CHARLES SCHWAB & CO., INC.

(SEC. I.D. NO. 8-16514)

Consolidated Statement of Financial Condition (Unaudited)
June 30, 2018

CHARLES SCHWAB & CO., INC.

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
JUNE 30, 2018 (In millions, except share and per share amounts)
(Unaudited)

Assets		
Cash and cash equivalents	$	1,004
Cash and investments segregated and on deposit for regulatory purposes (including resale agreements of $5,391)		10,801
Receivables from brokers, dealers, and clearing organizations		1,016
Receivables from brokerage clients — net		22,417
Securities owned — at fair value		408
Equipment, office facilities, and property — net		937
Goodwill		935
Intangible assets — net		64
Other assets		807
Total assets	$	38,389
Liabilities, Subordinated Borrowings, and Stockholder's Equity		
Payables to brokers, dealers, and clearing organizations	$	1,242
Payables to brokerage clients		30,274
Accrued expenses and other liabilities		1,747
Finance lease obligation		57
Total		33,320
Subordinated borrowings due to The Charles Schwab Corporation		185
Stockholder's equity:		
Preferred stock — 3,000,000 shares authorized; $.10 par value per share; none issued		—
Common stock — 7,000,000 shares authorized; $.10 par value per share; 2,823,000 shares issued and outstanding		—
Additional paid-in capital		2,448
Retained earnings		2,436
Total stockholder's equity		4,884
Total liabilities, subordinated borrowings, and stockholder's equity	$	38,389

See Notes to Consolidated Statement of Financial Condition.

1. Organization and Nature of Business

Charles Schwab & Co., Inc. is a wholly-owned subsidiary of Schwab Holdings, Inc., a wholly-owned subsidiary of The Charles Schwab Corporation (CSC). The accompanying consolidated statement of financial condition includes Charles Schwab & Co., Inc. and its wholly-owned subsidiary (collectively referred to as "CS&Co," "we," "us," "our," or "the Company").

The Company is registered as a broker-dealer with the United States Securities and Exchange Commission (SEC), the fifty states, the District of Columbia and Puerto Rico, and as an investment advisor with the SEC. We are regulated by the Commodities Futures Trading Commission (CFTC) with respect to the commodity futures and trading activities we conduct as an introducing broker. Much of the regulation of broker-dealers has been delegated to self-regulatory organizations. CS&Co is a member of the Financial Industry Regulatory Authority, Inc. (FINRA), the Municipal Securities Rulemaking Board (MSRB), NYSE Arca, and the Chicago Board Options Exchange. Our primary regulators are FINRA, the MSRB for municipal securities, and the National Futures Association for futures and commodities trading activities.

2. Summary of Significant Accounting Policies

Basis of presentation

The accompanying consolidated statement of financial condition has 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 consolidated statement of financial condition. Certain estimates relate to valuation of tax accruals and legal and regulatory reserves. Actual results may differ from those estimates. Intercompany balances and transactions have been eliminated.

Cash and cash equivalents

The Company considers all highly liquid investments that mature in three months or less from the time of acquisition and that are not segregated and on deposit for regulatory purposes to be cash equivalents. Cash and cash equivalents include money market funds and deposits with banks.

Cash and investments segregated and on deposit for regulatory purposes

Cash and investments segregated and on deposit for regulatory purposes include securities purchased under agreements to resell (resale agreements), which are collateralized by U.S. Government and agency securities. Resale agreements are accounted for as collateralized financing transactions that are recorded at their contractual amounts plus accrued interest. The Company obtains control of collateral with a market value equal to or in excess of the principal amount loaned and accrued interest under resale agreements. Collateral is valued daily by the Company, with additional collateral obtained to ensure full collateralization. Cash and investments segregated also include certificates of deposit and U.S. Government securities. Certificates of deposit and U.S. Government securities are recorded at fair value. Pursuant to Rule 15c3-3 under the Securities Exchange Act of 1934 (Customer Protection Rule), cash balances not collateralizing margin positions and not swept to money market funds or bank deposit accounts, are segregated by CS&Co for the exclusive benefit of clients.

Receivables from brokerage clients

Receivables from brokerage clients include margin loans to securities brokerage clients and other trading receivables from clients. Margin loans are collateralized by client securities and are carried at the amount receivable, net of an allowance for doubtful accounts. The Company monitors margin levels and requires clients to deposit additional collateral, or reduce margin positions to meet minimum collateral requirements if the fair value of the collateral changes. Receivables from brokerage clients that remain unsecured or partially secured for more than 30 days are fully reserved for in the allowance for doubtful accounts, except in the case of confirmed fraud, which is reserved immediately. Clients with margin loans have agreed to allow the Company to pledge collateralized securities in accordance with federal regulations. The collateral is not reflected in the statement of financial condition. The allowance for doubtful accounts for brokerage clients and related activity was immaterial for the period presented.

Securities owned

Securities owned are recorded at fair value based on quoted market prices or other observable market data.

Securities borrowed and securities loaned

Securities borrowed require the Company to deliver cash to the lender in exchange for securities and are included in receivables from brokers, dealers, and clearing organizations. For securities loaned, the Company receives collateral in the form of cash in an amount equal to or greater than the market value of securities loaned. Securities loaned are included in payables to brokers, dealers, and clearing organizations. The market value of securities borrowed and loaned are monitored, with additional collateral obtained or refunded to ensure full collateralization.

Equipment, office facilities, and property

Equipment, office facilities, and property are recorded at cost net of accumulated depreciation and amortization, except for land, which is recorded at cost. Equipment, office facilities, and property include certain capitalized costs of acquired or internally developed software. Costs for internally developed software are capitalized when the costs relate to development of approved projects for our internal needs that result in additional functionality. Costs related to preliminary project and post-project activities are expensed as incurred. Equipment, office facilities, and property (other than land) are depreciated on a straight-line basis over their estimated useful lives. Estimated useful lives are as follows:

Equipment and office facilities	5 to 7 years
Buildings	20 to 40 years
Software	3 or 5 years [1]
Leasehold improvements	Lesser of useful life or lease term

[1]Amortized over contractual term if less than three years.

Equipment, office facilities, and property are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable.

Goodwill

Goodwill represents the fair value of acquired businesses in excess of the fair value of the individually identified net assets acquired. Goodwill is not amortized but is tested for impairment annually or whenever indications of impairment exist. Impairment exists when the carrying amount of goodwill exceeds its implied fair value, resulting in an impairment charge for this excess. The Company's annual impairment testing date is April 1st. The Company can elect to qualitatively assess goodwill for impairment if it is more likely than not that the fair value of a reporting unit exceeds its carrying value. A qualitative assessment considers macroeconomic and other industry-specific factors, such as trends in short-term and long-term interest rates and the ability to access capital, and Company specific factors such as market capitalization in excess of net assets, trends in revenue generating activities, and merger or acquisition activity.

If the Company elects to bypass qualitatively assessing goodwill, or it is not more likely than not that the fair value of a reporting unit exceeds its carrying value, management estimates the fair values of each of the Company's reporting units (defined as the Company's businesses for which financial information is available and reviewed regularly by management) and compares it to their carrying values. The estimated fair values of the reporting units are established using an income approach based on a discounted cash flow model that includes significant assumptions about the future operating results and cash flows of each reporting unit, a market approach which compares each reporting unit to comparable companies in their respective industries, as well as a market capitalization analysis.

Intangible assets

Finite-lived intangible assets are amortized over their useful lives in a manner that best reflects their economic benefit. All intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable.

Guarantees and indemnifications

The Company recognizes, at the inception of a guarantee, a liability equal to the estimated fair value of the obligation undertaken in issuing the guarantee. The fair values of obligations relating to guarantees are estimated based on transactions for similar guarantees or expected present value measures.

Income taxes

The Company is included in the consolidated federal income tax return of CSC. The Company provides for income taxes on all transactions that have been recognized in the consolidated statement of financial condition on a pro rata basis with CSC's other subsidiaries in the consolidated income tax return. Accordingly, deferred tax assets are adjusted to reflect the tax rates at which future taxable amounts will likely be settled or realized. The effects of tax rate changes on future deferred tax assets and deferred tax liabilities, as well as other changes in income tax laws, are recorded in earnings in the period during which such changes are enacted. The Company's unrecognized tax benefits, which are included in accrued expenses and other liabilities, represent the difference between positions taken on tax return filings and estimated potential tax settlement outcomes.

Fair values of assets and liabilities

Fair value is defined as the price that would be received to sell an asset or the price paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurement accounting guidance describes the fair value hierarchy for disclosing assets and liabilities measured at fair value based on the inputs used to value them. The fair value hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs are based on market pricing data obtained from sources independent of the Company. A quoted price in an active market provides the most reliable evidence of fair value and is generally used to measure fair value whenever available.

Unobservable inputs reflect management's judgment about the assumptions market participants would use in pricing the asset or liability. Where inputs used to measure fair value of an asset or liability are from different levels of the hierarchy, the asset or liability is categorized based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input requires judgment.

The fair value hierarchy includes three levels based on the objectivity of the inputs as follows:

- Level 1 inputs are quoted prices in active markets as of the measurement date for identical assets or liabilities that the Company has the ability to access.

- Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates, benchmark yields, issuer spreads, new issue data, and collateral performance.

- Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

The Company's policy is to recognize transfers of financial instruments between levels as of the beginning of the reporting period in which a transfer occurs.

Assets and liabilities measured at fair value on a recurring basis

The Company's assets and liabilities measured at fair value on a recurring basis include certain cash equivalents, certain investments segregated and on deposit for regulatory purposes, and securities owned. The Company uses the market approach to determine the fair value of assets and liabilities. When available, the Company uses quoted prices in active markets to measure the fair value of assets and liabilities. When utilizing market data and bid-ask spread, the Company uses the price within the bid-ask spread that best represents fair value. When quoted prices do not exist, the Company uses prices obtained from independent third-party pricing services to measure the fair value of investment assets.

Our primary independent pricing service provides prices based on observable trades and discounted cash flows that incorporate observable information such as yields for similar types of securities (a benchmark interest rate plus observable spreads) and weighted-average maturity for the same or similar "to-be-issued" securities. The Company does not adjust the prices received from independent third-party pricing services unless such prices are inconsistent with the definition of fair value and result in a material difference in the recorded amounts.

(Tabular amounts in millions)

New Accounting Standards

Adoption of New Accounting Standards

Standard	**Description**	**Date of Adoption**	**Effects on the Consolidated Statement of Financial Condition or Other Significant Matters**
Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)" and related ASUs	Clarifies that revenue from contracts with clients should be recognized in a manner that depicts the timing of the related transfer of goods or performance of services at an amount that reflects the expected consideration. Adoption allows either full or modified retrospective transition. Full retrospective transition required a cumulative effect adjustment to retained earnings as of the earliest comparative period presented. Modified retrospective transition required a cumulative effect adjustment to retained earnings as of the beginning of the reporting period in which the entity first applies the new guidance.	January 1, 2018	The guidance does not apply to revenue earned from the Company's loans and securities. Accordingly, net interest revenue was not impacted. The primary impact for the Company was the capitalization on the consolidated statement of financial condition of sales commissions paid to employees for obtaining new contracts with clients. These capitalized costs resulted in an asset of $219 million and a related deferred tax liability of $52 million upon adoption. The asset is being amortized to expense over time as the related revenues are recognized. The Company adopted the revenue recognition guidance using the modified retrospective method for all contracts that were not completed as of January 1, 2018. Further details of the impact of adoption on the consolidated statement of financial condition are included in Note 7.
ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10)" and ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10)"	Requires: (i) equity investments to be measured at fair value, with changes in fair value recognized in net income, unless the equity method is applied or the equity investments do not have readily determinable fair values in which case a practical alternative may be elected; (ii) use of an exit price when measuring the fair value of financial instruments for disclosures; (iii) separate presentation of financial assets and liabilities by measurement category and form of instrument on the balance sheet or in the accompanying notes. Adoption requires a cumulative effect adjustment to the balance sheet as of the beginning of the year of initial application, except for certain changes that require prospective adoption.	January 1, 2018	The adoption of this guidance did not have a material impact on the Company's consolidated statement of financial condition.

(Tabular amounts in millions)

Standard	Description	Date of Adoption	Effects on the Consolidated Statement of Financial Condition or Other Significant Matters
ASU 2016-18, “Statement of Cash Flows (Topic 230) - Restricted Cash a Consensus of the Emerging Issues Task Force”	Requires that the statement of cash flows explain the change during the period in the total cash and cash equivalents, including restricted cash and cash equivalents. Adoption requires retrospective presentation of the statement of cash flows to include restricted cash and cash equivalents in the beginning and ending amounts.	January 1, 2018	The Company adopted this guidance on a retrospective basis. The Company has significant amounts of restricted cash and cash equivalents due to its business as a broker-dealer. The changes did not impact the consolidated statement of financial condition.
ASU 2018-02, “Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income”	Permits reclassification of the impacts on certain tax affected items included in AOCI that were adjusted through income from continuing operations rather than AOCI upon the effective date of the Tax Act. Adoption provides for retrospective adoption to all periods presented and impacted by the Tax Act or as of the beginning of the period of adoption.	January 1, 2018	The Company early adopted this guidance as of the beginning of the year. The adoption of this guidance did not have a material impact on the Company’s consolidated statement of financial condition.

New Accounting Standards Not Yet Adopted

Standard	Description	Required Date of Adoption	Effects on the Consolidated Statement of Financial Condition or Other Significant Matters
ASU 2016-02, “Leases (Topic 842)”	Amends the accounting for leases by lessees and lessors. The primary change from the new guidance is the recognition of right-of-use assets and lease liabilities by lessees for those leases classified as operating leases. Additional changes include accounting for lease origination and executory costs, required lessee reassessments during the lease term due to changes in circumstances, and expanded lease disclosures. Adoption requires modified retrospective transition as of the beginning of the earliest comparative period presented in the financial statements in which the entity first applies the new standard. Certain transition relief is permitted if elected by the entity.	January 1, 2019	The guidance will result in a gross up of the consolidated statement of financial condition due to recognition of right-of-use assets and lease liabilities based on the present value of remaining operating lease payments (see Note 10 for the undiscounted rental commitments for operating leases). The Company is evaluating its adoption method due to a recently proposed ASU that provides an alternative adoption method. The Company is refining its methodology to estimate the right of use assets and lease liabilities and working on system updates to apply the lease accounting changes. The full population of contracts that may be subject to statement of financial condition recognition is still being evaluated, and is nearly complete. The Company has further work to perform related to disclosures.

(Tabular amounts in millions)

Standard	**Description**	**Required Date of Adoption**	**Effects on the Consolidated Statement of Financial Condition or Other Significant Matters**
ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments"	Provides guidance for recognizing impairment of most debt instruments measured at amortized cost, including loans and held to maturity (HTM) debt securities. Requires estimating current expected credit losses (CECL) over the remaining life of an instrument or a portfolio of instruments with similar risk characteristics based on relevant information about past events, current conditions, and reasonable forecasts. The initial estimate of, and the subsequent changes in, CECL will be recognized as credit loss expense through current earnings and will be reflected as an allowance for credit losses offsetting the carrying value of the financial instrument(s) on the balance sheet. Amends the OTTI model for available for sale (AFS) debt securities by requiring the use of an allowance, rather than directly reducing the carrying value of the security, and eliminating consideration of the length of time such security has been in an unrealized loss position as a factor in concluding whether a credit loss exists. Adoption requires a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the entity applies the new guidance except that a prospective transition is required for AFS debt securities for which an OTTI has been recognized prior to the effective date.	January 1, 2020 (early adoption permitted)	The Company is currently evaluating the impact of this guidance on its statement of financial condition. Initial implementation work performed to date has focused on evaluating the Company's impacted assets, including loans and other receivables. The Company has also been evaluating its current data and system capabilities and considering additional data sources and system enhancements. Additional work to be completed includes an in-depth analysis for each impacted asset type, selection of methods, and changes to policies and procedures.
ASU 2017-08, "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities"	Shortens the amortization period for the premium on certain callable debt securities to the earliest call date. The amendments are applicable to any purchased individual debt security with an explicit and noncontingent call feature with a fixed price on a preset date. ASU 2017-08 does not impact the accounting for callable debt securities held at a discount. Adoption requires modified retrospective transition as of the beginning of the period of adoption through a cumulative-effect adjustment to retained earnings.	January 1, 2019 (early adoption permitted)	While still under evaluation, the Company does not expect this guidance will have a material impact on its consolidated statement of financial condition.

(Tabular amounts in millions)

3. Receivables from and Payables to Brokerage Clients

Receivables from and payables to brokerage clients as of June 30, 2018 are as follows:

Receivables		
Margin loans, net of allowance for doubtful accounts	$	20,366
Other brokerage receivables		2,051
Receivables from brokerage clients — net	$	22,417

Payables		
Interest-bearing payables	$	21,592
Non-interest-bearing payables		8,682
Payables to brokerage clients	$	30,274

4. Securities Owned

A summary of securities owned at June 30, 2018 is as follows:

Equity and bond mutual funds	$	282
State and municipal debt obligations		42
Schwab Funds® money market funds		42
Equity, U.S. Government and corporate debt, and other securities		42
Total securities owned	$	408

Equity and bond mutual funds include inventory maintained to facilitate certain Schwab Funds and third-party mutual fund clients' transactions. The positions in Schwab Funds® money market funds arise from certain overnight funding of clients' redemption, check-writing, and debit card activities. State and municipal debt obligations, equity, U.S. Government and corporate debt, and other securities include securities held to meet clients' trading activities.

5. Equipment, Office Facilities, and Property

Equipment, office facilities, and property at June 30, 2018 are as follows:

Software	$	1,588
Buildings		380
Leasehold improvements		352
Furniture and equipment		193
Information technology equipment		189
Telecommunications equipment		60
Land		50
Construction in progress		22
Total equipment, office facilities, and property		2,834
Accumulated depreciation and amortization		(1,897)
Total equipment, office facilities, and property — net	$	937

(Tabular amounts in millions)

6. Intangible Assets

Intangible assets at June 30, 2018 are as follows:

	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Client relationships	$ 196	$ (149)	$ 47
Technology	70	(53)	17
Total intangible assets	$ 266	$ (202)	$ 64

7. Other Assets

The components of other assets at June 30, 2018 are as follows:

Accounts receivable [1]	$ 293
Capitalized contract costs [2]	239
Prepaid expenses	113
Receivables from affiliates	92
Interest and dividends receivable	19
Income tax receivable	17
Other	34
Total other assets	$ 807

[1] Receivables from contracts with customers within the scope of ASC 606 were $265 million at June 30, 2018. CS&Co does not have any other significant contract assets or contract liability balances as of June 30, 2018.

[2] Deferred contract costs relate to sales commissions paid to employees for obtaining contracts with clients. These costs are amortized to expense on a straight-line basis over a period that is consistent with how the related revenue is recognized.

8. Payables to Brokers, Dealers, and Clearing Organizations

Payables to brokers, dealers, and clearing organizations at June 30, 2018 are as follows:

Deposits for securities loaned	$ 946
Payables to broker-dealers	125
Payables to clearing organizations	124
Payables for securities failed to receive	47
Total payables to brokers, dealers, and clearing organizations	$ 1,242

9. Borrowings

CS&Co maintains a $6.0 billion credit facility with CSC which is scheduled to expire in December 2020. Borrowings under this facility do not qualify as regulatory capital for us. There was no amount drawn under this facility at June 30, 2018. When drawn, the amount is included in accrued expenses and other liabilities on the consolidated statement of financial condition (see Note 15).

To manage our regulatory capital requirement, we maintain a $1.5 billion subordinated revolving credit facility with CSC. The facility is available for general corporate purposes and is scheduled to expire in March 2020. There was $185 million drawn under this facility at June 30, 2018 (see Note 15).

(Tabular amounts in millions)

Subordinated borrowings are included in our net capital pursuant to Rule 15c3-1 under the Securities Exchange Act of 1934. Such borrowings are subordinated to the claims of general creditors and to the extent that these borrowings are required for our continued compliance with minimum net capital requirements, they may not be repaid (see Note 15).

A CS&Co subsidiary has a finance lease obligation related to an office building and land under a 20-year lease. At June 30, 2018, the carrying value of the office building and land was $63 million. The remaining finance lease obligation of $57 million is being reduced by a portion of the lease payments over the remaining lease term through June 30, 2024. CS&Co has not directly or indirectly guaranteed, endorsed or assumed the obligations or liabilities of the above mentioned subsidiary. Accordingly, we do not consolidate the assets and liabilities of the subsidiary for purposes of our net capital computation.

To manage short-term liquidity, we maintain uncommitted, unsecured bank credit lines with several banks. CSC has direct access to certain of these credit lines, which if borrowed, would reduce the amount available to us. There were no borrowings outstanding under these lines at June 30, 2018.

10. Commitments and Contingencies

Operating leases: CS&Co has non-cancelable operating leases for office space and equipment. Future annual minimum rental commitments under these operating leases, net of contractual operating subleases, at June 30, 2018 are as follows:

	Operating Leases	Subleases	Net
2018	$ 62	$ 2	$ 60
2019	122	2	120
2020	112	2	110
2021	90	2	88
2022	74	1	73
Thereafter	334	—	334
Total	$ 794	$ 9	$ 785

Certain leases contain provisions for renewal options, purchase options, and rent escalations based on increases in certain costs incurred by the lessor.

Purchase obligations: The Company has purchase obligations for services such as advertising and marketing, telecommunications, professional services, and hardware- and software-related agreements. The Company has purchase obligations at June 30, 2018 as follows:

2018	$ 135
2019	143
2020	68
2021	25
2022	22
Thereafter	181
Total	$ 574

Guarantees and indemnifications: CS&Co has clients that sell (i.e., write) listed option contracts that are cleared by the Options Clearing Corporation (OCC) – a clearing house that establishes margin requirements on these transactions. CS&Co partially satisfies the margin requirements by arranging unsecured standby letter of credit agreements (LOCs), in favor of the OCC, which are issued by several banks. At June 30, 2018, the aggregate face amount of these LOCs totaled $225 million. There were no funds drawn under any of these LOCs at June 30, 2018. In connection with its securities lending activities, CS&Co is required to provide collateral to certain brokerage clients. We satisfy the collateral requirements by providing cash as collateral.

CS&Co also provides guarantees to securities clearing houses and exchanges under standard membership agreements, which require members to guarantee the performance of other members. Under the agreements, if another member becomes unable to satisfy its obligations to the clearing houses and exchanges, other members would be required to meet shortfalls. CS&Co's liability under these arrangements is not quantifiable and may exceed the cash and securities it has posted as collateral. The potential requirement for CS&Co to make payments under these arrangements is remote. Accordingly, no liability has been recognized for these guarantees.

Legal contingencies: The Company is subject to claims and lawsuits in the ordinary course of business, including arbitrations, class actions and other litigation, some of which include claims for substantial or unspecified damages. The Company is also the subject of inquiries, investigations, and proceedings by regulatory and other governmental agencies.

Predicting the outcome of a litigation or regulatory matter is inherently difficult, requiring significant judgment and evaluation of various factors, including the procedural status of the matter and any recent developments; prior experience and the experience of others in similar cases; available defenses, including potential opportunities to dispose of a case on the merits or procedural grounds before trial (e.g., motions to dismiss or for summary judgment); the progress of fact discovery; the opinions of counsel and experts regarding potential damages; potential opportunities for settlement and the status of any settlement discussions; and potential insurance coverage and indemnification. It may not be reasonably possible to estimate a range of potential liability until the matter is closer to resolution – pending, for example, further proceedings, the outcome of key motions or appeals, or discussions among the parties. Numerous issues may have to be developed, such as discovery of important factual matters and determination of threshold legal issues, which may include novel or unsettled questions of law. Reserves are established or adjusted or further disclosure and estimates of potential loss are provided as the matter progresses and more information becomes available.

The Company believes it has strong defenses in all significant matters currently pending and is contesting liability and any damages claimed. Nevertheless, some of these matters may result in adverse judgments or awards, including penalties, injunctions or other relief, and the Company may also determine to settle a matter because of the uncertainty and risks of litigation. The Company has provided a description below of one matter in which a material loss is reasonably possible or that may otherwise be of significant interest. The Company is unable to provide a reasonable estimate of any potential liability given the stage of proceedings in the matter. With respect to all other pending matters, based on current information and consultation with counsel, it does not appear reasonably possible that the outcome of any such matter would be material to the financial condition, operating results, or cash flows of the Company.

Crago Order Routing Litigation: On July 13, 2016, a securities class action lawsuit was filed in the U.S. District Court for the Northern District of California on behalf of a putative class of customers executing equity orders through CS&Co. The lawsuit names CS&Co and CSC as defendants and alleges that an agreement under which CS&Co routed orders to UBS Securities LLC between July 13, 2011 and December 31, 2014 violated CS&Co's duty to seek best execution. Plaintiffs seek unspecified damages, interest, injunctive and equitable relief, and attorneys' fees and costs. After a first amended complaint was dismissed with leave to amend, plaintiffs filed a second amended complaint on August 14, 2017. Defendants again moved to dismiss, and in a decision issued December 5, 2017, the court denied the motion. Defendants have answered the complaint to deny all allegations, and intend to vigorously contest the lawsuit.

11. Financial Instruments Subject to Off-Balance Sheet Credit Risk

Off-Balance Sheet Credit Risk

Resale agreements: CS&Co enters into collateralized resale agreements principally with other broker-dealers, which could result in losses in the event the counterparty fails to purchase the securities held as collateral for the cash advanced and the fair value of the securities declines. To mitigate this risk, CS&Co requires that the counterparty deliver securities to a custodian, to be held as collateral, with a fair value at or in excess of the resale price. We also set standards for the credit quality of the counterparty, monitor the fair value of the underlying securities as compared to the related receivable, including accrued interest, and require additional collateral where deemed appropriate. The collateral provided under these resale agreements is utilized to meet obligations under broker-dealer client protection rules, which place limitations on our ability to access such segregated securities. For CS&Co to repledge or sell this collateral, it would be required to deposit cash and/or securities of an equal amount into its segregated reserve bank accounts in order to meet its segregated cash and investment requirement. CS&Co's resale agreements are not subject to master netting arrangements.

(Tabular amounts in millions)

Securities lending: CS&Co loans brokerage client securities temporarily to other brokers and clearing houses in connection with its securities lending activities and receives cash as collateral for the securities loaned. Increases in security prices may cause the fair value of the securities loaned to exceed the amount of cash received as collateral. In the event the counterparty to these transactions does not return the loaned securities or provide additional cash collateral, we may be exposed to the risk of acquiring the securities at prevailing market prices in order to satisfy our client obligations. CS&Co mitigates this risk by requiring credit approvals for counterparties, monitoring the fair value of securities loaned, and requiring additional cash as collateral when necessary. We also borrow securities from other broker-dealers to fulfill short sales by brokerage clients and deliver cash to the lender in exchange for the securities. The fair value of these borrowed securities was $472 million at June 30, 2018. All of our securities lending transactions are through a program with a clearing organization, which guarantees the return of cash to us and is subject to enforceable master netting arrangements with other broker-dealers; however, we do not net securities lending transactions. Therefore, the securities loaned and securities borrowed are presented gross in the consolidated statement of financial condition.

The following table presents information about our resale agreements and securities lending activity depicting the potential effect of rights of setoff between these recognized assets and recognized liabilities at June 30, 2018.

				Gross Amounts Not Offset in the Consolidated Statement of Financial Condition		
	Gross Assets/ Liabilities	Gross Amounts Offset in the Consolidated Statement of Financial Condition	Net Amounts Presented in the Consolidated Statement of Financial Condition	Counterparty Offsetting	Collateral	Net Amount
Assets:						
Resale agreements [1]	$ 5,391	$ —	$ 5,391	$ —	$ (5,391) [2]	$ —
Securities borrowed [3]	484	—	484	(362)	(119)	3
Total	$ 5,875	$ —	$ 5,875	$ (362)	$ (5,510)	$ 3
Liabilities:						
Securities loaned [4,5]	$ 946	$ —	$ 946	$ (362)	$ (492)	$ 92
Total	$ 946	$ —	$ 946	$ (362)	$ (492)	$ 92

(1) Included in cash and investments segregated and on deposit for regulatory purposes in the consolidated statement of financial condition.

(2) Actual collateral was greater than or equal to 102% of the related assets. At June 30, 2018, the fair value of collateral received in connection with resale agreements that are available to be repledged or sold was $5.5 billion.

(3) Included in receivables from brokers, dealers, and clearing organizations in the consolidated statement of financial condition.

(4) Included in payables to brokers, dealers, and clearing organizations in the consolidated statement of financial condition. The cash collateral received from counterparties under securities lending transactions was equal to or greater than the market value of the securities loaned at June 30, 2018.

(5) Securities loaned are predominantly comprised of equity securities held in client brokerage accounts with overnight and continuous remaining contractual maturities.

(Tabular amounts in millions)

Margin lending: Clients with margin loans have agreed to allow CS&Co to pledge collateralized securities in their brokerage accounts in accordance with federal regulations. The following table summarizes the fair value of client securities that were available, under such regulations, that could have been used as collateral, and the amounts pledged by the Company, as of June 30, 2018.

Fair value of client securities available to be pledged	$ 28,511
Fair value of client securities pledged for:	
Fulfillment of requirements with the Options Clearing Corporation [1]	2,921
Fulfillment of client short sales	1,831
Securities lending to other broker-dealers	741
Total collateral pledged	$ 5,493

Note: Excludes amounts available and pledged for securities lending from fully-paid client securities. The fair value of fully-paid client securities available and pledged was $104 million as of June 30, 2018.

[1] Client securities pledged to fulfill client margin requirements for open option contracts established with the Options Clearing Corporation.

12. Fair Values of Assets and Liabilities

For a description of the fair value hierarchy and the Company's fair value methodologies, including the use of independent third-party pricing services, see Note 2. The Company did not transfer any assets or liabilities between Level 1, Level 2, or Level 3 during the first six months of 2018. In addition, the Company did not adjust prices received from the primary independent third-party pricing service at June 30, 2018.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2018. Liabilities recorded at fair value were not material, and therefore are not included in the following table:

	Level 1	Level 2	Level 3	Balance at Fair Value
Assets				
Cash equivalents:				
Money market funds	$ 298	$ —	$ —	$ 298
Investments segregated and on deposit for regulatory purposes:				
Certificates of deposit	—	1,999	—	1,999
U.S. Government securities	—	1,532	—	1,532
Total investments segregated and on deposit for regulatory purposes	—	3,531	—	3,531
Securities owned:				
Equity and bond mutual funds	282	—	—	282
Schwab Funds® money market funds	42	—	—	42
State and municipal debt obligations	—	42	—	42
Equity, U.S. Government and corporate debt, and other securities	3	39	—	42
Total securities owned	327	81	—	408
Total	$ 625	$ 3,612	$ —	$ 4,237

(Tabular amounts in millions)

Fair Value of Other Financial Instruments

The following table presents the fair value hierarchy for other financial instruments at June 30, 2018:

	Carrying Amount	Level 1	Level 2	Level 3	Balance at Fair Value
Assets:					
Cash and cash equivalents	$ 706	$ —	$ 706	$ —	$ 706
Cash and investments segregated and on deposit for regulatory purposes	7,257	—	7,257	—	7,257
Receivables from brokers, dealers, and clearing organizations	1,016	—	1,016	—	1,016
Receivables from brokerage clients — net	22,410	—	22,410	—	22,410
Other assets	10	—	10	—	10
Total	$ 31,399	$ —	$ 31,399	$ —	$ 31,399
Liabilities:					
Payables to brokers, dealers, and clearing organizations	$ 1,242	$ —	$ 1,242	$ —	$ 1,242
Payables to brokerage clients	30,274	—	30,274	—	30,274
Accrued expenses and other liabilities	888	—	888	—	888
Subordinated borrowings due to The Charles Schwab Corporation	185	—	185	—	185
Finance lease obligation	57	—	57	—	57
Total	$ 32,646	$ —	$ 32,646	$ —	$ 32,646

13. Related-Party Transactions

The Company provides administrative, technology, and other support services to CSC and other affiliates under common control. The Company collects fees from clients for services performed by affiliates and makes payments to affiliates for those services. The accompanying consolidated statement of financial condition is not necessarily indicative of the conditions that would exist or the results of operations that would prevail if the Company were operated as an unaffiliated entity. Receivables from affiliates were $92 million at June 30, 2018 and are included in other assets. Payables to affiliates were $77 million at June 30, 2018 and are included in accrued expenses and other liabilities.

CS&Co offers a cash feature for certain client brokerage accounts that automatically sweeps uninvested cash balances in the brokerage accounts to deposit accounts at Charles Schwab Bank (CSB) and Charles Schwab Signature Bank (CSSB), bank subsidiaries of CSC. CSB and CSSB pay interest on these deposit accounts, and the accounts are FDIC-insured up to $250,000 per depositor per bank. CSB and CSSB pay CS&Co an annual per account flat fee for administrative services in support of the operation of the bank sweep program.

CSC provides us with a $6.0 billion credit facility, which is scheduled to expire in December 2020. There was no amount drawn under this facility at June 30, 2018. When drawn, the amount is included in accrued expenses and other liabilities on the consolidated statement of financial condition.

To manage our regulatory capital requirement, we maintain a $1.5 billion subordinated revolving credit facility with CSC. The facility is available for general corporate purposes and is scheduled to expire in March 2020. There was $185 million drawn under this facility at June 30, 2018.

(Tabular amounts in millions)

14. Taxes

The temporary differences that created deferred tax assets and liabilities as of June 30, 2018 are detailed below:

Deferred tax assets:		
Employee compensation, severance, and benefits	$	91
Facilities lease commitments		14
Reserves and allowances		8
Deferred rent		8
State and local taxes		1
Other		3
Total deferred tax assets		125
Deferred tax liabilities:		
Capitalized internal-use software development costs		(89)
Capitalized contract costs		(52)
Depreciation and amortization		(43)
Prepaid maintenance		(6)
Total deferred tax liabilities		(190)
Deferred tax liability — net	$	(65)

The Company's unrecognized tax benefits totaled $111 million as of June 30, 2018, $106 million of which if recognized, would affect the annual effective tax rate.

CS&Co had approximately $6 million for the payment of interest and penalties accrued at June 30, 2018.

CSC's consolidated federal income tax returns for 2011 through 2017 remain subject to examination. The years open to examination by state and local governments vary by jurisdiction.

15. Regulatory Requirements

The Company is subject to Rule 15c3-1 under the Securities Exchange Act of 1934 (the Uniform Net Capital Rule). We compute net capital under the alternative method permitted by the Uniform Net Capital Rule. This method requires the maintenance of minimum net capital, as defined, of the greater of 2% of aggregate debit balances arising from client transactions or a minimum dollar requirement, which is based on the type of business conducted by CS&Co. At June 30, 2018, 2% of aggregate debit balances was $475 million, which exceeded the minimum dollar requirement of $250,000. Under the alternative method, we may not repay subordinated borrowings, pay cash dividends, or make any unsecured advances or loans if such payment would result in a net capital amount of less than 5% of aggregate debit balances or less than 120% of its minimum dollar requirement. At June 30, 2018, CS&Co's net capital was $2.3 billion (10% of aggregate debit balances), which was $1.8 billion in excess of its minimum required net capital and $1.1 billion in excess of 5% of aggregate debit balances.

The Company is also subject to the Customer Protection Rule and other applicable regulations, which requires us to maintain cash or qualified securities in a segregated reserve account for the exclusive benefit of clients. The Customer Protection Rule requires broker-dealers to segregate client fully paid securities and cash balances not collateralizing margin positions and not swept to money market funds or bank deposit accounts. Amounts included in cash and investments segregated and on deposit for regulatory purposes represent actual balances on deposit, whereas cash and investments required to be segregated and on deposit for regulatory purposes at June 30, 2018 totaled $11.9 billion of which $20 million was for Proprietary Accounts of Broker-Dealers (PAB). We compute a separate reserve requirement for PAB and segregate cash to meet this requirement. On July 3, 2018, the Company deposited a net amount of $1.5 billion of cash into its segregated reserve accounts.

16. Subsequent Events

The Company has evaluated the impact of events that have occurred subsequent to June 30, 2018, through the date the consolidated statement of financial condition was issued. Based on this evaluation, other than as recorded or disclosed within the consolidated statement of financial condition and related notes, the Company has determined none of these events were required to be recognized or disclosed.

****

FOR MORE INFORMATION

The annual report as of December 31, 2017, prepared pursuant to Rule 17a-5 under the Securities Exchange Act of 1934, has been filed with the Securities and Exchange Commission, and is available for examination and copying at our headquarters: 211 Main Street, San Francisco, California 94105.

The Charles Schwab Corporation

For more information about the ultimate parent company of Charles Schwab & Co., Inc., write to The Charles Schwab Corporation, Investor Relations, 211 Main Street, San Francisco, California 94105; call 1-415-667-7000; email investor.relations@schwab.com; or visit our website at www.aboutschwab.com.

(0818-8MUR) REG10118-67 (08/18)