

# **Form ADV Firm Brochure Morgan Stanley Smith Barney LLC**

Institutional Services Program (directed brokerage)

**October 17, 2012**

2000 Westchester Avenue  
Purchase, NY 10577  
Tel: (914) 225-1000  
Fax: (614) 283-5057  
[www.morganstanleysmithbarney.com](http://www.morganstanleysmithbarney.com)

**This brochure provides information about the qualifications and business practices of Morgan Stanley Smith Barney LLC (“MSSB”). If you have any questions about the contents of this brochure, please contact us at [client.services@mssb.com](mailto:client.services@mssb.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority. Additional information about MSSB also is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). Registration with the SEC does not imply a certain level of skill or training.**

## Item 2: Material Changes

This section identifies and discusses material changes to the ADV brochure since the version of this brochure dated March 31, 2011. For more details on any particular matter, please see the item in this ADV brochure referred to in the summary below.

**Merger of Investment Advisory Programs.** MSSB used to provide investment advisory services through two channels. One channel generally provided the investment advisory programs previously provided by Smith Barney and/or Citigroup Global Markets Inc., and the other channel generally provided the investment advisory programs previously provided by Morgan Stanley & Co. Incorporated. MSSB has now merged the advisory programs previously provided in the Smith Barney and Morgan Stanley channels. (Item 4)

**For Participant-Directed Retirement Plans.** We now offer administrative services such as assistance with searches to retain third party providers and analyzing third party fees. These are in addition to existing services such as identifying suitable managers and providing initial and ongoing consulting services such as investment policy statement review, asset style analysis and mutual fund search. (Item 4.B)

We now offer participant-directed retirement plan clients the DC Investment Consulting Fund Screening service in which we screen funds in the Morningstar database to give plan clients a greater choice of funds in which to invest. (Item 8.A)

**Due Diligence.** Select teams from our Graystone Consulting and Private Wealth Management divisions perform due diligence on managers and, in the case of Graystone, mutual funds so that you have access to more investment options. The teams perform both qualitative and quantitative assessments. (Item 6.A)

**Cash Sweeps.** Any uninvested cash, and allocations to cash, in your account are invested in either interest bearing bank deposit accounts ("Deposit Accounts") or money market funds. If you have a Deposit Account, this may now be held at one or more of the following banks affiliated with us: (i) Morgan Stanley Bank, N.A., (ii) Morgan Stanley Private Bank, National Association or (iii) Citibank, N.A. Each bank pays us a fee based on your Deposit Account balances (except on retirement plans or Coverdell Education Savings accounts). Your Financial Advisor does not receive a portion of these fees.

If you have a retirement plan account or Coverdell Education Saving Account, the Exhibit to this ADV brochure ("Affiliated Money Market Funds Fee Disclosure Statement and Float Disclosure Statement") applies to your account. This Exhibit has information on the money market fund investments available to you, including fees and expenses.

These changes do not affect you if you have set up a custodian other than MSSB for your account. (Item 5.C)

**Description of Advisory Services.** We offer you an optional non-discretionary service of performance reporting on the alternative investments in your portfolio even if you did not buy them through MSSB, nor custody them with us. (Item 4.B)

**Fees.** We list the different ways we may charge fees for institutional services, a description of additional fees (e.g. those relating to mutual funds and exchange-traded funds) and the compensation we pay to Financial Advisors. (Items 5.A and 5.C)

**Risks.** We have expanded the investing risks discussion to include risks relating specifically to alternative investments, money market funds and exchange-traded funds. (Item 8.B)

**Evaluating Managers and Funds.** We describe how we select investment products for, and terminate them from, our programs. Our Consulting Group Investment Advisor Research department has two evaluation processes. CG IAR places managers and funds passing its most rigorous process on the Focus List. Alternatively, managers and funds on CG IAR's Approved List are subject to a less comprehensive evaluation process. (Item 8.A)

Eligible clients may also invest in alternative investments. Our Alternative Investments Research Group conducts qualitative and quantitative research on alternative investment managers and keeps a list of approved managers. (Item 8.A)

**Conflicts of Interest.** We disclose conflicts of interest arising when we act as placement agent, an affiliate acts as portfolio manager or we receive payment from alternative investment managers. (Item 10.D)

**Client Referrals and other Compensation.** We may make payments under our Professional Alliance Group program to certain unaffiliated third parties who refer a client to us if the client invests in an investment advisory program. (Item 14.B)

## Item 3: Table of Contents

Item 1: Cover Page .....	1
Item 2: Material Changes .....	2
Item 3: Table of Contents .....	3
Item 4: Advisory Business .....	4
A. Description of MSSB, Principal Owners .....	4
B. Description of Advisory Services .....	4
C. Customized Advisory Services and Client Restrictions .....	6
D. Portfolio Management Services to Wrap Fee Programs .....	6
E. Assets Under Management (“AUM”).....	6
Item 5: Fees and Compensation .....	6
A. Compensation for Advisory Services .....	6
B. Payment of Fees.....	7
C. Additional Fees and Expenses .....	7
D. Prepayment of Fees .....	8
E. Other Compensation to Financial Advisors .....	8
Conflicts Relating to Financial Advisor Compensation .....	9
Item 6: Performance Based Fees and Side by Side Management .....	9
Item 7: Types of Clients.....	9
Item 8: Methods of Analysis, Investment Strategies and Risk of Loss .....	9
A. Method of Analysis and Investment Strategies .....	9
B. Material, Significant, or Unusual Risks Relating to Investment Strategies .....	12
C. Risks Associated with Particular Types of Securities.....	13
Item 9: Disciplinary Information .....	13
Item 10: Other Financial Industry Activities and Affiliations .....	17
A. Broker-Dealer Registration Status .....	17
B. Futures Commission Merchant, Commodity Pool Operator, or Commodity Trading Adviser Registration Status .....	17
C. Material Relationships or Arrangements with Industry Participants .....	17
D. Material Conflicts of Interest Relating to Other Investment Advisers.....	19
Item 11: Code of Ethics, Participation or Interest in Client Transactions and Personal Trading .....	20
A. Code of Ethics .....	20
B. Securities in Which You or a Related Person Has a Material Financial Interest .....	21
C. Investing and Other Interests in Securities Which You or a Related Person Recommends to Clients .....	21
D. Conflicts of Interest Created by Contemporaneous Trading.....	21
Item 12: Brokerage Practices .....	21
A. Factors in Selecting or Recommending Broker-Dealers for Client Transactions .....	21
B. Aggregation of Securities Transactions for Clients .....	21
Item 13: Review of Accounts.....	21
A. Frequency and Nature of Review of Client Accounts or Financial Plans .....	21
B. Factors Prompting Review of Client Accounts other than a Periodic Review .....	21
C. Content and Frequency of Account Reports to Clients.....	22
Item 14: Client Referrals and Other Compensation .....	22
A. Economic Benefit for Providing Investment Advice to Clients.....	22
B. Compensation to Unsupervised Persons for Client Referrals .....	22
Item 15: Custody.....	22
Item 16: Investment Discretion .....	22
Item 17: Voting Client Securities.....	22
Item 18: Financial Information .....	22
Exhibit: Affiliated Money Market Funds Fee Disclosure Statement and Float Disclosure Statement .....	24

## Item 4: Advisory Business

***Special Note: The program described in this brochure is currently offered to clients on an asset-based fee or “wrap fee” basis. For the descriptive brochure on the MSSB Institutional Services wrap fee programs, please contact your Financial Advisor. In the past, certain MSSB clients engaged MSSB to be compensated for the services in this program on the basis of commissions paid on securities transactions. This brochure is intended for those clients only.***

### A. Description of MSSB, Principal Owners

#### Introduction to MSSB

Morgan Stanley Smith Barney LLC (“MSSB”, “we” or “us”) is, among other things, a registered investment adviser, a registered broker-dealer, a registered futures commission merchant, and a member of the New York Stock Exchange. MSSB is one of the largest financial services firms in the country with branch offices in all 50 states and the District of Columbia. Morgan Stanley and Smith Barney and their respective predecessors have been in business for over seventy five years.

MSSB teams offer a wide range of investment consulting services. This brochure focuses on one of those services. - Institutional Services (“IS”). MSSB focuses on providing a wide range of investment consulting services to institutional and high net worth individual clients, including assistance in developing investment policy statements, asset allocation, investment manager, mutual fund (“Fund”), exchange traded fund (“ETF”) and alternative investment research, performance reporting and custody services. These services are delivered through a select group of institutional consulting teams located across the country that have significant experience serving the investment advisory needs of institutional as well as high net worth individual clients and are supported by a management team dedicated to institutional consulting. Clients include corporations, Taft-Hartley plans, foundations and endowments public and private defined benefit plans, 401(k) plan sponsors, family offices and high net worth individuals.

MSSB is owned by a joint venture company which is indirectly owned 65% by Morgan Stanley (“Morgan Stanley Parent”) and 35% by Citigroup Inc. (“Citi”). On September 11, 2012 Morgan Stanley Parent and Citi reached agreement with respect to Morgan Stanley Parent’s purchase of Citi’s remaining 35% stake in the joint venture company no later than June 1, 2015, subject to regulatory approval.

MSSB used to provide investment advisory services through two channels. One channel generally provided the investment advisory programs previously provided by Smith Barney and/or

Citigroup Global Markets Inc. (“CGM”) (“SB Channel”). The other channel generally provided the investment advisory programs previously provided by Morgan Stanley & Co. Incorporated (now, Morgan Stanley & Co. LLC) (“MS&Co.”) (“MS Channel”). MSSB has now merged the SB Channel and MS Channel advisory programs.

MSSB offers clients (“you” and “your”) many different advisory programs. Many of MSSB’s advisory services are provided by its Consulting Group business unit. You may obtain brochures for other MSSB investment advisory programs at [www.morganstanley.com/ADV](http://www.morganstanley.com/ADV) or by asking your Financial Advisor or (for Morgan Stanley Private Wealth Management clients) your Private Wealth Advisor. (Throughout the rest of this brochure, “Financial Advisor” means either your Financial Advisor or your Private Wealth Advisor, as applicable.)

### B. Description of Advisory Services

MSSB offers the following institutional consulting services to its clients:

***Assistance in the Preparation of Investment Objectives and Policies.*** Your Financial Advisor will assist in the review, evaluation and preparation of investment policies and objectives and if requested will assist in preparing investment guidelines for each of your investment managers.

***Asset Allocation.*** Your Financial Advisor will review your asset allocation and will make asset allocation recommendations in accordance with your investment goals.

***Investment Searches.*** Your Financial Advisor will assist you in identifying and recommending investment managers, Funds, and ETFs (“Investment Products”). These recommendations are based either on MSSB Investment Advisor Research (using different methods to evaluate investment managers, Funds and ETFs -- research on investment managers is provided through MSSB’s Fiduciary Services (“FS”) and Consulting and Evaluation Services (“CES”) programs) or due diligence provided by MSSB’s Graystone Consulting business unit (“Graystone”). Graystone due diligence on managers is conducted through its Manager Assessment Program, a proprietary investment management scoring system that assesses investment manager products in that database. Graystone teams conduct further analysis in an effort to identify managers for clients. See Item 8 below for more details.

Depending on applicable legal and regulatory requirements, clients may invest in certain affiliated and/or unaffiliated alternative investment vehicles (such investments, together with Investment Products, “Investment Options”).

***Non-Researched Managers.*** Clients also may select investment managers outside of those covered by Investment Advisor Research or Graystone due diligence. Such outside managers,

if qualified, will be offered through MSSB's Investment Management Services Program ("IMS"). MSSB does not evaluate or make any representations concerning such investment managers and shall not assume any liability for any loss, claim, damage or expense attributable to the client's selection of such managers.

**Performance Measurement.** MSSB provides clients with customized performance reports that assess investment risk and return relative to benchmarks. The reports may include comparisons to recognized benchmarks and market segments.

**Custody and Statements.** For clients who elect to custody with MSSB, we serve as the custodian of all cash, securities and other assets held in the portfolio and credit the portfolio with dividends and interest paid on securities held and with the principal paid on called or matured securities in the portfolio. You will be provided with written confirmation of securities transactions and account statements at least quarterly.

#### ***Institutional Services Program – For Participant-Directed Retirement Plans.***

MSSB also offers a non-discretionary investment-consulting platform for participant directed retirement plans. Through this program, MSSB Financial Advisors offer initial and ongoing consulting services to Plan Sponsors with respect to investment decision making on behalf of the Plan, including investment policy statement review, asset style analysis and mutual fund search and selection. For participant-directed retirement plan clients, MSSB offers the DC Investment Consulting Fund Screening Program which is explained further in Item 8A below. Also, MSSB may assist the retirement plan and other institutional clients with certain administrative functions as described below. These are not investment advisory services and MSSB does not assume status as a fiduciary under ERISA, the Investment Advisers Act of 1940 or any other applicable law or regulation in performing these services.

- **Board Education/Asset Classification** – MSSB shall provide the Client with general financial and investment information relating to such concepts as diversification and asset classification with respect to various asset classes and historic rates of return.
- **Participant Education** – MSSB shall provide the Client and/or its employees eligible to participate in Client's Plan with general financial and investment information relating to such concepts as diversification, asset allocation and historic rates of return.
- **Provider Search Assistance.** MSSB may assist plan sponsors in searches to retain third party service providers such as record keepers. This service may be provided to existing clients of MSSB or on a one-time basis to plans that are not MSSB. In doing so, MSSB will:
  - 1) evaluate the plan sponsor's needs
  - 2) assist the plan sponsor in preparing a Request for Proposal ("RFP")

- 3) assist the plan sponsor in soliciting a reviewing responses from potential providers
- 4) assist the plan sponsor in selecting finalists and
- 5) provide the plan sponsor with an executive summary report to assist the plan sponsor in making its final decision.

- **Fee Benchmarking.** MSSB may perform a comparative analysis of fees charged by third party service providers and the expenses of funds that are available to plan sponsors in order to allow them to evaluate the level of such fees that they pay relative to similarly structured and sized retirement plans. This service may be provided to existing clients of MSSB or on a one-time basis to plans that are not MSSB clients and MSSB may retain third-party firms to assist it in providing this service. The service shall include the following:

- 1) obtaining information from plan sponsor for preparation of Fee Benchmarking report and
- 2) preparation of and assistance in the review and evaluation of the Fee Benchmarking report with the plan sponsor.

#### ***Alternative Investments Performance Reporting Service.***

MSSB may provide institutional clients with alternative investments performance reporting. This is a non-discretionary service, and clients are responsible for executing participation agreements directly with each alternative investment. MSSB offers IS clients the ability to receive periodic reports that provide historical performance reporting of their alternative investments that were not purchased through MSSB, are not held in custody by MSSB and are not researched by MSSB. The alternative investment historical performance information provided by this service is based upon information provided, directly or indirectly, to MSSB by the issuer of the alternative investment, or by its sponsor, investment manager, administrator ("Performance Reporting AI"). MSSB's ability to provide historical or other performance reporting on alternative investments is dependent upon its ability to obtain such information from each Performance Reporting AI.

The performance reporting service enables the client to receive from MSSB periodic reports containing the Client's historical performance information as reported by the applicable Performance Reporting AI. Client may also receive composite reports that show historical performance of alternative investments as reported by the Performance Reporting AI, along with historical or other performance information on other investments that were/acquired through MSSB, are held in custody by MSSB or are followed by MSSB research.

The performance information provided in a periodic performance review is based on information provided to MSSB by the Performance Reporting AI and is not independently verified by MSSB. MSSB shall not be liable for any misstatement or omission made by the Performance Reporting AI nor for any loss, liability, claim, damage or expense arising out of such misstatement or omission.

This reporting service is not intended to constitute investment advice or a recommendation by MSSB of any alternative investment and MSSB is not evaluating the appropriateness of the initial investment or the continued investment in the alternative investments reported on as part of this service. In addition, the service does not constitute, create or impose a fee-based brokerage relationship, a fiduciary relationship or an investment advisory relationship under the Investment Advisers Act of 1940, as amended, with regard to the investments covered under this service. If the Client is an employee benefit plan or is otherwise subject to the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), MSSB is **NOT** acting as a fiduciary (as defined in ERISA) with the respect to the provision of these reporting services as described herein). MSSB is not responsible for and will not provide tax reporting with respect to any alternative investment reported on under this service.

MSSB does not normally maintain custody of alternative investments as reported by on under this service and therefore such investments are not included under MSSB’s SIPC coverage.

The fee charged to the client for this service does not include any fee or charge for other services in connection with the client’s participation in any alternative investment. Clients are solely responsible for such arrangements.

**Asset/Liability Analysis Services.** MSSB works with third party vendors, whose proprietary asset/liability modeling software is used to generate customized asset liability studies for defined benefit plan clients. The asset/liability analysis service provides certain cash flow modeling, liability funding analysis and funding strategies including custom contribution policies.

**Account Opening.** To enroll in the program described in this brochure, you must enter into the program client agreement (“Client Agreement”).

## C. Customized Advisory Services and Client Restrictions

In IS, services are provided based on an analysis of each client’s objectives and risk tolerance.

**Restrictions.** The Client may impose reasonable restrictions on account investments. For example, you may restrict MSSB or the managers from buying specific securities, a category of securities (e.g., tobacco companies) or Fund shares. If you restrict a category of securities, we or the manager will determine which specific securities fall within the restricted category. In doing so, we or the manager may rely on research provided by independent service providers). Any restrictions you impose on individual securities have no effect on Fund holdings since Funds operate in accordance with the investment objectives and strategies described in their prospectuses.

## D. Portfolio Management Services to Wrap Fee Programs

This item does not apply to the advisory programs described in this brochure. IS is also offered as a wrap fee-only program; please see your Financial Advisor for the descriptive brochure for this program.

## E. Assets Under Management (“AUM”)

MSSB managed client assets of \$483,411,502,454 as of January 31, 2012. Of this amount, MSSB managed \$163,040,083,910 on a discretionary basis and \$320,371,418,544 on a non-discretionary basis. These amounts represent the client assets in all of our investment advisory programs. We calculated them using a different methodology than the “assets under management” we report in our ADV Part I filed with the SEC.

# Item 5: Fees and Compensation

**Introduction.** *Currently, IS is offered only as an asset-based fee based program. However in the past, IS was offered to certain clients with a fee structure in which MSSB is compensated by receiving brokerage commissions on account transactions. This brochure applies only to accounts operated under that fee structure. For the descriptive brochure on the asset-based or “wrap fee” IS program, please contact your Financial Advisor.*

## A. Compensation for Advisory Services

You may pay MSSB for the services provided in the IS program by:

- directed brokerage (i.e. paying commission on a transaction-by-transaction basis);
- an asset-based fee (at a maximum annual fee rate of 2.5%). Our separate Wrap Brochure about the IS program, available from your Financial Advisor, describes the asset based fee option; or
- alternatively, in some cases, institutional clients may negotiate an annual fixed dollar amount, paid quarterly.

In the commission based advisory programs, we receive the brokerage commissions on transactions executed by MSSB. Clients may choose to pay brokerage transactions on a “cents per share” or as a “percentage discount” off MSSB’s standard brokerage commission schedule. The brokerage commission schedule is very complex and is dependent on many factors (i.e. the stock exchange where the security is executed or the liquidity of the security) for more information please discuss with your Financial Advisor. The brokerage fees are negotiable

## B. Payment of Fees

In the advisory programs listed in this brochure, you will pay for our advisory fee through the execution of securities transactions. Therefore, your fees will accrue each time your investment manager executes a trade. The maximum commissions charged to the account will not exceed the maximum advisory fee available for your program. In addition to the MSSB fee you (paid with securities transactions, you may, at your choice, pay you investment management fee from your advisory account or you may be billed separately.

## C. Additional Fees and Expenses

If you open an account in one of the programs described in this brochure, you will pay commission on the transactions in your account for investment advisory services (except for IMS DB where we don't provide advice), custody of securities and trade execution with or MSSB. For more information regarding brokerage commissions please see Item 4B and Item 12A(3) and 12B. The program fees do not cover:

- the costs of investment management fees and other expenses charged by investment manager that you selected
- “mark-ups,” “mark-downs,” and dealer spreads (A) that MSSB or its affiliates may receive when acting as principal in certain transactions where permitted by law or (B) that other broker-dealers may receive when acting as principal in certain transactions effected through MSSB and/or its affiliates acting as agent, which is typically the case for dealer market transactions (e.g., fixed income and over-the-counter equity)
- brokerage commissions or other charges resulting from transactions not effected through MSSB or its affiliates
- MSSB account establishment or maintenance fees for its Individual Retirement Accounts (“IRA”) and Versatile Investment Plans (“VIP”), which are described in the respective IRA and VIP account and fee documentation (which may change from time to time)
- account closing/transfer costs
- processing fees or
- certain other costs or charges that may be imposed by third parties (including, among other things, odd-lot differentials, transfer taxes, foreign custody fees, exchange fees, supplemental transaction fees, regulatory fees and other fees or taxes that may be imposed pursuant to law).

Investing in Funds may be more expensive than other investment options offered in your advisory account. In addition to our fee, you pay the fees and expenses of the Funds in which your account is invested. Fund fees and expenses are charged directly to the pool of assets the Fund invests in and are reflected in each Fund's share price. These fees and expenses are an additional cost to you and are not included in the fee amount in your account statements. Each Fund and ETF expense ratio (the total amount of fees and expenses charged by the Fund) is stated in its prospectus. The expense ratio generally reflects the costs incurred by shareholders during the Fund's or ETF's most recent fiscal reporting period. Current and future expenses may differ from those stated in the prospectus.

You do not pay any sales charges for purchases of Funds in programs described in this brochure. However some mutual funds may charge, and not waive, a redemption fee on certain transaction activity in accordance with their prospectuses.

## Custody

***MSSB does not act as custodian.*** If you retain a custodian other than MSSB, your outside custodian will advise you of your cash sweep options and, as described in the Client Agreement, you will have the option of instructing us on whether you want the fee billed to you directly or to the outside custodian selected by you.

***MSSB acts as custodian.*** Unless you instruct us otherwise, MSSB will maintain custody of all cash, securities and other assets in the account and the following sections on cash sweeps will apply to you.

## Cash Sweeps

Generally, some portion of your account will be held in cash. If MSSB acts as custodian for your account, it will effect “sweep” transactions of uninvested cash and allocations to cash, if any, in your account into:

- interest-bearing bank deposit accounts (“Deposit Accounts”) established under the Bank Deposit Program (“BDP”) or
- money market mutual funds (each, a “Money Market Fund” and, together with BDP Deposit Accounts, “Sweep Investments”). The Money Market Funds are managed by Morgan Stanley Investment Advisors Inc. or another MSSB affiliate.

If you do not select a Sweep Investment when you open your account, your Sweep Investment will be BDP if you are eligible.

Clients with retirement plan accounts or Coverdell Education Savings Accounts should read the Exhibit to this brochure (“Affiliated Money Market Funds Fee Disclosure Statement and Float Disclosure Statement”).

The custodian will effect sweep transactions only to the extent permitted by law and if you meet the Sweep Investment's eligibility criteria.

***Bank Deposit Program.*** Through the Bank Deposit Program, Deposit Accounts are established for you at one or more of the following banks (individually and collectively, the “Sweep Banks”): (i) Morgan Stanley Bank, N.A. (ii) Morgan Stanley Private Bank, National Association or (iii) Citibank, N.A. The Sweep Banks are affiliated with MSSB. The Sweep Banks pay interest on the Deposit Accounts established under the BDP. Your deposits at the Sweep Banks will be insured by the Federal Deposit Insurance Corporation (“FDIC”) up to applicable limits, in accordance with FDIC rules, and subject to aggregation of all the accounts (including, without limitation, certificates of deposit) that you hold at the Sweep Banks in the same capacity. Bank deposits held through the BDP are not covered by SIPC or excess coverage.

If BDP is your Sweep Investment, you authorize us, as your agent, to establish the Deposit Accounts for you, and to make deposits into, withdrawals from and transfers among the Deposit Accounts.

Terms of the Bank Deposit Program are further described in the Bank Deposit Program Disclosure Statement, which will be provided to you upon your first investment in the Bank Deposit Program. You may also obtain the Bank Deposit Program Disclosure Statement as well as current interest rates applicable to your account, by contacting your Financial Advisor or through MSSB's web site at [www.morganstanleyindividual.com/accountoptions/activeassets/investmentfeatures](http://www.morganstanleyindividual.com/accountoptions/activeassets/investmentfeatures). We may amend the list of Sweep Banks at any time with or without notice to you. If you are participating in the Bank Deposit Program, please read the Bank Deposit Program Disclosure Statement carefully.

Please note the following: (i) you are responsible to monitor the total amount of deposits you have at each Sweep Bank in order to determine the extent of FDIC insurance coverage available to you; and (ii) MSSB is not responsible for any insured or uninsured portion of your deposits at any of the Sweep Banks. If BDP is your Sweep Investment, you should be aware that, each Sweep Bank will pay MSSB a fee equal to the percentage of the average daily deposit balances in your Deposit Account at the Sweep Banks. Your Financial Advisor will not receive a portion of these fees or credits. In addition, MSSB will not receive cash compensation or credits in connection with the BDP for assets in the Deposit Accounts for retirement plans or Coverdell Education Savings accounts. Also, the affiliated Sweep Banks have the opportunity to earn income on the BDP assets through lending activity, and that income is usually significantly greater than the fees MSSB earns on affiliated Money Market Funds. Thus, MSSB has a conflict of interest in selecting or recommending BDP as the Sweep Investment, rather than an eligible Money Market Fund.

*Unless otherwise specifically disclosed to you in writing, such as in connection with the Bank Deposit Program noted above, investments and services offered through MSSB are not insured by the FDIC, are not deposits or other obligations of, or guaranteed by, the Sweep Banks, and involve investment risks, including possible loss of the principal invested.*

**Money Market Funds.** We may, in our sole discretion, offer Money Market Funds as Sweep Investments. The Money Market Funds are affiliated with MSSB. You understand that purchases and redemptions of Money Market Fund shares may be effected only through MSSB and that you may not directly access the Money Market Fund.

If a Money Market Fund is your Sweep Investment, you authorize us, as your agent, to make investments in, and redemptions from, the Money Market Fund.

Each of these Money Market Funds is a separate investment with different investment objectives. Their fees, expenses, minimum investment requirements, dividend policies and procedures may vary. Before you invest in any Money Market Fund, read its prospectus carefully. Money Market Fund shares are neither insured nor protected by the FDIC. Investment in any

money market fund is a purchase of securities issued by the money market fund, not a bank deposit.

Certain of the Money Market Funds described above have minimum investment requirements. In addition, MSSB may require a minimum initial investment to activate some or all of the Sweep Investments. If you do not meet the minimum initial investment, uninvested cash and allocations to cash in eligible accounts will be invested in the BDP.

In addition, certain of the Money Market Funds have minimum balance requirements. For eligible accounts, if your investment falls below the minimum balance requirement, MSSB may redeem and reinvest all of your shares in the BDP. Once your sweep option has been changed, we will not automatically change it back to your previous Sweep Investment even if you meet the minimum initial investment and/or balance requirements. You must contact your Financial Advisor to do so. However, if a pattern develops of falling below the minimum balance requirement, we may preclude you from investing in that Sweep Investment in the future.

We may offer other money market funds as a non-sweep investment choice. You may purchase shares in these money market funds by giving specific orders for each purchase to your Financial Advisor. However, uninvested cash in your account will not be swept into these money market funds.

Since the Money Market Funds are sponsored or managed by MSSB affiliates, those MSSB affiliates receive advisory fees and may receive other fees from the Money Market Funds if your account cash balances are invested in the Money Market Funds. Therefore, MSSB has a conflict of interest in selecting or recommending the Money Market Funds as your Sweep Investment. **For retirement accounts with cash balances invested in Money Market Funds sponsored or managed by MSSB affiliates, certain fees received and retained by such MSSB affiliates will be credited to the account or offset against the advisory program fee. Please see the attached Exhibit "Affiliated Money Market Funds Fee Disclosure Statement and Float Disclosure Statement" for more details.**

The above provisions may not apply if you are not a U.S. resident. If you are not a U.S. resident, please contact your Financial Advisor to determine whether the BDP or a Money Market Fund will be your default Sweep Investment.

## **D. Prepayment of Fees**

You will pay your investment management fees quarterly in advance. If you terminate your advisory agreement with the investment manager or with us anytime during billing quarter, we will refund you the pro rata fee.

## **E. Other Compensation to Financial Advisors**

MSSB is a full service broker dealer and we offer many types of financial products to clients. A sample of the investment products include, stocks, bonds, futures, mutual funds, private



funds, insurance, options and structured products. We allocate to your Financial Advisor, on an ongoing basis, part of the fees payable to us in connection with your account. The Financial Advisor may receive different compensation depending on which program you invest in, the asset class within a program that you select (e.g. equity vs. fixed income), and the rate and amount of your fee. The amount we allocate to your Financial Advisor in connection with accounts opened in programs described in this brochure may be more than, if you participate in other MSSB investment advisory programs, or if you pay separately for investment advice, brokerage and other services. Your Financial Advisor may therefore have a financial incentive to recommend one of the programs in this brochure instead of other MSSB programs or services.

If you invest in one of the programs described in this brochure, the Financial Advisor may charge a fee less than the maximum fee stated above. The amount of the fee you pay is a factor we use in calculating the compensation we pay your Financial Advisor. Therefore, Financial Advisors have a financial incentive not to reduce fees. If your fee rate is below a certain threshold, we give your Financial Advisor credit for less than the total amount of your fee in calculating his or her compensation. Therefore, Financial Advisors also have a financial incentive not to reduce fees below that threshold.

### **Conflicts Relating to Financial Advisor Compensation**

The sale of some financial products will benefit your Financial Advisor more than others. Therefore, your Financial Advisor has an incentive to recommend certain investment products that pay your Financial Advisor a greater amount. We generally disclose the conflicts to clients at the point of sale or on the confirmation.

**Mutual Funds.** Traditional mutual funds are not available in the advisory programs described in this brochure. Generally, if an investment manager wants to use a mutual fund, they will use a no fee fund (a fund that has no expenses). If you have a no fee fund within your portfolio, you will have to liquidate the fund upon termination of the relationship with the investment manager.

You may be able to invest with managers directly or through brokers or agents not affiliated with MSSB, instead of investing through the IS program described.

In the programs described in this brochure, we do not charge any advisory fee in addition to commissions. Less than 50% of our revenue generated from our advisory business comes from commissions and compensation such as distribution fees for the sale of investment products we recommend to clients

## **Item 6: Performance Based Fees and Side by Side Management**

This item is not applicable to the programs described in this brochure.

## **Item 7: Types of Clients**

MSSB's clients include individuals, trusts, and institutions, including, banking or thrift institutions, pension and profit sharing plans, plan participants, other pooled investment vehicles (e.g., hedge funds), charitable organizations, corporations, other businesses, state or municipal government entities, investment clubs and other entities.

In the IS program, minimum account sizes are set by each manager.

## **Item 8: Methods of Analysis, Investment Strategies and Risk of Loss**

### **A. Method of Analysis and Investment Strategies**

MSSB does not provide portfolio management services in the programs listed in this brochure. Your investment manager provides the discretionary management of your account. Financial Advisors may recommend a particular investment manager focusing on a particular strategy to clients in the IS program. Investing in securities involves risk of loss that you should be prepared to bear.

In IS we offer a wide range of investment products (including managers, mutual funds and ETFs) that we have selected and approved. This Item 8.A describes more generally how we select and terminate Investment Options from these programs. If managers have more than one strategy, we may include only some of those strategies in the programs described in this brochure, may carry different strategies in different programs, and assign different statuses to different strategies. Please refer to the discussion in Item 4.B for a complete description of the programs.

### **Consulting Group Investment Advisor Research**

Our Consulting Group Investment Advisor Research department ("CG IAR") evaluates managers. Managers may only participate in the CES program if they are on CG IAR's Focus List or Approved List discussed below. The Focus List and Approved List are at [www.morganstanleyindividual.com/accountoptions/managedmoney/manager/default.asp](http://www.morganstanleyindividual.com/accountoptions/managedmoney/manager/default.asp) (or you can ask your Financial Advisor for these lists). In each program, only some of the managers on the Focus List and Approved List may be available. (The mutual funds and ETFs on the Focus List and Approved List are not offered in the CES program.)

As well as requiring managers to be on the Focus List or Approved List, we look at other factors in determining which managers we offer in these programs, including:

- program needs (such as whether we have a sufficient number of managers available in an asset class)

- client demand and
- the manager's minimum account size.

We automatically terminate managers in the CES program if CG IAR downgrades them to "Not Approved." We may terminate managers from the program for other reasons (e.g., the manager has a low level of assets under management in the program, the manager has limited capacity for further investment, or the manager is not complying with our policies and procedures).

**Focus List.** To be considered for the Focus List, a manager provides CG IAR with relevant documentation on the strategy being evaluated, which may include sample portfolios, asset allocation histories, its Form ADV (the form that investment managers use to register with the SEC), past performance information and marketing literature. For verification purposes, as part of the review process CG IAR may compare the manager's reported performance with the performance of a cross-section of actual accounts calculated by CG IAR. CG IAR personnel may also interview the manager and its key personnel, and examine its operations. Following this review process, managers are placed on the Focus List if they meet the required standards for Focus List status.

CG IAR periodically reviews managers on the Focus List. CG IAR considers a broad range of factors (including investment performance, staffing, operational issues and financial condition). Among other things, CG IAR personnel interview each manager periodically to discuss these matters. If CG IAR is familiar with a manager following repeated reviews, CG IAR is likely to focus on quantitative analysis and interviews and not require in-person meetings. CG IAR may also review the collective performance of a composite of the MSSB accounts managed by a manager and compare this performance to overall performance data provided by the manager, and then investigate any material deviations.

**Approved List.** The process for considering managers for the Approved List is less comprehensive, and evaluates various qualitative and quantitative factors. These include personnel depth, turnover and experience; investment process; business and organization characteristics; and investment performance. CG IAR may use an algorithm – a rules-based scoring mechanism – that reviews various qualitative and quantitative factors and ranks each manager in a third party database. (Not all managers reviewed for the Approved List are subject to this algorithm.) CG IAR analysts analyze the information contained in the algorithm to gauge the completeness and consistency of the data which drive the rankings, and then send the manager additional information requests. CG IAR then determines whether the manager meets the standards for Approved List status. Furthermore, CG IAR may evaluate a manager under the evaluation process for the Focus List but then decide to instead put it on the Approved List.

CG IAR periodically evaluates managers on the Approved List to determine whether they continue to meet the Approved List standards.

**Changes in Status from Focus List to Approved List.** In light of the differing evaluation methodology and standards for the

Focus List and Approved List, CG IAR may determine that a manager no longer meets the criteria for the Focus List or will no longer be reviewed under the Focus List review process, but meets the criteria for the Approved List. If so, MSSB generally notifies program clients regarding such status changes on a quarterly basis.

**Changes in Status to Not Approved.** CG IAR may determine that a manager no longer meets the criteria under either evaluation process and therefore the manager will no longer be recommended in MSSB investment advisory programs. We notify affected clients of these downgrades. You cannot retain downgraded managers in your CES account and must select a replacement from the Approved List or Focus List, and that is available in the program, if you wish to retain the program's benefits in respect of the affected assets.

In some circumstances, you may be able to retain terminated managers in another advisory program or in a brokerage account subject to the regular terms and conditions applying to that program or account. Ask your Financial Advisor about these options.

**Watch Policy.** CG IAR has a "Watch" policy for managers on the Focus List and Approved List. Watch status indicates that, in reviewing a manager, CG IAR has identified specific areas of the manager's business that (a) merit further evaluation by CG IAR and (b) may, but are not certain to, result in the manager becoming "Not Approved." Putting a manager on Watch does not signify an actual change in CG IAR opinion nor is it a guarantee that CG IAR will downgrade the manager. The duration of a Watch status depends on how long CG IAR needs to evaluate the manager and for the manager to address any areas of concern. For additional information, ask your Financial Advisor for a copy of CG IAR's Watch Policy.

**Tactical Opportunities List.** CG IAR also has a Tactical Opportunities List. This consists of certain managers on the Focus List or Approved List recommended for investment at a given time based in part on then-existing tactical opportunities in the market.

**Other Relationships with Managers.** Some managers on the Approved List or Focus List may have business relationships with us or our affiliates. For example, a manager may use MS&Co. or a Citi affiliate as its broker or may be an investment banking client of MS&Co. or a Citi affiliate. CG IAR does not consider the existence nor lack of a business relationship in determining whether to include or maintain a manager on the Approved List or Focus List.

Please review your investment managers ADV Part 2 for a discussion on the method of analysis and investment strategy.

### **Graystone Mutual Fund Due Diligence**

In addition to the Funds reviewed by CG IAR, certain Financial Advisors offering institutional services may offer clients access to additional Funds reviewed by Graystone. (Graystone is a division of MSSB.)

Select Graystone teams conduct due diligence on Funds using information provided by Funds' investment managers or outside independent databases, all unaffiliated with MSSB.

The Graystone team conducts both quantitative screening and a qualitative assessment. It starts by sending the Fund a request for information ("RFI") substantially similar to the one used by the MSSB mutual fund area in determining which Funds to bring on the MSSB platform. After reviewing the information it receives in response to the RFI, the team reviews the Fund's performance, speaks with Fund managers, and gathers information through an additional RFI and manager material.

The Graystone Director of Institutional Investments reviews the due diligence for completeness. Funds are then either approved or not approved for use in the Institutional Consulting Services programs. Graystone generally conducts periodic follow-up due diligence on approved Funds.

### **MAP Due Diligence**

Select Graystone and Morgan Stanley Private Wealth Management ("PWM") teams may approve a manager through the Graystone Manager Assessment Program or the PWM Manager Assessment Program. (PWM is a division of MSSB.)

The reviewing team uses a proprietary tool that assesses all separate account managers in a third party database to narrow the list of potential investment managers for consideration. It then generally conducts further analysis on managers, focusing on qualitative factors (e.g., quality of investment professionals and the manager's investment process).

If the manager is being reviewed by a Graystone team, the Graystone Director of Institutional Investments reviews the due diligence for completeness. If the manager is being reviewed by a PWM team, the Research Management Committee also reviews and, if appropriate, approves the manager. (The Research Management Committee reviews certain products made available in Consulting Group programs.) Once a manager has been approved by either reviewing team, it is available for Graystone Consulting, PWM MAP and certain other clients.

The reviewing team generally conducts periodic follow-up due diligence on approved managers (including follow-up interviews with the manager).

### **For Participant-Directed Plans**

In addition to the mutual funds and ETFs that appear on the Focus List and Approved List of CG IAR described above, for clients in the Institutional Services program for participant directed retirement plans, funds may be "approved" for the program in an alternate manner, as well. MSSB applies a proprietary screening process to funds in the Morningstar mutual fund database, which it applies in part using third party software. The screening algorithm, applied quarterly, is based on factors such as performance, ranking, stewardship grade, fees and manager tenure. Funds subject to this process are either approved or not approved for use in the Institutional Services program for participant directed retirement plans. MSSB does

not maintain a Watch List for these funds equivalent to CG IAR's Watch List.

### **Selection of Alternative Investments**

Managers may only participate in the IS program if they are on MSSB's Alternatives Approved List (described below). Managers often offer more than one alternative investment and we may include only some of those alternative investments (or only certain share classes of such alternative investment) in our programs, may carry different alternative investments (or share classes) in different programs, and assign different statuses to different alternative investments.

As well as requiring alternative investments to be on the Alternatives Approved List or Approved List, we look at other factors in determining which alternative investments we offer in these programs, including program needs (such as whether we have a sufficient number of managers available in an asset class), and client demand.

In the programs, investment and business risk due diligence on alternative investments is provided by MSSB through (i) our Alternative Investments Research group ("AIR"), (ii) an affiliate of MSSB that may provide due diligence and monitoring services, or (iii) an independent consulting firm retained by MSSB that is also in the business of evaluating the capabilities of alternative investments. Any firm providing due diligence will generally follow a methodology similar to that used by AIR (described below) in reviewing such alternative investments.

On an ongoing basis, AIR analysts conduct both quantitative and qualitative research on potential candidates. Their research includes, among other things, a review of relevant documents, calls and meetings with the investment team, and an analysis of investment performance. Generally, although the process may be modified for a particular manager or alternative investment as AIR may deem appropriate, AIR also conducts on-site visits, review a separate business risk due diligence questionnaire and examine areas such as portfolio pricing, contingency planning, background checks on key principals and other items. Their research covers the alternative investment in question, not the investments in which that alternative investment may in turn invest. For example, for a fund of funds, AIR's research process is applied to the fund of funds, and not to each individual fund in which the fund of funds invests.

If a new alternative investment is viewed as an appropriate candidate by AIR or the firm providing due diligence, the vehicle is presented to an MSSB alternative investment product review committee ("AIPRC"). The AIPRC consists of senior MSSB representatives who are mandated to approve proposed candidates and reconfirm existing vehicles on a periodic basis. Once a new alternative investment is approved by the AIPRC, and all required due diligence materials are verified, it receives an "Approved" status, is placed on the Alternatives Approved List, a list of alternative investment vehicles in which qualified clients may invest, and is available for allocations to qualified clients on a placement and/or advisory basis. Certain Alternatives Investments on the Alternatives Approved List are available to qualified clients in the programs.

Ongoing monitoring of managers and investment vehicles on the Alternatives Approved List is provided by AIR or the firm which provided the original due diligence. In addition to manager-specific monitoring, the reviewer monitors overall market conditions in their specific strategies of expertise.

MSSB removes alternative investments from the programs if AIR, or the due diligence service provider responsible for coverage of the alternative investment downgrades the alternative investment to "Terminate". We may terminate managers from these programs for other reasons (e.g., the manager has a low level of assets under management in the program, the manager has limited capacity for further investment, or the manager is not complying with our policies and procedures). AIR's head of research can remove an alternative investment vehicle from the Alternatives Approved List without consulting the AIPRC, but all actions must be assessed by the AIPRC at the next meeting.

**Watch Policy.** MSSB has a "Watch" policy for alternative investments on the Approved List. Watch status indicates that, in reviewing an alternative investment, AIR has identified specific areas related to the alternative investment, the manager of the alternative investment, or the markets in general that (i) merit further evaluation by AIR and (ii) may, but are not certain to, result in the removal of the alternative investment from the "Approved List". Putting an alternative investment on Watch does not signify an actual change in AIR opinion nor is it a guarantee that AIR will remove the alternative investment. The duration of a Watch status depends on how long AIR needs to evaluate the reason for the status change, which may include, among things, an evaluation of the markets, the alternative investment, and the manager of the alternative investment.

## **B. Material, Significant, or Unusual Risks Relating to Investment Strategies**

The strategies employed by MSSB and the managers entail all of the risks inherent in the markets in which managers or Investment Options are invested. All trading in your account is at your risk. The value of the assets in your account is subject to a variety of factors, such as the liquidity and volatility of the securities markets. We and the managers do not guarantee performance, and a manager's or Investment Option's past performance with respect to other accounts does not predict your account's future performance.

**Risks Relating to Money Market Funds.** An investment in a money market fund is neither insured nor guaranteed by the Federal Deposit Insurance Corporation ("FDIC") or any other government agency. Although money market funds seek to preserve the value of your investment at \$1.00 per share, there is no assurance that will occur, and it is possible to lose money if the fund value per share falls. Moreover, in some circumstances, money market funds may be forced to cease operations when the value of a fund drops below \$1.00 per share. If this happens, the fund's holdings are liquidated and distributed to the fund's shareholders. This liquidation process could take up to a month or more. During that time, these funds would not be available to you to support purchases,

withdrawals and, if applicable, check writing or ATM debits from your account.

**Risks Relating to Differing Classes of Securities.** Different classes of securities have different rights as creditor if the issuer files for bankruptcy or reorganization. For example, bondholders' rights generally are more favorable than shareholders' rights in a bankruptcy or reorganization.

**Risk Relating to ETFs.** There may be a lack of liquidity in certain ETFs which can lead to a large difference between the bid-ask prices (increasing the cost to you when you buy or sell the ETF). A lack of liquidity also may cause an ETF to trade at a large premium or discount to its net asset value. Additionally, an ETF may suspend issuing new shares and this may result in an adverse difference between the ETF's publicly available share price and the actual value of its underlying investment holdings. At times when underlying holdings are traded less frequently, or not at all, an ETF's returns also may diverge from the benchmark it is designed to track.

**Risks Relating to Alternative Investments.** Alternative investments have different features and risks from other types of investment products. As further described in the offering documents of any particular alternative investment, an investment in alternative investments can be highly illiquid, is speculative and not suitable for all investors. For example, alternative investment products may place substantial limits on liquidity and the redemption rights of investors, including only permitting withdrawals on a limited periodic basis and with a significant period of notice and may impose early withdrawal fees. Investing in alternative investments is intended for experienced and sophisticated investors only who are willing to bear the high economic risks of the investment. Investors should carefully review and consider potential risks before investing. Certain of these risks may include: loss of all or a substantial portion of the investment due to leveraging, shortselling, or other speculative practices; lack of liquidity, in that there may be no secondary market for the fund and none expected to develop; volatility of returns; restrictions on transferring interests in the fund; potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized; absence of information regarding valuations and pricing; complex tax structures and delays in tax reporting; less regulation and higher fees than mutual funds; and advisor risk. Alternative investment products may also have higher fees (including multiple layers of fees) compared to other types of investments.

Individual funds will have specific risks related to their investment programs that will vary from fund to fund. For more details on these and other features and risks, please carefully read the documentation (including risk disclosures) relating to any selected Investment Option, as well as your client agreement.

Please review your investment managers ADV Part 2 or the prospectus or offering document for any mutual fund, alternative investment or ETF in which your account may be invested for a discussion on the material risks associated with your account.

## C. Risks Associated with Particular Types of Securities

Please see response to Item 8 B.

### Item 9: Disciplinary Information

This section contains information on certain legal and disciplinary events.

In this section, “MSDW” means Morgan Stanley DW Inc., a predecessor broker-dealer of MS&Co. and registered investment adviser that was merged into MS&Co. in April 2007. MS&Co. and CGM are predecessor broker-dealer firms of MSSB.

- The National Association of Securities Dealers Inc. (“NASD”) alleged that between October, 1999 and December, 2002, MSDW violated the non-cash compensation provisions of the NASD Conduct Rules (under which MSDW was prohibited from providing its Financial Advisors with non-cash compensation for sales of mutual funds and variable annuities that were not based on total sales and equal weighting). MSDW offered rewards to its Financial Advisors for sales of affiliated mutual funds in general, or particular affiliated mutual funds or certain variable annuities. By a Letter of Acceptance, Waiver and Consent (“LAWC”) dated September 15, 2003, MSDW agreed to (1) fines totaling \$2.25 million; (2) update its compliance systems and procedures; and (3) retain an independent consultant to review and make recommendations on MSDW’s supervisory and compliance procedures.
- On April 28, 2003, the SEC filed a complaint alleging that MS&Co. violated certain NASD and New York Stock Exchange (“NYSE”) Conduct Rules (collectively, the “Conduct Rules”) by creating conflicts of interest for its research analysts with respect to investment banking activity, failing to adequately manage such conflicts, failing to ensure, in offerings where MS&Co. was the lead underwriter, that payments made to other broker-dealers for publishing research reports were disclosed by the issuers in the offering documents and the other broker-dealers in their research reports, and failing to supervise properly its research analysts, including with respect to the ratings, price targets and content of the reports of senior research analysts. Without admitting or denying the substantive allegations in the complaint, on October 31, 2003, MS&Co. consented to the entry of a final judgment that enjoined MS&Co. from violating the Conduct Rules and required it to make payments of \$50 million for past conduct and allocate \$75 million to fund independent research. In addition, MS&Co. agreed to a number of structural changes to the operations of its equity research and investment banking operations. Concurrently, MS&Co. also entered into a settlement with the NYSE, the NASD and the Attorney General of the State of New York with respect to the same conduct specified in the complaint. MS&Co. is also in the process of finalizing settlements with the other state and territorial securities administrators.
- In 2003, Salomon Smith Barney (“SSB”), now known as CGM, settled civil and regulatory actions brought by the SEC, the NYSE, the NASD, the Attorney General of the State of New York (“NYAG”), and state securities regulators, which alleged violations of certain federal and state securities laws and regulations, and certain NASD and NYSE rules, by SSB arising out of certain business practices concerning sell-side research during 1999 to 2001, and initial public offerings (“IPOs”) during 1996 to 2000. The actions alleged, among other things, that SSB published fraudulent research reports, permitted inappropriate influence by investment bankers over research analysts, and failed to adequately supervise the employees who engaged in those practices. It was also alleged that SSB engaged in improper “spinning” of shares to executives of investment banking clients and failed to maintain policies and procedures reasonably designed to prevent the potential misuse of material non-public information in certain circumstances. Without admitting or denying the findings, SSB consented to (1) censures by NASD and the NYSE; (2) cease and desist orders in state proceedings prohibiting SSB from violating certain state laws and regulations; (3) a judgment prohibiting SSB from violating certain laws and regulations; (4) certain operational reforms; (5) participating in a voluntary initiative pursuant to which SSB will no longer make allocations of securities in hot IPOs to accounts of executive officers or directors of U.S. public companies; and (6) a payment of \$400 million.
- The SEC alleged disclosure violations in connection with marketing arrangements between MSDW and certain mutual fund complexes in connection with the offer and sale of class B shares in certain Morgan Stanley proprietary mutual funds in the amount of \$100,000 or more in a single transaction. The SEC also alleged that receipt of directed brokerage commissions as payment for such marketing arrangements contravened NASD Rule 2830(k). On November 17, 2003, without admitting or denying the findings, MSDW consented to orders including a censure; a cease and desist; and an undertaking to distribute, for the benefit of certain customers, \$50 million dollars, consisting of disgorgement plus prejudgment interest in the amount of \$25 million and civil penalty of \$25 million. MSDW also made certain other undertakings including (1) preparing and distributing certain disclosures and a mutual fund bill of rights; (2) permitting certain class B shares to be converted to class A shares; and (3) retaining an independent consultant to review, among other things, the completeness of the disclosures and conformity with other aspects of the order.
- In 2004, the NYSE brought an administrative action alleging that MS&Co. and MSDW (1) failed to ensure delivery of prospectuses in connection with certain sales of securities; (2) failed to timely and accurately file daily program trade reports; (3) erroneously executed certain sell orders on a minus tick for securities in which MS&Co. held a short position; (4) failed to timely submit RE-3 in connection with certain matters; (5) hired certain individuals subject to statutory disqualification and failed to file fingerprint cards for certain non-registered employees; (6) failed to comply with requirements concerning certain market-on-close and limit-on-close orders; and (7) failed to reasonably supervise certain activities. MS&Co. and MSDW resolved the action on January 7, 2005, by consenting, without admitting or

denying guilt, to a censure, a fine of \$13 million, and a rescission offer to those clients who should have received a prospectus during the period from June 2003 to September 2004.

- In January 2005, the SEC filed a complaint in federal court alleging that, during 1999 and 2000, MS&Co. violated Regulation M by attempting to induce certain customers who received allocations of IPOs to place purchase orders for additional shares in the aftermarket. The SEC did not allege fraud or impact on the market. On January 25, 2005, MS&Co. agreed to the entry of a judgment enjoining MS&Co. from future violations and the payment of a \$40 million civil penalty. The settlement terms received court approval on February 4, 2005.
- In March 2005, the SEC entered an administrative and cease and desist order against CGM for two disclosure failures by CGM in offering and selling mutual fund shares. Firstly, CGM received from mutual fund advisers and distributors revenue sharing payments, in exchange for which CGM granted mutual funds preferential sales treatment. The order found that CGM did not adequately disclose its revenue sharing program to its clients, in violation of the Securities Act of 1933 (“Securities Act”) and Rule 10b-10 under the Securities Exchange Act of 1934 (“Exchange Act”). Secondly, on sales of Class B mutual fund shares in amounts aggregating \$50,000 or more, the order found that CGM, in violation of the Securities Act, failed to disclose adequately at the point of sale that such shares were subject to higher annual fees. These fees could have a negative impact on client investment returns, depending on the amount invested and the intended holding period. The SEC order censured CGM, required CGM to cease and desist from future violations of the applicable provisions, and required CGM to pay a \$20 million penalty.
- In March 2005, the NASD censured and fined CGM with respect to CGM’s offer and sale of Class B and Class C mutual fund shares during 2002 and the first six months of 2003. The NASD found that CGM either had not adequately disclosed at the point of sale, or had not adequately considered in connection with its recommendations to clients to purchase Class B and Class C shares, the differences in share classes and that an equal investment in Class A shares generally would have been more advantageous for the clients. The NASD also found that CGM’s supervisory and compliance policies and procedures regarding Class B and Class C shares had not been reasonably designed to ensure that SB Financial Consultants consistently provided adequate disclosure of, or consideration to, the benefits of the various mutual fund share classes as they applied to individual clients. The NASD censured CGM and required CGM to pay a \$6.25 million fine.
- On May 31, 2005, the SEC issued an order in connection with the settlement of an administrative proceeding against Smith Barney Fund Management LLC (“SBFM”) and CGM relating to the appointment of an affiliated transfer agent for the Smith Barney family of mutual funds (“Smith Barney Funds”). SBFM was an affiliate of CGM during the applicable period.

The SEC order found that SBFM and CGM willfully violated section 206(1) of the Investment Advisers Act of 1940 (“Advisers Act”). Specifically, the order found that SBFM and CGM knowingly or recklessly failed to disclose to the Boards of the Smith Barney Funds in 1999 when proposing a new transfer agent arrangement with an affiliated transfer agent that: First Data Investors Services Group (“First Data”), the Smith Barney Funds’ then-existing transfer agent, had offered to continue as transfer agent and do the same work for substantially less money than before; and Citigroup Asset Management (“CAM”), the Citi business unit that includes the Smith Barney Funds’ investment manager and other investment advisory companies, had entered into a side letter with First Data under which CAM agreed to recommend the appointment of First Data as sub-transfer agent to the affiliated transfer agent in exchange, among other things, for a guarantee by First Data of specified amounts of asset management and investment banking fees to CAM and CGM. The order also found that SBFM and CGM willfully violated section 206(2) of the Advisers Act by virtue of the omissions discussed above and other misrepresentations and omissions in the materials provided to the Smith Barney Funds’ Boards, including the failure to make clear that the affiliated transfer agent would earn a high profit for performing limited functions while First Data continued to perform almost all of the transfer agent functions, and the suggestion that the proposed arrangement was in the Smith Barney Funds’ best interests and that no viable alternatives existed. SBFM and CGM did not admit or deny any wrongdoing or liability. The settlement did not establish wrongdoing or liability for purposes of any other proceeding.

The SEC censured SBFM and CGM and ordered them to cease and desist from violations of sections 206(1) and 206(2) of the Advisers Act. The order required Citi to pay \$208.1 million, including \$109 million in disgorgement of profits, \$19.1 million in interest, and a civil money penalty of \$80 million. Approximately \$24.4 million has already been paid to the Smith Barney Funds, primarily through fee waivers. The remaining \$183.7 million, including the penalty, has been paid to the U.S. Treasury.

The order required SBFM to recommend a new transfer agent contract to the Smith Barney Fund Boards within 180 days of the entry of the order; if a Citi affiliate submitted a proposal to serve as transfer agent or sub-transfer agent, an independent monitor must be engaged at the expense of SBFM and CGM to oversee a competitive bidding process. Under the order, Citi also must comply with an amended version of a vendor policy that Citi instituted in August 2004. That policy, as amended, among other things, requires that when requested by a Smith Barney Fund Board, CAM will retain at its own expense an independent consulting expert to advise and assist the Board on the selection of certain service providers affiliated with Citi.

- In a LAW C dated August 1, 2005, the NASD found that MSDW failed to establish and maintain a supervisory system, including written procedures, reasonably designed to review and monitor MSDW’s fee-based brokerage business, between January 2001 and December 2003. Without

admitting or denying the allegations, MSDW consented to the described sanctions and findings and was censured and fined \$1.5 million, and agreed to the payment of restitution to 3,549 customers in the total amount of approximately \$4.7 million, plus interest.

- The SEC alleged that MS&Co. violated the Exchange Act by inadvertently failing to timely produce emails to the SEC staff pursuant to subpoenas in the SEC's investigation into MS&Co.'s practices in allocating shares of stock in IPOs and an investigation into conflicts of interest between MS&Co.'s research and investment banking practices. Without admitting or denying the allegations, MS&Co. consented to a final judgment on May 12, 2006 in which it was permanently restrained and enjoined from violating the Exchange Act. MS&Co. agreed to make payments aggregating \$15 million, which amount was reduced by \$5 million contemporaneously paid by MS&Co. to the NASD and the NYSE in related proceedings. MS&Co. also agreed to notify the SEC, the NASD and the NYSE that it has adopted and implemented policies and procedures reasonably designed to ensure compliance with the Exchange Act. MS&Co. also agreed to provide annual training to its employees responsible for preserving or producing electronic communications and agreed to retain an independent consultant to review and comment on the implementation and effectiveness of the policies, procedures and training.
- On June 27, 2006, the SEC announced the initiation and concurrent settlement of administrative cease and desist proceedings against MS&Co. and MSDW for failing to maintain and enforce adequate written policies and procedures to prevent the misuse of material nonpublic information. The SEC found that from 1997 through 2006, MS&Co. and MSDW violated the Exchange Act and the Advisers Act by failing to (1) conduct any surveillance of a number of accounts and securities; (2) provide adequate guidance to MS&Co.'s and MSDW's personnel charged with conducting surveillance; and (3) have adequate controls in place with respect to certain aspects of "Watch List" maintenance. The SEC's findings covered different areas from the 1997 through 2006 time period. MS&Co. and MSDW were ordered to pay a civil money penalty of \$10 million and agreed to enhance their policies and procedures.
- On August 21, 2006, MS&Co. and MSDW entered into a LAWC relating various finds that, at various times between July 1999 and 2005, MS&Co. violated a number of NASD and SEC rules. The violations related to areas including trade reporting through the Nasdaq Market Center (formerly Automated Confirmation Transaction Service (ACT)), Trade Reporting and Compliance Engine (TRACE) and Order Audit Trail System (OATS); market making activities; trading practices; short sales; and large options positions reports. The NASD also found that, at various times during December 2002 and May 2005, MSDW violated NASD rules and Municipal Securities Rulemaking Board ("MSRB") rules related to areas including trade reporting through TRACE, short sales, and OATS. The NASD further found that, in certain cases, MS&Co. and MSDW violated NASD Rule 3010 because their supervisory systems did not provide

supervision reasonably designed to achieve compliance with securities laws, regulations and/or rules.

Without admitting or denying the findings, MS&Co. and MSDW consented to the LAWC. In the LAWC, MS&Co. and MSDW were censured, required to pay a monetary fine of \$2.9 million and agreed to make restitution to the parties involved in certain transactions, plus interest, from the date of the violative conduct until the date of the LAWC. MS&Co. and MSDW also consented to (1) revise their written supervisory procedures; and (2) provide a report that described the corrective action that they completed during the year preceding the LAWC to address regulatory issues and violations addressed in the LAWC, and the ongoing corrective action that they were in the process of completing.

- On May 9, 2007, the SEC issued an Order ("May 2007 Order") settling an administrative action with MS&Co. In this matter, the SEC found that MS&Co. violated its duty of best execution under the Exchange Act. In particular, the SEC found that, during the period of October 24, 2001 through December 8, 2004, MS&Co.'s proprietary market-making system failed to provide best execution to certain retail OTC orders. In December 2004, MS&Co. removed the computer code in the proprietary market-making system that caused the best execution violations. MS&Co. consented, without admitting or denying the findings, to a censure, to cease and desist from committing or causing future violations, to pay disgorgement of approximately \$5.9 million plus prejudgment interest on that amount, and to pay a civil penalty of \$1.5 million. MS&Co. also consented to retain an Independent Compliance Consultant to review its policies and procedures in connection with its market-making system's order handling procedures and its controls relating to changes to those procedures, and to develop a better plan of distribution.
- On July 13, 2007, the NYSE issued a Hearing Board Decision in connection with the settlement of an enforcement proceeding brought in conjunction with the New Jersey Bureau of Securities against CGM. The decision held that CGM failed to (1) adequately supervise certain branch offices and Financial Advisors who engaged in deceptive mutual fund market timing on behalf of certain clients from January 2000 through September 2003 (in both proprietary and non-proprietary funds); (2) prevent the Financial Advisors from engaging in this conduct; and (3) make and keep adequate books and records. Without admitting or denying the findings, CGM agreed to (a) a censure; (b) establishing a \$35 million distribution fund for disgorgement payments; (c) a penalty of \$10 million (half to be paid to the NYSE and half to be paid to the distribution fund); (d) a penalty of \$5 million to be paid to the State of New Jersey; and (e) appointing a consultant to develop a plan to pay CGM's clients affected by the market timing.
- On September 27, 2007, MS&Co. entered into a LAWC with the Financial Industry Regulatory Authority ("FINRA"). FINRA found that, from October 2001 through March 2005, MSDW provided inaccurate information to arbitration claimants and regulators regarding the existence of pre-September 11, 2001 emails, failed to provide such emails in

response to discovery requests and regulatory inquiries, failed adequately to preserve books and records, and failed to establish and maintain systems and written procedures reasonably designed to preserve required records and to ensure that it conducted adequate searches in response to regulatory inquiries and discovery requests. FINRA also found that MSDW failed to provide arbitration claimants with updates to a supervisory manual in discovery from late 1999 through the end of 2005. MS&Co. agreed, without admitting or denying these findings, to establish a \$9.5 million fund for the benefit of potentially affected arbitration claimants. In addition, MS&Co. was censured and agreed to pay a \$3 million regulatory fine and to retain an independent consultant to review its procedures for complying with discovery requirements in arbitration proceedings relating to its retail brokerage operations.

- On October 10, 2007, MS&Co. became the subject of an Order Instituting Administrative and Cease-And-Desist Proceedings (“October 2007 Order”) by the SEC. The October 2007 Order found that, from 2000 until 2005, MS&Co. and MSDW failed to provide to their retail customers accurate and complete written trade confirmations for certain fixed income securities in violation of the Exchange Act and MSRB rules. In addition, MS&Co. was ordered to cease and desist from committing or causing any future violations, and was required to pay a \$7.5 million penalty and to retain an independent consultant to review MS&Co.’s applicable policies and procedures. MS&Co. consented to the issuance of the October 2007 Order without admitting or denying the SEC’s findings.
- On December 18, 2007, MS&Co. became the subject of an Order Instituting Administrative Cease-and-Desist Proceedings (“December 2007 Order”) by the SEC. The December 2007 Order found that, from January 2002 until August 2003, MSDW (1) failed to reasonably supervise four Financial Advisors, with a view to preventing and detecting their mutual fund market-timing activities and (2) violated the Investment Company Act of 1940 by allowing multiple mutual fund trades that were placed or amended after the close of trading to be priced at that day’s closing net asset value. The December 2007 Order also found that, from 2000 through 2003, MSDW violated the Exchange Act by not making and keeping records of customer orders placed after the market close and orders placed for certain hedge fund customers in variable annuity sub-accounts. Without admitting or denying the SEC’s findings, MS&Co. agreed to a censure, to cease and desist from future violations of the applicable provisions, to pay a penalty of approximately \$11.9 million, to disgorge profits related to the trading activity (including prejudgment interest) of approximately \$5.1 million and to retain an independent distribution consultant.
- In May 2005, MS&Co. and MSDW discovered that, from about January 1997 until May 2005, their order entry systems did not check whether certain secondary market securities transactions complied with state registration requirements known as Blue Sky laws. This resulted in the improper sale of securities that were not registered in 46 state and territorial jurisdictions. MS&Co. and MSDW conducted an internal

investigation, repaired system errors, self-reported the problem to all affected states and the New York Stock Exchange, identified transactions which were executed in violation of the Blue Sky laws, and offered rescission to affected customers. MS&Co. settled the state regulatory issues in a multi-state settlement with the 46 affected state and territorial jurisdictions. Under the settlement, MS&Co. consented to a cease and desist order with, and agreed to pay a total civil monetary penalty of \$8.5 million to be divided among, each of the 46 state and territorial jurisdictions. The first order was issued by Alabama on March 19, 2008, and orders are expected to be issued by subsequent states over the coming months.

- On August 13, 2008, MS&Co. agreed on the general terms of a settlement with the NYAG and the Office of the Illinois Secretary of State, Securities Department (“Illinois”) (on behalf of a task force of the North American Securities Administrators Association (“NASAA”)) with respect to the sale of auction rate securities (“ARS”). MS&Co. agreed, among other things, to repurchase at par approximately \$4.5 billion of illiquid ARS held by certain clients of MS&Co. which were purchased prior to February 13, 2008. Additionally, MS&Co. agreed to pay a total fine of \$35 million. Final agreements were entered into with the NYAG on June 2, 2009 and with Illinois on September 17, 2009. The Illinois agreement serves as the template for agreements with other NASAA jurisdictions.
- On November 13, 2008, in connection with the settlement of a civil action arising out of an investigation by the SEC into CGM’s underwriting, marketing and sale of ARS, CGM, without admitting or denying the allegations of the SEC’s complaint, except as to those relating to personal and subject matter jurisdiction, which were admitted, consented to the entry in the civil action of a Judgment As To Defendant Citigroup Global Markets Inc. (“November 2008 Judgment”). Thereafter, on December 11, 2008, the SEC filed its civil action in the federal district court for the Southern District of New York (“Court”). The November 2008 Judgment, which was entered on December 23, 2008 (i) permanently enjoined CGM from directly or indirectly violating section 15(c) of the Exchange Act; (ii) provides that, on later motion of the SEC, the Court is to determine whether it is appropriate to order that CGM pay a civil penalty pursuant to section 21(d)(3) of the Exchange Act, and if so, the amount of the civil penalty; and (iii) ordered that CGM’s Consent be incorporated into the November 2008 Judgment and that CGM comply with all of the undertakings and agreements in the Consent, which include an offer to buy back at par certain ARS from certain customers. The SEC’s complaint alleged that (1) CGM misled tens of thousands of its customers regarding the fundamental nature of and risks associated with ARS that CGM underwrote, marketed and sold; (2) through its financial advisers, sales personnel and marketing materials, CGM misrepresented to customers that ARS were safe, highly liquid investments comparable to money market instruments; (3) as a result, numerous CGM customers invested in ARS funds they needed to have available on a short-term basis; (4) in mid-February 2008, CGM decided to stop supporting the auctions; and (5) as a result of the failed auctions, tens of thousands of CGM



customers held approximately \$45 billion of illiquid ARS, instead of the liquid short-term investments CGM had represented ARS to be. CGM reached substantially similar settlements with the NYAG and the Texas State Securities Board (“TSSB”), although those settlements were administrative in nature and neither involved the filing of a civil action in state court. The settlements with the NYAG and the TSSB differed somewhat from the settlement with the SEC in that the state settlements (a) made findings that CGM failed to preserve certain recordings of telephone calls involving the ARS trading desk; and (b) required CGM to refund certain underwriting fees to certain municipal issuers. In addition, as part of the settlement with New York, CGM paid a civil penalty of \$50 million. CGM also agreed in principle to pay to states other than New York with which it enters into formal settlements a total of \$50 million. CGM paid \$3.59 million of this \$50 million to Texas as part of the settlement with that state. CGM expects it will reach settlements with the remaining states.

- On March 25, 2009, MS&Co. entered into a LAWC with FINRA. FINRA found that, from 1998 through 2003, MSDW failed to reasonably supervise the activities of two Financial Advisors in one of its branches. FINRA found that these Financial Advisors solicited brokerage and investment advisory business from retirees and potential retirees of certain large companies by promoting unrealistic investment returns and failing to disclose material information. FINRA also held that MS&Co. failed to ensure that the securities and accounts recommended for the retirees were properly reviewed for appropriate risk disclosure, suitability and other concerns. MS&Co. consented, without admitting or denying the findings, to a censure, a fine of \$3 million, and restitution of approximately \$2.4 million plus interest to 90 former clients of the Financial Advisors.

MSSB’s Form ADV Part 1 contains further information about its disciplinary history, and is available on request from your Financial Advisor.

## Item 10: Other Financial Industry Activities and Affiliations

Morgan Stanley Parent is a financial holding company under the Bank Holding Company Act of 1956. Both Morgan Stanley Parent and Citi are corporations whose shares are publicly held and traded on the New York Stock Exchange. MSSB is owned by a joint venture company which is indirectly owned 65% by Morgan Stanley Parent and 35% by Citi. On September 11, 2012 Morgan Stanley Parent and Citi reached agreement with respect to Morgan Stanley Parent’s purchase of Citi’s remaining 35% stake in the joint venture company no later than June 1, 2015, subject to regulatory approval.

**Activities of Morgan Stanley Parent and Citi.** Morgan Stanley Parent and Citi are both global firms engaging, through their various subsidiaries, in a wide range of financial services including:

- securities underwriting, distribution, trading, merger, acquisition, restructuring, real estate, project finance and other corporate finance advisory activities
- merchant banking and other principal investment activities
- brokerage and research services
- asset management
- trading of foreign exchange, commodities and structured financial products and
- global custody, securities clearance services, and securities lending.

### A. Broker-Dealer Registration Status

As well as being a registered investment advisor, MSSB is registered as a broker-dealer.

### B. Futures Commission Merchant, Commodity Pool Operator, or Commodity Trading Adviser Registration Status

As well as being a registered investment advisor, MSSB is registered as a futures commission merchant. MSSB has a related person that is a commodity pool operator (Demeter Management Corp.) For a full listing of affiliated investment advisers please see the ADV Part I.

### C. Material Relationships or Arrangements with Industry Participants

**Restrictions on Executing Trades.** As MSSB is affiliated with MS&Co., Citi and their affiliates, the following restrictions apply when executing client trades:

- MSSB, MS&Co. and Citi generally do not act as principal in executing trades for MSSB investment advisory clients (except to the extent permitted by a program and the law).
- Regulatory restrictions may limit your ability to purchase, hold or sell equity and debt issued by Morgan Stanley Parent, Citi and their affiliates in some investment advisory programs.
- Certain regulatory requirements may limit MSSB’s ability to execute transactions through alternative execution services (e.g., electronic communication networks and crossing networks) owned by MSSB, MS&Co., Citi or their affiliates.

These restrictions may adversely impact client account performance.

**Different Advice.** MSSB, MS&Co., Citi and their affiliates may give different advice, take different action, receive more or less compensation, or hold or deal in different securities for any other party, client or account (including their own accounts or those of their affiliates) from the advice given, actions taken, compensation received or securities held or dealt for your account.

**Trading or Issuing Securities in, or Linked to Securities in, Client Accounts.** MSSB, MS&Co., CGM and their affiliates may provide bids and offers, and may act as principal market maker, in respect of the same securities held in client accounts. MSSB, the investment managers in its programs, MS&Co., CGM and their affiliates and employees may hold a position (long or short) in the same securities held in client accounts. MS&Co., MSSB, CGM and/or their affiliates are regular issuers of traded financial instruments linked to securities that may be purchased in client accounts. From time to time, the trading of MSSB, a manager or their affiliates – both for their proprietary accounts and for client accounts – may be detrimental to securities held by a client and thus create a conflict of interest. We address this conflict by disclosing it to you.

**Trade Allocations.** CGM or MSSB may aggregate the securities to be sold or purchased for more than one client to obtain favorable execution to the extent permitted by law. MSSB will then allocate the trade in a manner that is equitable and consistent with MSSB's fiduciary duty to its clients (including pro rata allocation, random allocation or rotation allocation). Allocation methods vary depending on various factors (including the type of investment, the number of shares purchased or sold, the size of the accounts, and the amount of available cash or the size of an existing position in an account). The price to each client is the average price for the aggregate order.

**Services Provided to Other Clients.** MSSB, MS&Co., CGM, investment managers and their affiliates provide a variety of services (including research, brokerage, asset management, trading, lending and investment banking services) for each other and for various clients, including issuers of securities that MSSB may recommend for purchase or sale by clients or are otherwise held in client accounts, and investment management firms in the programs described in this brochure. MS&Co., CGM, MSSB, investment managers and their affiliates receive compensation and fees in connection with these services. MSSB believes that the nature and range of clients to which such services are rendered is such that it would be inadvisable to exclude categorically all of these companies from an account. Accordingly, it is likely that securities in an account will include some of the securities of companies for which MS&Co., CGM, MSSB, investment managers and their affiliates or an affiliate performs investment banking or other services.

**Restrictions on Securities Transactions.** There may be periods during which MSSB or investment managers are not permitted to initiate or recommend certain types of transactions in the securities of issuers for which MS&Co., Citi or one of their affiliates is performing broker-dealer or investment banking services or have confidential or material non-public information. Furthermore, in certain investment advisory programs, MSSB may be compelled to forgo trading in, or providing advice regarding, Morgan Stanley Parent or Citi securities, and in certain related securities. These restrictions may adversely impact your account performance.

MSSB, the managers and their affiliates may also develop analyses and/or evaluations of securities sold in a program described in this brochure, as well as buy and sell interests in securities on behalf of its proprietary or client accounts. These analyses, evaluations and purchase and sale activities are

proprietary and confidential, and MSSB will not disclose them to clients. MSSB may not be able to act, in respect of clients' account, on any such information, analyses or evaluations.

MSSB, investment managers and their affiliates are not obligated to effect any transaction that MSSB or a manager or any of their affiliates believe would violate federal or state law, or the regulations of any regulatory or self-regulatory body.

**Research Reports.** MS&Co. and CGM do business with companies covered by their respective research groups. Furthermore, MS&Co., CGM and their affiliates may hold a trading position (long or short) in, and client accounts may hold, the securities of companies subject to such research. Therefore, MS&Co. and CGM have a conflict of interest that could affect the objectivity of their research reports.

**Certain Trading Systems.** If MSSB directly or indirectly effects client trades through exchanges, electronic communication networks or other alternative trading systems ("Trading Systems") in which its affiliates have an ownership interest, these affiliates may receive an indirect economic benefit based on their ownership interest. Currently, affiliates of MSSB (including affiliates of MS&Co. and Citi) own over 5% of the voting securities of certain Trading Systems, including BATS Trading, Inc., operator of BATS Electronic Trading Network (commonly known as "BATS"); the entities that own and control the Block Interest Discovery System (commonly known as "BIDS"); LavaFlow Inc.; EBX Group, LLC; ELX Futures Holdings, LLC; ELX Futures, LP; TheMuniCenter; Automated Trading Desk Financial Services LLC; Automated Trading Desk Brokerage Services LLC; Boston Options Exchange, LLC; FX Alliance Inc.; and National Securities Exchange. Other Trading Systems on which MSSB may execute trades for client accounts include Archipelago; eSpeed; Instinet; NYFIX; Track ECN; BondDesk; ValuBond; NYSE Euronext; TradeWeb; and MarketAxe. The Trading Systems on which MSSB trades for Client accounts and in which affiliates of MSSB own interests may change from time to time. You may contact your Financial Advisor for an up-to-date list of Trading Systems in which affiliates of MSSB own interests and on which MSSB and/or MS&Co. trades for client accounts.

Certain Trading Systems offer cash credits for orders that provide liquidity to their books and charge explicit fees for orders that extract liquidity from their books. From time to time, the amount of credits that MSSB, MS&Co. and/or CGM receives from one or more Trading System may exceed the amount that is charged. Under these limited circumstances, such payments would constitute payment for order flow.

Certain Trading Systems through which MSSB and/or MS&Co. may directly or indirectly effect client trades execute transactions on a "blind" basis, so that a party to a transaction does not know the identity of the counterparty to the transaction. It is possible that an order for a client account that is executed through such a Trading System could be automatically matched with a counterparty that is (i) another investment advisory or brokerage client of MSSB or one of its affiliates or (ii) MSSB or one of its affiliates acting for its own proprietary accounts.

**Transaction-Related Agreements with MS&Co., Citi and Affiliates.** In connection with creating the joint venture, certain agreements were entered into between or involving some or all of MSSB, MS&Co, Citi, CGM and their affiliates, including the following:

- **Order Flow.** An agreement that, subject to best execution, MSSB will transmit an agreed percentage of client orders for the purchase and sale of securities to MS&Co., Citi, CGM and their affiliates. MSSB has a conflict of interest in transmitting client orders to these entities.
- **Distribution.** An agreement that, in return for the payment of certain fees and expenses, MSSB will market and promote certain securities and other products underwritten, distributed or sponsored by MS&Co., Citi or their affiliates. MSSB has a conflict of interest in offering, recommending or purchasing any such security or other product to or for its investment advisory clients.
- **Investment Research.** An agreement that MS&Co. and CGM (or their applicable affiliates) will supply investment research prepared by their respective research groups to MSSB for its use. It is possible that MS&Co.'s research group, on the one hand, and Citi's research group, on the other hand, may reach different conclusions, and may make different recommendations, with respect to the same issuer or investment manager. This may, among other things, result in different investment decisions or recommendations regarding the same issuer or investment manager being made for or given to MSSB investment advisory clients.
- **Affiliated Sweep Investments.** MSSB has a conflict of interest in selecting or recommending BDP or Money Market Funds as the Sweep Investment. See Item 5.C above for more information.

**Related Investment Advisors and Other Service Providers.** MSSB has related persons that are registered investment advisers in various investment advisory programs (including Morgan Stanley Investment Management Inc., Morgan Stanley Investment Advisors Inc. and Morgan Stanley Investment Management Limited). If you invest your assets and use an affiliated firm to manage your account, MSSB and its affiliates earn more money than if you use an unaffiliated firm. Generally, for ERISA or other retirement accounts, MSSB rebates or offsets fees so that MSSB complies with IRS and Department of Labor rules and regulations.

Morgan Stanley Investment Advisors Inc., its wholly owned subsidiary Morgan Stanley Services Company Inc., and Morgan Stanley Investment Management Inc. serve in various advisory, management, and administrative capacities to open-end and closed-end investment companies and other portfolios (some of which are listed on the NYSE).

Morgan Stanley Distributors Inc. serves as distributor for these open-end investment companies, and has entered into selected dealer agreements with MSSB and affiliates. Morgan Stanley Distributors Inc. also may enter into selected dealer agreements with other dealers. Under these agreements, MSSB and affiliates, and other selected dealers, are compensated for sale of fund shares to clients on a brokerage basis, and for shareholder

servicing (including pursuant to plans of distribution adopted by the investment companies pursuant to Rule 12b-1 under the Investment Company Act of 1940).

Morgan Stanley Trust FSB, an affiliate of MSSB, serves as transfer agent and dividend disbursing agent for investment companies advised by Morgan Stanley Investment Advisors Inc. and other affiliated investment advisers and may receive annual per shareholder account fees from or with respect to them and certain nonaffiliated investment companies.

Related persons of MSSB act as general partner, administrative agent or managing member in a number of funds in which clients may be solicited in a brokerage or advisory capacity to invest. These include funds focused on private equity investing, investments in leveraged buyouts, venture capital opportunities, research and development ventures, real estate, managed futures, hedge funds, funds of hedge funds and other businesses.

See Item 5.C above for a description of cash sweep investments managed or held by related persons of MSSB.

## **D. Material Conflicts of Interest Relating to Other Investment Advisers**

In the advisory programs described in this brochure, MSSB recommends investment advisers to clients. Many of the investment advisers that are available in the MSSB advisory program provide conferences and other training sessions to the Financial Advisors.

In addition, certain investment advisers also manage Funds, alternative products or act as a sub adviser to Mutual Funds affiliated with MSSB. Since MSSB receives fees from the mutual fund or its adviser, MSSB has a conflict to recommend the mutual fund products instead of the investment adviser managing the account directly.

**Payments from Managers.** Investment managers participating in MSSB-sponsored internal training and education conferences and meetings may make certain payments to, or for the benefit of, MSSB or its Financial Advisors to offset the expenses incurred for these events. A schedule of these registration fees is available upon request from a Financial Advisor.

While all asset management firms have sponsorship opportunities, certain firms (referred to as "Global Partners") dedicate significant financial and staffing resources to these activities and may receive additional opportunities to sponsor firm events and promote their funds to Financial Advisors and clients. This fact could lead Financial Advisors to focus on those investment products offered by our Global Partners when recommending investment managers to clients instead of on investment managers that do not commit similar resources to educational, marketing, and other promotional efforts. MSSB selects the investment managers that are Global Partners based on a number of quantitative and qualitative criteria.

Investment managers may also sponsor their own educational conferences and pay expenses of Financial Advisors attending

the events; MSSB's policies require that the training or educational portion of these conferences comprises substantially all of the event. Investment managers may sponsor educational meetings or seminars in which clients as well as Financial Advisors are invited to participate.

Investment managers are allowed occasionally to give nominal gifts to Financial Advisors and to occasionally entertain Financial Advisors subject to a limit of \$1,000 per employee per year. MSSB's non-cash compensation policies set conditions for each of these types of payments, and they do not permit any gifts or entertainment conditioned on the achievement of a sales target.

None of these amounts relate to any particular transactions or investment made by MSSB clients with investment managers. An annual estimate of the aggregate value of these amounts paid or provided by the investment managers to MSSB or particular Financial Advisors may be provided, upon request, to clients. Investment managers participating in a Program are not required to make any of these types of payments.

***Payments from Managers of Alternative Investments.*** Managers of alternative investments offered in the programs described in this brochure may agree to pay us additional fees. We have a conflict of interest in offering alternative investments because we or our affiliates earn more money in your account from your investments in alternative investments than from other investment options. However, in cases where we receive a portion of the management fee paid by you to a manager of an alternative investment and we charge a program fee under the programs in this brochure, we credit such fee to your account. Also, we do not share this money with your Financial Advisor (i.e. the compensation we pay to your Financial Advisor is not affected by the payments we receive from the alternative investments). Therefore, your Financial Advisor does not have a resulting incentive to buy alternative investments in your account, or to buy certain alternative investments rather than other alternative investments in any of the programs in this brochure.

***Affiliate Acting as Portfolio Manager.*** Where permitted by law, (except for plan accounts), an affiliate of MSSB may have been selected to act as the manager for one or more your investments. Where this occurs, we or our affiliates earn more money than from other investment options. MSSB and the Financial Advisor are also likely to earn more compensation if you invest in a program described in this brochure than if you open a brokerage account to buy individual securities.

These relationships create a conflict of interest for us or our affiliates as there is a financial incentive to recommend the investments. We address this conflict of interest by disclosing it to you and by requiring Financial Advisors' supervisors to review your account at account-opening to ensure that it is suitable for you in light of matters such as your investment objectives and financial circumstances.

***MSSB as Placement Agent.*** MSSB also acts a placement agent for certain alternative investments whereby such investments are available through MSSB on a non-advisory basis. When an alternative investment is purchased on a placement basis,

different terms and conditions, including different fee arrangements, may apply. For example, when a client invests on a placement basis, they do not pay an ongoing advisory fee, however, they pay an upfront placement fee and the program manager receives a higher program participation fee which is shared with MSSB and its Financial Advisors. A Client investing on an advisory basis may pay higher fees, in the aggregate, than if such investment had been made on a placement basis.

## **Item 11: Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### **A. Code of Ethics**

The MSSB US Investment Advisory Code of Ethics ("Code") applies to MSSB employees, supervisors, officers and directors engaged in offering or providing investment advisory products and/or services (collectively, the "Employees"). In essence, the Code prohibits Employees from engaging in securities transactions or activities that involve a material conflict of interest, possible diversion of a corporate opportunity, or the appearance of impropriety. Employees must always place the interests of MSSB's clients above their own and must never use knowledge of client transactions acquired in the course of their work to their own advantage. Supervisors are required to use reasonable supervision to detect and prevent any violations of the Code by the individuals, branches and departments that they supervise.

The Code generally operates to protect against conflicts of interest either by subjecting Employee activities to specified limitations (including pre-approval requirements) or by prohibiting certain activities. Key provisions of the Code include:

- An Employee who wishes to conduct business activity outside of his or her employment with MSSB, regardless of whether that Employee receives compensation for this activity, must first obtain written authorization from his or her supervisor. (Outside activities include serving as an officer or director of a business organization or non-profit entity, and accepting compensation from any person or organization other than MSSB.)
- Employees are generally prohibited from giving or receiving gifts or gratuities greater than \$100 per recipient per calendar year to or from persons or organizations with which MSSB has a current or potential business relationship, clients, or persons connected with another financial institution, a securities or commodities exchange, the media, or a government or quasi-governmental entity.
- Employees cannot enter into a lending arrangement with a client (unless they receive prior written approval from their supervisor and MSSB's Compliance Department).

- MSSB maintains a “Restricted List” of issuers for which it may have material non-public information or other conflicts of interest. Employees cannot, for themselves or their clients, trade in securities of issuers on the “Restricted List” (unless they receive prior written approval from the Compliance department).
- Certain Employees, because of their potential access to non-public information, must obtain their supervisors’ prior written approval before executing certain securities transactions for their personal securities accounts. All Employees must also follow special procedures for investing in private securities transactions.
- Certain Employees are subject to further restrictions on their securities transaction activities (including Financial Advisors and other MSSB employees who act as portfolio managers in MSSB investment advisory programs).

You may obtain a copy of the Code of Ethics from your Financial Advisor.

## **B. Securities in Which You or a Related Person Has a Material Financial Interest**

Please the paragraph entitled “*Cash Sweeps*” located in Item 5C.

## **C. Investing and Other Interests in Securities Which You or a Related Person Recommends to Clients**

See the following in Item 10.C:

- “Trading or Issuing Securities in, or Linked to Securities in, Client Accounts”
- “Restrictions on Securities Transactions”
- “Research Reports”
- “Certain Trading Systems”
- “Transaction-Related Agreements with MS&Co., Citi and Affiliates”

## **D. Conflicts of Interest Created by Contemporaneous Trading**

See “Different Advice” in Item 10.C.

# **Item 12: Brokerage Practices**

## **A. Factors in Selecting or Recommending Broker-Dealers for Client Transactions**

MSSB does not recommend broker-dealers to effect client securities transactions. For the programs listed in this brochure, securities are executed through MSSB.

For the programs described in this brochure, we do not receive research or soft dollars, nor recommend other broker-dealers.

We offer, but do not recommend, request or require clients to select directed brokerage as the option to pay their investment advisory program fees.

At the client’s request, MSSB permits clients to use direct brokerage commissions to pay for the MSSB investment advisory fee. As described above in Item 4B, you will enter into a separate agreement with each investment manager. Your investment manager as per your direction will direct trades to MSSB (the “Executing Broker-Dealer”). The Executing Broker-Dealer will execute trade on a best execution basis and the commissions generated will compensate MSSB and the Financial Advisor. The commissions will be capped by the maximum advisory allowed for this program (2.50%). Notwithstanding the commissions that pay for MSSB’s investment advisory fee, you will still pay you investment manager’s fee.

If you select a manager that has a high portfolio turn over ratio (executes many trades in the portfolio) you may pay an overall fee that is higher than if you negotiated an asset based fee that is lower than the overall transaction costs.

## **B. Aggregation of Securities Transactions for Clients**

Investment managers submit trade orders for all client’s in the same strategy to the Executing Broker-Dealer. It is the investment manager’s decision as to allocation of the trade orders. Please review your investment managers ADV for more information.

# **Item 13: Review of Accounts**

## **A. Frequency and Nature of Review of Client Accounts or Financial Plans**

At account opening, your Financial Advisor must ensure that, and the Financial Advisor’s Branch Manager confirms that, the account and the investment style are suitable investments for you.

As an IS client, your Financial Advisor is then responsible for reviewing your account on an ongoing basis and will recommend different asset allocations at any time according to market conditions. Your Financial Advisor will ask you at least annually if your investment objectives have changed. If your objectives change, your Financial Advisor will modify your asset allocation to be suitable for your needs.

See Item 15 below for a discussion of account statements and Investment Monitors.

## **B. Factors Prompting Review of Client Accounts other than a Periodic Review**

On an annual basis, your Financial Advisor will discuss with you if your investment criteria has changed. Additionally, unusual

market or other events may prompt an off-cycle review of client accounts.

### **C. Content and Frequency of Account Reports to Clients**

Please see Item 15 for a discussion relating to the quarterly reports.

## **Item 14: Client Referrals and Other Compensation**

### **A. Economic Benefit for Providing Investment Advice to Clients**

See Item 10.D for more details.

### **B. Compensation to Unsupervised Persons for Client Referrals**

Our Professional Alliance Group program allows certain unaffiliated third parties to refer clients to MSSB. If the client invests in an investment advisory program, we pay the third party an ongoing referral fee (generally about 25% of the portion of the client fee that we would otherwise allocate to the Financial Advisor). We may pay a fee greater or less than 25% depending on the facts and circumstances of the relationship.

## **Item 15: Custody**

MSSB is the custodian and provides you with written confirmation of securities transactions, and account statements at least quarterly. You may waive the receipt of trade confirmations after the completion of each trade in favor of alternative methods of communication where available. You may also receive mutual fund prospectuses, where appropriate. MSSB services are also provided to clients who engage third-party custodians. In the event that client accounts are held in custody outside of MSSB, the custodian will provide such statements.

We provide performance monitoring to clients with a frequency as requested by the client. See Item 4.B for additional details.

## **Item 16: Investment Discretion**

In the program described in this brochure, we do not accept investment discretion.

## **Item 17: Voting Client Securities**

MSSB does not accept proxy-voting authority in the program listed in this brochure.

Clients may elect the investment manager to vote proxies or they may vote on their own and MSSB will send the proxy materials to you.

## **Item 18: Financial Information**

MSSB is not required to include a balance sheet in this brochure because MSSB does not require or solicit prepayment of more than \$1,200 in fees per client, six months or more in advance.

MSSB does not have any financial conditions that are reasonably likely to impair its ability to meet its contractual commitments to clients.

MSSB and its predecessors have not been the subject of a bankruptcy petition during the past ten years

**Exhibit: Affiliated Money Market Funds Fee Disclosure Statement  
and Float Disclosure Statement**

**Sweep Vehicles in Retirement Accounts and CESAs**

Since the dates below (“Effective Dates”), the following “Retirement Plan Accounts” (IRAs, EBT, RPM and VIP accounts) and Coverdell Education Savings Accounts (“CESAs”) have generally been effecting temporary sweep transactions of new uninvested cash balances into Deposit Accounts established under the Bank Deposit Program (although SB Channel Retirement Plan Accounts did not begin using BDP as the Sweep Investment until MSSB merged its SB Channel and MS Channel):

- September 17, 2007 for “IRAs” (e.g., Traditional, Roth, Rollover, SEP, SAR-SEP, SIMPLE), and
- May 19, 2008 for the remaining Retirement Plan Accounts (i.e., EBT, RPM and VIP accounts) and CESAs.

Before the Effective Dates, MSSB effected such sweep transactions using the Morgan Stanley money market funds listed in the table below as follows (although SB Channel Retirement Plan Accounts did not begin using these Morgan Stanley money market funds as the Sweep Investment until some time after the Effective Date):

- IRAs or CESAs in advisory programs swept into the Morgan Stanley Liquid Asset Fund Inc. (“ILAF”) and
- all other Retirement Plan Accounts in advisory programs swept into one or a number of different proprietary mutual funds (which could have included ILAF) depending on the type of account and the advisory program.

As of the Effective Dates, any existing balances in these Morgan Stanley money market funds remained in the funds, pending use for account charges and other purposes. Therefore, these accounts could still maintain cash balances in these funds.

***Now, as an alternative to the Deposit Account, Retirement Plan Accounts and CESAs can choose to sweep into ILAF or the Morgan Stanley U.S. Government Money Market Trust (“SGMT”).***

For Retirement Plan Accounts that swept into affiliated money market funds before the Effective Dates and continue to hold cash amounts in these funds, or that now select one of these funds:

- any fee designated in the table below as “Advisory Fee” received by an MSSB affiliate is offset against the advisory program fees and
- any fees designated in the table as “Distribution and Service Fees” received by MSSB or its affiliates is credited to the account.

Accordingly, changes in these fees over time did not affect the fees paid by Retirement Plan Accounts.

**Interest Earned on Float**

If MSSB is the custodian of your account, MSSB may retain as compensation, for providing services, the account’s proportionate share of any interest earned on cash balances held by MSSB (or an affiliate) with respect to assets awaiting investment including:

- new deposits to the account (including interest and dividends) and
- uninvested assets held by the account caused by an instruction to the custodian to buy and sell securities (which may, after the period described below, be automatically swept into a sweep vehicle).

This interest is generally at the prevailing Federal Funds interest rate.

Generally, with respect to such assets awaiting investment:

- when the custodian receives the assets on a day on which the NYSE is open (“Business Day”) and before the NYSE closes, the custodian earns interest through the end of the following Business Day and
- when the custodian receives the assets on a Business Day but after the NYSE closes, or on a day which is not a Business Day, the custodian earns interest through the end of the second following Business Day.

**MSSB as an ERISA fiduciary**

If MSSB is a fiduciary (as defined under ERISA or the Internal Revenue Code) with respect to the Retirement Plan Account, the table below describes the fees and expenses charged to assets invested in shares of the money market funds in which the account invests (expressed as a percentage of each fund’s average daily net assets for the stated fiscal year). Note that:

- The rate of Advisory Fee and Distribution and Service Fees (including 12b-1 fees) (whether in basis points or dollars) may not be increased without first obtaining shareholder approval.

- Expenses designated as “Other Expenses” include all expenses not otherwise disclosed in the table that were deducted from each fund’s assets or charged to all shareholder accounts in the stated fiscal year (and may change from year to year).

These fees and expenses may be paid to MSSB and its affiliates for services performed. The aggregate amount of these fees is stated in the tables below. The amounts of expenses deducted from a fund’s assets are shown in each fund’s statement of operations in its annual report.

Morgan Stanley Investment Management (and/or its affiliates) may, from time to time, waive part of its advisory fee or assume or reimburse some of a fund’s operating expenses. (This may be for a limited duration.) Such actions are noted in the fund’s prospectus and/or statement of additional information. The table below shows the Total Annual Fund Operating Expenses (before management fee waivers and/or expense reimbursements) and the Total Annual Fund Operating Expenses After Fee Waivers and/or Expense Reimbursements.

MSSB believes that investing in shares of the funds for sweep purposes may be appropriate for Retirement Plans because using professionally managed money market funds allows you to access cash on an immediate basis, while providing a rate of return on your cash positions pending investment. As is typical of such arrangements, we use only affiliated money funds for this purpose.

MSSB also believes that investing a Retirement Plan’s assets in the Deposit Accounts may also be appropriate. Terms of the Bank Deposit Program are further described in the Bank Deposit Program Disclosure Statement, which has been provided to you with your account opening materials.

The fund expense information below reflects the most recent information available to us as of March 30, 2012, and is subject to change. Please refer to the funds’ current prospectuses, statements of additional information and annual reports for more information.

<b>Fund</b>	<b>Advisory Fee</b>	<b>Distribution and Service Fees</b>	<b>Other Expenses</b>	<b>Total Annual Fund Operating Expenses</b>	<b>Total Annual Fund Operating Expenses After Fee Waivers and/or Expense Reimbursements</b>
Active Assets Money Trust	0.29%	0.10%	0.08%	0.47%	0.26%
Active Assets Government Securities Trust	0.45%	0.10%	0.13%	0.68%	0.18%
Active Assets Institutional Government Securities Trust	0.10%	None	0.08%	0.18%	0.17%
Active Assets Institutional Money Trust	0.10%	None	0.08%	0.18%	N/A
Morgan Stanley Liquid Asset Fund Inc.	0.27%	0.10%	0.21%	0.58%	0.25%
Morgan Stanley U.S. Government Money Market Trust	0.44%	0.10%	0.16%	0.70%	0.21%