U.S. COMMODITY FUTURES TRADING COMMISSION
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Division of Swap Dealer and
Intermediary Oversight

Joshua B. Sterling
Director

Aubrey Thacker
Senior Vice President – Corporate Controller
Charles Schwab & Co., Inc.
9800 Schwab Way
Lone Tree, Co, 80124

Re: Net capital treatment of deferred tax liabilities directly related to intangible assets recognized as part of a business acquisition

Dear Mr. Thacker:

This responds to your letter dated August 17, 2020 ("Letter") to the Division of Swap Dealer and Intermediary Oversight ("DSIO") of the Commodity Futures Trading Commission ("Commission"). You submitted your letter on behalf of the Charles Schwab Corporation ("Schwab") requesting confirmation that DSIO staff will not recommend an enforcement action to the Commission under Commission Regulation 1.17.[1] In particular, you request that DSIO not recommend enforcement action if, when computing net capital, TD Ameritrade Futures and Forex, LLC ("TDAFF"), a futures commission merchant ("FCM"), add back to net worth the amount of deferred tax liabilities ("DTLs") they incur to the extent that amount directly relates to non-allowable intangible assets recognized as part of a non-taxable business combination. I understand the following facts are relevant to your request.

Background

On November 24, 2019 Schwab announced a pending acquisition of TD Ameritrade Holding Corporation ("TDA") and its subsidiaries (the "TDA Transaction"), including FCM

[1] Commission regulations are found at 17 CFR Ch. 1.

TDAFF. This transaction will not be a taxable business combination and, accordingly, you represent that Schwab will receive no increase in the tax basis in the acquired intangible assets.[2]

The TDA Transaction will be accounted for under the acquisition method of accounting in accordance with Accounting Standards Codification Topic 805, Business Combinations ("ASC 805"). ASC 805 generally requires assets acquired and liabilities assumed to be measured at fair value as of the acquisition date. Assets acquired and measured at fair value include intangible assets such as customer relationships or technology. While these intangible assets increase the equity and net worth of an FCM under U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), a non-taxable business combination will also result in the recognition of DTLs directly related to these intangible assets with a corresponding decrease to net worth. For book purposes, the intangible assets are amortized through earnings and the DTLs will simultaneously decrease as a result. You state that the DTLs will not change the cash flows, income tax liability, or overall operating risk profile of TDAFF. No tax will ever be due for the amount of the increase in the value of the intangible assets.

In your Letter, you provide a simplified example of the journal entries that will be used to account for the intangible assets and their related DTLs. The example assumes an intangible asset with a fair value of $1,000 and an effective tax blend rate of 25%. You state that the intangible assets and their related DTLs will be recognized within the accounting records of TDAFF because of the use of "pushdown accounting" by Schwab.[3]

Entry No. 1: Recognition of an intangible asset (e.g., customer relationships)

Dr. Intangible asset	$1,000	
Cr. Additional paid-in capital		$1,000

Entry No. 2: Recognition of related deferred tax liability

Dr. Additional paid-in capital	$250	
Cr. Deferred tax liability		$250

Analysis

In your Letter, you represent that while the combined effect of the above entries is an increase to TDAFF's equity computed in accordance with U.S. GAAP, it would decrease

[2] Schwab's Form S-4 Registration Statement for the merger filed with the U.S. Securities and Exchange Commission contains opinions of counsels supporting the transaction as a non-taxable business combination.

[3] You also represent that, at a later date, Schwab may integrate TDAFF into another FCM subsidiary. This integration would result in the intangible assets and their related DTLs from the TDA Transaction being transferred from TDAFF at carrying value through a common control transaction accounted for in accordance with ASC 805.

TDAFF's regulatory capital for its net capital computations. Entry No. 1 is FCM regulatory capital neutral as the increase in equity, through additional paid-in capital, is offset through the treatment of the intangible asset as a non-allowable asset. The effect of Entry No. 2 is a decrease in FCM regulatory capital as a result of the increase in DTLs, which increases liabilities that are subtracted from current assets in computing adjusted net capital.

You note that you do not believe the recognition of intangible assets and their related DTLs as the result of accounting for a non-taxable business combination in accordance with ASC 805 should negatively impact net capital for TDAFF under Commission Regulation 1.17. You therefore respectfully request that the staff of the Commission issue a "no-action" position allowing TDAFF and any future FCM subsidiary (to the extent that TDAFF is integrated into another FCM subsidiary at a later date), when computing net capital, to add back to net worth the amount of the DTLs to the extent that amount directly relates to the non-allowable intangible assets recognized as part of the non-taxable business combination described in your Letter. This position would leave TDAFF's net capital calculations unchanged by the intangible assets recognized in accordance with ASC 805 for a non-taxable business combination, which you believe results in a more accurate representation of their net capital.

Based on the facts and representations set forth in your Letter, DSIO staff will not recommend enforcement action to the Commission under Commission Regulation 1.17 if TDAFF or any future FCM subsidiary (to the extent that TDAFF is integrated into such other FCM subsidiary at a later date) exclude deferred tax liabilities that are directly related to the intangible assets booked as a result of the TDA Transaction as described herein and such assets are excluded from current assets under Regulation 1.17.

This letter, and the position taken herein, represent the views of DSIO only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does no excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in Commission regulations. Further, this letter, and the positions taken herein, are based upon the facts and circumstances presented to DSIO. Any different, changed or omitted material facts or circumstances might render the relief provided by this letter void.

Finally, as with all staff letters, the DSIO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of relief provided herein, in its discretion. If you have any questions concerning this correspondence, please feel free to contact Mark Bretscher, Special Counsel at 312-596-0529, or Josh Beale, Associate Director at 202-418-5446.

Sincerely,

Joshua Sterling
Director

Enclosure: Charles Schwab & Co., Inc., Request for No-Action Relief (Aug. 17, 2020).

Relief Request from Charles Schwab & Co. (Aug. 17, 2020).

August 17, 2020

Mr. Tom Smith, Deputy Director, Capital, Margin and Segregation
CFTC Division of Swap Dealer and Intermediary Oversight
Three Lafayette Center
1155 21st Street, NW
Washington DC, 20581-0001

Re: Net capital treatment of deferred tax liabilities directly related to intangible assets recognized as part of a business acquisition

Dear Mr. Smith:

On November 24, 2019 the Charles Schwab Corporation (Schwab) announced a pending acquisition of TD Ameritrade Holding Corporation (TDA) and Subsidiaries (the TDA Transaction), including the Futures Commission Merchant (FCM) TD Ameritrade Futures and Forex, LLC (TDAFF). This transaction will be a non-taxable business combination accounted for in accordance with Accounting Standards Codification Topic 805, *Business Combinations* (ASC 805). Through the application of pushdown accounting, the TDA Transaction will result in the recognition of certain non-current intangible assets and related deferred tax liabilities (DTLs) by TDAFF. At a later date, Schwab may integrate TDAFF into another FCM subsidiary. This integration would result in the intangible assets and their related DTLs from the TDA Transaction being transferred from TDAFF at carrying value through a common control transaction accounted for in accordance with ASC 805.

This letter respectfully requests that the staff of the Commodity Futures Trading Commission (the "Commission") issue an interpretation and no action relief to allow DTLs to be added back to net worth to the extent the amount directly relates to non-current intangible assets recognized as a result of the non-taxable business combination for purposes of computing the FCM's net capital under Commission Rule 1.17.

Accounting Overview

Acquisitions of businesses are accounted for in accordance with ASC 805. ASC 805 generally requires assets acquired and liabilities assumed to be remeasured at fair value as of the acquisition date. Assets acquired and measured at fair value include intangible assets for such things as customer relationships or technology. While these intangible assets increase the GAAP equity and net worth of a FCM, a non-taxable business combination will also result in the recognition of DTLs directly related to these intangible assets with a corresponding decrease to net worth. For book purposes, the intangible assets are scheduled to be amortized through earnings and the DTLs will simultaneously decrease as a result. The DTLs do not represent a postponed tax obligation and will not change the cash flows, income tax liability, or overall operating risk profile of Schwab or its FCM subsidiaries. No tax will ever be due for the amount of the increase in the value of the intangible assets.

The intangible assets and their related DTLs will be recognized within the accounting records of the FCM through the following two hypothetical journal entries, which assume an intangible asset with a fair value of $1,000 and an effective blended tax rate of 25%.

<u>Entry 1</u>: Recognition of an intangible asset (e.g., customer relationships)

Dr. Intangible asset	$1,000	
Cr. Additional paid-in capital		$1,000

<u>Entry 2</u>: Recognition of related deferred tax liability

Dr. Additional paid-in capital	$250	
Cr. Deferred tax liability		$250

While the combined effect of the above entries is an increase to a FCM's equity computed in accordance with US GAAP, it would decrease a FCM's regulatory capital. Entry one is FCM regulatory capital neutral as the increase in equity, through additional paid-in capital, is offset through the treatment of the intangible asset as a non-current asset. The effect of entry two is a decrease in FCM regulatory capital as a result of the decrease in equity through additional paid-in capital.

<u>Request</u>

We do not believe the recognition of intangible assets and their related DTLs as the result of accounting for a non-taxable business combination in accordance with ASC 805 should negatively impact net capital for FCMs under Commission Rule 1.17. We therefore respectfully request that the staff of the Commission issue a "no-action" position allowing Schwab's FCM subsidiaries, when computing net capital, to add back to net worth the amount of the DTL to the extent that amount directly relates to the non-current intangible assets recognized as part of a non-taxable business combination. This position would leave the FCM's net capital calculation unchanged by the intangible assets recognized in accordance with ASC 805 for a non-taxable business combination, which we also believe results in a more accurate representation of the FCM's net capital.

Please also be aware that we have received identical relief from the staff of the Securities and Exchange Commission (the "SEC") with respect to the calculation of regulatory capital pursuant SEC Rule 15c3-1 and capital requirements applicable to broker-dealers[4].

Thank you for this opportunity to provide you with the concerns regarding the consequences of acquired intangible assets on a FCM's net capital in a non-taxable business combination. We would be pleased to discuss our views or provide any additional information. Please contact me at Aubrey.Thacker@schwab.com if you have any questions.

Regards,

Aubrey Thacker
Senior Vice President – Corporate Controller
Charles Schwab & Co., Inc.
9800 Schwab Way
Lone Tree, Co, 80124

Cc: Michael A. Macchiaroli, Esq., Associate Director SEC Trading and Markets
Tom McGowan, Associate Director, SEC Trading and Markets
Randall Roy, Deputy Associate Director, SEC Trading and Markets
Tim Fox, Branch Chief, SEC Trading and Markets
Nina Kostyukovsky, Special Counsel, SEC Trading and Markets

[4] See Charles Schwab & Co., Inc. (SEC No-Act, August 13, 2020).