

# The Charles Schwab Corporation

## 2020 Annual Dodd-Frank Act Stress Test Disclosure

Supervisory Severely Adverse Scenario

The logo consists of a blue square containing the text "charles" in a white, lowercase, serif font, and "SCHWAB" in a white, uppercase, sans-serif font below it.

*charles*  
SCHWAB

*Own your tomorrow™*

## **I. Dodd-Frank Act Stress Test Results**

### **A. About The Charles Schwab Corporation**

The Charles Schwab Corporation (CSC) is a savings and loan holding company, headquartered in San Francisco, California<sup>1</sup>. CSC was incorporated in 1986 and engages, through its subsidiaries (collectively referred to as Schwab or the Company), in wealth management, securities brokerage, banking, asset management, custody, and financial advisory services. CSC is regulated, supervised, and examined by the Board of Governors of the Federal Reserve System (Federal Reserve). CSC is also subject to various requirements and restrictions under federal and state laws.

### **B. About Capital Stress Testing**

Since 2017 in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA), CSC has been required to conduct annual stress tests and publicly disclose a summary of certain results.

DFA stress testing requirements are implemented by the Federal Reserve through its Dodd-Frank Act Stress Testing program (DFAST). Consistent with requirements of this program, CSC submitted a regulatory filing detailing the testing methodology and pro-forma results for various hypothetical economic scenarios to the Federal Reserve in April 2020. Results in this disclosure reflect certain forecasted financial measures under the severely adverse scenario prescribed by the Federal Reserve. The results span the nine-quarter timeframe beginning December 31, 2019 and ending March 31, 2022.

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<sup>1</sup> The Company has announced its intention to eventually relocate our corporate headquarters to the Dallas, Texas area.

## C. Discussion of Risks Included in Stress Testing

The Company developed its capital management process by leveraging its existing enterprise risk management infrastructure in order to ensure that capital adequacy is assessed based on Schwab's material risks and its associated risk profile. In the normal course of business, Schwab assumes various types of risk. These risks are categorized into five key areas – credit, market (including interest rate risk), liquidity, operational, and compliance. Management execution against each of these risk categories can affect strategic risk and reputation. As such, Schwab considers potential strategic risk and reputational impact across all of the aforementioned risk categories.

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

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

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

Operational Risk: Operational risks arise due to potential inadequacies or failures related to people, internal processes, and systems, or from external events and relationships impacting the Company and/or any of its key business partners and vendors.

Compliance Risk: The potential exposure to legal or regulatory sanctions, fines or penalties, financial loss, or damage to reputation resulting from the failure to comply with laws, regulations, rules, or other regulatory requirements.

Strategic Risk: The risk to Schwab's ability to achieve its vision (to be the most trusted leader in investment services) and create stockholder value arising from inconsistent/insufficient strategic decisions or lack of responsiveness to external factors.

Reputational Impact: The risk that public trust in Schwab will be adversely affected as a result of actual or perceived credit, market, liquidity, operational, legal, compliance, or strategic risk failures. This risk may expose the Company to litigation, financial loss, or a decline in its client base.

## D. Discussion of Methodologies Included in Stress Testing

Schwab uses models and estimation techniques to translate the economic and financial variables in the severely adverse scenario in order to project pre-provision net revenue (PPNR), the provision for loan and lease losses, gains and losses related to investment securities, and income before taxes.

The PPNR is estimated as total revenues (including net interest revenue and non-interest revenue), less non-interest expenses. Net interest revenue is the difference between interest earned on interest-earning assets—such as the loan portfolio and investment portfolio—and interest paid on funding sources. Schwab uses multiple models and management overlays to project net interest revenue. Non-interest revenues and expenses are projected based on business drivers, such as new client assets, compensation and benefits—including discretionary compensation—and operational risk losses.

Schwab projects the provision for loan losses using models, qualitative assessments, and/or management judgment overlays (as necessary) that consider relationships between macroeconomic indicators, internal and industry-wide historic data, and portfolio characteristics.

Management judgment is used in certain cases to develop adjustment overlays to modeled outputs. Such overlays are used primarily to account for the unique risks or trends of certain portfolios that are not well captured in the Company's models, or to otherwise compensate for model and data limitations.

Beginning in 2019, CSC was required to include all components of accumulated other comprehensive income (AOCI) in calculating regulatory capital ratios. Then, effective December 31, 2019, the Federal Reserve adopted a final rule allowing the Company to elect to exclude AOCI, which it did so beginning in the first quarter of 2020. The capital ratios in this disclosure for 2019 are actuals and so include all components of AOCI. The capital ratios in the forecast exclude all components of AOCI.

## **E. Summary of Results**

### ***i. Scenario Summary***

The severely adverse scenario is characterized by a severe global recession accompanied by a period of heightened stress in commercial real estate markets and corporate debt markets. Asset prices drop sharply in this scenario with equity prices falling 50% through the end of 2020, accompanied by a rise in the VIX, which reaches a peak of 70. Housing prices and commercial real estate prices also experience large declines of about 28% and 35%, respectively.

In this scenario, the U.S. unemployment rate climbs to a peak of 10% in the third quarter of 2021. Additionally, real GDP falls about 8.5% from its pre-recession peak, reaching a trough in the third quarter of 2021.

As a result of the severe decline in real activity, short-term Treasury rates fall and remain near zero through the end of the scenario. The 10-year Treasury yield reaches a trough of about 0.75% in the first quarter of 2020 and rises gradually thereafter to 2.25% by the first quarter of 2022. The spread between yields on investment-grade corporate bonds and yields on long-term Treasury securities widens to 5.5% by the third quarter of 2020, an increase of 4% relative to the fourth quarter of 2019. The spread between mortgage rates and 10-year Treasury yields widens to 3.5% over the same time period.

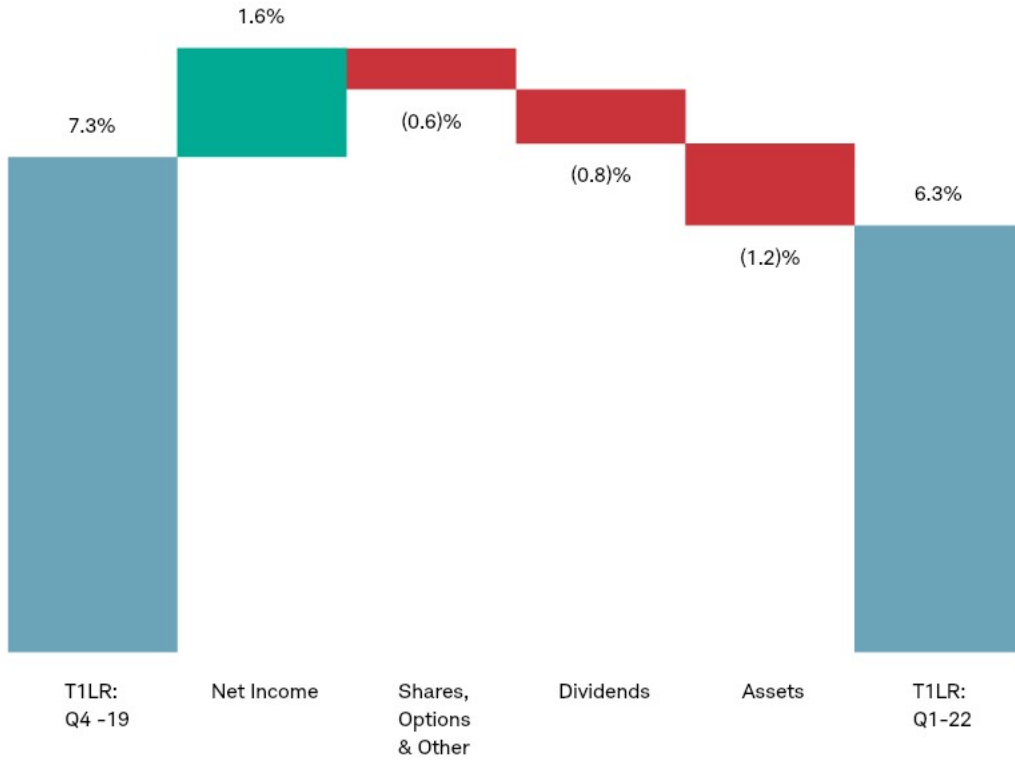
A complete description of the severely adverse scenario can be found on the Federal Reserve's website at:

<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200206a1.pdf>

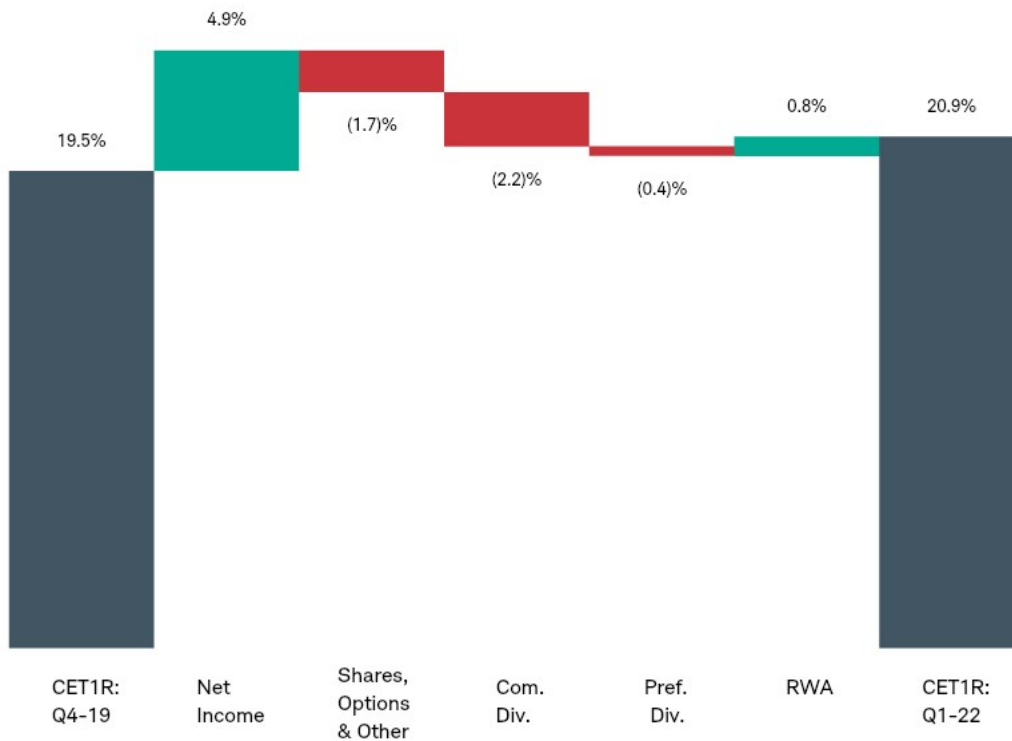
### ***ii. CSC Results***

In the severely adverse scenario, CSC's capital ratios remain above regulatory-defined thresholds and internal limits throughout the forecasted nine-quarter horizon. The Company's 7.3% tier 1 leverage ratio (T1LR) at the beginning of the forecast declines to a low point of 6.2% in Q4 2020, ending the forecast at 6.3%. The decrease is due primarily to declining income from lower market interest rates, and deposit growth. The common equity tier 1 capital ratio (CET1R) decreases slightly from 19.5% to a low point of 19.1% in Q4 2020 and then increases to 20.9% by the end of the forecast horizon due to a change in the mix of assets, resulting in a decrease in risk-weighted assets (RWA). RWA were calculated under the regulatory capital rules' risk-based standardized approach.

### Tier 1 Leverage Ratio, Severely Adverse Scenario



### Common Equity Tier 1 Capital Ratio, Severely Adverse Scenario



The following tables have not been adjusted for actual results realized.

a) *Actual Q4 2019, Projected Q1 2022, and Minimum Capital Ratios in the Severely Adverse Scenario*

	Actual 12/31/2019	Stressed Capital Ratios	
		3/31/2022	Minimum <sup>2</sup>
Common equity tier 1 capital ratio (%)	19.5%	20.9%	19.1%
Tier 1 capital ratio (%)	22.6%	24.1%	22.4%
Total capital ratio (%)	22.6%	24.2%	22.6%
Tier 1 leverage ratio (%)	7.3%	6.3%	6.2%

b) *Actual Q4 2019 and Projected Q1 2022 Risk-weighted Assets in the Severely Adverse Scenario*

	Actual 12/31/2019	Projected 3/31/2022
Risk-weighted assets (millions of dollars)	\$90,512	\$86,929

c) *Projected Losses, Revenues, Net Income, and Other Comprehensive Income in the Severely Adverse Scenario, through Q1 2022*

	Millions of dollars	Percent of average assets <sup>3</sup>
Pre-provision net revenue <sup>4</sup>	\$5,524	1.7%
Plus:		
Provisions for loan and lease losses	(161)	< 0.1%
Trading and counterparty losses	0	0.0%
Realized gains/losses on securities (AFS and HTM)	370	< 0.1%
Other gain/loss	0	0.0%
<b>Net Income Before Taxes</b>	<b>\$5,733</b>	<b>1.7%</b>

<sup>2</sup> "Minimum" represents the lowest value over the nine-quarter forecast.

<sup>3</sup> "Average assets" is the nine-quarter average of total assets.

<sup>4</sup> PPNR = Asset Mgmt Fees + Net Interest Revenue + Trading Revenue + Other Revenue – Total Expenses + PLLL for CRA Loans

d) *Projected Loan Losses, by Type of Loan in the Severely Adverse Scenario, through Q1 2022*

	Millions of dollars	Portfolio loss rate <sup>5</sup>
Loan Losses	\$88	0.6%
First-lien mortgages, domestic	68	0.5%
Junior liens and HELOCs, domestic	7	0.7%
Commercial and industrial	0	0.0%
Commercial real estate, domestic	0	0.0%
Other consumer	0	0.0%
Other loan losses	13	5.3%

## F. Forward-looking Statements

This disclosure contains forward-looking statements, including the projections of CSC's capital ratios, risk-weighted assets, revenue, losses and net income, under a hypothetical scenario incorporating a set of assumed economic and financial conditions that are more adverse than Schwab expects, as determined by the regulators. The projections do not represent forecasts of expected results of operations or financial condition, but rather reflect the possible results under the prescribed hypothetical scenario. Schwab's future results of operations and financial condition will be influenced by actual economic and financial conditions and various other factors as described in the Company's annual report on Form 10-K for the year ended December 31, 2019, and other reports filed with the Securities and Exchange Commission, which are available at [www.sec.gov](http://www.sec.gov).

<sup>5</sup> Denominator of the loss rate is based on the average of the nine quarters' balance.