



DIVISION OF
CORPORATION FINANCE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

July 9, 2018

Elizabeth A. Marino, Esq.
Sidley Austin LLP
60 State Street
36th Floor
Boston, MA 02109

Re: SEC v. Charles Schwab & Co., Inc., Civil Action No. 4:18-cv-03974 (N.D.CA, July 2, 2018)
Waiver of Disqualification pursuant to Rule 506(d)(2)(ii) of Regulation D

Dear Ms. Marino:

This letter responds to your letter dated June 29, 2018 (“Waiver Letter”), written on behalf of Charles Schwab & Co., Inc. (“Schwab”), and constituting an application for a waiver of disqualification under Rule 506(d)(2)(ii) of Regulation D under the Securities Act of 1933 (“Securities Act”). In the Waiver Letter, you requested relief from any disqualification that will arise as to Schwab under Rule 506 of Regulation D under the Securities Act as a result of the entry of a judgment (“Final Judgment”) on July 9, 2018 in the United States District Court for the Northern District of California relating to the complaint filed by the Commission on July 2, 2018 in SEC v. Charles Schwab & Co., Inc. (Civil Action No 4:18-cv-03974).

Based on the facts and representations in the Waiver Letter and assuming Schwab complies with the Final Judgment, we have determined that Schwab has made a showing of good cause under Rule 506(d)(2)(ii) of Regulation D that it is not necessary under the circumstances to deny reliance on Rule 506 of Regulation D by reason of the entry of the Final Judgment. Accordingly, the relief requested in the Waiver Letter regarding any disqualification that may arise as to Schwab under Rule 506 of Regulation D by reason of the entry of the Final Judgment is granted on the condition that Schwab fully complies with the terms of the Final Judgment. Any different facts from those represented or failure to comply with the terms of the Final Judgment would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

Sincerely,

/s/

Elizabeth M. Murphy
Associate Director
Division of Corporation Finance



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AMERICA • ASIA PACIFIC • EUROPE

June 29, 2018

By Email and Overnight Courier

Timothy Henseler, Esq.
Chief, Office of Enforcement Liaison
Division of Corporation Finance
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *Securities and Exchange Commission v. Charles Schwab & Co., Inc.*

Dear Mr. Henseler:

We are writing on behalf of Charles Schwab & Co., Inc. (“CS&Co.” or the “Firm”) in connection with the anticipated settlement with the United States Securities and Exchange Commission (“SEC” or “Commission”) relating to the proceeding captioned *Securities and Exchange Commission v. Charles Schwab & Co., Inc.* Pursuant to the terms of the settlement, it is anticipated that a Judgment will be entered by the District Court against CS&Co. (the “Final Judgment”).

On behalf of CS&Co., we hereby respectfully request a waiver of any disqualification that will arise pursuant to Rule 506 of Regulation D under the Securities Act of 1933 (the “Securities Act”) with respect to CS&Co. or any of its affiliates as a result of the entry of the Final Judgment.

BACKGROUND

CS&Co. is dually registered with the Commission as a broker-dealer and investment adviser. CS&Co. is a wholly owned indirect subsidiary of The Charles Schwab Corporation (“CS”).

CS&Co. anticipates that the Commission will file a complaint in federal district court relating to the above captioned proceeding (the “Complaint”) alleging violations of Section 17(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule 17a-8 thereunder. As discussed below, CS&Co. has agreed to consent to the entry of the Final Judgment, without admitting or denying the allegations made in the Complaint.

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According to the Complaint, CS&Co. failed to file Suspicious Activity Reports (“SARs”) on suspicious transactions by independent, third party investment advisers (“Advisers”) that CS&Co. terminated from its custodial platform in violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Such Advisers were not affiliated or associated with CS&Co. CS&Co. terminated the Advisers for engaging in activity CS&Co. determined violated its internal policies and presented risk to CS&Co. or its customers. The Complaint alleges (1) that CS&Co.’s failure to file SARs during the 2012-2013 time period resulted from its inconsistent implementation of policies and procedures for identifying reportable transactions under the SAR Rule (31 C.F.R. § 1023.320(a)) when CS&Co. investigated and terminated Advisers from its custodial platform; (2) although CS&Co. took steps to investigate and terminate Advisers, CS&Co. did not have clear or consistent policies for the types of activities for which SARs needed to be filed; and (3) in a number of cases in which Advisers were terminated and there was reason for CS&Co. to suspect fraudulent activity, CS&Co. applied an unreasonably high standard for determining whether to file a SAR on the suspicious transactions.

CS&Co. anticipates submitting an executed Consent of the Defendant Charles Schwab & Co., Inc. to Entry of Final Judgment (the “Consent”), which will be presented to the U.S. District Court for the Northern District of California when the Commission files its Complaint. In the Consent, solely for the purpose of proceedings brought by or on behalf of the Commission or in which the Commission is a party, CS&Co. anticipates that it will consent to the entry of the Final Judgment without admitting or denying the allegations made in the above-captioned proceeding (except as to personal and subject matter jurisdiction, which will be admitted).

The Final Judgment will permanently restrain and enjoin CS&Co. from violating Section 17(a) of the Exchange Act and Rule 17a-8 thereunder and order CS&Co. to pay a civil penalty in the amount of \$2,800,000.

DISCUSSION

CS&Co. understands that, absent a waiver, the entry of the Final Judgment will disqualify it, affiliated entities, and certain other issuers from relying on Rule 506 of Regulation D under the Securities Act. CS&Co. is concerned that, if it or its affiliates are deemed to be an issuer, predecessor of an issuer, affiliated issuer, general partner or managing member of an issuer, or promoter of securities, or if it is deemed to be acting in any other capacity described in Rule 506 for purposes of Rule 506(d)(1), then CS&Co., its affiliates, and third parties that engage CS&Co. and its affiliates to act in (or otherwise involve CS&Co. in) one of the listed capacities in connection with their securities offerings would be prohibited from relying on Rule 506.

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The Commission has the authority to waive this disqualification upon a showing of good cause that such disqualification is not necessary under the circumstances.¹ CS&Co. requests that the Commission do so here, on the following grounds:

1. *The Violations in the Order Do Not Arise Out of the Offer or Sale of Securities by CS&Co.*

The conduct discussed in the Complaint does not arise out of the offer or sale of securities. Rather, the conduct discussed in the Complaint arises out of CS&Co.'s alleged failure to file SARs when CS&Co. investigated and terminated Advisers from its custodial platform. Furthermore, the conduct discussed in the Complaint arises solely out of the duties of a broker-dealer to file SARs under the Commission's books and records rules.

2. *The Alleged Misconduct Does Not Involve Violations of Section 5 of the Securities Act or Scienter-Based Statutory or Regulatory Provisions and Does Not Involve a Criminal Proceeding by CS&Co.*

The violations alleged in the Complaint are not criminal in nature and do not involve any anti-fraud violations (scienter or non-scienter based) or violations of Section 5 of the Securities Act.

3. *CS&Co. Has Taken Substantial Remedial Steps*

In the years since the Commission's original examination which was the basis for the enforcement referral, CS&Co. has taken substantial remedial steps, on its own initiative, to address the conduct at issue in the Complaint and Final Judgment, including the following:

- CS&Co. made significant structural changes to streamline the SAR decision-making process when it terminates Advisers. The Adviser Services ("AS") Surveillance and Investigations group, who investigates Advisers for possible termination from CS&Co.'s custodial platform, now determines whether or not to file SARs related to Adviser misconduct. During the review period (2012-13), the SAR-filing determinations were done by another group within CS&Co.
- CS&Co. added resources consistent with heightened regulatory expectations related to the filing of SARs for Advisers, including significantly increasing the

¹ See Rule 506(d)(2)(i).

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number of employees dedicated to anti-money laundering and fraud prevention, including employees with law enforcement backgrounds.

- CS&Co. increased the quantity, and improved the quality of, internal training for the AS Surveillance and Investigations group, as well as provided opportunities and funding for AS Personnel to attend industry conferences. For example, CS&Co.:
 - Conducted training led by internal and external counsel as well as members of the anti-money laundering (“AML”) group regarding the SAR rules, the proper definition of suspicious activity and fraud under the SAR rules and risk issues particular to Advisers;
 - Conducted training led by AML leadership regarding the SAR filing process;
 - Included training on SAR filings in its new hire materials;
 - Requires that certain personnel attend SAR-related webinars; and
 - Sponsored on-site presentations from law enforcement related to the importance of SAR filings.

CS&Co. thus has taken concrete steps to remediate the conduct at issue in the Complaint and Final Judgment and therefore significantly enhance CS&Co.’s Bank Secrecy Act program (“BSA Program”). Accordingly, it is not necessary to disqualify CS&Co. and its affiliates from relying on Rule 506 in connection with an offering.

4. *No Individuals Associated with CS&Co. Were Charged With Any Violations in Connection with the Final Judgment*

The Commission has not charged any individuals currently (or formerly) associated with CS&Co. with violations in connection with the conduct underlying the Final Judgment, and we understand that no such charges are forthcoming.

5. *Nature and Duration of the Misconduct*

The conduct described in the Complaint arises out of CS&Co.’s alleged failure to file SARs on suspicious transactions by independent investment advisers that CS&Co. terminated from its custodial platform. The Complaint alleges that although CS&Co. took steps to

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investigate and terminate the Advisers, CS&Co. did not have clear or consistent policies for the types of activities for which SARs needed to be filed, such as Adviser registration lapses and suitability concerns. As discussed above, the BSA Program has been significantly enhanced.

The conduct alleged in the Complaint occurred from 2012 to 2013 and involved only 37 of the 83 terminated Advisers during that time period. CS&Co. terminated its business relationship with the Advisers due to determinations that such Advisers violated its internal policies and presented risk to CS&Co. or its customers. The Commission has alleged that CS&Co. failed to file SARs relating to the suspicious transactions of 37 of the 83 Advisers.

6. *Disqualification Would Have a Material and Disproportionate Impact on CS&Co and its Clients*

CS&Co.'s disqualification from acting as a placement agent for Rule 506 offerings would have a significant adverse impact on the Firm and its clients. CS&Co. currently acts, and in the future desires to continue to act, as a "placement agent" for private placements of securities offered by the Firm. Schwab Alternative Investment Access ("AI Access") is a private investment platform available to select Advisor Services registered investment advisers and their eligible clients, who meet certain criteria to participate in the platform.²

Exchange funds, which are private placements offered pursuant to Rule 506 of Regulation D ("Exchange Funds"), are currently available on the AI Access platform. Exchange Funds are private offerings that provide investors who own large, concentrated positions in equity securities the ability to diversify their holdings without incurring an immediate tax liability by "exchanging" a concentrated stock position for a position in the fund.

CS&Co. currently makes four Exchange Funds and one private equity fund available on its AI Access platform. The Exchange Funds employ unique diversification strategies that are not widely available in the marketplace. Consequently, such Exchange Funds meet a very specific need for clients on the AI Access platform. Currently, there are approximately 260 advisers on the AI Access platform and approximately 50 of such advisers have clients holding at least one Exchange Fund in their portfolios. Approximately 54,000 CS&Co. households with a combined net worth of approximately \$700 billion are eligible to participate in the AI Access platform, with over 18,000 of those households holding concentrated stock positions.

² The clients to whom CS&Co. offers the Exchange Funds (defined herein) must be "accredited investors" as defined in Regulation D and "qualified purchasers" as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940.

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Access to the Exchange Funds is very important to the AI Access clients and, as discussed above, allows such clients to meet their very specific needs in a unique manner. If CS&Co. were disqualified from making the Exchange Funds available to the clients on the AI Access platform, clients would lose access to the types of Exchange Funds they may have accessed in the past or wish to access in the future. Furthermore, such clients may not be able to diversify their holdings in a way that best meets their needs since the Exchange Funds are not available through many other broker-dealers.

For the period July 2015 through April 2018, CS&Co. made available four Exchange Funds and one business development company issued in reliance on Rule 506 of Regulation D and such funds raised approximately \$250 million from clients on the AI Access platform.³ As of April 2018, CS&Co. is planning on continuing to make the four Exchange Funds and private equity fund, plus approximately three additional funds, available to clients on the AI Access platform in the next 12 months.

6. *Provision of Written Description of Final Judgment*

If this requested waiver is granted, for a period of five years, CS&Co. agrees to furnish (or cause to be furnished) to each purchaser in a Rule 506 offering that would otherwise be subject to the disqualification under Rule 506(d)(1) as a result of the Final Judgment, a description in writing of the Final Judgment a reasonable time prior to sale.

REQUEST FOR WAIVER

In light of the nature of the violations in the Final Judgment, the enforcement remedies that already will be obtained by entry of the Final Judgment, the remedial measures CS&Co. has taken and will take, and the fact that the disqualification would have a material and disproportionate negative impact on CS&Co.'s Rule 506 business, CS&Co. clients and CS&Co. affiliates, CS&Co. respectfully submits that it has shown good cause that relief from the Rule 506 disqualification should be granted.

Accordingly, we respectfully urge the Division, on behalf of the Commission, or the Commission, pursuant to Rule 506(d)(2)(ii), to waive the disqualification provisions in Rule 506

³ The business development company is no longer available for new investment.

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under the Securities Act to the extent they may be applicable to CS&Co. and its affiliates as a result of the entry of the Final Judgment.⁴

We appreciate your consideration of this request. Please feel free to contact me with any questions.

Very truly yours,



Elizabeth A. Marino

⁴ CS&Co. is not requesting a waiver of the disqualification from relying on Regulation A at this time because it does not now use or participate in transactions under such offering exemption. CS&Co. understands that it may request such waiver in a separate request if circumstances change.