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# **Schwab Managed Portfolios™**

## **Disclosure Brochure**

**Charles Schwab & Co., Inc. Disclosure Brochure for the  
Schwab Managed Portfolios Wrap Fee Program**

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

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

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## Services, Fees, and Compensation

### Services

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

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

### Schwab Managed Portfolios – Mutual Funds

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

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

### Selection of Funds

Pursuant to written parameters established by Schwab, CSIM does not select mutual funds for the Program from among all of the mutual funds available to investors. CSIM selects from a universe of mutual funds that: (1) are managed by CSIM (“Schwab Funds®”); or (2) participate in the Schwab Mutual Fund OneSource® service or that otherwise pay shareholder servicing fees to Schwab (collectively, “No-Transaction-Fee funds” or “NTF funds”); or (3) are non-retail share classes that meet the inclusion criteria described in “Participation or Interest in Client Transactions” (“Non-Retail Share Classes”). These funds pay fees to Schwab that are described in “Participation or Interest in Client Transactions.”

### Universe of Eligible Funds

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

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

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

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

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

Funds. Program restrictions set a target maximum concentration of Program assets within any particular fund.

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

For portfolios in SMP – MF Third Party, SMP – MF Blend with New Models, and the international equity and fixed income allocations of SMP – MF Blend with Standard Models, CSIM selects among favorably rated, actively managed NTF funds or Non-Retail Share Classes, except where no actively managed fund exists that meets CSIM's criteria or where a selected fund's mandate changes from actively managed to index, in which case a third-party index fund may be selected or retained. The fees that Schwab receives from NTF funds and Non-Retail Share Classes are credited back to SMP – MF clients as part of the calculation of the net Program Fee described in "Fees."

#### Other Considerations in SMP – Mutual Funds

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

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

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

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

#### Schwab Managed Portfolios™ – ETFs

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

#### Selection of ETFs

Pursuant to written parameters established by Schwab, CSIM does not select ETFs for the Program from among all of the ETFs available to investors. For SMP – ETF Blend, CSIM first selects Schwab ETFs™. If there are no eligible Schwab ETFs in this population, CSIM will look for the best eligible ETF. Schwab ETFs pay fees to CSIM that are described in "Participation or Interest in Client Transactions."

#### Universe of Eligible ETFs

	SMP – ETF Blend	SMP – ETF Third Party
Domestic Equity Allocation	Schwab ETFs if available, otherwise third-party ETFs	Third-party ETFs
International Equity Allocation		
Real Assets Allocation		
Fixed Income Allocation		

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

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

CSIM can choose to select Schwab ETFs—passive index funds—for these portfolios pursuant to the written parameters established by Schwab. The percentage of an SMP – ETF Blend account initially invested in Schwab ETFs varies significantly, depending on the model allocation, but typically ranges from 0% to 88%, although market movements or changes to the portfolio allocations by CSIM may cause the percentage to go above or below this range. CSIM has discretion to allocate any portion, up to 100%, of a portfolio into Schwab ETFs.

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

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

#### SMP – ETF Third Party Portfolios

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

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

#### Other Considerations in SMP – ETFs

CSIM may rebalance accounts at any time if the allocation of the ETFs in your account deviates from certain investment objectives by more

than a specified amount from the recommended allocation due to changes in ETFs' values.

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

#### **Investments of Cash**

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

#### **Tax-Gain/Loss Harvesting**

Beginning in November 2019 and subject to requirements described below, clients can request for CSIM to realize limited tax gain or loss opportunities in a given account on a transaction-specific basis. If accepted by CSIM, such a request will result in the sale of specific securities with unrealized losses or gains above certain amounts.

Clients, not Schwab representatives, decide whether and when to elect this option as well as what securities to select. All such requests are subject to CSIM's approval, and gain/loss opportunities will not be identified on an individual tax lot basis. CSIM will seek to implement such requests to harvest tax losses or gains, but the Program is not designed to achieve a specific tax objective.

This request is specific to each transaction and is not a standing request for tax-loss harvesting in the account. A new request must be made for each transaction. For additional details about the tax-loss harvesting feature, please also refer to the CSIM SMP brochure.

Requests are subject to a minimum gain/loss amount from the sale of the securities, which is determined in CSIM's sole discretion.

Securities in the client's account will be sold at a gain or loss to offset or lower potential tax consequences (although CSIM does not monitor the type and amount of capital gains/losses). The performance of the new securities may be better or worse than the performance of the securities that are sold for tax-gain/loss harvesting purposes. The utilization of gains/losses harvested through the strategy will depend upon the recognition of capital gains/losses in the same or a future tax period, and in addition may be subject to limitations under applicable tax laws.

Losses harvested through the strategy that are not utilized in the tax period when recognized generally may be carried forward to offset future capital gains, if any. Clients should consult with their professional tax advisors or check the Internal Revenue Service ("IRS") website at [www.irs.gov](http://www.irs.gov) about the consequences of tax-gain/loss harvesting, including impact on their tax return, in light of their particular circumstances. Neither the tax-gain/loss harvesting strategy for the Program, nor any discussion herein, is intended as tax advice, and neither Schwab nor CSIM represents that any particular tax consequences will be obtained.

CSIM considers only the requested account and requested security in order to determine if there are unrealized gains or losses for purposes of determining whether to harvest such gains or losses, respectively.

Clients are responsible for monitoring their and their spouse's other accounts (at Schwab or with another firm) to ensure that transactions in the same ETF or a substantially similar security do not create a "wash sale."

A wash sale is the sale at a loss and purchase of the same or substantially similar security within 30 days of each other. If a wash sale transaction occurs, the IRS may disallow or defer the loss for current

tax reporting purposes. More specifically, the wash sale period for any sale at a loss consists of 61 calendar days: the day of the sale, the 30 days before the sale, and the 30 days after the sale. The wash sale rule postpones losses on a sale if replacement shares are bought around the same time.

The effectiveness of the tax-gain/loss harvesting strategy to reduce the tax liability of the client will depend on the client's entire tax and investment profile, including purchases and dispositions in a client's (or client's spouse's) accounts outside of the Program and type of investments (e.g., taxable or nontaxable) or holding period (e.g., short term or long term).

There is no guarantee that the tax-gain/loss harvesting strategy will reduce, defer, or eliminate the tax liability generated by a client's investment portfolio in any given tax year.

Transactions in other accounts may affect whether a gain or loss is successfully harvested and, if so, whether that gain or loss is usable by the client in the most efficient manner. If a client requests tax-gain/loss harvesting for a particular security in a given account, CSIM will seek to avoid the wash sale disallowance rule for only 30 days following the harvesting transaction in the designated account and not for other time periods or in any other accounts.

#### **Fees**

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

Accounts subject to the same fee schedule may be combined in the same billing group with other eligible Program accounts to achieve fee breakpoints in the Program Fee schedule.

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

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

In rare circumstances, Schwab may negotiate the Program Fee for clients with large accounts or certain preexisting relationships with Schwab, which may result in a client paying a fee that is less than the standard Program Fee. Schwab may change the fee schedule applicable to your account by providing notice to you in accordance with your account application and your Schwab account agreement.

#### **Program Fee: SMP – Mutual Funds**

Schwab has two different fee schedules for SMP – MF Blend and SMP – MF Third Party. The schedules with higher fees generally apply to

accounts enrolled in SMP – MF after January 1, 2013, that are not ERISA-Type Accounts (as defined below). The lower fee schedules apply to accounts enrolled in SMP – MF before January 1, 2013. They will also apply to any accounts you enroll after January 1, 2013, if certain conditions are met. If you or someone in your household (i.e., generally, a person with the same last name living at the same address): (1) opened an SMP account (either SMP – MF or SMP – ETF) before January 1, 2013; and (2) has continuously maintained at least one SMP account since the time of your initial SMP enrollment (“Lower Price Conditions”), the lower fee schedules will apply to new SMP – MF accounts that you enroll after January 1, 2013. In addition, the lower fee schedules will apply to all SEP-IRAs, SIMPLE IRAs, Company Retirement Accounts, Qualified Retirement Plan accounts, and Schwab Personal Choice Retirement Accounts® (collectively, “ERISA-Type Accounts”), regardless of whether they are enrolled in SMP – MF before or after January 1, 2013, and regardless of the household affiliation of their account holders. However, if you enroll an ERISA-Type Account after January 1, 2013, and do not otherwise meet the Lower Price Conditions, the higher fee schedules will apply to any other accounts you enroll in SMP that are not ERISA-Type Accounts.

#### **SMP – MF Blend**

##### **Schedule for Accounts Enrolled Before January 1, 2013, and ERISA-Type Accounts**

Daily Eligible Assets (excluding cash investments)	Gross Fee	Credit Amount	Annual Program Fee
First \$250,000	1.30%	0.80%	0.50%
Next \$250,000	1.15%	0.80%	0.35%
Assets over \$500,000	1.05%	0.80%	0.25%

##### **Schedule for Accounts Enrolled After January 1, 2013 (Except ERISA-Type Accounts)**

Daily Eligible Assets (excluding cash investments)	Gross Fee	Credit Amount	Annual Program Fee
First \$100,000	1.70%	0.80%	0.90%
Next \$150,000	1.50%	0.80%	0.70%
Next \$250,000	1.30%	0.80%	0.50%
Next \$500,000	1.10%	0.80%	0.30%
Assets over \$1 million	1.00%	0.80%	0.20%

#### **SMP – MF Third Party**

##### **Schedule for Accounts Enrolled Before January 1, 2013, and ERISA-Type Accounts**

Daily Eligible Assets (excluding cash investments)	Gross Fee	Credit Amount	Annual Program Fee
First \$250,000	0.90%	0.40%	0.50%
Next \$250,000	0.75%	0.40%	0.35%
Assets over \$500,000	0.65%	0.40%	0.25%

##### **Schedule for Accounts Enrolled After January 1, 2013 (Except ERISA-Type Accounts)**

Daily Eligible Assets (excluding cash investments)	Gross Fee	Credit Amount	Annual Program Fee
First \$100,000	1.30%	0.40%	0.90%
Next \$150,000	1.10%	0.40%	0.70%
Next \$250,000	0.90%	0.40%	0.50%
Next \$500,000	0.70%	0.40%	0.30%
Assets over \$1 million	0.60%	0.40%	0.20%

The Gross Fee charged in your account is reduced by the Credit Amount to determine the annual Program Fee paid to Schwab. The purpose of this Credit Amount for SMP – MF Blend is to lower the annual fee by at least the amount of fees received by CSIM for investment management services in connection with the Schwab Affiliate Funds purchased in your account, and the amount of the shareholder servicing fees paid to Schwab by mutual funds participating in the Schwab Mutual Fund OneSource® service and other NTF funds. The purpose of this Credit Amount for SMP – MF Third Party is to lower the annual fee by at least the amount of the shareholder servicing fees paid to Schwab by mutual funds participating in the Schwab Mutual Fund OneSource service and other NTF funds.

#### **Program Fee: SMP – ETFs**

Schwab also has two different fee schedules for SMP – ETF Blend and SMP – ETF Third Party. The same criteria for determining whether your account is subject to the lower or higher fee schedule applies as described above under “Program Fee: SMP – Mutual Funds.”

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

##### **Schedule for Accounts Enrolled Before January 1, 2013**

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

##### **Schedule for Accounts Enrolled After January 1, 2013**

Daily Eligible Assets (excluding cash investments)	Annual Program Fee
First \$100,000	0.90%
Next \$400,000	0.75%
Next \$500,000	0.65%
Assets over \$1 million	0.50%

#### **Services Covered by the Program Fee**

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

Pursuant to an agreement between CSIM and Schwab, Schwab pays all costs and expenses incurred by CSIM in connection with the Program and with other research services provided by CSIM, plus an additional amount based on a fixed percentage of such costs and expenses. CSIM does not enter into agreements directly with SMP clients and accordingly does not receive direct compensation from or negotiate fees with them.

#### **Other Charges**

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

In addition to the Program Fee, each mutual fund or ETF is subject to investment advisory, administrative, distribution, transfer agent, custodial, legal, audit, and other customary fees and expenses related to investments in investment companies, as set forth in the prospectuses of the funds. These fees and expenses are paid by the funds but ultimately are borne by fund shareholders, and are in addition to the Program Fee. These fees and expenses will generally not be deducted from the Program Fee. The mutual funds available through the Program may be available directly from the funds pursuant to the terms of their prospectuses and without paying the Program Fee, and

ETFs are available outside of the Program without paying the Program Fee, subject to applicable commissions and/or transaction charges. Conversely, the Program may provide access to certain mutual funds, ETFs, or classes of funds that Program clients may not be qualified to purchase outside of the Program. If an account leaves the Program, these investments may be liquidated or exchanged for the share class corresponding to the size of a client's individual investment in the fund. Further, to the extent that cash used for investment in the Program comes from redemptions of mutual fund shares, ETFs, or other investments outside of the Program, there may be tax consequences or additional costs from sales charges previously paid and redemption fees incurred. Such redemption fees would be in addition to the Program Fee on those assets.

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

### **Compensation**

Among Schwab investment professionals, branch-based and phone-based Financial Consultants ("FCs") are most often responsible for recommending the Program to clients like you. FCs may be Schwab employees or non-employee independent contractors who, with their own employees, operate Schwab Independent Branches pursuant to a franchise agreement with Schwab. The FCs who operate Schwab Independent Branches are known as Independent Branch Leaders ("IBLs") or, if employed by such IBLs, Independent Branch ("IB") Representatives.

In addition to their base salaries, FCs receive compensation for successfully navigating clients to the Program and other investment advisory programs and for servicing those clients after enrollment in such programs. Schwab as a company may earn more or less revenue depending on what products and services an FC recommends and a client chooses. FC compensation varies by the type of program or service an account participates in. Schwab has designed FC compensation to be based on factors that include the time, complexity, and expertise necessary to understand and recommend a program and to provide ongoing service to a client enrolled in a given program.

As independent contractors, IBLs receive a monthly "Net Payout" from Schwab, which includes amounts earned on assets in the Program and assets in commission-based brokerage accounts, and it is from this Net Payout amount that IBLs pay their IB Representative employees. As with FCs, the amounts earned by IBLs and IB Representatives vary by the type of program in which an account participates.

Based on these factors, amounts earned by Financial Consultants on assets enrolled in the Program exceed the amounts earned on assets in commission-based brokerage accounts and in some other advisory program accounts.

### **Compensation to Other Schwab Employee Investment Professionals**

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

For detailed information on the compensation of these and other Schwab investment professionals, please visit our website at [www.schwab.com/compensation](http://www.schwab.com/compensation).

## **Account Requirements and Types of Clients**

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

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

### **Retirement Accounts**

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

## **Portfolio Manager Selection and Evaluation**

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

The fact that CSIM and Schwab are affiliates creates a potential conflict of interest for both firms. Schwab has a potential conflict in selecting and maintaining CSIM as portfolio manager for the Program. CSIM has a potential conflict in selecting mutual funds and ETFs—some of which pay greater compensation to Schwab or other affiliates than other eligible mutual funds and ETFs—for the Program portfolios. CSIM also has a potential conflict in selecting ETFs that may be used or considered in other managed accounts for which CSIM also acts as portfolio manager, as described in more detail below in "Other Financial Industry Activities and Affiliations." Schwab addresses these conflicts by establishing written parameters that CSIM must follow in selecting securities for, and removing securities from, Program portfolios, and by reviewing CSIM's performance as Program portfolio manager. CSIM addresses these conflicts by adhering to written parameters that do not allow it to consider compensation to Schwab or other affiliates or affects in other programs in connection with managing Program portfolios.

## **Client Information Provided to Portfolio Managers**

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

## **Client Contact With Portfolio Managers**

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

## Additional Information

### Risks

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

### Disciplinary Information

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

1. A disciplinary action initiated by the Financial Industry Regulatory Authority ("FINRA") asserted that, in violation of FINRA Rules 2010 and 3310(a), Schwab failed to implement policies and procedures that were reasonably designed to detect and cause the reporting of suspicious incoming wire transactions occurring in August 2011. Without admitting or denying the findings, Schwab consented to the described sanctions and to the entry of findings. Therefore, in December 2013, Schwab was censured, fined \$175,000, and required to conduct a comprehensive review of the adequacy of its Anti-Money Laundering policies, systems, procedures (written or otherwise), and training with respect to detecting and reporting suspicious incoming wire transfers.

2. A disciplinary action initiated by FINRA asserted that Schwab failed on 44 occasions during the second quarter of 2011 and on 245 occasions during the first half of the 2012 review period to provide written notification disclosing to its customers a call date that was consistent with the disclosed yield to call in violation of SEC Rule 10b-10. Without admitting or denying the allegations, Schwab consented on August 23, 2013, to a censure and a monetary fine of \$12,500.

3. A disciplinary action initiated by the Chicago Board Options Exchange ("CBOE") alleged that Schwab: (1) violated CBOE Rule 9.21 by disseminating sales literature and failed to withhold the sales literature from circulation prior to incorporating the required changes specified by the CBOE; and (2) violated CBOE Rule 4.2 by failing to adequately supervise its associated persons to assure compliance with Rule 9.21. Without admitting or denying these allegations, Schwab consented to a censure and a monetary fine of \$10,000 on May 29, 2013.

4. In May 2013, the CBOE alleged that from approximately November 8, 2011, through approximately December 7, 2011, Schwab failed to have adequate supervisory procedures to assure compliance with SEC Rule 14E-4 relating to partial short tender activity. The CBOE accepted Schwab's offer of settlement consisting of a \$10,000 fine and a censure. Schwab neither admitted nor denied the allegations.

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

6. Schwab entered into a stipulation and consent agreement with the state of Florida on March 26, 2012, in which Schwab was fined \$1,100,000 and ordered to offer restitution to certain clients for distributing trade confirmations to Florida clients between 2008 and 2011 containing inaccurate information with respect to certain municipal bond, corporate bond, and preferred equity security trades, and for failing to have adequate written supervisory procedures with respect to the review of such trade confirmations, in violation of the Florida Administrative Code.

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

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

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

As part of the SEC settlement, the SEC found that Schwab violated certain investment-related laws and regulations related to the offer, sale, and management of the Fund from 2005 through 2008. In particular, the SEC found that Schwab: (1) deviated from the Fund's concentration policy with respect to investments in non-agency mortgage-backed securities, without shareholder approval; (2) made materially misleading statements and omissions about the Fund and its associated risks before and during the decline of its net asset value ("NAV"); (3) materially understated the Fund weighted average maturity ("WAM"); (4) willfully aided and abetted misstatements and omissions appearing in Fund sales materials and other documents; and (5) lacked policies and procedures reasonably designed to prevent the misuse of material nonpublic information about the Fund.

Without admitting or denying these allegations, Schwab agreed to pay a total of approximately \$118,944,996 in disgorgement of fees and penalties. As part of the settlement with the SEC, Schwab agreed to take a number of actions to improve procedures and reinforce Schwab's commitment to its clients. These actions included retaining an independent consultant to conduct a comprehensive review of Schwab's policies, practices, and procedures designed to prevent the misuse of material nonpublic information by or related to Schwab's mutual funds. The SEC settlement was approved by the United States District Court for the Northern District of California on February 16, 2011. Additionally, the SEC has brought related complaints against two former employees of Schwab.

The amount 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 in which Illinois made related factual allegations against Schwab and found that Schwab's conduct violated Illinois

Securities Law provisions relating to supervision of securities and advisory activity by employees and to maintenance of written procedures reasonably designed to comply with securities laws and regulations.

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



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

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

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

Schwab is also registered as an investment advisor under the Investment Advisers Act of 1940. Schwab provides other investment advisory services in addition to the Program. The Schwab Private Client (“SPC”) service is a nondiscretionary wrap fee program in which clients receive periodic, ongoing advice from a team of Schwab representatives. In the Schwab Advisor Network® Schwab makes referrals of investment advisors to investors who are looking for assistance in managing their assets and/or other financial planning activities. Advisors participating in Schwab Advisor Network are independent and not affiliated with Schwab.

Investment advisors pay a fee to participate in the Schwab Advisor Network program. Other programs in which Schwab acts as a registered investment advisor include the Managed Account Select® and Managed Account Connection® (“MAC”) wrap fee programs and the Schwab Intelligent Portfolios Solutions™ program, all sponsored by Schwab and the financial planning services provided through the Schwab Personal Financial Plan™ Schwab Retirement Consultation, and Schwab Equity Compensation Consultation. A separate agreement and disclosure brochure is available for these other investment advisory services and would be provided to you at the time of referral or purchase.

Schwab does not trade futures and is not a Futures Commission Merchant (“FCM”). However, for our customers who have a desire to trade futures, we have a referral relationship with Charles Schwab Futures, Inc., an FCM that is an affiliate of Schwab.

CSIM also provides portfolio management services for the strategies offered in MAC. On March 30, 2020, Charles Schwab Investment Advisory, Inc. (“CSIA”) portfolio management teams that managed the Windhaven® Strategies and ThomasPartners® Strategies were integrated into CSIM from CSIA, with CSIM assuming fiduciary responsibilities for the Windhaven Strategies and ThomasPartners Strategies. 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 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. Another affiliate, CSIA, provides portfolio management services for the Schwab Intelligent Portfolios®

program. The Schwab Intelligent Portfolio strategies, the Windhaven Strategies in MAC, and similar strategies managed through other non-Schwab-sponsored programs feature portfolios of ETFs that may overlap with ETFs held in SMP – ETF accounts.

In addition to Schwab, CSIA, and CSIM, other wholly owned subsidiaries of CSCorp are engaged in investment advisory, brokerage, trust, custody, or banking services. CSIM also provides advisory and administrative services to certain proprietary mutual funds and exchange-traded funds marketed under the Schwab Funds®, Laudus Funds®, and Schwab ETFs™ names that are included in Program portfolios. CSIM also serves as a separate account manager in other Schwab wrap fee programs.

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

#### **Code of Ethics**

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

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

##### **Broker-Dealer Order Routing and Execution**

In arranging for the execution of non-directed orders for equities and listed options, Schwab seeks out industry-leading execution services and access to the best-performing markets. Schwab routes orders for execution to unaffiliated broker-dealers, who may act as market maker or manage execution of the orders in other market venues, and also routes orders directly to major exchanges.

Schwab considers a number of factors in evaluating execution quality among markets and firms, including execution price and opportunities for price improvement, market depth, and order size; the trading characteristics of the security, speed, and accuracy of executions; the availability of efficient and reliable order handling systems, liquidity, and automatic execution guarantees; the likelihood of execution when limit orders become marketable; and service levels and the cost of executing orders at a particular market or firm. Price improvement occurs when an order is executed at a price more favorable than the displayed national best bid or offer. Schwab regularly monitors the execution quality obtained to ensure orders are routed to market venues that have provided high-quality executions over time.

Schwab receives remuneration, such as liquidity or order flow rebates, from market venues to which orders are routed, and also pays fees for execution of certain orders. Quarterly information regarding the market venues to which we route orders and remuneration received is available on our website at Schwab.com or in written form upon request. Information regarding the specific routing destination and execution time of your orders for up to a six-month period is also available upon request.

Schwab may execute fixed income orders for customers as agent or as principal for our own account. In the bond market, there is no centralized exchange or quotation service for most fixed income products. Prices generally reflect activity by market participants or dealers linked to various trading systems. A small number of corporate bonds are

listed on national exchanges. Although Schwab seeks access to major trading systems, exchanges, and dealer markets in an effort to obtain competitive pricing, at any given time, it is possible that securities could be available through other trading systems, exchanges, or dealers at superior or inferior prices compared to those available at Schwab. All prices are subject to change without prior notice.

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

#### **Mutual Funds**

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

Certain funds sponsors or their affiliates, such as fund advisors, pay a flat fee to compensate Schwab for activities related to Schwab's sponsorship of its Mutual Fund Marketplace® platform. These payments are separate from and in addition to the fees specific to a particular share class that are described below. These flat fees can be based on any number of factors, such as the level of assets, purchases over a period, net flows, or other qualitative factors, such as Schwab and the fund's mutual assessment of the quality of the relationship. This flat fee is paid to Schwab in addition to the asset-based fees discussed below; however, if the flat fee were converted from dollars to an annual asset-based fee, it would compare to an annual fee of 0.10% or less of the average fund assets at Schwab on which Schwab does not receive other asset-based compensation as described elsewhere in this disclosure. This flat fee is generally paid by the fund advisor or another fund affiliate out of its own resources, and not directly out of fund assets.

Additionally, fund companies are segmented into relationship tiers based on a combination of their fund assets held at Schwab and the asset-based and flat fee paid to Schwab. This tiered structure may lead to conflicts, as fund companies that are in the top tiers will have greater access to Schwab representatives and advisors that custody their clients' assets at Schwab. However, these tiers will not impact or influence selection of any fund on the Mutual Fund Select List® or other tools and lists prepared by Schwab.

#### **Schwab Mutual Fund OneSource® Service, Other No-Transaction-Fee Funds, and Non-Retail Share Classes**

Through Schwab Mutual Fund OneSource, Schwab offers a selection of no-load and load-waived mutual funds. Schwab receives remuneration for the shareholder services provided to these funds and other NTF funds, which are generally retail mutual fund share classes.

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

The Program is also open to Non-Retail Share Classes that pay Schwab a shareholder servicing fee and that meet other operational criteria enabling their inclusion in the Program. Non-Retail Share Classes have lower OERs (and proportionally better net-of-fees performance) than NTF share classes. By limiting the universe of third-party mutual funds to NTF funds and Non-Retail Share Classes, Schwab excludes some lower

cost share classes from the Program and earns additional revenue from the fees received by Schwab for shareholder servicing provided to NTF funds and Non-Retail Share Classes.

#### **Schwab Affiliate Funds**

Schwab currently has two affiliated mutual fund families: Schwab Funds® and Laudus Funds® (collectively, "Schwab Affiliate Funds"). CSIM serves as investment advisor and/or administrator to both fund families. These Schwab Affiliate Funds pay CSIM a fee for investment advisory and/or administrative services, the amount of which is described in the funds' prospectuses.

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

Some Schwab Funds have adopted a shareholder servicing plan pursuant to which they may pay fees to Schwab for shareholder services ranging up to 0.25% annually. Also pursuant to this plan, some Schwab Money Market Funds™ may pay Schwab up to 0.15% annually for shareholder services and, with respect to sweep shares of the Schwab Government Money Fund™ up to an additional 0.15% annually for sweep administrative services Schwab provides to shareholders invested in sweep shares of the Schwab Government Money Fund. The Schwab Target Funds, Schwab Target Index Funds, Schwab Balanced Fund™, Schwab® Monthly Income Funds, Schwab Equity Index Funds, and Schwab Bond Index Funds do not make any payments to Schwab under a shareholder servicing plan. Many of the Schwab Funds have adopted a unitary fee structure under which a single fee is paid to CSIM, and out of which CSIM pays for certain services provided to the funds; CSIM and its affiliates are entitled to retain any portion of this fee not paid out to a service provider.

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

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

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

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

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

Third-party sponsors or their affiliates may make payments to Schwab for ETF-related opportunities, such as education and events and reporting. Schwab does not receive payment to promote any particular third-party ETF to its customers.

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

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

#### **Addressing Potential Conflicts**

As described above, Schwab has a conflict of interest because of the economic incentive to select Schwab Affiliate Funds, NTF funds, and Non-Retail Share Classes. Schwab addresses this conflict in a variety of

ways, including establishing written parameters for the Program that limit the criteria CSIM may use in selecting mutual funds and ETFs from among those eligible for the Program. These criteria do not include the specific or differing amounts of compensation received by Schwab or CSIM. Schwab also monitors its representatives for compliance with the Code and has established advice policies and guidelines that Schwab representatives must follow when recommending and evaluating initial and ongoing program assessment criteria. Schwab representatives are supervised by their direct managers and by a Central Supervision Team for compliance with Schwab's advice policies and guidelines. In order to address potential conflicts of interest identified under ERISA and the parallel provisions of the Internal Revenue Code, ERISA-Type Accounts are eligible only for a single set of model portfolios—SMP – MF Third Party New Models. Schwab representatives may provide owners of ERISA-Type Accounts with educational information about these portfolios but may not recommend them.

### **Personal Trading**

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

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

### **Review of Accounts**

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

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

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

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

Clients should consult their professional tax advisor for help with their unique situations.

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

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

Schwab has entered into an agreement (the “Referral Agreement”) with USAA Investment Management Company (“USAA IMCO”) under which Schwab will pay USAA IMCO based on a percentage of the assets in Schwab accounts attributable to a referral by USAA IMCO, including assets in SMP accounts. Under the Referral Agreement, Schwab will pay USAA IMCO an annual percentage amount of 0.15% (or 15 basis points) of asset balances of applicable accounts.

### **Financial Information**

Schwab does not require or solicit prepayment of the Program Fee and is therefore not required to include a balance sheet for its most recent fiscal year. Schwab is not the subject of any financial condition that is reasonably likely to impair its ability to meet its contractual obligations to its clients. Schwab is not the subject of any bankruptcy petition, nor has it been the subject of any bankruptcy petition at any time during the past 10 years.

*charles*  
**SCHWAB**