

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

Financial Planning Services

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**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.**

**MorganStanley  
SmithBarney**

## Item 2: Material Changes

This section identifies and discusses material changes to the ADV brochure since the version of this brochure dated March 28, 2011.

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 (see Item 4 for more details).

This ADV brochure also has revised disclosure on the types of software and methodologies offered for financial plans, their supervision and the charges associated with such tools. MSSB no longer offers the Financial Outlook software for financial planning services. MSSB may change the financial planning software or the financial planning methodologies it uses when creating your financial plan. Your financial plan will provide details on the software and methodologies used. Please see Items 5, 8 and 13 for additional details.

This ADV has revised disclosure on MSSB's assets under management. As of January 31, 2012, MSSB managed client assets of \$483,411,502,454. Of this amount, MSSB managed \$163,040,083,910 on a discretionary basis and \$320,371,418,544 on a non-discretionary basis. Please see Item 4 E for additional details.

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## Item 4: Advisory Business

### A. Description of MSSB, Principal Owners

#### Introduction to Morgan Stanley Smith Barney

Morgan Stanley Smith Barney LLC ("Morgan Stanley Smith Barney", "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.

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 Financial Planning

MSSB offers a wide range of investment advisory programs, including a non-discretionary advisory program, advisory programs where your Financial Advisor exercises discretion to make investment decisions on your behalf, separately managed account programs where third-party asset managers followed by MSSB investment advisory research exercise discretion to make investment decision on your behalf and the financial planning services program described below.

At your request, MSSB will provide a financial plan through one of its Financial Advisors, who utilize MSSB approved financial planning tool(s) and/or MSSB's Wealth Planning

Centers. Clients desiring a financial plan complete a detailed discovery process with their Financial Advisor, which includes a discussion of their financial resources and projected needs, and provide copies of any documents that MSSB may reasonably request as necessary to evaluate a client's financial circumstances. Generally, this process seeks information about your current assets, liabilities, income sources, and expenditures, current tax status and future objectives, educational, retirement and other long-term financial goals, insurance and estate planning needs. MSSB relies on your care, completeness and clarity in responding to this discovery process, as your input will form the factual basis for the financial plan.

Each financial plan is tailored to the individual needs of each client, but generally the financial plan shall include an analysis of the client's current financial position, a summary of the client's financial objectives that were identified in the discovery process (e.g., education, retirement, estate planning, and other long-term financial goals), and recommendations and an analysis regarding each of those financial objectives.

MSSB acts as your investment adviser, and not as your broker, in providing a financial plan to you and reviewing it with you. This advisory relationship begins upon delivery of the financial plan to you and ends thirty days later, during which time your Financial Advisor is available to review the financial plan with you. While a financial plan may consider assets held in your brokerage accounts at MSSB (if any), those accounts will continue to be brokerage accounts, and not advisory accounts. Moreover, you have sole responsibility for determining whether, when and how to implement any part of a financial plan, whether through MSSB or otherwise, and you have no obligation to implement any part of the financial plan through MSSB. If you do choose to implement a financial plan through MSSB, unless you expressly engage MSSB in writing to act as an investment adviser in one or more advisory accounts, MSSB will implement solely in its capacity as broker, and not as an investment adviser. In a brokerage account, you retain the sole responsibility for making all investment decisions with respect to the account and for monitoring account performance.

By providing a Financial Plan, neither MSSB nor your Financial Advisor is acting as a fiduciary for purposes of the Employee Retirement Income Security Act of 1974, as amended (ERISA) or section 4975 of the Internal Revenue Code (the "Code") with respect to any ERISA-covered employee benefit plan or any individual retirement account in either the planning, execution or provision of this analysis. Unless otherwise provided in a written agreement between you and MSSB, MSSB, its affiliates and their respective employees, agents and representatives, including your Financial Advisor: (a) do not have discretionary authority or control with respect to the assets in any ERISA-covered employee benefit plan or any individual retirement account included in the Financial Plan, (b) will not be deemed an "investment manager" as defined under ERISA, or otherwise have the authority or responsibility to act as a "fiduciary" (as defined under ERISA) with respect to such assets, and (c) will not provide "investment advice," as defined by ERISA and/or

section 4975 of the Code, as amended, with respect to such assets.

## **C. Customized Advisory Services and Client Restrictions**

### **Customized Advisory Services.**

In the financial planning services program, we tailor our financial planning recommendations to the individual needs of our clients. As described above, MSSB relies on your care, completeness and clarity in responding to our discovery process, as your responses will form the factual basis for your individual financial plan.

### **Securities Restrictions.**

MSSB does not provide individual security recommendations as part of its financial planning services. Therefore, this item is not applicable to the program described in this brochure.

## **D. Portfolio Management Services to Wrap Fee Programs**

This item does not apply to the financial planning services program described in this brochure.

## **E. Assets Under Management (“AUM”)**

While this information does not apply to the financial planning services described in this brochure, 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**

### **A. Compensation for Advisory Services**

The maximum fee for delivery and review of a financial plan is \$2,500. MSSB generally pays a portion of the fee to your Financial Advisor. These fees are negotiable. In addition, your Financial Advisor has the discretion to discount up to 100% of the fee. The fee for financial planning services may be paid by individuals, or by employers on behalf of their employees,

### **B. Payment of Fees**

MSSB confirms its financial planning fee arrangements with a Financial Planning Fee Consent Form that is signed by the client. As reflected in that document, the client may elect to pay the fee by check or by deducting the fee from an eligible MSSB account designated by client. The fee is payable in one lump sum.

MSSB may enter into separate contractual arrangements with employers paying fees on behalf of their employees and the

manner of payment will be specified in those arrangements. A separate Financial Planning Fee Consent Form may not be required in those instances.

## **C. Additional Fees and Expenses**

There are no additional fees or expenses for the services offered in the financial planning services program. There are additional fees and expenses associated with implementing a financial plan in an advisory account, a brokerage account or a combination of advisory and brokerage accounts. Your Financial Advisor can provide you with that information upon your request.

## **D. Payment of Fees**

Fees generally are payable upon delivery of the financial plan. Generally, the fee is not applied if you terminate your request for a financial plan prior to the delivery of the financial plan.

## **E. Compensation for the Sale of Securities or Other Investment Products**

Since MSSB does not offer securities transactions or individual investment products as part of its financial planning services program, this item is not applicable to the program described in this brochure.

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

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

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

MSSB’s clients for this program are individuals. MSSB may also contract with employers to make financial planning services available to their individual employees.

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

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

Our financial planning services are based on general financial information as well as the information that a client provides to us. The principal source of client information generally is captured during the discovery process with a client’s Financial Advisor and reflects a client’s current assets, liabilities, income sources, and expenditures, current tax status and future objectives, educational, retirement and other long-term financial goals, insurance and estate planning needs. We rely

solely on the information that the client or their designated agents and representatives provide to us without independent verification. As such, it is the client's responsibility to ensure that the information provided is accurate and complete.

We obtain general financial information from various sources, including information about the economy, statistical information, market data, accounting and tax law interpretations, risk measurement analysis, performance analysis and other information which may affect the economy.

Different financial planning software uses different financial planning methodologies and the financial plan will describe the specific methodologies used for the particular plan and should be carefully considered in evaluating the results presented to you. The analysis contained in the financial plan is currently conducted using MSSB's Global Investment Committee's Strategic Return Estimates ("GIC Estimate"). GIC Estimate approved returns are generated based on proprietary formulas which include studying historic return averages on the broad market indices and making strategic adjustments for the more recent market conditions and other factors deemed relevant by the forecaster.

In addition, your financial plan may include a Monte Carlo simulation. Monte Carlo simulations are used to show how variances in rates of return each year can affect your results. Results using Monte Carlo simulations indicate the likelihood that an event may occur as well as the likelihood that it may not occur.

MSSB may change the software or the methodologies it uses when creating your financial plan. Your financial plan will provide details on the software and methodologies used.

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

No financial plan has the ability to accurately predict the future, eliminate risk or guarantee investment results. As investment returns, inflation, taxes, and other economic conditions vary from the assumptions used in the financial plan, actual results will vary, perhaps significantly, from those presented in the financial plan. Indeed, because the results shown in the financial plan are calculated over many years, small changes can create large differences in future results. Investment returns can, and often do, vary widely from year to year and vary widely from a long-term average.

Timing for implementing, monitoring and adjusting your strategies is a critical element in achieving your financial objectives. You are responsible for implementing, monitoring and periodically reviewing and adjusting your investment strategies.

Your financial plan is based on the information you provide to MSSB. Your Financial Advisor and MSSB will only be responsible for correcting and updating the information you provided and/or the financial plan (e.g., to reflect future changes in your life, financial situation, goals, and market or economic conditions) if you engage them to do so. As a result, your financial plan may very well become outdated or

inaccurate as these factors change over time, unless you take steps to work with your Financial Advisor to correct and update your financial plan

MSSB is not responsible for the accuracy of the assumptions and calculations made in financial planning software by third parties. Enhancements and changes to financial planning software may be made in the future.

MSSB is not a legal or tax advisor and the financial plan does not constitute tax, legal, or accounting advice.

## **C. Risks Associated with Particular Types of Securities**

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

## **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, Solomon 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 LAWC 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 and other Registrations Status**

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

MSSB also 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.

### **B. Material Relationships or Arrangements with Industry Participants**

This item is not applicable to the program described in this brochure

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

This item is not applicable to the program described in this brochure

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

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.

Topics relating to individual securities and trading are not applicable to the program described in this brochure.

## **Item 12: Brokerage Practices**

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

## **Item 13: Review of Accounts**

Financial plans prepared by MSSB’s Wealth Planning Centers generally are reviewed by the firm’s planning directors before they are delivered to clients.

Information regarding the review of client accounts and frequency of account reports are not applicable to the program described in this brochure.

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

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

## **Item 15: Custody**

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

## **Item 16: Investment Discretion**

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

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

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

## **Item 18: Financial Information**

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

## **Item 19: Requirements for State-Registered Adviser**

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