



April 23, 2020

# Charles Schwab Investment Management, Inc. Pooled Investment Vehicles Disclosure Brochure

211 Main Street  
San Francisco, CA 94105  
1-877-824-5615  
[www.schwabfunds.com](http://www.schwabfunds.com)

This brochure provides information about the qualifications and business practices of Charles Schwab Investment Management, Inc. If you have any questions about the contents of this brochure, please contact us at 1-877-824-5615. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority. Registration with the SEC does not imply a certain level of skill or training.

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

## **Summary of Material Changes**

### **(As of March 27, 2020, since prior annual update on March 29, 2019)**

On March 30, 2020, the Charles Schwab Investment Advisory, Inc. ("CSIA") portfolio management teams that managed the Schwab Managed Portfolios™ (the "SMP Program"), Windhaven® Strategies and ThomasPartners® Strategies and their respective assets will be integrated into CSIM, with CSIM assuming fiduciary responsibilities for the SMP Program, Windhaven Strategies and ThomasPartners Strategies and their respective assets. These changes are described under "Advisory Business". As a result of these changes, material changes were made throughout the brochure and are summarized as follows:

#### **Types of Clients**

- CSIM has updated the types of clients that to which it provides investment advice.

#### **Methods of Analysis, Investment Strategy and Risk of Loss**

- CSIM has modified the discussion of its methods of analysis and investment strategies to reflect its new fiduciary responsibilities.

#### **Other Financial Industry Activities and Affiliations**

- CSIM has modified the discussion of its relationship with affiliates to disclose new and modified relationships.

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

- CSIM has modified the discussion to reflect updates to its Code of Ethics and to disclose potential conflicts of interest and mitigation efforts to reduce any such conflicts, including disclosure of conflicts of interest arising out of selecting mutual funds and ETFs managed by CSIM.

#### **Brokerage Practices**

- CSIM has updated information pertaining to its trading process for the different types of accounts it manages, the provision of trading services to an affiliate, the use of separate trading groups, the ability of a trading group to aggregate trades and how trade rotation and trade allocation are handled.

#### **Voting Client Securities**

- CSIM has updated and modified the description of its proxy voting policy and procedures.

# Contents

Advisory Business . . . . .	4
Fees and Compensation . . . . .	4
Performance-Based Fees and Side-by-Side Management . . . . .	5
Types of Clients . . . . .	5
Methods of Analysis, Investment Strategies and Risk of Loss. . . . .	5
Disciplinary Information . . . . .	8
Other Financial Industry Activities and Affiliations. . . . .	9
Code of Ethics, Participation or Interest in Client Transactions and Personal Trading . . . . .	10
Brokerage Practices . . . . .	11
Review of Accounts . . . . .	14
Client Referrals and Other Compensation . . . . .	14
Custody . . . . .	15
Investment Discretion . . . . .	15
Voting Client Securities . . . . .	15
Financial Information . . . . .	16

## Advisory Business

Charles Schwab Investment Management, Inc., a Delaware corporation ("CSIM"), was founded in 1989 as a wholly-owned subsidiary of The Charles Schwab Corporation ("CSC"), a Delaware corporation that is publicly traded and listed on the New York Stock Exchange. CSIM provides advisory services to separately managed accounts ("SMAs"), registered investment companies, which include mutual funds and exchange-traded funds ("ETFs," and collectively with the mutual funds, "Registered Funds"), collective investment trusts and one non-U.S. pooled investment vehicle. As further described in the "Methods of Analysis, Investment Strategies and Risk of Loss" section, CSIM provides advice about a variety of investments, ranging from equity and fixed income to money market securities and also provides advice as to the selection of investment advisers and pooled investment vehicles for certain clients.

On March 30, 2020, the Charles Schwab Investment Advisory, Inc. ("CSIA") portfolio management teams that manage the Schwab Managed Portfolios™ (the "SMP Program"), Windhaven® Strategies and ThomasPartners® Strategies were integrated into CSIM from CSIA, with CSIM assuming fiduciary responsibilities for the SMP Program, Windhaven Strategies and ThomasPartners Strategies. CSIA is a wholly owned subsidiary of CSC and an affiliate of CSIM that has been registered as an investment adviser since November 5, 2009.

Prior to March 30, 2020, the Windhaven Strategies were managed by Windhaven Investment Management, a division of CSIA. Windhaven Investment Management, Inc. became a division of CSIA in early 2018 when it merged into CSIA. Prior to the 2018 merger, Windhaven Investment Management, Inc. was founded in 2010 when CSC purchased the assets and intellectual property of Windward Investment Management, Inc., which had been registered as an investment adviser since April 2000 (and registered as Windward Capital Inc. since October 1994).

Prior to March 30, 2020, the ThomasPartners Strategies were managed by ThomasPartners Investment Management, a division of CSIA. ThomasPartners, Inc. became a division of CSIA in early 2018 when it merged into CSIA. Prior to the 2018 merger, ThomasPartners, Inc. was purchased by CSC in December 2012. Prior to this acquisition, ThomasPartners, Inc. traced its roots back to July 1970 under other names, including Shorey-Huntington; during a change in control in 2004, the firm adopted the ThomasPartners name.

This brochure relates to the portfolio management services that CSIM provides for certain pooled investment vehicles. CSIM serves as investment adviser to certain Registered Funds and provides investment management and administrative services to those Registered Funds. With respect to the Registered Funds, CSIM utilizes different methods of analysis that are tailored to each Registered Fund's investment objective and strategies and are described, along with applicable risks, in their respective prospectuses and statements of additional information. The Registered Funds' prospectuses, statements of additional information and applicable law may also impose restrictions on investing in certain securities or types of securities.

CSIM provides non-discretionary investment management advice to Charles Schwab Trust Bank ("CSTB"), which is an affiliate of CSIM. CSTB maintains and advises collective investment trusts. CSIM makes recommendations to CSTB on a non-discretionary basis relating to portfolio management, investment objectives and guidelines, asset allocation, sub-adviser selection, monitoring and termination, investing in underlying collective investment trusts or registered investment companies, broker selection and such other matters relating to the collective investment trusts as CSTB may request from time to time. As required by applicable law, CSTB retains ultimate investment discretion over the collective investment

trusts and may follow or reject CSIM's recommendations. CSIM tailors its recommendations to CSTB based on a collective investment trust's specific investment objectives and investment strategies as set forth in its governing and/or offering documents. A collective investment trust's governing and/or offering documents may also impose restrictions on investing in certain securities or types of securities.

CSIM also provides discretionary investment advisory services to Charles Schwab Asset Management (Ireland) Limited ("CSAMIL"), an Irish limited liability management company under common control with CSIM, with respect to a non-U.S. pooled investment vehicle ("non-U.S. fund") managed by CSAMIL. CSIM tailors its recommendations to the non-U.S. fund based on the non-U.S. fund's specific investment objectives and investment strategies as set forth in its prospectus. The non-U.S. fund's prospectus and applicable law may also impose restrictions on investing in certain securities or types of securities.

CSIM also provides model portfolios to sponsors of certain advisory programs and platforms and other financial intermediaries ("Sponsors") on a non-discretionary basis. In these arrangements, the sponsors have the ultimate decision making and discretionary responsibility for the determination of which securities are to be purchased and sold for their account and effect all security transactions in connection with such determinations. CSIM does not have any transparency into which securities were ultimately purchased or sold or the ending portfolio weighting of the accounts of such advisory programs. In addition, CSIM has no specific knowledge of the sponsor's clients or their circumstances. There may be differences between the model portfolios provided to Sponsors and the portfolios CSIM manages for its own discretionary clients that follow the same or a similar investment strategy. These differences may result from various factors, including but not limited to: cash availability, investment restrictions, timing of transactions, account size, holding limits, tax considerations and trade execution. As a result, the performance of CSIM's discretionary advisory client portfolios and that of a model portfolio following the same or similar investment strategy may differ. For more information regarding transactions involving model portfolios, see the section entitled "Brokerage Practices".

As of December 31, 2019, CSIM managed approximately \$479,902,028,402 on a discretionary basis and approximately \$26,393,701,775 on a non-discretionary basis. As of December 31, 2019, the SMP Program, Windhaven Strategies and ThomasPartners Strategies had approximately \$43,931,257,088 assets under management on a discretionary basis.

## Fees and Compensation

As described above, CSIM serves as investment adviser to certain Registered Funds and provides investment management and administrative services to those Registered Funds. The fees paid to CSIM by the Registered Funds are (i) based upon a percentage of each Registered Fund's averaged daily net assets, (ii) described in their respective prospectuses and statements of additional information, and (iii) reflected in their financial statements, which are included in shareholder reports. For certain Registered Funds, CSIM and its affiliates have agreed to reimburse those Registered Funds to the extent that the Registered Funds' total annual operating expenses exceed a specified limitation.

Pursuant to an agreement between CSIM and CSTB, CSIM is entitled to receive a fee from CSTB based on the costs incurred by CSIM to provide the services, utilizing a cost allocation methodology agreed upon between CSIM and CSTB. The fee is payable monthly to CSIM. Collective investment trusts may incur custodian fees, brokerage fees and other transaction costs in connection with purchasing or

selling securities recommended by CSIM and may also incur expenses related to underlying pooled investment vehicles. CSIM's fees do not cover the costs of operating the collective investment trusts in general, such as legal fees, audit expenses, and trustee's fees. Pursuant to an agreement between CSIM and CSAMIL, CSIM is entitled to receive a fee based on a percentage of the assets under management for the non-U.S. fund. The non-U.S. fund will incur similar costs in connection with purchasing or selling securities and similar operating costs.

CSIM does not enter into agreements directly with the collective investment trusts or the non-U.S. fund and accordingly does not receive direct compensation from, or negotiate fees with, them.

Information relating to CSIM's brokerage practices is included in the "Brokerage Practices" section of this brochure.

## **Performance-Based Fees and Side-by-Side Management**

Not applicable.

## **Types of Clients**

Pooled investment vehicles to which CSIM provides investment advice include registered investment companies and non-U.S. funds. CSIM also provides investment advice to trustees of collective investment trusts.

## **Methods of Analysis, Investment Strategies and Risk of Loss**

In managing discretionary client accounts and providing recommendations to non-discretionary clients, CSIM uses various investment strategies and methods of analysis, as described below. This section also contains a discussion of the primary risks associated with these investment strategies, although it is not possible to identify all of the risks associated with investing and the particular risks applicable to a client account will depend on the nature of the account, its investment strategy or strategies and the types of securities held. Where available, please refer to the applicable prospectus or other offering documents for a more detailed discussion of strategies and risks involved with your particular account.

While CSIM seeks to manage accounts so that risks are appropriate to the return potential for the strategy, it is often not possible or desirable to fully mitigate risks. Any investment includes the risk of loss and there can be no guarantee that a particular level of return will be achieved. Clients should understand that they could lose some or all of their investment and should be prepared to bear the risk of such potential losses.

Clients should be aware that while CSIM does not limit its advice to particular types of investments, client mandates may be limited to certain types of securities (e.g., equities) or to the recommendation of investment advisers or pooled investment vehicles and may not be diversified. Unless specifically discussed with a client, the accounts managed by CSIM are generally not intended to provide a complete investment program for a client or investor and CSIM expects that the assets it manages typically do not represent all of the client's assets. Clients are responsible for appropriately diversifying their assets to guard against the risk of loss.

CSIM receives a broad range of research from a wide variety of sources that includes Schwab-affiliated entities, other brokers, and independent research providers, including issuers and trading partners. CSIM may use written reports prepared by recognized analysts who are specialists in the industry and may use computer-based models to assist in portfolio management. CSIM

may also use statistical and other information published by third-party data providers, industry, and government, information gathered at meetings of professionals within the industry, and its own research of investment trends.

CSIM creates diversified portfolios that primarily consist of ETFs and/or mutual funds in a single account for several SMA strategies, such as the SMP Program and Windhaven Strategies, and also for certain pooled investment vehicles. In addition, CSIM also provides portfolio management for ThomasPartners Strategies, which invests primarily in dividend-paying stocks and fixed income investments, and pooled investment vehicles that invest in a variety of equity and fixed income securities. Each SMA strategy or pooled investment vehicle maintains a cash component which may be invested in Schwab Cash Vehicles (as defined later in this brochure), a money market fund, an ETF, or similar cash instruments. The guidelines for asset allocations for each SMA strategy or pooled investment vehicle differ from the others. However, certain pooled investment vehicles may have substantially equivalent strategies. In such circumstances, the guidelines for multiple pooled investment vehicles may be substantially similar. There may be times when CSIM is investing in the same ETF or mutual fund for different SMA strategies or pooled investment vehicles; however, although certain SMA strategies share portfolio management personnel, each SMA strategy has a separate portfolio management team making investing decisions and the SMA portfolio management teams are different than the ones investing for pooled investment vehicles.

## **Methods of Analysis and Investment Strategies**

With respect to the Registered Funds, CSIM utilizes different methods of analysis that are tailored to each Registered Fund's investment objective and strategies and are described, along with applicable risks, in their respective prospectuses and statements of additional information. Shareholders of the Registered Funds should carefully read the prospectuses and statements of additional information.

CSIM provides non-discretionary investment advice to CSTB with respect to collective investment trusts that encompass a number of distinct investment strategies, which are governed by each collective investment trust's governing and/or offering documents. Such non-discretionary investment advice includes periodic evaluation of the performance of third party sub-advisers and underlying pooled investment vehicles to the collective investment trusts, evaluation of compliance by the sub-advisers with any relevant policies and procedures, including best execution and other broker practices, and recommendations to select or terminate sub-advisers or underlying pooled investment vehicles. When providing recommendations to CSTB about the selection, monitoring and removal of sub-advisers or underlying pooled investment vehicles, CSIM considers both qualitative and quantitative factors. Quantitative statistics considered include, but are not limited to, risk adjusted results over multiple time periods relative to peer groups and benchmarks, and return patterns in rising and falling markets. The qualitative review includes, but is not limited to, strategy philosophy and process, investment team, firm, institutional experience, portfolio characteristics, and fit with other sub-advisers or underlying pooled investment vehicles in a portfolio context.

In choosing securities for the non-U.S. fund, CSIM seeks to generate current income within the limit of the fund's investment objective, credit, maturity, liquidity and diversification policies. CSIM's credit research department analyzes and monitors the securities that the non-U.S. fund owns or is considering buying. CSIM may adjust the non-U.S. fund's holdings or its average maturity based on actual or anticipated changes in interest rates, credit quality or market dynamics.

## **Risk of Loss**

There are inherent risks to investing in pooled investment vehicles. The following list of risks does not purport to be a complete enumeration or explanation of the risks involved in CSIM's strategies. As the strategies develop and change over time, clients and investors may be subject to additional and different risk factors. No assurance can be made that profits will be achieved or that substantial losses will not be incurred.

With respect to the Registered Funds, the risks associated with their investment strategies are described in their respective prospectuses and statements of additional information. Shareholders of the Registered Funds should carefully read the prospectuses and statements of additional information.

## **Risks Applicable to Equity and Fixed Income Investments**

### **Investment Risk**

Investing in securities is subject to a number of risks, any of which could cause a client to lose money and clients should be prepared to bear the risk of such loss.

### **Management Risk**

CSIM applies its own investment techniques and risk analyses in making investment decisions or recommendations for its clients, but there can be no guarantee that they will produce the desired results. In addition, there is no guarantee that a strategy based on historical information will produce the desired results in the future and, if market dynamics change, the effectiveness of the strategy may be limited.

### **Market Risk**

Financial markets rise and fall in response to a variety of factors, sometimes rapidly and unpredictably. Markets may be impacted by economic, political, regulatory and other conditions, including economic sanctions and other government actions. In addition, the occurrence of global events, such as war, terrorism, environmental disasters, natural disasters or epidemics, may also negatively affect the financial markets. As with any investment whose performance is tied to these markets, the value of an investment in a client account will fluctuate, which means that an investor could lose money over short or long periods.

### **Asset Allocation Risk**

Asset allocation risk is the risk that the allocation of a client's assets among the various sub-advisers, underlying pooled investment vehicles, asset classes and/or market segments will cause the client's account to underperform other accounts with a similar investment objective but different allocations.

### **Liquidity Risk**

Liquidity risk exists when particular investments may be difficult to purchase, sell or value, especially during stressed market conditions. The market for certain investments may become illiquid due to specific adverse changes in the conditions of a particular issuer or under adverse market or economic conditions independent of the issuer. In such cases, a client account with limitations on investments in illiquid securities and the difficulty in readily purchasing and selling such securities at favorable times or prices, may decline in value, experience lower returns and/or be unable to achieve its desired level of exposure to a certain issuer or sector. Further, transactions in illiquid securities may entail transaction costs that are higher than those for transactions in liquid securities.

Liquidity risk also includes the risk that market conditions or large redemptions may impact the ability of a client account to meet redemption requests. In order to meet such redemption requests, a client account may be forced to sell securities at inopportune times or prices.

### **Frequent Trading Risk**

CSIM's recommendations to CSTB may result in frequent trading by a collective investment trust, depending on the particular fund's investment objective and strategy. To the extent a client account engages in frequent trading, its portfolio turnover rate and transaction costs will rise, which may lower performance and may have tax consequences unless the securities are held in a tax-exempt account.

### **Foreign Investment Risk.**

Investments in securities of foreign issuers involve certain risks that may be greater than those associated with investments in securities of U.S. issuers. These include risks of adverse changes in foreign economic, political, regulatory and other conditions; changes in currency exchange rates or exchange control regulations (including limitations on currency movements and exchanges); differing accounting, auditing, financial reporting and legal standards and practices; differing securities market structures; and higher transaction costs. In certain countries, legal remedies available to investors may be more limited than those available with respect to investments in the U.S. These risks may negatively impact the value or liquidity of a client account's investments and could impair that client account's ability to meet its investment objective or invest in accordance with its investment strategy. In addition, investments in foreign securities may be subject to economic sanctions or other government restrictions. There also is the risk that the cost of buying, selling, and holding foreign securities, including brokerage, tax, and custody costs, may be higher than those involved in domestic transactions. The securities of some foreign companies may be less liquid and, at times, more volatile than securities of comparable U.S. companies. A client account invested in foreign securities may also experience more rapid or extreme changes in value as compared to a client account that invests solely in securities of U.S. companies because the securities markets of many foreign countries are relatively small, with a limited number of companies representing a small number of industries. To the extent a client account's investments in a single country or a limited number of countries represent a large percentage of the client account's assets, the client account's performance may be adversely affected by the economic, political, regulatory and social conditions in those countries, and a client account's value may be more volatile than the value of a client account that is geographically diversified.

### **Emerging Markets Risk**

The risks of foreign investments apply to, and may be heightened in connection with, investments in emerging market countries or securities of issuers that conduct their business in emerging markets. Emerging market countries may be more likely to experience political turmoil or rapid changes in market or economic conditions than more developed countries. Emerging market countries often have less uniformity in accounting and reporting requirements and greater risk associated with the custody of securities. It is sometimes difficult to obtain and enforce court judgments in such countries. There is often a greater potential for nationalization, expropriation, confiscatory taxation, government regulation, social instability or diplomatic developments (including war) in emerging market countries, which could adversely affect the economies of, or investments in securities of issuers located in, such countries. In addition, emerging markets are substantially smaller than developed markets, and the financial stability of issuers



(including governments) in emerging market countries may be more precarious than in developed countries. As a result, there will tend to be an increased risk of illiquidity and price volatility associated with a client account's investments in emerging market countries which may be magnified by currency fluctuations relative to the U.S. dollar, and, at times, it may be difficult to value such investments.

## **Equity Securities Investment Risks**

### **Equity Risk**

The prices of equity securities rise and fall daily. These price movements may result from factors affecting individual companies, industries or the securities market as a whole. Individual companies may report poor results or be negatively affected by industry and/or economic trends and developments. The prices of securities issued by such companies may suffer a decline in response. In addition, markets tend to move in cycles, which may cause stock prices to fall over short or extended periods of time.

### **Market Capitalization Risk**

Securities issued by companies of different market capitalizations tend to go in and out of favor based on market and economic conditions. In addition, there may be less trading volume in securities issued by mid- and small-cap companies than those issued by larger companies and, as a result, trading volatility may have a greater impact on the value of securities of mid- and small-cap companies. Securities issued by large-cap companies, on the other hand, may not be able to attain the high growth rates of some mid- and small-cap companies. During a period when securities of a particular market capitalization fall behind other types of investments a client account's performance could be impacted.

### **Large-Cap Company Risk**

Large-cap companies are generally more mature than smaller companies. They also may have fewer new market opportunities for their products or services, may focus resources on maintaining their market share, and may be unable to respond quickly to new competitive challenges. As a result, the securities issued by these companies may not be able to reach the same levels of growth as the securities issued by small- or mid-cap companies.

### **Mid-Cap Company Risk**

Mid-cap companies may be more vulnerable to adverse business or economic events than larger, more established companies and their securities may be riskier than those issued by large-cap companies. The value of securities issued by mid-cap companies may be based in substantial part on future expectations rather than current achievements and their prices may move sharply, especially during market upturns and downturns.

### **Small-Cap Company Risk**

Small-cap companies may be more vulnerable to adverse business or economic events than larger, more established companies and their securities may be riskier than those issued by larger companies. The value of securities issued by small-cap companies may be based in substantial part on future expectations rather than current achievements and their prices may move sharply, especially during market upturns and downturns. In addition, small-cap companies may have limited financial resources, management experience, product lines and markets, and their securities may trade less frequently and in more limited volumes than the securities of larger companies. Further, small-cap companies may have less publicly available information and such information may be inaccurate or incomplete.

## **Real Estate Investment Trusts ("REITs") Risk**

Investments in REITs will be subject to the risks associated with the direct ownership of real estate, including fluctuations in the value of underlying properties, defaults by borrowers or tenants, changes in interest rates and risks related to general or local economic conditions. REITs are also subject to certain additional risks, for example, REITs are dependent upon specialized management skills and cash flows, and may have their investments in relatively few properties, a small geographic area or a single property type. Failure of a company to qualify as a REIT under federal tax law may have adverse consequences on a client account. In addition, REITs have their own expenses, and a client account will bear a proportionate share of those expenses.

## **Fixed Income Investment Risks**

### **Interest Rate Risk**

Interest rates rise and fall over time. During periods when interest rates are low or there are negative interest rates, a client account's yield and total return also may be low or the client account may be unable to maintain positive returns. Changes in interest rates also may affect the client account's value: a rise in interest rates generally causes a client account's value to fall. The risk is greater when an account holds fixed income securities with longer maturities. A client account may also lose money if interest rates rise sharply. The longer the client account's duration, the more sensitive to interest rate movements its value is likely to be. For example a client account with a longer portfolio duration is more likely to experience a decrease in its share price as interest rates rise. Duration is an estimate of a security's (or portfolio of securities) sensitivity to changes in prevailing interest rates that is based on certain factors that may prove to be incorrect. It is therefore not an exact measurement and may not be able to reliably predict a particular security's price sensitivity to changes in interest rates. Certain countries have recently experienced negative interest rates on certain fixed-income securities. A change in a central bank's monetary policy or improving economic conditions may result in a change in interest rates. Rising interest rates may decrease liquidity in the fixed income securities markets, making it more difficult for CSIM to sell a client account's fixed income securities holdings at a time when CSIM might wish to sell such securities. In addition, decreased market liquidity also may make it more difficult to value some or all of the client account's fixed income securities holdings. In general, changing interest rates, including rates that fall below zero, could have unpredictable effects on markets and may expose fixed-income and related markets to heightened volatility. To the extent that CSIM anticipates interest rate trends imprecisely, a client account could miss yield opportunities or its share price could fall. Inflation-protected securities may react differently to interest rate changes than other types of debt securities and tend to react to changes in "real" interest rates.

### **Credit Risk**

A decline in the credit quality of a portfolio investment could cause a client's account to lose money or underperform. A client could lose money if the issuer or guarantor of a portfolio investment or the counterparty to a derivatives contract fails to make timely principal or interest payments or otherwise honor its obligations. The negative perceptions of an issuer's ability to make such payments could also cause the price of that investment to decline. The credit quality of a portfolio holding can change rapidly in certain market environments and any default on the part of a single portfolio investment could have a negative impact on the value of a client's account.

### **High Yield Risk**

Client accounts that invest in high yield securities and unrated securities of similar credit quality (sometimes called junk bonds) are

subject to greater levels of credit and liquidity risks than client accounts that do not invest in such securities. High yield securities are considered predominately speculative with respect to the issuer's continuing ability to make principal and interest payments. High-yield securities may be more volatile than higher-rated securities. An economic downturn or period of rising interest rates could adversely affect the market for these securities and reduce a client account's ability to sell these securities (liquidity risk). If the issuer of a security is in default with respect to interest or principal payments, a client account may lose its entire investment. Because of the risks involved in investing in high yield securities, an investment in a client account that invests in such securities should be considered speculative.

#### **Government Securities Risk**

Many U.S. government securities are not backed by the full faith and credit of the United States government, which means they are neither issued nor guaranteed by the U.S. Treasury. Although maintained in conservatorship by the Federal Housing Finance Agency since September 2008, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) maintain only lines of credit with the U.S. Treasury. Other securities, such as obligations issued by the Federal Farm Credit Banks Funding Corporation, are supported solely by the credit of the issuer. There can be no assurance that the U.S. government will provide financial support to securities of its agencies and instrumentalities if it is not obligated to do so under law. Also, any government guarantees on securities a client account owns do not extend to the client account itself. Although the risk of default with U.S. government securities is considered unlikely, any default on the part of a portfolio investment could cause the client account's value to fall. The risk of default may be heightened when there is uncertainty relating to negotiations in the U.S. Congress over increasing the statutory debt ceiling. If the U.S. Congress is unable to negotiate an increase to the statutory debt ceiling, the U.S. government may default on certain U.S. government securities including those held by a client account, which could have an adverse impact on that client account. In recent years, the long-term credit rating of the U.S. government was downgraded by a major rating agency as a result of concern about the U.S. government's budget deficit and rising debt burden. Similar downgrades in the future could increase volatility in domestic and foreign financial markets, result in higher interest rates, lower prices of U.S. Treasury securities and increase the costs of different kinds of debt. Although remote, it is at least theoretically possible that under certain scenarios the U.S. government could default on its debt, including U.S. Treasury securities.

#### **Prepayment and Extension Risk**

An investment in fixed income securities is subject to the risk that the securities may be paid off earlier or later than expected. Either situation could cause you to hold securities paying lower-than-market rates of interest, which could hurt an account's yield. In addition, rising interest rates tend to extend the duration of certain fixed income securities, making them more sensitive to changes in interest rates. As a result, in a period of rising interest rates, your account may exhibit additional volatility. This is known as extension risk. When interest rates decline, borrowers may pay off their fixed income securities sooner than expected. This can reduce the returns of an account because the account will have to reinvest that money at the lower prevailing interest rates. This is known as prepayment risk.

#### **Counterparty Risk**

When CSIM enters into a repurchase agreement for a client account, the client's account is exposed to the risk that the other party (i.e.,

the counterparty) will not fulfill its contractual obligation. In a repurchase agreement, there exists the risk that, when the account buys a security from a counterparty that agrees to repurchase the security at an agreed upon price (usually higher) and time, the counterparty will not repurchase the security. These risks are magnified to the extent that a repurchase agreement is secured by collateral other than cash and government securities, such as debt securities, equity securities and high-yield securities that are rated below investment grade (also referred to as junk bonds) ("Alternative Collateral"). High-yield securities that are used as Alternative Collateral are subject to greater levels of credit and liquidity risk, and are considered primarily speculative with respect to the issuer's continuing ability to make principal and interest payments. Alternative Collateral may be subject to greater price volatility and may be more volatile or less liquid than other types of collateral, increasing the risk that the account will be unable to recover fully in the event of a counterparty's default.

#### **Limitations of Disclosure**

The foregoing list of risks does not purport to be a complete enumeration or explanation of the risks involved in CSIM's strategies. As the strategies develop and change over time, clients and investors may be subject to additional and different risk factors. No assurance can be made that profits will be achieved or that substantial losses will not be incurred.

### **Disciplinary Information**

Charles Schwab & Co., Inc., Charles Schwab Investment Management, Inc. and/or Schwab Investments (together, "Schwab" for this section only) reached agreements with the United States Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("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<sup>®</sup> (the "Yield Plus Fund") and/or Schwab Total Bond Market Fund (the "Bond Fund," and together with Yield Plus Fund, the "Funds" for this section only).

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 Funds from 2005 through 2008. In particular, the SEC found that Schwab: (1) deviated from the Funds' concentration policy with respect to investments in non-agency mortgage-backed securities, without shareholder approval; (2) made materially misleading statements and omissions about the Yield Plus Fund and its associated risks before and during the decline of its net asset value ("NAV"); (3) materially understated the Yield Plus Fund's weighted average maturity ("WAM") in certain instances; (4) willfully aided and abetted misstatements and omissions appearing in Yield Plus Fund sales materials and other documents; and (5) lacked policies and procedures reasonably designed to prevent the misuse of material nonpublic information about the Yield Plus Fund. Without admitting or denying these allegations, Schwab agreed to pay a total of approximately \$118,944,996 in disgorgement of fees, penalties and interest. The SEC settlement was approved by the U.S. District Court for the Northern District of California on February 16, 2011.

The amount paid by Schwab pursuant to the SEC settlement included approximately \$18,000,000 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 also agreed to pay approximately \$8,567,364 in settlement of the Illinois matter, and \$2,800,000 in settlement of the Connecticut



matter, in which those states made related factual allegations against Schwab and found that Schwab's conduct violated Illinois and Connecticut laws and regulations relating to the supervision of its employees and the maintenance of written procedures reasonably designed to comply with securities laws and regulations. The amounts paid to Illinois and Connecticut were included in the settlement with the SEC.

Schwab and certain affiliated entities and individuals (the "Schwab Parties") were named as defendants in a number of Yield Plus 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. The Parties entered into a settlement agreement to settle the plaintiffs' federal securities law claims for approximately \$200,000,000 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.

## Other Financial Industry Activities and Affiliations

As a wholly owned subsidiary of CSC, CSIM leverages the resources of CSC, Schwab, and their affiliated companies, such as personnel including, but not limited to, its Chief Executive Officer ("CEO") (also CEO of CSIA, an affiliated investment adviser); Chief Compliance Officer ("CCO"); Chief Legal Officer; legal and compliance support; sales, marketing, technology, operations, finance, human resources, and risk management personnel. CSIM pays Schwab for the services of certain employees and for the facilities and equipment necessary to enable it to provide advisory services to clients. CSIM, CSIA and Schwab personnel have reporting relationships to personnel of affiliated entities. These arrangements and others noted below create the potential for conflicts of interest to arise. These potential conflicts of interest are governed by various policies adopted by CSIM. For example, CSIM has adopted policies and procedures reasonably designed to protect against the misuse of information (and mitigate potential conflicts of interest) whether among CSC-affiliated entities or entities or individuals outside of CSC and its affiliates. Other wholly owned subsidiaries of CSC are engaged in investment advisory, brokerage, trust, custody, or banking services.

### Charles Schwab & Co., Inc.

CSIM is under common control with Schwab, which is both a registered broker-dealer and a registered investment adviser, and a wholly-owned subsidiary of CSC. Schwab serves as the principal underwriter for certain Registered Funds managed by CSIM but does not receive any compensation in that capacity. However, Schwab receives recordkeeping, shareholder servicing and other administrative servicing fees from certain Registered Funds managed by CSIM.

CSIM pays Schwab an annual fee to obtain the Schwab Equity Ratings used in its management of the equity strategies for certain Registered Funds. If the Schwab Equity Ratings were no longer available, CSIM would need to significantly alter its methods of analysis for these Registered Funds.

Schwab, which is also an insurance agency, offers certain Registered Funds managed by CSIM as part of its insurance product offerings.

Schwab sponsors, develops, coordinates the calculation of and maintains the Schwab 1000 Index. Pursuant to a licensing agreement between Schwab and CSIM, Schwab grants a license to an ETF ("self-indexing ETF") that is a series of Schwab Strategic Trust and is managed by CSIM, to use the Schwab 1000 Index and related

intellectual property at no cost to Schwab Strategic Trust or the self-indexing ETF. Schwab does not provide recommendations to the self-indexing ETF using the Schwab 1000 Index regarding the purchase or sale of specific securities. In addition, Schwab will not provide any information relating to changes to the Schwab 1000 Index methodology for the inclusion or exclusion of component securities or methodology for the calculation or the return of component securities to the self-indexing ETF, in advance of a public announcement of such changes by Schwab. The Schwab 1000 Index is used by another Registered Fund managed by CSIM. That Registered Fund, like the self-indexing ETF, seeks to track the performance of the Schwab 1000 Index by investing in the constituents of such index or a representative sample of such constituents of the index. Consistent with the self-indexing ETF's exemptive relief, such Registered Fund will not engage in creation unit transactions with the self-indexing ETF.

Investment advisers recommended or selected by CSIM to act as (i) sub-advisers for Registered Funds advised by CSIM, or (ii) investment advisers of mutual funds or ETFs in which the funds-of-funds or SMAs that CSIM advises invest, may have a business relationship with Schwab whereby Schwab has agreed to make mutual funds advised by such investment advisers available through Schwab Mutual Fund OneSource platform. Schwab receives fees from mutual funds and/or their affiliates for the services Schwab provides in connection with Schwab Mutual Fund OneSource. CSIM does not take into consideration whether an adviser participates in these platforms when making its recommendations or selections. Schwab also makes available certain Registered Funds advised by CSIM through its Schwab Mutual Fund OneSource platform.

In its role as sponsor of the SMP Program, CSIM's affiliate, Schwab, sets the target asset allocations for each SMP Program portfolio and creates the parameters that determine mutual fund and ETF eligibility for the SMP Program. Although CSIM does not favor its own Registered Funds, or disfavor any third-party mutual fund or ETF, in its selection of investments or allocation among investments for the SMP Program portfolios, the parameters and eligibility criteria created by Schwab are designed, in part, to favor certain CSIM managed Registered Funds and to disfavor certain third-party mutual funds and ETFs. Schwab has a financial interest in certain Registered Funds because it or its affiliates receive advisory and recordkeeping, shareholder servicing and other administrative servicing fees from those Registered Funds. This results in higher overall compensation to Schwab, CSIM, and the ultimate parent entity, CSC. Schwab also receives fees from third party funds (or their affiliates) in the SMP model portfolios for record keeping, shareholder services, and other administrative services. The aggregate fees Schwab or its affiliates receive from the Registered Funds may be greater than the fees Schwab receives from third party funds.

If a client's account(s) is custodied at Schwab, cash in the account(s), whether as an investment holding, or while awaiting pending investment or distribution, may be invested in: (1) a money market fund that is managed by CSIM or distributed by Schwab; (2) a sweep vehicle sponsored by Schwab Bank; or (3) a Schwab One<sup>®</sup> product (collectively, "Schwab Cash Vehicles"). In addition, Direct Client accounts may also have investments in CSIM managed Registered Funds. This presents a conflict of interest. The CSIM Fees will be adjusted relative to the Schwab Cash Vehicle and CSIM managed Registered Funds for retirement accounts, including IRAs and accounts subject to ERISA. CSIM reserves the right to change the manner in which it makes accommodations, to the extent permitted by applicable law. More information about Schwab Cash Vehicles may be found in clients' brokerage account agreement(s) with Schwab.

CSIM serves as an investment manager on the Windhaven Strategies and ThomasPartners Strategies available in the Managed Account

Programs sponsored by Schwab and other programs sponsored by other firms. The Schwab Managed Account Programs include, but are not limited to, the following Schwab wrap fee programs: (i) Charles Schwab & Co., Inc. – Managed Account Access®, and (ii) Charles Schwab & Co., Inc. – Managed Account Connection®. CSIM receives from the program sponsor a fee for the investment management services it provides for the Windhaven Strategies and ThomasPartners Strategies. Each program sponsor has prepared a brochure which contains detailed information about its wrap fee program, including the wrap fee charged. Copies of each brochure are available from the program sponsor upon request.

Schwab effects securities transactions for clients in the SMP Program, Windhaven Strategies and ThomasPartners Strategies on an agency basis. Windhaven Strategies and ThomasPartners Strategies wrap fee program clients should note that over time only a small portion of transactions, specifically maintenance trades, are executed for their accounts through the program sponsor.

In connection with the SMP Program, SIP, ThomasPartners Strategies and Windhaven Strategies, CSIM provides Schwab with composite performance reporting data resources and support, for which CSIM is paid a fee.

Schwab sponsors the advisory services Schwab Intelligent Portfolios® ("SIP") and Schwab Intelligent Portfolios Premium™ ("SIP Premium" or the "SIP Premium Program") (collectively, "Schwab Intelligent Portfolios Solutions™"). SIP is an automated discretionary investment advisory service that offers clients a diversified portfolio based on their stated investment objectives and risk tolerance. SIP Premium is a hybrid advisory service that combines financial planning and guidance from Schwab planning consultants with discretionary portfolio management through SIP. SIP portfolios may include ETFs managed by CSIM, for which CSIM receives investment advisory fees. SIP is further described below.

#### **Charles Schwab, Hong Kong, Ltd.**

Charles Schwab, Hong Kong, Ltd. has been appointed the Hong Kong representative of Charles Schwab Asset Management (Ireland) Limited ("CSAMIL") and is authorized by CSAMIL to receive requests from Hong Kong investors for subscriptions, redemptions and exchange of shares of the non-U.S. fund advised by CSIM. Charles Schwab, Hong Kong, Ltd. is a registered securities dealer that is regulated by the Hong Kong securities and futures commission.

#### **Pooled Investment Vehicles**

CSIM provides investment advice to a number of Registered Funds and a non-U.S. fund, and may be deemed to control such funds, although CSIM disclaims any control relationship. CSIM also makes recommendations in connection with the management of certain collective investment trusts although Charles Schwab Trust Bank ("CSTB") retains ultimate investment discretion over those funds.

#### **Charles Schwab Investment Advisory, Inc.**

CSIM is under common control with CSIA, a registered investment adviser. CSIM pays CSIA an annual fee to obtain CSIA's asset allocation models which are used in the management of certain Registered Funds.

CSIA provides portfolio management services to SIP. SIP is an automated discretionary investment advisory service that offers clients a diversified portfolio based on their stated investment objectives and risk tolerance. SIP Premium is a hybrid advisory service that combines financial planning and guidance from Schwab planning consultants with discretionary portfolio management through SIP. SIP portfolios may include Schwab ETFs managed by CSIM, for which CSIM receives investment advisory fees. CSIM provides CSIA with composite performance reporting data resources

and support in connection with the SMP Program, SIP, ThomasPartners Strategies and Windhaven Strategies, for which CSIM is paid a fee. CSIM also provides CSIA with trade execution services for SIP, under an inter-company agreement. CSIM directs these trades to Schwab. In addition, CSIM provides proxy voting services to CSIA under an inter-company agreement. CSIM pays CSIA for the services of certain employees primarily providing sales and marketing services.

#### **Charles Schwab Trust Bank**

CSIM is under common control with CSTB. CSIM provides non-discretionary investment management advice to CSTB pursuant to an agreement between CSIM and CSTB with respect to collective investment trusts maintained and advised by CSTB. CSTB, however, retains the authority to accept or reject CSIM's recommendations. In addition, CSIM provides administrative and proxy voting services to, and receives compensation from, CSTB. CSTB further provides custodial and other trust services to certain of Schwab's customers and affiliates. CSTB provides directed trust and custody services to employee benefit or similar types of plans, and makes certain Registered Funds advised by CSIM available to these clients.

#### **Charles Schwab Asset Management (Ireland) Limited**

CSIM provides discretionary investment advisory services to CSAMIL, an Irish limited liability management company under common control with CSIM, with respect to a non-U.S. pooled investment vehicle ("non-U.S. fund") managed by CSAMIL and receives compensation from CSAMIL with respect to the non-U.S. fund.

#### **Charles Schwab Trust Company**

CSIM is under common control with Charles Schwab Trust Company ("CSTC"). Upon request from CSTC, CSIM may offer access to some of its SMP Program strategies and ThomasPartners Strategies to CSTC in connection with the management of trust assets. CSIM also provides proxy voting guidance to CSTC under an inter-company agreement.

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

#### **Code of Ethics**

##### **General**

CSIM has adopted a code of ethics (the "Code") pursuant to Rule 204A-1 under the Investment Advisers Act of 1940, as amended from time to time. The Code sets forth standards of business conduct that reflect CSIM's fiduciary obligations to its clients and requires CSIM employees to comply with all applicable laws, rules and regulations and promptly report any violation of the Code to a supervisor or CSIM's CCO or their designee. The Code also requires CSIM's officers, directors, employees, contractors and any person who is determined to have access to non-public information regarding any client or CSIM ("access persons") to (i) report, and CSIM to review, personal securities transactions and securities holdings periodically, (ii) pre-clear transactions in covered securities, and (iii) confirm compliance with the provisions of the Code on a periodic basis. Covered securities do not include direct obligations of the U.S. government, high quality short-term debt instruments, investments in non-Schwab affiliated 529 college savings plans, investment in the Schwab Fund for Charitable Giving, and shares of affiliated and non-affiliated money market funds. The Code may be changed as necessary to remain current with regulatory requirements and internal policies and procedures.

A client or prospective client may obtain a copy of CSIM's Code without charge by calling CSIM at (877) 824-5615.

### **Material Non-Public Information**

The Code prohibits access persons from disclosing portfolio transactions or any other material non-public information to anyone outside of CSIM, except as required to effect securities transactions for clients, and from using material non-public information for personal profit or to cause others to profit. Employees are also prohibited from engaging in deceptive conduct in connection with the purchase or sale of securities for client accounts.

### **Gifts and Business Entertainment**

CSIM access persons may not give or accept gifts or business entertainment that violate applicable laws or create a conflict of interest or the appearance of impropriety.

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

CSIM or Schwab may recommend that a client purchase securities of CSC, the parent company of both CSIM and Schwab. Certain Registered Funds managed by CSIM may purchase securities in an underwriting in which Schwab participates, to the extent consistent with the Investment Company Act of 1940, as amended, and the rules and regulations thereunder. Schwab, as an insurance agency, may offer to advisory clients of Schwab insurance products that offer Registered Funds managed by CSIM as part of the insurance product offerings.

CSIM has a conflict of interest because it selects ETFs and mutual funds, including Registered Funds, for various client accounts in the SMP Program, ThomasPartners Strategies and Windhaven Strategies and also for certain funds-of-funds. Other affiliates of CSIM may buy or sell the same securities for client accounts. These are all inherent conflicts of interest within and among CSIM, Schwab, and its affiliates. CSIM mitigates these conflicts of interest through its policies and procedures, which include the evaluation of the selection and investment in ETFs and mutual funds, including Registered Funds, consistent with CSIM's fiduciary duty. Subject to Schwab's oversight as the SMP Program sponsor, the investment decision-making processes of CSIM portfolio management teams are separate and independent from Schwab.

Certain Registered Funds to which CSIM provides investment advice are fund-of-funds. Consistent with the funds-of-funds' investment objectives and strategies, CSIM may recommend that these funds-of-funds allocate a portion of their portfolios to other Registered Funds advised by CSIM for which CSIM receives investment advisory fees. CSIM has policies and procedures in place to establish appropriate controls to identify, and to limit use and distribution of, confidential information about the firm, its businesses and its clients. CSIM does not receive investment management fees from many of the fund-of-funds that it manages. For those funds-of-funds that do pay CSIM an investment management fee, the Board of Trustees of such funds-of-funds meets annually to determine that the amount of the fee is appropriate given the services provided by CSIM. Similarly, CSIM may recommend that certain collective investment trusts advised by CSTB invest in other collective investment trusts advised by CSTB.

When recommending that the funds-of-funds invest in other Registered Funds with multiple share classes, CSIM will recommend that the funds-of-funds invest in the lowest cost share class for which the funds-of-funds are eligible. Similarly, when recommending to CSTB that a collective investment trust invest in underlying pooled investment vehicles with multiple share classes, CSIM will recommend to CSTB the lowest cost share class for which the collective investment trust is eligible.

Schwab, a related person of CSIM, is a registered broker-dealer that effects securities transactions for its brokerage customers. Schwab may act as a principal or agent in these transactions. In the normal course of the conduct of its business as a broker-dealer, Schwab may enter into purchase and sale transactions in securities that CSIM has recommended to its clients.

CSC, Schwab and CSTB may invest for the benefit of their own accounts in the same securities that CSIM recommends to its clients. These affiliates may buy or sell securities at the same time that CSIM clients are buying or selling the same security and may take positions that are the same or contrary to one that CSIM has recommended. In addition, directors, officers and employees of CSIM may buy or sell for themselves (through personal accounts or through accounts of which they are direct or indirect beneficiaries) securities that are also recommended to, or purchased or sold on behalf of, clients.

### **Personal Trading**

CSIM and its affiliates have established policies and procedures designed to prevent the exchange of information between employees at each organization relating to securities holdings and possible trades. Additionally, the personal securities transactions of CSIM's access persons are subject to the Code, which is designed to detect and mitigate or prevent conflicts of interest and unlawful practices that may arise in connection with an access person's personal securities transactions. For example, as described above, the Code requires periodic reporting and review of personal securities transactions and securities holdings. Furthermore, the Code requires access persons to obtain prior approval from the compliance department prior to engaging in a security transaction except for certain types of transactions deemed not to present conflicts of interest with CSIM's advisory activities on behalf of its clients ("Exempted Transactions"), such as purchases pursuant to an automatic investment plan. Access persons are restricted from executing personal transactions in securities, except for Exempted Transactions, when they know or should have known at the time that there is a pending "buy" or "sell" order in the same security for any client account. Portfolio managers are subject to a blackout period of 7 calendar days for both when a security is traded, or is expected to be traded on behalf of a client account and after a security has been traded on behalf of a client. In addition, certain access persons are prohibited from realizing a profit from purchasing and selling, or selling and purchasing, the same security on a short term basis. All access persons are also restricted from executing a personal transaction in securities when the access person has material non-public information regarding the security or issuer, including affiliated money market funds. Certain personal transactions in securities may be subject to further review by CSIM's CCO or their designee.

### **Brokerage Practices**

CSIM operates separate trading groups with one trading group supporting the Registered Funds, collective investment trusts and the non-U.S. fund (the "Pooled Investment Vehicle Trading Group") and a second trading group supporting SIP, the SMP Program, Windhaven Strategies and ThomasPartners Strategies (the "SMA Trading Group," and together with the Pooled Investment Vehicle Trading Group, the "Trading Groups"). Each Trading Group trades solely the products and strategies for which it is designated. The SMA Trading desk also provides trading services to SIP, which is managed by CSIA.

CSIM has established informational barriers and procedures that seek to prohibit the personnel of one Trading Group from communicating or distributing any non-public information related to



the trading activities of a product or strategy it supports (including information regarding pending orders for clients), to personnel of another Trading Group, or supporting a product or strategy serviced by that Trading Group.

Consequently, CSIM generally does not coordinate trading among Trading Groups and, therefore, will at times execute trades for one client from one Trading Group that differ from, or take the opposite side of, trades executed on behalf of another client from another Trading Group. Each Trading Group seeks to obtain best execution on all orders it originates; however, clients serviced by different Trading Groups could receive or appear to receive more favorable outcomes.

CSIM does not aggregate trades or seek opportunities for cross-transactions between client accounts serviced by different Trading Groups. Accordingly, each Trading Group will generally aggregate and allocate orders only among those clients that it services and independently of the other Trading Group. The following discusses CSIM's trading practices with respect to the Pooled Investment Vehicles Trading Group. A discussion of the SMA Trading Group trading practices is included in the disclosure brochures for the SMP Program, Windhaven Strategies and ThomasPartners Strategies.

### **Selecting or Recommending Broker-Dealers – Pooled Investment Vehicles Trading Group**

With the exception of the assets under the management of sub-advisers, CSIM is responsible for selecting brokers or dealers to execute transactions for client accounts. When a portion of a collective investment trusts' assets are under the management of a particular sub-adviser that sub-adviser is responsible for recommending brokers or dealers to CSIM. The sub-advisers are subject to the general oversight of CSIM and CSIM provides assistance to CSTB with respect to policies and procedures for selecting and monitoring collective investment trust brokers.

Similarly, brokerage for the portion of a Registered Fund's assets under the management of a particular sub-adviser is allocated by that sub-adviser, although the sub-advisers are subject to the oversight of CSIM.

CSIM seeks best execution for its clients' portfolio transactions. CSIM places trades in various manners including through different broker/dealers, agency brokers, principal marketmaking dealers, smaller brokers and dealers, which may specialize in particular regions or asset classes, futures commission merchants and over-the-counter derivatives dealers (each, a "broker" for purposes of the discussion in this section). CSIM also uses electronic trading methods, including electronic communications networks ("ECNs") (including, without limitation, multilateral trading facilities ("MTFs") and alternative trading systems ("ATs")). CSIM evaluates the quality and cost of services received from broker-dealers on a periodic and systematic basis and considers a number of factors in selecting brokers or dealers to execute these transactions. These factors can include, without limitation, the following: execution price; brokerage commission or dealer spread; size or type of the transaction; nature or character of the markets; clearance or settlement capability; reputation; financial strength and stability of the broker or dealer; efficiency of execution and error resolution; block trading capabilities; willingness to execute related or unrelated difficult transactions in the future; order of call; ability to facilitate short selling; or provision of additional brokerage or research services or products. CSIM does not consider sales of Registered Funds advised by CSIM as a factor in selecting a broker to effect a portfolio transaction; however, CSIM can execute through brokers that sell shares of Registered Funds advised by CSIM. In addition, CSIM can

execute through Authorized Participants (institutional investors who have entered into an authorized participant agreement with the Schwab ETFs) for the Schwab ETFs or through Authorized Participants' affiliated broker-dealers.

CSIM can place orders directly with ECNs or other ATs. Placing orders with ECNs or other ATs could enable clients to trade directly with other institutional holders. At times, this allows clients to trade larger blocks than would be possible trading through a single market maker.

In determining when and to what extent to use Schwab or any other affiliated broker-dealer as a broker for executing orders for clients, CSIM follows procedures that are designed to assure that affiliated brokerage commissions (if relevant) are reasonable and fair in comparison to unaffiliated brokerage commissions for comparable transactions.

Additional information about CSIM's brokerage practices with respect to the Registered Funds is included in their respective prospectuses and statements of additional information.

### **Soft Dollars**

CSIM generally will not enter into formal soft-dollar arrangements with brokers to obtain brokerage or research services in exchange for brokerage commissions paid by advised accounts. However, CSIM does receive various forms of eligible proprietary research that is bundled with brokerage services at no additional cost from certain of the brokers with whom CSIM executes equity or fixed income trades. These include brokers CSIM is affiliated with such as Schwab or from participation Broker/Custodian-Related Programs for the Windhaven Strategies and ThomasPartners Strategies. These services or products can typically include: company financial data and economic data (e.g., unemployment, inflation rates and GDP figures), stock quotes, last sale prices and trading volumes, research reports analyzing the performance of a particular company or stock, access to websites that contain data about various securities markets, narrowly distributed trade magazines or technical journals covering specific industries, products, or issuers, seminars or conferences registration fees which provide substantive content relating to eligible research, discussions with research analysts or meetings with corporate executives which provide a means of obtaining oral advice on securities, markets or particular issuers, short-term custody related to effecting particular transactions and clearance and settlement of those trades, lines between the broker-dealer and order management systems operated by a third party vendor, dedicated lines between the broker-dealer and CSIM's order management system, dedicated lines providing direct dial-up service between CSIM and the trading desk at the broker-dealer, and message services used to transmit orders to broker-dealers for execution. CSIM can use research services furnished by brokers or dealers in servicing all client accounts, and not all services will necessarily be used in connection with the account that paid commissions or spreads to the broker or dealer providing such services.

CSIM does not currently cause a client to pay a higher commission in return for brokerage or research services or products to obtain research or other products or services. Nonetheless, CSIM benefits from its receipt of bundled research because it does not have to produce or pay for the research, products or services. Consequently, CSIM has an incentive to select or recommend a broker-dealer based on its interest in receiving the proprietary research or other products or services.

CSIM will sometimes purchase for clients new issues of securities in a fixed price offering. In these situations, the seller may be a member of the selling group that will, in addition to selling securities, provide CSIM with research services, in accordance with applicable rules

and regulations permitting these types of arrangements. Generally, the seller will provide research “credits” in these situations at a rate that is higher than that which is available for typical secondary market transactions.

CSIM has an internal committee to oversee trading practices, and has established policies and procedures applicable to best execution, soft dollars and other client commissions practices. The policies and procedures require CSIM portfolio management to obtain approval from that committee for certain arrangements with a broker to obtain a research product or brokerage services. CSIM is not obligated to direct client transactions to broker-dealers that provide research information. During its last fiscal year, CSIM did not pay commissions to a particular broker-dealer in return for brokerage and research services but, as noted above, CSIM may have executed through “full service” broker dealers at a rate higher than might otherwise be available.

### **Directed Brokerage – Pooled Investment Vehicles Trading Group**

CSIM does not recommend, request, require or permit any Registered Fund, collective investment vehicle or the non-U.S fund to direct CSIM to execute transactions through a specified broker-dealer.

### **Trading Process – Pooled Investment Vehicles Trading Group**

Trade orders for different strategies (e.g., the Registered Funds, non-U.S. Fund, collective investment trusts, SMP Program, SIP, Windhaven Strategies, and ThomasPartners Strategies) and for the different Trading Groups are generated by each strategy’s portfolio management team, on different systems, and may utilizing one or more trading strategies (e.g., price at the time of order arrival, market closing price, volume weighted average price over some specified period). Certain trading strategies place relatively greater emphasis on timing, others on speed of execution, while others place greater emphasis on reducing market impact cost. As a result, the speed of trade order fulfillment and the prices achieved for the same security are likely to vary in different programs or strategies and among Trading Groups. Certain strategies or different Trading Groups, which include accounts in programs with different fee structures, may trade in advance of other strategies or their trades could be completed more quickly, and, in these cases, could achieve different execution on the same or similar securities. In addition, market, regulatory, and/or country limitations (especially in the case of emerging markets) may contribute to differences in security prices.

### **Aggregation and Allocation of Securities Transactions – Pooled Investment Vehicles Trading Group**

In certain market circumstances, CSIM could determine that it is in the best interests of one or more clients to execute their trades on an aggregated basis. CSIM will not aggregate transactions if it determines that to do so (i) would be unfair or inequitable in the circumstances; (ii) is impractical; or (iii) is otherwise inappropriate in the circumstances. Clients could pay higher brokerage costs or otherwise receive less favorable prices or execution if CSIM does not aggregate trades when it has an opportunity to do so.

CSIM’s aggregation and allocation procedures are reasonably designed to provide that trade allocations are timely, that no set of trade allocations is accomplished to the unfair advantage of one client over another and that, over time, client accounts are treated fairly and equitably, even though a specific trade could have the effect of benefiting one account over another when viewed in isolation. To aggregate purchase and sale orders for two or more

client accounts:

- (1) CSIM will not receive additional compensation or remuneration of any kind as a result of aggregating transactions for clients.
- (2) CSIM, for each client, will determine that the purchase or sale of each particular security involved is appropriate for the client and consistent with its investment objectives and its investment guidelines or restrictions.
- (3) Each client that participates in a block trade will participate at the average security price with all transaction costs shared on a pro-rata basis.
- (4) Client account information at CSIM will separately reflect the securities that have been bought, sold and held for each client.

For equity transactions, CSIM’s portfolio management and trading departments determine whether aggregation is appropriate for orders received on the trading desk.

Registered Fund trade orders received contemporaneously for the same security, trading in the same direction (buy/sell) and which use the same trading strategy are candidates for aggregation. However, such trades will only be aggregated if the portfolio manager and trader believe that aggregation is appropriate and consistent with CSIM’s duty to seek best execution. Portfolio managers and traders could encounter other circumstances where they believe it is appropriate to aggregate trades across multiple fund accounts. Portfolio managers and traders are permitted to aggregate orders not meeting the above criteria provided that the portfolio managers and traders believe that such aggregation is in the best interest of each client account and consistent with CSIM’s duty to seek best execution. Adjustments to a pro-rata allocation can be made to avoid having odd lots of shares held in any client account, or to avoid conflicts with limitations established for a client.

CSIM portfolio management personnel are responsible for placing orders for fixed income securities transactions with broker-dealers for client accounts for which they provide day-to-day portfolio management. When orders for the same fixed income security for different client accounts are aggregated, they are generally allocated after execution. For fixed income and money market fund accounts that have similar strategies, allocations are determined with the general purpose of achieving, as nearly as possible, performance and portfolio characteristic parity/proportionality among such accounts over time. Additional factors considered in determining allocations include, but are not limited to: (i) duration; (ii) sector weights relative to benchmarks; (iii) capacity available for a particular name or sector; (iv) cash flow/liquidity; (v) portfolio yield; and (vi) weighted average maturity or weighted average life. In furtherance of our general goal, similar money market fund accounts furthest from achieving performance and portfolio characteristic parity typically receive priority in allocations. For fixed income and money market fund accounts that do not have similar strategies, portfolio management personnel document target ranges for significant portfolio characteristics (“Target Ranges”) and allocations among such accounts are determined in accordance with the Target Ranges in effect at the time of the trade. Portfolio management personnel can give priority to a particular account in circumstances where the transaction is necessary to meet that account’s investment objective, and can consider additional factors including, but not limited to: (i) the factors set forth for similar client accounts; (ii) alternative minimum tax; (iii) issuing state; (iv) tax exempt versus taxable income status of the security; and (v) portfolio characteristics of client accounts.



Trade allocations made in a manner other than as described above, other than adjustments to equity pro rata allocations to avoid odd lots or partial executions, must be made in accordance with CSIM's policies and procedures.

Additional information about CSIM's aggregation and allocation of securities practices with respect to the Registered Funds is included in their respective statements of additional information.

### **Trade Errors**

CSIM maintains policies and procedures that address the identification and correction of trade errors. On those occasions when such an error does occur, CSIM will use reasonable efforts to identify and resolve errors as promptly as possible. CSIM will address and resolve errors on a case-by-case basis, in its discretion, based on the facts and circumstances. CSIM is not obligated to follow any single method of resolving errors but will seek to treat all clients fairly in the resolution of trade errors.

### **Model Portfolios - Pooled Investment Vehicles Trading Group**

In model portfolio arrangements with Sponsors, CSIM is ultimately not responsible for determining which securities to buy or sell and is not responsible for executing such trades. However, these Sponsors may be buying or selling the same securities that CSIM is buying or selling on behalf of its own discretionary clients. As a result, these Sponsors may be in the market at or near the same time as CSIM, which may have an adverse impact on the price CSIM is able to obtain for certain securities for its own discretionary clients and may likewise have an adverse impact on the price such Sponsor is able to obtain for such securities.

In connection with model portfolio program Sponsors, CSIM utilizes a trade rotation policy that seeks to execute securities transactions for CSIM's discretionary clients and disseminate model portfolios to Sponsors in a fair and equitable manner. CSIM can communicate model changes to Sponsors in a variety of ways depending on the investment strategy, the advisory program parameters and the advisory agreements. For certain investment strategies, CSIM can provide notification of model portfolio changes on a delayed basis as compared to placing trade orders for CSIM's discretionary clients. The length of the notification delay is generally based on the factors listed above. As a result, certain model portfolio program Sponsors can receive notification of model portfolio changes after CSIM has executed at least a portion of trade orders on behalf of its discretionary clients. It should be noted that certain portfolio securities will overlap among investment strategies, including those used by model portfolio program Sponsors, and orders for such securities may be placed by the Sponsors' clients concurrently or at a different time than CSIM's trading group or with the same brokers utilized by CSIM's trading group.

### **Review of Accounts**

CSIM periodically reviews client accounts, including Registered Funds, utilizing product-specific review processes. Accordingly, account review may differ across client and product types. CSIM's portfolio managers are generally responsible for the daily management and review of the client accounts under their supervision. Such reviews examine compliance with client's investment objectives and account guidelines, account performance and CSIM's current investment process and practices. Below are more detailed descriptions of account reviews conducted for the collective investment trusts and the non-U.S. fund.

A team of investment professionals are responsible for overseeing the sub-advisers to and underlying pooled investment vehicles held by collective investment trusts, which are maintained and advised by

CSTB. The team monitors each collective investment trust for asset allocation, sub-adviser and underlying pooled investment vehicles performance, and sub-adviser exposure as compared to the fund's guidelines on a daily basis, with additional meetings or reviews on monthly basis. CSIM meets with CSTB at least quarterly to review sub-adviser performance, provide updates relating to general economic conditions and matters related to the collective investment trusts and to recommend changes when deemed appropriate. CSIM portfolio managers also perform reviews on an as needed basis, including review of a new asset class or sub-adviser searches.

The portfolio managers and officers of CSIM review the performance of the non-U.S. fund at least quarterly and report on performance to the board of directors of the non-U.S. fund. These reviews and reports include analysis of adherence to the fund's objective and policies, fund performance and other matters relating to CSIM's management of the fund. In addition, CSIM provides information to CSAMIL on a monthly basis, including a compliance checklist and performance summary, that is included as part of CSAMIL's monthly management report to certain designated persons.

### **Client Referrals and Other Compensation**

Certain employees of CSIM's affiliates are compensated based on net sales in Registered Funds managed by CSIM. Consequently, these employees may have an incentive to recommend CSIM advised Registered Funds over other types of accounts.

Schwab provides CSIM, its affiliate, with access to its institutional trading and operations services, which are typically not available to Schwab clients. Schwab's services include research, brokerage, custody, and access to mutual funds and other investments that are otherwise available only to institutional investors or would require a significantly higher minimum initial investment. Schwab also makes available to CSIM other products and services that benefit CSIM but may not benefit clients' accounts. Some of these other products and services assist CSIM in managing and administering clients' accounts. These include software and other technology that provide access to client account data (such as trade confirmations and account statements); facilitate trade execution (and allocation of aggregated trade orders for multiple client accounts); provide research, pricing information, and other market data; facilitate payment of CSIM's Fees from its clients' accounts in the Windhaven Strategies and ThomasPartners Strategies; and assist with back-office support, recordkeeping, and client reporting. Many of these services generally may be used to service all or a substantial number of Windhaven Strategies, ThomasPartners Strategies and SMP Program client accounts, including accounts not maintained at Schwab.

Schwab may also provide CSIM with other services intended to help CSIM manage and further develop its business. These services may include consulting, publications and presentations on practice management, information technology, business succession, regulatory compliance, and marketing. In addition, Schwab may make available, arrange, and/or pay for these types of services to CSIM by independent third parties. Schwab may discount or waive fees it would otherwise charge for some of these services or pay all or a part of the fees of a third party providing these services to CSIM.

### **Other Broker/Custodian-Related Programs**

For the ThomasPartners Strategies, CSIM participates in a number of Broker/Custodian-Related Programs sponsored by unaffiliated firms, including programs from TD Ameritrade Institutional, a division of TD Ameritrade, Inc. ("TD Ameritrade"), Morgan Stanley Smith Barney LLC, and the Fidelity Wealth Advisor Solutions<sup>®</sup> program. These Broker/Custodian-Related Programs and their affiliates provide CSIM with certain economic benefits and access to products and services

not typically available to retail clients as a result of CSIM's participation in their programs. These benefits may include the following products and services:

- access to client account data (such as program client statements and trade confirmations);
- research, pricing and other market data;
- equity trade fee waivers;
- consulting services;
- access to a trading desk serving program clients;
- access to block trading (which provides the ability to bundle securities transactions for execution and then allocate the appropriate shares to program client accounts);
- the ability to have advisory fees deducted directly from program client accounts;
- access to an electronic communications network for client order entry and account information;
- access to mutual funds with no transaction fees and to certain institutional money managers;
- assistance with back-office functions, recordkeeping, and program client reporting; and
- discounts on compliance, marketing, research, technology, and practice management products.

Some of the products and services made available by these custodians through their program benefit program clients; some products and services may benefit CSIM but not the clients. These products or services may assist CSIM in managing and administering client accounts, including accounts not maintained at the custodian. As part of its fiduciary duties to clients, CSIM strives at all times to put the interests of its clients first.

## Custody

With respect to the Registered Funds, collective investment trusts and non-U.S. fund, CSIM generally does not maintain physical custody of its clients' assets. Client assets are typically held by a qualified custodian pursuant to a separate custody agreement.

However, pursuant to Rule 206(4)-2 under the Investment Advisers Act of 1940, as amended, in certain circumstances CSIM may be deemed to have custody of client assets.

CSIM is deemed to have custody of the non-U.S. fund because it is authorized or permitted to withdraw client funds or securities maintained with the non-U.S. fund's custodian upon its instruction to the custodian. The non-U.S. fund's custodian is not a related person of CSIM. Non-U.S. fund shareholders receive the non-U.S. fund's annual audited financial statements, which conform to the requirements of Rule 206(4)-2 and applicable SEC guidance. Non-U.S. fund shareholders should carefully review the audited financial statements they received.

## Investment Discretion

CSIM has investment discretion over the non-U.S. fund pursuant to an investment management agreement between CSAMIL and CSIM. As described in the Advisory Business section, CSIM manages the fund in accordance with its prospectus. CSAMIL and/or the board of directors of the fund may also place additional restrictions on CSIM's investment discretion.

CSIM has investment discretion over the Registered Funds pursuant to investment management/advisory agreements between the Registered Funds and CSIM. As described in the Advisory Business

section, CSIM manages the Registered Funds in accordance with their respective prospectuses and statements of additional information. The Registered Funds' boards of trustees and applicable law may also place additional restrictions on CSIM's investment discretion.

## Voting Client Securities

The following is a summary of CSIM's Proxy Voting Policy (the "Proxy Policy") concerning proxies voted by CSIM on behalf of each investment advisory client who delegates voting authority to CSIM ("Delegating Client"). The Proxy Policy may be changed as necessary to comply with regulatory requirements and internal policies and procedures. An internal proxy committee (the "Proxy Committee") exercises and documents CSIM's responsibility with regard to voting of client proxies.

To assist CSIM and the overall proxy voting process, CSIM has elected to retain an unaffiliated third party proxy voting service as an expert in the proxy voting and corporate governance area (the "Service"). The services provided by the Service include in-depth research, global issuer analysis and voting recommendations, as well as vote execution, reporting and record keeping. CSIM may retain additional experts in the proxy voting and corporate governance area in the future.

The Proxy Committee has the ultimate responsibility for developing the Proxy Policy to determine how to vote the shares. CSIM's Investment Stewardship Team has the primary responsibility to oversee that voting is carried out consistent with the Proxy Policy. However, portfolio managers to certain fundamentally managed separate account clients, including ThomasPartners Strategies portfolio managers, maintain full discretion to vote the shares held by these clients based on their analysis of the economic impact of the ballot items. Therefore, shares for these separate account clients may be voted differently from those voted solely under the guidance of the Investment Stewardship Team.

As a leading asset manager, it is CSIM's responsibility to use its proxy votes to encourage transparency and corporate governance structures that it believes protect or promote shareholder value. CSIM takes a long-term, measured approach to investment stewardship. CSIM's client-first philosophy drives all of its efforts, including its approach to decision making. In the investment stewardship context, that unfolds through CSIM's efforts to appropriately manage risk by encouraging transparency and focusing on those corporate governance structures that will help protect or promote shareholder value. In general, CSIM believes corporate directors, as the elected representatives of all shareholders, are best positioned to oversee the management of their companies. Accordingly, CSIM typically supports a board of directors' and management's recommendations on proxy matters but may not always do so.

CSIM invests on behalf of its clients in companies domiciled all over the world. Since corporate governance standards and best practices differ by country and jurisdiction, the market context is taken into account in the analysis of proposals. Furthermore, there are instances where CSIM may determine that voting is not in the best interests of its Delegating Clients (typically due to costs or to trading restrictions) and will refrain from submitting votes.

The Proxy Committee reviews the Service's written proxy voting guidelines (the "Service's Proxy Guidelines") with input from the Investment Stewardship Team. CSIM generally utilizes the Service's Proxy Guidelines to vote. However, CSIM may create custom voting guidelines where its view does not align with the Service's Proxy Guidelines. Further, the Proxy Committee has delegated voting decisions on particular types of votes to the Investment Stewardship Team, and the Investment Stewardship Team may vote differently

than the Service's Proxy Guidelines suggest, to the extent they believe it is in the best interest of a Delegating Client. In addition, securities held in fundamentally managed separate accounts will generally be voted on a case-by-case basis by an appropriate portfolio manager for the account.

CSIM has adopted proxy voting principles on key proposals, including election of directors, ratification of auditors, classified boards, majority/cumulative voting, proxy access, independent chair, executive compensation and frequency, equity compensation plans, employee stock purchase plans, re-price/exchange option plans, shareholder rights plans, right to call special meetings, right to act by written consent, supermajority voting, increase in authorized common shares, preferred shares, mergers and acquisitions, environmental and social proposals, and political contributions.

CSIM maintains the following practices that seek to prevent undue influence on its proxy voting activity. Such influence might arise from any relationship between the company holding the proxy (or any shareholder or board member of the company) and CSIM, CSIM's affiliates, a client or client's affiliate, or a CSIM employee.

From time to time, client accounts may hold securities issued by a Registered Fund advised by CSIM or securities issued by CSC, CSIM's parent company. Because CSIM has an inherent conflict of interest with respect to such proxies, CSIM will "echo vote" proxies solicited by a Registered Fund or by CSC, unless otherwise required by law. When required by law or applicable exemptive order, CSIM will also "echo vote" proxies of an unaffiliated mutual fund or ETF. Echo voting means that proxies for CSIM clients will be voted for and against management in the same proportion as proxies are voted by all of the other shareholders of the relevant issuer. Echo voting allows shares held by CSIM to count towards any necessary quorum without otherwise influencing the outcome of a proxy measure.

Where the Proxy Committee has delegated an item to the Investment Stewardship Team or a portfolio manager of a fundamentally managed separate account, CSIM has taken certain steps to mitigate perceived or potential conflicts of interest, including, but not limited to, the following: (i) maintaining a reporting structure that separates employees with voting authority from those with sales or business relationship authority; (ii) reporting of potential conflicts to the Proxy Committee to review the conflict and provide final vote determination; and (ii) defaulting to CSIM's Proxy Policy.

In all cases, proxy issues that present material conflicts of interest between CSIM and/or any of its affiliates, and its clients, will be delegated to the Service to be voted in accordance with CSIM's Proxy Policy which is set each year based on governance criteria and not influenced by any individual issuer or ballot item.

Voting proxies with respect to shares of foreign securities may involve significantly greater effort and corresponding cost than voting proxies with respect to domestic securities due to the variety of regulatory schemes and corporate practices in foreign countries with respect to proxy voting. In consideration of the foregoing issues, the Service uses its best-efforts to vote foreign proxies. As part of its ongoing oversight, the Proxy Committee will monitor the voting of foreign proxies to determine whether all reasonable steps are taken to vote foreign proxies. If the Proxy Committee determines that the cost associated with the attempt to vote outweighs the potential benefits Delegating Clients may derive from voting, the Proxy Committee may decide not to attempt to vote. To preserve liquidity and freedom of action, CSIM will not vote proxies solicited by foreign issuers in countries that impose restrictions on the sale of securities for a period of time before and/or after a shareholder meeting.

Where CSIM has delegated day-to-day investment management responsibilities for a client account to a sub-adviser, CSIM may (but generally does not) delegate proxy voting responsibility to the sub-adviser. However, each sub-adviser to whom proxy voting

responsibility has been delegated will be required to review all proxy solicitation material and to exercise the voting rights associated with the securities it has been allocated in the best interest of such Delegating Client. Prior to delegating the proxy voting responsibility, CSIM will review each sub-adviser's proxy voting policy to determine whether it believes each sub-adviser's proxy voting policy is generally consistent with the maximization of the value of CSIM's clients' investments by protecting the long term best interests of a company's shareholders.

Additional information about CSIM's proxy voting practices with respect to the Registered Funds is included in their respective prospectuses and statements of additional information. A client may obtain a copy of CSIM's Proxy Policy, or information regarding how his or her securities were voted, by calling CSIM at (877) 824-5615.

## Financial Information

CSIM does not require nor solicit prepayment of investment advisory fees from its clients. CSIM (and historically CSIA, Windhaven Investment Management, Inc. and ThomasPartners, Inc.) is not aware of any financial condition that is reasonably likely to impair its ability to meet its contractual commitments to clients, nor has CSIM been the subject of a bankruptcy petition at any time during the past ten years.