SCHWAB CHARLES CORP
Form 10-Q
May 06, 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 March 31, 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.

1,321,691,068 shares of $.01 par value Common Stock

Outstanding on April 25, 2016

THE CHARLES SCHWAB CORPORATION

Quarterly Report on Form 10-Q

For the Quarter Ended March 31, 2016

Index

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 325 domestic branch offices in 45 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.

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 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”);
- the impact of the final Federal Deposit Insurance Corporation (FDIC) rule on the Company’s expenses (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 the final Department of Labor’s fiduciary rule on the Company’s business, financial condition and results of operations (see “Part I, Item 2. – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Overview – Current Regulatory Environment and Other Developments”);
- 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”);
- 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 impact of changes in the likelihood of indemnification and guarantee payment obligations on the Company’s results of operations (see “Part I, Item 1. – Condensed Consolidated Financial Statements (Unaudited) – Notes – 8. Commitments and Contingencies – Guarantees and indemnifications”); and
- 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”).

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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:

- changes in general economic and financial market conditions;
- changes in revenues and profit margin due to changes in interest rates;
- 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 Company’s ability to develop and launch new products, services and capabilities in a timely and successful manner;
- fluctuations in client asset values due to changes in equity valuations;
- the performance or valuation of securities available for sale and securities held to maturity;
- trading activity;
- the level of interest rates, including yields available on money market mutual fund eligible instruments;
- the timing and impact of changes in the Company’s level of investments in land, leasehold improvements, information technology equipment and software;
- the adverse impact of financial reform legislation and related regulations;
- the timing of the FDIC rate decrease, surcharge and the amount of deposits at Schwab Bank;
- the clarification and interpretation of certain provisions in the final Department of Labor rule concerning fiduciary standards;
- the amount of loans to the Company’s brokerage and banking clients;
- the level of the Company’s stock repurchase activity;
- the availability and terms of external financing;
- capital needs and management;
- client sensitivity to interest rates;
- timing, amount and impact of the migration of certain balances from brokerage accounts and sweep money market funds into Schwab Bank;
- regulatory guidance;
- the Company’s ability to manage expenses;
- the level of client assets, including cash balances;
- competitive pressures on rates and fees;

- acquisition integration costs;
- potential breaches of contractual terms for which the Company has indemnification and guarantee obligations;
- adverse developments in litigation or regulatory matters;
- the extent of any charges associated with litigation and regulatory matters; and
- amounts recovered on insurance policies.

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 Company’s Annual Report on Form 10-K for the year ended December 31, 2015, and “Part II – Other Information – Item 1A – Risk Factors.”

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GLOSSARY OF TERMS

Active brokerage accounts: Brokerage accounts with balances or 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 (commonly referred to as the Customer Protection Rule), 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.

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.

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Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank): Regulatory reform legislation signed into federal law in 2010 containing numerous provisions aimed at promoting financial stability in the United States (U.S.) financial system through enhanced 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 rating of "Baa" or higher, or a Standard & Poor's or 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: Potential for loss due to inadequate or failed internal processes, systems, and firms or exchanges handling client orders, or loss from external events and relationships impacting the Company and/or any of its key business partners and vendors.

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 execution 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 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.

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OVERVIEW

Management of the Company focuses on several key 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 first quarters of 2016 and 2015 are:

	Three Months Ended March 31, 2016	2015	Percent Change
Client Metrics:			
Net new client assets (in billions)	$ 32.0	$ 28.7	11 %
Core net new client assets (in billions) (1)	$ 32.0	$ 34.2	(6) %
Client assets (in billions, at quarter end)	$ 2,556.7	$ 2,524.4	1 %
Average client assets (in billions)	$ 2,445.4	$ 2,508.5	(3) %
New brokerage accounts (in thousands)	265	274	(3) %
Active brokerage accounts (in thousands, at quarter end)	9,869	9,493	4 %
Assets receiving ongoing advisory services (in billions, at quarter end)	$ 1,281.9	$ 1,251.8	2 %
Client cash as a percentage of client assets (at quarter end)	13.1 %	12.0 %	
Company Financial Metrics:			
Net revenues	$ 1,764	$ 1,526	16 %
Expenses excluding interest	1,109	1,042	6 %
Income before taxes on income	655	484	35 %
Taxes on income	243	182	34 %
Net income	412	302	36 %
Preferred stock dividends and other	20	11	82 %
Net income available to common stockholders	$ 392	$ 291	35 %
Earnings per common share – diluted	$ .29	$ .22	32 %
Net revenue growth from prior year	16 %	3 %	
Pre-tax profit margin	37.1 %	31.7 %	
Return on average common stockholders' equity	13 %	10 %	
Expenses excluding interest as a percentage of average client assets (annualized)	0.18 %	0.17 %	

(1) 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.

The Company continued to experience strong client engagement and demand for the Company's contemporary, full-service wealth management capabilities during the first quarter of 2016. Investors faced sharp market swings as the major equity indices fell by double-digit percentages and subsequently recovered by quarter-end. Clients turned to the Company for help navigating these market conditions and over 33,000 accounts enrolled in one of the Company's retail advisory solutions during the quarter. The Company ended the first quarter with 567,000 accounts enrolled in a Schwab® advice program, up 11% year-over-year, bringing the total assets receiving ongoing advisory services to $1.28 trillion at March 31, 2016, an increase of 2% from March 31, 2015. At quarter-end, there were 9.9 million active brokerage accounts, 1.0 million banking accounts and 1.5 million retirement plan participants, up 4%, 6% and 4%, respectively, from the prior year.

Clients brought $32.0 billion of core net new assets to the Company in the first three months of 2016 compared to $34.2 billion in the same period of 2015. Total client assets ended the quarter at $2.56 trillion, up 1% from a year ago despite the challenging environment for equity valuations during the quarter, which negatively affected average asset balances. Also, in the first quarter of 2016, the Company completed a $1.4 billion bulk transfer of brokerage client cash balances to bank deposits, continuing its work to migrate more uninvested client cash to Schwab Bank.

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During the first quarter of 2016, the Company experienced strong earnings growth. The increase in the target federal funds interest rate in December 2015 had a positive impact on the Company's diversified revenue streams generating strong first quarter revenue growth. Asset management and administration fees rose 9% year-over-year primarily due to a reduction in money fund fee waivers resulting from the increase in short-term interest rates, partially offset by a reduction in average client assets in Mutual Fund OneSource®. Net interest revenue increased 31% year-over-year, reflecting robust interest-earning asset growth during the past several quarters, and the investment portfolios' positive sensitivity to the rise in short-term interest rates. Altogether, revenues grew approximately 16% from the prior year.

On the expense side, spending increased approximately 6%, in keeping with expectations of reinvesting a portion of improved revenues to support stronger growth. The pre-tax profit margin of approximately 37% was up over five percentage points from first quarter 2015. This produced earnings of $412 million, reflecting a 36% increase from the same period in 2015.

Finally, on March 7, 2016, the Company issued $750 million of non-cumulative perpetual preferred stock at a dividend rate of 5.95%. The $725 million of net proceeds provides capital to support the future transfers of money market fund sweep balances to Schwab Bank as well as incremental Schwab Bank deposit growth as the bank's sweep feature will be the default option for all new brokerage accounts as of June 1, 2016.

Current Regulatory Environment and Other Developments

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 ends on August 5, 2016 and the rule is subject to further modification. The Company is currently evaluating the impact of the proposed rule.

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 March 2016, the FDIC issued a final rule that will impose a surcharge on insured depository institutions with total consolidated assets of $10 billion or more in order to increase the reserve ratio of the FDIC’s Deposit Insurance Fund (DIF). Based on expected reductions in the Company’s regular FDIC insurance assessments combined with the surcharge, the Company anticipates that its overall FDIC assessment, relative to its regular assessment base, will increase by a net of approximately 2 to 2.5 basis points annually, beginning as early as the third quarter of 2016 and likely running through the end of 2018.

In December 2015, the OCC issued proposed guidelines to establish standards for recovery planning by national banks and federal savings banks with total consolidated assets of $50 billion or more. The proposed guidelines would require each bank to develop and maintain a recovery plan that sets forth the bank’s plan for how it will remain a going concern when it is experiencing considerable financial or operational stress. The comment period for the proposed guidelines ended on February 16, 2016 and the guidelines are subject to further modification. The Company is currently evaluating the impact of the proposed guidelines.

In October 2015, the Federal Reserve issued a notice of proposed rulemaking that 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 is currently evaluating the impact of the proposed rule.

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Results of Operations

The following discussion presents an analysis of the Company's results of operations for the first quarter of 2016 compared to the same period in 2015.

Net Revenues

Three Months Ended March 31,	Percent Change	2016 Amount	2016 % of Total Net Revenues	2015 Amount	2015 % of Total Net Revenues
Asset management and administration fees					
Mutual funds and ETF service fees (1)	16 %	$ 415	24 %	$ 358	23 %
Advice solutions	(2) %	215	12 %	220	14 %
Other (1)	5 %	69	4 %	66	5 %
Asset management and administration fees	9 %	699	40 %	644	42 %
Net interest revenue					
Interest revenue	31 %	810	46 %	617	41 %
Interest expense	31 %	(38)	(2) %	(29)	(2) %
Net interest revenue	31 %	772	44 %	588	39 %
Trading revenue					
Commissions	(1) %	215	12 %	218	14 %
Principal transactions	89 %	17	1 %	9	1 %
Trading revenue	2 %	232	13 %	227	15 %
Other	-	63	3 %	63	4 %
Provision for loan losses	(150) %	(2)	-	4	-
Total net revenues	16 %	$ 1,764	100 %	$ 1,526	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.

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. For a discussion of the impact of current market conditions on asset management and administration fees, see “Item 3 – Quantitative and Qualitative Disclosures About Market Risk.”

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The following table presents 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 March 31,	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)	1,252	(5,600)	2,082	4,798	(4,742)	(2,593)
Net market gains (losses) and other	27	164	759	1,913	847	5,529
Balance at end of period	$ 167,427	$ 162,473	$ 104,953	$ 95,161	$ 203,759	$ 237,317

The following table presents asset management and administration fees, average client assets, and average fee yields:

Three Months Ended March 31,	2016			2015		
	Average Client Assets	Revenue	Average Fee	Average Client Assets	Revenue	Average Fee
Schwab money market funds before fee waivers	$ 168,440	$ 246	0.59%	$ 165,403	$ 238	0.58%
Fee waivers		(97)			(184)	
Schwab money market funds	168,440	149	0.36%	165,403	54	0.13%
Schwab equity and bond funds and ETFs	103,392	51	0.20%	97,127	52	0.22%
Mutual Fund OneSource®	194,644	164	0.34%	233,252	196	0.34%
Other third-party mutual funds and ETFs (1)	235,317	51	0.09%	248,545	56	0.09%
Total mutual funds and ETFs (2)	$ 701,793	415	0.24%	$ 744,327	358	0.20%
Advice solutions (2):						
Fee-based	$ 166,419	215	0.52%	$ 169,835	220	0.53%
Intelligent Portfolios	5,116	-	-	423	-	-
Legacy Non-Fee	16,469	-	-	16,197	-	-
Total advice solutions	$ 188,004	215	0.46%	$ 186,455	220	0.48%
Other balance-based fees (3)	318,027	56	0.07%	313,829	55	0.07%
Other (4)		13			11	
Total asset management and administration fees		$ 699			$ 644	

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

(1) Includes Schwab ETF OneSourceTM.
(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 $55 million, or 9%, in the first quarter of 2016 compared to the same period in 2015. The increase in mutual fund and ETF service fees is primarily due to higher net yields on money market fund assets, 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 brokerage client 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 borrowed and loaned 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 non-interest bearing 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 table presents net interest revenue information corresponding to interest-earning assets and funding sources on the condensed consolidated balance sheets:

Three Months Ended March 31,	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	$ 10,752	$ 13	0.49 %	$ 9,383	$ 5	0.22 %
Cash and investments segregated	20,265	19	0.38 %	19,510	6	0.12 %
Broker-related receivables (1)	384	-	0.04 %	280	-	0.10 %
Receivables from brokerage clients	14,890	125	3.38 %	14,416	119	3.35 %
Securities available for sale (2)	68,163	198	1.17 %	57,416	142	1.00 %
Securities held to maturity	50,257	322	2.58 %	34,879	218	2.53 %
Bank loans	14,405	99	2.76 %	13,534	90	2.70 %
Total interest-earning assets	179,116	776	1.74 %	149,418	580	1.57 %
Other interest revenue		34			37	
Total interest-earning assets	$ 179,116	$ 810	1.82 %	$ 149,418	$ 617	1.67 %
Funding sources:						
Bank deposits	$ 131,620	$ 8	0.02 %	$ 105,834	$ 8	0.03 %
Payables to brokerage clients (1)	26,728	-	0.01 %	26,071	1	0.01 %
Short-term borrowings (1,4)	20	-	0.20 %	8	-	0.15 %
Long-term debt (5)	2,877	26	3.63 %	2,141	19	3.60 %
Total interest-bearing liabilities (5)	161,245	34	0.08 %	134,054	28	0.08 %
Non-interest-bearing funding sources (4)	17,871			15,364		
Other interest expense (3)		4			1	
Total funding sources	$ 179,116	$ 38	0.09 %	$ 149,418	$ 29	0.07 %
Net interest revenue		$ 772	1.73 %		$ 588	1.60 %

(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) Includes the impact of capitalizing interest on building construction and software development.
(4) Certain prior period amounts have been reclassified to conform to the 2016 presentation.
(5) 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.

Net interest revenue increased $184 million, or 31%, in the first quarter of 2016 compared to the same period in 2015, primarily due to higher average balances of interest-earning assets, and higher average interest rates on securities available for sale and cash and investments segregated. The growth in average balances in bank deposits resulted from an increase in amounts swept to Schwab Bank of uninvested cash balances in certain client brokerage accounts.

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.

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	Three Months Ended March 31, 2016	2015	Percent Change
Daily average revenue trades (in thousands)	328	313	5 %
Clients' daily average trades (in thousands)	616	582	6 %
Number of trading days	61.0	61.0	-
Average revenue per revenue trade	$ 11.44	$ 11.98	(5) %

Trading revenue increased by $5 million, or 2%, in the first quarter of 2016 compared to the first quarter of 2015. Daily average revenue trades increased in the first quarter of 2016 compared to the first quarter of 2015, primarily due to a higher volume of equity, mutual funds, and fixed income trades. Average revenue per revenue trade decreased 5% in the first quarter of 2016 compared to the first quarter of 2015.

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. Order flow revenue was $27 million during the first quarters of both 2016 and 2015.

Expenses Excluding Interest

The following table shows a comparison of expenses excluding interest:

	Three Months Ended March 31, 2016	2015	Percent Change

Compensation and benefits	$ 626	$ 581	8 %
Professional services	116	114	2 %
Occupancy and equipment	98	83	18 %
Advertising and market development	70	69	1 %
Communications	60	58	3 %
Depreciation and amortization	56	54	4 %
Other	83	83	-
Total expenses excluding interest	$ 1,109	$ 1,042	6 %
Expenses as a percentage of total net revenues:			
Compensation and benefits	35 %	38 %	
Advertising and market development	4 %	5 %	

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.

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

	Three Months Ended March 31,		Percent
	2016	2015	Change
Salaries and wages	$ 336	$ 317	6 %
Incentive compensation	173	157	10 %
Employee benefits and other	117	107	9 %
Total compensation and benefits expense	$ 626	$ 581	8 %
Full-time equivalent employees (in thousands)			
At quarter end	15.6	14.9	5 %
Average	15.6	14.8	5 %

Salaries and wages increased in the first quarter of 2016 compared to the same period in 2015 primarily due to higher employee headcount and annual salary increases.

Incentive compensation increased in the first quarter of 2016 compared to the same period in 2015 primarily due to higher discretionary bonus and stock compensation expense.

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

Expenses Excluding Compensation and Benefits

Occupancy and equipment expense increased in the first quarter of 2016 compared to the same period 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 changes in the Company's geographic footprint.

Taxes on Income

The Company's effective income tax rate on income before taxes was 37.1% and 37.6% for the first quarters of 2016 and 2015, respectively. The decrease in the first quarter of 2016 from the first quarter of 2015 was primarily due to an increase in tax exempt income from U.S. state and municipal securities.

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 allocated 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.

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

	Investor Services (1)			Advisor Services (1)			Total		
Three Months Ended March 31,	Percent Change	2016	2015	Percent Change	2016	2015	Percent Change	2016	2015
Net Revenues:									
Asset management and administration fees	6 %	$ 472	$ 446	15 %	$ 227	$ 198	9 %	$ 699	$ 644
Net interest revenue	20 %	613	510	104 %	159	78			