361	360		1,106	1,140	(3%)
Taxes on income	114	140	(19%)	389	439	(11%)
Net income	$ 247	$ 220	12%	$ 717	$ 701	2%
Earnings per common share diluted	$ .19	$ .18	6%	$ .54	$ .57	(5%)
Net revenue growth from prior year	1%	11%		3%	15%	
Pre-tax profit margin	30.2%	30.5%		30.2%	31.9%	
Return on average common stockholders equity (annualized) [(3)]	11%	12%		11%	13%	
Annualized net revenue per average full-time equivalent employee (in thousands)	$ 352	$ 350	1%	$ 354	$ 361	(2%)

(1) Includes outflows of $1.3 billion as a result of the closure and/or sale of certain subsidiaries of optionsXpress Holdings, Inc. in the third quarter of 2012. Includes inflows of $12.0 billion from a mutual fund clearing services client in the first quarter of 2012. Includes inflows of $60.9 billion from mutual fund clearing services clients and $7.5 billion from the acquisition of optionsXpress Holdings, Inc. in the third quarter of 2011.

(2) Amounts include revenue trades from commissions or principal mark-ups (i.e., fixed income), trades by clients in asset-based pricing relationships, and all commission-free trades, including the Company s Mutual Fund OneSource® funds and Exchange-Traded Funds, and other proprietary products.

(3) Return on average common stockholders equity is calculated using net income available to common stockholders divided by average common stockholders equity.

The broad equity markets improved during the third quarter of 2012 compared to the third quarter of 2011, as the Nasdaq Composite Index, Standard & Poor s 500 Index, and Dow Jones Industrial Average increased 29%, 27%, and 23%, respectively. While the federal funds target rate remained unchanged at a range of zero to 0.25%, the average three-month Treasury Bill yield increased by 8 basis points to 0.09% during the

third quarter of 2012 compared to the third quarter of 2011. At the same time, the average 10-year Treasury yield decreased by 78 basis points to 1.62%.

Clients remained engaged in the third quarter of 2012 despite the challenging economic and market environment that continued during the period. Net new client assets before significant one-time flows totaled $21.7 billion in the third quarter of 2012, up 23% from the third quarter of 2011. Total client assets ended the quarter at a record $1.89 trillion, up 20% from the third quarter of 2011. Clients daily average trades were 402,400 in the third quarter of 2012, down 15% on a year-over-year basis.

For the third quarter of 2012, net revenues remained relatively flat compared to the third quarter of 2011 as the increase in asset management and administration fees was largely offset by a decrease in trading revenue. Asset management and administration fees increased primarily due to increases in mutual fund service fees and advice solutions fees. Trading

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revenue decreased primarily due to lower daily average revenue trades. Net interest revenue was relatively flat, reflecting higher balances of interest-earning assets offset by the effect of lower interest rate spreads during the third quarter of 2012 due to the continued low interest rate environment.

For the first nine months of 2012, net revenues increased by 3% compared to the first nine months of 2011 primarily due to increases in asset management and administration fees and other revenue, partially offset by a decrease in trading revenue. Asset management and administration fees increased due to increases in advice solutions fees and other asset management and administration fees, offset by a decrease in mutual fund service fees. Other revenue increased primarily due to a pre-tax gain of $70 million relating to a confidential resolution of a vendor dispute in the second quarter of 2012. Trading revenue decreased primarily due to lower daily average revenue trades, partially offset by the inclusion of optionsXpress option, future, and equity trades from its acquisition in September 2011. Net interest revenue was flat as higher average balances of interest-earning assets were offset by lower interest rate spreads during the first nine months of 2012 due to the continued pressure on market interest rates.

Expenses excluding interest increased by 2% and 5% in the third quarter and first nine months of 2012 compared to the same periods in 2011, respectively, primarily due to the inclusion of optionsXpress. Taxes on income in the third quarter of 2012 include a non-recurring state tax benefit of $20 million. Overall, net income increased by 12% and 2% in the third quarter and first nine months of 2012 compared to the same periods in 2011, respectively.

In comparison to the second quarter of 2012, the broad equity markets increased in the third quarter of 2012 as the Nasdaq Composite Index, Standard & Poor s 500 Index, and Dow Jones Industrial Average increased 6%, 6%, and 4%, respectively, while the average three-month Treasury Bill yield remained relatively flat at 0.09%. The average 10-year Treasury yield decreased by 19 basis points to 1.62% from the second quarter of 2012. Despite the challenging economic environment, the Company s growing client base and ongoing expense discipline helped maintain a pre-tax profit margin of 30.2% in the third quarter of 2012. Net income in the third quarter and second quarter of 2012 include the non-recurring state tax benefit of $20 million and pre-tax gain of $70 million (after-tax of $44 million), respectively, discussed above.

CURRENT MARKET AND REGULATORY ENVIRONMENT AND OTHER DEVELOPMENTS

The broad equity markets and short-term interest rates showed improvement from 2011, however the low interest rate environment continues to constrain growth in the Company s net revenues.

As discussed above, interest rates remained at low levels during the third quarter of 2012. To the extent rates remain at these low levels, the Company s net interest revenue will continue to be constrained, even as growth in average balances helps to increase such revenue. The low interest rate environment also affects asset management and administration fees. While net money market mutual fund fees improved in the third quarter of 2012 from the second quarter of 2012 primarily due to sustained improvement in short-term interest rates, the overall yields on certain Schwab-sponsored money market mutual funds have remained at levels at or below the management fees on those funds. The Company continues to waive a portion of its management fees so that the funds can maintain a positive return to clients. These and other money market mutual funds may not be able to replace maturing securities with securities of equal or higher yields. As a result, the yields on such funds may remain around or decline from their current levels, and therefore below the management fees on those funds. To the extent this occurs, asset management and administration fees may be negatively affected.

The Company recorded net impairment losses of $3 million and $28 million related to certain non-agency residential mortgage-backed securities in the third quarter and first nine months of 2012, respectively, due to further credit deterioration of the securities underlying loans. Net impairment losses in the first nine months of 2012 were also due to an increase in projected default rates for modified loans in the first quarter of 2012. Further deterioration in the performance of the underlying loans in the Company s residential mortgage-backed securities portfolio could result in the recognition of additional impairment charges.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law in July 2010. Among other things, the legislation transferred the supervision and regulation of CSC from the Office of Thrift Supervision (OTS) to the Board of Governors of the

Federal Reserve System (the Federal Reserve) and supervision and

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regulation of Schwab Bank from the OTS to the Office of the Comptroller of the Currency (OCC); both transfers were effective July 21, 2011. The Federal Reserve recently issued notices of proposed rulemaking (NPRs) to meet certain requirements of the Dodd-Frank Act and to align current capital rules with the BASEL III capital standards. The NPRs would subject all savings and loan holding companies, including CSC, to consolidated capital requirements. In addition, the NPRs would establish more restrictive capital definitions, higher risk-weightings for certain asset classes, higher minimum capital ratios and capital buffers. The NPRs would be phased in under an extended timeframe, beginning January 2013. The comment period for the NPRs ended on October 22, 2012 and the NPRs are subject to further modification. CSC is currently evaluating the impact of the NPRs but does not expect them to have a material impact on the Company s business, financial condition, and results of operations.

The Company is pursuing lawsuits in state court in San Francisco for rescission and damages against issuers, underwriters, and dealers of individual non-agency residential mortgage-backed securities on which the Company has experienced realized and unrealized losses. The lawsuits allege that offering documents for the securities contained material untrue and misleading statements about the securities and the underwriting standards and credit quality of the underlying loans. On January 27, 2012, and July 24, 2012, the court denied defendants motions to dismiss the claims with respect to all but 3 of the 51 securities, and discovery is proceeding.

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RESULTS OF OPERATIONS

The following discussion presents an analysis of the Company s results of operations for the third quarter and first nine months of 2012 compared to the same periods in 2011.

Net Revenues

The Company s major sources of net revenues are asset management and administration fees, net interest revenue, and trading revenue. Asset management and administration fees increased and net interest revenue was relatively flat, while trading revenue decreased in the third quarter and first nine months of 2012 compared to the same periods in 2011, respectively.

Three Months Ended September 30,		2012		2011	
	Percent Change	Amount	% of Total Net Revenues	Amount	% of Total Net Revenues
Asset management and administration fees					
Schwab money market funds before fee waivers		$ 221		$ 220	
Fee waivers	(15%)	(136)		(160)	
Schwab money market funds after fee waivers	42%	85	7%	60	5%
Equity and bond funds	10%	32	3%	29	2%
Mutual Fund OneSource®	2%	171	14%	168	14%
Total mutual funds	12%	288	24%	257	21%
Advice solutions	15%	148	12%	129	11%
Other	10%	88	8%	80	7%
Asset management and administration fees	12%	524	44%	466	39%
Net interest revenue					
Interest revenue	(2%)	478	40%	487	41%
Interest expense	(11%)	(39)	(3%)	(44)	(3%)
Net interest revenue	(1%)	439	37%	443	38%
Trading revenue					
Commissions	(18%)	190	16%	233	20%
Principal transactions	(7%)	14	1%	15	1%
Trading revenue	(18%)	204	17%	248	21%
Other	(7%)	42	3%	45	4%

Provision for loan losses	25%	(10)	(1%)	(8)	(1%)
Net impairment losses on securities	(77%)	(3)		(13)	(1%)
Total net revenues	1%	$ 1,196	100%	$ 1,181	100%

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Nine Months Ended September 30,		2012		2011	
	Percent Change	**Amount**	**% of Total Net Revenues**	**Amount**	**% of Total Net Revenues**
Asset management and administration fees					
Schwab money market funds before fee waivers	4%	$ 663		$ 639	
Fee waivers	11%	(445)		(400)	
Schwab money market funds after fee waivers	(9%)	218	6%	239	7%
Equity and bond funds	7%	95	2%	89	2%
Mutual Fund OneSource®	(4%)	501	14%	520	15%
Total mutual funds	(4%)	814	22%	848	24%
Advice solutions	9%	427	12%	392	11%
Other	14%	263	7%	230	6%
Asset management and administration fees	2%	1,504	41%	1,470	41%
Net interest revenue					
Interest revenue	(1%)	1,447	39%	1,464	41%
Interest expense	(13%)	(116)	(3%)	(134)	(4%)
Net interest revenue		1,331	36%	1,330	37%
Trading revenue					
Commissions	(4%)	624	17%	647	18%
Principal transactions	(11%)	42	1%	47	1%
Trading revenue	(4%)	666	18%	694	19%
Other	76%	209	6%	119	4%
Provision for loan losses	8%	(14)		(13)	
Net impairment losses on securities	27%	(28)	(1%)	(22)	(1%)
Total net revenues	3%	$ 3,668	100%	$ 3,578	100%

Asset Management and Administration Fees

Asset management and administration fees include mutual fund service fees and fees for other asset-based financial services provided to individual and institutional clients. The Company earns mutual fund service fees for shareholder services, administration, and investment management provided to its proprietary funds, and recordkeeping and shareholder services provided to third-party funds. These fees are based upon the daily balances of client assets invested in these funds. The Company also earns asset management fees for advice solutions, which include advisory and managed account services that are based on the daily balances of client assets subject to the specific fee for service. The

fair values of client assets included in proprietary and third-party mutual funds are based on quoted market prices and other observable market data. Other asset management and administration fees include various asset based fees, such as trust fees, 401k record keeping fees, and mutual fund clearing and other service fees. Asset management and administration fees may vary with changes in the balances of client assets due to market fluctuations and client activity. For discussion of the impact of current market conditions on asset management and administration fees, see Current Market and Regulatory Environment and Other Developments.

Asset management and administration fees increased by $58 million, or 12%, in the third quarter of 2012 compared to the third quarter of 2011 primarily due to increases in mutual fund service fees and advice solutions fees. Asset management and administration fees increased by $34 million, or 2%, in the first nine months of 2012 compared to the first nine months of 2011 due to increases in advice solutions fees and other asset management and administration fees, offset by a decrease in mutual fund service fees.

Mutual fund service fees increased by $31 million, or 12%, in the third quarter of 2012 compared to the third quarter of 2011 primarily due to an increase in net money market mutual fund fees as a result of improved short-term rates. Mutual fund

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service fees decreased by $34 million, or 4%, in the first nine months of 2012 compared to the first nine months of 2011 primarily due to a decrease in net money market mutual fund fees as a result of lower yields on fund assets and a decrease in Mutual Fund OneSource fees.

Advice solutions fees increased by $19 million, or 15%, and $35 million, or 9%, in the third quarter and first nine months of 2012 compared to the same periods in 2011, respectively, primarily due to growth in client assets enrolled in retail advisory and managed account programs, which includes Windhaven®.

Other asset management and administration fees increased by $8 million, or 10%, and $33 million, or 14%, in the third quarter and first nine months of 2012 compared to the same periods in 2011 primarily due to an increase in third-party mutual fund service fees.

Net Interest Revenue

Net interest revenue is the difference between interest earned on interest-earning assets and interest paid on funding sources. Net interest revenue is affected by changes in the volume and mix of these assets and liabilities, as well as by fluctuations in interest rates and portfolio management strategies. The Company s investment strategy is structured to produce an increase in net interest revenue when interest rates rise and, conversely, a decrease in net interest revenue when interest rates fall (i.e., interest-earning assets generally reprice more quickly than interest-bearing liabilities). When interest rates fall, the Company may attempt to mitigate some of this negative impact by extending the maturities of assets in investment portfolios to lock in asset yields, and by lowering rates paid to clients on interest-bearing liabilities. Since the Company establishes the rates paid on certain brokerage client cash balances and deposits from banking clients, as well as the rates charged on receivables from brokerage clients, and also controls the composition of its investment securities, it has some ability to manage its net interest spread. The current low interest rate environment limits the extent to which the Company can reduce interest expense paid on funding sources. However, the spread is influenced by external factors such as the interest rate environment and competition. For discussion of the impact of current market conditions on net interest revenue, see Current Market and Regulatory Environment and Other Developments.

In clearing its clients trades, Charles Schwab & Co., Inc. (Schwab) and optionsXpress, Inc. hold cash balances payable to clients. In most cases, Schwab and optionsXpress, Inc. pay their clients interest on cash balances awaiting investment, and in turn invest these funds and earn interest revenue. Receivables from brokerage clients consist primarily of margin loans to brokerage clients. Margin loans are loans made to clients on a secured basis to purchase securities. Pursuant to applicable regulations, client cash balances that are not used for margin lending are generally segregated into investment accounts that are maintained for the exclusive benefit of clients, which are recorded in cash and investments segregated on the Company s condensed consolidated balance sheet.

Schwab Bank maintains investment portfolios for liquidity as well as to invest funds from deposits in excess of loans to banking clients and liquidity limits. Schwab Bank s securities available for sale include residential mortgage-backed securities, certificates of deposit, corporate debt securities, U.S. agency notes, and asset-backed and other securities. Schwab Bank s securities held to maturity include residential mortgage-backed and other securities. Schwab Bank lends funds to banking clients primarily in the form of mortgage loans and home equity lines of credit (HELOCs). These loans are largely funded by interest-bearing deposits from banking clients.

The Company s interest-earning assets are financed primarily by brokerage client cash balances and deposits from banking clients. Non-interest-bearing funding sources include non-interest-bearing brokerage client cash balances and proceeds from stock-lending activities, as well as stockholders equity.

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The following tables present net interest revenue information corresponding to interest-earning assets and funding sources on the condensed consolidated balance sheet:

Three Months Ended September 30,	2012			2011		
	Average Balance	Interest Revenue/ Expense	Average Yield/ Rate	Average Balance	Interest Revenue/ Expense	Average Yield/ Rate
Interest-earning assets:						
Cash and cash equivalents	$ 7,942	$ 4	0.20%	$ 6,025	$ 3	0.20%
Cash and investments segregated	23,516	12	0.20%	26,597	7	0.10%
Broker-related receivables [(1)]	414			300		0.03%
Receivables from brokerage clients	10,956	112	4.07%	10,749	117	4.32%
Securities available for sale [(2)]	40,701	146	1.43%	27,947	116	1.65%
Securities held to maturity	15,311	95	2.47%	15,469	128	3.28%
Loans to banking clients	10,014	77	3.06%	9,646	79	3.25%
Loans held for sale [(1)]	1		4.06%	49	1	4.27%
Total interest-earning assets	108,855	446	1.63%	96,782	451	1.85%
Other interest revenue		32			36	
Total interest-earning assets	$ 108,855	$ 478	1.74%	$ 96,782	$ 487	2.00%
Funding sources:						
Deposits from banking clients	$ 67,027	$ 11	0.07%	$ 53,247	$ 16	0.12%
Payables to brokerage clients	28,435	1	0.01%	30,962	1	0.01%
Long-term debt	1,923	27	5.59%	2,003	27	5.35%
Total interest-bearing liabilities	97,385	39	0.16%	86,212	44	0.20%
Non-interest-bearing funding sources	11,470			10,570		
Total funding sources	$ 108,855	$ 39	0.14%	$ 96,782	$ 44	0.18%
Net interest revenue		$ 439	1.60%		$ 443	1.82%

(1) Interest revenue was less than $500,000 in the period or periods presented.
(2) Amounts have been calculated based on amortized cost.

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Nine Months Ended September 30,	2012			2011		
	Average Balance	Interest Revenue/ Expense	Average Yield/ Rate	Average Balance	Interest Revenue/ Expense	Average Yield/ Rate
Interest-earning assets:						
Cash and cash equivalents	$ 6,741	$ 12	0.24%	$ 5,496	$ 9	0.22%
Cash and investments segregated	25,259	33	0.17%	25,120	30	0.16%
Broker-related receivables [1]	345		0.02%	346		0.05%
Receivables from brokerage clients	10,750	333	4.14%	10,784	356	4.41%
Securities available for sale [2]	38,443	443	1.54%	26,373	332	1.68%
Securities held to maturity	15,175	302	2.66%	16,313	413	3.38%
Loans to banking clients	9,921	233	3.14%	9,343	231	3.31%
Loans held for sale	24	1	4.12%	63	2	4.11%
Total interest-earning assets	106,658	1,357	1.70%	93,838	1,373	1.96%
Other interest revenue		90			91	
Total interest-earning assets	$ 106,658	$ 1,447	1.81%	$ 93,838	$ 1,464	2.08%
Funding sources:						
Deposits from banking clients	$ 63,577	$ 31	0.07%	$ 51,649	$ 49	0.13%
Payables to brokerage clients	29,651	2	0.01%	29,288	2	0.01%
Long-term debt	1,974	81	5.48%	2,004	81	5.40%
Total interest-bearing liabilities	95,202	114	0.16%	82,941	132	0.21%
Non-interest-bearing funding sources	11,456			10,897		
Other interest expense		2			2	
Total funding sources	$ 106,658	$ 116	0.14%	$ 93,838	$ 134	0.19%
Net interest revenue		$ 1,331	1.67%		$ 1,330	1.89%

(1) Interest revenue was less than $500,000 in the period or periods presented.

(2) Amounts have been calculated based on amortized cost.

Net interest revenue was relatively flat in the third quarter and first nine months of 2012 compared to the same periods in 2011, reflecting higher average balances of interest-earning assets, primarily securities available for sale, offset by lower interest rate spreads due to the continued pressure on market interest rates. The growth in the average balance of deposits from banking clients funded the increase in the balance of securities available for sale.

Trading Revenue

Trading revenue includes commission and principal transaction revenues. Commission revenue is affected by the number of revenue trades executed and the average revenue earned per revenue trade. Principal transaction revenue is primarily comprised of revenue from client fixed income securities trading activity. To accommodate clients fixed income trading activity, the Company maintains positions in fixed income securities, including state and municipal debt obligations, U.S. Government, corporate debt, and other securities. The difference between the price at which the Company buys and sells securities to and from its clients and other broker-dealers is recognized as principal transaction revenue. Principal transaction revenue also includes unrealized gains and losses on these securities positions. Factors that influence principal transaction revenue include the volume of client trades and market price volatility.

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Trading revenue decreased by $44 million, or 18%, and $28 million, or 4%, in the third quarter and first nine months of 2012 compared to the same periods in 2011, respectively, primarily due to lower daily average revenue trades. Daily average revenue trades decreased in the third quarter and first nine months of 2012 primarily due to a lower volume of equity and mutual fund trades, partially offset by a higher volume of option and future trades as a result of the inclusion of optionsXpress. Average revenue earned per revenue trade remained relatively flat in the third quarter and first nine months of 2012 compared to the same periods in 2011.

	Three Months Ended September 30,		Percent	Nine Months Ended September 30,		Percent
	2012	2011	Change	2012	2011	Change
Daily average revenue trades (in thousands) [1]	261.5	323.1	(19%)	288.3	302.7	(5%)
Number of trading days	62.5	64.0	(2%)	187.5	189.0	(1%)
Average revenue earned per revenue trade	$ 12.44	$ 12.04	3%	$ 12.31	$ 12.13	1%

(1) Includes all client trades that generate trading revenue (i.e., commission revenue or revenue from fixed income securities trading).

Other Revenue

Other revenue includes nonrecurring gains, software fees from the Company s portfolio management services, education services, exchange processing fees, gains on sales of mortgage loans, and other service fees. Other revenue increased by $90 million, or 76%, in the first nine months of 2012 from the first nine months of 2011 primarily due to a pre-tax gain of $70 million relating to a confidential resolution of a vendor dispute in the second quarter of 2012. The increase was also due to the inclusion of revenues relating to education services and other fees from the optionsXpress acquisition.

Net Impairment Losses on Securities

Net impairment losses in the Company s non-agency residential mortgage-backed securities portfolio were $3 million and $28 million in the third quarter and first nine months of 2012, respectively. Net impairment losses on securities were $13 million and $22 million in the third quarter and first nine months of 2011, respectively. These charges were higher in the first nine months of 2012 primarily due to further credit deterioration of the securities underlying loans and an increase in projected default rates for modified loans in the first quarter of 2012. For further discussion, see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 4. Securities Available for Sale and Securities Held to Maturity.

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Expenses Excluding Interest

As shown in the table below, expenses excluding interest increased in the third quarter and first nine months of 2012 compared to the same periods in 2011, which was primarily due to the inclusion of optionsXpress.

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Percent Change	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011	Percent Change
Compensation and benefits	$ 442	$ 423	4%	$ 1,353	$ 1,290	5%
Professional services	98	104	(6%)	287	288	
Occupancy and equipment	77	78	(1%)	233	222	5%
Advertising and market development	49	48	2%	173	159	9%
Communications	53	56	(5%)	166	166	
Depreciation and amortization	50	39	28%	146	107	36%
Class action litigation and regulatory reserve					7	N/M
Other	66	73	(10%)	204	199	3%
Total expenses excluding interest	$ 835	$ 821	2%	$ 2,562	$ 2,438	5%
Expenses as a percentage of total net revenues:						
Total expenses excluding interest	70%	70%		70%	68%	
Advertising and market development	4%	4%		5%	4%	

N/M Not meaningful.

Compensation and Benefits

Compensation and benefits expense includes salaries and wages, incentive compensation, and related employee benefits and taxes. Incentive compensation includes variable compensation, discretionary bonuses, and stock-based compensation. Variable compensation includes payments to certain individuals based on their sales performance. Discretionary bonuses are based on the Company s overall performance as measured by earnings per common share, and therefore will fluctuate with this measure. Stock-based compensation primarily includes employee and board of director stock options, restricted stock units, and restricted stock awards.

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Compensation and benefits expense increased by $19 million, or 4%, and $63 million, or 5%, in the third quarter and first nine months of 2012 compared to the same periods in 2011 primarily due to increases in salaries and wages and employee benefits and other expense. The following table shows a comparison of certain compensation and benefits components and employee data:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Percent Change	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011	Percent Change
Salaries and wages	$ 255	$ 247	3%	$ 785	$ 745	5%
Incentive compensation	119	114	4%	350	338	4%
Employee benefits and other	68	62	10%	218	207	5%
Total compensation and benefits expense	$ 442	$ 423	4%	$ 1,353	$ 1,290	5%
Compensation and benefits expense as a percentage of total net revenues:						
Salaries and wages	21%	21%		21%	21%	
Incentive compensation	10%	10%		10%	9%	
Employee benefits and other	6%	5%		6%	6%	
Total compensation and benefits expense	37%	36%		37%	36%	
Full-time equivalent employees (in thousands) [1]						
At quarter end	13.6	13.9	(2%)			
Average	13.6	13.5	1%	13.8	13.2	5%

[1] Includes full-time, part-time and temporary employees, and persons employed on a contract basis, and excludes employees of outsourced service providers.

Salaries and wages increased in the third quarter and first nine months of 2012 compared to the same periods in 2011 primarily due to an increase in full-time employees, partially due to the addition of full-time employees from the optionsXpress acquisition. Employee benefits and other expense increased in the third quarter and first nine months of 2012 compared to the same periods in 2011 primarily due to increases in the Company s deferred compensation plan expense as a result of improvement in the broad equity markets and payroll taxes as a result of the increase in full-time employees.

Expenses Excluding Compensation and Benefits

Occupancy and equipment expense increased in the first nine months of 2012 compared to the first nine months of 2011 primarily due to an increase in software maintenance expense relating to the Company s information technology systems.

Advertising and market development expense increased in the first nine months of 2012 compared to the first nine months of 2011 primarily due to the inclusion of optionsXpress expenses, including electronic media and customer seminars, and the Company s higher spending on customer promotions.

Depreciation and amortization expense increased in the third quarter and first nine months of 2012 compared to the same periods in 2011 primarily due to amortization of intangible assets relating to the optionsXpress acquisition.

Taxes on Income

The Company s effective income tax rate on income before taxes was 31.6% and 38.9% for the third quarters of 2012 and 2011, respectively. The Company s effective income tax rate on income before taxes was 35.2% and 38.5% for the first nine months of 2012 and 2011, respectively. The decrease in the third quarter of 2012 was primarily due to the recognition of a non-recurring state tax benefit of $20 million. The decrease in the first nine months of 2012 was primarily due to the non-recurring state tax benefit and the impact of a lower effective state income tax rate.

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Segment Information

The Company provides financial services to individuals and institutional clients through two segments Investor Services and Institutional Services. The Investor Services segment provides retail brokerage and banking services to individual investors. The Institutional Services segment provides custodial, trading, and support services to independent investment advisors. The Institutional Services segment also provides retirement plan services, specialty brokerage services, and mutual fund clearing services, and supports the availability of Schwab proprietary mutual funds and collective trust funds on third-party platforms. Banking revenues and expenses are allocated to the Company s two segments based on which segment services the client. The Company evaluates the performance of its segments on a pre-tax basis, excluding items such as significant nonrecurring gains, impairment charges on non-financial assets, discontinued operations, extraordinary items, and significant restructuring and other charges.

Financial information for the Company s reportable segments is presented in the following tables:

	Investor Services			Institutional Services		
Three Months Ended September 30,	**Percent Change**	**2012**	**2011**	**Percent Change**	**2012**	**2011**
Net Revenues:						
Asset management and administration fees	12%	$ 285	$ 254	12%	$ 238	$ 212
Net interest revenue	(3%)	367	377	9%	72	66
Trading revenue	(18%)	136	166	(16%)	69	82
Other	(12%)	22	25	5%	20	19
Provision for loan losses	29%	(9)	(7)		(1)	(1)
Net impairment losses on securities	(83%)	(2)	(12)		(1)	(1)
Total net revenues		799	803	5%	397	377
Expenses Excluding Interest	2%	571	561	2%	264	259
Income before taxes on income	(6%)	$ 228	$ 242	13%	$ 133	$ 118

	Unallocated			Total		
Three Months Ended September 30,	**Percent Change**	**2012**	**2011**	**Percent Change**	**2012**	**2011**
Net Revenues:						
Asset management and administration fees	N/M	$ 1	$	12%	$ 524	$ 466
Net interest revenue	N/M			(1%)	439	443
Trading revenue	N/M	(1)		(18%)	204	248
Other	N/M		1	(7%)	42	45
Provision for loan losses	N/M			25%	(10)	(8)
Net impairment losses on securities	N/M			(77%)	(3)	(13)
Total net revenues	N/M		1	1%	1,196	1,181

Expenses Excluding Interest	N/M			1	2%		835		821
Income before taxes on income	N/M	$	$			$	361	$	360
Taxes on income					(19%)		114		140
Net Income					12%	$	247	$	220

N/M Not meaningful.

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	Investor Services			Institutional Services		
Nine Months Ended September 30,	**Percent Change**	**2012**	**2011**	**Percent Change**	**2012**	**2011**
Net Revenues:						
Asset management and administration fees	1%	$ 816	$ 805	3%	$ 688	$ 665
Net interest revenue	(2%)	1,117	1,137	11%	214	193
Trading revenue	(3%)	446	462	(5%)	221	232
Other	25%	76	61	7%	61	57
Provision for loan losses	9%	(12)	(11)		(2)	(2)
Net impairment losses on securities	20%	(24)	(20)	100%	(4)	(2)
Total net revenues	(1%)	2,419	2,434	3%	1,178	1,143
Expenses Excluding Interest	6%	1,764	1,662	3%	798	777
Income before taxes on income	(15%)	$ 655	$ 772	4%	$ 380	$ 366

	Unallocated			Total		
Nine Months Ended September 30,	**Percent Change**	**2012**	**2011**	**Percent Change**	**2012**	**2011**
Net Revenues:						
Asset management and administration fees	N/M	$	$	2%	$ 1,504	$ 1,470
Net interest revenue	N/M				1,331	1,330
Trading revenue	N/M	(1)		(4%)	666	694
Other	N/M	72	1	76%	209	119
Provision for loan losses	N/M			8%	(14)	(13)
Net impairment losses on securities	N/M			27%	(28)	(22)
Total net revenues	N/M	71	1	3%	3,668	3,578
Expenses Excluding Interest	N/M		(1)	5%	2,562	2,438
Income before taxes on income	N/M	$ 71	$ 2	(3%)	$ 1,106	$ 1,140
Taxes on income				(11%)	389	439
Net Income				2%	$ 717	$ 701

N/M Not meaningful.

Investor Services

Net revenues were flat in the third quarter of 2012 compared to the third quarter of 2011 as the increase in asset management and administration fees was largely offset by a decrease in trading revenue. Asset management and administration fees increased primarily due to increases in mutual fund service fees, including net money market mutual fund fees, and revenue from the Company s advice solution fees relating to Windhaven. Trading revenue decreased primarily due to lower daily average revenue trades. Expenses excluding interest increased by $10 million, or 2%, in the third quarter of 2012 compared to the third quarter of 2011 primarily due to the inclusion of optionsXpress compensation and benefits and depreciation and amortization expenses.

Net revenues were relatively flat in the first nine months of 2012 compared to the first nine months of 2011 as the decreases in net interest revenue and trading revenue were largely offset by increases in asset management and administration fees and other revenue. Net interest revenue decreased primarily due to the effect of lower interest rate spreads due to the continued pressure on market interest rates. Trading revenue decreased primarily due to lower daily average revenue trades. Asset management and administration fees increased primarily due to an increase in revenue from the Company s advice solution fees relating to Windhaven, partially offset by a decrease in net money market mutual fund fees. Other revenue increased primarily due to the inclusion of revenues relating to education services and other fees from optionsXpress. Expenses excluding interest increased by $102 million, or 6%, primarily due to the inclusion of optionsXpress compensation and benefits, advertising and market development, and depreciation and amortization expenses.

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Institutional Services

Net revenues increased by $20 million, or 5%, and $35 million, or 3%, in the third quarter and first nine months of 2012 compared to the same periods in 2011, respectively, primarily due to increases in asset management and administration fees and net interest revenue, partially offset by a decrease in trading revenue. Asset management and administration fees increased primarily due to an increase in third-party mutual fund service fees. Net interest revenue increased primarily due to higher average balances of interest-earning assets, partially offset by the effect of lower interest rate spreads due to the continued low interest rate environment. Trading revenue decreased primarily due to lower daily average revenue trades. Expenses excluding interest increased by $21 million, or 3% in the first nine months of 2012 compared to the first nine months of 2011 primarily due to increases in compensation and benefits and occupancy and equipment expenses.

Unallocated

Other revenue in the first nine months of 2012 includes a pre-tax gain of $70 million relating to a confidential resolution of a vendor dispute in the second quarter of 2012.

LIQUIDITY AND CAPITAL RESOURCES

CSC conducts substantially all of its business through its wholly-owned subsidiaries. The Company s capital structure is designed to provide each subsidiary with capital and liquidity to meet its operational needs and regulatory requirements.

CSC is a savings and loan holding company and Schwab Bank, CSC s depository institution, is a federal savings bank. CSC is subject to supervision and regulation by the Federal Reserve and Schwab Bank is subject to supervision and regulation by the OCC.

Liquidity

CSC

While CSC is not currently subject to specific statutory capital requirements, CSC is required to serve as a source of strength for Schwab Bank and must have the ability to provide financial assistance if Schwab Bank experiences financial distress. To manage capital adequacy, the Company currently utilizes a target Tier 1 Leverage Ratio, as defined by the Federal Reserve, of at least 6%. At September 30, 2012, CSC s Tier 1 Leverage Ratio was 6.9%.

CSC s liquidity needs are generally met through cash generated by its subsidiaries, as well as cash provided by external financing. CSC has a universal automatic shelf registration statement (Shelf Registration Statement) on file with the SEC which enables CSC to issue debt, equity and other securities. CSC maintains excess liquidity in the form of overnight cash deposits and short-term investments to cover daily funding needs and to support growth in the Company s business. Generally, CSC does not hold liquidity at its subsidiaries in excess of amounts deemed sufficient to support the subsidiaries operations, including any regulatory capital requirements. Schwab, Schwab Bank, and optionsXpress, Inc. are subject to regulatory requirements that may restrict them from certain transactions with CSC, as further discussed below. Management believes that funds generated by the operations of CSC s subsidiaries will continue to be the primary funding source in meeting CSC s liquidity needs, providing adequate liquidity to meet Schwab Bank s capital guidelines, and maintaining Schwab and optionsXpress, Inc. s net capital.

In August 2012, CSC completed an exchange offer with certain eligible holders of its 4.950% Senior Notes due 2014 (Old Senior Notes), whereby Old Senior Notes in an aggregate principal amount of $256 million were exchanged for the same aggregate principal amount of 3.225% Senior Notes due 2022 (New Senior Notes) and cash consideration of $19 million. For further discussion of this debt exchange, see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 6. Borrowings.

On August 31, 2012, CSC redeemed all of the fixed-to-floating rate trust preferred securities issued by Schwab Capital Trust (Trust) of which $202 million in principal was outstanding for $207 million, which included accumulated and unpaid distributions up to and including the redemption date. The trust preferred securities were redeemed, along with the common securities issued by the Trust and held by CSC, as a result of the concurrent redemption in whole by CSC of the Junior

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Subordinated Notes held by the Trust which underlay the trust preferred securities. For further discussion of this redemption, see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 6. Borrowings.

In June and January 2012 the Company completed equity offerings of 485,000 and 400,000 shares of its preferred stock, Series B and Series A, respectively, under the Shelf Registration Statement. CSC s preferred stock is rated Baa2 by Moody s Investors Service (Moody s), BBB+ by Standard & Poor s Ratings Group (Standard & Poor s), and BB+ by Fitch Ratings, Ltd (Fitch). For further discussion of these equity offerings, see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 9. Preferred Stock.

CSC has liquidity needs that arise from the funding of cash dividends, acquisitions, and investments, as well as its Senior Notes and Senior Medium-Term Notes, Series A (Medium-Term Notes). The following are details of CSC s long-term debt:

September 30, 2012	Par Outstanding	Maturity	Interest Rate	Moody s	Standard & Poor s	Fitch
Senior Notes	$ 1,450	2014 - 2022	3.225% to 4.950% fixed	A2	A	A
Medium-Term Notes	$ 250	2017	6.375% fixed	A2	A	A

CSC has authorization from its Board of Directors to issue unsecured commercial paper notes (Commercial Paper Notes) not to exceed $1.5 billion. Management has set a current limit for the commercial paper program of $800 million. The maturities of the Commercial Paper Notes may vary, but are not to exceed 270 days from the date of issue. The commercial paper is not redeemable prior to maturity and cannot be voluntarily prepaid. The proceeds of the commercial paper program are to be used for general corporate purposes. There were no borrowings of Commercial Paper Notes outstanding at September 30, 2012. CSC s ratings for these short-term borrowings are P1 by Moody s, A1 by Standard & Poor s, and F1 by Fitch.

CSC maintains an $800 million committed, unsecured credit facility with a group of 11 banks, which is scheduled to expire in June 2013. This facility replaced a similar facility that expired in June 2012 and was unused during the first nine months of 2012. The funds under this facility are available for general corporate purposes. The financial covenants under this facility require Schwab to maintain a minimum net capital ratio, as defined, Schwab Bank to be well capitalized, as defined, and CSC to maintain a minimum level of stockholders equity. At September 30, 2012, the minimum level of stockholders equity required under this facility was $5.7 billion (CSC s stockholders equity at September 30, 2012, was $9.5 billion). Management believes that these restrictions will not have a material effect on CSC s ability to meet foreseeable dividend or funding requirements.

CSC also has direct access to $670 million of the $820 million uncommitted, unsecured bank credit lines discussed below, that are primarily utilized by Schwab to manage short-term liquidity. These lines were not used by CSC during the first nine months of 2012.

In addition, Schwab provides CSC with a $1.0 billion credit facility, maturing December 2014. There were no funds drawn under this facility at September 30, 2012.

Schwab

Schwab is subject to regulatory requirements that are intended to ensure the general financial soundness and liquidity of broker-dealers. These regulations prohibit Schwab from repaying subordinated borrowings from CSC, paying cash dividends, or making unsecured advances or loans to its parent company or employees if such payment would result in a net capital amount of less than 5% of aggregate debit balances or less than 120% of its minimum dollar requirement of $250,000. At September 30, 2012, Schwab s net capital was $1.4 billion (10% of aggregate debit balances), which was $1.1 billion in excess of its minimum required net capital and $692 million in excess of 5% of aggregate debit balances.

Schwab is also subject to Rule 15c3-3 under the Securities Exchange Act of 1934 and other applicable regulations that require it to maintain cash or qualified securities in a segregated reserve account for the exclusive benefit of clients. These funds are included in cash and investments segregated and on deposit for regulatory purposes in the Company s condensed consolidated balance sheets and are not available as a general source of liquidity.

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Most of Schwab s assets are readily convertible to cash, consisting primarily of short-term (i.e., less than 150 days) investment-grade, interest-earning investments (the majority of which are segregated for the exclusive benefit of clients pursuant to regulatory requirements), receivables from brokerage clients, and receivables from brokers, dealers, and clearing organizations. Client margin loans are demand loan obligations secured by readily marketable securities. Receivables from and payables to brokers, dealers, and clearing organizations primarily represent current open transactions, which usually settle, or can be closed out, within a few business days.

Liquidity needs relating to client trading and margin borrowing activities are met primarily through cash balances in brokerage client accounts, which were $32.8 billion and $33.5 billion at September 30, 2012 and December 31, 2011, respectively. Management believes that brokerage client cash balances and operating earnings will continue to be the primary sources of liquidity for Schwab.

Schwab has a finance lease obligation related to an office building and land under a 20-year lease. The remaining finance lease obligation of $95 million at September 30, 2012, is being reduced by a portion of the lease payments over the remaining lease term of 12 years.

To manage short-term liquidity, Schwab maintains uncommitted, unsecured bank credit lines with a group of six banks totaling $820 million at September 30, 2012. The need for short-term borrowings arises primarily from timing differences between cash flow requirements, scheduled liquidation of interest-earning investments, and movements of cash to meet regulatory brokerage client cash segregation requirements. Schwab used such borrowings for three days during the first nine months of 2012, with average daily amounts borrowed of $62 million. There were no borrowings outstanding under these lines at September 30, 2012.

To partially satisfy the margin requirement of client option transactions with the Options Clearing Corporation (OCC), Schwab has unsecured standby letter of credit agreements (LOCs) with six banks in favor of the OCC aggregating $325 million at September 30, 2012. In connection with its securities lending activities, Schwab is required to provide collateral to certain brokerage clients. Schwab satisfies the collateral requirements by arranging LOCs, in favor of these brokerage clients, which are issued by multiple banks. At September 30, 2012, the aggregate face amount of these LOCs totaled $99 million. There were no funds drawn under any of these LOCs during the first nine months of 2012.

To manage Schwab s regulatory capital requirement, CSC provides Schwab with a $1.4 billion subordinated revolving credit facility, which is scheduled to expire in March 2014. The amount outstanding under this facility at September 30, 2012, was $315 million. Borrowings under this subordinated lending arrangement qualify as regulatory capital for Schwab.

In addition, CSC provides Schwab with a $2.5 billion credit facility, which is scheduled to expire in December 2014. Borrowings under this facility do not qualify as regulatory capital for Schwab. There were no funds drawn under this facility at September 30, 2012.

Schwab Bank

Schwab Bank is subject to regulatory requirements that restrict and govern the terms of affiliate transactions, such as extensions of credit and repayment of loans between Schwab Bank and CSC or CSC s other subsidiaries. In addition, Schwab Bank is required to provide notice to and may be required to obtain approval of the OCC and the Federal Reserve to declare dividends to CSC.

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Schwab Bank is required to maintain capital levels as specified in federal banking laws and regulations. Failure to meet the minimum levels could result in certain mandatory, and possibly additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on Schwab Bank. Based on its regulatory capital ratios at September 30, 2012, Schwab Bank is considered well capitalized. Schwab Bank s regulatory capital and ratios at September 30, 2012, are as follows:

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 Risk-Based Capital	$ 5,584	21.7%	$ 1,031	4.0%	$ 1,547	6.0%
Total Risk-Based Capital	$ 5,639	21.9%	$ 2,062	8.0%	$ 2,578	10.0%
Tier 1 Leverage	$ 5,584	7.5%	$ 2,993	4.0%	$ 3,741	5.0%
Tangible Equity	$ 5,584	7.5%	$ 1,496	2.0%	N/A	

N/A Not applicable.

Management lowered its target Tier 1 Leverage Ratio for Schwab Bank from at least 7.5% to at least 6.25% in the third quarter of 2012. This change reflects Schwab Bank s approach to lending and investing, which results in a lower risk profile relative to the industry and risk-based capital ratios significantly in excess of well capitalized levels. This allows greater flexibility in managing capital resources to either support Schwab Bank s balance sheet growth or return capital to CSC. Schwab Bank s current liquidity needs are generally met through deposits from banking clients and equity capital.

The excess cash held in certain Schwab brokerage client accounts is swept into deposit accounts at Schwab Bank. At September 30, 2012, these balances totaled $48.5 billion.

Schwab Bank has access to traditional funding sources such as deposits, federal funds purchased, and repurchase agreements. Additionally, Schwab Bank has access to short-term funding through the Federal Reserve Bank (FRB) discount window. Amounts available under the FRB discount window are dependent on the fair value of certain of Schwab Bank s securities available for sale and/or securities held to maturity that are pledged as collateral. Schwab Bank maintains policies and procedures necessary to access this funding and tests discount window borrowing procedures annually. At September 30, 2012, $2.8 billion was available under this arrangement. There were no funds drawn under this arrangement during the first nine months of 2012.

Schwab Bank maintains a credit facility with the Federal Home Loan Bank System. Amounts available under this facility are dependent on the amount of Schwab Bank s residential real estate mortgages and HELOCs that are pledged as collateral. At September 30, 2012, $4.9 billion was available under this facility. There were no funds drawn under this facility during the first nine months of 2012.

CSC provides Schwab Bank with a $100 million short-term credit facility, which is scheduled to expire in December 2014. Borrowings under this facility do not qualify as regulatory capital for Schwab Bank. There were no funds drawn under this facility during the first nine months of 2012.

optionsXpress

optionsXpress, Inc., a wholly-owned subsidiary of optionsXpress, is a registered broker-dealer and is subject to regulatory requirements that are intended to ensure the general financial soundness and liquidity of broker-dealers. These regulations prohibit optionsXpress, Inc. from paying cash dividends or making unsecured advances or loans to its parent company or employees if such payment would result in a net capital amount

of less than 5% of aggregate debit balances or less than 120% of its minimum dollar requirement of $250,000. At September 30, 2012, optionsXpress, Inc. s net capital was $78 million (33% of aggregate debit balances), which was $73 million in excess of its minimum required net capital and $66 million in excess of 5% of aggregate debit balances.

optionsXpress, Inc. is also subject to Commodity Futures Trading Commission Regulation 1.17 (Reg. 1.17) under the Commodity Exchange Act, which also requires the maintenance of minimum net capital. optionsXpress, Inc. as a futures

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commission merchant, is required to maintain minimum net capital equal to the greater of its net capital requirement under Reg. 1.17 ($1 million), or the sum of 8% of the total risk margin requirements for all positions carried in customer accounts and 8% of the total risk margin requirements for all positions carried in non-customer accounts (as defined in Reg. 1.17).

Additionally, optionsXpress, Inc. is subject to Rule 15c3-3 under the Securities Exchange Act of 1934 and other applicable regulations that require it to maintain cash or qualified securities in a segregated reserve account for the exclusive benefit of clients. These funds are included in cash and investments segregated and on deposit for regulatory purposes in the Company s condensed consolidated balance sheets and are not available as a general source of liquidity.

Liquidity needs relating to client trading and margin borrowing activities are met primarily through cash balances in brokerage client accounts, which were $1.2 billion at September 30, 2012. Management believes that brokerage client cash balances and operating earnings will continue to be the primary sources of liquidity for optionsXpress, Inc.

CSC provides optionsXpress, Inc. with a $100 million credit facility, which is scheduled to expire in December 2014. The amount outstanding under this facility at September 30, 2012, was $60 million. Borrowings under this facility do not qualify as regulatory capital for optionsXpress, Inc.

optionsXpress has a term loan with CSC, of which $95 million was outstanding at September 30, 2012, and it matures in December 2014.

Capital Resources

The Company monitors both the relative composition and absolute level of its capital structure. Management is focused on limiting the Company s use of capital and currently targets a long-term debt to total financial capital ratio not to exceed 30%. The Company s total financial capital (long-term debt plus stockholders equity) at September 30, 2012, was $11.2 billion, up $1.5 billion, or 16%, from December 31, 2011.

At September 30, 2012, the Company had long-term debt of $1.8 billion, or 16% of total financial capital, that bears interest at a weighted-average rate of 4.73%. At December 31, 2011, the Company had long-term debt of $2.0 billion, or 21% of total financial capital. In August 2012, CSC completed an exchange offer with certain eligible holders of its Old Senior Notes, whereby Old Senior Notes in an aggregate principal amount of $256 million were exchanged for the same aggregate principal amount of New Senior Notes and cash consideration of $19 million. On August 31, 2012, CSC redeemed all of the fixed-to-floating rate trust preferred securities issued by the Trust of which $202 million in principal was outstanding for $207 million, which included accumulated and unpaid distributions up to and including the redemption date. The trust preferred securities were redeemed, along with the common securities issued by the Trust and held by CSC, as a result of the concurrent redemption in whole by CSC of the Junior Subordinated Notes held by the Trust which underlay the trust preferred securities. In addition, the Company repaid $5 million of other long-term debt in the first nine months of 2012.

The Company s cash position (reported as cash and cash equivalents on its condensed consolidated balance sheets) and cash flows are affected by changes in brokerage client cash balances and the associated amounts required to be segregated under regulatory guidelines. Timing differences between cash and investments actually segregated on a given date and the amount required to be segregated for that date may arise in the ordinary course of business, and are addressed by the Company in accordance with applicable regulations. Other factors which affect the Company s cash position and cash flows include investment activity in securities, levels of capital expenditures, acquisition and divestiture activity, banking client deposit activity, brokerage and banking client loan activity, financing activity in long-term debt, payments of dividends, and repurchases and issuances of CSC s preferred and common stock. The combination of these factors can cause significant fluctuations in the cash position during specific time periods.

Equity Offerings

In June 2012, the Company issued and sold 485,000 shares of 6.00% non-cumulative perpetual preferred stock, Series B, with a liquidation preference of $1,000 per share for net proceeds of $469 million (Series B Preferred Stock). In January 2012, the Company issued and sold 400,000 shares of fixed-to-floating rate (currently fixed at 7.000%) non-cumulative perpetual preferred stock, Series A, with a liquidation preference of $1,000 per share for net proceeds of $394 million

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(Series A Preferred Stock). Net proceeds received from these sales are being used for general corporate purposes, which may include, without limitation, extending credit to, or funding investments in, the Company s subsidiaries, and the possible refinancing of outstanding indebtedness. For further discussion of these equity offerings, see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 9. Preferred Stock.

Capital Expenditures

The Company s capital expenditures were $98 million and $135 million in the first nine months of 2012 and 2011, respectively. Capital expenditures in the first nine months of 2012 and 2011 were primarily for capitalized costs for developing internal-use software, software and equipment relating to the Company s information technology systems, and leasehold improvements. Capitalized costs for developing internal-use software were $45 million and $40 million in the first nine months of 2012 and 2011, respectively.

As discussed in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, management anticipated that 2012 capital expenditures would be 30% lower than 2011 spending. Due primarily to increased spending on capitalized costs for developing internal-use software and software relating to the Company s information technology systems, management currently anticipates that full-year 2012 capital expenditures will be approximately 20% lower than 2011 levels.

Dividends

CSC paid common stock cash dividends of $231 million ($0.18 per share) and $218 million ($0.18 per share) in the first nine months of 2012 and 2011, respectively.

CSC paid Series A Preferred Stock cash dividends of $14 million ($36.17 per share) and Series B Preferred Stock cash dividends of $7 million ($14.17 per share) in the first nine months of 2012. Under the respective terms of the Series A Preferred Stock and Series B Preferred Stock, the Company s ability to pay dividends on, make distributions with respect to, or to repurchase, redeem or acquire its common stock or any preferred stock ranking on parity with or junior to the relevant series of preferred stock, is subject to restrictions in the event that the Company does not declare and either pay or set aside a sum sufficient for payment of dividends on the relevant series of preferred stock for the immediately preceding dividend period. For further discussion of the Series A and Series B Preferred Stock offerings, see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 9. Preferred Stock.

Share Repurchases

There were no repurchases of CSC s common stock in the first nine months of 2012 or 2011. As of September 30, 2012, CSC had remaining authority from the Board of Directors to repurchase up to $596 million of its common stock, which does not have an expiration date.

Business Acquisition

On September 1, 2011, the Company completed its acquisition of all of the outstanding common shares of optionsXpress, an online brokerage firm primarily focused on equity option securities and futures, for total consideration of $714 million. Under the terms of the merger agreement, optionsXpress stockholders received 1.02 shares of the Company s common stock for each share of optionsXpress stock. As a result, the Company issued 59 million shares of the Company s common stock valued at $710 million, based on the closing price of the Company s common stock on September 1, 2011. The Company also assumed optionsXpress stock-based compensation awards valued at $4 million.

Off-Balance Sheet Arrangements

The Company enters into various off-balance sheet arrangements in the ordinary course of business, primarily to meet the needs of its clients. These arrangements include firm commitments to extend credit. Additionally, the Company enters into guarantees and other similar

arrangements as part of transactions in the ordinary course of business. For discussion on the Company s off-balance sheet arrangements, see Part II Item 7 Management s Discussion and Analysis of Financial

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Condition and Results of Operations Liquidity and Capital Resources in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, and Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 7. Commitments and Contingencies.

RISK MANAGEMENT

The Company s business activities expose it to a variety of risks, including technology, operations, credit, market, liquidity, legal, and reputational. Identification and management of these risks are essential to the success and financial soundness of the Company.

For a discussion on risks that the Company faces and the policies and procedures for risk identification, assessment, and management, see Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Risk Management in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. For updated information on the Company s credit risk and concentration risk exposures, see below. See Item 3 Quantitative and Qualitative Disclosures About Market Risk for additional information relating to market risk.

Risk is inherent in the Company s business. Consequently, despite the Company s efforts to identify areas of risk and implement risk management policies and procedures, there can be no assurance that the Company will not suffer unexpected losses due to operating or other risks.

Credit Risk Exposures

The Company s credit risk exposure related to loans to banking clients is actively managed through individual and portfolio reviews performed by management. Management regularly reviews asset quality, including concentrations, delinquencies, nonaccrual loans, charge-offs, and recoveries. All are factors in the determination of an appropriate allowance for loan losses, which is reviewed quarterly by management. The Company s mortgage loan portfolios primarily include first lien residential real estate mortgage loans (First Mortgage) of $6.0 billion and HELOCs of $3.3 billion at September 30, 2012.

The Company s First Mortgage portfolio underwriting requirements are generally consistent with the underwriting requirements in the secondary market for loan portfolios. The Company s guidelines include maximum loan-to-value (LTV) ratios, cash out limits, and minimum Fair Isaac Corporation (FICO) credit scores. The specific guidelines are dependent on the individual characteristics of a loan (for example, whether the property is a primary or secondary residence, whether the loan is for investment property, whether the loan is for an initial purchase of a home or refinance of an existing home, and whether the loan is conforming or jumbo). These credit underwriting standards have limited the exposure to the types of loans that experienced high foreclosures and loss rates elsewhere in the industry in recent years. There have been no significant changes to the LTV ratio or FICO credit score guidelines related to the Company s First Mortgage or HELOC portfolios during the first nine months of 2012. At September 30, 2012, the weighted-average originated LTV ratios were 60% and 59% for the First Mortgage and HELOC portfolios, respectively. The computation of the origination LTV ratio for a HELOC includes any first lien mortgage outstanding on the same property at the time of origination. At September 30, 2012, 22% of HELOCs ($735 million of the HELOC portfolio) were in a first lien position. The weighted-average originated FICO credit scores were 767 and 768 for the First Mortgage and HELOC portfolios, respectively.

The Company does not offer loans that allow for negative amortization and does not originate or purchase subprime loans (generally defined as extensions of credit to borrowers with a FICO credit score of less than 620 at origination), unless the borrower has compensating credit factors. At September 30, 2012, approximately 1% of both the First Mortgage and HELOC portfolios consisted of loans to borrowers with FICO credit scores of less than 620.

The Company monitors the estimated current LTV ratios of its First Mortgage and HELOC portfolios on an ongoing basis. At September 30, 2012, the weighted-average estimated current LTV ratios were 60% and 69% for the First Mortgage and HELOC portfolios, respectively. The computation of the estimated current LTV ratio for a HELOC includes any first lien mortgage outstanding on the same property at the time of the HELOC s origination. The Company estimates the current LTV ratio for each loan by reference to a home price appreciation index. The Company also monitors updated borrower

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FICO scores, delinquency trends, and verified liquid assets held by individual borrowers. At September 30, 2012, the weighted-average updated FICO scores were 769 for both the First Mortgage and HELOC portfolios.

A portion of the Company s HELOC portfolio is secured by second liens on the associated properties. Second lien mortgage loans possess a higher degree of credit risk given the subordination to the first lien holder in the event of default. At September 30, 2012, 78% of the HELOCs ($2.6 billion of the HELOC portfolio) were in a second lien position. In addition to the credit monitoring activities described above, the Company also monitors credit risk on second lien HELOC loans by reviewing the delinquency status of the first lien loan on the associated property, when such status is available. The portion of the Company s second lien HELOC portfolio for which the Company either holds the first lien or has the ability to monitor the delinquency status of the related first mortgage was $626 million, or 19%, of the HELOC portfolio at September 30, 2012. Additionally, at September 30, 2012, approximately 35% of the HELOC borrowers that had a balance only paid the minimum amount due.

For more information on the Company s credit quality indicators relating to its First Mortgage and HELOC portfolios, including delinquency characteristics, borrower FICO scores at origination, updated borrower FICO scores, LTV ratios at origination, and estimated current LTV ratios, see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 5. Loans to Banking Clients and Related Allowance for Loan Losses.

The following table presents certain of the Company s loan quality metrics as a percentage of total outstanding loans:

	September 30, 2012	December 31, 2011
Loan delinquencies [(1)]	0.90%	0.81%
Nonaccrual loans	0.45%	0.53%
Allowance for loan losses	0.56%	0.55%

(1) Loan delinquencies are defined as loans that are 30 days or more past due.

The Company has exposure to credit risk associated with its securities available for sale and securities held to maturity portfolios, whose fair values totaled $42.4 billion and $16.2 billion at September 30, 2012, respectively. These portfolios include U.S. agency and non-agency residential mortgage-backed securities, corporate debt securities, certificates of deposit, commercial paper, U.S. agency notes, and asset-backed and other securities. U.S. agency residential mortgage-backed securities do not have explicit credit ratings, however, management considers these to be of the highest credit quality and rating given the guarantee of principal and interest by the U.S. government-sponsored enterprises. Included in non-agency residential mortgage-backed securities are securities collateralized by loans that are considered to be Prime (defined by the Company as loans to borrowers with a FICO credit score of 620 or higher at origination), and Alt-A (defined by the Company as Prime loans with reduced documentation at origination).

Residential mortgage-backed securities, particularly Alt-A securities, experienced continued credit deterioration in the first nine months of 2012, including increased payment delinquency rates and losses on foreclosures of underlying mortgages. For a discussion of the impact of current market conditions on residential mortgage-backed securities, see Current Market and Regulatory Environment and Other Developments. At September 30, 2012, the amortized cost of non-agency residential mortgage-backed securities represented 2% of the total residential mortgage-backed securities portfolio. These securities were originated between 2003 and 2007. At September 30, 2012, all of the corporate debt securities and non-mortgage asset-backed securities were rated investment grade (defined as a rating equivalent to a Moody s rating of Baa or higher, or a Standard & Poor s rating of BBB- or higher).

Concentration Risk Exposures

The Company has exposure to concentration risk when holding large positions in financial instruments collateralized by assets with similar economic characteristics or in securities of a single issuer or industry.

The fair value of the Company s investments in residential mortgage-backed securities totaled $40.6 billion at September 30, 2012. Of these, $39.8 billion were issued by U.S. agencies and $782 million were issued by private entities (non-agency

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securities). The U.S. agency securities are included in securities available for sale and securities held to maturity and the non-agency securities are included in securities available for sale. Included in non-agency residential mortgage-backed securities are securities collateralized by Alt-A loans. At September 30, 2012, the amortized cost and fair value of Alt-A mortgage-backed securities were $326 million and $280 million, respectively.

The Company s investments in corporate debt securities and commercial paper totaled $7.6 billion at September 30, 2012, with the majority issued by institutions in the financial services industry. These securities are included in securities available for sale, securities held to maturity, cash and investments segregated and on deposit for regulatory purposes, cash and cash equivalents, and other securities owned in the Company s condensed consolidated balance sheets. At September 30, 2012, the Company held $535 million of corporate debt securities issued by financial institutions and guaranteed under the FDIC Temporary Liquidity Guarantee Program.

The Company s loans to banking clients include $5.5 billion of adjustable rate first lien residential real estate mortgage loans at September 30, 2012. The Company s adjustable rate mortgages have initial fixed interest rates for three to ten years and interest rates that adjust annually thereafter. Approximately 55% of these mortgages consisted of loans with interest-only payment terms. The interest rates on approximately 65% of these interest-only loans are not scheduled to reset for three or more years. The Company s mortgage loans do not include interest terms described as temporary introductory rates below current market rates. At September 30, 2012, 44% of the residential real estate mortgages and 50% of the HELOC balances were secured by properties which are located in California.

The Company s HELOC product has a 30-year loan term with an initial draw period of 10 years from the date of origination. After the initial draw period, the balance outstanding at such time is converted to a 20-year amortizing loan. The interest rate during the initial draw period and the 20-year amortizing period is a floating rate based on the prime rate plus a margin. The following table presents when current outstanding HELOCs will convert to amortizing loans:

September 30, 2012	**Balance**
Within 1 year	$ 49
> 1 year 3 years	645
> 3 years 5 years	464
> 5 years	2,188
Total	$ 3,346

As of September 30, 2012, all of the Company s HELOC loans are within the 10-year initial draw period, and as such, none of the HELOCs have converted to an amortizing loan.

The Company also has exposure to concentration risk from its margin and securities lending activities collateralized by securities of a single issuer or industry.

The Company has indirect exposure to U.S. Government and agency securities held as collateral to secure its resale agreements. The Company s primary credit exposure on these resale transactions is with its counterparty. The Company would have exposure to the U.S. Government and agency securities only in the event of the counterparty s default on the resale agreements. The fair value of U.S. Government and agency securities held as collateral for resale agreements totaled $18.2 billion at September 30, 2012.

European Holdings

The Company has exposure to non-sovereign financial institutions in Europe. The following table shows the amortized cost and fair values of cash equivalents, cash and investments segregated and on deposit for regulatory purposes, securities available for sale, and securities held to maturity by each country in Europe in which the issuer or counterparty is domiciled. The Company has no direct exposure to sovereign governments in Europe. The Company does not have unfunded commitments to counterparties in Europe, nor does it have exposure as a result of credit default protection purchased or sold separately as of September 30, 2012.

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	Fair Value as of September 30, 2012								
	Denmark [1]	France	Germany	Netherlands	Norway	Sweden	Switzerland	United Kingdom	Total
Cash equivalents:									
Time deposits	$	$ 408	$ 144	$	$ 300	$	$	$ 300	$ 1,152
Commercial paper		100							100
Cash and investments segregated and on deposit for regulatory purposes:									
Trust deposits			62						62
Securities available for sale:									
Certificates of deposit		100	300	100	100	702	802	1,000	3,104
Corporate debt securities	213			193		100		326	832
Commercial paper								299	299
Securities held to maturity:									
Corporate debt securities							100		100
Total fair value	$ 213	$ 608	$ 506	$ 293	$ 400	$ 802	$ 902	$ 1,925	$ 5,649
Total amortized cost	$ 212	$ 608	$ 506	$ 292	$ 400	$ 800	$ 900	$ 1,922	$ 5,640
Maturities:									
Overnight	$	$ 408	$ 206	$	$ 300	$	$	$ 300	$ 1,214
1 day < 6 months		200	300	70	100	200	76	1,200	2,146
6 months < 1 year	213					301	551	223	1,288
1 year 2 years				223		301	175	99	798
> 2 years							100	103	203
Total fair value	$ 213	$ 608	$ 506	$ 293	$ 400	$ 802	$ 902	$ 1,925	$ 5,649

(1) The exposures in Denmark are also backed by the full faith and credit of the Denmark government.

In addition to the direct holdings of European companies listed above, the Company also has indirect exposure to Europe through its investments in Schwab sponsored money market funds (collectively, the Funds) resulting from clearing activities. At September 30, 2012, the Company had $244 million in investments in these Funds. Certain of the Funds positions include certificates of deposits, time deposits, commercial paper and corporate debt securities issued by counterparties in Europe.

CRITICAL ACCOUNTING ESTIMATES

Certain of the Company s accounting policies that involve a higher degree of judgment and complexity are discussed in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. There have been no changes to these critical accounting estimates during the first nine months of 2012.

As disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, the Company s annual goodwill impairment testing date is April 1. In testing for a potential impairment of goodwill on April 1, 2012, management estimated the fair value of each of the Company s reporting units (generally defined as the Company s businesses for which financial information is available and reviewed regularly by management) and compared this value to the carrying value of the reporting unit. The estimated fair value of each reporting unit exceeded its carrying value, and therefore management concluded that goodwill was not impaired.

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FORWARD-LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are identified by words such as believe, anticipate, expect, intend, plan, will, may, estimate, appear, aim, target, could, and other similar expres statements that refer to expectations, projections, or other characterizations of future events or circumstances are forward-looking statements.

These forward-looking statements, which reflect management s beliefs, objectives, and expectations as of the date hereof, are necessarily estimates based on the best judgment of the Company s senior management. These statements relate to, among other things:

- the impact of current market conditions on the Company s results of operations (see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 4. Securities Available for Sale and Securities Held to Maturity and Current Market and Regulatory Environment and Other Developments);
- the expected impact of the Federal Reserve s NPRs (see Current Market and Regulatory Environment and Other Developments);
- the impact of changes in the likelihood of guarantee payment obligations on the Company s results of operations (see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 7. Commitments and Contingencies);
- the impact of legal proceedings and regulatory matters (see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 7. Commitments and Contingencies and Part II Other Information Item 1 Legal Proceedings);
- target capital ratios (see Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 12. Regulatory Requirements and Liquidity and Capital Resources);
- sources of liquidity, capital, and level of dividends (see Liquidity and Capital Resources); and
- capital expenditures (see Liquidity and Capital Resources Capital Resources).

Achievement of the expressed beliefs, objectives, and expectations described in these statements is subject to certain risks and uncertainties that could cause actual results to differ materially from the expressed beliefs, objectives, and expectations. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q or, in the case of documents incorporated by reference, as of the date of those documents.

Important factors that may cause actual results to differ include, but are not limited to:

changes in general economic and financial market conditions;

changes in revenues and profit margin due to changes in interest rates;

the Company s ability to attract and retain clients and grow client assets and relationships;

the Company s ability to develop and launch new products, services and capabilities in a timely and successful manner;

fluctuations in client asset values due to changes in equity valuations;

the Company s ability to monetize client assets;

the performance or valuation of securities available for sale and securities held to maturity;

trading activity;

the level of interest rates, including yields available on money market mutual fund eligible instruments;

the adverse impact of financial reform legislation and related regulations;

potential breaches of contractual terms for which the Company has guarantee obligations;

adverse developments in litigation or regulatory matters;

amounts recovered on insurance policies;

the extent of any charges associated with litigation and regulatory matters;

the amount of loans to the Company s brokerage and banking clients;

the level of the Company s stock repurchase activity;

capital needs;

level of expenses;

acquisition integration costs;

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Management s Discussion and Analysis of Financial Condition and Results of Operations

(Tabular Amounts in Millions, Except Ratios, or as Noted)

- the level of brokerage client cash balances and deposits from banking clients;
- the availability and terms of external financing; and
- timing and impact of changes in the Company s level of investments in software.

Certain of these factors, as well as general risk factors affecting the Company, are discussed in greater detail in Part I Item 1A Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, and Part II Other Information Item 1A Risk Factors.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the potential for changes in revenue or the value of financial instruments held by the Company as a result of fluctuations in interest rates, equity prices or market conditions.

For the Company s market risk related to interest rates, a sensitivity analysis, referred to as a net interest revenue simulation model, is shown below. The Company is exposed to interest rate risk primarily from changes in market interest rates on its interest-earning assets relative to changes in the costs of its funding sources that finance these assets.

Net interest revenue is affected by various factors, such as the distribution and composition of interest-earning assets and interest-bearing liabilities, the spread between yields earned on interest-earning assets and rates paid on interest-bearing liabilities, which may reprice at different times or by different amounts, and the spread between short and long-term interest rates. Interest-earning assets include residential real estate loans and mortgage-backed securities. These assets are sensitive to changes in interest rates and to changes to prepayment levels, which tend to increase in a declining rate environment.

To mitigate the risk of loss, the Company has established policies and procedures which include setting guidelines on the amount of net interest revenue at risk, and monitoring the net interest margin and average maturity of its interest-earning assets and funding sources. To remain within these guidelines, the Company manages the maturity, repricing, and cash flow characteristics of the investment portfolios. Because the Company establishes the rates paid on certain brokerage client cash balances and deposits from banking clients, the rates charged on margin loans, and controls the composition of its investment securities, it has some ability to manage its net interest spread, depending on competitive factors and market conditions.

The Company is also subject to market risk as a result of fluctuations in equity prices. The Company s direct holdings of equity securities and its associated exposure to equity prices are not material. The Company is indirectly exposed to equity market fluctuations in connection with securities collateralizing margin loans to brokerage customers, and customer securities loaned out as part of the Company s securities lending activities. Equity market valuations may also affect the level of brokerage client trading activity, margin borrowing, and overall client engagement with the Company. Additionally, the Company earns mutual fund service fees and asset management fees based upon daily balances of certain client assets. Fluctuations in these client asset balances caused by changes in equity valuations directly impact the amount of fee revenue earned by the Company.

Financial instruments held by the Company are also subject to liquidity risk that is, the risk that valuations will be negatively affected by changes in demand and the underlying market for a financial instrument. Recent conditions in the credit markets have significantly reduced market liquidity in a wide range of financial instruments, including the types of instruments held by the Company, and fair value can differ significantly from the value implied by the credit quality and actual performance of the instrument s underlying cash flows.

Financial instruments held by the Company are also subject to valuation risk as a result of changes in valuations of the underlying collateral, such as housing prices in the case of residential real estate loans and mortgage-backed securities.

For discussion of the impact of current market conditions on asset management and administration fees, net interest revenue, and securities available for sale, see Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations Current Market and Regulatory Environment and Other Developments.

The Company s market risk related to financial instruments held for trading and forward sale and interest rate lock commitments related to its loans held for sale portfolio is not material.

Net Interest Revenue Simulation

The Company uses net interest revenue simulation modeling techniques to evaluate and manage the effect of changing interest rates. The simulation model (the model) includes all interest-sensitive assets and liabilities. Key variables in the model include the repricing of financial instruments, prepayment, reinvestment, and product pricing assumptions. The Company uses constant balances and market rates in the model assumptions in order to minimize the number of variables

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and to better isolate risks. The simulations involve assumptions that are inherently uncertain and, as a result, cannot precisely estimate net interest revenue or predict the impact of changes in interest rates on net interest revenue. Actual results may differ from simulated results due to balance growth or decline and the timing, magnitude, and frequency of interest rate changes, as well as changes in market conditions and management strategies, including changes in asset and liability mix.

As represented by the simulations presented below, the Company s investment strategy is structured to produce an increase in net interest revenue when interest rates rise and, conversely, a decrease in net interest revenue when interest rates fall (i.e., interest-earning assets generally reprice more quickly than interest-bearing liabilities).

The simulations in the following table assume that the asset and liability structure of the consolidated balance sheet would not be changed as a result of the simulated changes in interest rates. As the Company actively manages its consolidated balance sheet and interest rate exposure, in all likelihood the Company would take steps to manage any additional interest rate exposure that could result from changes in the interest rate environment. The following table shows the results of a gradual 100 basis point increase or decrease in market interest rates relative to the Company s current market rates forecast on simulated net interest revenue over the next 12 months beginning September 30, 2012 and December 31, 2011.

	September 30, 2012	December 31, 2011
Increase of 100 basis points	20.7%	19.1%
Decrease of 100 basis points	(9.7%)	(8.1%)

The sensitivities shown in the simulation reflect the fact that short-term interest rates in the first nine months of 2012 remained at historically low levels, including the federal funds target rate, which was unchanged at a range of zero to 0.25%. The current low interest rate environment limits the extent to which the Company can reduce interest expense paid on funding sources in a declining interest rate scenario. A decline in interest rates could therefore negatively impact the yield on the Company s investment portfolio to a greater degree than any offsetting reduction in interest expense, further compressing net interest margin. Any increases in short-term interest rates result in a greater impact as yields on interest-earning assets are expected to rise faster than the cost of funding sources.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures: The management of the Company, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of September 30, 2012. Based on this evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that the Company s disclosure controls and procedures were effective as of September 30, 2012.

Changes in internal control over financial reporting: No change in the Company s internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) was identified during the quarter ended September 30, 2012, that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

For a discussion of legal proceedings, see Part I Financial Information Item 1 Condensed Consolidated Financial Statements (Unaudited) Notes 7. Commitments and Contingencies.

Item 1A. Risk Factors

During the first nine months of 2012, there have been no material changes to the risk factors in Part I Item 1A Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

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

Issuer Purchases of Equity Securities

The following table summarizes purchases made by or on behalf of CSC of its common stock for each calendar month in the third quarter of 2012:

Month	Total Number of Shares Purchased (in thousands)		Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program [1] (in thousands)		Approximate Dollar Value of Shares that May Yet be Purchased Under the Program (in millions)
July:						
Share repurchase program [1]		$			$	596
Employee transactions [2]	6	$	12.87	N/A		N/A
August:						
Share repurchase program [1]		$			$	596
Employee transactions [2]	6	$	13.08	N/A		N/A
September:						
Share repurchase program [1]		$			$	596
Employee transactions [2]	7	$	13.99	N/A		N/A
Total:						
Share repurchase program [1]		$			$	596
Employee transactions [2]	19	$	13.34	N/A		N/A

N/A Not applicable.

(1) There were no share repurchases under the Share Repurchase Program during the third quarter. Repurchases under this program would occur under two authorizations by CSC s Board of Directors, each covering up to $500 million of common stock that were publicly announced by the Company on April 25, 2007, and March 13, 2008. The remaining authorizations do not have an expiration date.

(2) Includes restricted shares withheld (under the terms of grants under employee stock incentive plans) to offset tax withholding obligations that occur upon vesting and release of restricted shares. The Company may receive shares delivered or attested to pay the exercise price and/or to satisfy tax withholding obligations by employees who exercise stock options (granted under employee stock incentive plans), which are commonly referred to as stock swap exercises.

Item 3. Defaults Upon Senior Securities

None.

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Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

The following exhibits are filed as part of this Quarterly Report on Form 10-Q.

Exhibit Number	Exhibit	
4.25	Third Supplemental Indenture, dated as of August 27, 2012, between the Company and The Bank of New York Mellon Trust Company, N.A., filed as Exhibit 4.25 to the Registrant s Form 8-K dated August 27, 2012, and incorporated herein by reference.	
4.26	Form of QIB Global Note for the Company s 3.225% Senior Notes due 2022, filed as Exhibit 4.26 to the Registrant s Form 8-K dated August 27, 2012, and incorporated herein by reference.	
4.27	Form of Regulation S Global Note for the Company s 3.225% Senior Notes due 2022, filed as Exhibit 4.27 to the Registrant s Form 8-K dated August 27, 2012, and incorporated herein by reference.	
4.28	Exchange and Registration Rights Agreement, dated August 27, 2012, by and among the Company and Citigroup Global Markets Inc., Goldman Sachs & Co. and Wells Fargo Securities, LLC, filed as Exhibit 4.28 to the Registrant s Form 8-K dated August 27, 2012, and incorporated herein by reference.	
10.298	Directed Employee Benefit Trust Agreement under the SchwabPlan Retirement Savings and Investment Plan dated August 17, 2007.	(1)
12.1	Computation of Ratio of Earnings to Fixed Charges and Ratio of Earnings to Fixed Charges and Preferred Stock Dividends.	
31.1	Certification Pursuant to Rule 13a-14(a)/15d-14(a), As Adopted Pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.	
31.2	Certification Pursuant to Rule 13a-14(a)/15d-14(a), As Adopted Pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.	
32.1	Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.	(2)
32.2	Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.	(2)
101.INS	XBRL Instance Document	(3)
101.SCH	XBRL Taxonomy Extension Schema	(3)
101.CAL	XBRL Taxonomy Extension Calculation	(3)
101.DEF	XBRL Extension Definition	(3)
101.LAB	XBRL Taxonomy Extension Label	(3)
101.PRE	XBRL Taxonomy Extension Presentation	(3)

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Exhibit Number	Exhibit

(1) *Management contract or compensatory plan.*

(2) *Furnished as an exhibit to this Quarterly Report on Form 10-Q.*

(3) *Attached as Exhibit 101 to this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2012 are the following materials formatted in XBRL (Extensible Business Reporting Language) (i) the Condensed Consolidated Statements of Income, (ii) the Condensed Consolidated Statements of Comprehensive Income, (iii) the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements.*

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SIGNATURE

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.

THE CHARLES SCHWAB CORPORATION
(Registrant)

Date: November 6, 2012

/s/ Joseph R. Martinetto
Joseph R. Martinetto
Executive Vice President and Chief Financial Officer