INVESTMENT MANAGEMENT

Repurchase Agreements and Money Market Funds

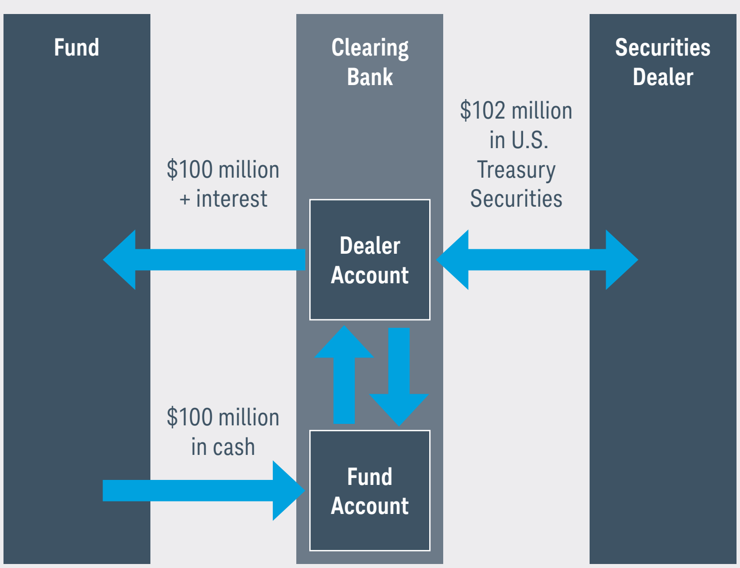
Repurchase Agreements Defined

- A repurchase agreement, or repo, is an agreement between a buyer and a seller in which the buyer agrees to (1) buy securities from a seller for cash and (2) sell back the same securities to the seller at a specified date.
- A repurchase agreement is, in essence, similar to a collateralized loan — a secured loan for a specified period against which interest is paid and collateral is pledged.
- Although a broad range of assets may be used for collateral in a repurchase agreement, the most common are highly liquid U.S. Treasury and government agency securities (such as those issued by the Federal Home Loan Bank), high quality mortgage-backed securities, corporate bonds and equities.

Repurchase Agreements and Money Market Funds

- Because money market funds are designed to offer stability of capital and liquidity, the repurchase agreements they engage in are generally of a short duration, frequently either overnight or seven days.
- Money market funds can also use repurchase agreements with contracts greater than seven days. These arrangements are commonly referred to as “term repo.” By using longer term repurchase agreements, portfolio managers seek to balance the liquidity requirements of the fund with the opportunity for potentially higher yield.
- To provide an extra degree of risk management, typically repurchase agreements require the total value of the collateral to be greater than the cash that is borrowed. For example, a seller in a repurchase agreement who receives $100 million in cash may have to provide collateral in the form of $102 million worth of securities.
- Transactions can be managed through the use of an independent third party (i.e., a custodian) who ensures the exchange of securities and cash and holds the securities for safe-keeping. Such an arrangement is known as a tri-party repurchase agreement.

Example of a Tri-Party Repurchase Agreement



- Using existing contracts, the fund and securities dealer agree to enter into an overnight repurchase agreement for $100 million in U.S. Treasury securities.
- Both parties inform the clearing bank of the trade.
- At the time of the trade execution, the following movements occur:
  - $100 million in cash from the fund moves to the securities dealer account through the clearing bank.
  - Collateral of $102 million in Treasuries from the securities dealer (including the required premium) is held by the clearing bank in the fund’s name.
- Upon maturity of the agreement, the flow reverses. Interest on the $100 million is paid to the fund by the securities dealer through the clearing bank.

How and Why Repos are Used

- Repurchase agreements are widely used for short-term investing or for borrowing cash for short-term needs.
- Repurchase agreement buyers (cash providers) typically include money market funds, insurance companies, corporations, municipalities, central banks and commercial banks that have excess short-term cash and are willing to lend it for a specified period of time and for an agreed price.
- Repurchase agreement sellers (securities providers) include commercial banks, central banks, insurance companies and investment banks. Although sellers may want to own those assets for the long-term, they also have short-term cash needs; by using a repurchase agreement, these sellers receive the short-term cash they require while retaining the ability to own the securities for the long term. Repurchase agreements also provide the certainty of fixed terms, so sellers know their costs up-front, as opposed to the uncertainty of buying and selling in the open market.

Risks and Risk Management

- Because most repurchase agreements are fully collateralized — in fact, more often than not, over-collateralized — their risks are significantly reduced. However they are still subject to risks, including the credit risk of the seller. There is also the possibility that the value of the collateral could change during the contract's term. And, if the seller were to become unable to repurchase the securities as promised, the buyer may experience a delay in receiving the cash pending the sale of the collateral and/or the potential loss of value upon the sale of those securities. There is also a relatively small risk that the conversion of the securities used for collateral may take longer than the original term of the repurchase agreement. Such delays may be caused by factors such as operational issues, market conditions or legal actions.
- Measures to manage the risks include ensuring that assets are liquid, establishing maximum exposure limits for potential securities providers, and undertaking a rigorous credit-review process to continuously monitor investments.
- Repurchase agreement collateral is continually marked to market, with additional collateral required if the value of the securities falls below the contracted value.

Investors should consider carefully information contained in the prospectus, or if available, the summary prospectus, including investment objectives, risks, charges and expenses. You can request a prospectus by visiting schwabfunds.com. Please read it carefully before investing.

Money market funds are neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the funds seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.