

SCHWAB CHARLES CORP  
Form 10-Q  
November 07, 2016  
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, 2016

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 (I.R.S. Employer Identification No.)

of incorporation or organization)

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

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 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

Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

1,325,672,135 shares of \$.01 par value Common Stock

Outstanding on October 26, 2016

THE CHARLES SCHWAB CORPORATION

Quarterly Report on Form 10-Q

For the Quarter Ended September 30, 2016

Index

<u>Part I - Financial Information</u>	Page
Item 1. <u>Condensed Consolidated Financial Statements (Unaudited):</u>	
<u>Statements of Income</u>	28
<u>Statements of Comprehensive Income</u>	29
<u>Balance Sheets</u>	30
<u>Statements of Cash Flows</u>	31
<u>Notes</u>	32-56
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	1-25
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	26-27
Item 4. <u>Controls and Procedures</u>	57
<u>Part II - Other Information</u>	
Item 1. <u>Legal Proceedings</u>	58
Item 1A. <u>Risk Factors</u>	58
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	58
Item 3. <u>Defaults Upon Senior Securities</u>	59

Item 4.	<u>Mine Safety Disclosures</u>	59
Item 5.	<u>Other Information</u>	59
Item 6.	<u>Exhibits</u>	60-61
	<u>Signature</u>	62

---

Part I – FINANCIAL INFORMATION

THE CHARLES SCHWAB CORPORATION

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

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)

INTRODUCTION

The Charles Schwab Corporation (CSC) is a savings and loan holding company engaged, through its subsidiaries, in wealth management, securities brokerage, banking, money management, custody, and financial advisory services. Charles Schwab & Co., Inc. (Schwab) is a securities broker-dealer with over 330 domestic branch offices in 46 states, as well as a branch in each of the Commonwealth of Puerto Rico and London, England. 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 (ETFs), which are referred to as the Schwab ETFs™.

CSC and its subsidiaries (collectively, referred to as the Company) operate through two reportable segments – Investor Services and Advisor Services. The Investor Services segment provides retail brokerage and banking services, retirement plan services, and other corporate brokerage services. The Advisor Services segment provides custodial, trading, and support services as well as retirement business services.

This quarterly report on Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2015 (2015 Form 10-K).

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,” “would,” “continue,” and other similar expressions. In addition, any statements 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 expected impact of the final Department of Labor fiduciary rule and the proposed rule relating to a regulatory capital deduction for investments in unsecured debt issued by global systemically important banking organizations (see “Part I, Item 2. – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Overview – Current Regulatory Environment and Other Developments”);
  - the impact of current market conditions and interest rates on the Company’s results of operations (see “Part I, Item 2. – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Overview” and “– Results of Operations – Net Interest Revenue”);
  - sources of liquidity, capital, and level of dividends (see “Part I, Item 2. – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity”);
  - the timing of bulk transfers (see “Part I, Item 2. – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity”);
  - target capital ratios (see “Part I, Item 2. – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Management – Regulatory Capital Requirements”);
  - the likelihood of indemnification and guarantee payment obligations (see “Part I, Item 1. – Condensed Consolidated Financial Statements (Unaudited) – Notes – 8. Commitments and Contingencies – Guarantees and indemnifications”);
- and

- 1 -

---

THE CHARLES SCHWAB CORPORATION

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

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

- the impact of legal proceedings and regulatory matters (see "Part I, Item 1. – Condensed Consolidated Financial Statements (Unaudited) – Notes – 8. Commitments and Contingencies – Legal contingencies" and "Part II, Item 1. – Legal Proceedings").

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:

- the clarification and interpretation of certain provisions in the final Department of Labor rule concerning fiduciary standards;
- the adverse impact of financial reform legislation and related regulations;
- general market conditions, including the level of interest rates, equity valuations and trading activity;
- the Company's ability to attract and retain clients and registered investment advisors and grow those relationships and client assets;
- client use of the Company's investment advisory services and other products and services;
- the level of client assets, including cash balances;
- competitive pressure on rates and fees;
- client sensitivity to interest rates;
- regulatory guidance;
- timing, amount and impact of the migration of certain balances from brokerage accounts and sweep money market funds into Schwab Bank;
- capital needs and management;
- the availability and terms of external financing;
  - the company's ability to manage expenses;
- the failure of another member of a securities clearing house or exchange to satisfy its obligations for which the Company has a guarantee obligation; and
- the effect of adverse developments in litigation or regulatory matters and the extent of any related charges.

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 2015 Form 10-K, and "Part II – Other Information – Item 1A – Risk Factors."





THE CHARLES SCHWAB CORPORATION

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

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

GLOSSARY OF TERMS

Active brokerage accounts: Brokerage accounts with activity within the preceding eight months.

Asset-backed securities: Debt securities backed by financial assets such as loans or receivables.

Assets receiving ongoing advisory services: Client relationships under the guidance of independent advisors and assets enrolled in one of the Company's retail or other advisory solutions.

Average client assets: The daily average client asset balance for the period.

Basel III: Global regulatory standards on bank capital adequacy and liquidity issued by the Basel Committee on Banking Supervision.

Basis point: One basis point equals 1/100th of 1%, or 0.01%.

Cash and investments segregated and on deposit for regulatory purposes: Client cash or qualified securities balances not used for margin lending are segregated into investment accounts maintained for the exclusive benefit of clients, pursuant to Rule 15c3-3 of the Securities Exchange Act of 1934, by the Company's broker-dealer subsidiaries.

Client assets: The market value of all client assets custodied at the Company, which includes both cash and securities, at a point in time.

## Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Client cash as a percentage of client assets: Calculated as money market fund balances, bank deposits, Schwab One® balances, and certain cash equivalents as a percentage of client assets.

Clients' daily average trades: Includes daily average revenue trades by clients, trades by clients in asset-based pricing relationships, and all commission-free trades.

Commitments to extend credit: Legally binding agreements to extend credit for unused home equity loans and lines of credit (HELOCs), Pledged Asset Lines® (PALs) and other lines of credit.

Common Equity Tier 1 (CET1) Capital: The sum of common stock and related surplus net of treasury stock, retained earnings, accumulated other comprehensive income (AOCI) and qualifying minority interests, less applicable regulatory adjustments and deductions.

Common Equity Tier 1 Risk-Based Capital Ratio: The ratio of CET1 Capital to total risk-weighted assets.

Concentration risk: The potential for loss resulting from holding large positions in financial instruments collateralized by assets with similar economic characteristics or in securities of a single issuer or particular industry or geographical area.

Core net new client assets: Net new client assets before significant one-time inflows or outflows, such as acquisitions/divestitures or extraordinary (generally, greater than \$10 billion) mutual fund clearing transfers.

Credit risk: The potential for loss due to a borrower, counterparty, or issuer failing to perform its contractual obligations.

Customer Protection Rule: Refers to Rule 15c3-3 of the Securities Exchange Act of 1934.

Daily average revenue trades: Total revenue trades during a certain period, divided by the number of trading days in that period. Revenue trades include all client trades that generate trading revenue (i.e., commission revenue or principal transaction revenue).

Debt to total capital ratio: Calculated as long-term debt divided by stockholders' equity and long-term debt.

- 3 -

---

THE CHARLES SCHWAB CORPORATION

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

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

**Delinquency roll rates:** The rates at which loans transition through delinquency stages, ultimately resulting in a loss. The Company considers a loan to be delinquent if it is 30 days or more past due.

**Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank):** Regulatory reform legislation signed into federal law in 2010 containing numerous provisions which expanded prudential regulation of large financial services companies.

**Final Regulatory Capital Rules:** Refers to the regulatory capital rules issued by U.S. banking agencies in July 2013 that implemented Basel III and relevant provisions of Dodd-Frank, which apply to savings and loan holding companies, as well as federal savings banks. Implementation began on January 1, 2015.

**First Mortgages:** Refers to first lien residential real estate mortgage loans, which include two loan classes: first mortgages and purchased first mortgages.

**Full-time equivalent employees:** Represents the total number of hours worked divided by a 40-hour work week for the following categories: full-time, part-time, and temporary employees and persons employed on a contract basis.

**Interest rate risk:** The potential for variability in net interest revenue or the fluctuation in the valuation of assets arising from changes in interest rates.

**Interest-bearing liabilities:** Includes bank deposits, payables to brokerage clients, short-term borrowings, and long-term debt on which the Company pays interest.

**Interest-earning assets:** Includes cash and cash equivalents, cash and investments segregated, broker-related receivables, receivables from brokerage clients, securities available for sale, securities held to maturity, and bank loans on which the Company earns interest.

**Investment grade:** Defined as a rating equivalent to a Moody's Investors Service (Moody's) rating of "Baa" or higher, or a Standard & Poor's Ratings Group (Standard & Poor's) or Fitch Ratings, Ltd (Fitch) rating of "BBB-" or higher.

**Liquidity risk:** The potential that the Company will be unable to sell assets or meet cash flow obligations when they come due without incurring unacceptable losses.

**Loan-to-value ratio:** Calculated as the principal amount of a loan divided by the value of the collateral securing the loan.

**Margin loans:** Advances made to brokerage clients on a secured basis to purchase securities reflected in receivables from brokerage clients on the Company's balance sheets.

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

**Master netting arrangement:** An agreement between two counterparties that have multiple contracts with each other that provides for net settlement of all contracts through a single cash payment in the event of default or termination of any one contract.

**Mortgage-backed security:** A type of asset-backed security that is secured by a mortgage or group of mortgages.

**Net interest margin:** Net interest revenue divided by average interest-earning assets.

**Net new client assets:** Total inflows of client cash and securities to the Company less client outflows.

**New brokerage accounts:** All brokerage accounts opened during the period, as well as any accounts added via acquisition.

**Nonperforming assets:** The total of nonaccrual loans and other real estate owned.



THE CHARLES SCHWAB CORPORATION

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

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

**Operational risk:** The risk, including litigation, of inadequate or failed internal processes, people, systems or from external events and relationships impacting the Company and/or any of its key business partners and third parties.

**Order flow revenue:** Net compensation received from markets and firms to which Schwab and optionsXpress, Inc. send equity and options orders. Reflects rebates received for certain types of orders, minus fees paid for types of orders for which exchange fees or other charges apply.

**Pledged Asset Line:** A non-purpose revolving line of credit from Schwab Bank secured by eligible assets held in a separate pledged asset account maintained at Schwab.

**Return on average common stockholders' equity:** Calculated as net income available to common stockholders annualized divided by average common stockholders' equity.

**Risk-weighted assets:** Primarily computed by assigning specific risk-weightings as specified by the regulators to assets and off-balance sheet instruments for capital adequacy calculations.

**Tier 1 Capital:** The sum of CET1 Capital and additional Tier 1 Capital instruments and related surplus, less applicable adjustments and deductions.

**Tier 1 Leverage Ratio:** Tier 1 Capital divided by adjusted average total consolidated assets at the end of the quarter.

**Trading days:** Days in which the markets/exchanges are open for the buying and selling of securities. Early market closures are counted as half-days.

U.S. federal banking agencies: Refers to the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Consumer Financial Protection Bureau (CFPB).

Uniform Net Capital Rule: Refers to Rule 15c3-1 under the Securities Exchange Act of 1934 which specifies minimum capital requirements that are intended to ensure the general financial soundness and liquidity of broker-dealers.



## THE CHARLES SCHWAB CORPORATION

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

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

## OVERVIEW

Management of the Company focuses on several client activity and financial metrics in evaluating the Company's financial position and operating performance. Management believes that net revenue growth, pre-tax profit margin, earnings per common share (EPS), and return on average common stockholders' equity provide broad indicators of the Company's overall financial health, operating efficiency, and ability to generate acceptable returns. Expenses excluding interest as a percentage of average client assets are considered by management to be a measure of operating efficiency. Results for the third quarters and first nine months of 2016 and 2015 are:

	Three Months Ended September 30,		Percent	Nine Months Ended September 30,		Percent
	2016	2015	Change	2016	2015	Change
Client Metrics:						
Net new client assets (in billions)	\$ 30.0	\$ 30.8	(3) %	\$ 88.6	\$ 96.5	(8) %
Core net new client assets (in billions) (1)	\$ 30.0	\$ 30.8	(3) %	\$ 88.6	\$ 102.0	(13) %
Client assets (in billions, at quarter end)	\$ 2,725.3	\$ 2,415.9	13 %			
Average client assets (in billions)	\$ 2,699.5	\$ 2,513.5	7 %	\$ 2,576.8	\$ 2,532.7	2 %
New brokerage accounts (in thousands)	264	254	4 %	800	808	(1) %
Active brokerage accounts (in thousands, at quarter end)	10,046	9,691	4 %			
Assets receiving ongoing advisory services (in billions, at quarter end)	\$ 1,368.8	\$ 1,204.8	14 %			
Client cash as a percentage of client assets (at quarter end)	12.5 %	12.9 %				
Company Financial Metrics:						
Net revenues	\$ 1,914	\$ 1,597	20 %	\$ 5,506	\$ 4,689	17 %
Expenses excluding interest	1,120	1,014	10 %	3,337	3,055	9 %
Income before taxes on income	794	583	36 %	2,169	1,634	33 %
Taxes on income	291	207	41 %	802	603	33 %
Net income	503	376	34 %	1,367	1,031	33 %

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Preferred stock dividends and other	33		11		200 %	99		45		120 %
Net income available to common stockholders	\$ 470		\$ 365		29 %	\$ 1,268		\$ 986		29 %
Earnings per common share – diluted	\$ .35		\$ .28		25 %	\$ .95		\$ .74		28 %
Net revenue growth from prior year	20	%	3	%		17	%	4	%	
Pre-tax profit margin	41.5	%	36.5	%		39.4	%	34.9	%	
Return on average common stockholders' equity	14	%	13	%		13	%	12	%	
Expenses excluding interest as a percentage of average client assets (annualized)	0.17	%	0.16	%		0.17	%	0.16	%	

(1) The nine months ended September 30, 2015 excludes an inflow of \$6.1 billion to reflect the final impact of the consolidation of the Company's retirement plan recordkeeping platforms and an outflow of \$11.6 billion relating to the Company's planned resignation from an Advisor Services cash management relationship netting to an adjustment of (\$5.5) billion.

During the third quarter of 2016, the Company's range of full-service investment capabilities continued to attract a broad spectrum of investors. Core net new assets totaled \$30.0 billion and \$88.6 billion for the third quarter and nine months ended September 30, 2016, respectively, sustaining a 5% annualized organic growth rate over year-end 2015 client assets. The Company ended the quarter serving 10.0 million active brokerage accounts, 1.1 million banking accounts and 1.6 million retirement plan participants, up 4%, 6%, and 5%, respectively, from the same period in 2015. Total client assets reached \$2.73 trillion at September 30, 2016, up 13% year-over-year, as investors continued to engage with the Company throughout the summer quarter. During the third quarter of 2016, the Company's financial consultants held planning conversations with 34,000 clients, up 17% from the same quarter in 2015. For the nine months ended September 30, 2016, 101,000 clients have participated in such conversations, up 22% from September 30, 2015. Assets enrolled in some form of ongoing advisory service totaled \$1.37 trillion at quarter-end, up 14% from a year ago.

THE CHARLES SCHWAB CORPORATION

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

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

Net revenues increased 20% and 17% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015 primarily due to growth in client assets and higher short-term interest rates.

Expenses increased 10% and 9% in the third quarter and first nine months of 2016, respectively, compared to the same periods in 2015 consistent with management's expectations for spending to support current and future growth in the business.

The pre-tax profit margin for the third quarter and first nine months of 2016 was 41.5% and 39.4%, respectively, compared to 36.5% and 34.9% for the same periods in 2015. Net income grew by 34% and 33%, respectively, for the third quarter and first nine months 2016 compared to the same periods in 2015.

Subsequent Event

On October 31, 2016, the Company issued and sold 600,000 depositary shares, each representing a 1/100th ownership interest in a share of fixed-to-floating rate non-cumulative perpetual preferred stock, Series E, \$0.01 par value, with a liquidation preference of \$100,000 per share (equivalent to \$1,000 per depositary share) (Series E Preferred Stock). The Series E Preferred Stock has a fixed dividend rate of 4.625% through February 28, 2022, payable semi-annually, and thereafter at a floating rate of three-month LIBOR plus a fixed spread of 3.315%, payable quarterly. Net proceeds received from the sale were \$591 million and are being used to support balance sheet growth, including the migration of certain client balances from sweep money market funds into Schwab Bank.

Current Regulatory Environment and Other Developments

In September 2016, the OCC issued final guidelines for recovery planning by national banks and federal savings banks with total consolidated assets of \$50 billion or more. The guidelines establish enforceable standards requiring each bank to develop and maintain a recovery plan that describes how the bank will restore itself to financial health and viability in response to a wide range of external and internal financial and operational stress scenarios. The guidelines go into effect on January 1, 2017, and Schwab Bank will have until the end of 2017 to develop and prepare a recovery plan.

Effective July 1, 2016, the FDIC began imposing a surcharge on insured depository institutions with total consolidated assets of \$10 billion or more at the same time that a scheduled reduction in the regular FDIC insurance assessment also went into effect. As a result, the Company is now subject to a 3 basis point regular assessment on its total assessment base (down from 5 basis points) and a new 4.5 basis point surcharge on the amount of its assessment base in excess of \$10 billion. For the third quarter of 2016, the Company's combined FDIC assessment rate, measured against its total assessment base, rose by a net of 2.2 basis points.

In May 2016, the Federal Reserve, the OCC and the FDIC jointly issued a notice of proposed rulemaking that would impose a minimum net stable funding ratio (NSFR) on certain banking organizations, including CSC. The NSFR is intended to measure an organization's "available" amount of stable funding relative to its "required" amount of stable funding over a one-year time horizon. The effective date of the rule would be January 1, 2018. The comment period for the proposed rule ended on August 5, 2016 and the impact to the Company cannot be assessed until the final rule is released.

In April 2016, the Department of Labor published a final rule that significantly broadens the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974. Among other things, the new rule subjects broker-dealers who provide non-discretionary investment advice to retirement plans and accounts to a "best interest" standard, as well as other conditions and requirements. Based on the Company's evaluation of the final rule to date, the Company does not expect the rule to have a material impact on the Company's business, financial condition or results of operations.

In October 2015, the Federal Reserve issued a notice of proposed rulemaking that, among other things, would require certain financial institutions that are subject to the Federal Reserve's capital rules to apply a regulatory capital deduction treatment to their investments in unsecured debt issued by U.S. bank holding companies identified as global systemically important banking organizations. The comment period for the rule proposal ended on February 19, 2016 and the rule proposal is subject to further modification. The proposed effective date of the rule would be January 1, 2019. The Company continues to monitor developments in order to assess the impact of the proposed rule, but does not expect it to have a material impact on the Company's business, financial condition and results of operations.

## THE CHARLES SCHWAB CORPORATION

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

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

## 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 2016 compared to the same periods in 2015.

## Net Revenues

Three Months Ended September 30,	2016		% of		2015		% of	
	Percent Change	Amount	Total Net Revenues	Amount	Total Net Revenues			
Asset management and administration fees								
Mutual funds and ETF service fees (1)	32 %	\$ 486	25 %	\$ 369	23 %			
Advice solutions	5 %	237	12 %	225	14 %			
Other (1)	9 %	75	5 %	69	5 %			
Asset management and administration fees	20 %	798	42 %	663	42 %			
Net interest revenue								
Interest revenue	33 %	891	46 %	669	42 %			
Interest expense	35 %	(46)	(2) %	(34)	(2) %			
Net interest revenue	33 %	845	44 %	635	40 %			
Trading revenue								
Commissions	(15) %	181	10 %	214	13 %			
Principal transactions	(36) %	9	-	14	1 %			
Trading revenue	(17) %	190	10 %	228	14 %			
Other	15 %	76	4 %	66	4 %			
Provision for loan losses	-	5	-	5	-			
Total net revenues	20 %	\$ 1,914	100 %	\$ 1,597	100 %			

Nine Months Ended September 30,

2016

2015

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

	Percent Change	Amount	% of Total Net Revenues	Amount	% of Total Net Revenues
Asset management and administration fees					
Mutual funds and ETF service fees (1)	24 %	\$ 1,362	25 %	\$ 1,102	24 %
Advice solutions	1 %	678	12 %	673	14 %
Other (1)	6 %	214	4 %	202	4 %
Asset management and administration fees	14 %	2,254	41 %	1,977	42 %
Net interest revenue					
Interest revenue	32 %	2,541	46 %	1,931	41 %
Interest expense	31 %	(126)	(2) %	(96)	(2) %
Net interest revenue	32 %	2,415	44 %	1,835	39 %
Trading revenue					
Commissions	(6) %	586	10 %	623	13 %
Principal transactions	6 %	37	1 %	35	1 %
Trading revenue	(5) %	623	11 %	658	14 %
Other	-	209	4 %	208	5 %
Provision for loan losses	(55) %	5	-	11	-
Total net revenues	17 %	\$ 5,506	100 %	\$ 4,689	100 %

(1) Other third-party mutual funds have been reclassified to Mutual funds and ETFs. Related revenues have been reclassified from Other asset management and administration fees. Prior period information has been recast to reflect this change.

THE CHARLES SCHWAB CORPORATION

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

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

Asset Management and Administration Fees

Asset management and administration fees include mutual fund and ETF service fees and fees for other asset-based financial services provided to individual and institutional clients. The Company earns mutual fund and ETF 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. Asset management and administration fees do not include securities lending revenues earned by proprietary mutual funds and ETFs as those amounts, net of program fees, are credited to the fund shareholders.

The Company also earns asset management fees for advice solutions, which include managed portfolios, specialized strategies and customized investment advice.

The fair values of client assets included in proprietary and third-party mutual funds and ETFs 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, 401(k) recordkeeping fees, mutual fund clearing fees, collective trust fund fees, and non-balance based service and transaction fees.

Asset management and administration fees vary with changes in the balances of client assets due to market fluctuations and client activity.

The following tables present a roll forward of client assets for the Schwab money market funds, Schwab equity and bond funds and ETFs, and Mutual Fund OneSource®:

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

	Schwab Money		Schwab Equity and Bond Funds and		Mutual Fund	
	Market Funds		ETFs		OneSource®	
	2016	2015	2016	2015	2016	2015
Three Months Ended September 30,						
Balance at beginning of period	\$ 160,951	\$ 155,577	\$ 110,722	\$ 98,399	\$ 203,352	\$ 231,247
Net inflows (outflows)	(725)	6,221	3,297	2,457	(5,453)	(6,289)
Net market gains (losses) and other	26	9	4,435	(7,391)	8,184	(14,213)
Balance at end of period	\$ 160,252	\$ 161,807	\$ 118,454	\$ 93,465	\$ 206,083	\$ 210,745

	Schwab Money		Schwab Equity and Bond Funds and		Mutual Fund	
	Market Funds		ETFs		OneSource®	
	2016	2015	2016	2015	2016	2015
Nine Months Ended September 30,						
Balance at beginning of period	\$ 166,148	\$ 167,909	\$ 102,112	\$ 88,450	\$ 207,654	\$ 234,381
Net inflows (outflows)	(5,968)	(6,285)	8,951	10,753	(14,632)	(15,164)
Net market gains (losses) and other	72	183	7,391	(5,738)	13,061	(8,472)
Balance at end of period	\$ 160,252	\$ 161,807	\$ 118,454	\$ 93,465	\$ 206,083	\$ 210,745

- 9 -

---



## THE CHARLES SCHWAB CORPORATION

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

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

The following tables present asset management and administration fees, average client assets, and average fee yields:

Three Months Ended September 30,	2016			2015		
	Average Client Assets	Revenue	Average Fee	Average Client Assets	Revenue	Average Fee
Schwab money market funds before fee waivers	\$ 161,904	\$ 239	0.59%	\$ 160,266	\$ 237	0.59%
Fee waivers		(41)			(166)	
Schwab money market funds	161,904	198	0.49%	160,266	71	0.18%
Schwab equity and bond funds and ETFs	121,378	57	0.19%	102,898	55	0.21%
Mutual Fund OneSource®	203,589	175	0.34%	220,419	187	0.34%
Other third-party mutual funds and ETFs (1)	263,995	56	0.08%	251,245	56	0.09%
Total mutual funds and ETFs (2)	\$ 750,866	486	0.26%	\$ 734,828	369	0.20%
Advice solutions (2):						
Fee-based	\$ 183,191	237	0.51%	\$ 170,211	225	0.52%
Intelligent Portfolios	8,249	-	-	3,714	-	-
Legacy Non-Fee	17,232	-	-	16,372	-	-
Total advice solutions	\$ 208,672	237	0.45%	\$ 190,297	225	0.47%
Other balance-based fees (3)	350,117	62	0.07%	328,461	57	0.07%
Other (4)		13			12	
Total asset management and administration fees		\$ 798			\$ 663	

Nine Months Ended September 30,	2016			2015		
	Average Client Assets	Revenue	Average Fee	Average Client Assets	Revenue	Average Fee
Schwab money market funds before fee waivers	\$ 164,758	\$ 724	0.59%	\$ 161,029	\$ 706	0.59%
Fee waivers		(193)			(519)	
Schwab money market funds	164,758	531	0.43%	161,029	187	0.16%
Schwab equity and bond funds and ETFs	112,528	160	0.19%	101,337	163	0.22%
Mutual Fund OneSource®	199,758	508	0.34%	229,660	582	0.34%
Other third-party mutual funds and ETFs (1)	251,211	163	0.09%	252,423	170	0.09%
Total mutual funds and ETFs (2)	\$ 728,255	1,362	0.25%	\$ 744,449	1,102	0.20%

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Advice solutions (2):						
Fee-based	\$ 175,210	678	0.52%	\$ 171,516	673	0.52%
Intelligent Portfolios	6,662	-	-	2,578	-	-
Legacy Non-Fee	16,901	-	-	16,573	-	-
Total advice solutions	\$ 198,773	678	0.46%	\$ 190,667	673	0.47%
Other balance-based fees (3)	335,555	176	0.07%	323,087	169	0.07%
Other (4)		38			33	
Total asset management and administration fees		\$ 2,254			\$ 1,977	

Note: Certain changes have been made to the above categorizations. Prior period information has been recast to reflect these changes.

- (1) Includes Schwab ETF OneSource™.
- (2) Average client assets for advice solutions may also include the asset balances contained in the mutual fund and/or ETF categories listed above.
- (3) Includes various asset-based fees, such as trust fees, 401(k) recordkeeping fees, and mutual fund clearing fees and other service fees.
- (4) Includes miscellaneous service and transaction fees relating to mutual funds and ETFs that are not balance-based.

Asset management and administration fees increased by \$135 million, or 20%, and \$277 million, or 14%, in the third quarter and first nine months of 2016 compared to the same periods in 2015. The increase is primarily due to higher net yields on money market fund assets as short-term interest rates have risen in 2016, partially offset by a reduction in average client assets in Mutual Fund OneSource.

THE CHARLES SCHWAB CORPORATION

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

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

Net Interest Revenue

Net interest revenue is the difference between interest earned on interest-earning assets and interest paid on funding sources. The Company's interest-earning assets are primarily funded through bank deposits and client brokerage account balances.

Interest-earning assets primarily include cash and cash equivalents, segregated cash and investments, margin loans included in receivables from brokerage clients, investment securities and bank loans on which the Company earns interest. Revenue on interest-earning assets is affected by various factors such as the distribution and composition of assets, prevailing interest rates when purchased, and changes in prepayment levels. Fees earned on securities borrowing and lending activities conducted by the Company's broker-dealer subsidiaries on assets held in client brokerage accounts are included in other interest revenue and expense. The rates on the majority of the Company's investment securities and loans re-price or reset based on short-term interest rates and the remainder is invested in fixed-rate loans and securities.

The Company's interest-bearing liabilities include bank deposits, payables to brokerage clients, short-term borrowings and long-term debt. Interest-bearing liabilities are primarily sensitive to short-term interest rates and the Company establishes the rates paid on most of these liabilities. The Company expects that the rate paid on these liabilities will generally adjust at some fraction of the movement in short-term interest rates.

The Company expects that net interest revenue will increase as short-term interest rates increase and decline should rates fall below current levels. When interest rates fall, the Company may attempt to mitigate some of this negative impact by lowering rates paid to clients on interest-bearing liabilities. The current low interest rate environment limits the extent to which the Company can reduce interest expense on funding sources. The Company may also alter the amount and type of fixed rate loans and securities that are added to the portfolio. Generally, modest increases in the percentage of fixed-rate assets will reduce the rate at which net interest revenue changes if rates move.

Non-interest-bearing funding sources include certain cash balances, stockholders' equity and other miscellaneous assets and liabilities.



## THE CHARLES SCHWAB CORPORATION

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

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

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

Three Months Ended September 30,	2016			2015		
	Average Balance	Interest Revenue/Expense	Average Yield/Rate	Average Balance	Interest Revenue/Expense	Average Yield/Rate
<b>Interest-earning assets:</b>						
Cash and cash equivalents	\$ 12,875	\$ 17	0.53 %	\$ 9,764	\$ 6	0.24 %
Cash and investments segregated	19,941	24	0.48 %	18,061	8	0.18 %
Broker-related receivables (1)	667	-	0.31 %	312	-	0.09 %
Receivables from brokerage clients	14,940	123	3.28 %	15,594	130	3.31 %
Securities available for sale (2)	74,064	227	1.22 %	63,916	159	0.99 %
Securities held to maturity	57,669	349	2.41 %	38,533	241	2.48 %
Bank loans	14,739	100	2.70 %	14,137	93	2.61 %
Total interest-earning assets	194,895	840	1.71 %	160,317	637	1.58 %
Other interest revenue		51			32	
Total interest-earning assets	\$ 194,895	\$ 891	1.82 %	\$ 160,317	\$ 669	1.66 %
<b>Funding sources:</b>						
Bank deposits	\$ 143,578	\$ 10	0.03 %	\$ 115,606	\$ 8	0.03 %
Payables to brokerage clients	26,204	1	0.01 %	25,585	1	0.01 %
Short-term borrowings (1,3)	2,952	4	0.54 %	36	-	0.15 %
Long-term debt (4)	2,876	26	3.60 %	2,888	24	3.30 %
Total interest-bearing liabilities (4)	175,610	41	0.09 %	144,115	33	0.09 %
Non-interest-bearing funding sources (3)	19,285			16,202		
Other interest expense		5			1	
Total funding sources	\$ 194,895	\$ 46	0.10 %	\$ 160,317	\$ 34	0.09 %
Net interest revenue		\$ 845	1.72 %		\$ 635	1.57 %

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

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

(3) Certain prior period amounts have been reclassified to conform to the 2016 presentation.

(4) Adjusted for the retrospective adoption of Accounting Standards Update (ASU) 2015-03. See "Item 1 – Notes to Condensed Consolidated Financial Statements (Unaudited) – 2. New Accounting Standards" for additional information.



## THE CHARLES SCHWAB CORPORATION

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

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

Nine Months Ended September 30,	2016			2015		
	Average Balance	Interest Revenue/Expense	Average Yield/Rate	Average Balance	Interest Revenue/Expense	Average Yield/Rate
<b>Interest-earning assets:</b>						
Cash and cash equivalents	\$ 11,510	\$ 44	0.51 %	\$ 9,230	\$ 17	0.25 %
Cash and investments segregated	19,788	65	0.44 %	18,607	21	0.15 %
Broker-related receivables (1)	579	-	0.21 %	285	-	0.07 %
Receivables from brokerage clients	14,952	372	3.32 %	15,043	374	3.32 %
Securities available for sale (2)	71,230	636	1.19 %	60,866	454	1.00 %
Securities held to maturity	53,791	1,006	2.50 %	36,637	686	2.50 %
Bank loans	14,570	297	2.72 %	13,848	274	2.65 %
Total interest-earning assets	186,420	2,420	1.73 %	154,516	1,826	1.58 %
Other interest revenue		121			105	
Total interest-earning assets	\$ 186,420	\$ 2,541	1.82 %	\$ 154,516	\$ 1,931	1.67 %
<b>Funding sources:</b>						
Bank deposits	\$ 137,093	\$ 26	0.03 %	\$ 110,569	\$ 22	0.03 %
Payables to brokerage clients	26,079	2	0.01 %	25,596	2	0.01 %
Short-term borrowings (1,3)	1,674	6	0.48 %	23	-	0.15 %
Long-term debt (4)	2,876	78	3.62 %	2,642	67	3.39 %
Total interest-bearing liabilities (4)	167,722	112	0.09 %	138,830	91	0.09 %
Non-interest-bearing funding sources (3)	18,698			15,686		
Other interest expense		14			5	
Total funding sources	\$ 186,420	\$ 126	0.09 %	\$ 154,516	\$ 96	0.08 %
Net interest revenue		\$ 2,415	1.73 %		\$ 1,835	1.59 %

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

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

(3) Certain prior period amounts have been reclassified to conform to the 2016 presentation.

(4) Adjusted for the retrospective adoption of ASU 2015-03. See "Item 1 – Notes to Condensed Consolidated Financial Statements (Unaudited) – 2. New Accounting Standards" for additional information.

Net interest revenue increased \$210 million, or 33%, and \$580 million, or 32% in the third quarter and first nine months of 2016 compared to the same periods in 2015 due to higher interest-earning assets driven by growth in bank deposits. The Company has grown bank deposits through a combination of:

- gathering additional assets from new and current clients;

- transferring uninvested cash balances in certain client brokerage accounts to Schwab Bank; and
- establishing the Schwab Bank sweep feature as the default investment option for uninvested cash balances within all new brokerage accounts as of June 2016.

The Company has invested the cash from the growth in bank deposits and from recent short-term borrowings in investment securities. These incremental investments, coupled with an increase in short-term interest rates, have resulted in higher net interest revenue and higher net interest margins during the third quarter and first nine months of 2016.



## THE CHARLES SCHWAB CORPORATION

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

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

## 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 trading activity in fixed income securities with clients. To accommodate clients' fixed income trading activity, the Company maintains positions in fixed income securities, including U.S. state and municipal debt obligations, U.S. Government and 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 adjustments to the fair value of these securities positions.

The following table presents trading revenue and the related drivers:

	Three Months Ended			Nine Months Ended		
	September 30, 2016	2015	Percent Change	September 30, 2016	2015	Percent Change
Daily average revenue trades (in thousands)	268	304	(12) %	291	295	(1) %
Clients' daily average trades (in thousands)	543	537	1 %	558	537	4 %
Number of trading days	64.0	64.0	-	189.0	188.0	1 %
Average revenue per revenue trade	\$ 11.17	\$ 11.67	(4) %	\$ 11.30	\$ 11.87	(5) %
Trading revenue	\$ 190	\$ 228	(17) %	\$ 623	\$ 658	(5) %

Trading revenue decreased by \$38 million, or 17%, and \$35 million, or 5%, in the third quarter and first nine months of 2016 compared to the same periods in 2015, primarily due to a decrease in commission revenue as a result of lower daily average revenue trades related to equities and derivatives and lower commissions per revenue trade.

## Other Revenue

Other revenue includes order flow revenue, nonrecurring gains, software fees from the Company's portfolio management services, exchange processing fees, and other service fees.

Other revenue increased by \$10 million, or 15%, in the third quarter of 2016 compared to the third quarter of 2015, primarily due to higher litigation proceeds in the third quarter of 2016 relating to the Company's non-agency residential mortgage-backed securities portfolio. These proceeds conclude the last pending cases. Other revenue was \$209 million and \$208 million during the first nine months of 2016 and 2015, respectively.

Order flow revenue was \$26 million and \$78 million during the third quarters and first nine months of both 2016 and 2015, respectively.

## THE CHARLES SCHWAB CORPORATION

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

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

## Expenses Excluding Interest

The following table shows a comparison of expenses excluding interest:

	Three Months Ended			Nine Months Ended		
	September 30,		Percent Change	September 30,		Percent Change
	2016	2015		2016	2015	
Compensation and benefits	\$ 609	\$ 548	11 %	\$ 1,837	\$ 1,669	10 %
Professional services	131	114	15 %	372	340	9 %
Occupancy and equipment	100	92	9 %	299	260	15 %
Advertising and market development	64	58	10 %	204	189	8 %
Communications	57	58	(2) %	179	175	2 %
Depreciation and amortization	60	57	5 %	173	166	4 %
Other	99	87	14 %	273	256	7 %
Total expenses excluding interest	\$ 1,120	\$ 1,014	10 %	\$ 3,337	\$ 3,055	9 %
Expenses as a percentage of total net revenues:						
Compensation and benefits	32 %	34 %		33 %	36 %	
Advertising and market development	3 %	4 %		4 %	4 %	

## Compensation and Benefits

Compensation and benefits expense includes salaries and wages, incentive compensation, and related employee benefits. 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 EPS. Stock-based compensation primarily includes employee and board of director stock options and restricted stock.

The following table shows a comparison of certain compensation and benefits components and employee data:

	Three Months Ended			Nine Months Ended		
	September 30, 2016	September 30, 2015	Percent Change	September 30, 2016	September 30, 2015	Percent Change
Salaries and wages	\$ 343	\$ 313	10 %	\$ 1,018	\$ 943	8 %
Incentive compensation	170	152	12 %	509	453	12 %
Employee benefits and other	96	83	16 %	310	273	14 %
Total compensation and benefits expense	\$ 609	\$ 548	11 %	\$ 1,837	\$ 1,669	10 %
Full-time equivalent employees (in thousands)						
At quarter end	16.1	15.4	5 %			
Average	16.2	15.3	6 %	15.9	15.0	6 %

Salaries and wages increased in the third quarter and first nine months of 2016 compared to the same periods in 2015 primarily due to higher employee headcount to support the growth in the business and annual salary increases.

Incentive compensation increased in the third quarter and first nine months of 2016 compared to the same periods in 2015 primarily due to higher discretionary bonus expenses, long-term incentive plan costs, and field incentive plan costs relating to increased net client asset flows.

Employee benefits and other expenses increased in the third quarter and first nine months of 2016 compared to the same periods in 2015 due to increases in healthcare costs and higher employee headcount.

THE CHARLES SCHWAB CORPORATION

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

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

Expenses Excluding Compensation and Benefits

Professional services expense increased in the third quarter and first nine months of 2016 compared to the same periods in 2015, primarily due to higher spending on technology services and an increase in fees paid to outsourced service providers and consultants as the Company continued to invest in the business.

Occupancy and equipment expense increased in the third quarter and first nine months of 2016 compared to the same periods in 2015, primarily due to an increase in software maintenance expense relating to the Company's information technology systems and increases in property taxes and rent attributable to the growth in the Company's geographic footprint.

Advertising and market development expense increased in the third quarter and first nine months of 2016 compared to the same periods in 2015, primarily due to an increase in media advertising.

Other expense increased in the third quarter and first nine months of 2016 compared to the same periods in 2015, primarily due to an increase in the Company's FDIC assessments. The FDIC assessments rose as a result of higher bank deposits and the effect of a new surcharge that commenced in the third quarter of 2016.

Taxes on Income

The Company's effective income tax rate on income before taxes was 36.6% and 35.5% for the third quarters of 2016 and 2015, respectively. During the third quarter of 2015, the Company recognized \$14 million of net tax benefits primarily for positions taken in tax years 2011 to 2014. The effective income tax rate on income before taxes was 37.0% and 36.9% for the first nine months of 2016 and 2015, respectively.

## Segment Information

The Company provides financial services to individuals and institutional clients through two segments – Investor Services and Advisor Services. The Investor Services segment provides retail brokerage and banking services, retirement plan services, and other corporate brokerage services. The Advisor Services segment provides custodial, trading, and support services as well as retirement business services. Revenues and expenses are attributed 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 restructuring and other charges. Segment assets and liabilities are not used for evaluating segment performance or in deciding how to allocate resources to segments.

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

Three Months Ended September 30, Net Revenues:	Investor Services (1)			Advisor Services (1)			Total								
	Percent	Change	2016	2015	Percent	Change	2016	2015	Percent	Change	2016	2015			
Asset management and administration fees	19 %	\$	550	\$	461	23 %	\$	248	\$	202	20 %	\$	798	\$	663
Net interest revenue	22 %		654		534	89 %		191		101	33 %		845		635
Trading revenue	(17)%		123		148	(16)%		67		80	(17)%		190		228
Other	24 %		56		45	(5) %		20		21	15 %		76		66
Provision for loan losses	-		4		4	-		1		1	-		5		5
Total net revenues	16 %		1,387		1,192	30 %		527		405	20 %		1,914		1,597
Expenses Excluding Interest	11 %		847		762	8 %		273		252	10 %		1,120		1,014
Income before taxes on income	26 %	\$	540	\$	430	66 %	\$	254	\$	153	36 %	\$	794	\$	583

## THE CHARLES SCHWAB CORPORATION

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

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

Nine Months Ended September 30, Net Revenues:	Investor Services (1) Percent			Advisor Services (1) Percent			Total Percent		
	Change	2016	2015	Change	2016	2015	Change	2016	2015
Asset management and administration fees	12 %	\$ 1,536	\$ 1,372	19 %	\$ 718	\$ 605	14 %	\$ 2,254	\$ 1,977
Net interest revenue	21 %	1,895	1,568	95 %	520	267	32 %	2,415	1,835
Trading revenue	(8) %	395	428	(1) %	228	230	(5) %	623	658
Other	5 %	153	146	(10)%	56	62	-	209	208
Provision for loan losses	(60)%	4	10	-	1	1	(55)%	5	11
Total net revenues	13 %	3,983	3,524	31 %	1,523	1,165	17 %	5,506	4,689
Expenses Excluding Interest	9 %	2,518	2,308	10 %	819	747	9 %	3,337	3,055
Income before taxes on income	20 %	\$ 1,465	\$ 1,216	68 %	\$ 704	\$ 418	33 %	\$ 2,169	\$ 1,634

(1) The Corporate Brokerage Retirement Services business was transferred from the Investor Services segment to the Advisor Services segment in the fourth quarter of 2015. Prior period information has been recast to reflect these changes.

## Investor Services

Net revenues increased by \$195 million, or 16%, and \$459 million, or 13%, in the third quarter and first nine months of 2016 compared to the same periods in 2015, primarily due to increases in net interest revenue and asset management and administration fees, partially offset by a decrease in trading revenue. Net interest revenue increased primarily due to higher balances of interest-earning assets, and higher interest rates on securities available for sale and cash and investments segregated. Asset management and administration fees increased primarily due to higher net yields on money market fund assets, partially offset by a reduction in client assets in Mutual Fund OneSource®. Trading revenue decreased primarily due to lower daily average revenue trades related to equities and derivatives and lower commissions per revenue trade.

Expenses excluding interest increased by \$85 million, or 11%, and \$210 million, or 9%, in the third quarter and first nine months of 2016 compared to the same periods in 2015, primarily due to increases in compensation and benefits and depreciation and amortization expenses. Compensation and benefits expenses are higher as a result of higher headcount in client-facing positions and higher incentive compensation associated with growth in net client asset flows.

#### Advisor Services

Net revenues increased by \$122 million, or 30%, and \$358 million, or 31%, in the third quarter and first nine months of 2016 compared to the same periods in 2015 primarily due to increases in net interest revenue and asset management and administration fees. Net interest revenue increased primarily due to higher balances of interest-earning assets. This growth was bolstered by the migration of more uninvested client cash balances in the segment to the Schwab Bank sweep feature. Net interest revenue also improved due to higher interest rates on securities available for sale and cash and investments segregated. Asset management and administration fees increased primarily due to higher net yields on money market fund assets.

Expenses excluding interest increased by \$21 million, or 8%, and \$72 million, or 10%, in the third quarter and first nine months of 2016 compared to the same periods in 2015, primarily due to increases in compensation and benefits and occupancy and equipment expenses.

#### Risk Management

The Company's business activities expose it to a variety of risks, including operational, credit, market, liquidity, and compliance risk. The Company has a comprehensive risk management program to identify and manage these risks and their associated potential for financial and reputational impact. 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 these risks.



THE CHARLES SCHWAB CORPORATION

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

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

For a full discussion of the Company's risk management program, see "Item 7 – Risk Management" in the 2015 Form 10-K.

Credit Risk Exposures

The Company's exposure to credit risk mainly results from margin lending and client option and futures activities, securities lending activities, mortgage lending activities, pledged asset lending, its role as a counterparty in financial contracts and other investing activities. To manage the risks of such losses, the Company has established policies and procedures which include: establishing and reviewing credit limits, monitoring of credit limits and quality of counterparties, and adjusting margin, PAL, option, and futures requirements for certain securities. Collateral arrangements relating to margin loans, PALs, option positions, securities lending agreements, and resale agreements include provisions that require additional collateral in the event market fluctuations result in declines in the value of collateral received. Additionally, for margin loan, PAL and securities lending agreements, collateral arrangements require that the fair value of such collateral exceeds the amounts loaned.

Schwab performs clearing services for all securities transactions in its client accounts. Schwab has exposure to credit risk due to its obligation to settle transactions with clearing corporations, mutual funds, and other financial institutions even if Schwab's clients or a counterparty fail to meet their obligations to Schwab.

The Company's bank loan portfolio includes First Mortgages, HELOCs, PALs and other loans. The credit risk exposure related to loans is actively managed through individual loan and portfolio reviews. 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.

The Company's residential loan underwriting 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 size is conforming or jumbo).

The Company does not originate or purchase residential 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 score of less than 620 at origination), unless the borrower has compensating credit factors.

The Company's bank loans include \$7.8 billion of adjustable rate First Mortgage loans at September 30, 2016. The Company's adjustable rate mortgages have initial fixed interest rates for three to ten years and interest rates that adjust annually thereafter. Approximately 37% of these mortgages consisted of loans with interest-only payment terms. The interest rates on approximately 57% 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.

Among other items, the Company monitors the following information in evaluating the First Mortgage and HELOC portfolios and in the determination of an appropriate allowance for loan losses:

September 30, 2016	First Mortgages	HELOCs
Percentage of loans to borrowers with updated FICO scores <620	1 %	1 %
Weighted-average origination FICO scores	771	769
Weighted-average updated FICO scores	774	770
Weighted-average origination LTV ratios	57 %	58 %
Weighted-average current LTV ratios	47 %	48 %

## THE CHARLES SCHWAB CORPORATION

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

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

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

	September 30, 2016	December 31, 2015
Loan delinquencies (1)	0.21 %	0.25 %
Nonaccrual loans (2)	0.19 %	0.19 %
Allowance for loan losses	0.17 %	0.22 %

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

(2) Nonaccrual loans include loans past due more than 90 days and other nonaccrual loans.

The Company's HELOC product has a 30-year loan term with a revolving period of ten years from the date of origination. After the revolving period, the balance outstanding at such time is converted to a 20-year amortizing loan. The interest rate during the revolving period and the 20-year amortizing period is a floating rate based on the prime rate plus a margin. HELOCs that convert to an amortizing loan may experience higher delinquencies and higher loss rates than those in the revolving period. The Company's allowance for loan loss methodology takes this increased inherent risk into consideration.

The following table presents when current outstanding HELOCs will convert to amortizing loans:

September 30, 2016	Balance
Converted to an amortizing loan by period end	\$ 476
Within 1 year	136
> 1 year – 3 years	903
> 3 years – 5 years	231
> 5 years	726
Total	\$ 2,472

At September 30, 2016, \$1.9 billion of the HELOC portfolio was 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. In addition to the credit monitoring activities described previously, the Company also monitors credit risk by reviewing the delinquency status of the first lien loan on the associated property. At September 30, 2016, approximately 27% of the HELOC borrowers that had a balance only paid the minimum amount of interest due.

For more information on the Company's credit quality indicators relating to its bank loans, see "Item 1 – Notes to Condensed Consolidated Financial Statements (Unaudited) – 4. Bank Loans and Related Allowance for Loan Losses."

The Company has exposure to credit risk associated with its available for sale and held to maturity securities portfolios which include U.S. agency and non-agency mortgage-backed securities, asset-backed securities, corporate debt securities, U.S. agency notes, U.S. Treasury securities, certificates of deposit, U.S. state and municipal securities, and commercial paper.

At September 30, 2016, substantially all securities in the available for sale and held to maturity portfolios were rated investment grade. U.S. agency 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.

#### 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 within a particular industry or geographical area.

THE CHARLES SCHWAB CORPORATION

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

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

The fair value of the Company's investments in mortgage-backed securities totaled \$101.0 billion at September 30, 2016. Of these, \$99.9 billion were issued by U.S. agencies and \$1.1 billion were issued by private entities (non-agency securities). These U.S. agency and non-agency securities are included in securities available for sale and securities held to maturity.

The fair value of the Company's investments in asset-backed securities totaled \$21.5 billion at September 30, 2016. The Company holds \$10.3 billion floating rate Federal Family Education Loan Program Asset-Backed Securities (FFELP ABS). Beginning in 2015, two Nationally Recognized Statistical Rating Organizations began placing a portion of FFELP ABS on review for downgrade. During the third quarter of 2016, ten of the Company's FFELP ABS holdings were downgraded, including three securities that were downgraded to below investment grade. As of September 30, 2016, these three non-investment grade FFELP ABS had an aggregate fair value of \$588 million, or 1%, of the total fair value of the Company's available for sale portfolio, and were the only non-investment grade securities held by the Company. Subsequent to September 30, 2016, three additional FFELP ABS with an aggregate fair value of \$1.1 billion were downgraded to below investment grade, while one of the original securities discussed above (fair value of \$256 million) was restored to AAA rating after a maturity extension was executed. Both agencies have indicated that additional classes could be downgraded below investment grade due to the risk that some remainder of the securities could be outstanding after their legal final maturity dates. The timing of FFELP ABS principal payment is inherently uncertain given the variety of payment options available to student loan borrowers. Loans collateralizing these securities continue to be covered by a guarantee from the Department of Education of at least 97% of principal and interest. The Company holds only senior class notes that have additional credit enhancement of 3% or more that, together with the Department of Education guarantee, provide 100% or more credit enhancement. The Company has an independent credit assessment function and does not consider these securities to be impaired because it expects full payment of principal and interest. Therefore, the Company continues to assign them the highest internal credit rating.

The fair value of the Company's investments in corporate debt securities and commercial paper totaled \$11.3 billion at September 30, 2016, with 46% issued by institutions in the financial services industry. These securities are included in securities available for sale, cash and cash equivalents, and other securities owned in the Company's condensed consolidated balance sheets. Issuer, geographic, and sector concentrations are controlled by established credit policy limits to each concentration type.

The Company also has exposure to concentration risk from its margin and securities lending, PAL, and client option and futures activities collateralized by or referencing securities of a single issuer, an index, or within a single industry. This concentration risk is mitigated by collateral arrangements that require the fair value of such collateral exceed the amounts loaned.

The Company has indirect exposure to U.S. Government and agency securities held as collateral to secure its resale agreements. 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 \$9.6 billion at September 30, 2016.

#### Foreign Holdings

At September 30, 2016, the Company had exposure to non-sovereign financial and non-financial institutions in foreign countries of \$7.1 billion, with the fair value of the top three exposures being to issuers and counterparties domiciled in France at \$1.9 billion, Sweden at \$1.3 billion and Australia at \$1.1 billion. The Company has no direct exposure to sovereign foreign governments. The Company does not have unfunded commitments to counterparties in foreign countries, nor does it have exposure as a result of credit default protection purchased or sold separately as of September 30, 2016. In addition to the direct holdings in foreign companies, the Company has indirect exposure to foreign countries through its investments in Schwab sponsored money market funds (collectively, the Funds) resulting from brokerage clearing activities. At September 30, 2016, the Company had \$528 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 foreign countries. Additionally, at September 30, 2016, the Company had outstanding margin loans to foreign residents of \$369 million, which are fully collateralized.

THE CHARLES SCHWAB CORPORATION

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

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

## LIQUIDITY

CSC's liquidity needs are primarily driven by the capital needs of Schwab Bank and liquidity and capital needs of Schwab, the amount of dividend payments on CSC's common and preferred stock and principal and interest due on corporate debt. The liquidity needs of its brokerage subsidiaries are primarily driven by client activity including trading and margin borrowing activities and capital expenditures; and the capital needs of its bank subsidiary are primarily driven by client deposits.

The Company has established liquidity policies to support the successful execution of its business strategies, while ensuring ongoing and sufficient liquidity to meet its operational needs and satisfy applicable regulatory requirements under both normal and stress conditions. For additional information on the policies and methodologies used to monitor and manage liquidity, see "Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity" in the 2015 Form 10-K.

Beginning on January 1, 2016, the Company became subject to the modified liquidity coverage ratio (LCR) rule which, when fully phased in, will require CSC to hold high-quality liquid assets equal to at least 70% of projected net cash outflows over a 30-day period, as defined by the rule. At September 30, 2016, the Company was in compliance with the fully phased-in modified LCR rule. For additional information on the LCR rule, see "Item 1 – Business – Regulation" in the 2015 Form 10 K.

The Company's primary source of funds is cash generated by client activity: bank deposits and cash balances in client brokerage accounts. Bank deposits swept from brokerage accounts were \$127.9 billion at September 30, 2016 compared to \$108.1 billion at December 31, 2015. These funds were used to purchase investment securities, thereby funding a significant portion of the 14% growth in the Company's balance sheet.

Other sources of funds may include cash flows from operations, maturities and sales of investment securities, repayments on loans, securities lending of assets held in client brokerage accounts, and cash provided by external financing or equity offerings.

To meet daily funding needs, the Company maintains liquidity in the form of overnight cash deposits and short-term investments. For unanticipated liquidity needs, the Company maintains a buffer of highly liquid investments, currently comprised of U.S. Treasury notes.

In addition to internal sources of liquidity, the Company has sources of external funding. CSC maintains a \$750 million committed, unsecured credit facility with a group of banks that is scheduled to expire in June 2017. This facility replaced a similar facility that expired in June 2016, and both facilities were unused during the first nine months of 2016. The funds under this facility are available for general corporate purposes. The financial covenants require Schwab to maintain a minimum net capital ratio, Schwab Bank to be well capitalized, and CSC to maintain a minimum level of stockholders' equity, adjusted to exclude AOCI. At September 30, 2016, the minimum level of stockholders' equity required under this facility was \$10.0 billion (CSC's stockholders' equity, excluding AOCI, at September 30, 2016 was \$15.4 billion). Management believes these restrictions will not have a material effect on CSC's ability to meet foreseeable dividend or funding requirements.

CSC and Schwab also have access to uncommitted, unsecured bank credit lines with several banks. The need for short-term borrowings from these sources 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. These lines were not used by CSC during the first nine months of 2016. Schwab used such borrowings for one day during the first nine months of 2016 for \$15 million, and there were no borrowings outstanding under these lines at September 30, 2016.



THE CHARLES SCHWAB CORPORATION

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

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

To partially satisfy the margin requirement of client option transactions with the Options Clearing Corporation, the broker-dealer subsidiaries have unsecured standby letter of credit agreements (LOCs) with several banks in favor of the Options Clearing Corporation aggregating \$295 million at September 30, 2016. There were no funds drawn under any of these LOCs during the first nine months of 2016. In connection with its securities lending activities, the Company is required to provide collateral to certain brokerage clients. The collateral requirements were satisfied by providing cash as collateral.

Schwab Bank has access to short-term secured funding through the Federal Reserve's discount window. Amounts available under the Federal Reserve 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 on a periodic basis. At September 30, 2016, \$1.5 billion was available under this arrangement. Schwab Bank used such borrowings for one day during the first nine months of 2016 for \$1 million and there were no borrowings outstanding under these lines at September 30, 2016.

Schwab Bank also maintains a secured credit facility with the Federal Home Loan Bank of San Francisco (FHLB). Amounts available under this facility are dependent on the amount of Schwab Bank's First Mortgages, HELOCs, and the fair value of certain of Schwab'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 borrowing procedures on a periodic basis. At September 30, 2016, \$3.0 billion was outstanding under this facility with an additional \$5.9 billion available based on the loans currently pledged there. This funding source is being used to temporarily support recent investment purchases until later in 2016 when management expects to complete planned bulk transfers of uninvested client brokerage cash to Schwab Bank.

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 not to exceed the amount of the committed, unsecured credit facility, which was \$750 million at September 30, 2016. 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. CSC's ratings for these short-term borrowings are P1 by Moody's, A1 by Standard & Poor's, and F1 by Fitch. CSC had no Commercial Paper Notes outstanding as of September 30, 2016.

CSC had long-term debt of \$2.9 billion at September 30, 2016 and December 31, 2015, bearing a weighted-average interest rate of 3.37%. CSC has a universal automatic shelf registration statement on file with the Securities and Exchange Commission (SEC) which enables it to issue debt, equity, and other securities.

The following are details of CSC's Senior and Medium-Term Notes:

	Par		Weighted Average		Standard	
September 30, 2016	Outstanding	Maturity	Interest Rate	Moody's	& Poor's	Fitch
Senior Notes	\$ 2,581	2018 - 2026	3.03% fixed	A2	A	A
Medium-Term Notes	\$ 250	2017	6.375% fixed	A2	A	A

On March 7, 2016, CSC completed an equity offering of 30 million depository shares, each representing a 1/40th ownership interest in a share of 5.95% non-cumulative perpetual preferred stock (Series D Preferred Stock). The net proceeds from the sale were \$725 million. CSC's preferred stock is rated Baa2 by Moody's, BBB by Standard & Poor's, and BB+ by Fitch.

For further discussion of CSC's long-term debt and information on the equity offering, see "Item 1 – Notes to Condensed Consolidated Financial Statements (Unaudited) – 7. Borrowings and 11. Stockholders' Equity."

THE CHARLES SCHWAB CORPORATION

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

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

CAPITAL MANAGEMENT

The Company seeks to manage capital to a level and composition sufficient to support execution of its business strategy, including anticipated balance sheet growth, providing financial support to its subsidiaries, and sustained access to the capital markets, while at the same time meeting its regulatory capital requirements and serving as a source of financial strength to Schwab Bank. The Company's primary sources of capital are funds generated by the operations of its subsidiaries and securities issuances by CSC in the capital markets. To ensure that it has a sufficient amount of capital to absorb unanticipated losses or declines in asset values, the Company has adopted a policy to remain well capitalized even in stressed scenarios.

Internal guidelines are set, for both the Company and its regulated subsidiaries, to ensure capital levels are in line with the Company's strategy and regulatory requirements, and capital forecasts are reviewed monthly at Capital Planning and Asset-Liability Management and Pricing Committee meetings. A number of early warning indicators are monitored to help identify potential problems that could impact capital. In addition, the Company monitors its subsidiaries' capital levels and requirements. Subject to regulatory capital requirements and any required approvals, any excess capital held by subsidiaries is transferred to CSC in the form of dividends and returns of capital. When subsidiaries have need of additional capital, funds are provided by CSC as equity investments and also as subordinated loans (in a form approved as regulatory capital by regulators) for Schwab. The details and method used for each cash infusion are based on an analysis of the particular entity's needs and financing alternatives. The amounts and structure of infusions must take into consideration maintenance of regulatory capital requirements, debt/equity ratios, and equity double leverage ratios.

The Company conducts regular capital stress testing to assess the potential financial impacts of various adverse macroeconomic and company-specific events to which the Company could be subjected. The objective of the Company's capital stress testing is (1) to explore various potential outcomes – including rare and extreme events and (2) to assess impacts of potential stressful outcomes on both capital and liquidity. Additionally, the Company has a comprehensive Capital Contingency Plan to provide action plans for certain low probability/high impact capital events that the Company might face. The Capital Contingency Plan is issued under the authority of the Asset-Liability Management and Pricing Committee and provides guidelines for sustained capital events. It does not specifically address every contingency, but is designed to provide a framework for responding to any capital stress. The Capital Contingency Plan is reviewed annually and updated as appropriate.

For additional information, see "Part I – Item 1 – Business – Regulation" in the 2015 Form 10-K.

## Regulatory Capital Requirements

CSC is subject to capital requirements set by the Federal Reserve and is required to serve as a source of strength for Schwab Bank and to provide financial assistance if Schwab Bank experiences financial distress. To manage capital adequacy, the Company currently utilizes a target Tier 1 Leverage Ratio for CSC of at least 6%. Due to the relatively low risk of the Company's balance sheet assets and risk-based capital ratios at CSC and Schwab Bank that are well in excess of regulatory requirements, the Tier 1 Leverage Ratio is the most restrictive capital constraint on CSC's asset growth.

Schwab Bank is subject to capital requirements set by the OCC that are substantially similar to those imposed on CSC by the Federal Reserve. Schwab Bank's failure to remain well capitalized could result in certain mandatory and possibly additional discretionary actions by the regulators that could have a direct material effect on the bank. The Company currently utilizes a target Tier 1 Leverage Ratio for Schwab Bank of at least 6.25%. Based on its regulatory capital ratios at September 30, 2016, Schwab Bank is considered well capitalized.

## THE CHARLES SCHWAB CORPORATION

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

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

The following table details CSC's and Schwab Bank's capital ratios:

September 30, 2016	CSC	Schwab Bank
Total stockholders' equity	\$ 15,470	\$ 11,175
Less:		
Preferred Stock	2,192	-
Common Equity Tier 1 Capital before regulatory adjustments	\$ 13,278	\$ 11,175
Less:		
Goodwill, net of associated deferred tax liabilities	\$ 1,180	\$ 11
Other intangible assets, net of associated deferred tax liabilities	51	-
Deferred tax assets, net of valuation allowances and deferred tax liabilities	1	-
AOCI adjustment (1)	31	22
Common Equity Tier 1 Capital	\$ 12,015	\$ 11,142
Tier 1 Capital	\$ 14,207	\$ 11,142
Total Capital	14,234	11,168
Risk-Weighted Assets	66,794	59,122
Common Equity Tier 1 Capital/Risk-Weighted Assets	18.0 %	18.8 %
Tier 1 Capital/Risk-Weighted Assets	21.3 %	18.8 %
Total Capital/Risk-Weighted Assets	21.3 %	18.9 %
Tier 1 Leverage Ratio	7.1 %	7.0 %

(1) CSC and Schwab Bank have elected to opt-out of the requirement to include most components of AOCI in CET1 Capital.

Schwab Bank is also subject to regulatory requirements that restrict and govern the terms of affiliate transactions. In addition, Schwab Bank is required to provide notice to, and may be required to obtain approval from, the OCC and the Federal Reserve to declare dividends to CSC.

The Company's broker-dealer subsidiaries (Schwab and optionsXpress, Inc.) are subject to regulatory requirements of the Uniform Net Capital Rule. The rule is intended to ensure the general financial soundness and liquidity of broker-dealers. These regulations prohibit the broker-dealer subsidiaries from paying cash dividends, making unsecured advances and loans to their parent company and employees, and from repaying subordinated borrowings

from CSC 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. As such, the broker-dealer subsidiaries are required to maintain, at all times, at least the minimum level of net capital required under Rule 15c3-1. At September 30, 2016, Schwab and optionsXpress, Inc. met and exceeded their net capital requirements.

In addition to the capital requirements above, the Company's subsidiaries are subject to various regulatory requirements that are intended to ensure financial soundness and liquidity. See "Item 1 – Condensed Consolidated Balance Sheets and Notes to Condensed Consolidated Financial Statements (Unaudited) – 14. Regulatory Requirements" for additional information on the components of stockholders' equity and information on the capital requirements of each of the subsidiaries.

- 24 -

---

## THE CHARLES SCHWAB CORPORATION

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

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

## Dividends

On April 21, 2016, the Board of Directors of the Company declared a one cent, or 17%, increase in the quarterly cash dividend to \$0.07 per common share. The following table details the CSC cash dividends paid and per share amounts for the first nine months of 2016 and 2015:

Nine Months Ended September 30,	2016		2015	
	Cash Paid	Per Share Amount	Cash Paid	Per Share Amount
Common Stock	\$ 266	\$ 0.20	\$ 238	\$ 0.18
Series A Preferred Stock (1)	28	70.00	28	70.00
Series B Preferred Stock (2)	22	45.00	22	45.00
Series C Preferred Stock (2)	27	45.00	-	-
Series D Preferred Stock (2,3)	22	28.77	-	-

- (1) Dividends paid semi-annually until February 1, 2022 and quarterly thereafter.  
(2) Dividends paid quarterly.  
(3) Series D Preferred Stock was issued on March 7, 2016.

## off-Balance Sheet Arrangements

The Company enters into various off-balance sheet arrangements in the ordinary course of business. For information regarding our off-balance sheet arrangements, see the Notes to the Condensed Consolidated Financial Statements in this Form 10-Q: "4. Bank Loans and Related Allowance for Loan Losses, 5. Variable Interest Entities, 7. Borrowings, 8. Commitments and Contingencies," and the Company's 2015 Form 10-K, "Note 16. Financial Instruments Subject to

Off-Balance Sheet Credit Risk or Concentration Risk.”

#### 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 2015 Form 10-K. There have been no changes to these critical accounting estimates during the first nine months of 2016.

- 25 -

---



THE CHARLES SCHWAB CORPORATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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. The majority of the Company's interest-earning assets and interest-bearing liabilities are sensitive to changes in short-term interest rates. To a lesser degree, a portion of the Company's investment portfolios is sensitive to changes in long-term interest rates.

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 primarily include investment securities, margin loans and bank loans. These assets are sensitive to changes in interest rates and changes in prepayment levels that tend to increase in a declining rate environment and decrease in a rising rate environment. Because the Company establishes the rates paid on certain brokerage client cash balances and bank deposits and the rates charged on certain margin loans and bank 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.

To mitigate the risk of declining interest revenue, 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.

Financial instruments held by the Company are also subject to the risk that valuations will be negatively affected by changes in demand and the underlying market for a financial instrument. The Company is also subject to market risk as a result of fluctuations in option and equity prices. The Company's direct holdings of option and equity securities and its associated exposure to option and equity prices are not material. The Company is indirectly exposed to option, futures, and equity market fluctuations in connection with client option and futures accounts, securities collateralizing margin loans to brokerage customers, and client securities loaned out as part of the Company's brokerage 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 and ETF 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.

The Company's market risk related to financial instruments held for trading is not material.

#### Net Interest Revenue Simulation

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

If the Company's guidelines for its net interest revenue sensitivity are breached, management must report the breach to the Company's Corporate Asset-Liability Management and Pricing Committee and establish a plan to address the interest rate risk. This plan could include, but is not limited to, rebalancing certain investment portfolios or using derivative instruments to mitigate the interest rate risk. Depending on the severity and expected duration of the breach, as well as the then current interest rate environment, the plan could also be to take no action. Any plan that recommends taking action is required to be approved by the Company's Corporate Asset-Liability Management and Pricing Committee. There were no breaches of the Company's net interest revenue sensitivity guidelines during the first nine months of 2016 or year ended December 31, 2015.

## THE CHARLES SCHWAB CORPORATION

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.

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 additional interest rate exposure that could result from changes in the interest rate environment. The following table shows the simulated net interest revenue change over the next 12 months beginning September 30, 2016 and December 31, 2015 of a gradual 100 basis point increase or decrease in market interest rates relative to prevailing market rates at the end of each reporting period.

	September 30, 2016	December 31, 2015
Increase of 100 basis points	8.1 %	8.2 %
Decrease of 100 basis points	(11.1) %	(9.5) %

The change in net interest revenue sensitivities as of September 30, 2016 reflects the moderate increase of short- to medium-term interest rates. The current low interest rate environment limits the extent to which the Company can reduce interest expense paid on funding sources. A decline in interest rates could 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. The increase of short-term interest rates positively impacts net interest revenue as yields on interest-earning assets rise faster than the cost of funding sources.

## 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,	
	2016	2015	2016	2015
Net Revenues				
Asset management and administration fees (1)	\$ 798	\$ 663	\$ 2,254	\$ 1,977
Interest revenue	891	669	2,541	1,931
Interest expense	(46)	(34)	(126)	(96)
Net interest revenue	845	635	2,415	1,835
Trading revenue	190	228	623	658
Other	76	66	209	208
Provision for loan losses	5	5	5	11
Total net revenues	1,914	1,597	5,506	4,689
Expenses Excluding Interest				
Compensation and benefits	609	548	1,837	1,669
Professional services	131	114	372	340
Occupancy and equipment	100	92	299	260
Advertising and market development	64	58	204	189
Communications	57	58	179	175
Depreciation and amortization	60	57	173	166
Other	99	87	273	256
Total expenses excluding interest	1,120	1,014	3,337	3,055
Income before taxes on income	794	583	2,169	1,634
Taxes on income	291	207	802	603
Net Income	503	376	1,367	1,031
Preferred stock dividends and other (2)	33	11	99	45
Net Income Available to Common Stockholders	\$ 470	\$ 365	\$ 1,268	\$ 986
Weighted-Average Common Shares Outstanding:				

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Basic	1,324	1,316	1,322	1,315
Diluted	1,334	1,328	1,332	1,326
Earnings Per Common Share:				
Basic	\$ .36	\$ .28	\$ .96	\$ .75
Diluted	\$ .35	\$ .28	\$ .95	\$ .74
Dividends Declared Per Common Share	\$ .07	\$ .06	\$ .20	\$ .18

- (1) Includes fee waivers of \$41 and \$166 during the third quarters of 2016 and 2015, respectively and \$193 and \$519 during the first nine months of 2016 and 2015, respectively, relating to Schwab-sponsored money market funds.
- (2) Includes preferred stock dividends and undistributed earnings and dividends allocated to non-vested restricted stock units.

See Notes to Condensed Consolidated Financial Statements.

## THE CHARLES SCHWAB CORPORATION

## Condensed Consolidated Statements of Comprehensive Income

(In Millions)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net Income	\$ 503	\$ 376	\$ 1,367	\$ 1,031
Other comprehensive income (loss), before tax:				
Change in net unrealized gain on securities available for sale:				
Net unrealized gain (loss)	77	(249)	266	(233)
Other reclassifications included in other revenue	-	-	(3)	-
Other	-	-	1	-
Other comprehensive income (loss), before tax	77	(249)	264	(233)
Income tax effect	(29)	94	(99)	87
Other comprehensive income (loss), net of tax	48	(155)	165	(146)
Comprehensive Income	\$ 551	\$ 221	\$ 1,532	\$ 885

See Notes to Condensed Consolidated Financial Statements.

## THE CHARLES SCHWAB CORPORATION

## Condensed Consolidated Balance Sheets

(In Millions, Except Per Share and Share Amounts)

(Unaudited)

	September 30, 2016	December 31, 2015 (1)
Assets		
Cash and cash equivalents	\$ 10,431	\$ 11,978
Cash and investments segregated and on deposit for regulatory purposes (including resale agreements of \$9,425 at September 30, 2016 and \$8,088 at December 31, 2015)	20,077	19,598
Receivables from brokers, dealers, and clearing organizations	947	582
Receivables from brokerage clients — net	16,380	17,313
Other securities owned — at fair value	858	533
Securities available for sale	75,791	65,646
Securities held to maturity (fair value — \$67,843 at September 30, 2016 and \$50,088 at December 31, 2015)	66,056	50,007
Bank loans — net	14,858	14,334
Equipment, office facilities, and property — net	1,266	1,145
Goodwill	1,227	1,227
Intangible assets — net	154	181
Other assets	1,292	1,161
Total assets	\$ 209,337	\$ 183,705
Liabilities and Stockholders' Equity		
Bank deposits	\$ 149,630	\$ 129,502
Payables to brokers, dealers, and clearing organizations	3,497	2,588
Payables to brokerage clients	32,961	33,185
Accrued expenses and other liabilities	1,902	2,151
Short-term borrowings	3,001	-
Long-term debt	2,876	2,877
Total liabilities	193,867	170,303
Stockholders' equity:		
Preferred stock — \$.01 par value per share; aggregate liquidation preference of \$2,235 at September 30, 2016 and \$1,485 at December 31, 2015	2,192	1,459
Common stock — 3 billion shares authorized; \$.01 par value per share; 1,487,543,446 shares issued	15	15
Additional paid-in capital	4,254	4,152

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Retained earnings	12,261	11,253
Treasury stock, at cost — 163,516,791 shares at September 30, 2016 and 167,205,881 shares at December 31, 2015	(3,283)	(3,343)
Accumulated other comprehensive income	31	(134)
Total stockholders' equity	15,470	13,402
Total liabilities and stockholders' equity	\$ 209,337	\$ 183,705

(1) Adjusted for the retrospective adoption of ASU 2015-03. See "Notes – 2. New Accounting Standards" for additional information.

See Notes to Condensed Consolidated Financial Statements.

- 30 -

---



## THE CHARLES SCHWAB CORPORATION

## Condensed Consolidated Statements of Cash Flows

(In Millions)

(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash Flows from Operating Activities		
Net income	\$ 1,367	\$ 1,031
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Provision for loan losses	(5)	(11)
Stock-based compensation	101	98
Depreciation and amortization	173	166
Premium amortization, net, on securities available for sale and securities held to maturity	181	119
Other	25	7
Net change in:		
Cash and investments segregated and on deposit for regulatory purposes	(479)	3,538
Receivables from brokers, dealers, and clearing organizations	(370)	(110)
Receivables from brokerage clients	928	(1,426)
Other securities owned	(325)	46
Other assets	(61)	(59)
Payables to brokers, dealers, and clearing organizations	(111)	473
Payables to brokerage clients	(224)	(3,265)
Accrued expenses and other liabilities	(226)	(253)
Net cash provided by operating activities	974	354
Cash Flows from Investing Activities		
Purchases of securities available for sale	(22,782)	(17,497)
Proceeds from sales of securities available for sale	4,645	599
Principal payments on securities available for sale	8,652	5,172
Purchases of securities held to maturity	(19,439)	(8,824)
Principal payments on securities held to maturity	3,841	2,709
Net increase in bank loans	(600)	(863)
Purchases of equipment, office facilities, and property	(272)	(204)
Purchases of Federal Home Loan Bank stock	(152)	-
Proceeds from sales of Federal Home Loan Bank stock	88	8
Other investing activities	(25)	(18)
Net cash used for investing activities	(26,044)	(18,918)
Cash Flows from Financing Activities		
Net change in bank deposits	20,128	16,202
Proceeds from short-term borrowings	8,505	-

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Repayment of short-term borrowings	(5,504)	-
Issuance of long-term debt	-	998
Repayment of long-term debt	(5)	(6)
Net proceeds from preferred stock offering	725	581
Dividends paid	(365)	(288)
Proceeds from stock options exercised and other	31	67
Other financing activities	8	13
Net cash provided by financing activities	23,523	17,567
Decrease in Cash and Cash Equivalents	(1,547)	(997)
Cash and Cash Equivalents at Beginning of Period	11,978	11,363
Cash and Cash Equivalents at End of Period	\$ 10,431	\$ 10,366
Supplemental Cash Flow Information		
Cash paid during the period for:		
Interest	\$ 141	\$ 107
Income taxes	\$ 757	\$ 598
Non-cash investing activity:		
Securities purchased during the period but settled after period end	\$ 1,021	\$ 230

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

CSC is a savings and loan holding company engaged, through its subsidiaries, in wealth management, securities brokerage, banking, money management, custody, and financial advisory services. Schwab is a securities broker-dealer with over 330 domestic branch offices in 46 states, as well as a branch in each of the Commonwealth of Puerto Rico and London, England. In addition, Schwab serves clients in Hong Kong through one of CSC's subsidiaries. Other subsidiaries include Schwab Bank, a federal savings bank, and 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 U.S., 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 (OTTI) of securities available for sale and securities held to maturity, valuation of goodwill, allowance for loan losses, and legal and regulatory 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. 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 2015 Form 10-K.

The Company's significant accounting policies are included in "Notes – 2. Summary of Significant Accounting Policies" in the 2015 Form 10-K. There have been no significant changes to these accounting policies during the first nine months of 2016.

Principles of Consolidation

The Company evaluates for consolidation all entities in which it has financial interests, except for money market funds which are specifically excluded from consolidation guidance. For an entity subject to consolidation, the Company evaluates whether the Company's interest in the entity constitutes a controlling financial interest under either the variable interest entity (VIE) model or a voting interest entity (VOE) model. Based upon the Company's assessments, the Company is not deemed to have a controlling financial interest in and, therefore, is not required to consolidate any VIEs. See "Notes – 5. Variable Interest Entities" for further information about VIEs. The Company consolidates all VOEs in which it has majority voting interests.

For investments in entities in which the Company does not have a controlling financial interest, the Company accounts for those investments under the equity method of accounting when the Company has the ability to exercise significant influence over operating and financing decisions of the entity. Investments in entities for which the Company does not have the ability to exercise significant influence are generally carried at cost. Both equity method and cost method investments are included in other assets on the condensed consolidated balance sheets.

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

2. New Accounting Standards

Adoption of New Accounting Standards

On January 1, 2016, the Company adopted ASU 2015-02, "Consolidation (Topic 810)," which amends the analysis a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The new guidance is applicable to all entities but provides an exception for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The adoption of ASU 2015-02 did not have an impact on the Company's consolidated financial statements or EPS as the new guidance did not change any existing consolidation conclusions reached in accordance with the previous guidance.

On January 1, 2016, the Company adopted ASU 2015-03, "Interest – Imputation of Interest (Subtopic 835-30)." ASU 2015-03 requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Previously, debt issuance costs were presented as a separate asset on the balance sheet. The guidance in ASU 2015-03 has been applied on a retrospective basis which requires the adjustment of all prior period consolidated balance sheets. The effect of the adoption on the Company's December 31, 2015 consolidated balance sheet was to decrease other assets and total assets by \$13 million and to decrease long-term debt and total liabilities by \$13 million. A similar amount was also reclassified in the prior year. The Company considers the reclassifications immaterial.

On January 1, 2016, the Company also adopted ASU 2015-05, "Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40)," which provides new guidance that clarifies customer's accounting for fees paid in a cloud computing arrangement. Under the new guidance, if a cloud computing arrangement includes a software license, the customer shall account for the software license element of the arrangement consistent with the acquisition of other software licenses. If the cloud computing arrangement does not include a software license, the customer shall account for the arrangement as a service contract. The guidance applies to all new arrangements entered into after January 1, 2016. The adoption of ASU 2015-05 did not have an impact on the Company's financial statements or EPS.

New Accounting Standards Not Yet Adopted

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” which provides new guidance on revenue recognition. The guidance clarifies that revenue from contracts with customers should be recognized in a manner that depicts the timing of the related transfer of goods or performance of services at an amount that reflects the expected consideration. The new guidance will become effective January 1, 2018, with early adoption permitted as of January 1, 2017. Entities may elect either full or modified retrospective transition. Full retrospective transition will require a cumulative effect adjustment to retained earnings as of the earliest comparative period presented. Modified retrospective transition will require a cumulative effect adjustment to retained earnings as of the beginning of the reporting period in which the entity first applies the new guidance. The Company is currently evaluating the impact of this new guidance on its financial statements and EPS.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10),” which will become effective January 1, 2018. This new guidance addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The main provisions of the guidance include (i) most equity investments are to be measured at fair value with changes in fair value recognized in net income, except for those accounted for under the equity method or those that do not have readily determinable fair values for which a practical expedient can be elected, (ii) requires the use of an exit price notion when measuring the fair value of financial instruments for disclosure purposes, and (iii) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial instrument on the balance sheet or in the accompanying notes. The Company is currently evaluating the impact of this new guidance on its financial statements and EPS.

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)” which amends the accounting for leases by lessees and lessors. The primary change as a result of the new standard is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. Additional changes include accounting for lease origination and executory costs, required lessee reassessments during the lease term due to changes in circumstances and expanded lease disclosures. ASU 2016-02 will become effective January 1, 2019, with early adoption permitted, and requires entities to apply the new guidance using a modified retrospective transition. Modified retrospective transition requires entities to apply the new guidance as of the beginning of the earliest comparative period presented in the financial statements in which the entity first applies the new standard. Certain transition reliefs are permitted if elected by the entity. The Company is currently evaluating the impact of this new guidance on its financial statements and EPS.

In March 2016, the FASB issued ASU 2016-09, “Stock Compensation – Improvements to Employee Share-Based Payment Accounting (Topic 718)” which amends certain aspects of how an entity accounts for share-based payments to employees. The new guidance requires entities to recognize the income tax effects of share-based awards in the income statement when the awards vest or are settled, rather than recording such effects in additional paid-in capital. Entities will also be permitted to elect to account for forfeitures of share-based payments as they occur or continue with current practice which requires estimating the number of awards expected to be forfeited and adjusting the estimate when it is likely to change. ASU 2016-09 will become effective January 1, 2017, with early adoption permitted. The change in recognition of income tax effects of share-based awards will be applied prospectively. If an entity elects to account for forfeitures of share-based payments as they occur, such change will be applied using a modified retrospective transition method, with a cumulative-effect adjustment to retained earnings. The Company is currently evaluating the impact of this new guidance on its financial statements and EPS.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” which provides new guidance for recognizing impairment of most debt instruments measured at amortized cost, including loans and held to maturity debt securities. The new guidance will require estimating expected credit losses (ECL) over the remaining life of an instrument or a portfolio of instruments with similar risk characteristics based on relevant information about past events, current conditions and reasonable forecasts. The initial estimate of and the subsequent changes in ECL will be recognized as credit loss expense through current earnings and will be reflected as an allowance for credit losses offsetting the carrying value of the financial instrument(s) on the balance sheet. The new guidance also amends the OTTI model for available for sale debt securities by requiring the use of an allowance, rather than directly reducing the carrying value of the security, and eliminating consideration of the length of time such security has been in an unrealized loss position as a factor in concluding whether a credit loss exists. ASU 2016-13 will become effective January 1, 2020, with early adoption permitted as of January 1, 2019. The new guidance will be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the entity applies the new guidance except that a prospective transition is required for available for sale debt securities for which an OTTI had been recognized before

the effective date. The Company is currently evaluating the impact of this new guidance on its financial statements and EPS.

- 34 -

---



## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

## 3. 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:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2016				
Securities available for sale:				
U.S. agency mortgage-backed securities	\$ 33,195	\$ 219	\$ 44	\$ 33,370
Asset-backed securities	21,736	30	266	21,500
Corporate debt securities	10,067	54	2	10,119
U.S. Treasury securities	4,966	33	-	4,999
U.S. agency notes	2,206	-	1	2,205
Certificates of deposit	2,295	2	1	2,296
U.S. state and municipal securities	1,012	26	1	1,037
Commercial paper	214	-	-	214
Non-agency commercial mortgage-backed securities	51	-	-	51
Total securities available for sale	\$ 75,742	\$ 364	\$ 315	\$ 75,791
Securities held to maturity:				
U.S. agency mortgage-backed securities	\$ 64,836	\$ 1,738	\$ 4	\$ 66,570
Non-agency commercial mortgage-backed securities	997	43	-	1,040
U.S. Treasury securities	223	10	-	233
Total securities held to maturity	\$ 66,056	\$ 1,791	\$ 4	\$ 67,843

## December 31, 2015

## Securities available for sale:

U.S. agency mortgage-backed securities	\$ 22,014	\$ 183	\$ 48	\$ 22,149
Asset-backed securities	21,784	7	306	21,485
Corporate debt securities	10,764	14	31	10,747
U.S. Treasury securities	5,719	2	17	5,704
U.S. agency notes	3,177	-	27	3,150
Certificates of deposit	1,685	1	3	1,683
U.S. state and municipal securities	414	10	-	424

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Non-agency commercial mortgage-backed securities	298	1	-	299
Other securities	5	-	-	5
Total securities available for sale	\$ 65,860	\$ 218	\$ 432	\$ 65,646
Securities held to maturity:				
U.S. agency mortgage-backed securities	\$ 48,785	\$ 391	\$ 293	\$ 48,883
Non-agency commercial mortgage-backed securities	999	6	20	985
U.S. Treasury securities	223	-	3	220
Total securities held to maturity	\$ 50,007	\$ 397	\$ 316	\$ 50,088

Schwab Bank pledges securities issued by federal agencies to secure certain trust deposits. The fair value of these pledged securities was \$170 million at September 30, 2016.

- 35 -

---

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

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	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2016						
Securities available for sale:						
U.S. agency mortgage-backed securities	\$ 10,233	\$ 21	\$ 2,672	\$ 23	\$ 12,905	\$ 44
Asset-backed securities	1,235	14	10,504	252	11,739	266
Corporate debt securities	758	1	882	1	1,640	2
U.S. agency notes	499	1	-	-	499	1
Certificates of deposit	544	1	200	-	744	1
U.S. state and municipal securities	124	1	-	-	124	1
Total	\$ 13,393	\$ 39	\$ 14,258	\$ 276	\$ 27,651	\$ 315
Securities held to maturity:						
U.S. agency mortgage-backed securities	\$ 2,475	\$ 4	\$ -	\$ -	\$ 2,475	\$ 4
Total	\$ 2,475	\$ 4	\$ -	\$ -	\$ 2,475	\$ 4
Total securities with unrealized losses (1)	\$ 15,868	\$ 43	\$ 14,258	\$ 276	\$ 30,126	\$ 319

## December 31, 2015

## Securities available for sale:

U.S. agency mortgage-backed securities	\$ 8,541	\$ 47	\$ 813	\$ 1	\$ 9,354	\$ 48
Asset-backed securities	17,127	240	2,743	66	19,870	306
Corporate debt securities	5,433	25	942	6	6,375	31
U.S. Treasury securities	5,010	17	-	-	5,010	17
U.S. agency notes	1,281	10	1,547	17	2,828	27
Certificates of deposit	773	2	599	1	1,372	3
Total	\$ 38,165	\$ 341	\$ 6,644	\$ 91	\$ 44,809	\$ 432
Securities held to maturity:						
U.S. agency mortgage-backed securities	\$ 24,219	\$ 253	\$ 1,842	\$ 40	\$ 26,061	\$ 293
Non-agency commercial mortgage-backed securities	729	20	-	-	729	20
U.S. Treasury securities	220	3	-	-	220	3
Total	\$ 25,168	\$ 276	\$ 1,842	\$ 40	\$ 27,010	\$ 316

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Total securities with unrealized losses (2)      \$ 63,333    \$ 617    \$ 8,486    \$ 131    \$ 71,819    \$ 748

- (1) The number of investment positions with unrealized losses totaled 339 for securities available for sale and 24 for securities held to maturity.
- (2) The number of investment positions with unrealized losses totaled 409 for securities available for sale and 286 for securities held to maturity.

Management evaluates whether securities available for sale and securities held to maturity are OTTI on a quarterly basis as described in “Notes – 2. Summary of Significant Accounting Policies” in the 2015 Form 10-K.

- 36 -

---

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

The maturities of securities available for sale and securities held to maturity are as follows:

September 30, 2016	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 mortgage-backed securities (1)	\$ -	\$ 3,417	\$ 16,966	\$ 12,987	\$ 33,370
Asset-backed securities	-	9,125	4,150	8,225	21,500
Corporate debt securities	2,233	7,886	-	-	10,119
U.S. Treasury securities	200	4,592	207	-	4,999
U.S. agency notes	-	2,205	-	-	2,205
Certificates of deposit	876	1,420	-	-	2,296
U.S. state and municipal securities	-	-	51	986	1,037
Commercial paper	214	-	-	-	214
Non-agency commercial mortgage-backed securities	-	-	-	51	51
Total fair value	\$ 3,523	\$ 28,645	\$ 21,374	\$ 22,249	\$ 75,791
Total amortized cost	\$ 3,517	\$ 28,473	\$ 21,386	\$ 22,366	\$ 75,742
Securities held to maturity:					
U.S. agency mortgage-backed securities (1)	\$ -	\$ 4,201	\$ 22,947	\$ 39,422	\$ 66,570
Non-agency commercial mortgage-backed securities (1)	-	-	376	664	1,040
U.S. Treasury securities	-	-	233	-	233
Total fair value	\$ -	\$ 4,201	\$ 23,556	\$ 40,086	\$ 67,843
Total amortized cost	\$ -	\$ 4,019	\$ 22,605	\$ 39,432	\$ 66,056

(1) Mortgage-backed securities have been allocated to 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 and losses from sales of securities available for sale are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Proceeds	\$ 571	\$ 5	\$ 4,645	\$ 599
Gross realized gains	-	-	3	1
Gross realized losses	-	-	-	1

- 37 -

---

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

## 4. Bank Loans and Related Allowance for Loan Losses

The composition of bank loans and delinquency analysis by loan segment is as follows:

		30-59 days past due	60-89 days past due	>90 days past due and other nonaccrual loans	Total past due and other nonaccrual loans	Total loans	Allowance for loan losses	Allowance Total bank loans - net
September 30, 2016	Current							
Residential real estate mortgages	\$ 8,660	\$ 8	\$ 4	\$ 15	\$ 27	\$ 8,687	\$ 15	\$ 8,672
Home equity loans and lines of credit	2,456	4	1	11	16	2,472	10	2,462
Pledged asset lines	3,644	-	-	2	2	3,646	-	3,646
Other	79	-	-	-	-	79	1	78
Total bank loans	\$ 14,839	\$ 12	\$ 5	\$ 28	\$ 45	\$ 14,884	\$ 26	\$ 14,858
December 31, 2015								
Residential real estate mortgages	\$ 8,304	\$ 11	\$ 1	\$ 18	\$ 30	\$ 8,334	\$ 20	\$ 8,314
Home equity loans and lines of credit	2,720	4	1	10	15	2,735	11	2,724
Pledged asset lines	3,228	3	1	-	4	3,232	-	3,232
Other	64	-	-	-	-	64	-	64
Total bank loans	\$ 14,316	\$ 18	\$ 3	\$ 28	\$ 49	\$ 14,365	\$ 31	\$ 14,334

First Mortgages and HELOCs include unamortized premiums and discounts and direct origination costs of \$78 million and \$80 million at September 30, 2016 and December 31, 2015, respectively. The Company had commitments to extend credit related to unused HELOCs, PALs, and other lines of credit, which totaled \$8.2 billion and \$7.4 billion at September 30, 2016 and December 31, 2015, respectively. The Company had commitments to purchase First Mortgage loans of \$898 million and \$260 million at September 30, 2016 and December 31, 2015, respectively. All PALs were fully collateralized by securities with fair values in excess of borrowings at September 30, 2016 and December 31, 2015.

Schwab Bank provides 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 First Mortgages and HELOCs for Schwab Bank clients. Under the Program, Schwab Bank purchases certain First Mortgages and HELOCs that are originated by Quicken Loans. Schwab Bank purchased First Mortgages of \$858 million and \$469 million during the third quarters of 2016 and 2015, respectively, and \$2.1 billion and \$1.5 billion during the first nine months of 2016 and 2015, respectively. Schwab purchased HELOCs with commitments of \$93 million and \$150 million during the third quarters of 2016 and 2015, respectively, and \$315 million and \$432 million during the first nine months of 2016 and 2015, respectively.



## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

## Credit Quality

Changes in the allowance for loan losses were as follows:

Three Months Ended	September 30, 2016				September 30, 2015		
	Home Residential real estate and lines of mortgages	Home equity loans and credit	Other	Total	Home Residential real estate and lines of mortgages	Home equity loans and credit	Total
Balance at beginning of period	\$ 20	\$ 10	\$ 1	\$ 31	\$ 23	\$ 13	\$ 36
Charge-offs	-	-	-	-	-	-	-
Recoveries	-	-	-	-	1	-	1
Provision for loan losses	(5)	-	-	(5)	(4)	(2)	(6)
Balance at end of period	\$ 15	\$ 10	\$ 1	\$ 26	\$ 20	\$ 11	\$ 31

  

Nine Months Ended	September 30, 2016				September 30, 2015		
	Home Residential real estate and lines of mortgages	Home equity loans and credit	Other	Total	Home Residential real estate and lines of mortgages	Home equity loans and credit	Total
Balance at beginning of period	\$ 20	\$ 11	\$ -	\$ 31	\$ 29	\$ 13	\$ 42
Charge-offs	(1)	-	-	(1)	-	(2)	(2)
Recoveries	1	-	-	1	1	2	3
Provision for loan losses	(5)	(1)	1	(5)	(10)	(2)	(12)
Balance at end of period	\$ 15	\$ 10	\$ 1	\$ 26	\$ 20	\$ 11	\$ 31

Substantially all of the bank loans were collectively evaluated for impairment at September 30, 2016 and December 31, 2015. There were no loans accruing interest that were contractually 90 days or more past due at September 30, 2016 or December 31, 2015. Nonperforming assets, which include nonaccrual loans and other real

estate owned, totaled \$35 million and \$36 million at September 30, 2016 and December 31, 2015, respectively. Impaired assets, which include nonaccrual loans, other real estate owned and troubled debt restructurings, totaled \$48 million and \$50 million at September 30, 2016 and December 31, 2015, respectively. Troubled debt restructurings were not material at September 30, 2016 or December 31, 2015.

In addition to monitoring delinquency, the Company monitors the credit quality of First Mortgages and HELOCs by stratifying the portfolios by the following:

- year of origination;
- borrower FICO scores at origination (Origination FICO);
- updated borrower FICO scores (Updated FICO);
- loan-to-value ratios at origination (Origination LTV); and
- estimated current LTV ratios (Estimated Current LTV).

Borrowers' FICO scores are provided by an independent third-party credit reporting service and were last updated in September 2016. The Origination LTV and Estimated Current LTV 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.

As of September 30, 2016 and December 31, 2015, 48% of the Company's HELOC and First Mortgage portfolio was concentrated in California. These loans have performed in a manner consistent with the portfolio as a whole.

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

The credit quality indicators of the Company's bank loan portfolio are detailed below.

September 30, 2016	Balance	Weighted Average Updated FICO	Utilization Rate(1)	Percent of Loans on Nonaccrual Status
Residential real estate mortgages: Estimated Current LTV				
<70%	\$ 7,994	775	N/A	0.02 %
>70% – <90%	645	766	N/A	0.18 %
>90% – <100%	22	732	N/A	3.48 %
>100%	26	719	N/A	13.54 %
Total	\$ 8,687	774	N/A	0.08 %
Home equity loans and lines of credit: Estimated Current LTV				
<70%	\$ 2,146	772	36 %	0.15 %
>70% – <90%	270	758	49 %	0.55 %
>90% – <100%	33	750	60 %	1.66 %
>100%	23	737	65 %	3.05 %
Total	\$ 2,472	770	37 %	0.24 %
Pledged asset lines: Weighted-Average LTV =70%	\$ 3,646	763	47 %	-

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

	Residential	Home equity
	real estate	loans and
September 30, 2016	mortgages	lines of credit
Year of origination		

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Pre-2012	\$ 1,100	\$ 1,766
2012	1,263	111
2013	1,950	206
2014	766	166
2015	1,599	155
2016	2,009	68
Total	\$ 8,687	\$ 2,472
Origination FICO		
<620	\$ 8	\$ -
620 – 679	91	14
680 – 739	1,378	451
>740	7,210	2,007
Total	\$ 8,687	\$ 2,472
Origination LTV		
<70%	\$ 6,410	\$ 1,701
>70% – <90%	2,267	757
>90% – <100%	10	14
Total	\$ 8,687	\$ 2,472

- 40 -

---

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

December 31, 2015	Balance	Weighted Average Updated FICO	Utilization Rate(1)	Percent of Loans on Nonaccrual Status
Residential real estate mortgages:				
Estimated Current LTV				
<70%	\$ 7,508	774	N/A	0.03 %
>70% – <90%	759	764	N/A	0.31 %
>90% – <100%	37	736	N/A	5.54 %
>100%	30	713	N/A	7.72 %
Total	\$ 8,334	773	N/A	0.11 %
Home equity loans and lines of credit:				
Estimated Current LTV				
<70%	\$ 2,277	772	37 %	0.09 %
>70% – <90%	373	760	50 %	0.48 %
>90% – <100%	48	748	63 %	1.02 %
>100%	37	739	67 %	1.79 %
Total	\$ 2,735	770	39 %	0.18 %
Pledged asset lines:				
Weighted-Average LTV =70%	\$ 3,232	764	49 %	-

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

December 31, 2015 Year of origination	Residential real estate mortgages	Home equity loans and lines of credit
Pre-2012	\$ 1,306	\$ 2,048
2012	1,644	125
2013	2,450	232
2014	1,021	188

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

2015	1,913	142
Total	\$ 8,334	\$ 2,735
Origination FICO		
<620	\$ 10	\$ -
620 – 679	88	16
680 – 739	1,381	498
>740	6,855	2,221
Total	\$ 8,334	\$ 2,735
Origination LTV		
<70%	\$ 5,913	\$ 1,858
>70% – <90%	2,408	860
>90% – <100%	13	17
Total	\$ 8,334	\$ 2,735

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

5. Variable Interest Entities

A VIE requires consolidation by the entity's primary beneficiary. The Company evaluates all entities in which it has a financial interest to determine if the entity is a VIE and if so, whether the Company is the primary beneficiary. See the "Principles of Consolidation" section of "Notes – 1. Introduction and Basis of Presentation" in the 2015 Form 10-K, for discussion of the Company's evaluations of VIEs and whether it is deemed to be the primary beneficiary of any VIEs in which it holds an interest. The Company was not the primary beneficiary of, and therefore, not required to consolidate any VIEs at September 30, 2016 and December 31, 2015.

Community Reinvestment Act investments

Schwab Bank is subject to the Community Reinvestment Act (CRA). The CRA is intended to encourage banks to help meet the credit needs of the communities in which they operate, including low and moderate income neighborhoods, consistent with safe and sound banking operations. As part of Schwab Bank's community reinvestment initiatives, Schwab Bank invests with other institutional investors in funds that make equity investments in multifamily affordable housing properties. Schwab Bank receives tax credits and other tax benefits for these investments. Schwab Bank's Low-Income Housing Tax Credit (LIHTC) investments are accounted for using the proportional amortization method. Amortization, tax credits, and other tax benefits recognized in relation to LIHTC investments are included in taxes on income on the condensed consolidated statements of income. As of September 30, 2016 and December 31, 2015, the majority of the Company's VIEs related to Schwab Bank's LIHTC investments.

The carrying value of the LIHTC investments was \$153 million and \$104 million as of September 30, 2016 and December 31, 2015, respectively, which is included in other assets on the condensed consolidated balance sheets. Schwab Bank recorded liabilities of \$110 million and \$84 million for unfunded commitments related to LIHTC investments at September 30, 2016 and December 31, 2015, respectively, which are included in accrued expenses and other liabilities on the condensed consolidated balance sheets. Schwab Bank's funding of these remaining commitments is dependent upon the occurrence of certain conditions and Schwab Bank expects to pay substantially all of these commitments between 2016 and 2019.

## Aggregate assets, liabilities and maximum exposure to loss

The aggregate assets, liabilities, and maximum exposure to loss from those VIEs in which the Company holds a variable interest, but as to which the Company has concluded it is not the primary beneficiary, are summarized in the table below:

	September 30, 2016			December 31, 2015		
	Aggregate assets	Aggregate liabilities	Maximum exposure to loss	Aggregate assets	Aggregate liabilities	Maximum exposure to loss
LIHTC investments	\$ 153	\$ 110	\$ 153	\$ 104	\$ 84	\$ 104
Other CRA investments (1)	55	-	65	57	-	66
Total	\$ 208	\$ 110	\$ 218	\$ 161	\$ 84	\$ 170

(1) Other CRA investments are recorded using either the cost method or the equity method. Aggregate assets are included in either other assets or bank loans – net on the condensed consolidated balance sheets.

The Company's maximum exposure to loss would result from the loss of the investments, including any committed amounts. During the nine months ended September 30, 2016 and 2015, the Company did not provide or intend to provide financial or other support to the VIEs that it was not contractually required to provide.



## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

## 6. Bank Deposits

Bank deposits consist of interest-bearing and non-interest-bearing deposits as follows:

	September 30, 2016	December 31, 2015
Interest-bearing deposits:		
Deposits swept from brokerage accounts	\$ 127,866	\$ 108,137
Checking	13,543	12,822
Savings and other	7,643	7,896
Total interest-bearing deposits	149,052	128,855
Non-interest-bearing deposits	578	647
Total bank deposits	\$ 149,630	\$ 129,502

## 7. Borrowings

Long-term debt was net of unamortized debt discounts/premiums and debt issuance costs of \$25 million and \$29 million at September 30, 2016 and December 31, 2015, respectively.

	September 30, 2016	December 31, 2015
Senior Notes	\$ 2,556	\$ 2,553 (1)
Senior Medium-Term Notes	250	249 (1)
Finance lease obligation	70	75

Total long-term debt	\$ 2,876	\$ 2,877
----------------------	----------	----------

(1) Balances as of December 31, 2015 have been recast as a result of the adoption of ASU 2015-03, to present debt issuance costs of \$13 million as a direct deduction from the carrying amount of the associated debt liability, consistent with the recording of debt discounts.

Annual maturities on long-term debt outstanding at September 30, 2016 are as follows:

2016	\$ 2
2017	258
2018	908
2019	8
2020	709
Thereafter	1,016
Total maturities	2,901
Unamortized discount, net	(14)
Debt issuance costs	(11)
Total long-term debt	\$ 2,876

Short-term borrowings: Schwab Bank maintains a secured credit facility with the FHLB. At September 30, 2016, \$3.0 billion was outstanding under this facility with an additional \$5.9 billion available based on the loans currently pledged there. As a condition of the borrowings, Schwab Bank purchased \$152 million of FHLB stock, recorded at par, and sold \$88 million of FHLB stock in the first nine months of 2016, with the net investment recorded in other assets on the condensed consolidated balance sheets. Schwab Bank sold \$8 million of FHLB stock during the first nine months of 2015. No funds were drawn under this facility as of December 31, 2015. Amounts outstanding under this facility are included in short-term borrowings on the condensed consolidated balance sheets.

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

CSC has authorization from its Board of Directors to issue Commercial Paper Notes not to exceed \$1.5 billion. Management has set a current limit for the commercial paper program not to exceed the amount of the committed, unsecured credit facility, which was \$750 million at September 30, 2016. 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. CSC had no borrowings of Commercial Paper Notes outstanding at September 30, 2016 and December 31, 2015.

#### 8. Commitments and Contingencies

**Guarantees and indemnifications:** The Company has clients that sell (i.e., write) listed option contracts that are cleared by the Options Clearing Corporation – a clearing house that establishes margin requirements on these transactions. The Company partially satisfies the margin requirements by arranging unsecured standby LOCs, in favor of the Options Clearing Corporation, which are issued by several banks. At September 30, 2016, the aggregate face amount of these LOCs totaled \$295 million. There were no funds drawn under any of these LOCs at September 30, 2016. In connection with its securities lending activities, the Company is required to provide collateral to certain brokerage clients. The Company satisfies the collateral requirements by providing cash as collateral.

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, but 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.

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. Unless otherwise noted, the Company is unable to provide a reasonable estimate of any potential liability given the stage of proceedings in the matter.

With respect to all other pending matters, based on current information and consultation with counsel, it does not appear reasonably possible that the outcome of any such matter would be material to the financial condition, operating results or cash flows of the Company. Predicting the outcome of a litigation or regulatory matter is inherently difficult, requiring significant judgment and evaluation of various factors, 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. It may not be 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.

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

**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™. The lawsuit, which alleged violations of state law and federal securities law in connection with the fund's investment policy, named CSIM, Schwab Investments (registrant and issuer of the fund's shares) and certain current and former fund trustees 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. Plaintiff seeks unspecified compensatory and rescission damages, unspecified equitable and injunctive relief, costs and attorneys' fees. Plaintiff's federal securities law claim and certain of plaintiff's state law claims were dismissed. On August 8, 2011, the court dismissed plaintiff's remaining claims with prejudice. Plaintiff appealed to the Ninth Circuit, which issued a ruling on March 9, 2015 reversing the district court's dismissal of the case and remanding the case for further proceedings. Plaintiff filed a fourth amended complaint on June 25, 2015, and in decisions issued October 6, 2015 and February 23, 2016, the court dismissed all claims with prejudice. Plaintiff has appealed to the Ninth Circuit, where the case is again pending.

**Regulatory Matters:** On April 16, 2012, optionsXpress, Inc. was charged by the SEC in an administrative proceeding alleging violations of its close-out obligations under Regulation SHO (short sale delivery rules) in connection with certain customer trading activity. Following trial, in a decision issued June 7, 2013, the judge held that optionsXpress, Inc. had violated Regulation SHO and aided and abetted fraudulent trading activity by its customer, and ordered optionsXpress, Inc. and the customer to pay disgorgement and penalties in an amount that would not be material. The Company appealed to the SEC, and in a decision issued August 18, 2016 and amended September 13, 2016, the SEC dismissed all fraud charges but affirmed the violations of Regulation SHO and the financial sanctions imposed by its administrative law judge. This matter is now concluded.

## 9. Offsetting Assets and Liabilities

**Resale and repurchase agreements:** Schwab enters into collateralized resale agreements principally with other broker-dealers, which could result in losses in the event the counterparty fails to purchase the securities held as collateral for the cash advanced and the fair value of the securities declines. To mitigate this risk, Schwab requires that the counterparty deliver securities to a custodian, to be held as collateral, with a fair value at or in excess of 102% of the resale price. Schwab also sets standards for the credit quality of the counterparty, monitors the fair value of the underlying securities as compared to the related receivable, including accrued interest, and requires additional collateral where deemed appropriate. At September 30, 2016 and December 31, 2015, the fair value of collateral received in connection with resale agreements that are available to be pledged or sold was \$9.6 billion and

\$8.2 billion, respectively. Schwab utilizes the collateral provided under these resale agreements to meet obligations under broker-dealer client protection rules, which place limitations on its ability to access such segregated securities. For Schwab to repledge or sell this collateral, it would be required to deposit cash and/or securities of an equal amount into its segregated reserve bank accounts in order to meet its segregated cash and investment requirement. The Company's resale agreements are not subject to master netting arrangements.

**Securities lending:** The Company loans brokerage client securities temporarily to other brokers in connection with its securities lending activities and receives cash as collateral for the securities loaned. Increases in security prices may cause the fair value of the securities loaned to exceed the amount of cash received as collateral. In the event the counterparty to these transactions does not return the loaned securities or provide additional cash collateral, the Company may be exposed to the risk of acquiring the securities at prevailing market prices in order to satisfy its client obligations. The Company mitigates this risk by requiring credit approvals for counterparties, monitoring the fair value of securities loaned, and requiring additional cash as collateral when necessary. The fair value of client securities pledged in securities lending transactions to other broker-dealers was \$1.9 billion at September 30, 2016 and December 31, 2015. The Company has also pledged a portion of its securities owned in connection with securities lending transactions to other broker-dealers. Additionally, the Company borrows securities from other broker-dealers to fulfill short sales by brokerage clients and delivers cash to the lender in exchange for the securities. The fair value of these borrowed securities was \$304 million at September 30, 2016 and \$72 million at December 31, 2015. All of the Company's securities lending transactions are subject to enforceable master netting arrangements with other broker-dealers; however, the Company does not net securities lending transactions. Therefore, the Company's securities loaned and securities borrowed are presented gross in the condensed consolidated balance sheets.

## 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 presents information about the Company's resale agreements and securities lending activity to enable the users of the Company's financial statements to evaluate the potential effect of rights of setoff between these recognized assets and recognized liabilities at September 30, 2016 and December 31, 2015.

	Gross Assets/ Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		Net Amount
				Counterparty Offsetting	Collateral	
September 30, 2016						
Assets:						
Resale agreements (1)	\$ 9,425	\$ -	\$ 9,425	\$ -	\$ (9,425)(2)	\$ -
Securities borrowed (3)	632	-	632	(297)	(334)	1
Total	\$ 10,057	\$ -	\$ 10,057	\$ (297)	\$ (9,759)	\$ 1
Liabilities:						
Securities loaned (4,5)	\$ 2,371	\$ -	\$ 2,371	\$ (297)	\$ (1,961)	\$ 113
Total	\$ 2,371	\$ -	\$ 2,371	\$ (297)	\$ (1,961)	\$ 113
December 31, 2015						
Assets:						
Resale agreements (1)	\$ 8,088	\$ -	\$ 8,088	\$ -	\$ (8,088)(2)	\$ -
Securities borrowed (3)	198	-	198	(70)	(127)	1
Total	\$ 8,286	\$ -	\$ 8,286	\$ (70)	\$ (8,215)	\$ 1
Liabilities:						
Securities loaned (4,5)	\$ 2,233	\$ -	\$ 2,233	\$ (70)	\$ (1,990)	\$ 173
Total	\$ 2,233	\$ -	\$ 2,233	\$ (70)	\$ (1,990)	\$ 173

- (1) Included in cash and investments segregated and on deposit for regulatory purposes in the Company's condensed consolidated balance sheets.
- (2) Actual collateral was greater than or equal to 102% of the related assets.
- (3) Included in receivables from brokers, dealers, and clearing organizations in the Company's condensed consolidated balance sheets.
- (4) Included in payables to brokers, dealers, and clearing organizations in the Company's condensed consolidated balance sheets.

- (5) Securities loaned are predominantly comprised of equity securities held in client brokerage accounts with overnight and continuous remaining contractual maturities.

#### 10.Fair Values of Assets and Liabilities

Assets and liabilities measured at fair value on a recurring basis

The Company's assets and liabilities measured at fair value on a recurring basis include certain cash equivalents, certain investments segregated and on deposit for regulatory purposes, other securities owned, and securities available for sale. The Company uses the market approach 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 and liabilities. When utilizing market data and 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.

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.



THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Fair value of other financial instruments

Descriptions of the valuation methodologies and assumptions used to estimate the fair value of other financial instruments are described below. The Company's financial instruments not recorded at fair value but for which fair value can be approximated and disclosed include:

- Cash and cash equivalents are short-term in nature and accordingly are recorded at amounts that approximate fair 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 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 values of these financial instruments approximate their fair values.
- Receivables from/payables to brokers, dealers, and clearing organizations are short-term in nature, recorded at contractual amounts and historically have been settled at those values. Accordingly, the carrying values of these financial instruments approximate their fair values.
- Receivables from/payables to brokerage clients — net are short-term in nature, recorded at contractual amounts and historically have been settled at those values. Accordingly, the carrying values of these financial instruments approximate their fair values.
- Securities held to maturity – The fair values of securities held to maturity are obtained using an independent third-party pricing service similar to investment assets recorded at fair value as discussed above.
- Bank loans – The fair values of the Company's First Mortgages and HELOCs are estimated based on prices of mortgage-backed securities collateralized by similar types of loans. PALs are non-purpose revolving lines of credit secured by eligible assets; accordingly, the carrying values of these loans approximate their fair values.

- Financial instruments included in other assets primarily consist of LIHTC investments, cost method investments and FHLB stock, whose carrying values approximate their fair values. FHLB stock is recorded at par, which approximates its fair value.
- Bank deposits have no stated maturity and are recorded at the amount payable on demand as of the balance sheet date. The Company considers the carrying values of these deposits to approximate their fair values.
- Financial instruments included in accrued expenses and other liabilities consist of drafts payable and certain amounts due under contractual obligations, including unfunded LIHTC commitments. The carrying values of these instruments approximate their fair values.
- Short-term borrowings consist of commercial paper and funds drawn on Schwab Bank's secured credit facility with the Federal Home Loan Bank of San Francisco. Due to the short-term nature of these borrowings, carrying value approximates fair value.
- Long-term debt – Except for the finance lease obligation, the fair values of long-term debt 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.
- Firm commitments to extend credit – The Company extends credit to banking clients through HELOCs and PALs. The Company considers the fair value of these unused commitments to not be material because the interest rates earned on these balances are based on floating interest rates that reset monthly.

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

For a description of the fair value hierarchy, see “Notes – 2. Summary of Significant Accounting Policies” in the 2015 Form 10-K. There were no significant changes in these policies and methodologies during the first nine months of 2016. The Company did not transfer any assets or liabilities between Level 1, Level 2, or Level 3 during the nine months ended September 30, 2016, or the year ended December 31, 2015. In addition, the Company did not adjust prices received from the primary independent third-party pricing service at September 30, 2016 or December 31, 2015.

## Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the fair value hierarchy for assets measured at fair value on a recurring basis. Liabilities recorded at fair value were not material, and therefore are not included in the following tables:

	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
September 30, 2016				
Cash equivalents:				
Money market funds	\$ 852	\$ -	\$ -	\$ 852
Commercial paper	-	959	-	959
Total cash equivalents	852	959	-	1,811
Investments segregated and on deposit for regulatory purposes:				
Certificates of deposit	-	3,099	-	3,099
U.S. Government securities	-	3,512	-	3,512
Total investments segregated and on deposit for regulatory purposes	-	6,611	-	6,611
Other securities owned:				
Schwab Funds® money market funds	528	-	-	528
Equity and bond mutual funds	217	15	-	232
State and municipal debt obligations	-	55	-	55
Equity, U.S. Government and corporate debt, and				

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

other securities	2	41	-	43
Total other securities owned	747	111	-	858
Securities available for sale:				
U.S. agency mortgage-backed securities	-	33,370	-	33,370
Asset-backed securities	-	21,500	-	21,500
Corporate debt securities	-	10,119	-	10,119
U.S. Treasury securities	-	4,999	-	4,999
U.S. agency notes	-	2,205	-	2,205
Certificates of deposit	-	2,296	-	2,296
U.S. state and municipal securities	-	1,037	-	1,037
Commercial paper	-	214	-	214
Non-agency commercial mortgage-backed securities	-	51	-	51
Total securities available for sale	-	75,791	-	75,791
Total	\$ 1,599	\$ 83,472	\$ -	\$ 85,071

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

December 31, 2015	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	\$ 1,968	\$ -	\$ -	\$ 1,968
Commercial paper	-	360	-	360
Total cash equivalents	1,968	360	-	2,328
Investments segregated and on deposit for regulatory purposes:				
Certificates of deposit	-	3,430	-	3,430
U.S. Government securities	-	4,517	-	4,517
Total investments segregated and on deposit for regulatory purposes	-	7,947	-	7,947
Other securities owned:				
Schwab Funds® money market funds	261	-	-	261
Equity and bond mutual funds	205	-	-	205
State and municipal debt obligations	-	50	-	50
Equity, U.S. Government and corporate debt, and other securities	1	16	-	17
Total other securities owned	467	66	-	533
Securities available for sale:				
U.S. agency mortgage-backed securities	-	22,149	-	22,149
Asset-backed securities	-	21,485	-	21,485
Corporate debt securities	-	10,747	-	10,747
U.S. Treasury securities	-	5,704	-	5,704
U.S. agency notes	-	3,150	-	3,150
Certificates of deposit	-	1,683	-	1,683
U.S. state and municipal securities	-	424	-	424
Non-agency commercial mortgage-backed securities	-	299	-	299
Other securities	-	5	-	5
Total securities available for sale	-	65,646	-	65,646
Total	\$ 2,435	\$ 74,019	\$ -	\$ 76,454



## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

## Fair Value of Other Financial Instruments

The following tables present the fair value hierarchy for other financial instruments:

September 30, 2016	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	\$ 8,620	\$ -	\$ 8,620	\$ -	\$ 8,620
Cash and investments segregated and on deposit for regulatory purposes	13,461	-	13,461	-	13,461
Receivables from brokers, dealers, and clearing organizations	947	-	947	-	947
Receivables from brokerage clients – net	16,377	-	16,377	-	16,377
Securities held to maturity:					
U.S. agency mortgage-backed securities	64,836	-	66,570	-	66,570
Non-agency commercial mortgage-backed securities	997	-	1,040	-	1,040
U.S. Treasury securities	223	-	233	-	233
Total securities held to maturity	66,056	-	67,843	-	67,843
Bank loans: (1)					
Residential real estate mortgages	8,687	-	8,797	-	8,797
Home equity loans and lines of credit	2,472	-	2,614	-	2,614
Pledged asset lines	3,646	-	3,646	-	3,646
Other	79	-	79	-	79
Total bank loans	14,884	-	15,136	-	15,136
Other assets	291	-	291	-	291
Total	\$ 120,636	\$ -	\$ 122,675	\$ -	\$ 122,675
Liabilities:					
Bank deposits	\$ 149,630	\$ -	\$ 149,630	\$ -	\$ 149,630

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Payables to brokers, dealers, and clearing organizations	3,497	-	3,497	-	3,497
Payables to brokerage clients	32,961	-	32,961	-	32,961
Accrued expenses and other liabilities	880	-	880	-	880
Short-term borrowings	3,001	-	3,001	-	3,001
Long-term debt	2,876	-	3,024	-	3,024
Total	\$ 192,845	\$ -	\$ 192,993	\$ -	\$ 192,993

(1) The carrying value of bank loans excludes the allowance for loan losses of \$26 million at September 30, 2016.

- 50 -

---



## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

December 31, 2015	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
<b>Assets:</b>					
Cash and cash equivalents	\$ 9,650	\$ -	\$ 9,650	\$ -	\$ 9,650
Cash and investments segregated and on deposit for regulatory purposes	11,647	-	11,647	-	11,647
Receivables from brokers, dealers, and clearing organizations	582	-	582	-	582
Receivables from brokerage clients – net	17,310	-	17,310	-	17,310
<b>Securities held to maturity:</b>					
U.S. agency mortgage-backed securities	48,785	-	48,883	-	48,883
Non-agency commercial mortgage-backed securities	999	-	985	-	985
U.S. Treasury securities	223	-	220	-	220
Total securities held to maturity	50,007	-	50,088	-	50,088
<b>Bank loans: (1)</b>					
Residential real estate mortgages	8,334	-	8,347	-	8,347
Home equity loans and lines of credit	2,735	-	2,857	-	2,857
Pledged asset lines	3,232	-	3,232	-	3,232
Other	64	-	64	-	64
Total bank loans	14,365	-	14,500	-	14,500
Other assets	184	-	184	-	184
Total	\$ 103,745	\$ -	\$ 103,961	\$ -	\$ 103,961
<b>Liabilities:</b>					
Bank deposits	\$ 129,502	\$ -	\$ 129,502	\$ -	\$ 129,502
Payables to brokers, dealers, and clearing organizations	2,588	-	2,588	-	2,588
Payables to brokerage clients	33,185	-	33,185	-	33,185
Accrued expenses and other liabilities	1,115	-	1,115	-	1,115
Long-term debt (2)	2,877	-	2,967	-	2,967
Total	\$ 169,267	\$ -	\$ 169,357	\$ -	\$ 169,357

- (1) The carrying value of bank loans excludes the allowance for loan losses of \$31 million at December 31, 2015.
- (2) The amounts as of December 31, 2015 have been recast as a result of the adoption of ASU 2015-03, to present debt issuance costs of \$13 million as a direct deduction from the carrying amount of the associated debt liability, consistent with the recording of debt discounts.

## 11. Stockholders' Equity

There have been no significant changes to the Company's stockholders' equity with the exception of the issuance disclosed below. The Company did not issue any shares of common stock during the nine months ended September 30, 2016, or the year ended December 31, 2015.

On March 7, 2016, the Company issued and sold 30 million depositary shares, each representing a 1/40th ownership interest in a share of 5.95% non-cumulative perpetual preferred stock, Series D, \$0.01 par value, with a liquidation preference of \$1,000 per share (equivalent to \$25 per depositary share). The Series D Preferred Stock has a fixed dividend rate of 5.95%.

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Including the Series D issuance discussed above, the Company's preferred stock issued and outstanding is as follows:

	September 30, 2016				December 31, 2015			
	Shares Issued and Outstanding (In thousands)	Liquidation Preference (Per Share)	Liquidation Preference	Carrying Value	Shares Issued and Outstanding (In thousands)	Liquidation Preference (Per Share)	Liquidation Preference	Carrying Value
Series A	400	\$ 1,000	\$ 400	\$ 397	400	\$ 1,000	\$ 400	\$ 396
Series B	485	1,000	485	483	485	1,000	485	480
Series C	600	1,000	600	585	600	1,000	600	583
Series D	750	1,000	750	727	-	-	-	-
Total Preferred Stock	2,235		\$ 2,235	\$ 2,192	1,485		\$ 1,485	\$ 1,459

## 12. Accumulated Other Comprehensive Income

Accumulated other comprehensive income represents cumulative gains and losses that are not reflected in earnings. The components of other comprehensive income are as follows:

Three Months Ended September 30,	2016			2015		
	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
Change in net unrealized gain on securities available for sale:						
Net unrealized gain (loss)	\$ 77	\$ (29)	\$ 48	\$ (249)	\$ 94	\$ (155)
Other reclassifications included in						

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

other revenue	-	-	-	-	-	-
Change in net unrealized gain (loss) on securities available for sale	77	(29)	48	(249)	94	(155)
Other comprehensive income (loss)	\$ 77	\$ (29)	\$ 48	\$ (249)	\$ 94	\$ (155)

Nine Months Ended September 30,	2016			2015		
	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
Change in net unrealized gain on securities available for sale:						
Net unrealized gain (loss)	\$ 266	\$ (100)	\$ 166	\$ (233)	\$ 87	\$ (146)
Other reclassifications included in other revenue	(3)	1	(2)	-	-	-
Change in net unrealized gain (loss) on securities available for sale	263	(99)	164	(233)	87	(146)
Other	1	-	1	-	-	-
Other comprehensive income (loss)	\$ 264	\$ (99)	\$ 165	\$ (233)	\$ 87	\$ (146)

- 52 -

---

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Accumulated other comprehensive income balances are as follows:

	Total Accumulated Other Comprehensive Income
Balance at December 31, 2014	\$ 165
Net unrealized loss on securities available for sale	(146)
Balance at September 30, 2015	\$ 19
Balance at December 31, 2015	\$ (134)
Net unrealized gain on securities available for sale	164
Other	1
Balance at September 30, 2016	\$ 31

## 13.Earnings Per Common Share

EPS is computed using the two-class method. Preferred stock dividends, and undistributed earnings and dividends allocated to participating securities are subtracted from net income in determining net income available to common stockholders. 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, if dilutive, the effect of outstanding stock options and non-vested restricted stock awards and units. EPS under the basic and diluted computations is as follows:

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

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

	September 30,		September 30,	
	2016	2015	2016	2015
Net income	\$ 503	\$ 376	\$ 1,367	\$ 1,031
Preferred stock dividends and other (1)	(33)	(11)	(99)	(45)
Net income available to common stockholders	\$ 470	\$ 365	\$ 1,268	\$ 986
Weighted-average common shares outstanding — basic	1,324	1,316	1,322	1,315
Common stock equivalent shares related to stock incentive plans	10	12	10	11
Weighted-average common shares outstanding — diluted (2)	1,334	1,328	1,332	1,326
Basic EPS	\$ .36	\$ .28	\$ .96	\$ .75
Diluted EPS	\$ .35	\$ .28	\$ .95	\$ .74

- (1) Includes preferred stock dividends and undistributed earnings and dividends allocated to non-vested restricted stock units.
- (2) Antidilutive stock options and restricted stock awards excluded from the calculation of diluted EPS totaled 17 million and 14 million shares for the third quarters of 2016 and 2015, respectively, and 21 million and 16 million shares for the first nine months of 2016 and 2015, respectively.

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

## 14.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 examination, supervision, and regulation by the Federal Reserve. Schwab Bank is subject to examination, supervision, and regulation by the OCC, as its primary regulator, the FDIC, as its deposit insurer, and the CFPB. CSC is required to serve as a source of strength for Schwab Bank.

Schwab Bank is subject to various requirements and restrictions under federal and state laws, including regulatory capital requirements and requirements that restrict and govern the terms of affiliate transactions, such as extensions of credit to, or asset purchases from CSC or its other subsidiaries by Schwab Bank. 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. The federal banking agencies have broad powers to enforce these regulations, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties, and appoint a conservator or receiver. Under the Federal Deposit Insurance Act, Schwab Bank could be subject to restrictive actions if it were to fall within one of the lowest three of five capital categories. CSC and Schwab Bank are required to maintain minimum capital levels as specified in federal banking 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 CSC and Schwab Bank. At September 30, 2016, both CSC and Schwab Bank met all of their respective capital requirements. Certain events, such as growth in bank deposits and regulatory discretion, could adversely affect CSC's or Schwab Bank's ability to meet future capital requirements.

The regulatory capital and ratios for CSC and Schwab Bank are as follows:

	Actual		Minimum to be Well Capitalized		Minimum Capital Requirement	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2016						
CSC						
Common Equity Tier 1 Risk-Based Capital	\$ 12,015	18.0 %	N/A		\$ 3,006	4.5 %
Tier 1 Risk-Based Capital	14,207	21.3 %	N/A		4,008	6.0 %
Total Risk-Based Capital	14,234	21.3 %	N/A		5,343	8.0 %
Tier 1 Leverage	14,207	7.1 %	N/A		7,996	4.0 %
Schwab Bank						

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

Common Equity Tier 1 Risk-Based Capital	\$ 11,142	18.8 %	\$ 3,843	6.5 %	\$ 2,660	4.5 %
Tier 1 Risk-Based Capital	11,142	18.8 %	4,730	8.0 %	3,547	6.0 %
Total Risk-Based Capital	11,168	18.9 %	5,912	10.0 %	4,730	8.0 %
Tier 1 Leverage	11,142	7.0 %	7,910	5.0 %	6,328	4.0 %
December 31, 2015						
CSC						
Common Equity Tier 1 Risk-Based Capital	\$ 10,851	18.2 %	N/A		\$ 2,681	4.5 %
Tier 1 Risk-Based Capital	12,310	20.7 %	N/A		3,575	6.0 %
Total Risk-Based Capital	12,342	20.7 %	N/A		4,766	8.0 %
Tier 1 Leverage	12,310	7.1 %	N/A		6,912	4.0 %
Schwab Bank						
Common Equity Tier 1 Risk-Based Capital	\$ 9,314	18.1 %	\$ 3,349	6.5 %	\$ 2,318	4.5 %
Tier 1 Risk-Based Capital	9,314	18.1 %	4,121	8.0 %	3,091	6.0 %
Total Risk-Based Capital	9,345	18.1 %	5,152	10.0 %	4,121	8.0 %
Tier 1 Leverage	9,314	7.1 %	6,594	5.0 %	5,275	4.0 %

N/A Not applicable.



THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Based on its regulatory capital ratios at September 30, 2016, Schwab Bank is considered well capitalized (the highest category) under their respective regulatory capital rules. There are no conditions or events since September 30, 2016 that management believes have changed Schwab Bank's capital category.

Beginning on January 1, 2016, CSC and Schwab Bank became subject to a new capital conservation buffer requirement of .625% of risk-weighted assets, increasing each year by .625% until fully implemented at 2.5% of risk-weighted assets in January 2019. The capital conservation buffer is in addition to the minimum risk-based capital requirements described above. Failure to maintain the capital conservation buffer would limit an entity's ability to make capital distributions and discretionary bonus payments to executive officers. At September 30, 2016, both CSC's and Schwab Bank's capital levels exceeded the fully implemented capital conservation buffer requirement.

CSC's principal broker-dealers are Schwab and optionsXpress, Inc. 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), 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. are as follows:

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

		Minimum Net Capital	2% of Aggregate Debit Balances	Net Capital in Excess of Required Net Capital
September 30, 2016	Net Capital	Required		
Schwab	\$ 1,890	\$ 0.250	\$ 344	\$ 1,546
optionsXpress, Inc.	269	1	7	262
December 31, 2015				
Schwab	\$ 1,746	\$ 0.250	\$ 358	\$ 1,388
optionsXpress, Inc.	244	1	7	237

15. Segment Information

The Company's two reportable segments are Investor Services and Advisor Services. The Company structures its operating segments according to its clients and the services provided to those clients. The Investor Services segment provides retail brokerage and banking services, retirement plan services, and other corporate brokerage services. The Advisor Services segment provides custodial, trading, and support services as well as retirement business services. Revenues and expenses are attributed 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. 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 between the segments.

## THE CHARLES SCHWAB CORPORATION

## Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

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

Three Months Ended September 30,	Investor Services (1)		Advisor Services (1)		Total	
	2016	2015	2016	2015	2016	2015
Net Revenues:						
Asset management and administration fees	\$ 550	\$ 461	\$ 248	\$ 202	\$ 798	\$ 663
Net interest revenue	654	534	191	101	845	635
Trading revenue	123	148	67	80	190	228
Other	56	45	20	21	76	66
Provision for loan losses	4	4	1	1	5	5
Total net revenues	1,387	1,192	527	405	1,914	1,597
Expenses Excluding Interest	847	762	273	252	1,120	1,014
Income before taxes on income	\$ 540	\$ 430	\$ 254	\$ 153	\$ 794	\$ 583

Nine Months Ended September 30,	Investor Services (1)		Advisor Services (1)		Total	
	2016	2015	2016	2015	2016	2015
Net Revenues:						
Asset management and administration fees	\$ 1,536	\$ 1,372	\$ 718	\$ 605	\$ 2,254	\$ 1,977
Net interest revenue	1,895	1,568	520	267	2,415	1,835
Trading revenue	395	428	228	230	623	658
Other	153	146	56	62	209	208
Provision for loan losses	4	10	1	1	5	11
Total net revenues	3,983	3,524	1,523	1,165	5,506	4,689
Expenses Excluding Interest	2,518	2,308	819	747	3,337	3,055
Income before taxes on income	\$ 1,465	\$ 1,216	\$ 704	\$ 418	\$ 2,169	\$ 1,634

(1) The Corporate Brokerage Retirement Services business was transferred from the Investor Services segment to the Advisor Services segment in the fourth quarter of 2015. Prior period information has been recast to reflect these changes.

16.Subsequent Event

On October 31, 2016, the Company issued and sold 600,000 depositary shares, each representing a 1/100th ownership interest in a share of fixed-to-floating rate non-cumulative perpetual preferred stock, Series E, \$0.01 par value, with a liquidation preference of \$100,000 per share (equivalent to \$1,000 per depositary share). The Series E Preferred Stock has a fixed dividend rate of 4.625% through February 28, 2022, payable semi-annually, and thereafter at a floating rate of three-month LIBOR plus a fixed spread of 3.315%, payable quarterly. Net proceeds received from the sale were \$591 million and are being used to support balance sheet growth, including the migration of certain client balances from sweep money market funds into Schwab Bank.

THE CHARLES SCHWAB CORPORATION

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, 2016. 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, 2016.

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, 2016, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

THE CHARLES SCHWAB CORPORATION

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

For a discussion of legal proceedings, see “Part I – Financial Information – Item 1 – Notes to Condensed Consolidated Financial Statements (Unaudited) – 8. Commitments and Contingencies.”

Item 1A. Risk Factors

During the first nine months of 2016, there have been no material changes to the risk factors in “Part I – Item 1A – Risk Factors” in the 2015 Form 10-K.

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

Issuer Purchases of Equity Securities

At September 30, 2016, approximately \$596 million of future share repurchases are authorized under the Share Repurchase Program. There were no share repurchases during the third quarter of 2016. There were two authorizations under this program 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.

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 2016:

Month	Total Number of Shares Purchased (in thousands)	Average Price Paid per Share
July:		
Employee transactions (1)	5	\$ 25.07
August:		
Employee transactions (1)	4	\$ 28.30
September:		
Employee transactions (1)	3	\$ 31.09
Total:		
Employee transactions (1)	12	\$ 27.60

(1) 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.

THE CHARLES SCHWAB CORPORATION

Item 3.Defaults Upon Senior Securities

None.

Item 4.Mine Safety Disclosures

Not applicable.

Item 5.Other Information

None.

- 59 -

---



## THE CHARLES SCHWAB CORPORATION

## Item 6.Exhibits

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

Exhibit Number	Exhibit	
3.19	Certificate of Designations of 4.625% Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Stock, Series E, of The Charles Schwab Corporation filed as Exhibit 3.1 to the Registrant's Form 8-K dated October 31, 2016, and incorporated herein by reference.	
10.369	Form of Notice and Performance-Based Restricted Stock Unit Agreement under The Charles Schwab Corporation 2013 Stock Incentive Plan and successor plans (supersedes Exhibit 10.353).	(1)
10.370	Form of Notice and Nonqualified Stock Option Agreement under The Charles Schwab Corporation 2013 Stock Incentive Plan and successor plans (supersedes Exhibit 10.354).	(1)
10.371	Form of Notice and Restricted Stock Unit Agreement under The Charles Schwab Corporation 2013 Stock Incentive Plan and successor plans (supersedes Exhibit 10.355).	(1)
10.372	Form of Notice and Retainer Stock Option Agreement for Non-Employee Directors under The Charles Schwab Corporation 2013 Stock Incentive Plan and successor plans (supersedes Exhibit 10.356).	(1)
10.373	Form of Notice and Retainer Restricted Stock Unit Agreement for Non-Employee Directors under The Charles Schwab Corporation 2013 Stock Incentive Plan and successor plans (supersedes Exhibit 10.357).	(1)
10.374	Form of Notice and Stock Option Agreement for Non-Employee Directors under The Charles Schwab Corporation Directors' Deferred Compensation Plan II and successor plans (supersedes Exhibit 10.358).	(1)
10.375	Form of Notice and Restricted Stock Unit Agreement for Non-Employee Directors under The Charles Schwab Corporation Directors' Deferred Compensation Plan II and successor plans (supersedes Exhibit 10.359).	(1)
12.1	Computations of Ratio of Earnings to Fixed Charges and Ratio of Earnings to Fixed Charges and Preferred Stock Dividends.	
31.1		

Edgar Filing: SCHWAB CHARLES CORP - Form 10-Q

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)

THE CHARLES SCHWAB CORPORATION

- (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, 2016 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.

THE CHARLES SCHWAB CORPORATION

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 7, 2016 /s/ Joseph R. Martinetto  
Joseph R. Martinetto  
Senior Executive Vice President and  
Chief Financial Officer

- 62 -

---