

# Schwab's asset safety and security protections

*charles*  
SCHWAB

*Own your tomorrow<sup>®</sup>*

# Table of contents

## Charles Schwab Corporation

- Who we are
- Overview: Charles Schwab & Co.
- Overview: Schwab-affiliated banks

## Understanding custody

- The important role of a custodian
- Understanding different types of custody
  - Broker-dealer custody
  - Bank custody

*charles*  
SCHWAB

# The Charles Schwab Corporation

# The Charles Schwab Corporation

## Who we are



The Charles Schwab Corporation (“Schwab”) is one of the nation’s leading providers of financial services, offering securities brokerage, banking, money management and financial advisory services to individual investors, independent investment advisors, as well as corporate and retirement plan sponsors and participants.

Our principal operating subsidiaries include:

- **Charles Schwab & Co., Inc.** (“CS&Co.”), a securities broker-dealer with over 360 domestic branch offices in 48 states, as well as a branch in the Commonwealth of Puerto Rico.
- **Charles Schwab Bank** (“Schwab Bank”), our principal banking entity.
- **Charles Schwab Investment Management, Inc.**, the investment advisor for Schwab’s proprietary mutual funds and exchange-traded funds.

Schwab serves individual investors, as well as registered investment advisors.

- **Investor Services** provides a full-service brokerage platform serving millions of individual investors who invest on their own, or through a workplace-sponsored retirement or equity plan, as well as banking through Schwab Bank.
- **Advisor Services** provides trading, custody, technology, practice management, and other support services to approximately 15,000 independent investment advisors.\*

\*Based on combined Schwab Advisor Services and TD Ameritrade Institutional data.

# The Charles Schwab Corporation

## Who we are



### Financial strength and stability

- Schwab is committed to staying financially strong.
- We run our business with a sound capital structure and a disciplined focus on risk management, designed to minimize the kind of investment risks that have troubled other securities firms.

### A commitment to the principles of safety, soundness, and transparency

- We adhere to strict internal practices and standards designed to keep client assets safe, and have comprehensive measures in place to protect client privacy and data.
- We have a long history of being transparent. As a publicly traded company, we are subject to disclosure laws and regulations, monitored and enforced by the U.S. Securities and Exchange Commission.

### Champion of clients

- Our purpose is to champion every client's goals with passion and integrity, treating clients in an ethical and empathetic way.
- We know that our success ultimately depends on how we serve all our clients and their confidence in us.

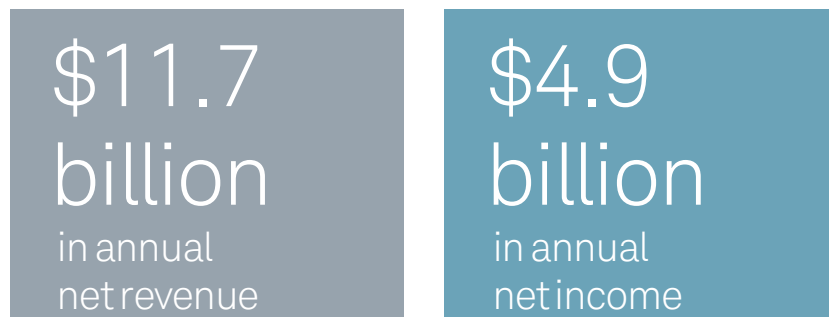
# The Charles Schwab Corporation

## Financial results

### Client assets and accounts:<sup>1</sup>



### Year-end financials:<sup>2</sup>



*Financial results and more information about The Charles Schwab Corporation's business and financial condition can be viewed at any time at [aboutschwab.com](https://about.schwab.com).*

1. Based on combined data for Schwab and TD Ameritrade through January 31, 2022.
2. For 12 months ending December 31, 2020. Schwab acquired TD Ameritrade, effective October 6, 2020. TD Ameritrade's results of operations and financial condition are included from the date of acquisition forward.

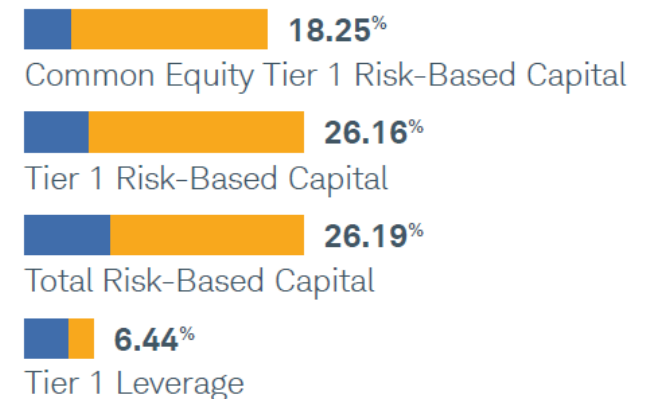
# The Charles Schwab Corporation

## Long-term financial strength

- The Charles Schwab Corporation is financially strong. Our capital structure and liquidity are sound, and we operate the firm conservatively to minimize the kind of investment risks that have troubled many other securities firms.
- With the majority of our assets in cash and in U.S. Treasury and U.S. agency-backed securities, and with a debt-to-equity ratio well below one, we maintain a high-quality balance sheet with limited leverage.
- We emphasize a disciplined focus on risk management, and our internal controls and business standards are designed to keep your assets safe. We know that our success ultimately depends on your confidence in us, which in turn is a reflection on how we serve you.

### Capitalization for The Charles Schwab Corporation:

#### The Charles Schwab Corporation



■ Minimum capital requirement  
■ Our capitalization

SEC Form 10-Q, as of March 31, 2021 for Charles Schwab Corporation. Notes to Consolidated Financial Statements.

# The Charles Schwab Corporation

Sound business practices designed to safeguard assets

- All of Schwab's different businesses are dedicated to the principles of safety and soundness.
- We take appropriate actions to help give our clients peace of mind about the security of their accounts, adhering to strict internal practices and standards designed to keep client assets safe.
- Schwab is committed to its clients. In line with that commitment, you can feel confident that your assets are held by a disciplined, conservative company.

## Key principles:

- Operating discipline
- Profitability balanced with investment to drive growth
- Conservative approach to managing credit risk
- Rigorous capital management
- Commitment to strong and flexible balance sheet



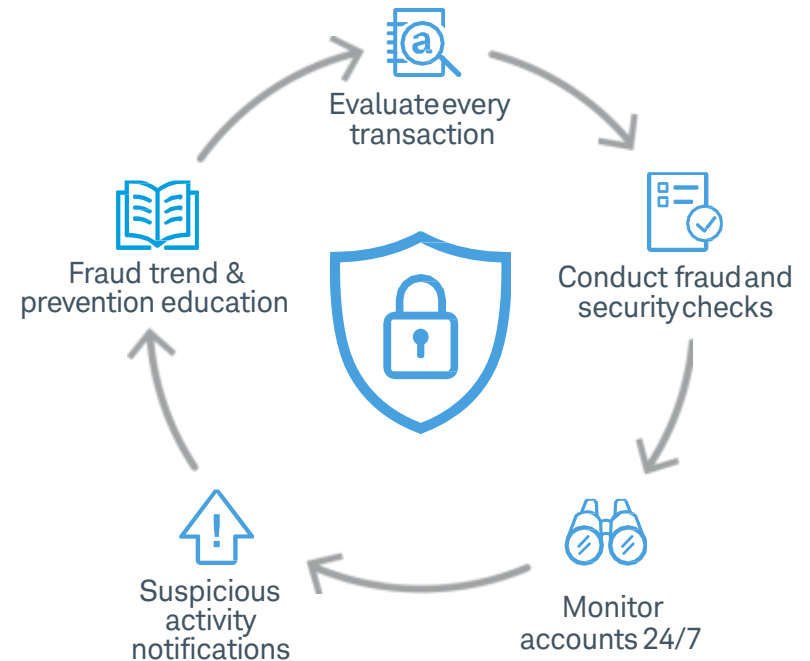
# The Charles Schwab Corporation

## Comprehensive strategies designed to protect accounts

We protect client accounts through an effective mix of complementary strategies, including technology, rigorous business practices, and oversight. Our approach includes:

- Advanced encryption technology, automated alerts, pattern analysis, and sophisticated analytical systems help us secure communications and detect suspicious activity.
- A dedicated team of experts continuously monitors the threat environment, account activity, and our systems to help keep client accounts and financial information safe.
- Collaboration with government agencies, law enforcement, and other financial services firms to address potential threats.
- A requirement that each RIA firm maintain insurance covering the firm for actions that may arise in the firm's services to investors and clients.
- Ensuring all employees who handle sensitive information receive privacy and security training, and understand our commitment to protecting privacy and safeguarding information.<sup>1</sup>

### Schwab's multi-step approach



1. For more details on how we help keep our clients' accounts and information safe, visit [schwab.com/schwabsafe](https://schwab.com/schwabsafe).

# The Charles Schwab Corporation

## How clients can help guard against fraud

### Key highlights when talking to your clients:

- Keep your advisor informed about any changes to your personal information.
- Expect your advisor to call you to confirm email requests to move money, trade, or change account information. Consider establishing a verbal password, or request a video chat to confirm your identity.
- Leverage Schwab's voice ID service to confirm your identity when calling the Schwab Alliance support team.
- Use two-factor authentication, which requires a unique code each time you login to the Schwab website.



### How clients can help you and Schwab guard their information:

- Be suspicious of phone calls, emails, and texts asking you to send money or disclose information. If someone calls you claiming to be from your advisor's office or a Schwab representative, hang up and call them back using a known phone number.
- Avoid sharing sensitive information via email, and beware of phishing emails and malicious links.
- Check your email and statements regularly for suspicious activity.
- Never enter confidential information in public areas or use public Wi-Fi.

For more details on how we help keep our clients' accounts and information safe, visit [schwab.com/schwabsafe](https://schwab.com/schwabsafe).

# The Charles Schwab Corporation

## Committed to client privacy

Recognizing that our most important asset is our relationship with clients, Schwab has a privacy notice that applies to consumers who are current or former account holders at Schwab.

- Our privacy notice explains how we use client information and the strict limitations we place on sharing it with third parties.
- We do not sell client personal information. We share it with third parties only to provide services. We share information with trusted service providers who support and help develop our products and services. Our service providers are committed to our standards for safeguarding client information. We may also share certain information on a case-by-case basis to comply with legal and regulatory obligations.

For more information, go to [schwab.com/public/schwab/nn/legal\\_compliance/privacy](https://schwab.com/public/schwab/nn/legal_compliance/privacy)

# The Charles Schwab Corporation

Committed to client privacy

Reasons we can share client information	Does the Charles Schwab Corporation share?	Can you limit this sharing?
For our everyday business purposes—such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or report to credit bureaus	YES	NO
For our marketing purposes—to offer our products and services to you	YES	NO
For joint marketing with other financial companies	NO	We don't share
For our affiliates' everyday business purposes—information about your transactions and experiences	YES	NO
For our affiliates' everyday business purposes—information about your creditworthiness	YES	YES
For our affiliates to market to you	YES	YES
For nonaffiliates to market to you	NO	We don't share

This table is an excerpt from our Corporate Privacy Notice. For more information, please visit [Schwab.com/Privacy](https://www.schwab.com/Privacy)

For institutional investors only.

# The Charles Schwab Corporation Security Guarantee

## Schwab's Commitment to Clients

We offer you this simple guarantee:

**Schwab will cover losses in any of your Schwab accounts due to unauthorized activity.**

The highest levels of security are only possible when we work together. To ensure your protection under this guarantee, it is your responsibility to:

- **Safeguard your account access information.<sup>(1)</sup>**

Please do not share your account access information, including but not limited to your login ID, password, PIN and transaction codes, with anyone. If you share this information with anyone, we will consider their activities to have been authorized by you.<sup>(2)</sup>

- **Report any unauthorized transactions to us as quickly as possible.<sup>(3)</sup>**

If you suspect you are a victim of fraud, please contact us immediately at **888-3-SCHWAB**.

There may be other individuals to whom you grant authority in your account. Their activities in your account will also be considered authorized.<sup>(2)</sup>

We are committed to safeguarding your accounts and the privacy of your information, as stated in our Privacy Notice. To further ensure a more secure online experience, we recommend that you visit [Schwab.com/Security](https://www.schwab.com/Security).

Note: There is nothing in Security Guarantee that is intended to limit any right conferred or claim or protections provided to customers under Regulation E, for applicable transactions.

Please visit [Schwab.com/Guarantee](https://www.schwab.com/Guarantee) to learn more, including about an Advisor's role as an Authorized party.

# Charles Schwab & Co.

A leading custodian for independent financial advisors

When an advisor places assets at Schwab on behalf of their client, they are choosing a custodian experienced in serving the unique needs of independent advisors and their clients.

We're committed not only to meeting our industry's rigorous requirements, but also to upholding our own stringent business standards, which are designed to safeguard assets and help ensure our firm's financial health and stability.

Nearly  
**46%**

Overall assets held at Schwab represented by Schwab Advisor Services and TD Ameritrade Institutional<sup>(1)</sup>



Schwab Advisor Services/TD Ameritrade Institutional client assets ~ \$3.5 trillion<sup>1</sup>

Approx.  
**15,000+**

Independent advisor firms served<sup>(2)</sup>

1. Based on combined data for Schwab and TD Ameritrade through February 25, 2022.

2. Based on combined Schwab and TD Ameritrade data.

# Charles Schwab & Co.

## How Schwab protects brokerage account assets

### Your assets are yours.

- The SEC's Customer Protection Rule (Rule 15c3-3) safeguards customer assets at brokerage firms by preventing firms from using customer assets to finance their own proprietary businesses. It is a violation of SEC rules for brokerage firms to merge customer assets with their own.
- At Schwab, clients' fully paid securities are segregated so that they are not available to the firm. Client cash deposits invested at the broker-dealer are maintained in Special Reserve Accounts for the Exclusive Benefit of our Customers, as required by the SEC's Customer Protection Rule.
- The Securities Investor Protection Corporation (SIPC) was created to protect against the loss of customer assets at brokerage firms.
- Charles Schwab & Co., Inc. is a SIPC-member brokerage firm and also maintains excess SIPC protection.

"At Schwab, we are dedicated to the principles of safety and soundness. They form the heart of our relationship with our clients."



Charles R. Schwab  
Chairman

# Charles Schwab & Co.

## How Schwab protects brokerage account assets

Security accounts held at the broker-dealer are protected in several ways.

Protected:	Up to \$500,000	Up to \$149.5MM
<b>SEC<sup>1</sup>—Customer Protection Rule</b> Keeps client securities separate from broker-dealer securities	<b>SIPC<sup>2</sup> account protection</b> Protects Schwab (a SIPC member) client in the event the firm fails financially	<b>Excess SIPC<sup>3</sup> protection</b> Provides Schwab customers with extra protection from Lloyd's of London

- SIPC and Excess SIPC funds are used to make investors whole after all customer assets held at the brokerage firm have been accounted for after the failure of the broker-dealer, AND assets are discovered to be missing.
- Excess SIPC policy provided by Lloyd's of London.
- Customer assets aren't subject to claims by the broker-dealer's creditors.
- In a SIPC customer proceeding, the account will receive a pro rata share of all client assets recovered in liquidation, and will then receive up to \$150,000,000 (including \$1,150,000 in cash) from SIPC and Excess SIPC to make up any difference that may still exist.

1. SEC (Securities and Exchange Commission) Customer Protection Rule, [sec.gov/divisions/enforce/customer-protection-rule-initiative.shtml](https://www.sec.gov/divisions/enforce/customer-protection-rule-initiative.shtml).

2. SIPC (Securities Investor Protection Corporation), [sipc.org](https://www.sipc.org).

3. Schwab Account Protection Information [schwab.com/legal/sipc-account-protection](https://www.schwab.com/legal/sipc-account-protection).



# Charles Schwab & Co.

## How Schwab protects brokerage account assets

### Customer Protection Rule

Regulatory rules around how client cash can be invested—called the Customer Protection Rule—set limitations on both the type of investments that Schwab can have, and what Schwab can do with that cash in terms of lending to other clients.

### Counterparty and concentration controls:

- **Independent research team:** In having an independent credit research team, Schwab doesn't rely on rating agencies to tell the company what is high quality and what is not, or to evaluate investment options.
- **Margin lending:** When Schwab engages in margin lending, the firm focuses on the volatility and liquidity of securities pledged by the client against the margin loan, and whether that collateral is concentrated in a single security or industry. Managing concentration risk both at the security and individual client level is a key component of our margin-lending risk management process.
- **Special reserve account:** Any cash that is client money at the firm is segregated into a separate account and protected from creditor claims. This is called the Special Reserve Account.
- **Securities lending:** Schwab predominantly lends securities, receiving cash collateral at least 102% of the market value of securities lent. Risk to the cash collateral held by Charles Schwab Co. therefore rests with the potential for both 1) failure of the borrowing counterparty to return the borrowed shares at a time of the borrowed security's rapid increase in market value above the cash collateral, and 2) simultaneous failure of the securities lending counterparty. To mitigate this risk, Schwab conducts a credit review of each counterparty and establishes appropriate limits subject to diversification requirements.



# Schwab-affiliated banks



TRUST BANK

PREMIER BANK

# Schwab-affiliated banks

Charles Schwab Bank®



## The bank built for investors

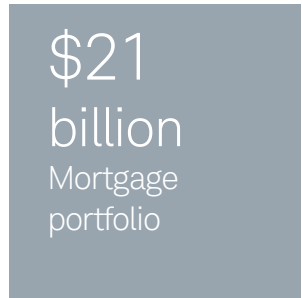
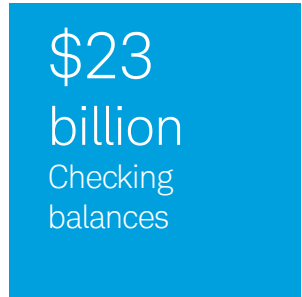
Checking

Lending

- Pledged Asset Line® from Schwab Bank®
- Home loans provided by Rocket Mortgage®:
  - Fixed-rate, adjustable-rate, and interest-only mortgages<sup>1</sup>
  - Home Equity Lines of Credit<sup>2</sup>



As of December 31, 2021



Brokerage Products: Not FDIC-Insured ▪ No Bank Guarantee ▪ May Lose Value

# Schwab-affiliated banks

## How Schwab-affiliated banks protect assets

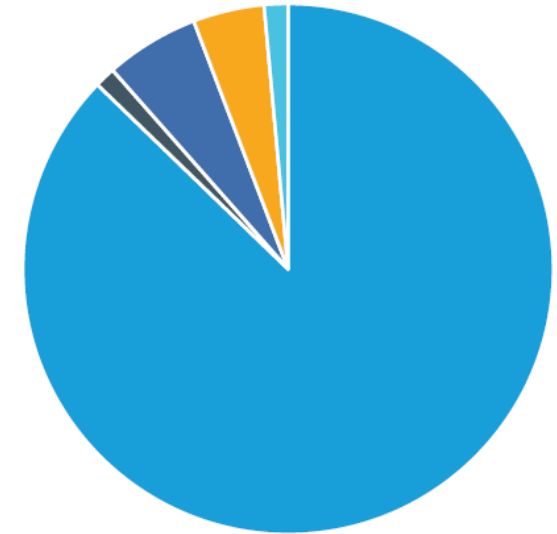


Our conservative approach to investments and lending and our highly liquid balance sheet are the first lines of protection for clients.

- **Regulatory protections.** The products we offer are properly structured and presented clearly and accurately, in accordance with rules designed to help safeguard client assets.
- **Conservative investments.** As of March 31, 2021, more than half of Schwab-affiliated banks' investments in total securities were held in government-sponsored enterprise (GSE) securities.<sup>1</sup> Other investments include asset-backed securities, corporate debt, cash, long-term certificates of deposit, and non-GSE mortgage-backed securities.
- **Low-risk loan portfolio.** Charles Schwab Bank maintains a low loan-to-deposit ratio that has ranged between 7.55% and 9.11% over the past two years.<sup>2</sup> Schwab Bank's high-quality, low-risk loan portfolio is made up of three main loan products: first mortgages, HELOCs, and pledged asset lines.

### Schwab Bank's Investment Portfolio<sup>3</sup>

Dollars in millions



Charles Schwab Trust Bank and Charles Schwab Premier Bank are managed with a similar risk profile and portfolio composition.

#### SECURITIES

- U.S. agency mortgage-backed securities
- U.S. treasuries and U.S. agency debentures
- Asset-backed securities\*
- Corporate debt securities\*
- Other securities\*

\*Investment grade risk profile

1. Charles Schwab Bank March 31, 2021 Call Report. Supplemental Financial Data for Charles Schwab Bank and Charles Schwab Premier Bank (unaudited).

2. Federal Financial Institutions Examination Council (FFIEC), Reports of Condition and Income Call Report beginning March 2019. Loan-to-deposit ratio is calculated by dividing total loans (Schedule RC - Balance Sheet, line 4b) by total deposits (Schedule RC - Balance Sheet, line 13a).

3. Charles Schwab Bank March 31, 2021 Call Report. Supplemental Financial Data for Charles Schwab Bank and Charles Schwab Premier Bank (unaudited).

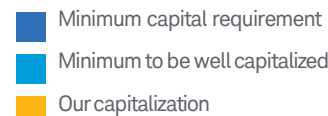
# Schwab-affiliated banks

## How Schwab-affiliated banks protect assets

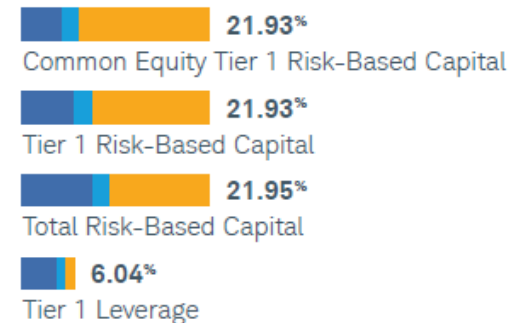


- To evaluate a bank's financial strength and its ability to withstand economic stresses, regulators look at capital and liquidity. We currently have no long-term debt, and our assets are primarily funded by deposits and common equity.
- Our capitalization is further strengthened by the fact that neither Charles Schwab Bank, Charles Schwab Trust Bank, Charles Schwab Premier Bank, Charles Schwab, nor any other subsidiaries of The Charles Schwab Corporation engage in investment banking, proprietary trading, or other high-risk speculative investment practices that could put client deposits at higher risk during times of extraordinary market volatility.

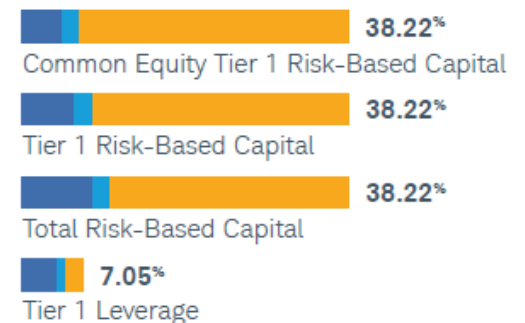
Capitalization for Charles Schwab Bank, Charles Schwab Trust Bank, and Charles Schwab Premier Bank:<sup>4</sup>



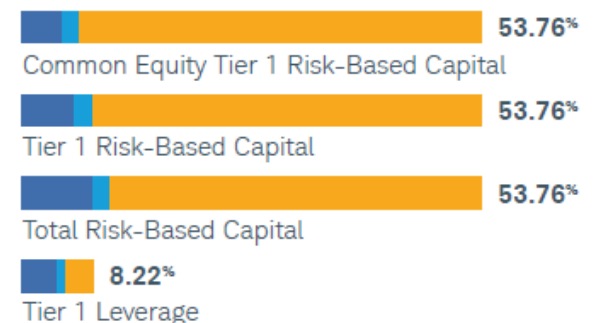
### The Charles Schwab Bank



### The Charles Schwab Premier Bank<sup>5</sup>



### The Charles Schwab Trust Bank



4. SEC Form 10-Q, as of March 31, 2021 for Charles Schwab Corporation and Charles Schwab Bank. Charles Schwab Bank March 31, 2021 Call Report for Charles Schwab Premier Bank. Notes to Consolidated Financial Statements.

5. These metrics are cited from the Charles Schwab Premier Bank March 31, 2021 Call Report.

# Schwab-affiliated banks

## How Schwab-affiliated banks protect assets



Accounts are protected depending on the type of account:

Single accounts	Joint accounts	Certain retirement accounts	Retirement plans
<p>Deposit accounts owned by one person</p> <p>Up to \$250,000 per owner for all single accounts at each bank</p>	<p>Deposit accounts owned by two or more people</p> <p>Up to \$250,000 per owner for all joint accounts at each bank</p>	<p>Accounts such as IRAs and self-directed defined contribution plans</p> <p>Up to \$250,000 per owner for all deposits in such retirement bank accounts at each bank</p>	<p>Defined contribution and defined benefit plans</p> <p>Up to \$250,000 per owner for all deposits in such retirement bank accounts at each bank</p>

### FDIC<sup>6</sup>

All deposit accounts held at Schwab-affiliated banks, including Bank Sweep deposit accounts for uninvested brokerage cash, Charles Schwab Bank High Yield Investor Checking<sup>®</sup> (linked to a Schwab One<sup>®</sup> Brokerage Account),<sup>7</sup> and Charles Schwab Bank High Yield Investor Savings<sup>®</sup>, are insured up to allowable limits by the FDIC, a U.S. agency that protects depositors against the loss of their deposit accounts in the event of the failure of an FDIC-insured bank.

6. Coverage includes principal and accrued interest. Funds deposited at Schwab-affiliated banks are insured, in aggregate, up to \$250,000 based on account ownership type, by the FDIC.

7. The Charles Schwab Bank High Yield Investor Checking<sup>®</sup> account is available only as a linked account with a Schwab One<sup>®</sup> brokerage account. The Schwab One brokerage account has no minimum balance requirements, minimum balance changes, minimum trade requirements, and there is no requirement to fund this account when opened with a High Yield Investor Checking account.

# Schwab-affiliated banks

## How Schwab-affiliated banks protect assets



### Schwab's enhanced Bank Sweep feature

- Through Schwab-affiliated banks, clients can obtain extended FDIC insurance coverage of up to \$500,000 for cash balances held in domestic accounts.
- The multiple-bank version of Bank Sweep provides extended FDIC insurance by spreading an account's uninvested cash across multiple Schwab-affiliated banks. Each bank will provide FDIC insurance coverage up to \$250,000 per depositor for principal and accrued interest for all deposits held by that depositor in the same insurable capacity at the same affiliated bank.<sup>8</sup>
- The distribution of cash across the banks is done seamlessly behind the scenes. Once the cash balance reaches a threshold near the maximum FDIC coverage for one bank, the excess funds will sweep to the next bank.

#### Example 1

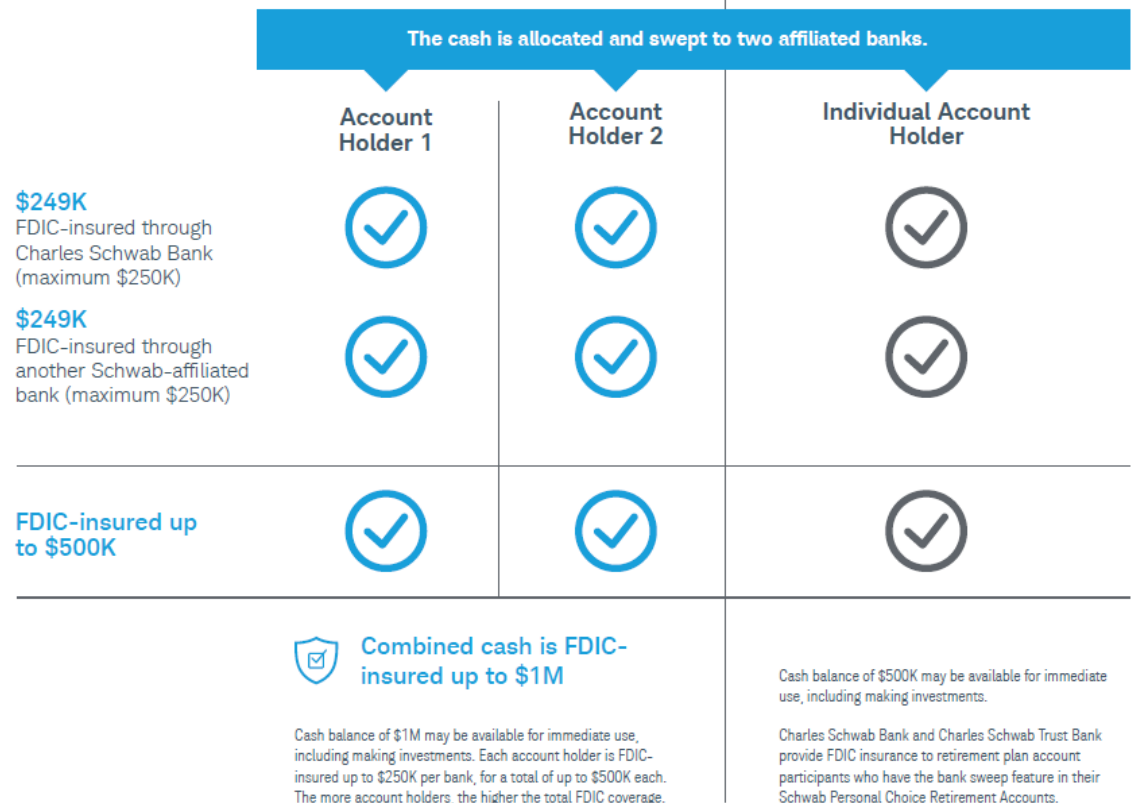


\$1M of a client's uninvested cash is in a joint brokerage account with two account holders.

#### Example 2



\$500K of a client's uninvested cash is in an individual brokerage account.



8. Bank Sweep and Bank Sweep for Benefit Plans deposits are held at one or more FDIC-insured banks ("Affiliated Banks") that are affiliated with Charles Schwab & Co., Inc. ("Schwab"). Investment products and services (including unswept or intra-day cash, net credit or debit balances, money market funds, and assets held in a Schwab Personal Choice Retirement Account®) are not deposits or obligations of the Affiliated Banks, are subject to investment risk, are not FDIC insured, may lose value, and are not Affiliated Bank-guaranteed.

# Schwab-affiliated bank disclosures

**Brokerage Products: Not FDIC-Insured ▪ No Bank Guarantee ▪ May Lose Value**

In order to participate, the borrower must agree that the lender, Rocket Mortgage, may share their information with Charles Schwab Bank and Charles Schwab Bank will share their information with the lender Rocket Mortgage. Nothing herein is or should be interpreted as an obligation to lend. Loans are subject to credit and collateral approval. Other conditions and restrictions may apply. This offer is subject to change or withdraw at any time and without notice. Interest rate discounts cannot be combined with any other offers or rate discounts. Hazard insurance may be required.

1. Interest-only mortgages have an initial interest-only payment period followed by a fully amortizing payment period. After the interest-only period ends, your monthly payments will increase because you will be paying both principal and interest. Interest-only mortgages include additional risks you should consider. For more information about these risks, please contact a home loan specialist.
2. Home equity lines may not be used as a bridge loan, for commercial purposes, to invest in securities or to repay a margin loan. See Schwab.com for additional details.



# Schwab-affiliated bank disclosures continued

Entering into a Pledged Asset Line and pledging securities as collateral involve a high degree of risk. Before you decide to apply for a Pledged Asset Line, make sure you understand the risks.

Schwab Bank requires that the assets pledged as collateral for the Pledged Asset Line be held in a separate Pledged Asset Account (PAASB) maintained at Charles Schwab & Co., Inc. (Schwab). Schwab Bank establishes collateral requirements regarding the type of assets, value of assets, and concentration of assets that are required to be maintained in the PAASB as collateral for the Pledged Asset Line, and reserves the right to change the requirements from time to time. Proceeds may not be used to purchase securities or to pay down margin loans; proceeds may not be deposited into a Schwab brokerage account.

Charles Schwab Bank, SSB, and Charles Schwab & Co., Inc. are separate but affiliated companies and subsidiaries of The Charles Schwab Corporation. Brokerage products, including the Pledged (Asset) Account, are offered by Charles Schwab & Co., Inc., Member SIPC, and are not insured by the FDIC, are not deposits or obligations of Charles Schwab Bank, SSB and are subject to investment risk, including the possible loss of principal invested. Charles Schwab & Co., Inc. does not solicit, offer, endorse, negotiate or originate any mortgage loan products and is neither a licensed mortgage broker nor a licensed mortgage lender. Home lending is offered and provided by Rocket Mortgage, LLC. Rocket Mortgage LLC., is not affiliated with The Charles Schwab Corporation, Charles Schwab & Co., Inc. or Charles Schwab Bank, SSB. Deposit and other lending products are offered by Charles Schwab Bank, SSB, Member FDIC and Equal Housing Lender.

Rocket Mortgage, LLC; NMLS #3030; [www.nmlsconsumeraccess.org](http://www.nmlsconsumeraccess.org). Equal Housing Lender. Licensed in 50 states. AL License No. MC 20979, Control No. 100152352. AR, TX: 1050 Woodward Ave., Detroit, MI 48226-1906, (888) 474-0404; AZ: 1 N. Central Ave., Ste. 2000, Phoenix, AZ 85004, Mortgage Banker License #BK-0902939; CA: Licensed by Dept. of Business Oversight, under the CA Residential Mortgage Lending Act and Finance Lenders Law; CO: Regulated by the Division of Real Estate; GA: Residential Mortgage Licensee #11704; IL: Residential Mortgage Licensee #4127 - Dept. of Financial and Professional Regulation; KS: Licensed Mortgage Company MC.0025309; MA: Mortgage Lender License #ML 3030; ME: Supervised Lender License; MN: Not an offer for a rate lock agreement; MS: Licensed by the MS Dept. of Banking and Consumer Finance; NH: Licensed by the NH Banking Dept., #6743MB; NV: License #626; NJ: New Jersey - Rocket Mortgage, LLC, 1050 Woodward Ave., Detroit, MI 48226, (888) 474-0404, Licensed by the N.J. Department of Banking and Insurance.; NY: Licensed Mortgage Banker - NYS Banking Dept.; OH: MB 850076; OR: License #ML-1387; PA: Licensed by the Dept. of Banking - License #21430; RI: Licensed Lender; WA: Consumer Loan Company License CL-3030. Conditions may apply.

©2022 Charles Schwab Bank, Charles Schwab Trust Bank, and Charles Schwab Premier Bank. All rights reserved.





# The important role of a custodian

# The important role of a custodian

## Choosing the right firm to custody your assets

- A custodian provides for the safekeeping of client securities.
- A variety of different types of financial institutions—including banks, brokerage firms, and trust companies—may offer custody services. Each is subject to the oversight of its respective regulatory agencies.
- The safety and soundness of your custodian is an important consideration for you and your clients.

### **Before you select a custodian, you should consider:**

- The institution's financial condition
- What types of risk management controls the firm employs

# The important role of a custodian

## What you can expect from your custodian

A custodian's role and responsibility involves various regulatory requirements and protections, varying by institution and asset type.

### Through your custodian you will receive:

- Regular account statements detailing your current holdings in accordance with your assets
- Updates on activities conducted on your behalf or involving your assets
- Access to your account information, including account statements, trade confirmations, and tax reports

# The important role of a custodian

How assets are custodied—broker-dealer or bank

Custodians, including Schwab, may hold customer assets in the custodian's own name (or "street name") through omnibus accounts with third-party custodians, such as the Depository Trust and Clearing Company (DTCC), other clearing corporations, the Federal Reserve, etc., or in accounts held with intermediary brokers and banks who in turn hold accounts with third-party custodians.

The underlying assets are actually held by these ultimate third-party custodians.

Securities held in the "street name" allows for easier, faster, more efficient transaction processing.

# The important role of a custodian

How assets are custodied—broker-dealer or bank

Most custodians, including Schwab, rarely hold client assets directly—such as through physical certificates in their vaults—and usually do not hold assets in their customers' names, such as through securities registered to specific customers (so-called “customer name” securities), or segregated bank deposit accounts held in the names of specific customers.

The assets purchased by you, as the customer, are usually spread across custodians, such as the DTCC, for ease of trade and transfer, but you are still the beneficial owner.

You have full rights to securities which are held at the DTCC—whether they are custodied by a bank or broker-dealer.

Securities held in “customer name” are actual certificates that must be physically delivered to a broker-dealer to sell them.

# Understanding different types of custody

# Understanding different types of custody

## How different custodians are regulated

- While all custodians are tasked with the safekeeping of assets, the specific protections vary depending on the type of account, by institution, and by asset type. Each provides a different set of risks and protections for the assets.
- Both banks and broker-dealers are highly regulated institutions—with comparable governing regulations involving capital adequacy, insurance protection, and financial transparency. They're subject to oversight by their respective regulatory agencies.

	Protection	Insurance
Broker-Dealer	<ul style="list-style-type: none"><li>▪ Securities and Exchange Commission (SEC)</li><li>▪ Financial Industry Regulatory Authority* (FINRA)</li><li>▪ Municipal Securities Rulemaking Board (MSRB)</li></ul>	Securities Investor Protection Corporation (SIPC)
Bank	<ul style="list-style-type: none"><li>▪ Office of the Comptroller of the Currency (OCC)</li><li>▪ Consumer Financial Protection Bureau (CFPB)</li></ul>	Federal Deposit Insurance Corporation (FDIC)

\*FINRA was created in July 2007 through the consolidation of the National Association of Securities Dealers, Inc. (NASD) and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange (NYSE).



# Understanding different types of custody

## Broker-dealer custody—How assets are custodied

- To protect clients, custodians are restricted on the use and commingling of assets, based on the type of assets and circumstances.
- Brokerage firms typically pool client assets and include them on their balance sheet. This process is commonly referred to as holding assets in “street name.” When assets are held in street name, they are often used for a variety of brokerage activities and are potentially subject to seizure by creditors in the event of the brokerage firm’s insolvency.

Type of Asset/Circumstance	Commingling permitted	Commingling prohibited
“Cash” accounts: Fully paid securities (purchased with 100% cash)		X
Margin accounts: Securities with a market value of up to 140% of the customer’s debt balance in a margin account	X	
Excess margin: Securities in a margin account with a market value of greater than 140% of the customer’s debt balance in the account		X
Customer provides written permission in a contract with the broker	X	
Same-day liens to facilitate transactions at clearing corporations	X	
Affiliated customer funds, or funds of a group, or syndicate of customers	X	

# Understanding different types of custody

## Broker-dealer custody—What is SIPC?

- The Securities Investor Protection Corporation (SIPC) was established by Congress in 1970 to protect investors in the event of a brokerage firm's failure.
- SIPC is a nonprofit, membership-based corporation, funded by its member securities broker-dealers. It's not a government agency or regulatory authority.
- SIPC protects against the loss of cash and securities—such as stocks and bonds—held by a customer at a failed SIPC-member brokerage firm.
- SIPC works to restore the financial value of customers' accounts as shown on the account statement (referred to as "net equity") as of the filing date of the SIPC proceeding.
- A customer's "net equity" is the value of cash and securities owed by the brokerage firm to the customer, minus the amount of any indebtedness that the customer owes to the brokerage firm.
- SIPC does not protect against the decline in value of a customer's securities, fraud, or deceptive selling practices.
- Since the inception of SIPC, 99% of eligible investors have been made whole in the failed brokerage firm cases that it has handled.

For more information about SIPC coverage, visit their website [sipc.org](https://www.sipc.org).

# Understanding different types of custody

## Broker-dealer custody—When SIPC gets involved

- SIPC initiates the liquidation process when it receives a referral from a securities regulator such as the U.S. Securities and Exchange Commission (SEC) or a securities self-regulator such as the Financial Industry Regulatory Authority (FINRA).
- When starting a liquidation, SIPC asks the court to appoint a Trustee to liquidate the firm and protect its customers.
- In order for SIPC or Excess SIPC to get involved, a broker-dealer must fail financially, and cash and/or securities must be missing from customer accounts. Every broker-dealer failure does not involve missing client assets.
- Trustee determines if assets are missing overall. The shortage is applied to customers on a pro-rata basis.
- Customer assets are not subject to claims by the broker-dealer's creditors.
- Schwab is a member of SIPC. In fact, all broker-dealers registered with the SEC are required to be members of SIPC.

The rules of SRO membership (Section 15(b)(8) and Rule 15(b)(9-1) require brokerage firms to become a member of an SRO in order to assist the SEC in regulating the firms' activities. For more information about SIPC coverage, visit their website [sipc.org](http://sipc.org).

# Understanding different types of custody

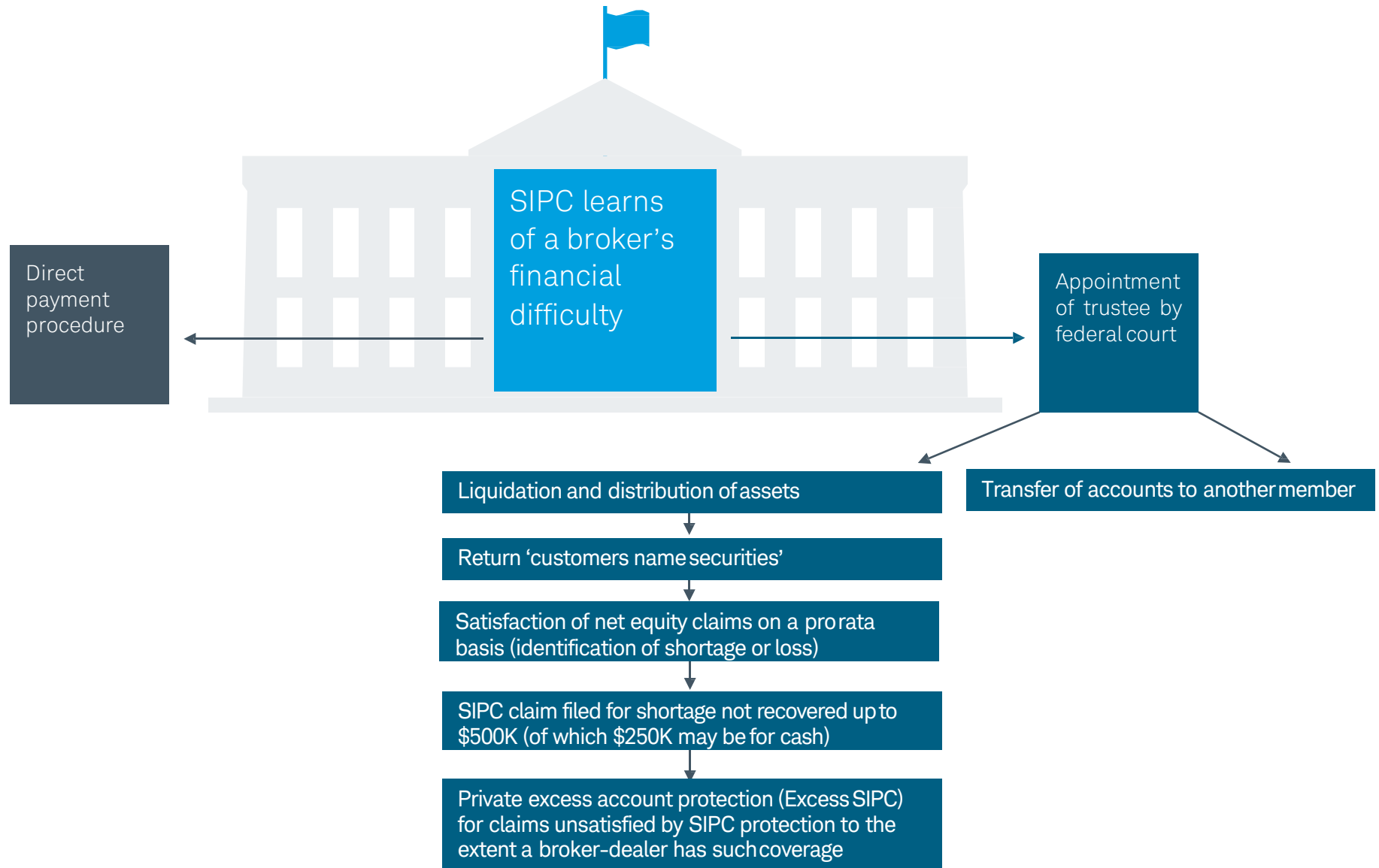
## Broker-dealer custody—How SIPC protects investors

- If a brokerage firm fails and assets go missing, a trustee is assigned to liquidate the firm and protect its customers. The trustee seeks to transfer customer accounts to a viable brokerage firm. The remaining assets are then allocated on a pro-rata basis.
- If there is a shortage, the trustee assists customers in making a claim with SIPC. An active SIPC claim is required to make an Excess SIPC claim. SIPC provides up to \$500,000 (including up to \$250,000 in cash) per client account\* to make the customer whole.
- Some brokerage firms carry Excess SIPC, provided by a private insurer. If there is an incident where the \$500,000 from SIPC can't make a customer account whole, a claim is filed with the Excess SIPC policy for the remaining shortfall.
- Schwab's Excess SIPC coverage is provided by Lloyd's of London. Coverage is provided in excess of the \$500,000 paid by SIPC. The coverage is \$149,500,000 (including \$900,000 in cash) per client account.\* The program's aggregate is \$600 million (the most the program will pay).

\*Client account – accounts held in the same capacity are considered one account (e.g., two accounts held by the same individual would be “one” account). See [sipc.org](https://www.sipc.org) for more specific information.

# Understanding different types of custody

Broker-dealer custody—What happens when SIPC gets involved



For more information about SIPC coverage, visit their website [sipc.org](http://sipc.org)

# Understanding different types of custody

## Broker-dealer custody—Hypothetical example: No Excess SIPC Coverage

If the trustee recovers 40% of all customer assets, and 60% of customer assets are missing, customers would be treated as follows:

### Customer A

Net Equity of  
\$400,000

- \$160,000 is transferred to a viable broker-dealer by trustee.
- Has a SIPC claim for securities valued at \$240,000.
- Would receive his securities, or \$240,000 in cash from SIPC.
- 40% of the value would come from customer assets and 60% from funds advanced by SIPC.

### Customer B

Net Equity of  
\$1,000,000

- \$400,000 is transferred to a viable broker-dealer by trustee.
- Has a SIPC claim for securities valued at \$600,000.
- Would receive securities or cash valued at \$500,000 from SIPC.
- Would receive \$900,000 in total, and would have a general creditor claim for the remaining \$100,000.

- All “customer name securities” held by brokerage firm are returned outright to customers.
- Note: Charles Schwab & Co. has an excess SIPC policy provided by Lloyd’s of London, so the example above would not apply to Schwab.

For more information about SIPC coverage, visit their website [sipc.org](http://sipc.org)

# Understanding different types of custody

## Broker-dealer custody—Hypothetical example: SIPC Coverage

XYZ declares  
bankruptcy



Mr. Jones is  
a customer of  
XYZ Brokerage

Account value:  
\$5 million

### Case details

- A trustee is appointed by the court and takes control of XYZ.
- An accounting of all accounts and assets is completed. It is determined that 10% of all client assets are missing (90% are recovered).
- Each and every client will be missing 10% of their account.
- Mr. Jones is missing \$500,000 of his \$5 million.
- SIPC would contribute \$500,000.
- The court-appointed trustee makes arrangements and transfers the recovered portion of Mr. Jones' account to an alternative brokerage firm that is a member of SIPC.

### Recovery

Account value	\$5,000,000
Recovered assets from alternative broker	\$4,500,000
SIPC contribution	\$500,000
<b>Total loss</b>	<b>\$0</b>

For more information about SIPC coverage, visit their website [sipc.org](http://sipc.org).

# Understanding different types of custody

## Broker-dealer custody—Hypothetical example: SIPC/Excess SIPC Coverage

ABC declares  
bankruptcy



Mr. Smith is a  
customer of ABC  
Brokerage

Account value: \$5  
million

### Case details

- A trustee is appointed by the court and takes control of ABC.
- An accounting of all accounts and assets is completed. It is determined that 40% of all client assets are missing (60% are recovered).
- Each client will be missing 40% of their account. Mr. Smith is missing \$2,000,000 of his \$5 million.
- The trustee makes arrangements and transfers the recovered portion of Mr. Smith's account, \$3,000,000, to an alternative brokerage firm that is a member of SIPC.

### Recovery

Account value	\$5,000,000
Recovered assets from alternative broker	\$3,000,000
SIPC contribution	\$500,000
Excess SIPC	\$1,500,000
<b>Total loss</b>	<b>\$0</b>

For more information about SIPC coverage, visit their website [sipc.org](http://sipc.org).





# Charles Schwab & Co.

Broker-dealer services  
and protections

# Understanding different types of custody

Broker-dealer custody: Hypothetical scenario where loss is assumed

ABC Brokerage:  
\$1.4T firm declares  
bankruptcy  
\$2B missing



Mrs. Ann Smith is  
a customer of  
ABC Brokerage  
Account value:  
\$100 million

Individual customer account value	\$100,000,000
All customer/firm assets	\$1,400,000,000,000
Total missing assets	\$2,000,000,000
All customer assets held by trustee	\$1,398,000,000,000
Pro rata share of customer assets	99.86%
Pro rata customer value	\$99,860,000
SIPC coverage up to \$500,000	\$140,000
Amount customer receives	\$100,000,000

For more information about SIPC coverage, visit their website [sipc.org](https://www.sipc.org).

# Understanding different types of custody

## Bank custody

- Historically, banks performed fiduciary functions, including safekeeping and custody, in a separate trust department. Many banks have now changed from the traditional trust department structure in favor of a less formal configuration, including private banking, wealth management, personal trust, corporate trust, and custodial services.
- The bank custody relationship is essentially a directed agency contract, with the customer as the principal and the bank as the agent. A bank custodian may not use, commingle, pledge, or trade in custodial securities except as expressly authorized by the customer.
- Generally, as custodian the bank acts only upon the direction of the customer and has authority to act with regard to the assets only in accordance with the instructions of the customer.
- In addition, banking regulations prohibit a bank custodian from commingling custodial securities with its own assets, and require the bank to maintain careful records reflecting each customer's holdings.
- If the bank fails, such assets are not considered bank assets and are thus not part of the bank's receivership estate.

# Understanding different types of custody

## Bank custody

### Securities in Custodial Accounts

- Bank custodians typically hold securities as book entries with the DTCC or other clearing corporation (vs. physical form), in the bank's own name or a nominee's name.
- The bank identifies the assets in its records as "fiduciary" or "custody" by indicating that the bank is acting as agent or custodian or that the nominee is the nominee for custodial accounts.

### Cash Deposit Accounts

- Most cash deposits are considered "general commercial" deposits, which a bank may commingle with its own assets and use for profit. The balance in a deposit account represents the bank's general obligation to provide currency or transferable credit to the depositor or to third parties upon the depositor's instructions. General deposit obligations are backed by the unencumbered assets of the bank maintaining the deposit.
- Deposits at an FDIC member bank are insured by the Federal Deposit Insurance Corporation, generally up to coverage limits set by law.

### Custodial Cash Deposits

- As noted above, in the absence of specific arrangements for the investment of cash, such as the sweep accounts discussed above, bank custodians generally deposit cash held in custody accounts in general commercial deposits at the custodian bank.
- Deposits may or may not bear interest and are insured by the FDIC up to the applicable insurance limits, as more fully described in the section on FDIC insurance. Amounts in custodial cash deposits in excess of the FDIC insurance limits are typically unsecured obligations of the bank.
- Additional protection may be provided for accounts that are considered "fiduciary," typically trust accounts and accounts over which a bank custodian has investment discretion.

# Understanding different types of custody

## Bank custody: FDIC Insurance

- The Federal Deposit Insurance Corporation (FDIC) is an independent agency of the United States government, and FDIC insurance is backed by the full faith and credit of the United States government. The intent of FDIC insurance is to protect bank depositors against the loss of their deposits if an FDIC-insured bank or savings association fails.
- The FDIC considers deposits per institution, meaning a client may extend FDIC coverage by holding deposits at more than one FDIC-insured bank or savings association.
- FDIC deposit insurance coverage doesn't apply to securities, mutual funds, or similar types of investments held at a bank or a bank subsidiary or affiliate.
- Currently, the limit of protection provided by FDIC is \$250,000 per depositor, per insured bank, for each ownership category.

For more information about FDIC coverage, visit [fdic.gov](https://www.fdic.gov) or contact the FDIC at 877-ASK-FDIC (877-275-3342).

# Understanding different types of custody

## Bank custody: FDIC Insurance example

FDIC-insured  
Bank WXY fails



Mr. Jones is a customer of WXY Bank and has these deposit accounts at the bank:

- An individual account with a balance of \$100,000
- A joint account held with Mrs. Jones with \$550,000
- A revocable trust account held with Mrs. Jones and their two children with \$1,000,000

Total Deposits at Bank WXY: \$1,650,000

FDIC insurance would provide:

- |                                   |           |
|-----------------------------------|-----------|
| ▪ Individual account to Mr. Jones | \$100,000 |
| ▪ Joint account to Mr. Jones      | \$250,000 |
| ▪ Joint account to Mrs. Jones     | \$250,000 |
| ▪ Revocable Trust to Mr. Jones    | \$250,000 |
| ▪ Revocable Trust to Mrs. Jones   | \$250,000 |
| ▪ Revocable Trust to Child #1     | \$250,000 |
| ▪ Revocable Trust to Child #2     | \$250,000 |

Total Recovery from FDIC \$1,600,000

# Disclosure

Schwab Advisor Services™ provides custody and trading, as well as technology and other support services, to independent investment advisors. This includes the custody, trading, and related support services of Charles Schwab & Co., Inc., a registered broker-dealer and member SIPC. Independent investment advisors are not owned by, affiliated with, or supervised by Schwab.

Schwab Advisor Services also includes trust, custody, and deposit products and services are offered by Charles Schwab Bank, SSB, Charles Schwab Trust Bank, and Charles Schwab Premier Bank, Members of FDIC. Charles Schwab & Co., Inc. (Member SIPC), Charles Schwab Bank, SSB, Charles Schwab Trust Bank, and Charles Schwab Premier Bank are separate but affiliated companies and subsidiaries of The Charles Schwab Corporation.

Charles Schwab & Co., Inc. does not solicit, offer, endorse, negotiate, or originate any mortgage loan products and is neither a licensed mortgage broker nor a licensed mortgage lender. Home lending is offered and provided by Rocket Mortgage, LLC. Rocket Mortgage LLC., is not affiliated with The Charles Schwab Corporation, Charles Schwab & Co., Inc. or Charles Schwab Bank, SSB. Deposit and other lending products are offered by Charles Schwab Bank, SSB, Member FDIC and Equal Housing Lender.

This material is for institutional investor use only. This presentation is to be used exclusively for the one-on-one meeting between Schwab Advisor Services and your firm. This material may not be forwarded or made available, in whole or in part, to any party that is not an institutional investor.

This presentation is for general educational purposes only. Any examples are intended for illustrative purposes only. This material is not intended to provide specific financial, regulatory, accounting, compliance, or legal advice.

Third-party firms mentioned in this presentation are not affiliated with Charles Schwab.

©2022 Charles Schwab & Co., Inc. All rights reserved. Member [SIPC](#).

(0322-2PCR)