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

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

Commission File Number: 1-9700

THE CHARLES SCHWAB CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	94-3025021
(State or other jurisdiction 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

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

Yes No

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

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

Outstanding on October 26, 2016

THE CHARLES SCHWAB CORPORATION

Quarterly Report on Form 10-Q

For the Quarter Ended September 30, 2016

Index

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

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

Part I – FINANCIAL INFORMATION

THE CHARLES SCHWAB CORPORATION

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

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

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

INTRODUCTION

The Charles Schwab Corporation (CSC) is a savings and loan holding company engaged, through its subsidiaries, in wealth management, securities brokerage, banking, money management, custody, and financial advisory services. Charles Schwab & Co., Inc. (Schwab) is a securities broker-dealer with over 330 domestic branch offices in 46 states, as well as a branch in each of the Commonwealth of Puerto Rico and London, England. In addition, Schwab serves clients in Hong Kong through one of CSC's subsidiaries. Other subsidiaries include Charles Schwab Bank (Schwab Bank), a federal savings bank, and Charles Schwab Investment Management, Inc. (CSIM), the investment advisor for Schwab's proprietary mutual funds, which are referred to as the Schwab Funds®, and for Schwab's exchange-traded funds (ETFs), which are referred to as the Schwab ETFs™.

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

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

Forward-Looking Statements

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

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

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

THE CHARLES SCHWAB CORPORATION

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

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

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

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

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

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

Certain of these factors, as well as general risk factors affecting the Company, are discussed in greater detail in "Part I –Item 1A – Risk Factors" in the 2015 Form 10-K, and "Part II – Other Information – Item 1A – Risk Factors."

THE CHARLES SCHWAB CORPORATION

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

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

GLOSSARY OF TERMS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

THE CHARLES SCHWAB CORPORATION

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

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

OVERVIEW

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

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

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

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

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

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

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

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

Subsequent Event

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

Current Regulatory Environment and Other Developments

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

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

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

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

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

THE CHARLES SCHWAB CORPORATION

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

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

Results of Operations

The following discussion presents an analysis of the Company's results of operations for the third quarter and first nine months of 2016 compared to the same periods in 2015.

Net Revenues

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

Nine Months Ended September 30,	2016	2015

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

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

Asset Management and Administration Fees

Asset management and administration fees include mutual fund and ETF service fees and fees for other asset-based financial services provided to individual and institutional clients. The Company earns mutual fund and ETF service fees for shareholder services, administration, and investment management provided to its proprietary funds, and recordkeeping and shareholder services provided to third-party funds. These fees are based upon the daily balances of client assets invested in these funds. Asset management and administration fees do not include securities lending revenues earned by proprietary mutual funds and ETFs as those amounts, net of program fees, are credited to the fund shareholders.

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

The fair values of client assets included in proprietary and third-party mutual funds and ETFs are based on quoted market prices and other observable market data.

Other asset management and administration fees include various asset-based fees, such as trust fees, 401(k) recordkeeping fees, mutual fund clearing fees, collective trust fund fees, and non-balance based service and transaction fees.

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

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

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

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

THE CHARLES SCHWAB CORPORATION

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

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

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

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

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

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

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

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

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

Net Interest Revenue

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

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

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

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

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

THE CHARLES SCHWAB CORPORATION

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

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

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

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

(1) Interest revenue or expense was less than $500,000 in the period or periods presented.
(2) Amounts have been calculated based on amortized cost.
(3) Certain prior period amounts have been reclassified to conform to the 2016 presentation.
(4) Adjusted for the retrospective adoption of Accounting Standards Update (ASU) 2015-03. See "Item 1 – Notes to Condensed Consolidated Financial Statements (Unaudited) – 2. New Accounting Standards" for additional information.

THE CHARLES SCHWAB CORPORATION

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

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

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

(1) Interest revenue or expense was less than $500,000 in the period or periods presented.
(2) Amounts have been calculated based on amortized cost.
(3) Certain prior period amounts have been reclassified to conform to the 2016 presentation.
(4) Adjusted for the retrospective adoption of ASU 2015-03. See “Item 1 – Notes to Condensed Consolidated Financial Statements (Unaudited) – 2. New Accounting Standards” for additional information.

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

- gathering additional assets from new and current clients;

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

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

THE CHARLES SCHWAB CORPORATION

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

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

Trading Revenue

Trading revenue includes commission and principal transaction revenues. Commission revenue is affected by the number of revenue trades executed and the average revenue earned per revenue trade. Principal transaction revenue is primarily comprised of revenue from trading activity in fixed income securities with clients. To accommodate clients' fixed income trading activity, the Company maintains positions in fixed income securities, including U.S. state and municipal debt obligations, U.S. Government and corporate debt, and other securities. The difference between the price at which the Company buys and sells securities to and from its clients and other broker-dealers is recognized as principal transaction revenue. Principal transaction revenue also includes adjustments to the fair value of these securities positions.

The following table presents trading revenue and the related drivers:

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

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

Other Revenue

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

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

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

THE CHARLES SCHWAB CORPORATION

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

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

Expenses Excluding Interest

The following table shows a comparison of expenses excluding interest:

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

Compensation and Benefits

Compensation and benefits expense includes salaries and wages, incentive compensation, and related employee benefits. Incentive compensation includes variable compensation, discretionary bonuses, and stock-based compensation. Variable compensation includes payments to certain individuals based on their sales performance. Discretionary bonuses are based on the Company's overall performance as measured by EPS. Stock-based compensation primarily includes employee and board of director stock options and restricted stock.

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

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

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

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

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

Expenses Excluding Compensation and Benefits

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

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

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

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

Taxes on Income

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

Segment Information

The Company provides financial services to individuals and institutional clients through two segments – Investor Services and Advisor Services. The Investor Services segment provides retail brokerage and banking services, retirement plan services, and other corporate brokerage services. The Advisor Services segment provides custodial, trading, and support services as well as retirement business services. Revenues and expenses are attributed to the Company's two segments based on which segment services the client. The Company evaluates the performance of its segments on a pre-tax basis, excluding items such as restructuring and other charges. Segment assets and liabilities are not used for evaluating segment performance or in deciding how to allocate resources to segments.

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

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

THE CHARLES SCHWAB CORPORATION

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

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

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

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

Investor Services

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

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

Advisor Services

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

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

Risk Management

The Company’s business activities expose it to a variety of risks, including operational, credit, market, liquidity, and compliance risk. The Company has a comprehensive risk management program to identify and manage these risks and their associated potential for financial and reputational impact. Despite the Company’s efforts to identify areas of risk and implement risk management policies and procedures, there can be no assurance that the Company will not suffer unexpected losses due to these risks.

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

Credit Risk Exposures

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

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

The Company's bank loan portfolio includes First Mortgages, HELOCs, PALs and other loans. The credit risk exposure related to loans is actively managed through individual loan and portfolio reviews. Management regularly reviews asset quality, including concentrations, delinquencies, nonaccrual loans, charge-offs, and recoveries. All are factors in the determination of an appropriate allowance for loan losses.

The Company's residential loan underwriting guidelines include maximum loan-to-value (LTV) ratios, cash out limits, and minimum Fair Isaac Corporation (FICO) credit scores. The specific guidelines are dependent on the individual characteristics of a loan (for example, whether the property is a primary or secondary residence, whether the loan is for investment property, whether the loan is for an initial purchase of a home or refinance of an existing home, and whether the loan size is conforming or jumbo).

The Company does not originate or purchase residential loans that allow for negative amortization and does not originate or purchase subprime loans (generally defined as extensions of credit to borrowers with a FICO score of less than 620 at origination), unless the borrower has compensating credit factors.

The Company’s bank loans include $7.8 billion of adjustable rate First Mortgage loans at September 30, 2016. The Company’s adjustable rate mortgages have initial fixed interest rates for three to ten years and interest rates that adjust annually thereafter. Approximately 37% of these mortgages consisted of loans with interest-only payment terms. The interest rates on approximately 57% of these interest-only loans are not scheduled to reset for three or more years. The Company’s mortgage loans do not include interest terms described as temporary introductory rates below current market rates.

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

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

THE CHARLES SCHWAB CORPORATION

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

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

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

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

(1) Loan delinquencies include loans that are 30 days or more past due.
(2) Nonaccrual loans include loans past due more than 90 days and other nonaccrual loans.

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

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

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

At September 30, 2016, $1.9 billion of the HELOC portfolio was secured by second liens on the associated properties. Second lien mortgage loans possess a higher degree of credit risk given the subordination to the first lien holder in the event of default. In addition to the credit monitoring activities described previously, the Company also monitors credit risk by reviewing the delinquency status of the first lien loan on the associated property. At September 30, 2016, approximately 27% of the HELOC borrowers that had a balance only paid the minimum amount of interest due.

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

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

At September 30, 2016, substantially all securities in the available for sale and held to maturity portfolios were rated investment grade. U.S. agency mortgage-backed securities do not have explicit credit ratings; however, management considers these to be of the highest credit quality and rating given the guarantee of principal and interest by the U.S. government-sponsored enterprises.

Concentration Risk Exposures

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

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

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

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

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

The Company has indirect exposure to U.S. Government and agency securities held as collateral to secure its resale agreements. The Company would have exposure to the U.S. Government and agency securities only in the event of the counterparty's default on the resale agreements. The fair value of U.S. Government and agency securities held as collateral for resale agreements totaled $9.6 billion at September 30, 2016.

Foreign Holdings

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

LIQUIDITY

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

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

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

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

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

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

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

CSC and Schwab also have access to uncommitted, unsecured bank credit lines with several banks. The need for short-term borrowings from these sources arises primarily from timing differences between cash flow requirements, scheduled liquidation of interest-earning investments, and movements of cash to meet regulatory brokerage client cash segregation requirements. These lines were not used by CSC during the first nine months of 2016. Schwab used such borrowings for one day during the first nine months of 2016 for $15 million, and there were no borrowings outstanding under these lines at September 30, 2016.

THE CHARLES SCHWAB CORPORATION

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

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

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

Schwab Bank has access to short-term secured funding through the Federal Reserve's discount window. Amounts available under the Federal Reserve discount window are dependent on the fair value of certain of Schwab Bank's securities available for sale and/or securities held to maturity that are pledged as collateral. Schwab Bank maintains policies and procedures necessary to access this funding and tests discount window borrowing procedures on a periodic basis. At September 30, 2016, $1.5 billion was available under this arrangement. Schwab Bank used such borrowings for one day during the first nine months of 2016 for $1 million and there were no borrowings outstanding under these lines at September 30, 2016.

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

CSC has authorization from its Board of Directors to issue unsecured commercial paper notes (Commercial Paper Notes) not to exceed $1.5 billion. Management has set a current limit for the commercial paper program not to exceed the amount of the committed, unsecured credit facility, which was $750 million at September 30, 2016. The maturities of the Commercial Paper Notes may vary, but are not to exceed 270 days from the date of issue. The commercial paper is not redeemable prior to maturity and cannot be voluntarily prepaid. The proceeds of the commercial paper program are to be used for general corporate purposes. CSC's ratings for these short-term borrowings are P1 by Moody's, A1 by Standard & Poor's, and F1 by Fitch. CSC had no Commercial Paper Notes outstanding as of September 30, 2016.

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

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

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

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

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

CAPITAL MANAGEMENT

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

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

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

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

Regulatory Capital Requirements

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

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

THE CHARLES SCHWAB CORPORATION

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

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

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

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

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

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

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

from CSC if such payment would result in a net capital amount of less than 5% of aggregate debit balances or less than 120% of its minimum dollar requirement of $250,000. As such, the broker-dealer subsidiaries are required to maintain, at all times, at least the minimum level of net capital required under Rule 15c3-1. At September 30, 2016, Schwab and optionsXpress, Inc. met and exceeded their net capital requirements.

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

THE CHARLES SCHWAB CORPORATION

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

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

Dividends

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

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

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

off-Balance Sheet Arrangements

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

Off-Balance Sheet Credit Risk or Concentration Risk."

Critical Accounting ESTIMATES

Certain of the Company's accounting policies that involve a higher degree of judgment and complexity are discussed in "Part II – Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Estimates" in the 2015 Form 10-K. There have been no changes to these critical accounting estimates during the first nine months of 2016.

Item 3.Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to interest rate risk primarily from changes in market interest rates on its interest-earning assets relative to changes in the costs of its funding sources that finance these assets. The majority of the Company's interest-earning assets and interest-bearing liabilities are sensitive to changes in short-term interest rates. To a lesser degree, a portion of the Company's investment portfolios is sensitive to changes in long-term interest rates.

Net interest revenue is affected by various factors, such as the distribution and composition of interest-earning assets and interest-bearing liabilities, the spread between yields earned on interest-earning assets and rates paid on interest-bearing liabilities, which may reprice at different times or by different amounts, and the spread between short and long-term interest rates. Interest-earning assets primarily include investment securities, margin loans and bank loans. These assets are sensitive to changes in interest rates and changes in prepayment levels that tend to increase in a declining rate environment and decrease in a rising rate environment. Because the Company establishes the rates paid on certain brokerage client cash balances and bank deposits and the rates charged on certain margin loans and bank loans, and controls the composition of its investment securities, it has some ability to manage its net interest spread, depending on competitive factors and market conditions.

To mitigate the risk of declining interest revenue, the Company has established policies and procedures which include setting guidelines on the amount of net interest revenue at risk, and monitoring the net interest margin and average maturity of its interest-earning assets and funding sources. To remain within these guidelines, the Company manages the maturity, repricing, and cash flow characteristics of the investment portfolios.

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

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

Net Interest Revenue Simulation

For the Company's net interest revenue sensitivity analysis, the Company uses net interest revenue simulation modeling techniques to evaluate and manage the effect of changing interest rates. The simulation includes all interest-sensitive assets and liabilities. Key variables in the simulation include the repricing of financial instruments, prepayment, reinvestment, and product pricing assumptions. The Company uses constant balances and market rates in the simulation assumptions in order to minimize the number of variables and to better isolate risks. The simulations involve assumptions that are inherently uncertain and, as a result, cannot precisely estimate net interest revenue or predict the impact of changes in interest rates on net interest revenue. Actual results may differ from simulated results due to balance growth or decline and the timing, magnitude, and frequency of interest rate changes, as well as changes in market conditions and management strategies, including changes in asset and liability mix.

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

As represented by the simulations presented below, the Company's investment strategy is structured to produce an increase in net interest revenue when interest rates rise and, conversely, a decrease in net interest revenue when interest rates fall.

The simulations in the following table assume that the asset and liability structure of the consolidated balance sheet would not be changed as a result of the simulated changes in interest rates. As the Company actively manages its consolidated balance sheet and interest rate exposure, in all likelihood the Company would take steps to manage additional interest rate exposure that could result from changes in the interest rate environment. The following table shows the simulated net interest revenue change over the next 12 months beginning September 30, 2016 and December 31, 2015 of a gradual 100 basis point increase or decrease in market interest rates relative to prevailing market rates at the end of each reporting period.

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

The change in net interest revenue sensitivities as of September 30, 2016 reflects the moderate increase of short- to medium-term interest rates. The current low interest rate environment limits the extent to which the Company can reduce interest expense paid on funding sources. A decline in interest rates could negatively impact the yield on the Company's investment portfolio to a greater degree than any offsetting reduction in interest expense, further compressing net interest margin. The increase of short-term interest rates positively impacts net interest revenue as yields on interest-earning assets rise faster than the cost of funding sources.

Part I – FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Statements of Income

(In Millions, Except Per Share Amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net Revenues				
Asset management and administration fees (1)	$ 798	$ 663	$ 2,254	$ 1,977
Interest revenue	891	669	2,541	1,931
Interest expense	(46)	(34)	(126)	(96)
Net interest revenue	845	635	2,415	1,835
Trading revenue	190	228	623	658
Other	76	66	209	208
Provision for loan losses	5	5	5	11
Total net revenues	1,914	1,597	5,506	4,689
Expenses Excluding Interest				
Compensation and benefits	609	548	1,837	1,669
Professional services	131	114	372	340
Occupancy and equipment	100	92	299	260
Advertising and market development	64	58	204	189
Communications	57	58	179	175
Depreciation and amortization	60	57	173	166
Other	99	87	273	256
Total expenses excluding interest	1,120	1,014	3,337	3,055
Income before taxes on income	794	583	2,169	1,634
Taxes on income	291	207	802	603
Net Income	503	376	1,367	1,031
Preferred stock dividends and other (2)	33	11	99	45
Net Income Available to Common Stockholders	$ 470	$ 365	$ 1,268	$ 986
Weighted-Average Common Shares Outstanding:				

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

(1) Includes fee waivers of $41 and $166 during the third quarters of 2016 and 2015, respectively and $193 and $519 during the first nine months of 2016 and 2015, respectively, relating to Schwab-sponsored money market funds.

(2) Includes preferred stock dividends and undistributed earnings and dividends allocated to non-vested restricted stock units.

See Notes to Condensed Consolidated Financial Statements.

THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Statements of Comprehensive Income

(In Millions)

(Unaudited)

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

See Notes to Condensed Consolidated Financial Statements.

THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Balance Sheets

(In Millions, Except Per Share and Share Amounts)

(Unaudited)

	September 30, 2016	December 31, 2015 (1)
Assets		
Cash and cash equivalents	$ 10,431	$ 11,978
Cash and investments segregated and on deposit for regulatory purposes (including resale agreements of $9,425 at September 30, 2016 and $8,088 at December 31, 2015)	20,077	19,598
Receivables from brokers, dealers, and clearing organizations	947	582
Receivables from brokerage clients — net	16,380	17,313
Other securities owned — at fair value	858	533
Securities available for sale	75,791	65,646
Securities held to maturity (fair value — $67,843 at September 30, 2016 and $50,088 at December 31, 2015)	66,056	50,007
Bank loans — net	14,858	14,334
Equipment, office facilities, and property — net	1,266	1,145
Goodwill	1,227	1,227
Intangible assets — net	154	181
Other assets	1,292	1,161
Total assets	$ 209,337	$ 183,705
Liabilities and Stockholders' Equity		
Bank deposits	$ 149,630	$ 129,502
Payables to brokers, dealers, and clearing organizations	3,497	2,588
Payables to brokerage clients	32,961	33,185
Accrued expenses and other liabilities	1,902	2,151
Short-term borrowings	3,001	-
Long-term debt		