

# The Charles Schwab Corporation Liquidity Coverage Ratio Disclosure Report

For the quarter ended December 31, 2018

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. About the Charles Schwab Corporation

The Charles Schwab Corporation (CSC) is a savings and loan holding company, headquartered in San Francisco, California. 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 state and other federal laws.

## II. U.S. Liquidity Coverage Ratio Overview

### A. General Requirements

The U.S. Liquidity Coverage Ratio (LCR) rule is designed to promote short-term resilience of the banking sector by requiring that certain large U.S. banking entities (Covered Companies) maintain a liquidity risk profile which ensures that they have sufficient High Quality Liquid Assets (HQLA), such as central bank reserves, government securities, and eligible corporate debt that can be converted easily and quickly to cash, to survive a significant stress lasting 30 days.

The LCR rule requires Covered Companies including Schwab to maintain an amount of HQLA that are unencumbered and controlled by the Covered Company's liquidity management function in an amount sufficient to meet their total stressed net cash outflows over a prospective 30 calendar-day period, as calculated in accordance with the LCR rule.

For the fourth quarter of 2018 Schwab is subject to a modified version of the LCR rule, which requires Covered Companies to maintain HQLA to cover at least 70% of total stressed net cash outflows, as compared to 100% of total stressed net cash outflows under the full version of the rule. Under the modified LCR rule, Schwab is required to satisfy its LCR requirement and report its LCR on a month-end basis, rather than daily. Unlike institutions that are subject to the full version of the LCR rule, Schwab is also not required to include a maturity mismatch add-on amount to its net cash outflows, and Schwab's depository institution subsidiaries with \$10 billion or more of total assets are not subject to a separate LCR requirement. If Schwab is not in compliance with its LCR requirement it must provide notice to the Federal Reserve.

### B. High-Quality Liquid Assets

The LCR rule classifies HQLA into three categories of assets: Level 1, Level 2A, and Level 2B liquid assets. The rule provides that Level 1 assets, which are considered to be the highest quality and most liquid assets, are included in a Covered Company's eligible HQLA without limit and without haircuts. The LCR treats Level 2A and Level 2B liquid assets as having characteristics that are associated with being relatively stable and significant sources of liquidity, but not to the same degree as Level 1 liquid assets. Accordingly, the LCR subjects Level 2A liquid assets to a 15% haircut, and when combined with Level 2B liquid assets, they may not exceed 40% of the total eligible HQLA. Level 2B liquid assets, which are associated with a lower degree of liquidity and more volatility than Level 2A liquid assets, are subject to a 50% haircut and may not exceed 15% of the total eligible HQLA. Other classes of assets do not qualify as HQLA.

To be included in a Covered Company's eligible HQLA, which is the numerator of the LCR, Level 1, Level 2A, or Level 2B assets must meet a variety of specific standards designed to

ensure that such assets have robust liquidity characteristics. In general, Level 1 assets include central bank reserve balances, both domestic and foreign, that are withdrawable by a Covered Company without restriction; securities that are issued or guaranteed by the U.S. Treasury Department, or in some cases, by other agencies of the U.S. Government; and certain other securities that are issued or guaranteed by non-U.S. sovereign governments, multi-lateral development banks, and similar institutions. Level 2A assets include certain investment-grade securities issued or guaranteed by U.S. government-sponsored enterprises, and certain other securities that are issued or guaranteed by select non-U.S. sovereign governments, multi-lateral development banks, and similar institutions that do not meet Level 1 asset criteria. Level 2B assets may include certain corporate debt and common equity securities that are not issued by financial sector entities and that meet a variety of eligibility criteria, including market price stability in periods of significant stress.

### **C. Total Net-Cash Outflows**

A Covered Company's total net-cash outflow amount, which is the denominator of the LCR, is determined by applying mandated outflow and inflow rates, which reflect certain prescribed, industry-wide stressed assumptions, against the balances of a Covered Company's funding sources, obligations, transactions, and assets over a prospective 30-day calendar period. Inflows that can be included to offset outflows are limited to 75% of outflows to ensure that Covered Companies are maintaining sufficient on-balance sheet liquidity and are not overly reliant on inflows, which may not materialize in a period of stress. Accordingly, a Covered Company will always be required to maintain a certain amount of HQLA to satisfy its LCR rule requirements.

## **III. LCR Public Disclosure Requirements**

The LCR Public Disclosure rule requires Covered Companies subject to the modified LCR rule to disclose on a quarterly basis their average month-end LCRs over the quarter, as well as quantitative and qualitative information on certain components of their LCRs.

The information presented in this document is based on calculations prescribed by the LCR rule and is presented in accordance with the public disclosure provisions of the rule.

The LCR disclosure presented is based on our current understanding of the LCR rule, which may be subject to change as we receive additional clarification and interpretive guidance from the Federal Reserve and as the LCR rule evolves over time.

## **IV. LCR Qualitative Disclosures**

### **A. The Main Drivers of the Liquidity Coverage Ratio**

Our LCR quantitative disclosures reflect the simple average of month-end values for each disclosure category over the quarter. When discussing the main drivers of our LCR, we are referring to these average month-end values.

Our cash outflow amounts for the quarter were predominantly driven by two categories: first, assumed deposit outflows from retail customers and counterparties, primarily from brokered sweep deposit outflow, the category to which our retail customer bank sweep deposits are assigned; and second, from non-operational funding outflow, which represents primarily deposit outflows associated with counterparties that due to deposit size, are categorized under the LCR Rule as wholesale counterparties and presumed to be less stable. These two

accounted for over 80% of weighted cash outflows.

Offsetting a portion of cash outflows are cash inflows, which were predominantly driven by three categories: first, secured lending and asset exchange cash inflow, which is concentrated in our broker-dealer business representing primarily unwinds of customer margin loans; second, securities cash inflow primarily representing inflow from short-term investments of our working capital or principal and interest due in our investment portfolio; and third, broker-dealer segregated account inflow, which is the fair value of our broker dealer’s actual segregated assets held under the customer protection rule as of the calculation date, less the fair value of the required balance of the customer reserve account in a period of prescribed stress. Together these account for over 90% of calculated cash inflows.

## B. The Composition of Eligible HQLA

As shown in the below chart, our total eligible consolidated HQLA was wholly concentrated in Level 1 HQLA, on both an average unweighted and average weighted basis in the fourth quarter of 2018. Level 1 HQLA are represented predominantly by excess cash on deposit with the Federal Reserve Bank, U.S Treasury securities, and other eligible high-quality securities, such as certain securities guaranteed by the Government National Mortgage Association.

	HQLA Categories as a Percentage of Schwab’s Total Eligible HQLA	
	Average Unweighted	Average Weighted
Level 1 Assets	100%	100%
Level 2A Assets	0%	0%
Level 2B Assets	0%	0%

## C. Concentration of Funding Sources

Schwab has adopted a comprehensive liquidity risk management program designed to ensure funding is available for our ongoing commitments and to meet obligations to clients. While our primary source of funding is generated by client activity and the cash they deposit with us, we also maintain various long and short-term funding sources. These include long-term corporate debt, which we periodically issue in the capital markets and is used for long-term needs, or short-term debt such as commercial paper issuance or borrowing against third party lines of credit, which may be utilized for short-term funding needs.

## D. Derivative Exposures and Potential Collateral Calls

While Schwab does not have material exposure to commonly defined derivatives or collateral calls, trades in our investment portfolio settling outside of a 5-day window are disclosed as either “Outflow Related to Derivative Exposures and Other Collateral Requirements”, or “Net Derivative Cash Inflow” in our disclosure.

## E. Currency Mismatch in the Liquidity Coverage Ratio

Schwab does not have material exposure to currency mismatch.

## F. Centralized Liquidity Management Function

Our management has adopted a formal liquidity risk management framework that imposes responsibilities on the centralized liquidity management function (first line of defense), the independent risk management oversight function (second line of defense), and the internal audit function (third line of defense).

With oversight and challenge by the second and third lines of defense, the first line of defense sits within the Company's Corporate Treasury Function and is tasked with identifying and assessing liquidity risks, incorporating risks into liquidity stress testing, and conducting rigorous liquidity stress testing to measure liquidity risks over a range of scenarios and time horizons. Together, in consideration of both our liquidity risk tolerance and our business needs, these activities allow us to assess liquidity and funding needs under adverse conditions and drive the sizing of our liquidity buffer, which is composed of HQLA. Schwab's Treasurer has overall responsibility for the management of HQLA.

Schwab further manages liquidity risk through a broader risk governance framework that includes our Liquidity Risk Management Policy (Policy) and other key risk policies. The Policy establishes standards for defining, measuring, limiting and reporting liquidity risk. It reflects our risk appetite which is memorialized in our Risk Appetite Statement and adopted by CSC's Board of Directors. Compliance with the Risk Appetite Statement is overseen by the Chief Risk Officer and the second line of defense. The second line of defense is also responsible for governance of liquidity risk management and provides analytical challenge to the Company's liquidity risk management framework. CSC's Board of Directors reviews and approves liquidity management strategies and policies.

## V. LCR Quantitative Disclosures

In the following table, the figures reported in the "Average Weighted Amount" column reflect the prescribed, industry-wide assumptions and haircuts defined by the LCR rule to determine a Covered Company's eligible HQLA, cash outflow amounts and cash inflow amounts. The figures reported in the "Average Unweighted Amount" column reflect gross values that are not included in the calculation used to determine the Company's compliance with LCR requirements.

10/31/2018 to 12/31/2018 \$ in millions	Average Unweighted Amount	Average Weighted Amount
<b>HIGH-QUALITY LIQUID ASSETS (HQLA)</b>		
1 Total eligible HQLA of which: <sup>1</sup>	38,881	38,881
2 Eligible level 1 liquid assets	38,881	38,881
3 Eligible level 2A liquid assets	0	0
4 Eligible level 2B liquid assets	0	0
<b>CASH OUTFLOW AMOUNTS</b>		
5 Deposit outflow from retail customers and counterparties, of which:	181,976	39,576
6 Stable retail deposit outflow	4,628	139
7 Other retail funding	22,650	8,440
8 Brokered deposit outflow	154,698	30,997
9 Unsecured wholesale funding outflow, of which:	68,927	28,977
10 Operational deposit outflow	0	0
11 Non-operational funding outflow	68,905	28,955
12 Unsecured debt outflow	22	22
13 Secured wholesale funding and asset exchange outflow	1,778	1,612
14 Additional outflow requirements, of which:	11,396	913
15 Outflow related to derivative exposures and other collateral requirements	128	128
16 Outflow related to credit and liquidity facilities including unconsolidated structured transactions	11,267	785
17 Other contractual funding obligation outflow	1,145	1,145
18 Other contingent funding obligations outflow	0.00	0.00
19 TOTAL CASH OUTFLOW	265,222	72,224
<b>CASH INFLOW AMOUNTS</b>		
20 Secured lending and asset exchange cash inflow	7,686	3,963
21 Retail cash inflow	64	32
22 Unsecured wholesale cash inflow	2,116	2,113
23 Other cash inflows, of which:	15,843	15,843
24 Net derivative cash inflow	0	0
25 Securities cash inflow	6,854	6,854
26 Broker-dealer segregated account inflow	8,989	8,989
27 Other cash inflow	0	0
28 TOTAL CASH INFLOW	25,710	21,951
<b>Average Amount<sup>2</sup></b>		
29 HQLA AMOUNT		38,881
30 TOTAL NET CASH OUTFLOW AMOUNT EXCLUDING THE MATURITY MISMATCH ADD-ON <sup>3</sup>		35,191
31 MATURITY MISMATCH ADD-ON		0
32 TOTAL NET CASH OUTFLOW AMOUNT		35,191
33 LIQUIDITY COVERAGE RATIO (%)		110.52%

<sup>1</sup> Excludes non-transferable liquidity at subsidiaries

<sup>2</sup> Amounts reported may not equal the calculation of those amounts reported in rows 1-28 due to technical factors such as the application of the level 2 liquid asset caps, the total inflow cap, and for depository institution holding companies subject to subpart G, the application of the modification of total net cash outflows

<sup>3</sup> After the 70% modifier