

SCHWAB CHARLES CORP
Form 10-Q
November 06, 2014
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, 2014

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 (I.R.S. Employer Identification No.)

of incorporation or organization)

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

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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.

1,305,768,922 shares of \$.01 par value Common Stock

Outstanding on October 24, 2014

THE CHARLES SCHWAB CORPORATION

Quarterly Report on Form 10-Q

For the Quarter Ended September 30, 2014

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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,	
	2014	2013	2014	2013
Net Revenues				
Asset management and administration fees	\$ 649	\$ 583	\$ 1,892	\$ 1,707
Interest revenue	600	531	1,767	1,527
Interest expense	(27)	(25)	(79)	(79)
Net interest revenue	573	506	1,688	1,448
Trading revenue	209	224	668	682
Other	120	57	253	172
Provision for loan losses	1	4	7	(1)
Net impairment losses on securities (1)	(1)	(1)	(1)	(8)
Total net revenues	1,551	1,373	4,507	4,000
Expenses Excluding Interest				
Compensation and benefits	593	482	1,641	1,512
Professional services	117	103	335	308
Occupancy and equipment	82	77	242	231
Advertising and market development	59	57	187	198
Communications	55	55	168	165
Depreciation and amortization	49	51	145	153
Other	78	84	228	226
Total expenses excluding interest	1,033	909	2,946	2,793
Income before taxes on income	518	464	1,561	1,207
Taxes on income	197	174	590	455
Net Income	321	290	971	752
Preferred stock dividends	9	8	39	39
Net Income Available to Common Stockholders	\$ 312	\$ 282	\$ 932	\$ 713

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Weighted-Average Common Shares Outstanding — Diluted	1,316	1,296	1,313	1,288
Earnings Per Common Share — Basic	\$.24	\$.22	\$.71	\$.55
Earnings Per Common Share — Diluted	\$.24	\$.22	\$.70	\$.55

(1) Net impairment losses on securities include total other-than-temporary impairment losses of \$1 million and \$0 recognized in other comprehensive income, net of \$0 and \$(1) million reclassified from other comprehensive income, for the three months ended September 30, 2014 and 2013, respectively. Net impairment losses on securities include total other-than-temporary impairment losses of \$1 million and \$2 million recognized in other comprehensive income, net of \$0 and \$(6) million reclassified from other comprehensive income, for the nine months ended September 30, 2014 and 2013, respectively.

See Notes to Condensed Consolidated Financial Statements.

THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Statements of Comprehensive Income

(In Millions)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net Income	\$ 321	\$ 290	\$ 971	\$ 752
Other comprehensive (loss) income, before tax:				
Change in net unrealized gain on securities available for sale:				
Net unrealized (loss) gain	(25)	72	260	(408)
Reclassification of impairment charges included in net impairment losses on securities	1	1	1	8
Other reclassifications included in other revenue	(12)	(2)	(14)	(5)
Other	-	-	-	1
Other comprehensive (loss) income, before tax	(36)	71	247	(404)
Income tax effect	13	(28)	(93)	152
Other comprehensive (loss) income, net of tax	(23)	43	154	(252)
Comprehensive Income	\$ 298	\$ 333	\$ 1,125	\$ 500

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, 2014	December 31, 2013
Assets		
Cash and cash equivalents	\$ 8,588	\$ 7,728
Cash and investments segregated and on deposit for regulatory purposes (including resale agreements of \$11,729 at September 30, 2014 and \$14,016 at December 31, 2013)	19,890	23,553
Receivables from brokers, dealers, and clearing organizations	458	509
Receivables from brokerage clients — net	15,416	13,951
Other securities owned — at fair value	572	517
Securities available for sale	52,201	51,618
Securities held to maturity (fair value — \$33,939 at September 30, 2014 and \$29,490 at December 31, 2013)	34,007	30,318
Loans to banking clients — net	13,080	12,419
Equipment, office facilities, and property — net	991	790
Goodwill	1,227	1,227
Intangible assets — net	233	266
Other assets	781	746
Total assets	\$ 147,444	\$ 143,642
Liabilities and Stockholders' Equity		
Deposits from banking clients	\$ 97,345	\$ 92,972
Payables to brokers, dealers, and clearing organizations	2,099	1,467
Payables to brokerage clients	33,131	35,333
Accrued expenses and other liabilities	1,496	1,586
Long-term debt	1,900	1,903
Total liabilities	135,971	133,261
Stockholders' equity:		
Preferred stock — \$.01 par value per share; aggregate liquidation preference of \$885	872	869
Common stock — 3 billion shares authorized; \$.01 par value per share; 1,487,543,446 shares issued	15	15

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Additional paid-in capital	4,050	3,951
Retained earnings	9,949	9,253
Treasury stock, at cost — 181,992,826 shares at September 30, 2014 and 190,657,263 shares at December 31, 2013	(3,576)	(3,716)
Accumulated other comprehensive income	163	9
Total stockholders' equity	11,473	10,381
Total liabilities and stockholders' equity	\$ 147,444	\$ 143,642

See Notes to Condensed Consolidated Financial Statements.

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THE CHARLES SCHWAB CORPORATION

Condensed Consolidated Statements of Cash Flows

(In Millions)

(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Cash Flows from Operating Activities		
Net income	\$ 971	\$ 752
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	(7)	1
Net impairment losses on securities	1	8
Stock-based compensation	80	83
Depreciation and amortization	145	153
Premium amortization, net, on securities available for sale and securities held to maturity	91	129
Other	(5)	23
Net change in:		
Cash and investments segregated and on deposit for regulatory purposes	3,663	4,949
Receivables from brokers, dealers, and clearing organizations	56	(177)
Receivables from brokerage clients	(1,469)	332
Other securities owned	(55)	154
Other assets	(49)	(48)
Payables to brokers, dealers, and clearing organizations	389	101
Payables to brokerage clients	(2,202)	(5,798)
Accrued expenses and other liabilities	(121)	163
Net cash provided by operating activities	1,488	825
Cash Flows from Investing Activities		
Purchases of securities available for sale	(10,556)	(19,910)
Proceeds from sales of securities available for sale	5,724	4,665
Principal payments on securities available for sale	4,630	9,087
Purchases of securities held to maturity	(5,612)	(13,442)
Principal payments on securities held to maturity	1,948	3,332
Net increase in loans to banking clients	(672)	(1,315)
Purchase of equipment, office facilities, and property	(310)	(176)
Other investing activities	(8)	2
Net cash used for investing activities	(4,856)	(17,757)
Cash Flows from Financing Activities		
Net change in deposits from banking clients	4,373	11,810
Repayment of commercial paper	-	(300)
Issuance of long-term debt	-	275

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Repayment of long-term debt	(5)	(4)
Dividends paid	(286)	(283)
Proceeds from stock options exercised and other	138	140
Other financing activities	8	(7)
Net cash provided by financing activities	4,228	11,631
Increase (Decrease) in Cash and Cash Equivalents	860	(5,301)
Cash and Cash Equivalents at Beginning of Period	7,728	12,663
Cash and Cash Equivalents at End of Period	\$ 8,588	\$ 7,362
Supplemental Cash Flow Information		
Cash paid during the period for:		
Interest	\$ 91	\$ 89
Income taxes	\$ 588	\$ 448
Non-cash investing activity:		
Securities purchased during the period but settled after period end	\$ 243	\$ 38

See Notes to Condensed Consolidated Financial Statements.

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

1. Introduction and Basis of Presentation

The Charles Schwab Corporation (CSC) is a savings and loan holding company engaged, through its subsidiaries, in securities brokerage, banking, money management, and financial advisory services. Charles Schwab & Co., Inc. (Schwab) is a securities broker-dealer with over 300 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, which are referred to as the Schwab ETFs™.

The accompanying unaudited condensed consolidated financial statements include CSC and its majority-owned subsidiaries (collectively referred to as the Company). Intercompany balances and transactions have been eliminated. These condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (U.S.), which require management to make certain estimates and assumptions that affect the reported amounts in the accompanying financial statements. Certain estimates relate to other-than-temporary impairment of securities available for sale and securities held to maturity, valuation of goodwill, allowance for loan losses, and legal and regulatory reserves. Actual results may differ from those estimates. These condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the periods presented. These adjustments are of a normal recurring nature. The Company's results for any interim period are not necessarily indicative of results for a full year or any other interim period. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

The Company's significant accounting policies are included in note "2 – Summary of Significant Accounting Policies" in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. There have been no significant changes to these accounting policies during the first nine months of 2014.

2. New Accounting Standards

New Accounting Standards Not Yet Adopted

In January 2014, the Financial Accounting Standards Board (FASB) issued new guidance for creditors of consumer mortgage loans, which is effective January 1, 2015. The guidance clarifies when physical possession of a property underlying a consumer mortgage loan transfers to the creditor, and therefore when a loan receivable should be derecognized and the real estate property underlying the loan should be recognized. The adoption of this new guidance is not expected to have a material impact on the Company's financial position, results of operations, earnings per common share (EPS), or cash flows.

In May 2014, the FASB issued new guidance on revenue recognition, which is effective January 1, 2017. The guidance clarifies that revenue from contracts with customers should be recognized in a manner that depicts both the likelihood of payment and the timing of the related transfer of goods or performance of services. The Company is currently evaluating the impact of this new guidance on its financial position, results of operations, EPS, and cash flows.

THE CHARLES SCHWAB CORPORATION

Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

3. Securities Available for Sale and Securities Held to Maturity

The amortized cost, gross unrealized gains and losses, and fair value of securities available for sale and securities held to maturity are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2014				
Securities available for sale:				
Asset-backed securities	\$ 19,419	\$ 90	\$ 6	\$ 19,503
U.S. agency mortgage-backed securities	18,001	215	15	18,201
Corporate debt securities	7,644	46	6	7,684
U.S. agency notes	3,990	-	67	3,923
Certificates of deposit	1,533	1	-	1,534
Non-agency residential mortgage-backed securities	543	19	24	538
Treasury securities	499	1	-	500
Non-agency commercial mortgage-backed securities	311	7	-	318
Total securities available for sale	\$ 51,940	\$ 379	\$ 118	\$ 52,201
Securities held to maturity:				
U.S. agency mortgage-backed securities	\$ 33,005	\$ 316	\$ 357	\$ 32,964
Non-agency commercial mortgage-backed securities	1,002	4	31	975
Total securities held to maturity	\$ 34,007	\$ 320	\$ 388	\$ 33,939

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2013				
Securities available for sale:				
U.S. agency mortgage-backed securities	\$ 18,554	\$ 140	\$ 49	\$ 18,645
Asset-backed securities	15,201	42	37	15,206
Corporate debt securities	8,973	49	15	9,007
U.S. agency notes	4,239	1	104	4,136
Certificates of deposit	3,650	4	2	3,652
Non-agency residential mortgage-backed securities	616	11	34	593
Non-agency commercial mortgage-backed securities	271	8	-	279

Other securities