



October 5, 2012

# Schwab Managed Portfolios™ Disclosure Brochure

Charles Schwab & Co., Inc.  
211 Main Street  
San Francisco, CA 94105  
Tel: 800-435-4000  
[www.schwab.com](http://www.schwab.com)

This wrap fee program brochure provides information about the qualifications and business practices of Charles Schwab & Co., Inc. ("Schwab"). If you have any questions about the contents of this brochure, please contact us at the phone number above. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority. Schwab's description of itself in this brochure as a registered investment advisor does not imply a certain level of skill or training on the part of Schwab or its representatives.

Additional information about Schwab is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

# Contents

- Services, Fees and Compensation . . . . .1**
  - Services. . . . . 1
    - Schwab Managed Portfolios™ – Mutual Funds . . . . .1
    - Schwab Managed Portfolios – ETFs. . . . .2
    - Investments of Cash. . . . .3
  - Fees . . . . . 3
    - Program Fee: SMP – Mutual Funds . . . . .3
    - Program Fee: SMP – ETFs. . . . .3
    - Services Covered by the Program Fee . . . . .3
    - Other Charges . . . . .3
  - Compensation . . . . . 4
  - FC Compensation. . . . . 4
  - LMFC Compensation. . . . . 5
  - Portfolio Consultants . . . . . 5
  - Compensation to Other Schwab Employee Investment Professionals . . . . . 5
  - IBL and IBS-FC Compensation. . . . . 5
- Account Requirements and Types of Clients . . . . .5**
  - Retirement Accounts . . . . . 6
- Portfolio Manager Selection and Evaluation . . . . .6**
- Client Information Provided to Portfolio Managers. . . . .6**
- Client Contact With Portfolio Managers . . . . .6**
- Additional Information. . . . .6**
  - Disciplinary Information . . . . . 6
  - Other Financial Industry Activities and Affiliations . . . . . 7
  - Code of Ethics, Participation or Interest in Client Transactions and Personal Trading. . . . . 8
    - Code of Ethics . . . . .8
    - Participation or Interest in Client Transactions. . . . .8
    - Addressing Potential Conflicts. . . . .9
    - Personal Trading. . . . .9
- Review of Accounts. . . . . 9
- Client Referrals and Other Compensation . . . . . 9
- Financial Information . . . . . 9

## Services, Fees and Compensation

### Services

Schwab Managed Portfolios™ is a wrap fee program (“SMP” or the “Program”) sponsored by Charles Schwab & Co., Inc. (“Schwab”). Schwab acts as the qualified custodian for Program accounts and provides execution, reporting, administration and related services for Program accounts. Schwab’s affiliated registered investment advisor, Charles Schwab Investment Advisory, Inc. (“CSIA”), manages Program accounts on a discretionary basis consistent with clients’ chosen investment allocations and is responsible for trading decisions.

The Program offers clients a diversified portfolio of either mutual funds (“SMP – MF Blend” or “SMP – MF Third Party”) or ETFs (“SMP – ETF Blend” or “SMP – ETF Third Party”) in a single account that is managed on a discretionary basis. Schwab representatives help clients decide which Program portfolio best matches their preferred investment strategy, but this decision ultimately rests with the client, and neither Schwab nor CSIA has discretion to select a different portfolio without written authorization. Program portfolios are intended to be long-term investments, typically of at least three to five years.

### Schwab Managed Portfolios – Mutual Funds

Introduced on July 24, 2006, SMP – MF initially comprised four allocation models intended for taxable accounts and four allocation models intended for tax-deferred accounts. The model portfolios included four asset groups—Domestic Equity, International Equity, Bond Funds, and Cash Investments—and corresponded to four risk tolerance levels—aggressive, moderately aggressive, moderate, and moderately conservative. These models are collectively referred to as the “SMP – MF with Standard Models.” As of July 23, 2010, SMP – MF with Standard Models was closed to new enrollments. Only clients with SMP – MF accounts prior to that date can continue to add assets and open new accounts using SMP – MF with Standard Models.

On July 23, 2010, SMP – MF introduced new models: six intended for tax-deferred accounts and six intended for taxable accounts. These model portfolios include five asset groups—Domestic Equity, International Equity, Real Assets, Fixed Income and Cash Investments—and correspond to six investing goals—conservative income, income with growth, balanced, balanced with growth, growth and aggressive growth. These models are collectively referred to as “SMP – MF with New Models.”

### Selection of Funds

Pursuant to written parameters established by Schwab, CSIA does not select mutual funds for the Program from among all of the mutual funds available to investors. CSIA selects from a universe of mutual funds managed by Charles Schwab Investment Management, Inc. (“CSIM”), an affiliate of Schwab and CSIA (“Schwab Funds”) and third-party mutual funds available on the Schwab OneSource® platform, including institutional OneSource funds. These funds pay fees to Schwab that are described in “Participation or Interest in Client Transactions” beginning on page 8.

### Universe of Eligible Funds

SMP – MF Blend with New Models portfolios aim for a 50/50 target asset split of Schwab-affiliated mutual funds and third-party mutual funds for the domestic equity allocation, the international equity allocation, the fixed income allocation and the real estate allocation. While target allocations may vary from the 50/50 split due to portfolio drift and other reasons described below, the 50/50 target allocation is reset each year as part of the annual portfolio rebalancing. SMP – MF Blend with Standard Models portfolios are created from Schwab-affiliated funds for the domestic equity allocation and third-party funds for the international equity and fixed income allocations. SMP – MF Third Party portfolios are composed entirely of third-party funds. The universe of funds is illustrated in the following table.

	SMP – MF Blend with New Models (target percentage)	SMP – MF Third Party with New Models	SMP – MF Blend with Standard Models	SMP – MF Third Party with Standard Models
<b>Domestic Equity Allocation</b>	50% Schwab-affiliated funds; 50% third-party funds	Third-party funds	Schwab-affiliated funds	Third-party funds
<b>International Equity Allocation</b>	50% Schwab-affiliated funds; 50% third-party funds	Third-party funds	Third-party funds	Third-party funds
<b>Real Estate Allocation</b>	50% Schwab-affiliated funds; 50% third-party funds	Third-party funds	Not applicable	Not applicable
<b>Commodities Allocation</b>	50% Schwab-affiliated funds; 50% third-party funds	Third-party funds	Not applicable	Not applicable
<b>Fixed Income Allocation</b>	50% Schwab-affiliated funds; 50% third-party funds	Third-party funds	Third-party funds	Third-party funds

The domestic equity allocation in SMP – MF Blend with Standard Models is composed exclusively of Schwab Funds. Preference is generally given to those funds that employ the Schwab Equity Ratings® proprietary stock evaluation system, followed by other actively managed Schwab-affiliated mutual funds. Schwab-affiliated index mutual funds may be used where no other Schwab-affiliated mutual fund meets the relevant selection criteria, or to complete a portion of the domestic equity allocation for diversification purposes. As a result of these criteria set by Schwab, the overall universe of available funds is significantly smaller than the universe of available funds evaluated for the domestic equity allocation of SMP – MF Third Party.

The international equity and fixed income portions of SMP – MF Blend portfolios with Standard Models are composed entirely of unaffiliated third-party mutual funds using the same selection process described below for SMP – MF Third Party funds.

The proportion of an SMP – MF Blend with Standard Models account initially invested in Schwab Funds varies depending on the model allocation but typically ranges from 30% to 70%, although market movements or changes to the portfolio allocations by CSIA may cause the percentage to go above or below this range. CSIA has discretion to allocate the domestic equity portion of an SMP – MF Blend with Standard Models account entirely into funds that use Schwab Equity Ratings as a principal means of selecting individual equities, entirely into other actively managed Schwab-affiliated funds, entirely into Schwab index funds, or into any combination of Schwab Funds. Because of the limited universe of funds available, SMP clients may collectively account for a large portion of the assets in certain Schwab Funds. Program restrictions set a target maximum concentration of Program assets within any particular affiliated fund, but that maximum concentration is higher than the target maximum concentration permitted for third-party funds.

SMP – MF Blend with New Models portfolios are composed of unaffiliated third-party mutual funds (using the same selection process described below for SMP – MF Third Party funds) and Schwab Funds, including those that employ Schwab Equity Ratings® and other affiliated, actively managed mutual funds. CSIA may also invest in Schwab fundamental index funds, but other Schwab-affiliated index mutual funds are not eligible for SMP – MF with New Models. If Schwab-affiliated funds cannot be used due to insufficient ratings, capacity, or inventory, CSIA will select eligible third-party mutual funds. Third-party funds are used when clients have placed restrictions prohibiting the use of Schwab Funds.

For portfolios in SMP – MF Third Party, SMP – MF Blend with New Models, and the international equity and fixed income allocations of SMP – MF Blend with Standard Models, CSIA selects among favorably rated actively managed third-party mutual funds available through Schwab's Mutual Fund OneSource® service, except where no actively managed fund exists that meets CSIA's criteria or where a selected fund's mandate changes from actively managed to index, in which case a third-party index fund may be selected or retained. The fees that Schwab receives from the mutual funds that participate in its OneSource platform are credited back to SMP – MF clients as part of the calculation of the net Program Fee described in "Fees" beginning on page 3.

#### Other Considerations in SMP – Mutual Funds

In any asset class where there are not sufficient mutual funds that meet CSIA's eligibility criteria, third-party ETFs can be substituted. If, at a later date, a mutual fund satisfies all investment requirements, CSIA will replace the ETF.

Beginning on September 1 of each year, CSIA considers the likelihood of a significant capital gain distribution associated with each fund in the Program. If a significant distribution is expected for a fund, CSIA may choose to purchase an ETF and hold it instead of the fund in certain accounts. CSIA may make such a substitution only for new deposits, and only in accounts invested in a Program allocation that includes municipal bond mutual funds or municipal money market funds. After a mutual fund has made a significant distribution, and no later than January 15, CSIA will replace the substituted ETF with the mutual fund. Client holdings and investment returns in Program accounts where a substitution has taken place will vary from other Program holdings and returns during the period of the substitution. Affected clients may also be subject to short-term capital gains tax on the eventual sale of the ETF.

Municipal bond mutual funds that have small allocations to bonds that are subject to the alternative minimum tax ("AMT") are eligible for models intended for taxable accounts if there are not enough AMT-free mutual funds that meet CSIA's eligibility and selection criteria to adequately diversify the portfolios.

SMP – MF is not designed to address specific tax objectives.

#### Schwab Managed Portfolios™ – ETFs

There are six investment strategies available in SMP – ETFs. The available strategies include the following: conservative, conservative with income, balanced, balanced with growth, growth and aggressive growth. Schwab may change, add or delete available investment strategies at any time.

#### Selection of ETFs

Pursuant to written parameters established by Schwab, CSIA does not select ETFs for the Program from among all of the ETFs available to investors. For example, Vanguard ETFs are not eligible to be selected by CSIA. For SMP – ETF Blend, CSIA first selects ETFs managed by Charles Schwab Investment Management, Inc. ("CSIM"), an affiliate of Schwab and CSIA ("Schwab ETFs™"). If there are no recommendable Schwab ETFs in this population, CSIA will look for the best eligible ETF. Schwab ETFs pay fees to CSIM that are described in "Participation or Interest in Client Transactions" beginning on page 8.

#### Universe of Eligible ETFs

	SMP – ETF Blend	SMP – ETF Third Party
Domestic Equity Allocation	Schwab ETFs if available, otherwise third-party ETFs  Vanguard ETFs not eligible	Third-party ETFs  Vanguard ETFs not eligible
International Equity Allocation		
Real Assets Allocation		
Fixed Income Allocation		

#### SMP – ETF Blend Portfolios and Use of Schwab ETFs

SMP – ETF Blend is built around both a core strategic asset allocation and portfolio tilts—i.e., trades executed by CSIA in order to take advantage of what it believes are limited short-term trading opportunities to outperform the portfolio benchmark. CSIA gives preference to affiliated ETFs, where available, when executing portfolio tilts. However, where no affiliated ETF is available that will allow CSIA to implement its portfolio tilt, CSIA may choose to sell some or all of its allocation to an affiliated ETF and replace it with a third-party ETF for the purpose of implementing a portfolio tilt. In all cases, these substitutions will be temporary and based on the duration of the tactical opportunity.

CSIA can choose to select Schwab ETFs—passive index funds—for these portfolios as long as they are recommendable to Schwab clients pursuant to Schwab's advice policies and guidelines. The percentage of an SMP – ETF Blend account initially invested in Schwab ETFs varies significantly depending on the model allocation but typically ranges from 0% to 88%, although market movements or changes to the portfolio allocations by CSIA may cause the percentage to go above or below this range. CSIA has discretion to allocate any portion, up to 100%, of a portfolio into Schwab ETFs.

If an affiliated ETF is otherwise recommendable and meets CSIA's criteria for inclusion in SMP – ETF Blend after a client's enrollment, the Program rebalancing rules established by Schwab require CSIA to substitute the Schwab ETF for the third-party ETF at the time of the client's annual rebalancing, even if the third-party ETF's performance is better than the Schwab ETF's performance and/or CSIA otherwise prefers the third-party ETF.

CSIA selects third-party ETFs for the SMP – ETF Blend portfolios from Schwab's predetermined list of recommendable ETFs. The ETFs are chosen by CSIA based on how closely the underlying index matches the sub-asset class or viewpoint, the ETF's tracking deviation, expenses, and liquidity, and other factors. ETFs that were originally recommendable but lose this designation are not necessarily removed from existing portfolios. CSIA continues to monitor such non-recommendable ETFs in Program accounts using the evaluation process described above and will remove such ETFs from Program accounts only if it determines that there is no longer merit in keeping them as part of the asset allocation strategy.

#### SMP – ETF Third Party Portfolios

For SMP – ETF Third Party portfolios, CSIA selects third-party ETFs from Schwab's predetermined list of recommendable ETFs. The ETFs are chosen by CSIA based on how closely the underlying index matches the sub-asset class or viewpoint, the ETF's tracking deviation, expenses, and liquidity, and other factors. ETFs that were originally recommendable but lose this designation are not necessarily removed from existing portfolios. CSIA continues to monitor such non-recommendable ETFs in Program accounts using the evaluation process described above and will remove such ETFs from Program accounts only if it determines that there is no longer merit in keeping them as part of the asset allocation strategy.

SMP – ETF Third Party is built around both a core strategic asset allocation and portfolio tilts where the portfolio manager can take advantage of short-term trading opportunities in market segments that are perceived to be undervalued or overvalued.

### Other Considerations in SMP – ETFs

CSIA may rebalance accounts at any time if the allocation of the ETFs in your account deviates from certain investment objectives by more than a specified amount from the recommended allocation due to changes in ETFs' values.

SMP – ETFs is not designed to address specific tax objectives.

Investing in securities, whether through the Program or otherwise, involves the risk of loss that you should be prepared to bear. The specific risks associated with the mutual funds and ETFs comprising the Program portfolios, as well as the risks associated with securities held in those mutual funds and ETFs, are described in detail in the Charles Schwab Investment Advisory, Inc. Disclosure Brochure.

### Investments of Cash

Depending upon the election you make in your account application, cash in your account may be invested in a money market fund sponsored by Schwab or CSIM (a "Schwab Money Market Fund") if the amount of cash to be invested satisfies the Schwab Money Market Fund's minimum investment requirement. CSIM or another affiliate of Schwab serving as investment advisor to a Schwab Money Market Fund will receive advisory fees from the fund as set forth in its prospectus. CSIM and other affiliates also may receive other compensation in connection with the operation and/or sale of shares of the Schwab Money Market Fund to the extent permitted by applicable law such as investment advisory, transfer agent and shareholder servicing fees (see the prospectus and statement of additional information for the Schwab Money Market Fund for more information). However, Program Fees are not charged on the cash investment in your account. Compensation to Schwab and CSIM from Schwab Money Market Funds and other Schwab Funds is described in detail in "Participation or Interest in Client Transactions" beginning on page 8.

### Fees

Schwab charges a quarterly asset-based fee (the "Program Fee") that is applied against all assets in SMP accounts except cash and money market fund assets ("Eligible Assets"). The Program Fee is not charged on cash investments in the account. As the market value of an account reaches a higher breakpoint, as shown in the table below, the assets within that higher breakpoint category are charged a lower rate. Schwab calculates the quarterly Program Fee by multiplying the daily value of the assets in your account for each calendar day in the quarter by the applicable daily fee rate (i.e., the annual rate divided by the number of days in that year) and then adding together the fee for each calendar day in the quarter. Because the Program Fee is billed to your account quarterly rather than yearly, the fee you pay on an annual basis may be higher than the annual rate due to the effects of compounding. Accounts subject to the same fee schedule may be combined in the same billing group with other eligible Program accounts to achieve fee breakpoints in the Program Fee schedule.

The Program Fee is billed and deducted from accounts on the last business day of each calendar quarter. The Program Fee is payable from free credit balances, if any, in Program accounts. If there are no free credit balances in an account, Schwab may redeem money market fund or other fund shares in the account to cover the charges or notify clients to deposit additional funds in the Program account. For purposes of calculating the Program Fee, mutual fund shares will be valued based on the net asset value of the shares as published the previous day. ETF shares listed on a national securities exchange will be valued, as of the valuation date, at the closing or last sale price on the principal market where the security is traded.

When a Program client terminates participation in the Program or changes investment strategies in the Program at any time, the amount of the Program Fee to date for that quarter will be charged immediately to the client's account to complete service within the existing investment strategy and a new billing cycle will commence for the new investment strategy.

In rare circumstances, Schwab may negotiate the Program Fee for clients with large accounts or certain preexisting relationships with

Schwab, which may result in a client paying a fee that is less than the standard Program Fee. Schwab may change the fee schedule applicable to your account by providing notice to you in accordance with your account application and your Schwab account agreement.

### Program Fee: SMP – Mutual Funds

#### SMP – MF Blend

Daily Eligible Assets (does not include cash investments)	Gross Fee	Credit Amount	Annual Program Fee
First \$250,000	1.30%	0.80%	0.50%
Next \$250,000	1.15%	0.80%	0.35%
Assets over \$500,000	1.05%	0.80%	0.25%

#### SMP – MF Third Party

Daily Eligible Assets (does not include cash investments)	Gross Fee	Credit Amount	Annual Program Fee
First \$250,000	0.90%	0.40%	0.50%
Next \$250,000	0.75%	0.40%	0.35%
Assets over \$500,000	0.65%	0.40%	0.25%

The Gross Fee charged in your account is reduced by the Credit Amount to determine the annual Program Fee paid to Schwab. The purpose of this Credit Amount for SMP – MF Blend is to lower the annual fee by at least the amount of fees received by CSIM, a Schwab affiliate, for investment management services in connection with the Schwab Affiliate Funds purchased in your account, and the amount of fees third-party funds pay Schwab for inclusion on its Mutual Fund OneSource® platform.

### Program Fee: SMP – ETFs

#### SMP – ETF (Blend and Third Party)

Daily Eligible Assets (excluding cash investments)	Annual Program Fee
First \$500,000	0.75%
Next \$500,000	0.65%
Assets over \$1,000,000	0.50%

### Services Covered by the Program Fee

The Program Fee covers CSIA's Program investment advisory services, including asset management services, as well as the following services provided by Schwab: (1) execution of transactions; (2) custody of account assets; (3) Program administration; (4) monthly account statements; (5) quarterly performance reports; and (6) the services of a Schwab investment professional relating to Program accounts.

Pursuant to an agreement between CSIA and Schwab, Schwab pays all costs and expenses incurred by CSIA in connection with the Program and with other research services provided by CSIA, plus an additional amount up to 10% of all such costs and expenses. The portion of those annual fees and expenses that relates to the provision of services by CSIA in connection with SMP is expected to range from \$2.5 to \$3.0 million and may be adjusted from time to time as fewer or additional resources are required to support SMP and as negotiated between Schwab and CSIA. CSIA does not enter into agreements directly with SMP clients and accordingly does not receive direct compensation from or negotiate fees with them.

CSIM provides performance reporting services in connection with the Program in exchange for a fixed annual fee of \$175,000 paid by Schwab.

### Other Charges

The Program Fee does not cover certain costs or charges imposed by third parties, including odd-lot differentials, exchange fees, contingent redemption fees and transfer taxes mandated by law. Schwab may also impose additional charges for special services elected by Program clients, including electronic fund and wire transfer fees, certificate delivery fees, and reorganization fees.

In addition to the Program Fee, each mutual fund or ETF is subject to investment advisory, administrative, distribution, transfer agent, custodial, legal, audit, and other customary fees and expenses related to investments in investment companies, as set forth in the prospectuses of the funds. These fees and expenses are paid by the funds but ultimately are borne by fund shareholders, and are in addition to the Program Fee. These fees and expenses will generally not be deducted from the Program Fee. The mutual funds available through the Program may be available directly from the funds pursuant to the terms of their prospectuses and without paying the Program Fee, and ETFs are available outside of the Program without paying the Program Fee, subject to applicable commissions and/or transaction charges. Conversely, the Program may provide access to certain mutual funds, ETFs or classes of funds that Program clients may not be qualified to purchase outside of the Program. If an account leaves the Program, these investments may be liquidated or exchanged for the share class corresponding to the size of a client's individual investment in the fund. Further, to the extent that cash used for investment in the Program comes from redemptions of mutual fund shares, ETFs or other investments outside of the Program, there may be tax consequences or additional costs from sales charges previously paid and redemption fees incurred. Such redemption fees would be in addition to the Program Fee on those assets.

The Program Fee may cost clients more or less than they would pay if they purchased separately the types of services included in the Program. Clients may be able to obtain some or all of the types of services available through the Program on a stand-alone basis from Schwab or other firms. Factors that bear upon the cost of the Program in relation to the cost of the same services purchased separately include, among other things, the type and size of the account (and other accounts that clients may be able to combine to determine fee breakpoints), the historical and expected size or number of trades for an account, and the number and range of supplementary advisory and other services provided to an account. The Program Fee also may be higher or lower than the fees charged by other firms for comparable services.

### Compensation

Among Schwab investment professionals, branch-based and phone-based Financial Consultants are most often responsible for recommending the Program to clients like you. As described immediately below, Financial Consultants have a financial incentive to recommend the Program.

Please note that Financial Consultants may be Schwab employees ("FCs" and Local Market FCs or "LMFCs") or non-employee independent contractors who, with their own employees, operate Schwab Independent Branches pursuant to a franchise agreement with Schwab. Financial Consultants who work out of Schwab Independent Branches are known as Independent Branch Leaders ("IBLs") or, if employed by such independent contractors, Independent Branch Services Financial Consultants ("IBS-FCs"). LMFCs are Schwab employees who manage and work in Schwab branches in places where Schwab has recently decided to expand its branch presence. If you are enrolled in Schwab Private Client™ ("SPC"), you may have both an FC, LMFC, IBL or IBS-FC and/or a Portfolio Consultant ("PC") acting as your investment professional, the last of these being an employee of Schwab's affiliated investment advisor, Schwab Private Client Investment Advisory, Inc. ("SPCIA").

### FC Compensation

The so-called "Service" compensation factor pays the FC an amount, subject to a minimum, designed to reflect the approximate annual revenue to Schwab attributed to clients in their "Practice"—i.e., clients for whom they are the primary point of contact with Schwab—which includes both Program clients and other practice clients. FCs receive more compensation depending on whether a client accepts certain recommendations made by the FC, including the recommendation to enroll in the Program<sup>1</sup> as opposed to maintaining a purely commission-based brokerage relationship.

<sup>1</sup> For SEP-IRAs, SIMPLE IRAs, Company Retirement Accounts, Qualified Retirement Plan accounts, and Schwab Personal Choice Retirement Accounts (collectively, "ERISA-Type Accounts"), plan participants are only eligible to enroll in SMP – MF Third Party. Financial Consultants, whether Schwab employees or independent contractors, may not recommend SMP – MF Third Party to account holders of ERISA-Type Accounts, but may provide investment education and factual information regarding the terms and features of SMP – MF Third Party and other eligible wrap fee programs. Schwab may restrict payment of FCs' Service and Sales compensation on assets held in Schwab Personal Choice Retirement Accounts.

### Service Compensation

	Products/Services	Compensation
Non-Fee-Based	Stocks Options Bonds Certificates of Deposit Exchange-Traded Funds High Yield Investor Checking High Yield Investor Savings	0.0028% of assets
	All Mutual Funds All Money Funds All Other Cash Fixed and Variable Deferred Annuities <sup>2</sup> Margin Balances <sup>3</sup>	0.0350% of assets
Fee-Based	Assets in accounts enrolled in Schwab Private Client ("SPC") or Schwab Advisor Network® where Financial Consultant does not provide ongoing service	0.0350% of assets
	Assets in accounts enrolled in SMP, Schwab Managed Account Select®, or Schwab Managed Account Connection™	0.0595% of assets
	Assets enrolled in SPC where Financial Consultant provides ongoing service	0.0770% of assets

<sup>2</sup> Applicable to insurance-licensed representatives only.

<sup>3</sup> The Proxy Revenue for margin applies only to margin balances in a client's account greater than \$5,000 but not greater than 10% of a client's margin buying power.

FCs also receive so-called "Sales" compensation when clients—both within and outside their Practices—bring net new assets to Schwab, enroll in fee-based services like the Program or purchase certain securities or other products. For example, an FC's Sales compensation for a Program enrollment ranges from 0.09% to 0.21% of the assets enrolled, depending on the FC's payout rate. In contrast, an FC receives only from 0.0375% to 0.0875% of net mutual fund purchases (excluding money market funds), again depending on payout rate. Schwab may cap the amount of Sales compensation that an FC earns from any one client.

### Sales Compensation

Service or Product	Compensation (Depending on the FC's Payout Rate)
Mutual Funds	0.0375% to 0.0875% of Net Mutual Fund purchases—excludes money market funds
Advice Referrals—Schwab Private Client, Schwab Advisor Network, Schwab Managed Portfolios™, Schwab Managed Account Select, Schwab Managed Account Connection	0.09% to 0.21% of Net Advice Enrollments

Service or Product	Compensation (Depending on the FC's Payout Rate)
Referrals to SMP or Windhaven Portfolios®	\$38 to \$88 for Clients who are new to SMP or Windhaven Portfolios; limited to one credit per Client
Financial Planning Services	\$135 to \$315 for converted referrals to Personal Financial Plans or Equity Compensation Consultations \$68 to \$158 for converted referrals to Retirement Consultations

FCs can earn additional compensation through the Circle of Excellence program by ranking in the top 50% among their peers in terms of sales credits and asset consolidation.

### LMFC Compensation

The assets in accounts assigned to LMFC Practices are divided into two categories: (1) "Advised Assets," meaning assets in accounts enrolled in the Program or in a discretionary wrap fee program or accounts managed by an independent third-party investment advisor to whom the client was referred through the Schwab Advisor Network® service; and (2) "Non-Advised Assets," consisting of assets not in the Advised Asset category, which include stocks, bonds, mutual funds, and ETFs, as well as payment for providing cash management services.

Each month, Schwab calculates and applies an Advised Asset revenue rate and a Non-Advised Asset revenue rate to the assets in accounts assigned to the LMFC's Practice. The two revenue rates are calculated by looking at 12-month trailing assets and revenue from all accounts assigned to all LMFC Practices. This is done by dividing the adjusted revenue amount for each asset category by the associated assets and excluding certain revenues not earned at an individual account level. Schwab then applies these revenue rates to the daily average assets in each category in accounts assigned to the LMFC, yielding an adjusted revenue figure for each asset category. The revenue rates change monthly, but the Advised Asset revenue rate is higher because Schwab generally generates more revenue on Advised Assets. This is due to the asset-based fees paid for advisory services and other revenue generated by the underlying assets in the enrolled accounts, such as shareholder servicing fees paid to Schwab by certain mutual funds. An LMFC, therefore, earns more money by successfully recommending that clients enroll or open an account in the Program or another product in the Advised Asset category.

### Portfolio Consultants

PCs are not employed by Schwab, but instead by SPCIA, an affiliated investment advisor that is primarily in the business of providing non-discretionary investment advice to clients of the SPC non-discretionary wrap fee program. PCs provide investment portfolio advice to clients who are enrolled in SPC. They do not receive differential compensation based on the securities that they recommend to enrolled clients. PCs assess their clients' financial needs, analyze clients' portfolios, deliver portfolio advice, and provide periodic portfolio reviews to clients enrolled in SPC. In addition to a base salary, PCs are eligible to earn a bonus that is funded based on Schwab's performance and determined based on manager discretion, which may include consideration of the quality of the representative's interactions with clients, retaining appropriate clients in advised offers, client satisfaction, teamwork, training, professional development, accuracy, and net new assets.

### Compensation to Other Schwab Employee Investment Professionals

Other Schwab employee investment professionals, such as Investment Consultants, Investor Development Specialists, Prospect Development Specialists and Participant Services Financial Consultants, can also earn additional incentive compensation for helping to enroll clients in fee-based advice services, including the Program.

Schwab-employed representatives who demonstrate exceptional performance during the year may also be eligible to earn an annual trip through the Chairman's Club program.

### IBL and IBS-FC Compensation

The assets in accounts assigned to IBLs are divided into two categories: (1) "Advised Assets," meaning assets in accounts enrolled in the Program or in another fee-based investment advisory program like SPC or SMP, or accounts managed by an independent third-party investment advisor to whom the client was referred through the Schwab Advisor Network service; and (2) "Non-Advised Assets," consisting of assets not in the Advised Asset category, which include stocks, bonds, mutual funds, and ETFs, as well as payment for providing cash management services.

Each month Schwab calculates and applies an Advised Asset revenue rate and a Non-Advised Asset revenue rate to the assets in accounts assigned to all Schwab Independent Branches. The two revenue rates are calculated by looking at 12-month trailing assets and revenue from all Schwab Independent Branch accounts. This is done by dividing the adjusted revenue amount for each asset category by the associated assets, subtracting certain product-level expenses and excluding certain revenues not earned at the individual account level. Schwab then applies these revenue rates to the daily average assets in each category in accounts assigned to individual Schwab Independent Branches, yielding an adjusted revenue figure for each asset category. The revenue rates change monthly, but the Advised Asset revenue rate is higher because Schwab generally generates more revenue on Advised Assets. This is due to the asset-based fees paid for advisory services and other revenue generated by the underlying assets in the enrolled accounts such as shareholder servicing fees paid to Schwab by certain mutual funds. An IBL, therefore, earns more money by successfully recommending that a client enroll or open an account in the Program or another product in the Advised Asset category.

After adding together the adjusted revenue figures for Advised and Non-Advised Assets, Schwab then applies a multiplier based on the tenure of the IBL. Finally, Schwab deducts certain monthly fees and expenses from the total adjusted revenue amount that the IBL owes to Schwab under the franchise agreement. This results in a Net Payout for the month.

IBS-FCs receive a salary paid by the IBL and, as determined by the IBL as their employer, may be eligible for a bonus based on a percentage of either their salary or the IBL's Net Payout.

The criteria used by the IBL to determine the amount of the bonus may include such factors as net new assets, net new clients acquired through the efforts of an IBS-FC, or the portion of the Net Payout attributable to clients serviced by an IBS-FC.

### Account Requirements and Types of Clients

Clients of the Program may include individuals, trusts, charitable organizations, investment clubs, corporations and other business organizations. ERISA-Type Accounts are only eligible for SMP – MF Third Party, and certain ERISA-Type Accounts may, at Schwab's discretion, not be eligible for the Program. Charitable remainder trusts are not eligible for the Program.

The minimum investment required to open an account in SMP – MF is \$50,000 for non-IRA accounts and \$25,000 for IRA accounts and other retirement accounts. The minimum investment required to open an account in SMP – ETFs is \$100,000 for all accounts. If the market value of a Program account falls below these specified minimums due to withdrawal of assets from the account, Schwab may require the client to deposit additional money or securities to bring the account up to the required minimum, and CSIA reserves the right to discontinue management of the account.

## Retirement Accounts

Schwab does not and will not render advice on a regular basis pursuant to an arrangement or understanding that such advice shall serve as a primary basis for investment decisions with respect to any retirement account. Schwab, its employees and agents (i) are not fiduciaries as defined under ERISA or under the Internal Revenue Code; (ii) have no investment or other discretion with respect to assets covered by the Program; (iii) will perform no discretionary acts with respect to such assets; (iv) will effect only such transactions as you instruct CSIA you have selected; and (v) will exercise no discretion and provide no advice as to the voting of proxies. CSIA is the sole fiduciary, as defined under ERISA or under the Internal Revenue Code, in performing investment management services and exercising discretion over the assets managed in your retirement account, subject to such reasonable restrictions you may impose.

## Portfolio Manager Selection and Evaluation

Schwab has selected CSIA as the Program portfolio manager. Schwab believes CSIA possesses the requisite expertise to serve in this capacity. Schwab reviews the performance of the Program model allocations quarterly through standardized composite performance reporting.

The fact that CSIA and Schwab are affiliates creates a potential conflict of interest for both firms. Schwab has a potential conflict in selecting and maintaining CSIA as portfolio manager for the Program. CSIA has a potential conflict in selecting mutual funds and ETFs, some of which pay greater compensation to Schwab or other affiliates, for the Program portfolios. Schwab addresses this conflict by establishing written parameters that CSIA must follow in selecting securities for, and removing securities from, Program portfolios, and by reviewing CSIA's performance as Program portfolio manager. CSIA addresses this conflict by adhering to written parameters that do not allow it to consider compensation to Schwab or other affiliates in connection with managing Program portfolios.

## Client Information Provided to Portfolio Managers

At the time a client enrolls in the Program, Schwab provides CSIA with information about that client's chosen portfolio allocation and any reasonable restrictions applicable to the client's Program account. Schwab provides updated information to CSIA as necessary thereafter to notify CSIA of material changes.

## Client Contact With Portfolio Managers

Clients who wish to contact CSIA can do so by making a request to a Schwab representative. Schwab and its representatives are the primary points of contact for clients in the Program.

## Additional Information

### Disciplinary Information

The SEC and other regulatory agencies and organizations have taken certain disciplinary actions against us for violations of investment-related statutes, regulations, and rules. The matters have been settled, and Schwab has paid fines with respect to certain violations.

1. A disciplinary action initiated by the Financial Industry Regulatory Authority ("FINRA") asserted that Schwab violated Municipal Securities Rulemaking Board Rule G-14 by: (1) failing to report required information about certain municipal securities transactions to the Real-Time Transaction Reporting System ("RTRS") within 15 minutes of trade time in the first and fourth quarters of 2010; and (2) failing to report the correct yield to RTRS for certain municipal securities transactions in the second quarter of 2010. Without admitting or denying these assertions, Schwab consented to a censure and a fine of \$35,000 on July 26, 2012.

2. Schwab entered into a consent order with the State of Nevada on November 2, 2011, in which Schwab was fined \$10,000 for failing to detect the lack of Nevada state registration of a non-employee investment advisor. Schwab was found to have violated its own procedures and Nevada Administrative Code Section 90.321 for failing to determine that the non-employee was acting as a professional investment advisor at the time the accounts were set up or during the course of his management of the accounts at issue.

3. A disciplinary action initiated by FINRA asserted that Schwab violated Municipal Securities Rulemaking Board Rule G-14 by: (1) failing to report required information about certain municipal securities transactions to the RTRS within 15 minutes of trade time; and (2) failing to report the correct trade execution time to the RTRS for some of these transactions. Without admitting or denying these assertions, Schwab consented to a censure and a fine of \$12,500 on June 17, 2011.

4. In January 2011, Schwab and its affiliate CSIM (together, for purposes of this disclosure, "Schwab") reached agreements with the SEC, FINRA, the Illinois Secretary of State, Securities Department ("Illinois") and the Connecticut Department of Banking, Securities and Business Investments Division ("Connecticut") to settle matters related to the Schwab YieldPlus Fund® (the "Fund").

As part of the SEC settlement, the SEC found that Schwab violated certain investment-related laws and regulations related to the offer, sale and management of the Fund from 2005 through 2008. In particular, the SEC found that Schwab: (1) deviated from the Fund's concentration policy with respect to investments in non-agency mortgage-backed securities, without shareholder approval; (2) made materially misleading statements and omissions about the Fund and its associated risks before and during the decline of its net asset value ("NAV"); (3) materially understated the Fund weighted average maturity ("WAM"); (4) willfully aided and abetted misstatements and omissions appearing in Fund sales materials and other documents; and (5) lacked policies and procedures reasonably designed to prevent the misuse of material nonpublic information about the Fund. Without admitting or denying these allegations, Schwab agreed to pay a total of approximately \$118,944,996 in disgorgement of fees and penalties. As part of the settlement with the SEC, Schwab will also take a number of actions to improve procedures and reinforce Schwab's commitment to its clients. These actions include retaining an independent consultant to conduct a comprehensive review of Schwab's policies, practices and procedures designed to prevent the misuse of material nonpublic information by or related to Schwab's mutual funds. The SEC settlement was approved by the United States District Court for the Northern District of California on February 16, 2011. Additionally, the SEC has brought related complaints against two former employees of Schwab.

The amount to be paid by Schwab pursuant to the SEC settlement includes approximately \$18,000,000 to be paid by Schwab in settlement of the FINRA matter in which FINRA made related factual allegations against Schwab and found that Schwab's conduct violated FINRA's just and equitable principles of trade and its rules pertaining to communications with the public and supervision.

Schwab has also agreed to pay approximately \$8,567,364 in settlement of the Illinois matter in which Illinois made related factual allegations against Schwab and found that Schwab's conduct violated Illinois Securities Law provisions relating to supervision of securities and advisory activity by employees and to maintenance of written procedures reasonably designed to comply with securities laws and regulations.

Schwab has also agreed to pay an amount not to exceed approximately \$2,800,000 in settlement of the Connecticut matter in which Connecticut made related factual allegations against Schwab and found that Schwab violated applicable Connecticut laws and regulations by failing to reasonably supervise its employees.

Schwab and certain affiliated entities and individuals (the "Schwab Parties") were named as defendants in a number of Fund-related class action lawsuits filed in the United States District Court for the Northern



District of California in 2008. These lawsuits were consolidated into a single class action complaint that alleged violations of state law and federal securities law similar to those described above. On March 30, 2010, the court granted plaintiffs' motion for summary judgment holding defendants liable for plaintiffs' state law claim regarding changes to the investment policy of the Fund, which plaintiffs alleged were made without shareholder approval in violation of the Investment Company Act of 1940. Although the judgment was subject to a potential appeal and further proceedings on damages, the Schwab Parties entered into a settlement agreement to settle the plaintiffs' federal securities law claims for approximately \$202,700,000 and the plaintiffs' California law claims for approximately \$35,000,000. On April 19, 2011, the court entered an order granting plaintiffs' and defendants' motions for final approval of the settlement agreements.

5. A disciplinary action initiated by the New York Stock Exchange ("NYSE") asserted that Schwab: (a) submitted inaccurate electronic blue sheets in violation of NYSE Rules 410A and 401; and (b) failed to properly supervise the preparation of its electronic blue sheets in violation of NYSE Rule 342. Effective January 5, 2006, the NYSE approved a stipulation of facts and consent to penalty ("Stipulation") between Schwab and the NYSE Division of Enforcement. Without admitting or denying guilt, Schwab consented to the Stipulation that it violated the foregoing rules and regulations. As part of the Stipulation, Schwab consented to a censure and a fine of \$300,000. Schwab also agreed to conduct a validation of all required blue-sheet data elements and notify the NYSE in writing that it has completed the validation.

6. A disciplinary action initiated by the NYSE asserted that Schwab: (a) violated NYSE Rules 342(a) and (b) in that Schwab failed to establish and maintain appropriate procedures for supervision and control, including a separate system of follow-up and review, with respect to certain business activities relating to protection of customer assets in accounts managed by non-employee investment advisors and carried by Schwab; and (b) violated Section 17(A) of the Securities Exchange Act of 1934 and Rules 17A-4(b)(4) and 17A-4(f) thereunder and NYSE Rule 440 by failing to preserve and maintain certain electronic communications in the required format and for the required retention periods. Effective October 17, 2005, the NYSE approved a stipulation of facts and consent to penalty ("Stipulation") between Schwab and the NYSE Division of Enforcement. Without admitting or denying guilt, Schwab consented to the Stipulation that it violated the foregoing rules and regulations. As part of the Stipulation, Schwab consented to a censure and a fine of \$1 million. Schwab also undertook: (a) to retain an outside consultant to conduct a review of its policies and procedures with respect to the disbursement of funds from accounts managed by investment advisors; (b) to have the consultant provide a report to the NYSE's Division of Enforcement within 120 days of the date the decision becomes final; and (c) to submit to the NYSE a written representation setting forth the implementation of the recommendations contained in the consultant's report within 60 days of the report's issuance.

7. On September 14, 2004, the SEC issued an order instituting public administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21B of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act"), making findings, imposing remedial sanctions and issuing a cease-and-desist order as to Schwab ("Order"). Schwab consented to entry of the Order without admitting or denying the SEC's findings made in the Order. The SEC found that from at least January 2001 through October 2003, Schwab engaged in a practice that enabled certain mutual fund shareholders to place mutual fund orders after the time the funds calculated their net asset values ("NAV") for that day. Specifically, Schwab allowed clients of investment advisors to place substitute mutual fund orders after 4:00 p.m. Eastern time ("ET"), the time as of which those funds calculated their NAV. The order substitutions were permitted when one of these clients' original pre-4:00 p.m. ET mutual fund orders was rejected by Schwab's computer system because it could not be processed as submitted. The SEC found that this practice violated Rule 22c-1(a) under the Investment Company Act and Schwab's own internal policy requiring any orders Schwab

received after 4:00 p.m. ET to get the next day's fund price. These substitute orders were not made pursuant to any improper agreements between Schwab personnel and the investment advisor or the investment advisor's clients. The SEC imposed on Schwab the following sanctions: (1) that Schwab cease and desist from committing or causing any violations and any future violations of Rule 22c-1(a) under the Investment Company Act; (2) censure of Schwab; and (3) imposition of a civil money penalty in the amount of \$350,000.

8. A disciplinary action initiated by the NYSE asserted that during the time period between approximately February 1997 and September 2003, Schwab: (a) violated NYSE Rule 346(f) by having persons associated with it without permission of the NYSE that Schwab knew, or through the exercise of reasonable care should have known, were subject to statutory disqualification; (b) violated NYSE Rule 351(a)(5) by failing to promptly report to the NYSE certain arrests, arraignments, indictments, convictions, guilty pleas and/or contest pleas to criminal offenses, other than minor traffic violations of employees; (c) violated NYSE Rule 342 by failing to reasonably supervise its business in order to ensure compliance with federal securities laws and NYSE rules relating to associations with statutorily disqualified individuals and reporting to the NYSE of events related to employee criminal matters. Effective July 8, 2004, the NYSE approved a stipulation of facts and consent to penalty ("Stipulation") between Schwab and the NYSE Division of Enforcement. Without admitting or denying guilt, Schwab consented to the Stipulation that it violated NYSE rules. As part of the Stipulation, Schwab agreed to censure and a fine of \$250,000. Schwab also agreed to: (a) retain an outside consultant within 30 days of the decision to perform a review and prepare a report; (b) have the consultant provide a report to the NYSE's Division of Enforcement and Schwab's Board of Directors within 120 days from the date the decision becomes final; and (c) submit to the NYSE a written representation setting forth the implementation of the recommendations contained in the report within 60 days of the report's issuance.

9. A disciplinary action initiated by the National Association of Securities Dealers ("NASD") asserted that: (a) during the period August 14, 2002, through March 25, 2003, Schwab violated Municipal Securities Rulemaking Board Rules G-17 and G-30(a) when it relied solely on the bids provided by a broker's broker to determine the fair market value in the liquidation of six municipal security positions for customers; (b) the prices paid to the customers and received by Schwab were below the fair market value for the security in amounts ranging from 6.57% to 38.57%; and (c) Schwab failed to ensure that the transactions were executed at aggregate prices that were fair and reasonable. Effective June 28, 2004, the NASD approved a letter of acceptance, waiver and consent ("AWC") from Schwab. Without admitting or denying guilt, Schwab agreed to censure and a fine of \$30,000 and was required to pay \$30,869.25 plus interest in restitution to the customers. Schwab agreed to provide a copy of its updated written supervisory procedures as they relate to the determination of the fair market value of municipal securities being bought or sold from a public customer to the NASD within 90 days of the acceptance of the AWC.

### Other Financial Industry Activities and Affiliations

Schwab is a wholly owned subsidiary of The Charles Schwab Corporation ("CSCorp"), a Delaware corporation that is publicly traded and listed on the NASDAQ (symbol: SCHW). Schwab is registered as a broker-dealer under the Securities Exchange Act of 1934 and is a member of FINRA. Schwab provides brokerage services to clients located throughout the United States and in some circumstances outside the United States. Incidental to its broker-dealer business, Schwab offers its clients a variety of investment information services and products, including seminars, periodicals, reports, guides, planning tools, brochures and other publications about securities and investment techniques. Schwab also provides certain online data and financial reporting services.

Schwab is also registered as an investment advisor under the Investment Advisers Act of 1940. Schwab provides other investment advisory services in addition to the Program. The SPC service is a

non-discretionary wrap fee program in which clients receive periodic, ongoing advice from a team of Schwab representatives. In the Schwab Advisor Network®, Schwab makes referrals of investment advisors to investors who are looking for assistance in managing their assets and/or other financial planning activities. Advisors participating in Schwab Advisor Network are independent and not affiliated with Schwab. Investment advisors pay a fee to participate in the Schwab Advisor Network program. Other programs in which Schwab acts as a registered investment advisor include Schwab Managed Account Services™ (“MAS”) wrap fee programs sponsored by Schwab and the financial planning services provided through the Schwab Personal Financial Plan™, Schwab Retirement Consultation, and Schwab Equity Compensation Consultation. A separate agreement and disclosure brochure is available for these other investment advisory services and would be provided to you at the time of referral or purchase.

Schwab does not trade futures and is not a Futures Commission Merchant. However, for our customers that have a desire to trade futures, we have a referral relationship with a company not affiliated with Schwab. Per the terms of the referral relationship, Schwab receives a portion of the commissions that Schwab clients pay that company.

In addition to Schwab and CSIA, other wholly owned subsidiaries of CSCorp are engaged in investment advisory, brokerage, trust, custody, or banking services. CSIM provides advisory and administrative services to certain proprietary mutual funds marketed under the Schwab Funds® and Laudus Funds® names and to Schwab ETFs™ that are included in Program portfolios.

The potential conflicts created by this compensation, and the steps taken by Schwab to address those conflicts are described in “Participation or Interest in Client Transactions” beginning on page 8.

## **Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### **Code of Ethics**

Schwab has a code of ethics adopted pursuant to SEC Rule 204A-1 under the Investment Advisers Act of 1940 (the “Code”). The Code reflects the fiduciary principles that govern the conduct of Schwab and its employees and agents when we are acting as an investment advisor. The Code requires that Schwab’s covered employees and agents comply with applicable federal securities laws and report violations of the Code. Covered employees and agents who are deemed “access persons” by virtue of providing investment advice or having access to certain related information must report their personal transactions and holdings in, and obtain clearance before buying, ETFs used in Program portfolios. The Code prohibits access persons from disclosing Program transactions or any other nonpublic information to anyone except as required to effect securities transactions for clients. The Code also prohibits access persons from using the information for personal profit or the profit of others. Access persons may not engage in deceptive conduct in connection with the purchase or sale of securities for client accounts. The Code is subject to change as necessary to remain current with regulatory requirements and internal business policies and procedures. A copy of the Code is available upon request.

### **Participation or Interest in Client Transactions**

Pursuant to an agreement between CSCorp and UBS Capital Markets, L.P. and UBS Securities LLC (collectively, “UBS”), UBS manages the execution of most types of equity, ETF and options trade orders for which customers have not provided specific instructions, and order routing services for most types of directed orders.

Exchanges and broker-dealers frequently offer rebates for customer orders routed to them for execution. Although Schwab does not receive rebates or other payments from UBS, part of the consideration CSCorp received for the sale of its capital markets business to UBS in 2004 related to the services agreements with UBS and Schwab’s commitments to route most types of equity, ETF and listed options orders through UBS.

UBS routing and execution services are subject to Schwab’s execution quality standards for seeking best execution. In certain circumstances, Schwab itself may route orders directly to a market for execution. Schwab considers a number of factors in evaluating execution quality, including execution price and opportunities for price improvement, market depth and order size, the trading characteristics of the security, speed and accuracy of executions, the availability of efficient and reliable order handling systems, and service levels and the cost of executing orders at a particular market or firm. Price improvement occurs when an order is executed at a price more favorable than the displayed national best bid or offer, and may be available for stocks and ETFs traded on the exchanges and dealer markets, and for listed options. Schwab regularly monitors the execution quality provided by UBS and the various markets to which UBS and Schwab may route orders, to ensure orders are routed to markets that have provided high-quality executions over time.

In addition to the Program Fee, Schwab and its affiliate CSIM earn compensation from the mutual funds and Schwab ETFs held in Program accounts, as described below.

### **Mutual Funds**

When clients invest in a mutual fund through the Program, Schwab receives compensation from mutual fund companies for the recordkeeping, shareholder services and other administrative services that Schwab provides to shareholders of the funds. These shareholder services include transaction processing, settlement of trades, dividend distribution, record maintenance, and distribution of statements, confirmations, prospectuses, and other regulatory shareholder documents. To the extent that any part of the fees described below are paid out of fund assets, those amounts are included in the fund’s operating expense ratio (“OER”), which means they are indirectly borne by the fund’s shareholders.

### **Schwab Mutual Fund OneSource® Service and Other No-Transaction-Fee Funds**

Through Schwab Mutual Fund OneSource, Schwab offers a selection of no-load and load-waived mutual funds. Schwab receives remuneration for the shareholder services provided to these funds and other no-transaction-fee funds it makes available (collectively, “NTF funds”).

To compensate Schwab for various shareholder services, NTF funds pay Schwab an asset-based annual fee, which usually equals 0.40% of the average fund assets held at Schwab but may be as high as 0.45%. The fee may be subject to a monthly minimum that generally does not exceed \$2,000 and applies beginning with the seventh full month after the fund is made available for purchase at Schwab. When adding a new fund to Schwab’s NTF platform, NTF funds also pay Schwab a one-time establishment fee, which Schwab may waive. The amount of this fee generally does not exceed \$10,000 for the first fund added and \$1,000 for each new fund after that.

### **Schwab Affiliate Funds**

Schwab currently has two affiliated mutual fund families: Schwab Funds and Laudus Funds (collectively, “Schwab Affiliate Funds”). Schwab’s affiliate, CSIM, serves as investment advisor to both fund families. These Schwab Affiliate Funds pay CSIM a fee for investment advisory services, the amount of which is described in the funds’ prospectuses.

All Schwab Affiliate Funds are part of Schwab’s Mutual Fund OneSource platform. Consequently, like unaffiliated Mutual Fund OneSource and NTF mutual funds, these funds pay Schwab an asset-based fee for the shareholder services that Schwab provides.

Schwab Funds have adopted a shareholder servicing plan pursuant to which they may pay fees for shareholder services ranging from 0.02% to 0.25% annually on all funds except the Schwab Target Funds and Schwab® Monthly Income Funds. Also pursuant to this plan, some Schwab Money Market Funds may pay Schwab an additional 0.15% annually for administrative services Schwab provides to shareholders invested in Sweep and Premier Sweep Shares of the funds. Laudus Funds pay a fee ranging up to 0.40% annually for the shareholder services that Schwab provides, of which all or a portion may be paid from the funds’ Distribution

and Shareholder Service Plan (Rule 12b-1 plan). These fees are part of the funds' OER and are indirectly borne by the funds' shareholders.

In aggregate, the fees Schwab receives from Schwab Affiliate Funds are greater than the compensation Schwab receives from unaffiliated fund companies participating in the Schwab Mutual Fund OneSource service.

#### **Sponsorship and Educational Opportunities**

In addition to the fees described above, Schwab may earn additional compensation from certain mutual funds for the administrative services Schwab provides in connection with various event sponsorship and educational opportunities. The amount of such fees varies depending on the type and number of opportunities in which the fund participates.

#### **Exchange-Traded Funds ("ETFs")**

In addition to the compensation for reporting services described in "Fees" beginning on page 3, CSIM also receives compensation from affiliated ETFs selected for Program accounts in the form of the applicable OERs.

#### **Cash Balances Awaiting Investment/Distribution**

Schwab earns interest, generally at money market rates, on aggregate cash balances held in Schwab's bank accounts, which include assets in accounts enrolled in the Program that are awaiting investment or pending distribution. Assets awaiting investment include both cash that you have deposited into your account and uninvested amounts held in your account as a result of an authorized transaction. Schwab may earn interest on such amounts through the beginning of the second business day following the deposit or transaction in question. Schwab may earn interest on assets pending distribution from your account beginning on the day the assets are debited from your account and continuing until the distribution check is presented for payment, the timing of which is beyond Schwab's control.

#### **Addressing Potential Conflicts**

The compensation described above creates a potential conflict of interest. Schwab addresses this conflict in a variety of ways, including establishing written parameters for the Program that prohibit CSIA from considering compensation to Schwab or CSIM in selecting mutual funds and ETFs for the Program. Schwab also monitors its representatives for compliance with the Code and has established advice policies and guidelines that Schwab representatives must follow when recommending the Program and assessing initial and ongoing suitability for the Program. Schwab representatives are supervised by their direct managers and by a Central Supervision Team for compliance with Schwab's advice policies and guidelines. In order to address potential conflicts under ERISA and the parallel provisions of the Internal Revenue Code, Schwab prohibits Schwab representatives from recommending SMP – MF Third Party to account holders of ERISA-Type Accounts.

#### **Personal Trading**

Schwab monitors the personal securities holdings and trading of Schwab representatives. Schwab reviews accounts of its representatives custodied at Schwab and applicable accounts custodied at other firms. The surveillance program monitors holdings and trades against the Code, Schwab's Compliance Manual, and other applicable policies. Additionally, Schwab representatives must disclose all securities accounts they own or control after their hire date and review and confirm the accuracy of those accounts on an annual basis during their employment.

Schwab representatives are prohibited from engaging in activities that violate federal or state securities laws, or rules and regulations of the exchanges or regulatory agencies. These prohibitions include rules against frontrunning customer orders—which is when a representative buys or sells a security to possibly capitalize on advance knowledge of an imminent customer transaction that is expected to influence the market price, or passing such information to others for that purpose; so-called "shadowing"—which means misusing confidential customer trade information for possible personal benefit; and purchasing shares in initial public offerings.

## **Review of Accounts**

Schwab Financial Consultants or Managed Solutions Team members contact Program clients at least once a year in order to discuss whether the management of the client's account continues to reflect the client's investment objectives and financial requirements and/or whether a different investment strategy might be suitable. If clients have other accounts enrolled in the SPC non-discretionary wrap fee program, and those accounts are grouped at the clients' request with their Program accounts, then the representative assisting them in this process may also be an employee of Schwab's affiliated investment advisor, SPCIA. The Schwab representative may ask the client to complete a form to provide necessary information to the CSIA personnel managing the account. Clients who have experienced material changes to their financial circumstances or investment objectives, or who wish to impose or modify restrictions on the management of their Program accounts, should promptly inform a Schwab representative.

Schwab sends Program clients a monthly account statement detailing positions and activity in their accounts during the preceding month. The statement includes a summary of all transactions made on the client's behalf, all contributions and withdrawals made to or from the account, all fees and expenses charged to the account, and the account value at the beginning and end of the period. The statement may be based upon information obtained from third parties. Clients also receive a separate confirmation of each transaction.

A third party calculates investment performance for Program accounts, and a report containing this performance information is sent to Program clients quarterly. Schwab believes that the data obtained from these third parties is accurate, but does not independently verify it and is not responsible for its accuracy.

Ongoing investment income, capital gains, capital losses, and miscellaneous deductions for some commodity ETFs are reported annually on the Schedule K-1, and when commodity ETFs are sold in a taxable account, proceeds will be reported on the Form 1099-B. The Schedule K-1 is mailed separately to affected clients each year and needs to be included in income tax returns. In cases where the entity generating the Schedule K-1 files for a tax extension beyond April 15, affected clients may receive the Schedule K-1 after the due date for their income tax returns. Individual taxpayers who do not request a filing extension may need to file an amended federal and/or state tax return if they receive their Schedule K-1 after filing their original return. Also, gains and losses associated with some commodities may be taxed differently than standard short-term and long-term capital gains and losses. Clients should consult their professional tax advisor for help with their unique situations.

You should also understand that investments in ETFs by tax-exempt accounts may generate income that is subject to the unrelated business income tax. You are responsible for paying any unrelated business income tax liability associated with your account as well as the timely filing of the applicable tax forms with the Internal Revenue Service.

## **Client Referrals and Other Compensation**

The Program does not rely upon client referrals from any non-Schwab entity or person.

## **Financial Information**

Schwab does not require or solicit prepayment of the Program Fee and is therefore not required to include a balance sheet for its most recent fiscal year. Schwab is not the subject of any financial condition that is reasonably likely to impair its ability to meet its contractual obligations to its clients. Schwab is not the subject of any bankruptcy petition, nor has it been the subject of any bankruptcy petition at any time during the past ten years.