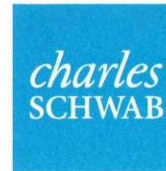


CORPORATION

211 Main Street
San Francisco, CA 94105

January 22, 2019

Via Electronic Delivery

Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

Office of the Comptroller of the Currency
400 7th E Street, SW, Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies (Docket Number R-1627 and RIN 7100-AF20)

Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements
FRB Docket No. R-1628; RIN 7100-AF21
OCC Docket ID OCC-2018—0037; RIN 1557-AE56
FDIC RIN 3064-AE96

Ladies and Gentlemen:

The Charles Schwab Corporation ("Schwab")[1] appreciates the opportunity to provide comments on the notice of proposed rulemaking, Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies, issued by the Board of Governors of the

---

[1] The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with more than 350 offices and 11.5 million active brokerage accounts, 1.6 million corporate retirement plan participants, 1.3 million banking accounts, and $3.43 trillion in client assets as of November 30, 2018. Through its operating subsidiaries, Schwab engages in wealth management, securities brokerage, banking, asset management, custody and financial advisory services. Schwab provides financial services to individuals and institutional clients through two segments, Investor Services and Advisor Services. The Investor Services segment provides retail brokerage and banking services, retirement plan services and corporate brokerage services to individuals and businesses. The Advisor Services segment provides custodial, trading, and support services to registered investment advisors, as well as retirement business services to independent retirement advisors and record-keepers. Schwab's services in respect of securities activities are primarily securities brokerage and investment advisory services. Substantially all of Schwab's securities brokerage activities are conducted as agent or riskless principal for its clients. Similarly, most of Schwab's asset management and administration revenues are generated through advising registered investment companies and exchange traded funds and its fee-based advisory solutions. As explained below, the relative simplicity and low-risk nature of Schwab's business are reflected in its asset composition, capital ratios, sources of net revenues and other metrics.

Federal Reserve System ("Board") and published in the Federal Register on November 29, 2018 (the "Proposal").[2] To the extent that Schwab's comment letter also addresses the proposed regulatory capital and liquidity provisions of the proposed rulemaking by the Board, Comptroller of the Currency ("OCC"), and Federal Deposit Insurance Corporation ("FDIC" and collectively, the "Agencies"), Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, published in the Federal Register on December 21, 2018,[3] this letter is also addressed to the OCC and FDIC.

Schwab supports the Board's efforts to implement section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA")[4] and to better align, or "tailor," the Board's prudential standards for large U.S. banking organizations relative to the risk profiles of these firms. There are a number of areas in which the Proposal adeptly embraces the notion of targeted regulatory tailoring on a broader scale. In particular, we commend the Agencies for proposing not to apply (i) the advanced approaches risk-weighted assets ("RWAs") calculation requirements or (ii) the requirement to recognize most elements of accumulated other comprehensive income in regulatory capital, to banking organizations identified as within "Category III" or "Category IV" of the Proposal. These proposed revisions to the Agencies' regulatory capital rules would relieve significant regulatory burdens for a number of institutions, including Schwab, without incurring any additional risk to the organizations or their customers.

Schwab also welcomes the efforts of the Agencies' staffs to address the complex, wide-ranging, and important issues covered by the Proposal (and the related interagency proposal) and to do so quickly after passage of the EGRRCPA. It is clear that, as Vice Chairman Randal K. Quarles noted, "a formidable effort of the [Agencies'] staffs stands behind the proposals."[5]

While Schwab appreciates the earnest efforts and hard work of the Agencies and their staffs to develop and propose various regulatory tailoring initiatives, we respectfully submit that more can be done to advance effective regulatory tailoring. Schwab is particularly concerned that the asset and other proposed risk-based indicators do not appropriately reflect risk to banking organizations, and that the proposed categorization framework will place firms with dramatically different risk profiles in the same category. Similarly, the Proposal does not achieve its goal of parity between bank holding companies ("BHCs") and savings and loan holding companies ("SLHCs"), as is evident when the activities and risks of Schwab—the only SLHC other than Synchrony Financial Corporation generally impacted by the Proposal—are compared to the BHCs in Categories III and IV of the Proposal. In this regard, Schwab respectfully requests that provisions of the Proposal be revised and calibrated to reflect relevant

---

[2] 83 *Fed. Reg.* 61408 (Nov. 29, 2018).

[3] 83 Fed. Reg. 66024 (Dec. 21, 2018).

[4] Pub. L. No. 115-174, 132 Stat. 1296 (2018).

[5] FRB Vice Chairman, Randal K. Quarles, Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations (Oct. 31, 2018).

risks among institutions within and across the designated categories referenced in the Proposal, as more fully described below.

Although not within the scope of this comment letter, we also have significant concerns regarding the application of, and the legal authority for, applying enhanced prudential standards[6] on safety and soundness grounds to SLHCs that have not been designated by the Financial Stability Oversight Council as systemically important.[7] SLHCs that predominately engage in insurance activities, and related trade organizations, have also raised this concern to the Board in the past.[8] The Proposal would not apply enhanced prudential standards to SLHCs that predominately engage in insurance and commercial activities but would otherwise apply the requirements to SLHCs. Schwab respectfully requests that the Board take into account the important differences between BHCs and SLHCs, including differences in business operations and risk, as well as the applicable legal frameworks and authorities for each.

The following discussion is divided into eight sections. Section 1 shows, through a number of metrics, that Schwab presents much less risk than all other organizations in Category III and less risk than most organizations in Category IV of the Proposal. Section 2 explains that the risk-based indicators for asset size, weighted short-term wholesale funding, and nonbanking assets, as currently proposed, do not adequately reflect risk, and that the Proposal's justifications for those indicators are primarily based on concerns that are inapplicable to SLHCs. Section 3 demonstrates that the proposed framework for categorizing banking organizations—using the proposed indicators as a "one-way ratchet"—places organizations of drastically different types, degrees and overall amounts of risk into the same category and places organizations with similar risk in different categories. Sections 4 and 5 explain that the methodology for calculating the GSIB surcharge, as well as the single counterparty credit limit requirement, respectively, are inappropriate for SLHCs. Sections 6 through 8 suggest important improvements to the proposed liquidity coverage ratio ("LCR") amendments, the conformance period for SLHCs, and regulatory reporting related to the Proposal, respectively.

---

6 The standards applied to covered SLHCs would be substantively identical to those of covered BHCs under the Proposal, with only minor modifications to the SLHC requirements to delete overt references in the proposed requirements to resolution planning or other considerations related exclusively to financial stability. Accordingly, this comment letter refers to the proposed standards for covered SLHCs as enhanced prudential standards.

7 Schwab agrees with the analysis of the U.S. Chamber of Commerce regarding the absence of legal authority to impose enhanced prudential standards on SLHCs that have not been designated by the Financial Stability Oversight Council as systemically important. Letter from Tod Quaadman, U.S. Chamber of Commerce, to Ann E. Misback, Secretary, Board, *et al.* (Jan. 22, 2019).

8 *See, e.g.*, Letter from Brandon Becker, EVP & Chief Legal Officer, TIAA CREF, to Jennifer J. Johnson, Secretary, Board (Apr. 30, 2012); Letter from Julie A. Splezlo, Senior Vice President, American Council of Life Insurers, to the Honorable Ben S. Bernanke, Board (Apr. 25, 2012).

1. <u>Schwab poses significantly less risk than the other organizations in Category III.</u>

We believe that further regulatory tailoring is particularly appropriate for Schwab because its business operations are low-risk and do not exhibit the level of complexity evident in the balance sheets of similarly sized and most smaller banking organizations covered by the Proposal. This is reflected in a number of metrics in addition to those identified in the Proposal. For example, Schwab's lower risk profile and relative simplicity is evident in Schwab's significantly lower RWAs relative to the other firms proposed to be in Category III. More than half of Schwab's total assets subject to risk-weighting fall within the 0 and 20 percent standardized risk-weighting categories.[9] As a result, as shown below, Schwab's RWA density (i.e., its RWAs-to-total assets) is less than 40 percent of that of the other proposed Category III firms.

Holding Company	Ttl. Consol. Assets ($B)[10]	Standardized RWAs ($B)[11]	Stnd. RWAs / TCA Ratio
U.S. Bancorp	464.6	377.7	81.2%
PNC Financial Services Group	380.3	318.9	83.9%
Capital One Financial	362.9	288.7	79.6%
Charles Schwab Corporation	272.1	86.8	31.9%

Schwab's standardized RWAs are also lower than all but two of the firms that the Proposal would place in Category IV (including Synchrony Financial) and are less than 70 percent of the average RWA amounts for such firms. Schwab's RWA density is also less than 40 percent of that of all other Category IV firms. As of September 30, 2018, Schwab's off-balance sheet exposures were less than 10 percent of off-balance sheet exposures of all other Category III firms and less than all but one of the Category IV firms' off-balance sheet exposure amounts.[12]

---

9 A significant amount of Schwab's liabilities are affiliate sweep deposits, which are a highly-stable source of funding. *See also infra* section 2.b (discussing Schwab's funding). Allocating these highly-stable liabilities to Schwab's low-risk assets similarly evidences the low-risk profile of Schwab relative to other Category III firms.

10 As calculated based on the standardized approaches and as reported by each holding company in Schedule HC of its Form FR Y-9C filed for the quarter ended September 30, 2018.

11 Schedule HC-R of Form FR Y-9C (quarter ended Sept. 30, 2018).

12 Schedule A of Form FR Y-15 (quarter ended Sept. 30, 2018) and Schedule HC of Form FR Y-9C (quarter ended Sept. 30, 2018).

Schwab also has significantly higher risk-based capital ratios relative to its proposed Category III peers,[13] as highlighted below.

Holding Company[14]	CET 1 capital ratio	Tier 1 capital ratio	Total RBC ratio
U.S. Bancorp	9.03%	10.62%	12.58%
PNC Financial Services Group	9.4%	10.5%	12.7%
Capital One Financial	11.2%	12.8%	15.2%
Charles Schwab Corporation	19.6%	22.8%	22.9%

Schwab's lower risk profile and lower complexity is also evident in the uncomplicated nature of its activities, the composition of its balance sheet, and its straightforward corporate structure. This is most apparent in Schwab's three main sources of net revenue. The largest component of Schwab's net revenue is net interest income, a majority of which it generates by sweeping client cash balances from its broker-dealer to deposit accounts at its two subsidiary federal savings banks, Charles Schwab Bank and Charles Schwab Premier Bank, where low-risk U.S. government, agency, and mortgage-backed securities comprise 76.8 percent and 84.5 percent of their investments, respectively. Funds not invested in low-risk securities are either invested in other securities that are not complex, as evidenced by the fact that Schwab had no level 3 assets as of September 30, 2018, or are used to fund loans that are highly collateralized by either client securities (as in the case of margin loans and pledged asset lines ("PALs")) or real estate (as in the case of mortgages and HELOCs).[15] The fairly narrow scope of Schwab's investing and lending activity contributes to a lower level of complexity and lower risk profile in comparison to the other Category III firms, and most Category IV firms.

Fees from asset management and administration and investment advisory services are the second largest component of Schwab's revenues. These businesses are also low risk because they do not utilize Schwab's balance sheet to any significant degree, and the fees generated are a stable source of income based primarily on the value of client assets or funds' net asset value. There is no principal risk to Schwab if these values decline. Schwab only engages in limited fund seeding (i.e., making principal investments in funds) as an activity that is mostly ancillary to its business of advising registered investment companies and unit investment trusts.

---

[13] Comparison based on standardized approach.

[14] Each of the common equity tier 1 capital ratio, the tier 1 capital ratio and the total risk-based capital ratio for each holding company are as calculated under the standardized approaches and as reported by each holding company in Schedule HC-R of its Form FR Y-9C for the quarter ended September 30, 2018.

[15] Schwab's first mortgage and HELOC loans are of a very low-risk nature. As of September 30, 2018, the average loan-to-value (LTV) ratio and FICO score for Schwab's first mortgage portfolio were 57 percent and 772, respectively, and the average combined LTV ratio and FICO score for Schwab's HELOC portfolio were 58 percent and 769.

Schwab's trading activities are largely limited to acting on behalf of its customers, and Schwab's trading revenues, which are its third largest source of revenues, consist almost entirely of commissions and markups on client-driven securities transactions. Schwab's securities brokerage business utilizes Schwab's balance sheet only to a very limited extent. Schwab also engages in a small amount of fixed-income securities market-making and fixed-income securities, equity securities, and certificate of deposit distribution activities. Less than one percent of its total assets are represented by trading assets, and those consist of US government, state and government agency obligations. Over 90 percent of its debt securities held to maturity or held for sale that, in each case, have a readily determinable fair value, carry a zero or 20 percent risk weight. The bulk of Schwab's securities brokerage activities are conducted for its customers as agent or riskless principal.

Schwab's relatively low level of complexity and low risk profile are also reflected in the composition of its total consolidated assets. As noted above, as of September 30, 2018, approximately 72 percent (or $195.8 billion)[16] of Schwab's total consolidated assets consisted of investment securities, over three-quarters of which were U.S. Treasury securities, U.S. agency securities or mortgage-backed securities. An additional 14 percent (or $39.0 billion)[17] of Schwab's total consolidated assets were loan and lease financing receivables, 9.7 percent (or $26.2 billion) were cash and balances due from depository institutions, and 1.6 percent (or $4.4 billion) were securities purchased under agreements to resell. The substantial majority of these assets are risk-weighted between zero and 20 percent under the standardized approach.

Schwab is exposed to a low level of counterparty credit risk with respect to these assets, which explains why its RWAs, amounting to $86.8 billion as of September 30, 2018, represented only 31.9 percent of its total consolidated assets. The vast majority (95.5 percent) of Schwab's investment securities are risk-weighted at either zero percent or 20 percent. Apart from its low-risk investment portfolio noted above, Schwab faces credit exposures from its receivables from brokerage clients and bank loans. Receivables from brokerage clients consist primarily of fully collateralized margin loans. Bank loans consist almost entirely of first-lien mortgages, HELOCs and fully collateralized PALs. A large portion of these exposures are secured by collateral meeting the definition of "financial collateral" in Section 217.2 of Regulation Q, and thus the actual exposure amounts for these brokerage client receivables and bank loans ($11.9 billion) represented a relatively small percentage of Schwab's RWAs: 13.7 percent as of September 30, 2018.

In addition, Schwab's strategy is much more focused on the individual investor than any of the other Category III or Category IV firms under the Proposal. Schwab's strategic goals are based on putting clients' perspectives, needs, and desires at the forefront in order to deliver a better investing experience for individual investors and the people and institutions who serve

---

16 Schedule HC of Form FR Y-9C (quarter ended Sept. 30, 2018).

17 FR Y-9C (quarter ended Sept. 30, 2018).

them. Without the more complex and institutional-types of products and services provided by the other Category III and many of the Category IV firms, Schwab is able to operate with less than one-half[18] of the subsidiaries of any other Category III firm and less than approximately one-quarter to slightly over one-third of the employees of the other Category III firms.[19]

2. Many of the proposed risk-based indicators do not adequately measure and reflect safety and soundness risks and therefore should not be applied as proposed.

Under the Proposal, a measure of average total consolidated assets or any of the four $75 billion thresholds for other "risk-based indicators" ("indicators") (specifically, average cross-jurisdictional activity, average nonbank assets, average weighted short-term wholesale funding, and average off-balance sheet exposures) is sufficient either to impose additional requirements on a covered SLHC or to curtail a SLHC's eligibility for reduced regulatory burdens of a lower category. However, none of the total consolidated assets, nonbank assets, and short-term wholesale funding indicators currently proposed adequately measure risk relevant to SLHCs and, thus, should not be used to impose additional requirements on SLHCs.

a. Asset size is a poor measure of risk and therefore should not be the predominant factor in determining an SLHC's category.

Under the Proposal, asset size alone may determine whether a SLHC is in Category II, III or IV. The primacy of asset size, however, does not achieve the purposes of EGRRCPA or otherwise appropriately tailor requirements to the risks posed by a firm. In this regard, the Proposal segments based on size more than it tailors based on risk. The Proposal is inconsistent with Congressional intent because section 401 of EGRRCPA does not contemplate asset size alone triggering enhanced prudential standards on BHCs below $250 billion. Rather, section 401 requires the Board to assess asset size along with a host of other factors, including "riskiness" and "complexity," in determining whether additional requirements are appropriate for such BHCs.

---

[18] According to the data available on the National Information Center (NIC) website, Schwab has 44 unique subsidiaries listed, whereas PNC Financial has 920 unique subsidiaries, Capital One has 319 unique subsidiaries, and US Bancorp has 90 unique subsidiaries. Schwab also has less subsidiaries that all but two of the Category IV firms. Specifically, BB&T has 1,043 unique subsidiaries, Fifth Third has 740 unique subsidiaries, American Express has 327 unique subsidiaries, KeyCorp has 93 unique subsidiaries, Huntington has 92 unique subsidiaries, Ally Financial has 73 unique subsidiaries, SunTrust has 55 unique subsidiaries, Regions Financial has 44 unique subsidiaries, M&T Bank has 37 unique subsidiaries, Citizens Financial has 33 unique subsidiaries, Discover has 28 unique subsidiaries, and Synchrony has 26 unique subsidiaries.

[19] Based on the full-time employee ("FTE") equivalent number reported on each companies' annual report for 2017. US Bancorp reported 74,000 FTEs, PNC Financial reported 53,000 FTEs, Capital One reported 49,300 FTEs, and Schwab reported 17,600 FTEs.

More generally, asset size is a poor measure of risk. Congress acknowledged as much by requiring the Board to consider "riskiness" separately from asset size in section 401 of EGRRCPA. Likewise, the Board and the OCC have previously explained that asset size alone should not generally determine the amount of capital a firm is required to hold.[20]

For example, the Proposal would place two organizations in the same category even if one's balance sheet consisted entirely of assets that receive a zero percent risk weight (e.g., debt obligations of the U.S. government) and the other's consisted entirely of assets that receive a 1,250 percent risk weight (e.g., certain securitization exposures). Similar to the former hypothetical organization, while Schwab's total consolidated assets exceed $250 billion, this does not reflect the low-risk nature of its balance sheet and there is no indicator to take this into account. Schwab's assets are weighted towards low-risk investment securities and other low-risk assets, as explained in section 1 of this letter.

The Proposal's rationale for using asset size as an indicator of safety and soundness risk is tenuous. The Proposal argues that (a larger) asset size may suggest greater operational and managerial complexity, and that greater operational and managerial complexity may suggest that the organization has "operational or control gaps," which could increase the probability of default. Essentially, the Proposal uses asset size as a proxy for another proxy, complexity, suggesting unspecified "gaps" in risk management. Based on that inference, the Proposal suggests that asset size may result in an unspecified increase in the probability of default of an organization. The Proposal, however, not only fails to establish the relationship between the indicator and underlying safety and soundness risk, it also fails to identify and address the risk management "gap" that is the basis for this aspect of the safety and soundness justification under the Proposal. In effect, the Proposal would subject a firm to a host of enhanced prudential standards based on a risk that is not identified and may not be present at a particular firm. Even if the risk is present, it may not be appropriately identified and measured by the proposed requirements that would be imposed. Finally, the other justifications for the asset size indicator—those related to financial stability[21]—are not relevant to SLHCs under section 10 of the Home Owners' Loan Act ("HOLA").[22]

---

20 *See, e.g.*, 83 *Fed. Reg.* 17317, 17319 (Apr. 19, 2018) ("Leverage capital requirements should generally act as a backstop to the risk-based requirements.").

21 *See, e.g.*, Proposal at 61413 (comparing a large banking institution's failure on the economy to the failure of a smaller banking organization).

22 12 U.S.C. § 1467a. The Proposal does not cite DFA § 165 as authority to impose the proposed requirements on SLHCs, but rather cites HOLA § 10(g). *See* Proposal at 61411 note 34 and 61422. Section 10(g) of HOLA authorizes the Board to issue regulations that the Board determines are necessary and appropriate to carry out the purposes of section 10 of HOLA, including regulations establishing capital requirements. 12 U.S.C. § 1467a(g)(1). The purposes of section 10 of HOLA do not include protecting the financial stability of the United States. *See id.* at 1467a.

Accordingly, in our view, asset size should not be the determinative factor in assigning a SLHC to a particular category under the Proposal because of the limited and tenuous relationship between asset size and risk, especially the safety and soundness risks posed by a particular SLHC. At a minimum, the indicator for SLHCs should be based on RWAs, as determined under the Agencies' risk-based capital rules, in order to better reflect risk associated with those assets. As noted in section 1, Schwab has a RWA amount that is significantly lower than all of the other Category III firms and is lower than all but two Category IV firms.

b. The weighted short-term wholesale funding indicator should appropriately distinguish between funding sources that pose safety and soundness risks from those that do not.

The weighted short-term wholesale funding indicator also does not appropriately distinguish funding sources such as repurchase agreements and short-term commercial paper that pose safety and soundness risks from other funding sources such as retail affiliated sweep deposits that do not. The bulk of Schwab's funds that would be designated as short-term wholesale funding under the Proposal do not present the kinds of risks described by the Proposal or otherwise present any risk that the Board may consider with respect to SLHCs.

The Proposal's rationale for including the weighted short-term wholesale funding indicator concerns large-scale funding runs—primarily, if not exclusively, relating to the risk of an asset fire sale.[23] As demonstrated by the most recent financial crisis, certain types of short-term wholesale funding may rapidly decrease the liquidity of a firm and lead to fire sales of illiquid assets. In addition, and as a consequence, the market for securities financing transactions and commercial paper may quickly become illiquid.

In contrast, Schwab's short-term wholesale funding, as defined in the Board's FR Y-15 report, consists primarily of retail brokerage cash balances swept to Schwab's subsidiary savings associations. Customers manage these cash balances in a manner similar to retail checking balances, though in a different part of their wallet (i.e., brokerage cash balances serve the same transactional purpose as balances in checking accounts). As Schwab has shown, these cash

---

[23] Proposal at 61414 ("[G]enerally uninsured funding from more sophisticated counterparties can make a firm vulnerable to large-scale funding runs. In particular, banking organizations that fund long-term assets with short-term liabilities from financial intermediaries such as investment funds may need to rapidly sell less liquid assets to meet withdrawals and maintain their operations in a time of stress, which they may be able to do only at 'fire sale' prices. Such asset fire sales can cause rapid deterioration in a firm's financial condition and negatively affect broader financial stability by driving down asset prices across the market. As a result, weighted short-term wholesale funding reflects both safety and soundness and financial stability risks. Short-term wholesale funding also provides a measure of interconnectedness among market participants, including other financial sector entities, which can provide a mechanism for transmission of distress."). The weighted short-term wholesale funding measure was developed by the Board to inform the measure of a BHC's systemic risk rather than its relative safety and soundness risk. *See also infra* note 24.

balances (across all cash-awaiting-investment product alternatives) demonstrate highly stable behaviors in both stressed and un-stressed economic markets.[24]

In fact, retail brokerage cash exhibits "right-way" risk, meaning that such cash balances typically and predictably grow during times of economic and/or market volatility. Because it is transactional cash being held to make future investments, this cash also is created out of a desire by retail investors to "de-risk," wherein retail investors during a crisis sell their other holdings and hold cash until such time as they desire to move back into the market. Schwab also notes that asset fire sale risk is primarily a financial stability concern,[25] which is not relevant to Schwab or any other SLHC subject to the Proposal.[26]

Over 57 percent of Schwab's short-term wholesale funding is comprised of affiliated brokered sweep deposits. In implementing the LCR, the Agencies explained that:

> Affiliated brokered sweep deposits generally exhibit a stability profile associated with retail customers, because the affiliated sweep providers generally have established relationships with the retail customer that in many circumstances include multiple products with both the covered company and the affiliated broker-dealer. Affiliated brokered sweep deposit relationships are usually developed over time. Additionally, the agencies believe that because such deposits are swept by an affiliated company, the affiliated

---

24 Letter from Peter Morgan to Mr. Robert deV. Frierson et al. commenting on the Federal banking agencies proposed liquidity coverage ratio rule (Jan. 31, 2014).

25 The weighted short-term wholesale funding measure was developed by the Board to inform the measure of a BHC's systemic risk rather than its relative safety and soundness risk. *See, e.g.*, 80 *Fed. Reg.* 49082, 49908 (Aug. 14, 2015) ("GSIB Surcharge Final Rule") ("The final rule does not reduce the [short-term wholesale funding] weight to 0 [for unsecured short-term wholesale funding], as the LCR does not fully address the systemic risks of unsecured short-term wholesale funding.); GSIB Surcharge Final Rule at 49907 ("However, while relative amounts of long- and short-term funding may be relevant in considering the probability of a firm's failure, the surcharge is designed so that a firm's capital requirement increases based on systemic losses assuming a default.").

26 For example, assets that would be available for sale at Charles Schwab Bank during a liquidity crisis would primarily consist of $181 billion dollars in Treasury securities and mortgage-back securities of U.S. government-sponsored enterprises. *See* Consolidated Report of Condition and Income for Charles Schwab Bank as of Sept. 30, 2018. The Proposal does not explain how the sale of less than $200 billion in high-quality liquid assets would cause an asset fire-sale. *See also supra* note 21; 5 U.S.C. § 553(b)-(c); *see, e.g.*, *United States v. Nova Scotia Food Products Corp.*, 568 F.2d 240 (2d Cir. 1977) (holding invalid an agency rule because the agency supported its rule by referring to studies it did not mention in its notice of proposed rulemaking even though the studies were published prior to the submission of comments); *Portland Cement Ass'n v. Ruckelshaus*, 486 F.2d 375, 393 (D.C. Cir. 1973) ("It is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data, or on data that, [to a] critical degree, is known only to the agency"); H.R. Rep. No. 79-1980, at 24 (1946) ("Notice must fairly apprise interested persons of the issues involved, so that they may present relevant data or argument. The required specification of legal authority must be done with particularity. Statements of issues in the general statutory language of legislative delegations of authority to the agency would not be in compliance with this section.").

> company would be incented to minimize harm to any affiliated depository institution.[27]

As a result, the Agencies' LCR rules apply smaller outflow amounts to these types of retail brokered deposits as compared to other types of retail brokered deposits. However, the Proposal would apply the same weight to all brokered deposits provided by a retail customer or counterparty regardless of risk.

In sum, the Proposal fails to provide sufficient justification to use weighted-short term wholesale funding, as currently defined in the Board's FR Y-15 report to include retail affiliate sweep deposits, as a factor to indicate risk to the safety and soundness of Schwab or other SLHCs. The indicator should, therefore, be revised to exclude retail affiliate sweep deposits. However, if such funds are included, Schwab respectfully requests that the Board provide a lower weighting for affiliated sweep deposits than for unaffiliated sweep deposits to be consistent with the Agencies' earlier acknowledgment in the LCR rules and preamble that affiliated sweep deposits pose less risk than unaffiliated sweep deposits.

c. *The nonbank asset indicator should distinguish between activities that pose risks to safety and soundness from those that do not and should exclude assets related to bank permissible activities.*

The nonbank asset indicator, as currently proposed, is a similarly inappropriate consideration for SLHCs. The Proposal asserts that nonbanking activities "may involve a broader range of risks than those associated with purely banking activities."[28] However, many assets representing numerous banking activities may count toward the nonbank asset indicator. For example, all the activities conducted by Schwab's clearing broker may be conducted by Charles Schwab Bank, a subsidiary savings association.[29]

The Proposal also argues that nonbanking activities "can increase interconnectedness with other financial firms" and that nonbank assets "also reflect the degree to which a firm may be engaged in activities through legal entities that are not subject to separate capital requirements or to the direct regulations and supervision applicable to a regulated banking entity."[30] In other

---

[27] 79 *Fed. Reg.* 61440, 61493 (Oct. 10, 2014).

[28] Proposal at 61415.

[29] *See* Letter from John E. Bowman, Chief Counsel, Office of Thrift Supervision (Nov. 28, 2006) *available at* https://www.occ.treas.gov/static/ots/legal-opinions/ots-lo-11-28-2006.pdf.

[30] Proposal at 61415. The Proposal also explains that a firm's nonbanking assets is to be used as a proxy for a firm's complexity, which "is positively correlated with the *impact* of a banking organization's failure or distress. Because nonbank subsidiaries will not be resolved through the FDIC's receivership process, significant investments in nonbank subsidiaries present heightened resolvability risk." *Id.* (emphasis added). However, the impact of a banking organization's failure or distress and its resolution are not relevant to the safety and soundness of the organization itself. Likewise, the observation that "the failure of a nonbank subsidiary could be destabilizing to a banking organization, and cause counterparties to lose confidence in the

contexts, the Board has noted that a $75 billion nonbank asset threshold was intended to capture "riskier" activities or financial intermediation activities of a "different nature or magnitude," such as prime brokerage, complex derivatives, and underwriting.[31]

Schwab agrees that certain types of nonbanking activities, if not properly managed, may pose a risk to the safety and soundness of SLHCs and their insured depository institutions. However, the Proposal does not distinguish between different types of nonbanking activities, effectively treating all nonbanking assets as equally risky, which is clearly not the case. For example, Schwab's primary nonbanking activity is retail brokerage, and Schwab's nonbank assets relating to that activity, such as overcollateralized margin loans and customer funds placed in reserve accounts pursuant to the Securities and Exchange Commission's ("SEC") Rule 15c3-3, are low risk. While Schwab had approximately $41.7 billion of nonbank assets as of September 30, 2018, its nonbank RWAs only amounted to approximately $9 billion, reflecting the fact that the vast majority of those assets are risk-weighted at either 20 percent or zero percent.

Retail brokerage is not similar to, and does not present the type or degree of risks that, the nonbanking activities typically conducted by many larger banking organizations (e.g., prime brokerage, complex derivatives, underwriting, merchant banking). As explained in detail in section 1, Schwab's retail brokerage activities present little risk to the safety and soundness of its insured depository institutions or the organization as a whole. The retail brokerage business also entails limited interconnections with other financial firms; in Schwab's case (and for similarly situated firms), the business primarily includes relationships with affiliate banks and retail customers. Moreover, Schwab engages in its retail brokerage activities through its broker-dealer subsidiaries. These subsidiaries are functionally regulated by the SEC and must comply with SEC prudential regulations, including net capital requirements and the liquidity requirements of SEC Rule 15c3-3.

Accordingly, Schwab respectfully requests that the nonbank asset indicator exclude assets relating to bank-permissible activities and exclude nonbanking activities that do not pose safety and soundness risks, such as retail brokerage. At a minimum, the nonbank asset indicator should exclude any subsidiary[32] or asset that may be owned by an insured depository institution, and should apply the standardized risk-weighting framework under the Agencies' risk-based capital rules to nonbanking assets as a better measure of the risk associated with those assets.

---

firm" appears to be related to systemic risk and resolution planning rather than safety and soundness risk. *Id.*; *see also*, *e.g.*, 12 U.S.C. § 5365(d)(1)(A).

[31] *See* 82 *Fed. Reg.* 9308, 9313 (Feb. 3, 2017); 81 *Fed. Reg.* 67239, 67243 (Sept. 30, 2016).

[32] Financial subsidiaries of an insured depository institution are, of course, not included within this requested exclusion.

3. The proposed framework treats firms with greatly different risk profiles the same, indicating that a more fulsome analysis of risk is required.

Apart from the propriety of the individual indicators for SLHCs, the proposed framework for categorizing institutions as a whole would not place institutions of similar overall risk in the same category. This failure of the proposed framework is evident even if one assumes *arguendo* that the indicators—individually—accurately reflect risk. The framework establishes a "one-way ratchet" where exceeding the threshold amount for any indicator increases the requirements for a firm regardless of the amount by which the threshold is exceeded, or of the relative amounts of other risk indicators. For example, a firm that exceeds the threshold for one indicator (other than total consolidated assets) is generally subject to the same requirements as a firm that exceeds the threshold for multiple indicators. Additionally, the amount by which a firm exceeds a $75 billion threshold—as well as the relationship between one measure of risk and other measures of risk at a firm and between firms—is also not taken into account in calibrating the relative risk exposure from firm to firm. For example, the proposed framework would treat a firm with $100 billion dollars in total consolidated assets and $75 billion in average weighted short-term wholesale funding the same as a firm that exceeds $250 billion in total consolidated assets as well as the thresholds for the nonbank asset, weighted short-term wholesale funding, and off-balance sheet exposure indicators. Similarly, a firm that has $250 billion in total consolidated assets and *de minimis* amounts for each of the other four indicator thresholds could be treated the same as a $250 billion firm with $150 billion—twice the threshold amount—in average nonbank assets, average weighted short-term wholesale funding, and average off-balance sheet assets.

The failure of the framework to place institutions with similar amounts of risk in the same category becomes even clearer when Schwab is compared to the other firms that the Proposal would include in Category III, as well as Category IV. As described in section 1 of this letter, Schwab's balance sheet and its organizational structure present significantly less risk than all other firms in Category III and less risk that most firms in Category IV.

Accordingly, the framework should be revised so that firms that present similar risk should be subject to the same requirements and firms that present less risk should be subject to lesser requirements. As noted, the Proposal does not provide sufficient safety and soundness based justifications to warrant a SLHC's placement into a particular category based on one or possibly two indicators. Rather, the justifications explain that exceeding a particular asset size or $75 billion threshold merely indicates increased risk to the safety and soundness of a SLHC (an insufficiently supported conclusion for SLHCs) and increased risks to financial stability (an impermissible consideration for SLHCs).

One method to improve the one-way ratchet framework would be, at a minimum, to take multiple risk factors into consideration in determining which category is, and the particular requirements for such category that are, appropriate for a SLHC. As shown above, a firm that exceeds the threshold for one indicator would not present the same risk as a firm in the same category that exceeds multiple thresholds. Thus, a firm should not be subject to a higher

category for exceeding the threshold for one indicator if it has negligible amounts of the other indicators. Moreover, positive indicator factors, such as high capital ratios, low RWA density, or a low level of off-balance sheet exposures should be available to mitigate the risks raised from exceeding other indicator thresholds and, in this regard, should be incorporated into the Proposal.[33] For example, firms would not be subject to additional requirements unless they met multiple indicators and could nonetheless be exempt from those requirements if they met the requisite positive indicator factors (e.g., risk-weighted density below a certain threshold). This would avoid imposing compliance costs for requirements where it is less likely that the requirements would materially improve the safety and soundness of the firm.

In short, a SLHC's particular category should be determined based on a weighing, both positively and negatively, of all relevant risk factors. Schwab also concurs with other commenters that any indicator based on an absolute dollar amount should be indexed to growth in domestic banking assets or otherwise account for growth of the banking sector.

4. The GSIB Surcharge is an inappropriate measure of safety and soundness risks for SLHCs

As an alternative to the category framework outlined above, the Proposal solicits comment on whether the Agencies should place a non-GSIB firm in a particular category based on their GSIB scoring methodology. We believe this approach would not be prudent given that the GSIB methodologies do not evidence safety and soundness risks of SLHCs. Rather, the GSIB methodologies were developed to evidence risk to financial stability, and financial stability concerns are inextricable in the calculations. For example, components of the numerator (e.g., substitutability) and the denominator itself evidence concerns that are exclusively macroeconomic. Thus, it is unclear how safety and soundness interests articulated in the Proposal would be promoted by use of a GSIB scoring methodology that apparently is unrelated and not designed to measure safety and soundness risk. Use of the GSIB methodology to impose requirements on SLHCs would take financial stability into consideration, which, as noted above HOLA § 10 does not authorize. The method 2 score would be particularly inappropriate for Schwab based on its additional concerns regarding the inclusion of affiliated retail sweep deposits in the wholesale funding indicator discussed above.

---

[33] Positive indicator factors also could discount the relevance of certain indicators. For example, risks of off-balance sheet exposures could be discounted to the extent such exposures were captured in an institution's capital requirements. *See, e.g.*, 12 CFR 217.33(b) (applying credit conversion factors for off-balance sheet exposures).

5. Single-counterparty credit limit requirements should not apply to SLHCs because the requirements would penalize SLHCs for high concentrations of agency MBS, which HOLA encourages.

The Proposal would also apply the single counterparty credit limit ("SCCL") requirements of DFA § 165 to SLHCs as if they were BHCs. The Proposal provides that "[g]reater parity in the regulation of covered savings and loan holding companies and bank holding companies would be appropriate in light of the significant similarities between the activities and risk profiles of these firms."[34] However, the proposed application of the SCCL requirements to SLHCs highlights that there are important differences between large BHCs and SLHCs, and that greater parity in the regulation of BHCs and SLHCs is not achieved by applying the same requirements to both.

Unlike other forms of banks, savings association subsidiaries of SLHCs are required to comply with the qualified thrift lender ("QTL") test,[35] which generally requires them to have an asset mix with a housing focus.[36] Under HOLA § 10(m), a savings association is a qualified thrift lender if its qualified thrift investments exceed 65 percent of its portfolio assets.[37] One of the primary methods that savings associations may use to satisfy the QTL test is by purchasing mortgage-backed securities of U.S. government-sponsored enterprises ("Agency MBS").[38] Agency MBS may be included in the QTL test without being subject to any percentage limitation.[39] Due to the government-sponsored entities' guarantees as to payments of principle and interest on the Agency MBS and the diversification that is achieved by investing in a pool of mortgage loans, it is generally recognized that Agency MBS represent a safer and more liquid and efficient means for a savings association to satisfy its QTL test requirements than if it were to hold individual mortgage loans on its balance sheet.

Nonetheless, the proposed SCCL would potentially include limits on the amount of Agency MBS an SLHC may hold.[40] Applying the SCCL requirements to SLHCs would, therefore, contravene the existing authority and Congressional intent to allow savings associations to use Agency MBS to satisfy the QTL test without limit. Applying the SCCL as

---

[34] Proposal at 61412.

[35] 12 U.S.C. § 1467a(m).

[36] *Id.* at § 1467a(m)(3)(B).

[37] *Id.* at § 1467a(m)(1). A savings association may also be a qualified thrift lender if it qualifies as a domestic building and loan association. *Id.*

[38] *Id.* at § 1467a(m)(4)(C).

[39] *Id.*

[40] Under the Proposal, any direct claim on, and the proportion of a claim that is directly and fully guaranteed as to principal and interest by, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation would only be excluded by the agencies while they are operating under the conservatorship or receivership of the Federal Housing Finance Agency. 12 CFR 238.157(a)(1) of the Proposal.

proposed could have a significant negative impact on the business of Schwab. Application of the SCCL could increase the risk to the safety and soundness of Schwab's subsidiary savings institutions by essentially requiring them to satisfy the QTL test through riskier investments. Unlike Agency MBS, many of the categories of qualifying thrift investments do not represent a diversified portfolio of loans and are not guaranteed by a government-sponsored enterprise. Accordingly, Schwab respectfully requests that SCCL requirements not be applied to SLHCs, or at a minimum, that Agency MBS be permanently excluded from the SCCL requirements applied to SLHCs.

6. Tailoring of the LCR should continue to exclude both depository institution subsidiaries with $10 billion or more in assets and the maturity mismatch add-on, and only require a monthly calculation.

Schwab commends the Agencies for proposing to tailor the LCR requirement for firms that present a lesser degree of risk to U.S. financial stability than Category I and II firms.[41] Schwab agrees that tailoring of the LCR requirement should include a lower ratio and monthly reporting of the FR 2052a to account for the lower risk of firms outside of Categories I and II. However, for the reasons discussed above, Schwab does not believe that a firm having $75 billion or more of weighted short-term wholesale funding consisting primarily of affiliated retail sweep deposits that bear none of the indicia of other more commonly recognized types of wholesale funding, should disqualify the firm from the benefits of a lower LCR requirement for Category III firms or require the firm to prepare and file FR 2052a reports on a daily basis.

In addition, Schwab respectfully requests that the Agencies not eliminate most of the benefits of their earlier LCR tailoring in the current modified version of the LCR rule—namely the exclusion of the maturity mismatch add-on, the exclusion of subsidiary depository institutions with $10 billion or more in total consolidated assets, and a monthly instead of daily calculation requirement—for firms with lower risk. Schwab believes that the lower ratio should be consistent with the current modified LCR rule as well: .70:1. The rationales for the Agencies' earlier tailoring would appear to continue to be applicable to all firms that do not have the heightened risk the Agencies propose to address with application of the full LCR requirement.[42] The proposals do not explain why it would be appropriate for a firm that is

---

[41] *See* 83 *Fed. Reg.* 66024, 66036 (Dec. 21, 2018) ("While the failure or distress of such a firm could pose risks to U.S. financial stability, their risk profile is lower than that of U.S. GSIBs and they are smaller or face a lesser degree of cross-border challenges than firms that would be subject to Category II standards.").

[42] *See, e.g.*, 79 *Fed. Reg.* 61440, 61520 (Oct. 10, 2014) ("Although the Board believes it is important for all bank holding companies subject to section 165 of the Dodd-Frank Act (and similarly situated savings and loan holding companies) to be subject to a quantitative liquidity requirement as an enhanced prudential standard, it recognizes that these smaller companies would likely not have as great a systemic impact as larger, more complex companies if they experienced liquidity stress.").

currently subject to the modified LCR rule essentially to exchange its current tailoring benefits thereunder with the proposed more stringent LCR requirements.[43]

7. If the final rule imposes any requirements on SLHCs, the rule should include a longer conformance period for SLHCs to accommodate such new requirement(s).

In contrast to most of the BHCs covered under the Proposal, covered SLHCs would be required to comply with many new and significant requirements. Currently, Schwab conducts many risk management practices related to capital and liquidity, including stress testing, in addition to that required by the Agencies. Nonetheless, many of the new requirements that the Proposal would impose on Schwab, such as supervisory stress tests, capital plan submissions, liquidity stress tests, and liquidity risk management, will individually take significant time and resources to develop, and would involve significantly modifying existing procedures and systems as well as hiring and training employees. The time required adequately to address multiple new requirements, of course, would be even longer than the time required to address each new requirement individually given that many of the same employees and resources will be required to implement the multiple new requirements. Accordingly, Schwab respectfully requests that it be provided with a reasonable phase-in compliance period for any new requirement(s) and, if there are multiple significant requirements imposed on Schwab, that the compliance periods be staggered so that the compliance dates for the new requirements do not all occur on the same date.

8. The Board should propose tailoring regulatory reporting.

As the Board is aware, a meaningful aspect of regulatory burden for many banking organizations is regulatory reporting. As currently drafted, the Proposal would significantly increase regulatory reporting requirements for Schwab. In order to better tailor its requirements and reduce unnecessary burden, Schwab requests that the Board also consider reducing the number, frequency, and information requirements of the reporting forms that large banking organizations such as Schwab are expected to complete. Schwab recommends that the Board, similar to the Proposal, take a risk-based approach to consider modifying reporting requirements. For example, Schwab is, or is proposed to be, required to complete: the FFIEC 009 although it has limited foreign exposures; the FR Y-14M although its loan portfolio is less than 15 percent of its total consolidated assets; and the FR Y-14Q although its securities portfolio is low risk.

Conclusion

Schwab appreciates the significant efforts of the Board and its staff to produce the Proposal in a relatively short amount of time, as well as the collective efforts of the other

---

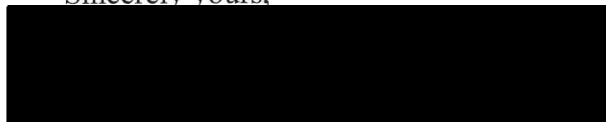
[43] For example, this exchange would happen to a bank holding company with $100 billion in total consolidated assets and $75 billion in nonbank assets.

Agencies and their staffs to issue the parallel regulatory proposal. The Proposal sets forth a number of important improvements that will benefit all covered institutions, including Schwab. However, as currently structured, the application of the Proposal to Schwab would fall short of the goal of effective regulatory tailoring. Schwab believes more can be done to correct these flaws in the Proposal.

As explained above, the total consolidated asset, weighted short-term wholesale funding, and nonbanking asset indicators set forth in the Proposal do not appropriately distinguish between activities that pose safety and soundness risk from those that do not. The proposed framework for categorizing organizations is based on an asset size threshold adjusted by certain other indicators. However, the construct, while well-intended, fails to account for the aggregate safety and soundness risk (or lack thereof) that an organization may pose, especially when compared to peers in the same category, because there is no calibration employed in the application of the risk indicators. As a result, heightened requirements may be imposed based on a single indicator even though risk-based indicators may collectively suggest a substantially lower relative risk profile for a firm compared to its category peers, as would be the case for Schwab. Because of shortcomings in the indicators and in the one-way ratchet framework (i.e., indicators can trigger more regulatory burdens but not reduce burdens), the Proposal would impose heightened requirements on organizations that do not pose heightened safety and soundness risk. Both the imposition of requirements without a sufficient safety and soundness concern and the imposition of SCCL requirements on SLHCs highlight the Proposal's failure to achieve parity between BHCs and SLHCs once the different statutory frameworks for these respective organizations are considered.

Schwab respectfully requests that the Board review the significant concerns with the Proposal discussed herein, and consider the suggested improvements that can be made to address these weaknesses in the Proposal. Thank you, again, for the opportunity to comment on the Proposal. We are available to address any questions and welcome the opportunity for further dialogue to discuss or clarify the issues discussed herein.

Sincerely yours,



Peter J. Morgan III
Senior Vice President & Deputy General Counsel