



NCM Client Notification

A publication of Northern Capital Management, Inc.

MARCH 19, 2008

Dear Clients,

Today Charles Schwab Institutional notified us of two informational postings on their site that we'd like to pass on to you.

First is an interview with Charles Schwab's CFO Joe Martinetto regarding their financial strength, followed by information regarding their financial condition.

Sincerely,

Northern Capital Management, Inc.



Charles Schwab's Joseph Martinetto

Winding up his first year on the job, the brokerage's CFO tells how a strong client focus helped insulate it from subprime heartache.

[Lori Calabro](#), CFO Magazine

March 1, 2008

Forgive Joe Martinetto if he sleeps soundly these days. Despite volatility in the markets and chaos in the financial-services sector, The Charles Schwab Corp. has remained fairly insulated from the turmoil. A conservative risk profile saved the company exposure to subprime-mortgage risk in its corporate portfolio. And unlike many of its peers in the financial sector, Schwab emerged from 2007 in a stronger position, recording a 26 percent increase in income from continuing operations and a 32 percent boost to its stock price. Even more telling, the San Francisco-based financial-services firm had total client assets of \$1.4 trillion at the end of the year, up more than 17 percent over 2006. The secret, says the 46-year-old Martinetto, who is completing his first year as Schwab's CFO, is simple: "Stay focused on the client."

Your CEO, Charles Schwab, has described this market as being "as difficult a time period" as he's ever seen. Do you agree?

This has certainly been one of the more protracted and broadly distributed financial events that I've seen in my career. You can go back and find individual events that have been more concentrated, but the nature of this crisis, with all its various touch points, has made for a much more complex environment.

Still, Schwab has been basically untouched by the subprime crisis. How?

The way Schwab approaches the business has given us a leg up. We are a very client-focused and client-driven organization. We don't have large trading portfolios. We don't have large proprietary positions. We really operate the firm on behalf of our clients. So our balance sheet is there to provide liquidity and capital necessary for the growth of the company going forward. It's there to ensure the safety of the assets that our clients have entrusted to us. And, finally, it's there to produce revenues off those balances. With those priorities in order, it makes it a lot easier for us to withstand times of crisis.

Yet some of the investments weren't completely off your radar screen. How did you resist?

We actually had [credit approval] to buy subprime. We didn't buy any largely because we didn't like the risk/return profile of the products. So while our credit process would have allowed us to invest, our investment-portfolio managers made the decision that kept us out. They just didn't see any reason to buy products with imbedded risk. [Editor's note: Schwab does have minimal exposure to SIVs in its taxable money-market funds.]

Was there a lot of internal debate over that decision?

We debated it pretty actively. But the spreads weren't compensating us for the risks. Again, look at the history of the firm. We have managed it very conservatively. We did get some commentary from analysts about the opportunities that we were missing in the marketplace.... [But] as a large company with \$1.4 trillion in client assets, we take enough risks in other parts of the business. We process hundreds of thousands of trades a day. We process probably a billion dollars in [securities] transactions on any given day. We have a lot of operating risks. We have a lot of brand risks. We don't suffer from a lack of financial risk.

So are you feeling any effects at all?

It's been more of a positive than a negative for us. We are definitely seeing better client endorsement. We're seeing slower client attrition. We're seeing positive transfer-account trends.... We measure these developments constantly, although we don't disclose the details. But since last summer, we've been seeing all of these trends.

What are the differences between Schwab's approach to the market and those of other financial-services firms?

I don't want to point fingers...[but] it was clear to us that risk wasn't being appropriately priced, and that credit spreads on certain kinds of products had gotten way too tight. As a result, we pushed away from some of those products. We just weren't buying. When the spreads tightened and the risk relationships appeared to be out of whack, that should have been a signal to the industry to ask questions.

Were there any other factors?

Some of the challenge here is that you have people working on the [risk] models who haven't operated in an environment like this, or even in some of the less bad environments we've been through. So it's possible to underplay what the ultimate risk question is.

Are we going to be dealing with the fallout for a long time?

Define a long time. I'm hopeful that what the Fed is doing will [encourage] people to invest in the economy. But I do think we will be dealing with the repercussions of this for quite some time to come. [Just consider] what's involved with the real estate market. It takes a certain amount of time for houses to [become] foreclosures, then become workout properties, then find their way into being remarketed. So I think it is almost inevitable at this point that we will have four to six quarters of uncertainty.

You've been in the CFO role for almost a year now. Has it been what you expected?

This has been a very eventful year on a lot of fronts. We closed the sale of U.S. Trust [to Bank of America, for \$3.3 billion] in July; we've had a major capital restructuring; we've had some management changes; and we've had to deal with new financial systems.

So, if you throw in the market environment on top of that, I haven't really had time to step back and ask what I thought the job would look like in a normal environment. It hasn't given me a chance.

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Schwab's Financial Condition (as of 12/31/2007)

The Charles Schwab Corporation's internal protective practices and stringent business standards are designed to keep your clients' assets safe.

FOCUSED ON SERVING INVESTORS

Our clear business focus and industry expertise provide a solid foundation for our financial performance. Schwab's business is focused on serving individual investors and the advisors who serve them.

OUR FINANCIAL RESULTS

The latest financial results, as of December 31, 2007:

For The Charles Schwab Corporation:

- Cash reserves: Available liquidity of about \$800 million¹
- Long-term debt of 19.4 percent of total financial capital²
- Net new assets of approximately \$160 billion³ over the last 12 months, bringing the company's total client assets to \$1.4 trillion⁴
- New brokerage accounts: Totaled 809,000 over the last 12 months, bringing the company's total to 7.0 million active brokerage accounts⁵

For Charles Schwab & Co., Inc.

- Net capital was \$1.2 billion, \$990 million in excess of the regulatory minimum required net capital⁶

LEARN MORE ABOUT SCHWAB'S FINANCIAL CONDITION

We can provide additional information about Schwab's financial condition and business focus to help you understand the care we take with your clients' accounts.

Please ask your relationship manager for details.

Your Next Step

Financial results and more information about Schwab's business and financial condition can be viewed any time at www.aboutschwab.com.

¹ The Charles Schwab Corporation (Parent Company Only) Q4 2007 Balance Sheet

² "The Charles Schwab Corporation Financial and Operating Highlights" from the The Charles Schwab Corporation Q4 2007 Quarterly Earnings Release

³ The Charles Schwab Corporation Q4 2007 Quarterly Earnings Release

⁴ The Charles Schwab Corporation Q4 2007 Quarterly Earnings Release

⁵ The Charles Schwab Corporation Q4 2007 Quarterly Earnings Release

⁶ The Charles Schwab Corporation 2007 10k