

Adding exchange-traded funds to your retirement offering

Exchange-traded funds (ETFs) can feature low costs, transparency, and access to diverse asset categories, making them a great option for 401(k) plans.

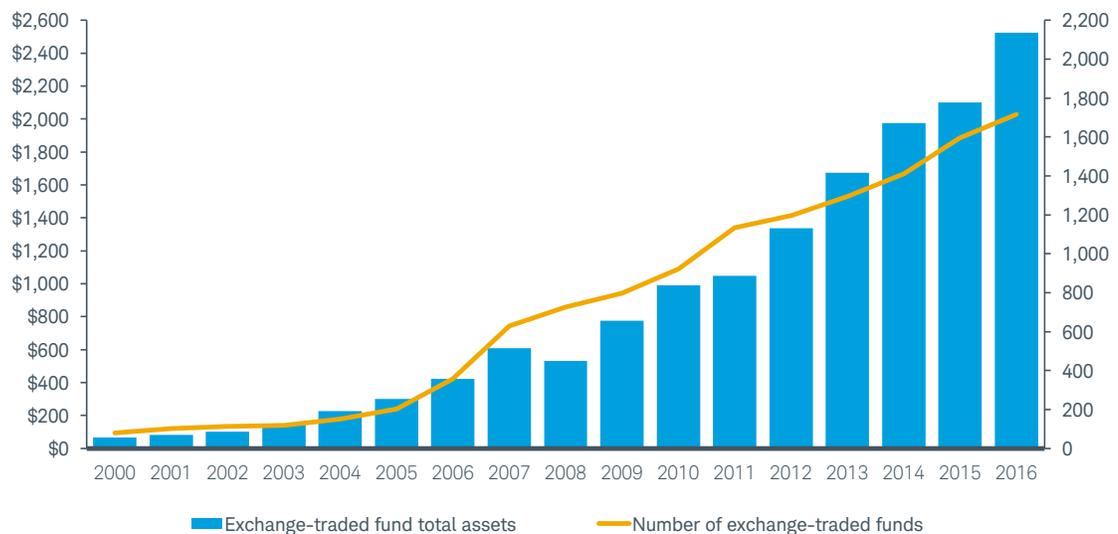
Now with a new and innovative infrastructure created by Schwab Retirement Plan Services¹ and its affiliates, the unique features of ETFs are being made more broadly available to 401(k) plans.

Investor interest in ETFs has been growing rapidly, perhaps because the investment vehicle does an excellent job of meeting investor needs. ETFs can offer retail investors low operating expenses, access to diverse asset categories, and transparency, with the opportunity to better respond to market movement during the day. At Schwab Retirement Plan Services, we believe retirement plan participants should have access to those same features but within a framework built specifically with retirement plans in mind. We've developed an approach that supports ETFs as core investment options in 401(k) plans. Our approach also addresses common questions we've heard in the industry—namely that some ETFs may be too risky, too complex, and too expensive for long-term retirement accounts, due to the potential of incurring frequent trading commissions.

But with Schwab Retirement Plan Services, sponsors can confidently consider offering ETFs in their core plan investment menu.

ETF industry growth

Number of ETFs and assets (dollars in billions)



Source: The Investment Company Institute, 2017 Investment Company Fact Book, 2017.

How ETFs work in a 401(k) plan

Plan participants should be able to take advantage of the features of ETFs, and Schwab Retirement Plan Services has thought about the unique context of investing in a 401(k) plan. We have thoughtfully designed an option that both considers how ETFs are offered to participants and relies on an innovative infrastructure to support ETF trade routing and processing. In developing this infrastructure, Schwab Retirement Plan Services and its affiliates drew on our collective experience serving retail investors, who are increasingly using ETFs.

Funds available. We applied rigorous criteria in selecting ETFs appropriate for 401(k) plans. These ETFs are on an availability list, and plan sponsors can choose from among these funds when selecting ETFs for their 401(k) plan core menu. Specific criteria are used to select the ETFs on the availability list and include factors such as assets under management, low tracking error, and low expenses (operating expense ratios, or OERs). These ETFs also have an active trading volume, which can help minimize the bid-ask spread. In addition to having low OERs, these ETFs also trade commission-free, helping to address industry comments that ETFs could be more costly due to commissions.

Buy or sell within the trading day. Schwab Retirement Plan Services is the first major provider to make trading ETFs in a 401(k) plan more flexible. ETFs give participants the freedom to place a trade and have it executed during market hours, capturing the market price at the time. This is unlike mutual funds, which trade only at the end of the day and at the price determined after market close. In addition, the platform infrastructure accommodates fractional share accounting for ETF positions and provides participants with both market and limit orders² on settled funds.

The ETF option is not intended to encourage an increase in trading frequency. In fact, participants using mutual funds could potentially change investments more frequently than participants using ETFs, because in the context of our infrastructure, ETFs take two business days to settle, and participants can only trade on their settled funds or positions.

Furthermore, our data indicates that most retirement plan participants are unlikely to be interested in frequent trading of their 401(k) assets: Participants traded ETFs at the same frequency as mutual funds.³ And participants who held an ETF position through our self-directed brokerage accounts averaged less than one ETF trade per quarter.⁴ But for those participants invested in core funds with the time, interest, and knowledge to manage their own accounts, ETFs offer more flexibility and timely access to information.

Trading logic. Our infrastructure also supports the process for handling and processing large trades directed by plan sponsors. It accesses an institutional style of trading that uses, among other things, average price execution to introduce these trades appropriately, intending to help reduce market disruption. The goal is that the processing of a major plan payroll will not have a significant impact on the purchase price of the ETF, which is a benefit to the plan sponsor and participants.

Built-in professional advice. Our approach to offering ETFs in 401(k) plans also builds in a personalized savings and investment strategy with low-cost, independent, third-party advice⁵ to help participants identify and work toward their savings goals. Many participants can take advantage of the unique features of ETFs as their initial and ongoing investment allocations are managed by an independent registered investment adviser.

Plan sponsor considerations

Employers want to offer their employees a 401(k) plan that's both forward thinking and provides access to diverse asset categories.

Access. As with mutual funds, ETFs allow plan sponsors to develop an investment menu that meets the diverse needs of participants. However, if a sponsor is looking for both low OERs and access to certain segments of the market that aren't covered by a low-cost index mutual fund, an ETF may be a good option. Sponsors can choose from ETFs that span many of the major asset categories, including several asset categories in which a low-cost index mutual fund product is not currently available in the marketplace.

Streamlined review. Since all these ETFs are indexed, fund review may be more straightforward compared with a review of actively managed funds.

Reduce operating costs⁶



Weighted average OER of plans before they transitioned to the ETF option

Weighted average OER of those plans after moving to an all-ETF menu

Features to consider

ETFs have grown so dramatically in the retail space because they offer a number of potential benefits unavailable or less available in other investment vehicles. When it comes to 401(k) plan participants taking advantage of these features, consider that ETFs offer:

Diversification. Plan participants can build a diverse retirement portfolio through easy access to a broad range of asset categories. Sponsors can choose an ETF for their plan menu in categories in which another low-cost investment vehicle, like an index mutual fund, may not currently exist in the marketplace.

Low costs. ETFs generally have low operating expenses, which can leave more money in participants' accounts to invest. And with Schwab Retirement Plan Services' ETF option, all ETFs in the core investment menu trade commission-free.

Looking at the weighted OER for the plans that have already transitioned to the ETF option, there has been a current average reduction from \$60 to \$11 per each \$10,000 invested.⁶

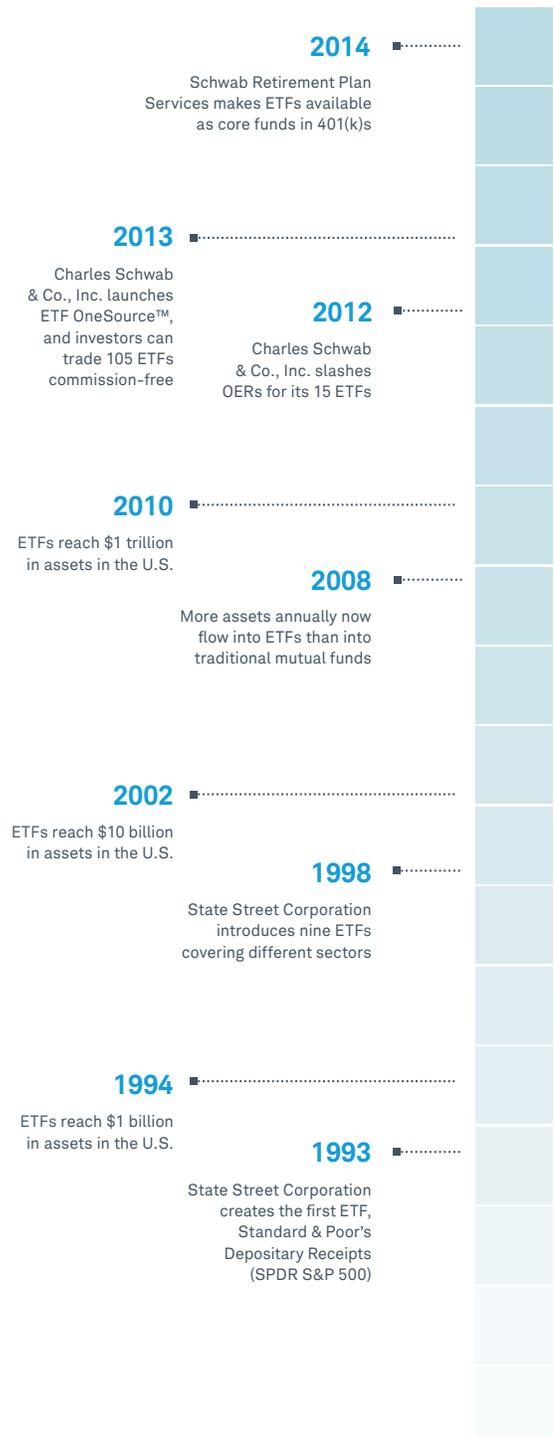
Transparency and timeliness. Timing and relevance are critical in today's digital world. Financial information should keep pace. ETFs let participants view the underlying holdings of each investment on a daily basis. Participants can see the price of an ETF fluctuate during the day and gain more insight into daily market movement, as opposed to waiting for a mutual fund price to be determined after market close.

Getting started

With an institutional infrastructure built to support ETFs, plan sponsors can provide the potential benefits of these popular investment vehicles to their participants in a way that may make sense for their retirement planning.

To find out whether ETFs are right for your retirement plan, contact your Schwab Retirement Plan Services representative or call **877-223-7036**.

Timeline of ETF milestones



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Investment returns will fluctuate and are subject to market volatility, so that an investor's shares, when redeemed or sold, may be worth more or less than their original cost. Unlike mutual funds, shares of exchange-traded funds are not individually redeemable directly with the exchange-traded fund. Shares are bought and sold at market price, which may be higher or lower than the net asset value.

All exchange-traded funds are subject to management fees and expenses.

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Fund operating expenses represent the total of all of a fund's annual fund operating expenses. Management fees are one component of the fund operating expenses. Index funds generally have low management fees because they don't have to pay investment managers to actively manage underlying investments.

Schwab Index Advantage provides a combination of index funds with low operating expenses, built-in independent professional advice available through Schwab Retirement Planner®, and Schwab Bank Savings, an interest-bearing, FDIC-insured savings feature available through Charles Schwab Bank. Schwab Retirement Planner provides participants with a fee-based retirement savings and investment strategy, a major component of which is a discretionary investment management service furnished by independent registered investment advisers GuidedChoice Asset Management, Inc.® ("GuidedChoice") or Morningstar Investment Management LLC, a subsidiary of Morningstar, Inc. GuidedChoice and Morningstar Investment Management are not affiliated with or agents of Schwab Retirement Plan Services, Inc.; Charles Schwab & Co., Inc., a federally registered investment advisor; or their affiliates. Schwab Index Advantage, including the Schwab Retirement Planner feature, is only available in select retirement plans serviced by Schwab Retirement Plan Services, Inc. The Morningstar name and logo are registered marks of Morningstar, Inc.

1. Schwab Retirement Plan Services is defined as Schwab Retirement Plan Services, Inc.
2. Limit orders in Schwab Index Advantage are defined as "all or none" and are good until the end of the trading day.
3. Schwab Retirement Plan Services ETF plan data as of February 2016.
4. Schwab Personal Choice Retirement Account® (PCRA) participants made an average of 0.65 ETF trades in Q4 2015. Charles Schwab and Co., Inc. internal data; analysis includes all PCRA accounts with a balance greater than \$0. Schwab PCRA is offered through Charles Schwab & Co., Inc. (Member SIPC), a registered broker-dealer, as part of the Plan, with Plan recordkeeping services provided by Schwab Retirement Plan Services, Inc.
5. Schwab Retirement Planner provides participants with a retirement savings and investment strategy, a major component of which is a discretionary investment management service furnished by independent registered investment advisers GuidedChoice Asset Management, Inc. ("GuidedChoice") or Morningstar Investment Management LLC, a subsidiary of Morningstar, Inc. Plan sponsors may select either investment advisor to provide the managed account service within Schwab Retirement Planner. GuidedChoice and Morningstar Investment Management are not affiliated with or agents of Schwab Retirement Plan Services, Inc.; Charles Schwab & Co., Inc., a federally registered investment advisor; or their affiliates. **There is no guarantee a participant's savings and investment strategy will provide adequate income at or through their retirement. Fees are charged for Schwab Retirement Planner, including its discretionary investment management service, based on the participant's account balance.**
6. Results are for Schwab Index Advantage plans with exchange-traded funds as of June 30, 2017. There are differences in the retirement plan features and services provided through Schwab Retirement Plan Services, Inc. for plans electing Schwab Index Advantage and plans not so electing Schwab Index Advantage, including funds available under the core investment menu, capital preservation vehicle, and third-party advice features.

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