

KMS Financial Services, Inc.
Form ADV Part 2A - Appendix 1
Wrap Fee Program

Sponsored by: KMS Financial Services, Inc.

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This Wrap Fee Program brochure provides information about the qualifications and business practices of KMS Financial Services, Inc. ("KMS"). If you have any questions about the contents of this brochure, please contact us at (206) 441-2885. The information in this brochure has not been approved by or verified by the United States Securities and Exchange Commission ("SEC") or by any state securities authority.

KMS is a registered investment adviser. Registration as an investment adviser does not imply any level or skill or training. Additional information about KMS is available at www.kms.com and the SEC's website at www.adviserinfo.sec.gov.

Item 2 - Material Changes

There are no material changes to report since the last annual update to this document in March 2011.

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Item 4 – Service, Fees and Compensation

KMS, founded in 1971, is a Seattle-based, independent, privately-owned investment advisory firm that is registered with the SEC. KMS is also a securities broker-dealer registered with the SEC, the Financial Industry Regulatory Authority (“FINRA”) and all 50 states plus the District of Columbia.

KMS operates through independent financial professionals, individuals who are investment advisory representatives and/or securities registered representatives. Registration does not imply any particular level of skill or training, although many KMS Representatives maintain related certifications and designations. KMS is owned by approximately a dozen officers and directors of the firm, with Mark Hamby, KMS’ Chairman & CEO, and Eric Westberg, KMS’ President & COO, currently owning together more than 70% of KMS shares outstanding.

KMS offers a wide range of investment advisory services including financial planning, investment advice and asset management, for consideration (fees) based on a percentage of assets under management, through multiple platforms and custody arrangements, as well as investment advisory services of a number of unaffiliated third party investment advisors. KMS offers these products and services to the public through its investment advisory representatives (“Advisors” or “KMS Advisors”). For a description of all these services, ask for a KMS’ Form ADV Part 2A Firm Brochure.

Each KMS Advisor should provide his or her advisory clients with details of their background in a 2B Brochure Supplement, which should be included herein as pages 6 and 7. **If you have not received such 2B Brochure Supplement, please contact your Advisor or KMS.**

As of December 31, 2011, KMS had approximately \$1.333 billion of discretionary assets under management and approximately \$1.022 billion of non-discretionary assets under management for a total of approximately \$2.355 billion assets under management.

Wrap Program Service: This brochure describes KMS' Wrap Program, a service offered by KMS through KMS Advisors. KMS Wrap Program is a flexible platform allowing KMS Advisors to provide a variety of Clients (individuals, businesses, etc.) with portfolio management services and account services on an ongoing fee basis (%-of-assets) rather than for transaction-based compensation. Individual Clients' needs and objectives are ascertained by the KMS Advisor and recorded on a questionnaire section of the KMS Client Services Agreement. Based on this information, the Advisor will recommend a portfolio he or she believes matches Client's financial situation, investment objective and risk tolerance. Over time, based on market conditions and other factors, changes may be made to the portfolio. **There is no guarantee that the portfolio will meet a Client's investment objective over any given time frame.**

Depending on the nature of the advisory relationship, a Client may decide to grant investment discretion to his or her KMS Advisor, as declared in the relevant investment advisory agreement. Investment discretion granted to a KMS Advisor is limited to the selection and amount of the securities to be bought or sold. If Client selects nondiscretionary authority, the Advisor will receive verbal authority from Client before executing trades in the account. Trades are confirmed promptly by KMS' clearing agent Pershing. Every calendar quarter Pershing will send Clients a full account statement and, under separate cover, performance reports. KMS encourages Clients to promptly review all such account information.

Fees and Compensation: The Program Fee schedule listed below reflects the maximum Program Fee calculated as a percentage of Client's assets invested in the Program. Part of the Program Fee paid to KMS will be paid by KMS to the Advisor pursuant to a contract. Program Fee maybe negotiable between the Advisor and Client and will be expressly set forth in the Asset Management Agreement – Wrap Fee Program. The amount of revenue paid to a KMS Advisor in the Wrap Fee Program may be more, but could be less than he or she might receive in a different advisory service. Since the maximum Wrap Program Fee generates more revenue to the Advisor, this may cause the Advisor to have a financial incentive to recommend it over another advisory service.

The Schedule of *maximum* Program Fees as a Percentage of Assets Under Mangement:

On the first \$100,000	2.50%
On the next \$150,000	2.25%
On the next \$250,000	2.00%
On the next \$500,000	1.75%
On the next \$1,000,000	1.50%
On the next \$3,000,000	1.25%
On amounts over \$5,000,000	1.00%

Mutual Fund Operating Expenses: If a Client's Program portfolio contains mutual funds, as an investor in such mutual fund, the Client will bear the operating expenses of the mutual fund as the expenses will affect the net asset value of the fund. Fund expenses ratios vary from fund to fund. Information on the specific expenses for each mutual fund will be set forth in the fund's prospectus and periodic reports provided by the fund to Client.

Comparative Costs: The Wrap Fee Program costs may be more or less than the cost of purchasing similar services separately. For example, direct investment in a no-load mutual fund would be less expensive than participation in the Program, because Client would not bear the Program Fee. However, because the KMS Advisor provides professional advice and service in recommending and monitoring such mutual funds, buying the packaged services through the Program may be less expensive than buying advice separately from an Advisor not offering the Program. If a Client engages in relatively active trading, the costs of the Program may be less than if the account were subject to commissions on each transaction.

Transaction Related Charges: Clients will not incur any brokerage charges for transactions executed in their account. However, Clients will incur postage and handling charges on virtually all transactions. These charges vary depending on the type of delivery of the confirmation (electronic or via mail). SEC charges may also accrue to certain transactions. These charges are subject to change and are listed on written confirmations provided to Clients promptly following each transaction. A listing of trading costs is available to Clients at any time. Clients can obtain a copy of the current trade and account fee schedules by contacting the KMS Advisor. It is possible that an account may indirectly pay a spread to an unaffiliated market maker when buying or selling certain types of securities. Neither KMS nor the Advisor benefits from such spreads. KMS does not permit mark ups or mark down on trades in its Wrap Program.

All mutual funds purchased in the Program will be funds available for purchase at each fund's net asset value and with no sales charge, so that no sales commissions will be incurred in connection with investment in the initial portfolio or subsequent portfolio purchases.

Other Compensation Issues: In the course of providing advisory services to Clients, KMS and Advisor receive advisory fees as described in the relevant advisory contract. For some advisory accounts, KMS Advisor may recommend the purchase of securities that pay a 12b-1 fee or service fee ("trails"), generally at the rate of 0.25% of asset value per year, paid quarterly. (That equates to \$6.25 of gross trail revenue per quarter per \$10,000 of assets.) In these circumstances, KMS and Advisor would have a financial interest in the recommendation which may constitute a conflict of interest. KMS monitors and addresses this potential conflict of interest through advisory fee discounts, offsetting trails against advisory fees, or disclosure.

In addition, Advisor may also recommend that a Client buy (or sell) a security or insurance product. If a Client decides to do so, KMS and Advisor may be paid a commission (including mark up or mark down) on the purchase or sale of such products. In these circumstances KMS and Advisor would have a financial interest in the transaction which may constitute a conflict of interest. Generally the Advisor will disclose the amount of compensation at the time a recommendation is made by delivering the relevant prospectus or the equivalent. Clients are under no obligation to purchase securities or insurance products through KMS or the Advisor.

Item 5 – Account Requirements and Types of Clients

KMS does not require a minimum account size. However, Portfolio Managers or Money Managers may stipulate a minimum investment amount. This would be disclosed and discussed with the Client prior to the investment purchase. KMS Advisors provide advisory services and investment advice to individuals, pension and profit sharing plans, trusts, estates, charitable organizations, corporations and other business entities, and government entities.

ERISA Plan clients are provided with an ERISA Plan Disclosure Brochure, which provides information about KMS' qualifications, business practices and potential conflicts of interest that may be important for

any ERISA Plan to consider. If you are a named fiduciary for an ERISA Plan and you have not received such Disclosure Brochure, please contact your Advisor or KMS.

Item 6 – Portfolio Manager Selection and Evaluation

KMS Advisors may act as a portfolio manager by monitoring a Client's Wrap Program account and making recommendations for (or executing trades in) investments consistent with the Client's investment objective as selected in the advisory agreement. **There is no guarantee that the recommendations or trades will meet a Client's investment objective over any given timeframe.** Neither KMS nor its Advisors select, review or evaluate outside portfolio managers. Since portfolio managers are not evaluated or selected through KMS' Wrap Program, outside portfolio manager performance is not calculated or presented.

Generally, Advisors conduct research and analysis through the use of third-party providers such as Morningstar, Inc., Standard & Poor's, Thomson Reuters, and various other reporting and research organizations. KMS Advisors may also use financial newspapers, magazines, journals, company press releases, annual reports, prospectuses, and filings with the SEC.

KMS' clearing agent, Pershing LLC, generates quarterly performance reports with comparisons to selected benchmarks. **Investing in securities involves risk of loss that Clients should be prepared to bear.**

The fact that a KMS Advisor acts a portfolio manager, creates a conflict of interest as describe above in Item 4 under "Other Compensation Issues." Since each Wrap Program account is client-specific, it may or may not bear any relationship with other advisory accounts.

If a KMS Advisor offers investment advice for a fee, that Advisor may tailor the advisory services he or she offers to the individual needs of specific clients. Clients may request that certain securities or types of securities be avoided. If it is difficult to determine all of the underlying securities of a particular advisory product or service, the Advisor will make reasonable efforts to avoid the specified securities or type of securities. KMS' Wrap Program Accounts are not offered under performance-based fee arrangements; nor does KMS employ side-by-side management.

Most KMS Advisors elect to NOT vote proxies on behalf of their clients. If an Advisor chooses to offer this service to clients, such clients must authorize KMS and the Advisor to do so through the applicable contract or agreement. Clients may obtain a copy of the KMS Proxy Voting Policies and also may obtain information as to how proxies were voted on their behalf.

Item 7 – Client Information Provided to Portfolio Managers

Client information is shared with KMS Advisors who act as Portfolio Managers under Wrap Accounts.

Item 8 – Client Contact with Portfolio Managers

Clients have ample access to KMS Advisors, who act as Portfolio Managers. The frequency and nature of such contact depends on Client and Advisor preferences.

Item 9 – Additional Information

Item 9A1 – Disciplinary Information

Registered investment advisors are required to disclose all material facts regarding any legal or disciplinary events that would be material to your evaluation of KMS or the integrity of KMS' management personnel. No events have occurred at KMS that are applicable to this Item.

Item 9A2 – Other Financial Industry Activities and Affiliations

KMS is a securities broker/dealer and as such sells securities products and services. Neither KMS nor any of its management personnel is registered as a futures commission merchant, commodity pool operator, commodity trading advisor, or associated person of such

Item 9B1 – Code of Ethics, Participation or Interest in Client Transactions & Personal Trading

Code of Ethics & Personal Trading: Like any SEC-registered investment adviser, KMS maintains an Investment Advisory Code of Ethics based on ethical conduct and premised on fundamental principles of good faith, fair dealing, integrity, honesty, and full and fair disclosure. KMS Advisors acknowledge in writing that they will follow KMS' Code of Ethics. For a copy of the Code of Ethics please contact KMS or your Advisor.

In summary, KMS' Code of Ethics:

- (1) requires full and fair disclosure of all material elements of the investment advisory relationship with the Client;
- (2) requires compliance with certain Policies on Personal Securities Trading, which, in general: (a) prohibit an Advisor from trading a security before a Client; and (b) prohibit an Advisor from opening or having a personal securities trading account without prior KMS approval;
- (3) prohibits an Advisor from acting on or distributing material, nonpublic information;
- (4) prohibits an Advisor from participating in an initial public offering without prior written approval from KMS' President.

Participation or Interest in Client Transactions: In KMS' Wrap Fee Program, KMS does not receive commission compensation for effecting securities transactions. However, KMS, as principal, may buy securities for itself from or sell securities it owns to some Wrap Fee Program Clients. The compensation for these principal trades is inconsequential relative to the trade size. KMS and/or its Advisor may, from time to time, buy or sell securities that its Clients may own.

Item 9B2 – Review of Accounts

Depending on the nature of the advisory relationship, Advisors review accounts quarterly, semi-annually, or annually to determine whether the positions, transactions, and strategies are consistent with the Client's stated investment objective(s). Advisors review accounts with each Client in-person or by phone on an ongoing basis on either a predetermined schedule based on each Client's preferences or some cycle. Clients may request a review of accounts with the Advisor at any time. Additionally, certain events such as market downturns may trigger an Advisor to have more frequent account reviews and/or more frequent Client communication. Periodically KMS employees and officers also review accounts for consistency with stated Client objectives, etc.

Item 9B3 – Client Referrals and Other Compensation

Client Referrals: KMS has a relationship with Hanson McClain Retirement Network, LLC ("HMRN") a registered broker-dealer and investment advisor. Through the Hanson McClain Partner Program, HMRN provides certain KMS Advisors marketing support, training, and Client introductions in exchange for a portion of the commission or investment advisory fees earned by KMS. All Client investment recommendations and specific advice are provided by the KMS Advisors. KMS Advisors will provide a separate Solicitor Disclosure Statement regarding the HMRN arrangement, a copy of KMS' Brochure, and any relevant Investment Advisory Agreement.

KMS has referral arrangements with financial institutions, such as banks or credit unions, under which they provide certain KMS Advisors with referrals to potential Clients in exchange for a portion of the investment advisory fees and/or commissions KMS may earn from that potential Client. All investment

recommendations and advice are provided by the KMS Advisor who will secure from each Client a written acknowledgement of that the Client understands of the respective roles of KMS and the financial institution.

Other Compensation: Neither KMS or its Advisors receive other compensation related to any advisory accounts *other than* the compensation described in the relevant investment advisory contract. However, out of an abundance of caution to provide disclosure, below are descriptions of several situations through which either KMS or a KMS Advisor may receive expense reimbursements or other forms of financial support.

KMS hosts an **annual conference** for its registered representatives and Advisors, discussing timely topics about products, services, investment strategies, KMS procedures, and practice management. Various sponsors attending the conference pay KMS a fee, which helps defray a portion of KMS' cost of hosting the conference. This type of cost sharing is a typical practice in the industry and the conference is a net expense to KMS even after the sponsor support.

Third party advisory firms, sponsors and custodians may offer KMS or KMS Advisors **financial assistance** in the form of marketing reimbursements, free or discounted technology platforms and/or free or discounted due diligence trips. Marketing reimbursement allows a third party advisor to help a KMS Advisor grow their asset base. Marketing support reimbursements are for documentable expense and do not exceed the cost of the item. Third party advisors provide support for due diligence and educational trips to educate and train KMS Advisors (and KMS home office staff) about that firm's services and tools. These reimbursements do not exceed the cost of attending the trip or meeting. Further, any technology (or technology support) provided is either a tool required for the Advisor to (efficiently) deliver the service under the advisory contract or it is merely a discount to the "retail" price of the particular technology which assists the Advisor in servicing their Clients. The level of these forms of support is both typical in the industry and modest relative to the total value of services rendered.

Item 9B4 – Financial Information

KMS is required to provide you with certain financial information or disclosures about its financial condition. KMS has no financial commitment that impairs our ability to meet our contractual and fiduciary commitments to you, and KMS has not been the subject of a bankruptcy proceeding.