Meeting Between Vice Chair for Supervision Quarles, Staff of the Federal Reserve Board, and Representatives from Charles Schwab Corporation
June 20, 2019

Participants: Vice Chair for Supervision Randal K. Quarles, Mark Van Der Weide, Benjamin McDonough, Mary Watkins, Asad Kudiya, and Richard Young (Federal Reserve Board)

Joe Martinetto and Peter Morgan (Charles Schwab Corporation); Randall Guynn and Luigi L. De Ghenci (Davis Polk & Wardwell LLP)

Summary: Vice Chair for Supervision Quarles and staff of the Federal Reserve Board met with representatives of the Charles Schwab Corporation to discuss the proposals issued by the Board, OCC, and FDIC that would establish a revised framework for applying prudential standards to large banking organizations. The representatives discussed issues related to the application of the proposed framework to covered savings and loan holding companies, including issues relating to expectations regarding capital planning and stress testing.

Attachment

Discussion Regarding Further Tailoring of the Application of Capital Planning Requirements to Category III Institutions

June 20, 2019

charles SCHWAB

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Executive Summary

- **We believe that further tailoring within Category III would be appropriate for firms with (1) low asset risk profiles; and (2) less complex business models**
  - The "low asset risk profile" would be reflected by having an RWAs/total consolidated assets ratio of less than 50%.
  - The "non-complex business model" would be reflected by having a GSIB method one score less than 50
- **Firms that are below these thresholds should qualify for streamlined capital planning and DFAST stress testing requirements in recognition of their lower asset risk profile and lower complexity (*e.g.*, Category IV standards), such as:**
  - Streamlined annual capital plan
  - Biennial supervisory stress testing
  - No company-run stress testing
  - Compliance with SR 15-19 rather than SR 15-18

Charles Schwab's Balance Sheet is Illustrative of the Need for Further Tailoring within Category III

Illustrative Risk Weighted Asset Calculation

Schwab's Balance Sheet	% of Assets		Risk Weighting
Fed Cash, Treasuries, GNMAs, Repos backed by such	~21%	×	0%
Government Guaranteed Asset Backed Securities, and Other Cash	~51%	×	20%
Margin Lending	~6%	×	0%
1st Mortgages	~4%	×	50%
HELOCs, securities-based loans, and other corporate debt and ABS	~18%	×	100%

~72% of Schwab's balance sheet is invested in cash and government securities

- As of December 31, 2018, CSC had RWAs of only $95B, an amount significantly lower relative to all but a small number of the other Category I-IV firms
- In addition, CSC's ratio of RWAs to total consolidated assets (TCAs) as of such date, is 35%, which is much lower than the ratios of most all other Category I-IV firms and less than half of the ratios of other Category III firms

CCAR and DFAST are much less meaningful for CSC due to its low-credit-risk balance sheet

2018 DFAST Results

- In contrast to all but three of the other Category I-IV firms, CSC's minimum and ending common equity tier 1 (CET1) ratios in the supervisory severely adverse scenario in its 2018 company-run stress tests increased as compared to its starting CET1 ratio
  - CSC's CET1 ratio in its severely adverse company-run stress test increased from 19.3% to 20.1% (minimum) and 26.8% (ending) due to movement of cash off its balance sheet and a change in its asset mix to Treasury securities and other lower-credit-risk assets
- Similarly, the minimum and ending CET1 ratios in the supervisory severely adverse scenarios of the supervisory stress tests of all but one other Category I-IV firms are lower than their starting ratios
  - CSC is not currently subject to supervisory stress testing
- In CSC's 2018 company-run stress tests, its T1LR in the supervisory severely adverse scenario declined from 7.6% (starting) to 7.1%(minimum) and increased to 8.3% (ending); these results are better than the results of the vast majority of other Category I-IV firms
  - Most of the other Category I-IV firms also experienced larger declines in their T1LRs in their 2018 supervisory stress tests in the severely adverse scenario

CCAR and DFAST are much less meaningful for CSC due to its low-credit-risk balance sheet, cont'd

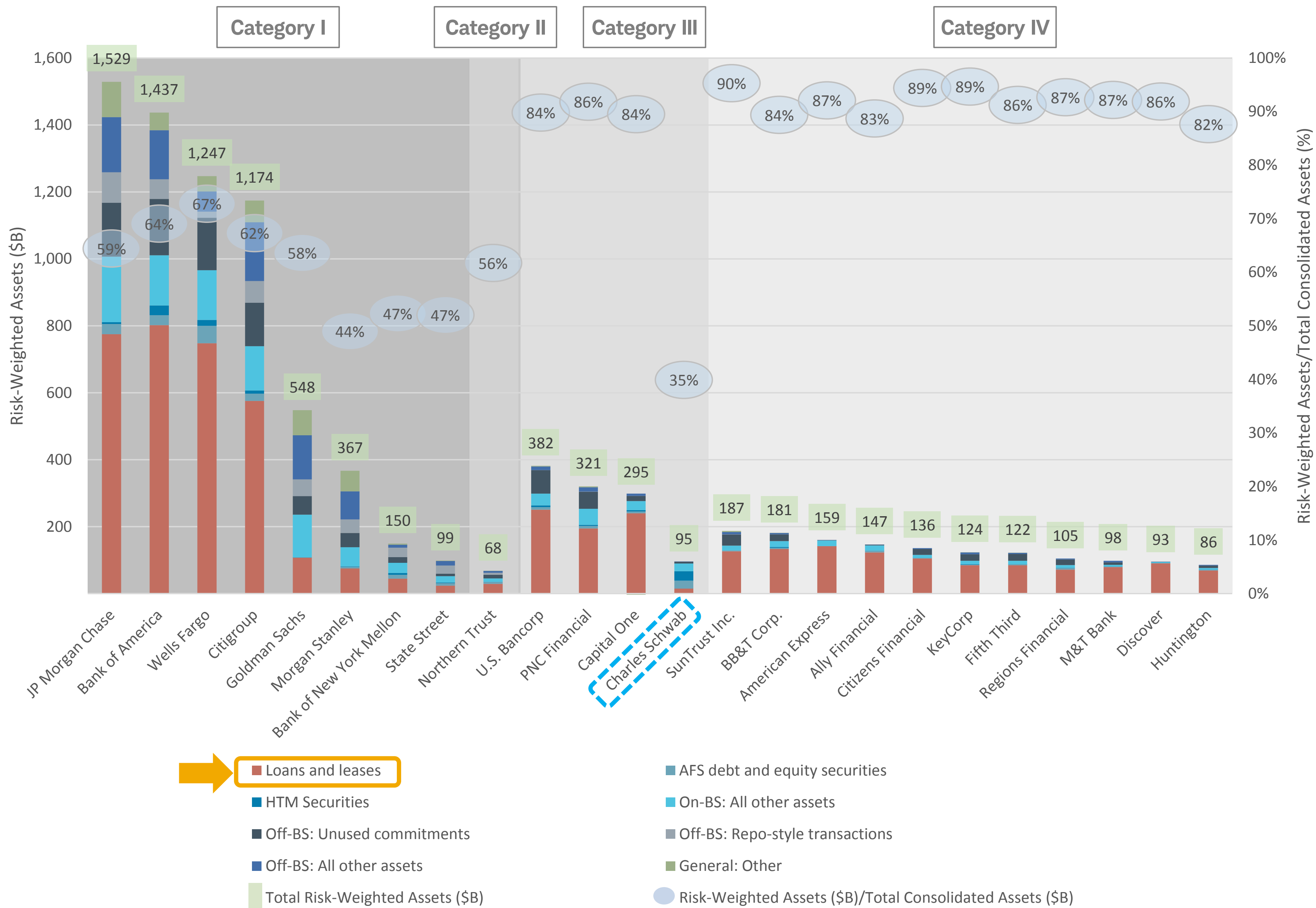
2019 CSC Company-Run DFAST Results

- CSC's 2019 company-run stress tests also resulted in an increase (both minimum and ending period) in its CET1 ratio in the supervisory severely adverse scenario
  - With a starting ratio of 17.6%, CSC's ending period CET1 ratio increases to 23.8%; CSC's minimum period CET1 ratio increases to 17.8%
- In CSC's 2019 stress tests, its T1LR declined from 7.0% (starting) to 6.3% (minimum) and increased to 7.8% (ending)
- Adjusted 2019 results are also provided where CSC's balance sheet increases and asset mix remains unchanged (for better comparability to other firms' supervisory stress test results)
  - With a starting ratio of 17.6%, CSC's ending period CET1 ratio increases to 20.0%; CSC's minimum period CET1 ratio declines slightly to 15.5%
  - CSC's ending period T1LR increases from 7.0% to 7.2%; CSC's minimum period T1LR declines to 6.1%
  - On a post-stress basis, these ratios all exceed well capitalized levels
- CSC's high percentage (~78%) of 0% and 20% risk-weighted on-balance sheet exposures means that post-stress loses are relatively contained

Further tailoring would mitigate the costs associated with application of CCAR and DFAST stress testing requirements in circumstances where the output is not as valuable

- The low percentage (~22%) of 50% and 100% risk-weighted on-balance sheet exposures that would experience more pronounced post-stress losses does not justify making CSC subject to Category III and SR 15-18 CCAR and DFAST requirements
- The expense to CSC of having to comply with the proposed Category III capital planning and supervisory and company-run stress testing requirements are unwarranted in light of the limited utility to it of stress testing
- CSC anticipates that it would benefit from material cost savings if it were able to qualify for more tailored (e.g., Category IV) CCAR and DFAST standards.

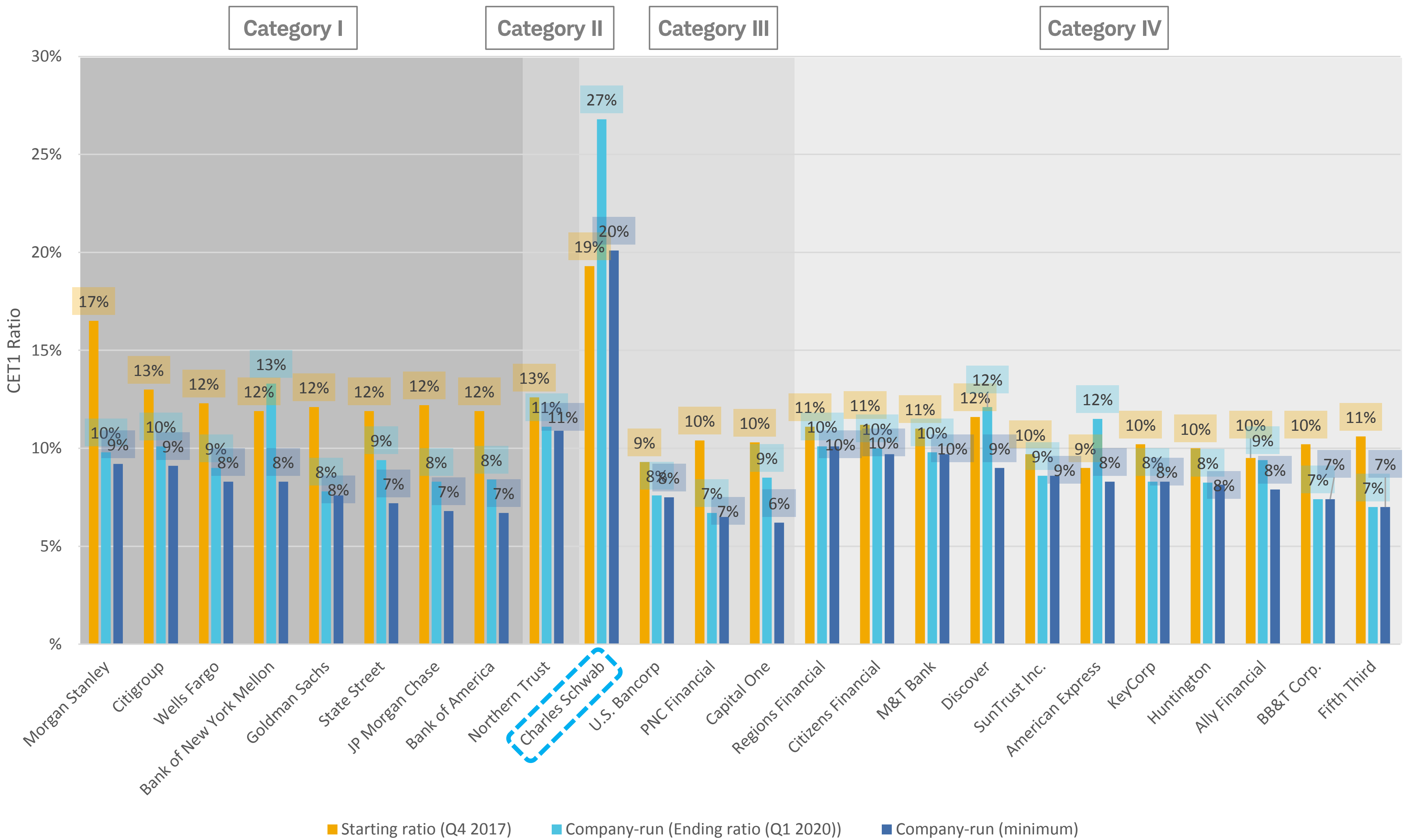
Total Risk-Weighted Assets and RWAs to TCAs Ratios by Proposed Tailoring Category



Note: Data as of 12/31/18, pulled via reports generated from S&P Market Global Intelligence, as well as each firm's FR Y-9C Consolidated Financial Statements for Holding Companies.

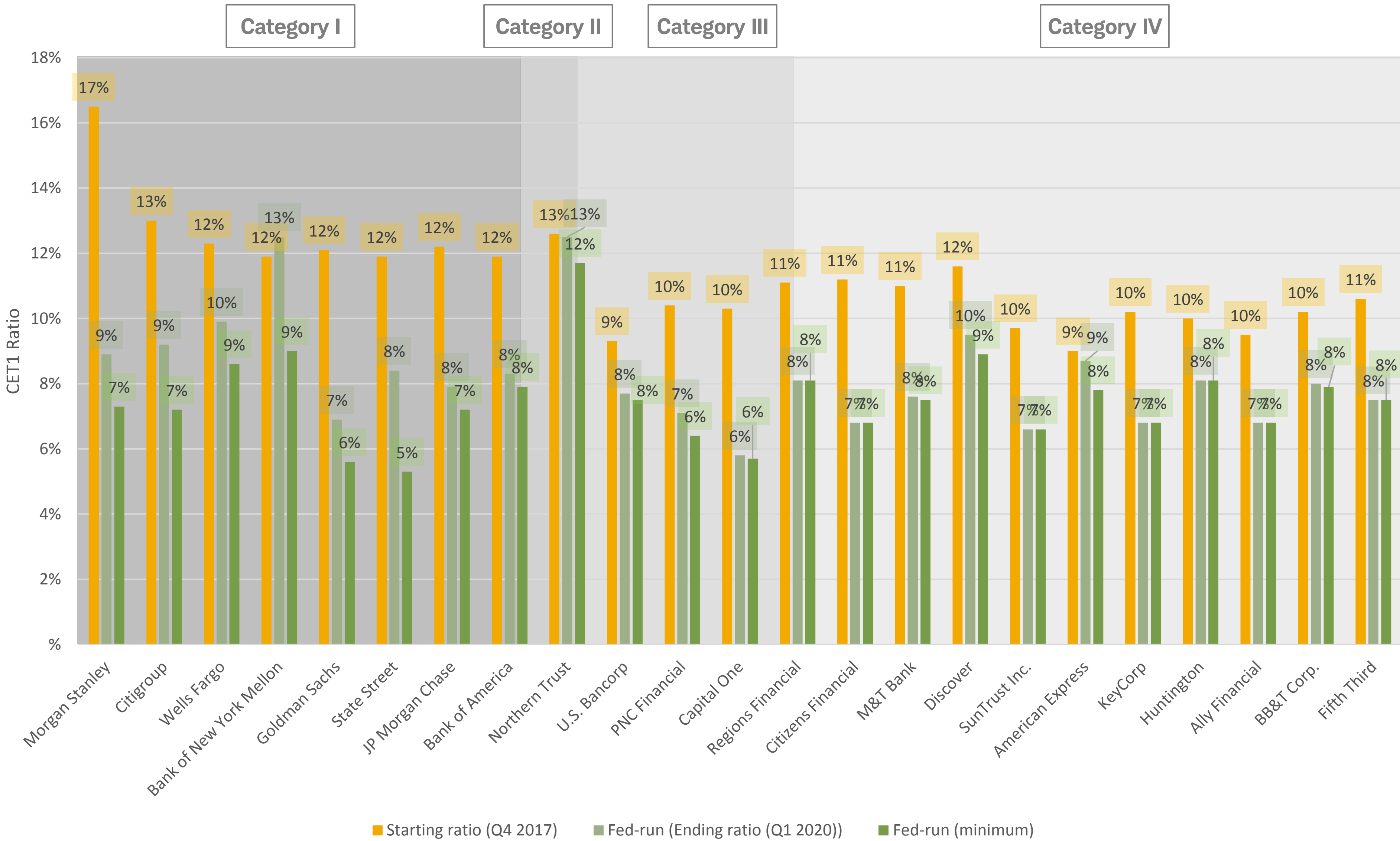
2018 DFAST Supervisory Severely Adverse Scenario: CET1 Ratios by Proposed Tailoring Category

Starting, Ending and Minimum ratios (Company-run)



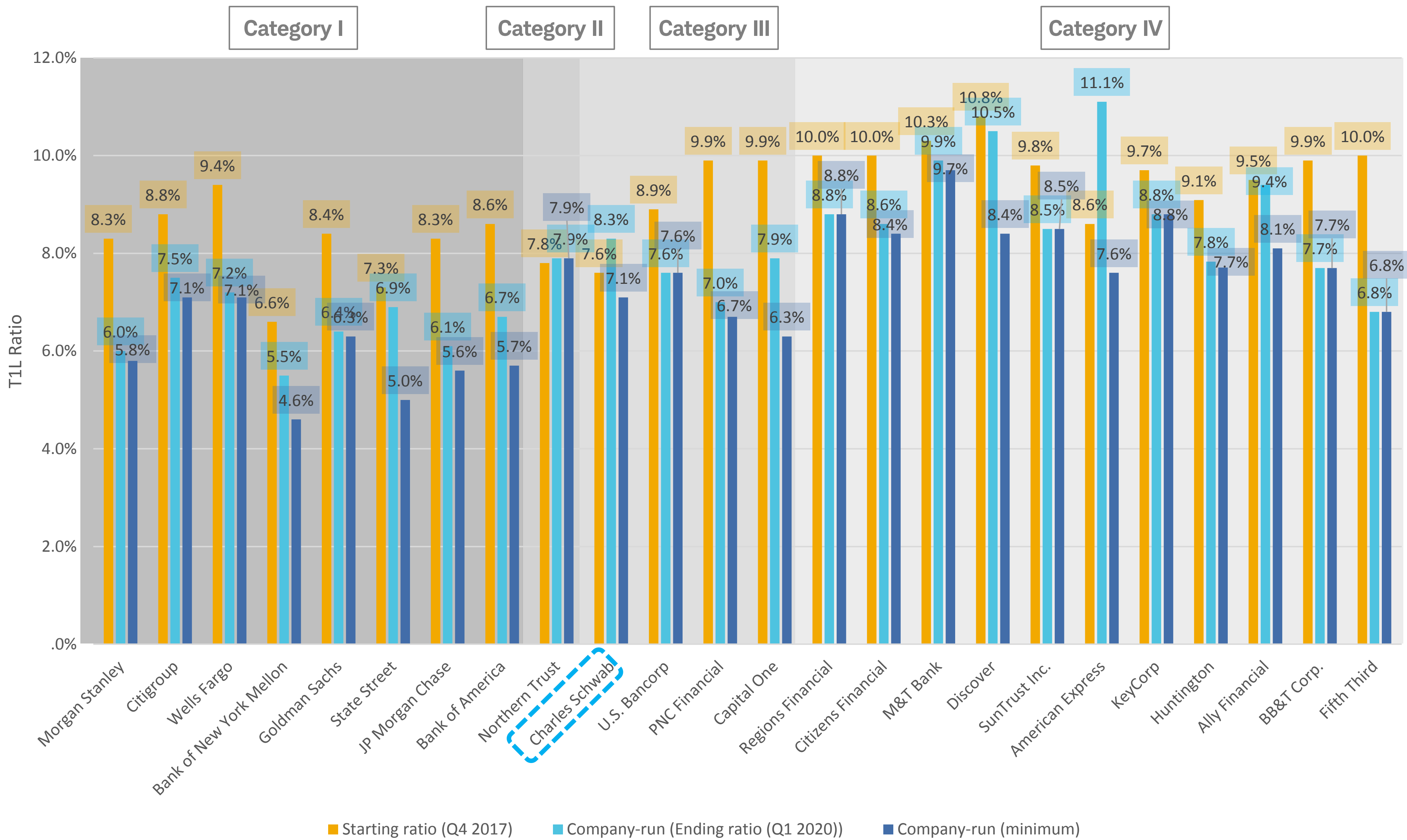
2018 DFAST Supervisory Severely Adverse Scenario: CET1 Ratios by Proposed Tailoring Category

Starting, Ending and Minimum ratios (Supervisory)



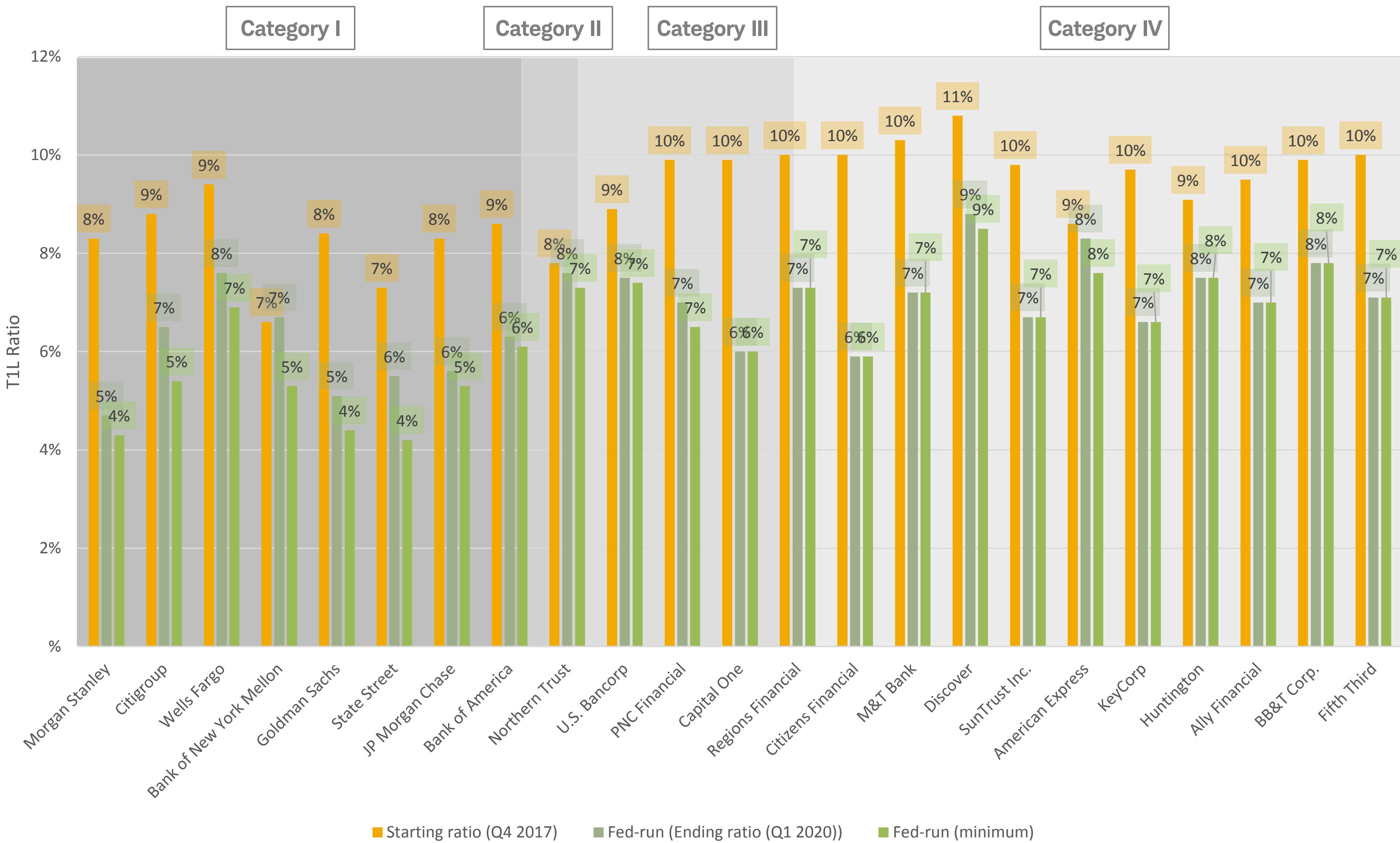
2018 DFAST Supervisory Severely Adverse Scenario: Tier 1 Leverage Ratios by Proposed Tailoring Category

Starting, Ending and Minimum ratios (Company-run)



2018 DFAST Supervisory Severely Adverse Scenario: Tier 1 Leverage Ratios by Proposed Tailoring Category

Starting, Ending and Minimum ratios (Supervisory)



Actual and Adjusted* CSC 2019 Company-Run Supervisory Severely Adverse Scenario: CET1 and Tier 1 Leverage Ratios

- 2019 DFAST SSA (actual):

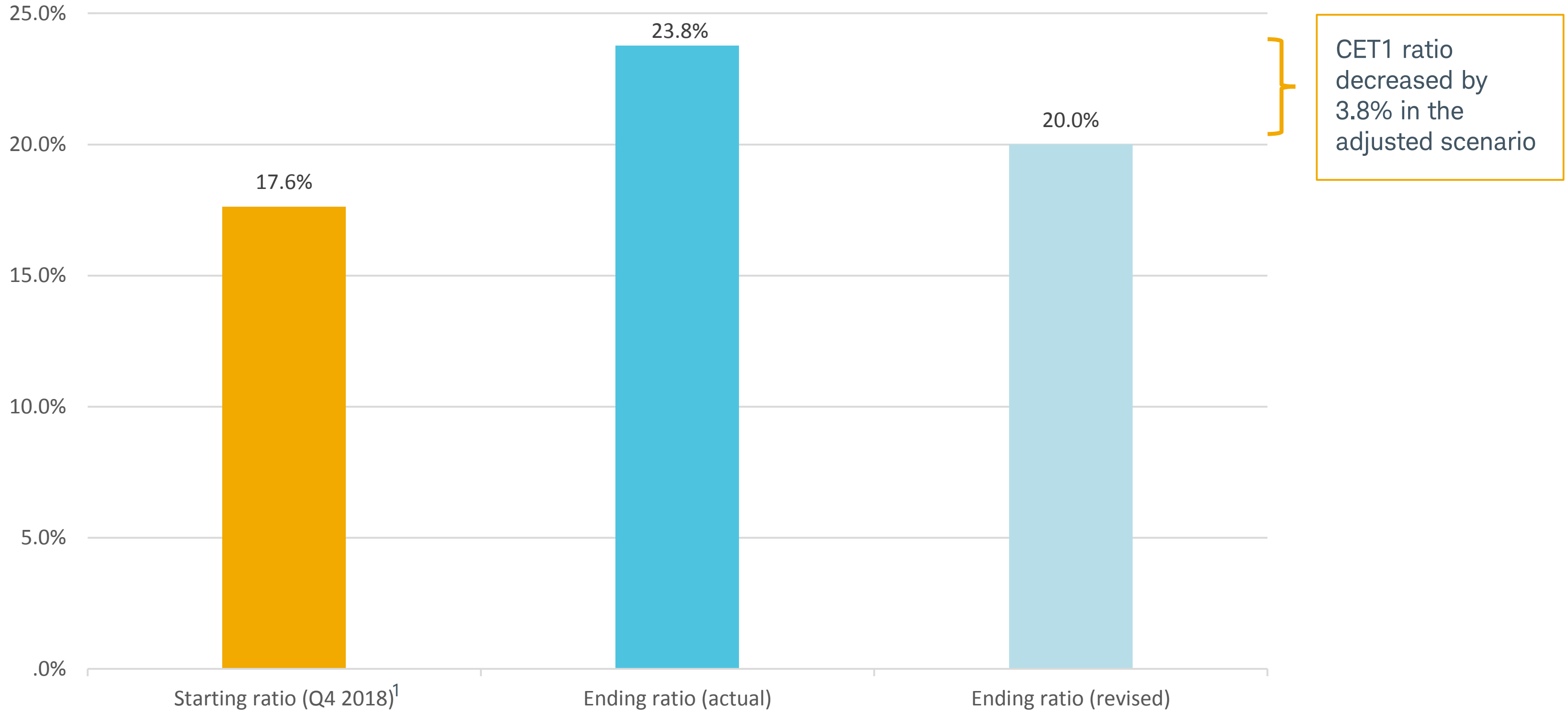
	Starting (Q4 2018)	Ending (Q1 2022)	Minimum
Common Equity Tier 1 Ratio (AA)	17.6%	23.8%	17.8%
Tier 1 Leverage Ratio (AA)	7.0%	7.8%	6.3%

- 2019 DFAST SSA (adjusted):

	Starting (Q4 2018)	Ending (Q1 2022)	Minimum
Common Equity Tier 1 Ratio (AA)	17.6%	20.0%	15.5%
Tier 1 Leverage Ratio (AA)	7.0%	7.2%	6.1%

* In the adjusted results, CSC's balance sheet does not decline (consistent with the assumption in the Federal Reserve's stress capital buffer proposal) and asset mix remains unchanged.

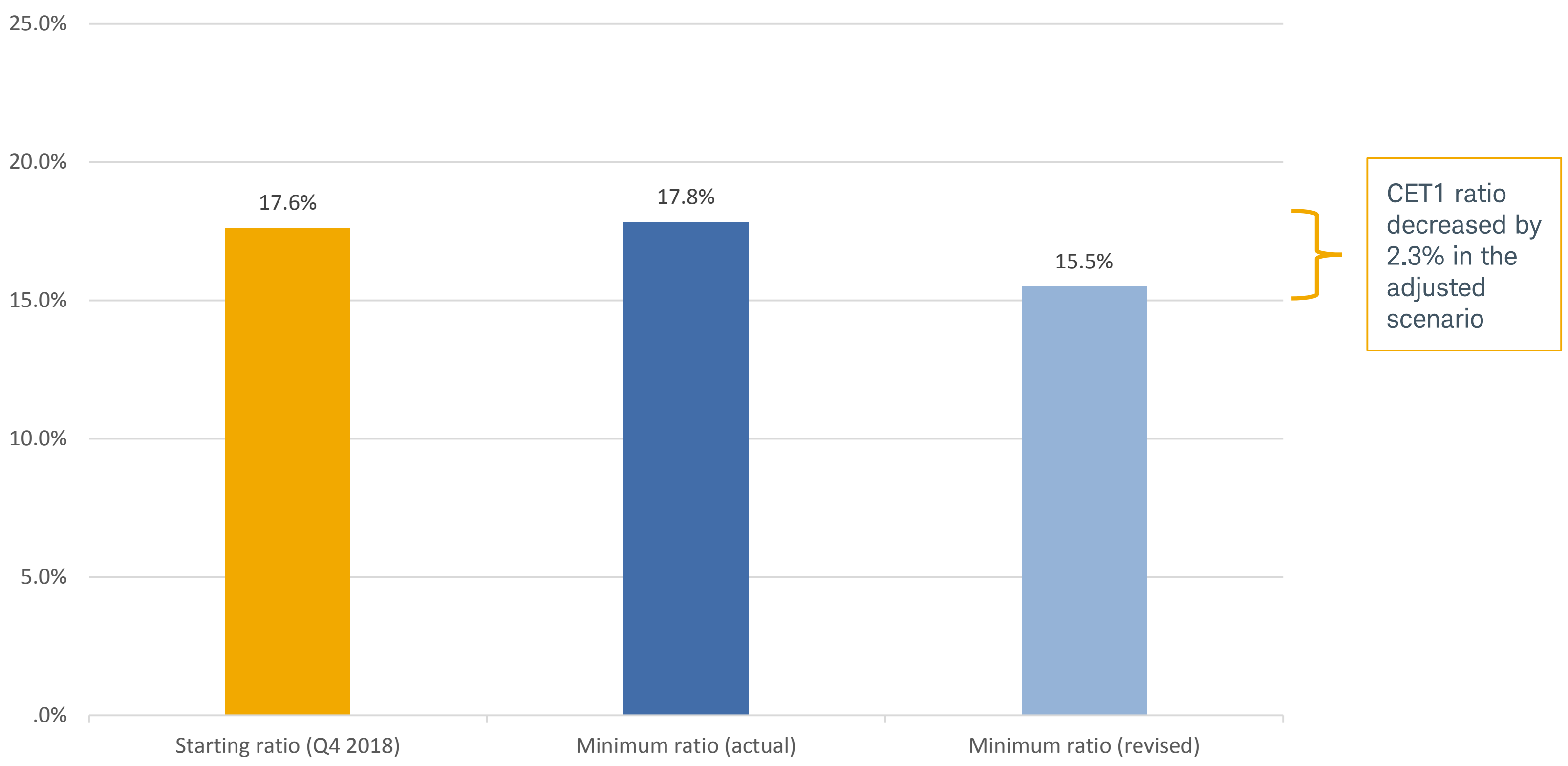
Actual and Adjusted* CSC 2019 Company-Run Supervisory Severely Adverse Scenario: Starting and Ending CET1 Ratios



* In the adjusted results, CSC's balance sheet does not decline (consistent with the assumption in the Federal Reserve's stress capital buffer proposal) and asset mix remains unchanged.

[1]Source: FR Y-9C Consolidated Financial Statements for Holding Companies.
Note: Beginning in 2019, CSC and CSB are subject to the "advanced approaches" (AA) framework under the Basel III capital rule. CSC's starting CET1 ratio as of 1/1/19 was 17.4%. The stress testing cycle uses this AA ratio.

Actual and Adjusted* CSC 2019 Company-Run Supervisory Severely Adverse Scenario: Starting and Minimum CET1 Ratios



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Estimated 2018 GSIB Method 1 Scores by Proposed Tailoring Categories