

SCHWAB CHARLES CORP
Form 10-Q
November 07, 2018

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, 2018

Commission File Number: 1-9700

THE CHARLES SCHWAB CORPORATION
(Exact name of registrant as specified in its charter)
Delaware 94-3025021
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

211 Main Street, San Francisco, CA 94105
(Address of principal executive offices and zip code)

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

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

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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.

1,350,452,801 shares of \$.01 par value Common Stock Outstanding on October 31, 2018

THE CHARLES SCHWAB CORPORATION

Quarterly Report on Form 10-Q
For the Quarter Ended September 30, 2018

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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

INTRODUCTION

The Charles Schwab Corporation (CSC) is a savings and loan holding company engaged, through its subsidiaries, in wealth management, securities brokerage, banking, asset management, custody, and financial advisory services.

Significant business subsidiaries of CSC include the following:

Charles Schwab & Co., Inc. (CS&Co), a securities broker-dealer;
Charles Schwab Bank (CSB), a federal savings bank; and
Charles Schwab Investment Management, Inc. (CSIM), the investment advisor for Schwab's proprietary mutual funds (Schwab Funds®) and Schwab's exchange-traded funds (Schwab ETFs™).

Unless otherwise indicated, the terms "Schwab," "the Company," "we," "us," or "our" mean CSC together with its consolidated subsidiaries.

Schwab 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 to individual investors, and retirement plan services, as well as other corporate brokerage services, to businesses and their employees. The Advisor Services segment provides custodial, trading, banking, and support services, as well as retirement business services, to independent registered investment advisors (RIAs), independent retirement advisors, and recordkeepers.

Schwab was founded on the belief that all Americans deserve access to a better investing experience. Although much has changed in the intervening years, our purpose remains clear – to champion every client's goals with passion and integrity. Guided by this purpose and the aspiration of creating the most trusted leader in investment services, management has adopted a strategy described as "Through Clients' Eyes."

This strategy emphasizes placing clients' perspectives, needs, and desires at the forefront. Because investing plays a fundamental role in building financial security, we strive to deliver a better investing experience for our clients – individual investors and the people and institutions who serve them – by disrupting longstanding industry practices on their behalf and providing superior service. We also aim to offer a broad range of products and solutions to meet client needs with a focus on transparency, value, and trust. In addition, management works to couple Schwab's scale and resources with ongoing expense discipline to keep costs low and ensure that products and solutions are affordable as well as responsive to client needs. In combination, these are the key elements of our "no trade-offs" approach to serving investors. We believe that following this strategy is the best way to maximize our market valuation and stockholder returns over time.

Management estimates that investable wealth in the United States (consisting of assets in defined contribution, retail wealth management and brokerage, and registered investment advisor channels, along with bank deposits) currently exceeds \$45 trillion, which means the Company's \$3.56 trillion in client assets leaves substantial opportunity for

growth. Our strategy is based on the principle that developing trusted relationships will translate into more assets from both new and existing clients, ultimately driving more revenue, and along with expense discipline, will generate earnings growth and build long-term stockholder value.

This Management's Discussion and Analysis should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (2017 Form 10-K).

On our website, www.aboutschwab.com, we post the following filings after they are electronically filed with or furnished to the Securities and Exchange Commission (SEC): annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. The SEC maintains a website at www.sec.gov that contains reports, proxy, and other information that we file electronically with the SEC.

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Management's Discussion and Analysis of Financial Condition and Results of Operations
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FORWARD-LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934.

Forward-looking statements are identified by words such as "believe," "anticipate," "expect," "intend," "plan," "will," "may," "estimate," "appear," "could," "would," and other similar expressions. In addition, any statements that refer to expectations, projections, or other characterizations of future events or circumstances are forward-looking statements.

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

Maximizing our market valuation and stockholder returns over time; our belief that developing trusted relationships will translate into more client assets which drives revenue and, along with expense discipline, generates earnings growth and builds stockholder value (see Introduction in Part I, Item 2);

Ongoing investments to drive growth and efficiency (see Overview);

Capital expenditures in 2018 (see Results of Operations);

Consolidated balance sheet assets remaining above \$250 billion (see Risk Management and Capital Management);

The expected impact of new accounting standards not yet adopted (see New Accounting Standards in Part I, Item 1, Financial Information – Notes to Condensed Consolidated Financial Statements (Item 1) – Note 2);

The likelihood of indemnification and guarantee payment obligations (see Commitments and Contingencies in Item 1 – Note 9); and

The impact of legal proceedings and regulatory matters (see Commitments and Contingencies in Item 1 – Note 9 and Legal Proceedings in Part II, Item 1).

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:

General market conditions, including the level of interest rates, equity valuations, and trading activity;

Our ability to attract and retain clients, develop trusted relationships, and grow client assets;

Client use of our advice solutions and other products and services;

The level of client assets, including cash balances;

Competitive pressure on pricing, including deposit rates;

Client sensitivity to interest rates;

Regulatory guidance;

Timing and amount of transfers of certain balances from sweep money market funds into bank sweep deposits;

Capital and liquidity needs and management;

Our ability to manage expenses;

Our ability to develop and launch new products, services, and capabilities, as well as implement infrastructure, in a timely and successful manner;

The effect of adverse developments in litigation or regulatory matters and the extent of any related charges; and

Potential breaches of contractual terms for which we have indemnification and guarantee obligations.

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 2017 Form 10-K.

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

Management focuses on several client activity and financial metrics in evaluating Schwab's financial position and operating performance. Results for the third quarters and first nine months of 2018 and 2017 are:

	Three Months Ended		Percent Change	Nine Months Ended		Percent Change
	September 30, 2018	September 30, 2017		September 30, 2018	September 30, 2017	
Client Metrics						
Net new client assets (in billions) ⁽¹⁾	\$53.5	\$51.6	4 %	\$78.6	\$155.0	(49)%
Core net new client assets (in billions)	\$53.5	\$51.6	4 %	\$172.5	\$136.7	26 %
Client assets (in billions, at quarter end)	\$3,563.7	\$3,181.2	12 %			
Average client assets (in billions)	\$3,508.1	\$3,107.8	13 %	\$3,420.2	\$2,986.3	15 %
New brokerage accounts (in thousands)	369	336	10 %	1,196	1,055	13 %
Active brokerage accounts (in thousands, at quarter end)	11,423	10,565	8 %			
Assets receiving ongoing advisory services (in billions, at quarter end)	\$1,851.9	\$1,613.6	15 %			
Client cash as a percentage of client assets (at quarter end)	10.3 %	11.1 %				
Company Financial Metrics						
Total net revenues	\$2,579	\$2,165	19 %	\$7,463	\$6,376	17 %
Total expenses excluding interest	1,360	1,220	11 %	4,111	3,679	12 %
Income before taxes on income	1,219	945	29 %	3,352	2,697	24 %
Taxes on income	296	327	(9)%	780	940	(17)%
Net income	923	618	49 %	2,572	1,757	46 %
Preferred stock dividends and other	38	43	(12)%	128	127	1 %
Net income available to common stockholders	\$885	\$575	54 %	\$2,444	\$1,630	50 %
Earnings per common share — diluted	\$.65	\$.42	55 %	\$1.79	\$1.21	48 %
Net revenue growth from prior year	19 %	13 %		17 %	16 %	
Pre-tax profit margin	47.3 %	43.6 %		44.9 %	42.3 %	
Return on average common stockholders' equity	20 %	15 %		19 %	15 %	
Expenses excluding interest as a percentage of average client assets (annualized)	0.15 %	0.16 %		0.16 %	0.16 %	
Consolidated Tier 1 Leverage Ratio (at quarter end)	7.5 %	7.7 %				

⁽¹⁾ The first nine months of 2018 includes outflows of \$93.9 billion from certain mutual fund clearing services clients. The first nine months of 2017 includes inflows of \$18.3 billion from certain mutual fund clearing services clients.

Net income grew 49% and 46% for the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017, driven primarily by business momentum, a generally favorable economic environment, and lower corporate income taxes. Total net revenues rose 19% and 17% in the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017, primarily due to higher net interest revenue as a result of higher interest rates and larger client cash sweep balances. Total expenses excluding interest grew 11% and 12% during the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017, reflecting hiring to support the Company's expanding client base and ongoing investments for driving growth and efficiency. Pre-tax

income increased 29% and 24% in the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017, delivering a 44.9% pre-tax profit margin for the first nine months of 2018.

Taxes on income decreased 9% and 17% for the third quarter and first nine months of 2018, compared to the same periods in 2017, resulting in effective tax rates of 24.3% and 23.3% for the third quarter and first nine months of 2018, respectively. The reduction in taxes on income was due to the Tax Act of 2017, which lowered the federal corporate income tax rate from 35% to 21% effective January 1, 2018.

During the third quarter of 2018, clients opened 369,000 new brokerage accounts, helping to bring active brokerage accounts to 11.4 million at September 30, 2018. Core net new assets gathered during the third quarter of 2018 were \$53.5 billion, compared to \$51.6 billion for the same period a year ago. Client engagement remained strong during the third quarter of 2018, with daily average revenue trades rising 22% from the same period in 2017.

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During the third quarter of 2018, we effectively managed our balance sheet to support both growth and solid financial performance. The consolidated balance sheet reached \$272 billion of assets at September 30, 2018, a \$10 billion quarterly increase, largely driven by bank sweep transfers and client activity. We transferred balances totaling \$23 billion from sweep money market funds to bank sweep in the quarter, bringing our 2018 transfers to \$68 billion and leaving \$33 billion remaining in sweep money market funds at September 30, 2018. In July 2018, the Board of Directors declared a 30% increase in the quarterly cash dividend to \$.13 per common share. We finished the quarter with a Tier 1 Leverage Ratio of 7.5%, and we lifted our return on equity to 20% and 19% for the third quarter and first nine months of 2018, respectively, compared to 15% for the same periods in 2017.

Subsequent Events

On October 25, 2018, CSC's Board of Directors terminated the existing two share repurchase authorizations and replaced them with a new authorization to repurchase up to a total of \$1.0 billion of common stock.

On October 31, 2018, CSC issued \$500 million aggregate principal amount of Senior Notes that mature in 2024 and \$600 million aggregate principal amount of Senior Notes that mature in 2029 under its universal shelf registration statement on file with the SEC. The Senior Notes due 2024 have a fixed interest rate of 3.550% with interest payable semi-annually. The Senior Notes due 2029 have a fixed interest rate of 4.000% with interest payable semi-annually.

Current Regulatory Environment and Other Developments

On October 31, 2018, the Board of Governors of the Federal Reserve System (Federal Reserve) issued a notice of proposed rulemaking and the Federal Reserve, the Office of the Comptroller of Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) jointly issued another notice of proposed rulemaking. The two proposals would establish a revised framework for applying enhanced prudential standards to large U.S. banking organizations, including savings and loan holding companies such as CSC, with four categories of standards that reflect the risks of banking organizations in each group. CSC would be in Category III based on having \$250 billion – \$700 billion in total assets. The comment period for both proposed rules ends on January 22, 2019 and we are currently evaluating the impact of the proposed rules.

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RESULTS OF OPERATIONS

Total Net Revenues

The following tables present a comparison of revenue by category:

Three Months Ended September 30,	Percent Change	2018		2017	
		Amount	% of Total Net Revenues	Amount	% of Total Net Revenues
Net interest revenue					
Interest revenue	49 %	\$1,755	68 %	\$1,176	54 %
Interest expense	143 %	(228)	(9)%	(94)	(4)%
Net interest revenue	41 %	1,527	59 %	1,082	50 %
Asset management and administration fees					
Mutual funds and ETF service fees	(16)%	435	17 %	519	24 %
Advice solutions	11 %	294	11 %	265	12 %
Other	4 %	80	3 %	77	4 %
Asset management and administration fees	(6)%	809	31 %	861	40 %
Trading revenue					
Commissions	14 %	155	6 %	136	6 %
Principal transactions	40 %	21	1 %	15	1 %
Trading revenue	17 %	176	7 %	151	7 %
Other	(6)%	67	3 %	71	3 %
Total net revenues	19 %	\$2,579	100 %	\$2,165	100 %
		2018		2017	
Nine Months Ended September 30,	Percent Change	Amount	% of Total Net Revenues	Amount	% of Total Net Revenues
Net interest revenue					
Interest revenue	42 %	\$4,766	64 %	\$3,358	52 %
Interest expense	155 %	(569)	(8)%	(223)	(3)%
Net interest revenue	34 %	4,197	56 %	3,135	49 %
Asset management and administration fees					
Mutual funds and ETF service fees	(10)%	1,386	19 %	1,538	24 %
Advice solutions	12 %	859	11 %	765	12 %
Other	1 %	229	3 %	226	4 %
Asset management and administration fees	(2)%	2,474	33 %	2,529	40 %
Trading revenue					
Commissions	10 %	501	7 %	456	7 %
Principal transactions	27 %	56	1 %	44	1 %
Trading revenue	11 %	557	8 %	500	8 %
Other	11 %	235	3 %	212	3 %
Total net revenues	17 %	\$7,463	100 %	\$6,376	100 %

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Net Interest Revenue

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,	2018			2017		
	Average Balance	Interest Revenue/Expense	Average Yield/Rate	Average Balance	Interest Revenue/Expense	Average Yield/Rate
Interest-earning assets						
Cash and cash equivalents	\$ 18,623	\$ 94	1.98 %	\$ 10,498	\$ 33	1.25 %
Cash and investments segregated	10,253	51	1.94 %	17,355	44	1.01 %
Broker-related receivables	307	1	1.94 %	459	1	0.96 %
Receivables from brokerage clients	20,224	217	4.19 %	16,498	151	3.63 %
Available for sale securities ⁽¹⁾	55,283	328	2.34 %	45,906	187	1.62 %
Held to maturity securities	137,065	887	2.57 %	107,557	606	2.24 %
Bank loans	16,579	142	3.43 %	16,058	122	3.01 %
Total interest-earning assets	258,334	1,720	2.63 %	214,331	1,144	2.12 %
Other interest revenue		35			32	
Total interest-earning assets	\$ 258,334	\$ 1,755	2.69 %	\$ 214,331	\$ 1,176	2.18 %
Funding sources						
Bank deposits	\$ 208,666	\$ 158	0.30 %	\$ 163,039	\$ 49	0.12 %
Payables to brokerage clients	20,595	16	0.31 %	24,833	6	0.10 %
Short-term borrowings	—	—	—	1,695	6	1.40 %
Long-term debt	5,790	51	3.52 %	3,436	30	3.46 %
Total interest-bearing liabilities	235,051	225	0.38 %	193,003	91	0.19 %
Non-interest-bearing funding sources	23,283			21,328		
Other interest expense		3			3	
Total funding sources	\$ 258,334	\$ 228	0.36 %	\$ 214,331	\$ 94	0.18 %
Net interest revenue		\$ 1,527	2.33 %		\$ 1,082	2.00 %
Nine Months Ended September 30,	2018			2017		
	Average Balance	Interest Revenue/Expense	Average Yield/Rate	Average Balance	Interest Revenue/Expense	Average Yield/Rate
Interest-earning assets						
Cash and cash equivalents	\$ 16,164	\$ 217	1.78 %	\$ 9,375	\$ 72	1.03 %
Cash and investments segregated	12,002	149	1.64 %	19,609	120	0.82 %
Broker-related receivables	324	4	1.62 %	428	2	0.74 %
Receivables from brokerage clients	19,629	600	4.03 %	15,861	415	3.50 %
Available for sale securities ⁽¹⁾	52,797	859	2.16 %	55,070	615	1.49 %
Held to maturity securities	129,490	2,420	2.48 %	99,523	1,691	2.27 %
Bank loans	16,522	410	3.31 %	15,764	347	2.94 %
Total interest-earning assets	246,928	4,659	2.50 %	215,630	3,262	2.02 %
Other interest revenue		107			96	
Total interest-earning assets	\$ 246,928	\$ 4,766	2.56 %	\$ 215,630	\$ 3,358	2.08 %

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Funding sources							
Bank deposits	\$ 193,010	\$ 339	0.23 %	\$ 163,475	\$ 98	0.08 %	
Payables to brokerage clients	21,591	37	0.23 %	26,198	11	0.06 %	
Short-term borrowings	4,488	54	1.59 %	1,475	11	1.00 %	
Long-term debt	5,053	131	3.46 %	3,349	89	3.55 %	
Total interest-bearing liabilities	224,142	561	0.33 %	194,497	209	0.14 %	
Non-interest-bearing funding sources	22,786			21,133			
Other interest expense		8			14		
Total funding sources	\$ 246,928	\$ 569	0.31 %	\$ 215,630	\$ 223	0.14 %	
Net interest revenue		\$ 4,197	2.25 %		\$ 3,135	1.94 %	

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

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Net interest revenue increased \$445 million, or 41%, and \$1.1 billion, or 34%, in the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017, primarily due to higher interest rates and growth in interest-earning assets.

Our net interest margin improved to 2.33% and 2.25% during the third quarter and first nine months of 2018, respectively, up from 2.00% and 1.94% during the same periods in 2017, primarily as a result of the Federal Reserve's 2017 and March, June, and September 2018 interest rate increases, partially offset by higher interest rates paid on bank deposits and other interest-bearing liabilities.

During the third quarter and the first nine months of 2018, average interest earning assets grew 21% and 15%, respectively, compared to the same periods in 2017. These increases reflect higher bank deposits due to transfers from sweep money market funds to bank sweep balances, as well as other client-related deposit inflows and higher borrowings, partially offset by client purchases of other assets. During the first six months of 2018, Schwab issued senior notes and utilized Federal Home Loan Bank (FHLB) advances to provide temporary funding for additional investments ahead of deposit growth. There were no FHLB borrowings in the third quarter of 2018.

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Asset Management and Administration Fees

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

Three Months Ended September 30,	2018			2017		
	Average Client Assets	Revenue	Average Fee	Average Client Assets	Revenue	Average Fee
Schwab money market funds before fee waivers	\$ 130,202	\$ 122	0.37 %	\$ 158,927	\$ 220	0.55 %
Fee waivers		—			(1)	
Schwab money market funds	130,202	122	0.37 %	158,927	219	0.55 %
Schwab equity and bond funds and ETFs	219,137	67	0.12 %	164,011	56	0.14 %
Mutual Fund OneSource® and other non-transaction fee funds	209,560	171	0.32 %	219,076	179	0.32 %
Other third-party mutual funds and ETFs ⁽¹⁾	342,316	75	0.09 %	291,307	65	0.09 %
Total mutual funds and ETFs ⁽²⁾	\$ 901,215	435	0.19 %	\$ 833,321	519	0.25 %
Advice solutions ⁽²⁾						
Fee-based	\$ 234,338	294	0.50 %	\$ 206,854	265	0.51 %
Non-fee-based	65,146	—	—	50,758	—	—
Total advice solutions	\$ 299,484	294	0.39 %	\$ 257,612	265	0.41 %
Other balance-based fees ⁽³⁾	400,048	63	0.06 %	424,280	67	0.06 %
Other ⁽⁴⁾		17			10	
Total asset management and administration fees		\$ 809			\$ 861	
Nine Months Ended September 30,	2018			2017		
	Average Client Assets	Revenue	Average Fee	Average Client Assets	Revenue	Average Fee
Schwab money market funds before fee waivers	\$ 142,177	\$ 451	0.42 %	\$ 160,230	\$ 675	0.56 %
Fee waivers		—			(10)	
Schwab money market funds	142,177	451	0.42 %	160,230	665	0.55 %
Schwab equity and bond funds and ETFs	206,058	195	0.13 %	151,579	163	0.14 %
Mutual Fund OneSource® and other non-transaction fee funds	216,699	524	0.32 %	214,058	528	0.33 %
Other third-party mutual funds and ETFs ⁽¹⁾	329,033	216	0.09 %	278,479	182	0.09 %
Total mutual funds and ETFs ⁽²⁾	\$ 893,967	1,386	0.21 %	\$ 804,346	1,538	0.26 %
Advice solutions ⁽²⁾						
Fee-based	\$ 228,326	859	0.50 %	\$ 199,500	765	0.51 %
Non-fee-based	62,377	—	—	46,785	—	—
Total advice solutions	\$ 290,703	859	0.40 %	\$ 246,285	765	0.42 %
Other balance-based fees ⁽³⁾	404,596	191	0.06 %	406,442	192	0.06 %
Other ⁽⁴⁾		38			34	
Total asset management and administration fees		\$ 2,474			\$ 2,529	

⁽¹⁾ Includes Schwab ETF OneSource™.

⁽²⁾ Beginning in the fourth quarter of 2017, a change was made to add non-fee-based average assets from managed portfolios. Average client assets for advice solutions may also include the asset balances contained in the mutual fund

and/or ETF categories listed above. Prior periods have been adjusted to accommodate this change.

(3) Includes various asset-related 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 decreased by \$52 million, or 6%, and \$55 million, or 2%, in the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017. The decreases were due to lower money market

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fund revenue as a result of transfers to bank sweep, client asset allocation choices, and our 2017 fee reductions. Part of the declines were offset by revenue from growing asset balances in advice solutions, equity and bond funds, and ETFs.

The following tables present a roll forward of client assets for the Schwab money market funds, Schwab equity and bond funds and exchange-traded funds (ETFs), and Mutual Fund OneSource[®] and other non-transaction fee (NTF) funds. These funds generated 44% and 47% of the asset management and administration fees earned during the third quarter and first nine months of 2018, respectively, compared to 53% and 54% for the same periods in 2017:

	Schwab Money Market Funds		Schwab Equity and Bond Funds and ETFs		Mutual Fund OneSource [®] and Other NTF funds	
	2018	2017	2018	2017	2018	2017
Three Months Ended September 30,						
Balance at beginning of period	\$134,166	\$156,186	\$201,361	\$151,336	\$212,513	\$224,749
Net inflows (outflows)	(6,204)	2,753	6,596	7,086	(7,126)	(13,255)
Net market gains (losses) and other	522	235	8,899	6,676	7,228	9,684
Balance at end of period	\$128,484	\$159,174	\$216,856	\$165,098	\$212,615	\$221,178
	Schwab Money Market Funds		Schwab Equity and Bond Funds and ETFs		Mutual Fund OneSource [®] and Other NTF funds	
	2018	2017	2018	2017	2018	2017
Nine Months Ended September 30,						
Balance at beginning of period	\$163,650	\$163,495	\$181,608	\$125,813	\$225,202	\$198,924
Net inflows (outflows)	(36,645)	(4,832)	24,867	22,347	(25,403)	(23,494)
Net market gains (losses) and other ⁽¹⁾	1,479	511	10,381	16,938	12,816	45,748
Balance at end of period	\$128,484	\$159,174	\$216,856	\$165,098	\$212,615	\$221,178

⁽¹⁾ Includes net inflows from other third-party mutual funds to Mutual Fund OneSource[®] in the second quarter of 2017.

Trading Revenue

The following table presents trading revenue and the related drivers:

	Three Months Ended September 30,		Percent Change	Nine Months Ended September 30,		Percent Change
	2018	2017		2018	2017	
Daily average revenue trades (DARTs) (in thousands)	382	312	22 %	406	313	30 %
Clients' daily average trades (in thousands)	683	633	8 %	732	602	22 %
Number of trading days	62.5	62.5	—	187.5	187.5	—
Daily average revenue per revenue trade	\$7.27	\$7.74	(6)%	\$7.27	\$8.52	(15)%
Trading revenue	\$176	\$151	17 %	\$557	\$500	11 %

DART volumes increased 22% and 30% in the third quarter and first nine months of 2018, respectively, compared to the prior year. This led to an increase in trading revenue of \$25 million, or 17%, and \$57 million, or 11%, in the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017, as the volume growth more

than offset Schwab's commission pricing reductions implemented in the first quarter of 2017. During that time, we announced two trading price reductions which lowered standard equity, ETF, and option trade commissions from \$8.95 to \$4.95 and lowered the per contract option fee from \$.75 to \$.65.

Other Revenue

Other revenue includes order flow revenue, other service fees, software fees from our portfolio management solutions, exchange processing fees, and non-recurring gains. Order flow revenue was \$33 million and \$29 million during the third quarters of 2018 and 2017, respectively, and \$104 million and \$82 million during the first nine months of 2018 and 2017, respectively. These increases were primarily due to higher rates on certain types of orders and higher volume of trades.

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Management's Discussion and Analysis of Financial Condition and Results of Operations
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Total Expenses Excluding Interest

The following table shows a comparison of expenses excluding interest:

	Three Months		Percent Change	Nine Months		Percent Change
	Ended September 30, 2018	2017		Ended September 30, 2018	2017	
Compensation and benefits						
Salaries and wages	\$423	\$372	14 %	\$1,253	\$1,110	13 %
Incentive compensation	193	187	3 %	615	580	6 %
Employee benefits and other	121	103	17 %	384	336	14 %
Total compensation and benefits	\$737	\$662	11 %	\$2,252	\$2,026	11 %
Professional services	164	152	8 %	476	429	11 %
Occupancy and equipment	124	111	12 %	368	323	14 %
Advertising and market development	70	63	11 %	220	205	7 %
Communications	59	56	5 %	179	171	5 %
Depreciation and amortization	78	69	13 %	226	200	13 %
Regulatory fees and assessments	57	43	33 %	158	133	19 %
Other	71	64	11 %	232	192	21 %
Total expenses excluding interest	\$1,360	\$1,220	11 %	\$4,111	\$3,679	12 %
Expenses as a percentage of total net revenues						
Compensation and benefits	29	% 31	%	30	% 32	%
Advertising and market development	3	% 3	%	3	% 3	%
Full-time equivalent employees (in thousands)						
At quarter end	19.1	17.3	10 %			
Average	19.0	17.1	11 %	18.4	16.7	10 %

Total compensation and benefits increased in the third quarter and first nine months of 2018 compared to the same periods in 2017, primarily due to an increase in employee headcount to support our expanding client base.

Professional services expense increased in the third quarter and first nine months of 2018 compared to the same periods in 2017, primarily due to higher spending on technology projects, as well as an increase in asset management and administration-related expenses resulting from growth in the Schwab Funds[®] and Schwab ETFs[™].

Occupancy and equipment expense increased in the third quarter and first nine months of 2018 compared to the same periods in 2017, primarily due to an increase in software maintenance expenses and additional licenses to support growth in the business.

Depreciation and amortization expenses grew in the third quarter and first nine months of 2018 compared to the same periods in 2017, primarily due to higher amortization of internally developed software associated with continued investments in software and technology enhancements.

Regulatory fees and assessments increased in the third quarter and first nine months of 2018 compared to the same periods in 2017, primarily due to an increase in FDIC insurance assessments, which rose as a result of higher average assets.

Other expenses increased in the first nine months of 2018 compared to the same period in 2017, primarily due to a \$15 million charge in the first quarter of 2018 associated with unsecured client margin losses in volatility-related products and other miscellaneous expense growth related to the expanding client base.

Capital expenditures were \$156 million and \$417 million in the third quarter and first nine months of 2018, respectively, compared with \$118 million and \$271 million in the third quarter and first nine months of 2017, respectively. The increases in the third quarter and year-to-date capital expenditures from the same periods in 2017 were due primarily to our office campus expansion in the U.S. and investments in technology projects. We anticipate capital expenditures for full-year 2018 will reach approximately 6-7% of total net revenues.

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Management's Discussion and Analysis of Financial Condition and Results of Operations
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Taxes on Income

Taxes on income were \$296 million and \$327 million for the third quarters of 2018 and 2017, respectively, resulting in effective income tax rates on income before taxes of 24.3% and 34.6%, respectively. Taxes on income were \$780 million and \$940 million for the first nine months of 2018 and 2017, respectively, resulting in effective income tax rates on income before taxes of 23.3% and 34.9%, respectively. The decrease in the effective tax rate was primarily due to the Tax Act which was signed into law on December 22, 2017. Among other things, the Tax Act lowered the federal corporate income tax rate from 35% to 21%, effective for tax years including or commencing January 1, 2018.

Segment Information

Financial information for our segments is presented in the following tables:

Three Months Ended September 30,	Investor Services		Advisor Services		Total				
	Percent Change	2018	2017	Percent Change	2018	2017	Percent Change	2018	2017
Net Revenues									
Net interest revenue	39%	\$1,138	\$818	47%	\$389	\$264	41%	\$1,527	\$1,082
Asset management and administration fees	(5)%	565	595	(8)%	244	266	(6)%	809	861
Trading revenue	19%	112	94	12%	64	57	17%	176	151
Other	(2)%	53	54	(18)%	14	17	(6)%	67	71
Total net revenues	20%	1,868	1,561	18%	711	604	19%	2,579	2,165
Expenses Excluding Interest	11%	1,015	918	14%	345	302	11%	1,360	1,220
Income before taxes on income	33%	\$853	\$643	21%	\$366	\$302	29%	\$1,219	\$945
Nine Months Ended September 30,	Investor Services		Advisor Services		Total				
	Percent Change	2018	2017	Percent Change	2018	2017	Percent Change	2018	2017
Net Revenues									
Net interest revenue	33%	\$3,158	\$2,366	35%	\$1,039	\$769	34%	\$4,197	\$3,135
Asset management and administration fees	(1)%	1,727	1,743	(5)%	747	786	(2)%	2,474	2,529
Trading revenue	14%	354	311	7%	203	189	11%	557	500
Other	14%	182	159	—	53	53	11%	235	212
Total net revenues	18%	5,421	4,579	14%	2,042	1,797	17%	7,463	6,376
Expenses Excluding Interest	11%	3,069	2,762	14%	1,042	917	12%	4,111	3,679
Income before taxes on income	29%	\$2,352	\$1,817	14%	\$1,000	\$880	24%	\$3,352	\$2,697

Investor Services

Total net revenues rose by 20% and 18% in the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017, primarily due to an increase in net interest revenue, partially offset by lower asset management and administration fees. Net interest revenue increased due to higher net interest margins and higher interest-earning assets. Asset management and administration fees decreased primarily due to lower money market fund revenue as a result of transfers to bank sweep, client asset allocation choices, and our 2017 fee reductions.

Expenses excluding interest increased by 11% in both the third quarter and first nine months of 2018 compared to the same periods in 2017, primarily due to higher compensation and benefits, technology project spend, and asset management and administration-related expenses to support our expanding client base.

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Advisor Services

Total net revenues rose by 18% and 14% in the third quarter and first nine months of 2018, respectively, compared to the same periods in 2017, primarily due to an increase in net interest revenue, partially offset by lower asset management and administration fees. Net interest revenue increased due to higher net interest margins and higher interest-earning assets. Asset management and administration fees decreased primarily due to lower money market fund revenue as a result of transfers to bank sweep, client asset allocation choices, and our 2017 fee reductions.

Expenses excluding interest increased by 14% in both the third quarter and first nine months of 2018 compared to the same periods in 2017, primarily due to higher compensation and benefits, technology project spend, and asset management and administration-related expenses to support our expanding client base.

RISK MANAGEMENT

Schwab's business activities expose us 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. For a discussion of our risk management programs, see Item 7 – Risk Management in the 2017 Form 10-K.

Net Interest Revenue Simulation

For Schwab's net interest revenue sensitivity analysis, we use 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 simulations involve assumptions that are inherently uncertain and, as a result, cannot precisely estimate 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 our guidelines for net interest revenue sensitivity are breached, management must report the breach to the Financial Risk Oversight Committee and establish a plan to address the interest rate risk. There were no breaches of Schwab's net interest revenue sensitivity risk limits during the nine months ended September 30, 2018, or year ended December 31, 2017.

As represented by the simulations presented below, our 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 sheets would not be changed as a result of the simulated changes in interest rates. As we actively manage the consolidated balance sheets and interest rate exposure, in all likelihood we 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, 2018 and December 31, 2017 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:

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	September 30, 2018		December 31, 2017	
Increase of 100 basis points	4.1	%	3.3	%
Decrease of 100 basis points	(4.7))%	(6.2))%

The change in net interest revenue sensitivities as of September 30, 2018 reflects the increase in interest rates across all maturities.

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

Schwab's primary source of funds is cash generated by client activity: bank deposits and cash balances in client brokerage accounts. These funds are used to purchase investment securities and extend loans to clients.

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 debt or equity financing.

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

In addition to internal sources of liquidity, Schwab has access to external funding. The following table describes external debt facilities available at September 30, 2018:

Description	Borrower	Outstanding	Available
Committed, unsecured credit facility with various external banks	CSC	\$ —	\$ 750
Uncommitted, unsecured lines of credit with various external banks	CSC, CS&Co	—	1,432
Federal Reserve Bank discount window ⁽¹⁾	CSB	—	2,422
Federal Home Loan Bank secured credit facility ⁽²⁾	Banking subsidiaries	—	30,002
Unsecured commercial paper ⁽³⁾	CSC	—	750

⁽¹⁾ Amounts available are dependent on the fair value of certain investment securities that are pledged as collateral.

⁽²⁾ Amounts available are dependent on the amount of first lien residential real estate mortgage loans (First Mortgages), home equity lines of credit (HELOCs), and the fair value of certain investment securities that are pledged as collateral.

⁽³⁾ CSC has authorization from its Board of Directors to issue Commercial Paper Notes to not exceed \$1.5 billion. Management has set a current limit not to exceed the amount of the committed, unsecured credit facility.

CSC's ratings for Commercial Paper Notes are P1 by Moody's Investor Service (Moody's), A1 by Standard & Poor's Rating Group (Standard & Poor's), and F1 by Fitch Ratings, Ltd (Fitch).

Borrowings

The following are details of the Senior Notes and short-term borrowings:

September 30, 2018	Par Outstanding	Maturity	Weighted Average Interest Rate	Moody's	Standard & Poor's	Fitch
Senior Notes	\$ 5,781	2020 - 2028	3.31%	A2	A	A
Short-term borrowings	\$ —	N/A	N/A	N/A	N/A	N/A

N/A Not applicable.

New Debt Issuances

All debt issuances in 2018 were senior unsecured obligations with interest payable quarterly or semi-annually. Additional details are as follows:

Issuance Date	Issuance Amount	Maturity Date	Interest Rate	Interest Payable
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May 22, 2018	\$ 600	5/21/2021	Three-month LIBOR + 0.32%	Quarterly
May 22, 2018	\$ 600	5/21/2021	3.25%	Semi-annually
May 22, 2018	\$ 750	5/21/2025	3.85%	Semi-annually

Schwab is subject to, and was in compliance with, the modified liquidity coverage ratio (LCR) rule at September 30, 2018. Schwab expects consolidated balance sheet assets to remain above \$250 billion in 2018, and as a result, would become subject to the full LCR rule in 2019.

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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

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

Regulatory Capital Requirements

CSC and CSB are subject to various capital requirements set by regulatory agencies as discussed in further detail in the 2017 Form 10-K and in Item 1 – Note 16. As of September 30, 2018, CSC and CSB are considered well capitalized.

The following table details CSC's consolidated and CSB's capital ratios as of September 30, 2018 and December 31, 2017:

	September 30, 2018		December 31, 2017		
	CSC	CSB	CSC	CSB	
Total stockholders' equity	\$20,834	\$14,899	\$18,525	\$13,224	
Less:					
Preferred stock	2,793	—	2,793	—	
Common Equity Tier 1 Capital before regulatory adjustments	\$18,041	\$14,899	\$15,732	\$13,224	
Less:					
Goodwill, net of associated deferred tax liabilities	\$1,191	\$13	\$1,191	\$13	
Other intangible assets, net of associated deferred tax liabilities	127	—	61	—	
Deferred tax assets, net of valuation allowances and deferred tax liabilities	2	—	2	—	
AOCI adjustment ⁽¹⁾	(304)	(278)	(152)	(144)	
Common Equity Tier 1 Capital	\$17,025	\$15,164	\$14,630	\$13,355	
Tier 1 Capital	\$19,818	\$15,164	\$17,423	\$13,355	
Total Capital	19,846	15,191	17,452	13,382	
Risk-Weighted Assets	86,830	75,224	75,866	66,519	
Common Equity Tier 1 Capital/Risk-Weighted Assets	19.6	% 20.2	% 19.3	% 20.1	%
Tier 1 Capital/Risk-Weighted Assets	22.8	% 20.2	% 23.0	% 20.1	%
Total Capital/Risk-Weighted Assets	22.9	% 20.2	% 23.0	% 20.1	%
Tier 1 Leverage Ratio	7.5	% 7.1	% 7.6	% 7.1	%

⁽¹⁾ CSC and CSB have elected to opt out of the requirement to include most components of accumulated other comprehensive income (AOCI) in Common Equity Tier 1 Capital. Schwab expects consolidated balance sheet assets to remain above \$250 billion in 2018, and as a result, would no longer exclude AOCI from regulatory capital beginning in 2019.

CSB is also subject to regulatory requirements that restrict and govern the terms of affiliate transactions. In addition, CSB is required to provide notice to, and may be required to obtain approval from, the Office of the Comptroller of

the Currency and the Federal Reserve to declare dividends to CSC.

Schwab's primary broker-dealer subsidiary, CS&Co, is subject to regulatory requirements of the Uniform Net Capital Rule. At September 30, 2018, CS&Co exceeded its net capital requirements.

In addition to the capital requirements above, Schwab's subsidiaries are subject to other regulatory requirements intended to ensure financial soundness and liquidity. See Item 1 – Note 16 for additional information on the components of stockholders' equity and information on the capital requirements of significant subsidiaries.

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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 July 25, 2018, the Board of Directors of the Company declared a three cent, or 30%, increase in the quarterly cash dividend to \$.13 per common share.

Cash dividends paid and per share amounts for the first nine months of 2018 and 2017 are as follows:

Nine Months Ended September 30,	2018		2017	
	Cash Paid	Per Share Amount	Cash Paid	Per Share Amount
Common Stock	\$448	\$.33	\$323	\$.24
Series A Preferred Stock ⁽¹⁾	28	70.00	28	70.00
Series B Preferred Stock ^(2,5)	N/A	N/A	22	45.00
Series C Preferred Stock ⁽²⁾	27	45.00	27	45.00
Series D Preferred Stock ⁽²⁾	33	44.64	33	44.64
Series E Preferred Stock ⁽³⁾	28	4,625.00	23	3,867.01
Series F Preferred Stock ⁽⁴⁾	15	2,930.56	N/A	N/A

⁽¹⁾ Dividends paid semi-annually until February 1, 2022 and quarterly thereafter.

⁽²⁾ Dividends paid quarterly.

⁽³⁾ Dividends paid semi-annually until March 1, 2022 and quarterly thereafter.

⁽⁴⁾ Series F Preferred Stock was issued on October 31, 2017. Dividends paid semi-annually beginning on June 1, 2018 until December 1, 2027, and quarterly thereafter.

⁽⁵⁾ Series B Preferred Stock was redeemed on December 1, 2017.

N/A Not applicable.

OTHER

Foreign Holdings

At September 30, 2018, Schwab had exposure to non-sovereign financial and non-financial institutions in foreign countries, as well as agencies of foreign governments. At September 30, 2018, the fair value of these holdings totaled \$7.4 billion, with the top three exposures being to issuers and counterparties domiciled in France at \$2.3 billion, Sweden at \$1.8 billion, and Canada at \$0.8 billion.

In addition to the direct holdings in foreign companies and securities issued by foreign government agencies, Schwab has indirect exposure to foreign countries through its investments in CSIM money market funds (collectively, the Funds) resulting from brokerage clearing activities. At September 30, 2018, Schwab had \$21 million in investments in these Funds. Certain of the Funds' positions include certificates of deposit, time deposits, commercial paper, and corporate debt securities issued by counterparties in foreign countries. Additionally, at September 30, 2018, Schwab had outstanding margin loans to foreign residents of \$816 million.

Off-Balance Sheet Arrangements

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

arrangements, see Item 1 – Note 5, Note 6, Note 8, Note 9, and Note 10, and Item 8 – Note 13 in the 2017 Form 10-K.

CRITICAL ACCOUNTING ESTIMATES

Certain of our 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 2017 Form 10-K. There have been no changes to critical accounting estimates during the first nine months of 2018.

THE CHARLES SCHWAB CORPORATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For discussion of the quantitative and qualitative disclosures about market risk, see Risk Management in Item 2.

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Part I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Statements of Income

(In Millions, Except Per Share Amounts)

(Unaudited)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Net Revenues				
Interest revenue	\$1,755	\$1,176	\$4,766	\$3,358
Interest expense	(228)	(94)	(569)	(223)
Net interest revenue	1,527	1,082	4,197	3,135
Asset management and administration fees	809	861	2,474	2,529
Trading revenue	176	151	557	500
Other	67	71	235	212
Total net revenues	2,579	2,165	7,463	6,376
Expenses Excluding Interest				
Compensation and benefits	737	662	2,252	2,026
Professional services	164	152	476	429
Occupancy and equipment	124	111	368	323
Advertising and market development	70	63	220	205
Communications	59	56	179	171
Depreciation and amortization	78	69	226	200
Regulatory fees and assessments	57	43	158	133
Other	71	64	232	192
Total expenses excluding interest	1,360	1,220	4,111	3,679
Income before taxes on income	1,219	945	3,352	2,697
Taxes on income	296	327	780	940
Net Income	923	618	2,572	1,757
Preferred stock dividends and other	38	43	128	127
Net Income Available to Common Stockholders	\$885	\$575	\$2,444	\$1,630
Weighted-Average Common Shares Outstanding:				
Basic	1,351	1,339	1,349	1,338
Diluted	1,364	1,353	1,363	1,352
Earnings Per Common Shares Outstanding:				
Basic	\$.66	\$.43	\$1.81	\$1.22
Diluted	\$.65	\$.42	\$1.79	\$1.21
Dividends Declared Per Common Share	\$.13	\$.08	\$.33	\$.24

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,	
	2018	2017	2018	2017
Net income	\$923	\$618	\$2,572	\$1,757
Other comprehensive income (loss), before tax:				
Change in net unrealized gain (loss) on available for sale securities:				
Net unrealized gain (loss)	(43)	—	(184)	81
Reclassification of net unrealized loss transferred to held to maturity	—	—	—	227
Other reclassifications included in other revenue	—	—	—	(7)
Change in net unrealized gain (loss) on held to maturity securities:				
Reclassification of net unrealized loss transferred from available for sale	—	—	—	(227)
Amortization of amounts previously recorded upon transfer from available for sale	8	10	26	21
Other	—	—	—	(3)
Other comprehensive income (loss), before tax	(35)	10	(158)	92
Income tax effect	9	(4)	39	(35)
Other comprehensive income (loss), net of tax	(26)	6	(119)	57
Comprehensive Income	\$897	\$624	\$2,453	\$1,814

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, 2018	December 31, 2017
Assets		
Cash and cash equivalents	\$ 21,830	\$ 14,217
Cash and investments segregated and on deposit for regulatory purposes (including resale agreements of \$4,424 at September 30, 2018 and \$6,596 at December 31, 2017)	8,487	15,139
Receivables from brokers, dealers, and clearing organizations	798	649
Receivables from brokerage clients — net	22,411	20,576
Other securities owned — at fair value	500	539
Available for sale securities	57,558	49,995
Held to maturity securities	138,952	120,926
Bank loans — net	16,564	16,478
Equipment, office facilities, and property — net	1,683	1,471
Goodwill	1,227	1,227
Other assets	2,092	2,057
Total assets	\$ 272,102	\$ 243,274
Liabilities and Stockholders' Equity		
Bank deposits	\$ 213,408	\$ 169,656
Payables to brokers, dealers, and clearing organizations	1,522	1,287
Payables to brokerage clients	27,851	31,243
Accrued expenses and other liabilities	2,697	2,810
Short-term borrowings	—	15,000
Long-term debt	5,790	4,753
Total liabilities	251,268	224,749
Stockholders' equity:		
Preferred stock — \$.01 par value per share; aggregate liquidation preference of \$2,850	2,793	2,793
Common stock — 3 billion shares authorized; \$.01 par value per share; 1,487,543,446 shares issued	15	15
Additional paid-in capital	4,484	4,353
Retained earnings	16,615	14,408
Treasury stock, at cost — 135,806,047 shares at September 30, 2018 and 142,210,890 shares at December 31, 2017	(2,769)	(2,892)
Accumulated other comprehensive income (loss)	(304)	(152)
Total stockholders' equity	20,834	18,525
Total liabilities and stockholders' equity	\$ 272,102	\$ 243,274

See Notes to Condensed Consolidated Financial Statements.

THE CHARLES SCHWAB CORPORATION
Condensed Consolidated Statements of Stockholders' Equity
(In Millions)
(Unaudited)

	Preferred Stock	Common Shares	Common Amount	Additional Paid-in Capital	Retained Earnings	Treasury Stock, at cost	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2016	\$ 2,783	1,488	\$ 15	\$ 4,267	\$ 12,649	\$(3,130)	\$ (163)	\$ 16,421
Net income	—	—	—	—	1,757	—	—	1,757
Other comprehensive income (loss), net of tax	—	—	—	—	—	—	57	57
Dividends declared on preferred stock	—	—	—	—	(120)	—	—	(120)
Dividends declared on common stock	—	—	—	—	(323)	—	—	(323)
Stock option exercises and other	—	—	—	(30)	—	128	—	98
Share-based compensation and related tax effects	—	—	—	105	—	—	—	105
Other	—	—	—	23	—	9	—	32
Balance at September 30, 2017	\$ 2,783	1,488	\$ 15	\$ 4,365	\$ 13,963	\$(2,993)	\$ (106)	\$ 18,027
Balance at December 31, 2017	\$ 2,793	1,488	\$ 15	\$ 4,353	\$ 14,408	\$(2,892)	\$ (152)	\$ 18,525
Adoption of accounting standards (Note 2)	—	—	—	—	200	—	(33)	167
Net income	—	—	—	—	2,572	—	—	2,572
Other comprehensive income (loss), net of tax	—	—	—	—	—	—	(119)	(119)
Dividends declared on preferred stock	—	—	—	—	(117)	—	—	(117)
Dividends declared on common stock	—	—	—	—	(448)	—	—	(448)
Stock option exercises and other	—	—	—	(8)	—	116	—	108
Share-based compensation and related tax effects	—	—	—	106	—	—	—	106
Other	—	—	—	33	—	7	—	40
Balance at September 30, 2018	\$ 2,793	1,488	\$ 15	\$ 4,484	\$ 16,615	\$(2,769)	\$ (304)	\$ 20,834

See Notes to Condensed Consolidated Financial Statements.

THE CHARLES SCHWAB CORPORATION
Condensed Consolidated Statements of Cash Flows
(in Millions)
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017 ⁽¹⁾
Cash Flows from Operating Activities		
Net income	\$2,572	\$1,757
Adjustments to reconcile net income to net cash (used for) provided by operating activities:		
Share-based compensation	113	111
Depreciation and amortization	226	200
Premium amortization, net, on available for sale and held to maturity securities	276	240
Other	108	35
Net change in:		
Investments segregated and on deposit for regulatory purposes	6,973	6,864
Receivables from brokers, dealers, and clearing organizations	(147)	61
Receivables from brokerage clients	(1,858)	(1,310)
Other securities owned	39	22
Other assets	(143)	(76)
Payables to brokers, dealers, and clearing organizations	43	(957)
Payables to brokerage clients	(3,392)	(4,414)
Accrued expenses and other liabilities	(155)	(82)
Net cash provided by operating activities	4,655	2,451
Cash Flows from Investing Activities		
Purchases of available for sale securities	(19,781)	(6,375)
Proceeds from sales of available for sale securities	115	5,773
Principal payments on available for sale securities	12,091	6,532
Purchases of held to maturity securities	(30,639)	(19,886)
Principal payments on held to maturity securities	12,382	7,927
Net increase in bank loans	(86)	(829)
Purchases of equipment, office facilities, and property	(400)	(267)
Purchases of Federal Home Loan Bank stock	(156)	(160)
Proceeds from sales of Federal Home Loan Bank stock	528	106
Other investing activities	(74)	(52)
Net cash provided by (used for) investing activities	(26,020)	(7,231)
Cash Flows from Financing Activities		
Net change in bank deposits	43,752	1,809
Net change in short-term borrowings	(15,000)	5,000
Issuance of long-term debt	1,936	643
Repayment of long-term debt	(906)	(256)
Dividends paid	(579)	(456)
Proceeds from stock options exercised and other	108	98
Other financing activities	(12)	(10)
Net cash provided by (used for) financing activities	29,299	6,828
Increase (Decrease) in Cash and Cash Equivalents, including Amounts Restricted	7,934	2,048

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Cash and Cash Equivalents including Amounts Restricted at Beginning of Year	19,160	17,873
Cash and Cash Equivalents, including Amounts Restricted at End of Period	\$27,094	\$19,921

⁽¹⁾Adjusted for the retrospective adoption of ASU 2016-18. See Note 2.

Continued on following page

THE CHARLES SCHWAB CORPORATION
Condensed Consolidated Statements of Cash Flows
(in Millions)
(Unaudited)

Continued from previous page

	Nine Months Ended September 30, 2018	2017 ⁽¹⁾
Supplemental Cash Flow Information		
Cash paid during the period for:		
Interest	\$ 550	\$ 233
Income taxes	\$ 649	\$ 890
Non-cash investing activity:		
Securities purchased during the period but settled after period end	\$ 221	\$ 3,977
	September 30, 2018	September 30, 2017
Reconciliation of cash, cash equivalents and amounts reported within the balance sheet ⁽²⁾		
Cash and cash equivalents	\$ 21,830	\$ 12,253
Restricted cash and cash equivalents amounts included in cash and investments segregated and on deposit for regulatory purposes	5,264	7,668
Total cash and cash equivalents, including amounts restricted shown in the statement of cash flows	\$ 27,094	\$ 19,921

⁽¹⁾ Adjusted for the retrospective adoption of ASU 2016-18. See Note 2.

⁽²⁾ For more information on the nature of restrictions on restricted cash and cash equivalents see Note 16.

See Notes to Condensed Consolidated Financial Statements.

CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

1. Introduction and Basis of Presentation

The Charles Schwab Corporation (CSC) is a savings and loan holding company engaged, through its subsidiaries, in wealth management, securities brokerage, banking, asset management, custody, and financial advisory services.

Significant business subsidiaries of CSC include the following:

Charles Schwab & Co., Inc. (CS&Co), a securities broker-dealer;

Charles Schwab Bank (CSB), a federal savings bank; and

Charles Schwab Investment Management, Inc. (CSIM), the investment advisor for Schwab's proprietary mutual funds (Schwab Funds[®]) and Schwab's exchange-traded funds (Schwab ETFs[™]).

Unless otherwise indicated, the terms "Schwab," "the Company," "we," "us," or "our" mean CSC together with its consolidated subsidiaries.

These unaudited condensed consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the U.S. (GAAP), which require management to make certain estimates and assumptions that affect the reported amounts in the accompanying financial statements, and in the related disclosures. These estimates are based on information available as of the date of the condensed consolidated financial statements. While management makes its best judgment, actual amounts or results could differ from these estimates. In the opinion of management, all normal, recurring adjustments have been included for a fair statement of this interim financial information.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in Schwab's 2017 Form 10-K.

The significant accounting policies are included in Note 2 in the 2017 Form 10-K. There have been no significant changes to these accounting policies during the first nine months of 2018, except as described in Note 2 below.

Principles of Consolidation

Schwab evaluates all entities in which it has financial interests for consolidation, except for money market funds, which are specifically excluded from consolidation guidance. When an entity is evaluated for consolidation, Schwab determines whether its interest in the entity constitutes a controlling financial interest under either the variable interest entity (VIE) model or a voting interest entity (VOE) model. In evaluating whether Schwab's interest in a VIE is a controlling financial interest, we consider whether our involvement, in the context of the design, purpose, and risks of the VIE, as well as any involvement of related parties, provides us with (i) the power to direct the most significant activities of the VIE, and (ii) the obligation to absorb losses or receive benefits that are significant to the VIE. If both of these conditions exist, then Schwab would be the primary beneficiary of that VIE, and consolidate it. Based upon the assessments for all of our interests in VIEs, there are no cases where Schwab is the primary beneficiary; therefore, we are not required to consolidate any VIEs. Schwab consolidates all VOEs in which it has majority-voting interests. Investments in entities in which Schwab does not have a controlling financial interest are accounted for under the equity method of accounting when we have the ability to exercise significant influence over operating and financing decisions of the entity. Investments in entities for which Schwab does not have the ability to exercise significant influence are generally carried at cost and adjusted for impairment and observable price changes of the identical or similar investments of the same issuer (adjusted cost method), except for certain investments in qualified affordable housing projects which are accounted for under the proportional amortization method. All equity method, adjusted cost method, and proportional amortization method investments are included in other assets on the condensed consolidated balance sheets.

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

Standard	Description	Date of Adoption	Effects on the Financial Statements or Other Significant Matters
Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606) and related ASUs	Clarifies that revenue from contracts with clients 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. Adoption allows either full or modified retrospective transition. Full retrospective transition required a cumulative effect adjustment to retained earnings as of the earliest comparative period presented. Modified retrospective transition required a cumulative effect adjustment to retained earnings as of the beginning of the reporting period in which the entity first applies the new guidance.	January 1, 2018	The guidance does not apply to revenue earned from the Company's loans and securities. Accordingly, net interest revenue was not impacted. The primary impact for the Company was the capitalization on the consolidated balance sheets of sales commissions paid to employees for obtaining new contracts with clients. These capitalized costs resulted in an asset of \$219 million and a related deferred tax liability of \$52 million upon adoption. The asset is being amortized to expense over time as the related revenues are recognized. The Company adopted the revenue recognition guidance using the modified retrospective method for all contracts that were not completed as of January 1, 2018. Further details of the impact of adoption are included below in this Note as well as in Note 3.
ASU 2016-01, "Financial Instruments Overall (Subtopic 825-10)" and ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments Overall (Subtopic 825-10)"	Requires: (i) equity investments to be measured at fair value, with changes in fair value recognized in net income, unless the equity method is applied or the equity investments do not have readily determinable fair values in which case a practical alternative may be elected; (ii) use of an exit price when measuring the fair value of financial instruments for disclosures; (iii) separate presentation of financial assets and liabilities by measurement category and form of instrument on the balance sheet or in the accompanying notes. Adoption requires a cumulative effect adjustment to the balance sheet as of the	January 1, 2018	The Company adopted this guidance on a prospective basis for its equity securities that do not have readily determinable fair values. No other significant changes resulted from adoption. Therefore, there was no material impact on the Company's financial statements. The Company elected to use the alternative to fair value measurement for its equity securities that do not have readily determinable fair values. These equity securities will be adjusted for impairment and observable price changes of the identical or similar investments of the same issuer, as applicable. Schwab refers to this approach as the adjusted

beginning of the year of initial application, except for certain changes that require prospective adoption.

cost method. This method was applied to an immaterial amount of Community Reinvestment Act (CRA) investments included in other assets on the consolidated balance sheets.

The Company adopted this guidance on a retrospective basis. The Company has significant amounts of restricted cash and cash equivalents due to its business as a broker-dealer.

ASU 2016-18, “Statement of Cash Flows (Topic 230) – Restricted Cash a Consensus of the Emerging Issues Task Force”

Requires that the statement of cash flows explain the change during the period in the total cash and cash equivalents, including restricted cash and cash equivalents.

Adoption requires retrospective presentation of the statement of cash flows to include restricted cash and cash equivalents in the beginning and ending amounts.

As a result of the adoption, changes in restricted cash and cash equivalents January 1, 2018, included within cash and investments segregated and on deposit for regulatory purposes in the consolidated balance sheets are now presented with changes in cash and cash equivalents throughout the consolidated statements of cash flows. The amount of restricted cash and cash equivalents is included in a separate table in the consolidated statements of cash flows.

CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Standard	Description	Date of Adoption	Effects on the Financial Statements or Other Significant Matters
ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income"	Permits reclassification of the impacts on certain tax affected items included in AOCI that were adjusted through income from continuing operations rather than AOCI upon the effective date of the Tax Act. Adoption provides for retrospective adoption to all periods presented and impacted by the Tax Act or as of the beginning of the period of adoption.	January 1, 2018	The Company adopted this guidance as of January 1, 2018. The Company elected to reclassify the income tax effects of the Tax Act from items in AOCI into retained earnings as of the beginning of the period of adoption. Adoption resulted in a reduction in AOCI and a corresponding increase in retained earnings of \$33 million.

New Accounting Standards Not Yet Adopted

Standard	Description	Required Date of Adoption	Effects on the Financial Statements or Other Significant Matters
ASU 2016-02, "Leases (Topic 842)"	Amends the accounting for leases by lessees and lessors. The primary change from the new guidance is the recognition of right-of-use 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. Adoption provides for modified retrospective transition as of the beginning of the earliest comparative period presented in the financial statements in which the entity first applies the new standard or prospectively with an adjustment as of the beginning of the period of adoption. Certain transition relief is permitted if elected by the entity.	January 1, 2019	The Company plans to adopt the new lease accounting guidance prospectively as of January 1, 2019 with a cumulative-effect adjustment to the opening balance of retained earnings (i.e., prior periods will not be adjusted). The Company does not expect this guidance will have a material impact on its earnings per common share (EPS). However, it will result in a gross up of the consolidated balance sheet due to recognition of right-of-use assets and lease liabilities primarily related to leases of office space and branches. These amounts will be based on the present value of our remaining operating lease payments (see Note 13 in the 2017 10-K for the undiscounted rental commitments for operating leases). The Company is refining its methodology to estimate the right-of-use assets and lease liabilities. We are also testing system updates and refining internal controls for applying the lease accounting changes. Based upon our current population of leases, we expect the right-of-use asset and corresponding lease liability to be less than 0.5% of our total assets.

CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Standard	Description	Required Date of Adoption	Effects on the Financial Statements or Other Significant Matters
ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments"	<p>Provides guidance for recognizing impairment of most debt instruments measured at amortized cost, including loans and held to maturity (HTM) debt securities. Requires estimating current expected credit losses (CECL) 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, CECL 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. Amends the OTTI model for available for sale (AFS) 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.</p> <p>Adoption requires 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 AFS debt securities for which an OTTI has been recognized prior to the effective date.</p>	January 1, 2020 (early adoption permitted)	The Company continues to evaluate the impact of this guidance on its financial statements, including EPS. The Company has finished the majority of its scoping work and assessment of the current state of data and systems. Work is transitioning to designing and building out approaches to address certain asset classes with a focus primarily on a subset of our securities, including corporate debt securities. The Company expects that a large portion of its securities will have zero expectation of credit losses based on industry and regulator views for U.S. treasury and certain government agency-backed securities. We are currently working on in-depth analysis for the other asset types that do not have zero expectation of credit losses to determine our methods and any needed changes to policies and procedures.
ASU 2017-08, "Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities"	<p>Shortens the amortization period for the premium on certain callable debt securities to the earliest call date. The amendments are applicable to any purchased individual debt security with an explicit and noncontingent call feature with a fixed price on a preset date. ASU 2017-08 does not impact the accounting for callable debt securities held at a discount.</p> <p>Adoption requires modified retrospective</p>	January 1, 2019 (early adoption permitted)	While still under evaluation, the Company does not expect this guidance will have a material impact on its financial statements, including EPS.

transition as of the beginning of the period of adoption through a cumulative-effect adjustment to retained earnings.

CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Standard	Description	Required Date of Adoption	Effects on the Financial Statements or Other Significant Matters
ASU 2018-15, "Intangibles–Goodwill and Other–Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force)"	Aligns the criteria for capitalizing implementation costs for cloud computing arrangements (CCA) that are service contracts with internal-use software that is developed or purchased and CCAs that include an internal-use software license. This guidance requires that the capitalized implementation costs be recognized over the period of the CCA service contract, subject to impairment evaluation on an ongoing basis. The guidance prescribes the balance sheet, income statement, and statement of cash flow classification of the capitalized implementation costs and related amortization expense, and requires additional quantitative and qualitative disclosures.	January 1, 2020 (early adoption permitted)	Historically, Schwab has expensed implementation costs as they are incurred for CCAs that are service contracts. Therefore, adopting this guidance will change the Company’s accounting treatment for these types of implementation costs. The Company is evaluating the impacts of this guidance on its financial statements, including EPS.
	Adoption provides for retrospective or prospective application to all implementation costs incurred after the date of adoption.		

The cumulative effect of the changes made to our consolidated January 1, 2018 balance sheet for the adoption of ASU 2014-09, "Revenue – Revenue from Contracts with Customers" and ASU 2018-02, "Other Comprehensive Income – Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" were as follows:

	Balance at December 31, 2017	Adjustments Due to ASU 2014-09	Adjustments Due to ASU 2018-02	Balance at January 1, 2018
Assets				
Other assets ⁽¹⁾	\$ 2,057	\$ 167	\$ —	\$2,224
Stockholders’ Equity				
Retained earnings	14,408	167	33	14,608
Accumulated other comprehensive income	(152)	—	(33)	(185)

(1) Adjustment is comprised of an increase in capitalized contract costs of \$219 million, partially offset by an increase in deferred tax liabilities of \$52 million.

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on our condensed consolidated statement of income and condensed consolidated balance sheet were as follows:

	Three Months Ended September 30, 2018		
	Balances		
Statement of Income	As Reported	Without Adoption of ASU 2014-09	Effect of Change Higher/(Lower)
Expenses Excluding Interest			
Compensation and benefits	\$737	\$ 744	\$ (7)
Taxes on income	296	294	2
Net Income	923	918	5

CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Statement of Income	Nine Months Ended September 30, 2018		
	As Reported	Balances Without Adoption of ASU 2014-09	Effect of Change Higher/(Lower)
Expenses Excluding Interest			
Compensation and benefits	\$2,252	\$ 2,279	\$ (27)
Taxes on income	780	773	7
Net Income	2,572	2,552	20

Balance Sheet	As of September 30, 2018		
	As Reported	Balances Without Adoption of ASU 2014-09	Effect of Change Higher/(Lower)
Assets			
Other assets ⁽¹⁾	\$2,092	\$ 1,905	\$ 187
Stockholders' Equity			
Retained earnings	16,615	16,428	187

⁽¹⁾ Adjustment is comprised of an increase in capitalized contract costs of \$246 million, partially offset by an increase in deferred tax liabilities of \$59 million.

3. Revenue Recognition

Disaggregated Revenue

Disaggregation of Schwab's revenue by major source is as follows:

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	2018	2017	2018	2017
Net interest revenue				
Interest revenue	\$1,755	\$1,176	\$4,766	\$3,358
Interest expense	(228)	(94)	(569)	(223)
Net interest revenue	1,527	1,082	4,197	3,135
Asset management and administration fees				
Mutual funds and ETF service fees	435	519	1,386	1,538
Advice solutions	294	265	859	765
Other	80	77	229	226
Asset management and administration fees	809	861	2,474	2,529
Trading revenue				
Commissions	155	136	501	456
Principal transactions	21	15	56	44

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Trading revenue	176	151	557	500
Other	67	71	235	212
Total net revenues	\$2,579	\$2,165	\$7,463	\$6,376

For a summary of revenue provided by our reportable segments, see Note 17. The recognition of revenue is not impacted by the operating segment in which revenue is generated.

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CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

Net interest revenue

Net interest revenue, which is generated from financial instruments covered by various other areas of GAAP, is not within the scope of Accounting Standards Codification (ASC) 606, Revenue From Contracts With Customers (ASC 606), and is included in the table above in order to reconcile to total net revenues per the condensed consolidated statement of income. Net interest revenue is the difference between interest generated on interest earning assets and interest paid on funding sources. Our primary interest earning assets include cash and cash equivalents; segregated cash and investments; margin loans, which constitute the majority of receivables from brokerage clients; investment securities; and bank loans. Revenue on interest earning assets is affected by various factors, such as the composition of assets, prevailing interest rates at the time of origination or purchase, changes in interest rates on floating rate securities, and changes in prepayment levels for mortgage related securities and loans. Fees earned on securities borrowing and lending activities, which are conducted by CS&Co on assets held in client brokerage accounts, are included in other interest revenue and expense.

Asset management and administration fees

The majority of asset management and administration fees are generated through our proprietary and third-party mutual fund and ETF offerings, as well as fee-based advisory solutions. Mutual fund and ETF service fees are charged for investment management, shareholder, and administration services provided to Schwab Funds® and Schwab ETFs™, as well as recordkeeping, shareholder, and administration services provided to third-party funds. Advice solutions fees are charged for brokerage and asset management services provided to advice solutions clients. Both mutual fund and ETF service fees and advice solutions fees are earned and recognized over time. Fees are generally based on a percentage of the daily value of assets under management and are collected on a monthly or quarterly basis.

Trading revenue

Substantially all trading revenue is generated through commissions earned for executing trades for clients in individual equities, options, fixed income securities, and certain third-party mutual funds and ETFs. This revenue is earned and collected when the trades are executed.

Other revenue

Other revenue includes order flow revenue, other service fees, software fees from our portfolio management solutions, exchange processing fees, and nonrecurring gains. Generally, the most significant portion of other revenue is order flow revenue, which are payments received from execution venues to which CS&Co sends equity and option orders. Order flow revenue is recognized when the trades are executed.

Capitalized contract costs

Deferred contract costs relate to sales commissions paid to employees for obtaining contracts with clients and are included in other assets on the condensed consolidated balance sheets. These costs are amortized to expense on a straight-line basis over a period that is consistent with how the related revenue is recognized. At September 30, 2018 and January 1, 2018, we had \$246 million and \$219 million of deferred contract costs, respectively. Amortization expense related to deferred contract costs was \$12 million and \$34 million for the third quarter and first nine months of 2018, respectively, which was recorded in compensation and benefits expense on the condensed consolidated statements of income.

Contract balances

Receivables from contracts with customers within the scope of ASC 606 were \$353 million at January 1, 2018 and \$359 million at September 30, 2018 and were recorded in other assets on the condensed consolidated balance sheets. Schwab does not have any other significant contract assets or contract liability balances as of September 30, 2018 and January 1, 2018.

Unsatisfied performance obligations

We do not have any unsatisfied performance obligations other than those that are subject to an elective practical expedient under ASC 606. The practical expedient applies to and is elected for contracts where we recognize revenue at the amount to which we have the right to invoice for services performed.

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CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

4. Investment Securities

The amortized cost, gross unrealized gains and losses, and fair value of AFS and HTM securities are as follows:

September 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities				
U.S. agency mortgage-backed securities	\$ 24,010	\$ 47	\$ 102	\$ 23,955
U.S. Treasury securities	12,412	—	169	12,243
Asset-backed securities ⁽¹⁾	9,378	19	10	9,387
Corporate debt securities ⁽²⁾	6,921	10	9	6,922
Certificates of deposit	2,765	4	—	2,769
U.S. agency notes	1,688	—	6	1,682
Commercial paper ^(2,3)	518	—	—	518
Foreign government agency securities	50	—	2	48
Non-agency commercial mortgage-backed securities	34	—	—	34
Total available for sale securities	\$ 57,776	\$ 80	\$ 298	\$ 57,558
Held to maturity securities				
U.S. agency mortgage-backed securities	\$ 113,453	\$ 26	\$ 3,483	\$ 109,996
Asset-backed securities ⁽¹⁾	17,964	122	12	18,074
Corporate debt securities ⁽²⁾	4,578	8	55	4,531
U.S. state and municipal securities	1,330	6	7	1,329
Non-agency commercial mortgage-backed securities	1,149	1	25	1,125
U.S. Treasury securities	223	—	11	212
Certificates of deposit	200	1	—	201
Foreign government agency securities	50	—	2	48
Other	5	—	—	5
Total held to maturity securities	\$ 138,952	\$ 164	\$ 3,595	\$ 135,521
December 31, 2017				
Available for sale securities				
U.S. agency mortgage-backed securities	\$ 20,915	\$ 53	\$ 39	\$ 20,929
U.S. Treasury securities	9,583	—	83	9,500
Asset-backed securities ⁽¹⁾	9,019	34	6	9,047
Corporate debt securities ⁽²⁾	6,154	16	1	6,169
Certificates of deposit	2,040	2	1	2,041
U.S. agency notes	1,914	—	8	1,906
Commercial paper ⁽²⁾	313	—	—	313
Foreign government agency securities	51	—	1	50
Non-agency commercial mortgage-backed securities	40	—	—	40
Total available for sale securities	\$ 50,029	\$ 105	\$ 139	\$ 49,995
Held to maturity securities				
U.S. agency mortgage-backed securities	\$ 101,197	\$ 290	\$ 1,034	\$ 100,453
Asset-backed securities ⁽¹⁾	12,937	127	2	13,062
Corporate debt securities ⁽²⁾	4,078	13	5	4,086
U.S. state and municipal securities	1,247	57	—	1,304

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Non-agency commercial mortgage-backed securities	994	10	5	999
U.S. Treasury securities	223	—	3	220
Certificates of deposit	200	—	—	200
Foreign government agency securities	50	—	1	49
Total held to maturity securities	\$ 120,926	\$ 497	\$ 1,050	\$ 120,373

(1) Approximately 37% and 42% of asset-backed securities held as of September 30, 2018 and December 31, 2017, respectively, were Federal Family Education Loan Program Asset-Backed Securities. Asset-backed securities collateralized by credit card receivables represented approximately 43% and 40% of the asset-backed securities held as of September 30, 2018 and December 31, 2017, respectively.

(2) As of September 30, 2018 and December 31, 2017, approximately 31% and 41%, respectively, of the total AFS and HTM investments in corporate debt securities and commercial paper were issued by institutions in the financial services industry. Approximately 18% and 22% of the holdings of these securities were issued by institutions in the information technology industry as of September 30, 2018 and December 31, 2017, respectively.

(3) Included in cash and cash equivalents on the condensed consolidated balance sheet, but excluded from this table is \$2.0 billion of AFS commercial paper. These holdings have maturities of three months or less and an aggregate market value equal to amortized cost.

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At September 30, 2018, certain banking subsidiaries had pledged securities with a fair value of \$21.5 billion as collateral to secure borrowing capacity on secured credit facilities with the FHLB (see Note 8). We also pledge certain investment securities as collateral to secure borrowing capacity at the Federal Reserve Bank discount window, and had pledged securities with a fair value of \$2.4 billion as collateral for this facility at September 30, 2018. CSB also pledges securities issued by federal agencies to secure certain trust deposits. The fair value of these pledged securities was \$898 million at September 30, 2018.

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Securities with unrealized losses, aggregated by category and period of continuous unrealized loss, are 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, 2018						
Available for sale securities						
U.S. agency mortgage-backed securities	\$10,119	\$ 68	\$1,988	\$ 34	\$12,107	\$ 102
U.S. Treasury securities	7,770	72	4,374	97	12,144	169
Asset-backed securities	1,841	4	601	6	2,442	10
Corporate debt securities	3,030	8	229	1	3,259	9
U.S. agency notes	566	2	1,116	4	1,682	6
Foreign government agency securities	—	—	48	2	48	2
Total	\$23,326	\$ 154	\$8,356	\$ 144	\$31,682	\$ 298
Held to maturity securities						
U.S. agency mortgage-backed securities	\$59,643	\$ 1,247	\$40,279	\$ 2,236	\$99,922	\$ 3,483
Asset-backed securities	2,115	12	39	—	2,154	12
Corporate debt securities	2,862	52	77	3	2,939	55
U.S. state and municipal securities	471	5	14	2	485	7
Non-agency commercial mortgage-backed securities	651	15	279	10	930	25
U.S. Treasury securities	—	—	212	11	212	11
Foreign government agency securities	—	—	48	2	48	2
Total	\$65,742	\$ 1,331	\$40,948	\$ 2,264	\$106,690	\$ 3,595
Total securities with unrealized losses ⁽¹⁾	\$89,068	\$ 1,485	\$49,304	\$ 2,408	\$138,372	\$ 3,893
December 31, 2017						
Available for sale securities						
U.S. agency mortgage-backed securities	\$5,696	\$21	\$2,548	\$18	\$8,244	\$39
U.S. Treasury securities	4,625	11	4,875	72	9,500	83
Asset-backed securities	904	3	424	3	1,328	6
Corporate debt securities	736	1	120	—	856	1
Certificates of deposit	799	1	—	—	799	1
U.S. agency notes	99	—	1,807	8	1,906	8
Foreign government agency securities	50	1	—	—	50	1
Total	\$12,909	\$38	\$9,774	\$101	\$22,683	\$139
Held to maturity securities						
U.S. agency mortgage-backed securities	\$42,102	\$310	\$24,753	\$724	\$66,855	\$1,034
Asset-backed securities	1,124	2	72	—	1,196	2
Corporate debt securities	1,078	5	—	—	1,078	5
Non-agency commercial mortgage-backed securities	607	5	—	—	607	5
U.S. Treasury securities	220	3	—	—	220	3
Foreign government agency securities	49	1	—	—	49	1
Total	\$45,180	\$326	\$24,825	\$724	\$70,005	\$1,050
Total securities with unrealized losses ⁽²⁾	\$58,089	\$364	\$34,599	\$825	\$92,688	\$1,189

⁽¹⁾ The number of investment positions with unrealized losses totaled 413 for AFS securities and 1,800 for HTM securities.

(2) The number of investment positions with unrealized losses totaled 251 for AFS securities and 938 for HTM securities.

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At September 30, 2018, substantially all securities in the investment 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 or U.S. government-sponsored enterprises.

Management evaluates whether investment securities are other-than-temporarily impaired (OTTI) on a quarterly basis as described in Note 2 in the 2017 Form 10-K. No amounts were recognized as OTTI in earnings or other comprehensive income in 2018 or 2017. As of September 30, 2018 and December 31, 2017, Schwab did not hold any securities on which OTTI was previously recognized.

The maturities of AFS and HTM securities are as follows:

September 30, 2018	Within 1 year	After 1 year through 5 years	After 5 years through 10 years	After 10 years	Total
Available for sale securities					
U.S. agency mortgage-backed securities ⁽¹⁾	\$ 169	\$ 3,669	\$ 10,571	\$ 9,546	\$ 23,955
U.S. Treasury securities	5,999	6,244	—	—	12,243
Asset-backed securities	250	6,968	1,750	419	9,387
Corporate debt securities	1,621	5,301	—	—	6,922
Certificates of deposit	866	1,903	—	—	2,769
U.S. agency notes	1,311	371	—	—	1,682
Commercial paper	518	—	—	—	518
Foreign government agency securities	—	48	—	—	48
Non-agency commercial mortgage-backed securities ⁽¹⁾	—	—	—	34	34
Total fair value	\$ 10,734	\$ 24,504	\$ 12,321	\$ 9,999	\$ 57,558
Total amortized cost	\$ 10,762	\$ 24,632	\$ 12,368	\$ 10,014	\$ 57,776
Held to maturity securities					
U.S. agency mortgage-backed securities ⁽¹⁾	\$ 383	\$ 14,370	\$ 31,785	\$ 63,458	\$ 109,996
Asset-backed securities	5	1,611	9,373	7,085	18,074
Corporate debt securities	238	3,550	743	—	4,531
U.S. state and municipal securities	—	59	254	1,016	1,329
Non-agency commercial mortgage-backed securities ⁽¹⁾	—	353	—	772	1,125
U.S. Treasury securities	—	—	212	—	212
Certificates of deposit	—	201	—	—	201
Foreign government agency securities	—	48	—	—	48
Other	—	—	—	5	5
Total fair value	\$ 626	\$ 20,192	\$ 42,367	\$ 72,336	\$ 135,521
Total amortized cost	\$ 628	\$ 20,540	\$ 43,339	\$ 74,445	\$ 138,952

⁽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 AFS securities are as follows:

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	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018	2017
Proceeds	\$ —	\$ 288	\$ 115
Gross realized gains	—	—	7

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CHARLES SCHWAB CORPORATION

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5. Bank Loans and Related Allowance for Loan Losses

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

September 30, 2018	Current	30-59 days past due	60-89 days past due	>90 days past due and other nonaccrual loans ⁽³⁾	Total past due and other nonaccrual loans	Total loans	Allowance for loan losses	Total bank loans – net
First Mortgages ^(1,2)	\$10,217	\$ 24	\$ 2	\$ 13	\$ 39	\$10,256	\$ 17	\$10,239
HELOCs ^(1,2)	1,589	2	1	10	13	1,602	7	1,595
Pledged asset lines	4,552	3	1	—	4	4,556	—	4,556
Other	176	—	—	—	—	176	2	174
Total bank loans	\$16,534	\$ 29	\$ 4	\$ 23	\$ 56	\$16,590	\$ 26	\$16,564
December 31, 2017								
First Mortgages ^(1,2)	\$9,983	\$ 14	\$ 2	\$ 17	\$ 33	\$10,016	\$ 16	\$10,000
HELOCs ^(1,2)	1,928	—	3	12	15	1,943	8	1,935
Pledged asset lines	4,361	4	4	—	8	4,369	—	4,369
Other	176	—	—	—	—	176	2	174
Total bank loans	\$16,448	\$ 18	\$ 9	\$ 29	\$ 56	\$16,504	\$ 26	\$16,478

⁽¹⁾ First Mortgages and HELOCs include unamortized premiums and discounts and direct origination costs of \$73 million and \$77 million at September 30, 2018 and December 31, 2017, respectively.

⁽²⁾ At September 30, 2018 and December 31, 2017, 47% and 48%, respectively, of the First Mortgage and HELOC portfolios were concentrated in California. These loans have performed in a manner consistent with the portfolio as a whole.

⁽³⁾ There were no loans accruing interest that were contractually 90 days or more past due at September 30, 2018 or December 31, 2017.

At September 30, 2018, CSB had pledged \$11.1 billion of First Mortgages and HELOCs as collateral to secure borrowing capacity on a secured credit facility with the FHLB (see Note 8).

Substantially all of the bank loans were collectively evaluated for impairment at September 30, 2018 and December 31, 2017.

Changes in the allowance for loan losses were as follows:

Three Months Ended	September 30, 2018				September 30, 2017			
	First Mortgages	HELOCs	Other	Total (1)	First Mortgages	HELOCs	Other	Total (1)
Balance at beginning of period	\$17	\$ 7	\$ 2	\$26	\$17	\$ 8	\$ 1	\$26
Charge-offs	—	—	—	—	(1)	—	—	(1)
Recoveries	—	1	—	1	—	—	1	1
Provision for loan losses	—	(1)	—	(1)	—	—	—	—
Balance at end of period	\$17	\$ 7	\$ 2	\$26	\$16	\$ 8	\$ 2	\$26
Nine Months Ended								
Balance at beginning of period	\$16	\$8	\$2	\$26	\$17	\$8	\$1	\$26

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Charge-offs	—	—	(1)	(1)	(2)	(1)	—	(3)
Recoveries	—	2	—	2	1	1	1	3
Provision for loan losses	1	(3)	1	(1)	—	—	—	—
Balance at end of period	\$17	\$7	\$2	\$26	\$16	\$8	\$2	\$26

⁽¹⁾ All pledged asset lines (PALs) were fully collateralized by securities with fair values in excess of borrowings at September 30, 2018 and December 31, 2017.

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A summary of impaired bank loan-related assets is as follows:

	September 30, December 31,	
	2018	2017
Nonaccrual loans ⁽¹⁾	\$ 23	\$ 28
Other real estate owned ⁽²⁾	3	3
Total nonperforming assets	26	31
Troubled debt restructurings	4	11
Total impaired assets	\$ 30	\$ 42

⁽¹⁾ Nonaccrual loans include nonaccrual troubled debt restructurings.⁽²⁾ Included in other assets on the condensed consolidated balance sheets.

Credit Quality

In addition to monitoring delinquency, Schwab 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 (LTV) 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 updated quarterly. 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 updated on a monthly basis by reference to a home price appreciation index.

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

September 30, 2018	Balance	Weighted Average Updated FICO	Utilization Rate ⁽¹⁾	Percent of Loans that are on Nonaccrual Status	
First Mortgages					
Estimated Current LTV					
<70%	\$9,383	777	N/A	0.05	%
>70% – <90%	868	771	N/A	0.24	%
>90% – <100%	4	713	N/A	8.70	%
>100%	1	742	N/A	—	
Total	\$10,256	776	N/A	0.07	%
HELOCs					
Estimated Current LTV ⁽²⁾					
<70%	\$1,509	771	31	%	0.18
>70% – <90%	84	752	47	%	0.90
>90% – <100%	5	746	77	%	0.90
>100%	4	704	81	%	5.28
Total	\$1,602	770	31	%	0.24
Pledged asset lines					
Weighted-Average LTV ⁽²⁾					
=70%	\$4,556	766	36	%	—
December 31, 2017	Balance	Weighted Average Updated FICO	Utilization Rate ⁽¹⁾	Percent of Loans that are on Nonaccrual Status	
First Mortgages					
Estimated Current LTV					
<70%	\$9,046	775	N/A	0.09	%
>70% – <90%	961	769	N/A	0.46	%
>90% – <100%	5	714	N/A	10.49	%
>100%	4	713	N/A	6.23	%
Total	\$10,016	775	N/A	0.14	%
HELOCs					
Estimated Current LTV ⁽²⁾					
<70%	\$1,773	772	32	%	0.18
>70% – <90%	148	755	47	%	0.84
>90% – <100%	14	742	64	%	2.85
>100%	8	718	72	%	4.91
Total	\$1,943	770	33	%	0.27
Pledged asset lines					
Weighted-Average LTV ⁽²⁾					
=70%	\$4,369	765	41	%	—

⁽¹⁾ The Utilization Rate is calculated using the outstanding balance divided by the associated total line of credit.⁽²⁾ Represents the LTV for the full line of credit (drawn and undrawn).

N/A Not applicable.

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September 30, 2018	First Mortgages	HELOCs
Year of origination		
Pre-2014	\$ 2,144	\$ 1,156
2014	436	93
2015	1,087	110
2016	2,662	96
2017	2,420	101
2018	1,507	46
Total	\$ 10,256	\$ 1,602
Origination FICO		
<620	\$ 5	—
620 – 679	83	8
680 – 739	1,595	305
>740	8,573	1,289
Total	\$ 10,256	\$ 1,602
Origination LTV		
<70%	\$ 7,737	\$ 1,127
>70% – <90%	2,514	468
>90% – <100%	5	7
Total	\$ 10,256	\$ 1,602

December 31, 2017	First Mortgages	HELOCs
Year of origination		
Pre-2014	\$ 2,804	\$ 1,496
2014	530	116
2015	1,218	128
2016	2,886	111
2017	2,578	92
Total	\$ 10,016	\$ 1,943
Origination FICO		
<620	\$ 6	\$ 1
620 – 679	89	10
680 – 739	1,569	365
>740	8,352	1,567
Total	\$ 10,016	\$ 1,943
Origination LTV		
<70%	\$ 7,569	\$ 1,360
>70% – <90%	2,441	574
>90% – <100%	6	9
Total	\$ 10,016	\$ 1,943

At September 30, 2018, First Mortgage loans of \$9.3 billion had adjustable interest rates. These mortgages have initial fixed interest rates for three to ten years and interest rates that adjust annually thereafter. Approximately 31% of the balance of these mortgages consisted of loans with interest-only payment terms. The interest rates on approximately

64% of the balance of these interest-only loans are not scheduled to reset for three or more years. Schwab's mortgage loans do not include interest terms described as temporary introductory rates below current market rates.

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The HELOC product has a 30-year loan term with an initial draw period of ten years from the date of origination. After the initial draw period, the balance outstanding at such time is converted to a 20-year amortizing loan. The interest rate during the initial draw period, and the 20-year amortizing period, is a floating rate based on the prime rate plus a margin. HELOCs that convert to an amortizing loan may experience higher delinquencies, and higher loss rates, than those in the initial draw period. The 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, 2018	Balance
Converted to an amortizing loan by period end	\$ 640
Within 1 year	186
> 1 year – 3 years	133
> 3 years – 5 years	163
> 5 years	480
Total	\$ 1,602

At September 30, 2018, \$1.3 billion of the HELOC portfolio was secured by second liens on the associated properties. Second lien mortgage loans typically 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, Schwab also monitors credit risk by reviewing the delinquency status of the first lien loan on the associated property.

At September 30, 2018, the borrowers on approximately 54% of HELOC loan balances outstanding only paid the minimum amount due.

6. Variable Interest Entities

As of September 30, 2018 and December 31, 2017, all of Schwab's involvement with variable interest entities (VIEs) is through CSB's Community Reinvestment Act-related investments and most of those are related to Low-Income Housing Tax Credit (LIHTC) investments. As part of CSB's community reinvestment initiatives, CSB generally invests with other institutional investors in funds that make equity investments in multifamily affordable housing properties. CSB receives tax credits and other tax benefits for these investments. CSB's LIHTC investments are accounted for using the proportional amortization method, which amortizes the cost of the investment over the period in which the investor expects to receive tax credits and other tax benefits, and the resulting amortization is included in taxes on income on the consolidated statements of income.

Aggregate assets, liabilities, and maximum exposure to loss

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

	September 30, 2018			December 31, 2017		
	Aggregate assets	Aggregate liabilities	Maximum exposure to loss	Aggregate assets	Aggregate liabilities	Maximum exposure to loss
LIHTC investments ⁽¹⁾	\$ 347	\$ 204	\$ 347	\$ 304	\$ 203	\$ 304
Other CRA investments ⁽²⁾	68	—	116	69	—	125
Total	\$ 415	\$ 204	\$ 463	\$ 373	\$ 203	\$ 429

⁽¹⁾ Aggregate assets and aggregate liabilities are included in other assets and accrued expenses and other liabilities, respectively, on the condensed consolidated balance sheets.

⁽²⁾ Other CRA investments are recorded using either the adjusted cost method, equity method, or as HTM securities. Aggregate assets are included in HTM securities, bank loans – net, or other assets on the condensed consolidated

balance sheets.

Schwab's maximum exposure to loss would result from the loss of the investments, including any committed amounts. During the nine months ended September 30, 2018 and 2017, Schwab did not provide or intend to provide financial or other support to the VIEs that it was not contractually required to provide. CSB's funding of these remaining commitments is dependent upon the occurrence of certain conditions, and CSB expects to pay substantially all of these commitments between 2018 and 2021.

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7. Bank Deposits

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

	September 30, December 31,	
	2018	2017
Interest-bearing deposits:		
Deposits swept from brokerage accounts	\$ 194,337	\$ 148,212
Checking	12,230	13,388
Savings and other	6,153	7,264
Total interest-bearing deposits	212,720	168,864
Non-interest-bearing deposits	688	792
Total bank deposits	\$ 213,408	\$ 169,656

8. Borrowings

CSC's Senior Notes are unsecured obligations and rank equally with the other unsecured senior debt. CSC may redeem some or all of the Senior Notes of each series prior to their maturity, subject to certain restrictions, and the payment of an applicable make-whole premium in certain instances. Interest is payable semi-annually for the fixed-rate Senior Notes and quarterly for the floating-rate Senior Notes. The following table lists long-term debt by instrument outstanding as of September 30, 2018 and December 31, 2017.

	Date of Issuance	Principal Amount Outstanding September 30, December 31, 2018 2017	
Fixed-rate Senior Notes:			
1.500% due March 10, 2018 ⁽¹⁾	03/10/15	\$—	\$ 625
2.200% due July 25, 2018 ⁽²⁾	07/25/13	—	275
4.450% due July 22, 2020	07/22/10	700	700
3.250% due May 21, 2021	05/22/18	600	—
3.225% due September 1, 2022	08/29/12	256	256
2.650% due January 25, 2023	12/07/17	800	800
3.000% due March 10, 2025	03/10/15	375	375
3.850% due May 21, 2025	05/22/18	750	—
3.450% due February 13, 2026	11/13/15	350	350
3.200% due March 2, 2027	03/02/17	650	650
3.200% due January 25, 2028	12/07/17	700	700
Floating-rate Senior Notes:			
Three-month LIBOR + 0.32% due May 21, 2021	05/22/18	600	—
Total Senior Notes		5,781	4,731
5.450% Finance lease obligation ⁽³⁾	06/04/04	55	61
Unamortized discount — net		(13)	(14)
Debt issuance costs		(33)	(25)
Total long-term debt		\$5,790	\$ 4,753

⁽¹⁾ Redeemed on February 8, 2018.

(2) Redeemed on June 25, 2018.

(3) Schwab has a finance lease obligation related to an office building and land under a 20-year lease. The remaining finance lease obligation is being reduced by a portion of the lease payments over the remaining lease term through June 30, 2024.

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Annual maturities on long-term debt outstanding at September 30, 2018 are as follows:

	Maturities
2018	\$ 2
2019	8
2020	709
2021	1,209
2022	266
Thereafter	3,642
Total maturities	5,836
Unamortized discount — net	(13)
Debt issuance costs	(33)
Total long-term debt	\$ 5,790

Short-term borrowings: Certain banking subsidiaries maintain secured credit facilities with the FHLB. Amounts available under these facilities are dependent on the value of our First Mortgages, HELOCs, and the fair value of certain of their investment securities that are pledged as collateral. As of September 30, 2018, the collateral pledged provided a total borrowing capacity of \$30.0 billion of which no amounts were outstanding. As of December 31, 2017, the collateral pledged by CSB provided a total borrowing capacity of \$32.3 billion, of which \$15.0 billion was outstanding.

As a condition of the FHLB borrowings, we are required to hold FHLB stock, which was recorded in other assets on the condensed consolidated balance sheets. The investment in FHLB was \$32 million at September 30, 2018 and \$405 million at December 31, 2017.

9. Commitments and Contingencies

Loan Portfolio: CSB provides a co-branded loan origination program for CSB clients (the Program) with Quicken Loans, Inc. (Quicken Loans®). Pursuant to the Program, Quicken Loans originates and services First Mortgages and HELOCs for CSB clients. Under the Program, CSB purchases certain First Mortgages and HELOCs that are originated by Quicken Loans. CSB purchased First Mortgages of \$491 million and \$696 million during the third quarters of 2018 and 2017, respectively, and \$1.6 billion and \$2.0 billion during the first nine months of 2018 and 2017, respectively. Schwab purchased HELOCs with commitments of \$104 million and \$115 million during the third quarters of 2018 and 2017, respectively, and \$311 million and \$344 million during the first nine months of 2018 and 2017, respectively.

The Company's commitments to extend credit on bank lines of credit and to purchase First Mortgages are as follows:

	September 30, December 31,	
	2018	2017
Commitments to extend credit related to unused HELOCs, PALs, and other lines of credit	\$ 11,028	\$ 10,060
Commitments to purchase First Mortgage loans	355	308
Total	\$ 11,383	\$ 10,368

Guarantees and indemnifications: Schwab 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. We partially satisfy the margin requirements by arranging unsecured standby letter of credit agreements (LOCs), in favor of the Options Clearing Corporation, which are issued by several banks. At September 30, 2018, the aggregate face amount of these LOCs totaled \$225 million. There were no funds drawn under any of these LOCs at September 30, 2018. In connection with its securities lending activities, Schwab is required to provide collateral to certain brokerage

clients. The Company satisfies the collateral requirements by providing cash as collateral. Schwab 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. Schwab's liability under these arrangements is not quantifiable and may exceed the cash and securities it has posted as collateral. The

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potential requirement for the Company to make payments under these arrangements is remote. Accordingly, no liability has been recognized for these guarantees.

Legal contingencies: Schwab 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.

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 reasonably possible to estimate 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.

Schwab 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.

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.TM Plaintiff's fourth amended complaint, filed on June 25, 2015, asserts state law breach of contract and fiduciary duty claims and names 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 fundholder vote. Plaintiff seeks unspecified compensatory and rescission damages, unspecified equitable and injunctive relief, costs, and attorneys' fees on behalf of a putative class of investors who held shares as of August 31, 2007, and a putative class of investors who purchased the shares between September 1, 2017 and February 27, 2009. In decisions issued October 6, 2015 and February 23, 2016, the court dismissed all claims with prejudice, holding that federal securities law precluded plaintiff from pursuing such claims as a class action. Plaintiff appealed to the Ninth Circuit, and on September 14, 2018, a 3-judge panel upheld dismissal, with leave for plaintiff to pursue the claims in its individual capacity. Action by plaintiff, including further appeal, remains pending.

Crago Order Routing Litigation: On July 13, 2016, a securities class action lawsuit was filed in the U.S. District Court for the Northern District of California on behalf of a putative class of customers executing equity orders through CS&Co. The lawsuit names CS&Co and CSC as defendants and alleges that an agreement under which CS&Co routed orders to UBS Securities LLC between July 13, 2011 and December 31, 2014 violated CS&Co's duty to seek best execution. Plaintiffs seek unspecified damages, interest, injunctive and equitable relief, and attorneys' fees and costs. After a first amended complaint was dismissed with leave to amend, plaintiffs filed a second amended complaint on August 14, 2017. Defendants again moved to dismiss, and in a decision issued December 5, 2017, the court denied the motion. Defendants have answered the complaint to deny all allegations, and intend to vigorously contest the lawsuit.

CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

10. Financial Instruments Subject to Off-Balance Sheet Credit Risk

Resale 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 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. The collateral provided under these resale agreements is utilized to meet obligations under broker-dealer client protection rules, which place limitations on our 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. Schwab's resale agreements are not subject to master netting arrangements.

Securities lending: Schwab loans brokerage client securities temporarily to other brokers and clearing houses 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, we may be exposed to the risk of acquiring the securities at prevailing market prices in order to satisfy our client obligations. Schwab mitigates this risk by requiring credit approvals for counterparties, monitoring the fair value of securities loaned, and requiring additional cash as collateral when necessary. We also borrow securities from other broker-dealers to fulfill short sales by brokerage clients and deliver cash to the lender in exchange for the securities. The fair value of these borrowed securities was \$338 million and \$215 million at September 30, 2018 and December 31, 2017, respectively. All of our securities lending transactions are through a program with a clearing organization, which guarantees the return of cash to us and is subject to enforceable master netting arrangements with other broker-dealers; however, we do not net securities lending transactions. Therefore, the securities loaned and securities borrowed are presented gross in the condensed consolidated balance sheets.

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 our resale agreements and securities lending activity depicting the potential effect of rights of setoff between these recognized assets and recognized liabilities at September 30, 2018 and December 31, 2017.

			Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets			
	Gross Assets/ Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Presented in the Condensed Consolidated Balance Sheets	Counterparty Offsetting	Collateral	Net Amount
September 30, 2018				&#		