

Form ADV Wrap Fee Program Brochure Morgan Stanley Smith Barney LLC

Legg Mason Private Portfolios Program
Strategic Portfolios Program

March 30, 2012

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

This wrap fee program 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. 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. 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 the 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 provides investment advisory services through two channels. One channel generally provides the investment advisory programs previously provided by Smith Barney and/or Citigroup Global Markets Inc., and the other channel generally provides the investment advisory programs previously provided by Morgan Stanley & Co. Incorporated. MSSB is in the process of merging the advisory programs currently operated in the Smith Barney and Morgan Stanley channels. In this ADV brochure, and in various client communications, we refer to this process as the “Conversion.” Accounts opened or operating on the merged platform will be referred to as “Converted Accounts”. We anticipate that the Conversion will occur in three “Cuts” during 2012, each of which will impact the clients and accounts of certain Smith Barney channel branch offices. If you are a client in the Smith Barney channel, this may affect your account in various ways. For example, there may be changes to where your account is custodied and to your cash sweep options. We will notify you in advance of any changes to your account resulting from the Conversion. If you are not sure whether your account is in the Smith Barney channel or the Morgan Stanley channel, please contact your Financial Advisor. (Item 4)

Legg Mason Private Portfolios Program Will Terminate. We intend to move remaining Legg Mason Private Portfolios accounts to the Fiduciary Services program, and then terminate the Legg Mason Private Portfolios program. We have already terminated the fee plus commission version of the Legg Mason Private Portfolios program. (Item 4)

Strategic Portfolios Program Closed to New Business. The Strategic Portfolios program is closed to new business. (Item 4)

Strategic Portfolios Rebalancing. Strategic Portfolios accounts are generally restructured and rebalanced annually, on or around the first business day of each calendar year. (Item 4)

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 opened a Strategic Portfolios retirement plan account or Coverdell Education Saving Account in the Smith Barney

channel, the Exhibit to this ADV brochure (“Affiliated Money Market Funds Fee Disclosure Statement and Float Disclosure Statement”) applies to your account after the Conversion. This Exhibit has information on the money market fund investments available to you, including fees and expenses. (Item 4.C)

Item 3: Table of Contents

Item 1: Cover Page	1
Item 2: Material Changes	2
Item 3: Table of Contents	3
Item 4: Services, Fees and Compensation.....	4
A. General Description of Programs and Services	4
Legg Mason Private Portfolios Program	4
Strategic Portfolios Program	5
Account Opening.....	6
Restrictions	6
Trade Confirmations, Account Statements and Performance Reviews	6
Risks	6
Tax Considerations.....	6
Fees	7
B. Comparing Costs	8
C. Additional Fees.....	8
D. Compensation to Financial Advisors	10
Item 5: Account Requirements and Types of Clients	10
Item 6: Portfolio Manager Selection and Evaluation	10
A. Selection and Review of Portfolio Managers for the Programs	10
Selection and Review of Sub-Managers.....	10
Calculating Sub-Managers' Performance.....	11
B. Conflicts of Interest.....	12
Conflicts of Interest – MSSB Acting as Portfolio Manager	12
Other Conflicts of Interest.....	12
C. MSSB Acting as Portfolio Manager.....	14
Description of Advisory Services.....	14
Tailoring Services for Individual Clients	14
Wrap Fee Programs	14
Performance-Based Fees	14
Methods of Analysis and Investment Strategies.....	14
Policies and Procedures Relating to Voting Client Securities	14
Item 7: Client Information Provided to Portfolio Managers	15
Legg Mason Private Portfolios.....	15
Strategic Portfolios	15
Item 8: Client Contact with Portfolio Managers	15
Item 9: Additional Information	15
Disciplinary Information	15
Other Financial Industry Activities and Affiliations	19
Code of Ethics	19
Reviewing Accounts	20
Client Referrals and Other Compensation.....	20
Financial Information.....	20
Exhibit: Affiliated Money Market Funds Fee Disclosure Statement and Float Disclosure Statement	21

Item 4: Services, Fees and Compensation

Morgan Stanley Smith Barney LLC (“MSSB”, “we”, “us” or “our”) 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.

In June 2009, Morgan Stanley (“Morgan Stanley Parent”) and Citigroup Inc. (“Citi”) combined the Global Wealth Management Group of Morgan Stanley & Co. Incorporated (now, Morgan Stanley & Co. LLC) (“MS&Co.”) and the Smith Barney and related businesses of Citi affiliates. Under the terms of the agreement, Citi sold 100% of its Smith Barney, Smith Barney Australia and Quilter units for a 49% stake in the joint venture company and an upfront cash payment of \$2.7 billion. Morgan Stanley Parent exchanged 100% of its Global Wealth Management business for a 51% stake in the joint venture company. After year three, Morgan Stanley Parent and Citi will have various purchase and sale rights for the joint venture company, but Citi will continue to own a significant stake in the joint venture company at least through year five. The joint venture owns MSSB.

MSSB’s investment advisory services are provided through two channels. One channel generally provides the investment advisory programs previously provided by Smith Barney and/or Citigroup Global Markets Inc. (“CGM”) (“SB Channel”) and generally provides these programs through the same businesses and retail locations as did Smith Barney and/or CGM. The other channel generally provides the investment advisory programs previously provided by MS&Co. and generally provides these programs through the same businesses and retail locations as did MS&Co. (“MS Channel”).

MSSB offers clients (“client”, “you” and “your”) many different advisory programs. Many of MSSB’s advisory services are provided by its Consulting Group (“CG”) business unit. Some advisory programs offered in the SB Channel and MS Channel are very similar to each other and may have different names based on the channel in which they are offered. Other programs may have the same name in both channels but the program details may differ in some respects between the channels. Some programs are available only in one channel. You may obtain brochures for other MSSB investment advisory programs at www.smithbarney.com/ADV or by asking your Financial Advisor.

MSSB is in the process of merging the SB Channel and MS Channel advisory programs. In addition, we anticipate that in 2012, the SB Channel and MS Channel will cease operating as separate channels, and will begin operating as a single channel on one platform which will at least initially be substantially similar to the channel and platform on which the MS Channel currently operates. This conversion of the SB Channel and the MS Channel will be referred to as the “Conversion”. Accounts opened or operating on this one platform will be referred to as “Converted Accounts”.

We do not anticipate that this Conversion will have any material impact on MS Channel clients or accounts. We anticipate that

the Conversion will occur in three “Cuts” during 2012, each of which will impact the clients and accounts of certain SB Channel branch offices.

We anticipate that, at each “Cut” of the Conversion described above, we will transition the Legg Mason Private Portfolios accounts impacted by that “Cut” to the Fiduciary Services program (so we do not anticipate that there will be any Legg Mason Private Portfolios Converted Accounts); and we will transition the impacted Strategic Portfolios accounts to Converted Accounts. Please see the MSSB ADV brochure for the Fiduciary Services program, for more information on that program. You may obtain this ADV brochure at www.smithbarney.com/ADV or by asking your Financial Advisor.

We anticipate that the Conversion will be complete after the third Cut, and that after the third Cut no accounts will remain on the SB Channel platform and all Legg Mason Private Portfolios accounts in existence at this time will have been converted to Fiduciary Services accounts or otherwise transitioned out of the Legg Mason Private Portfolios program (and the Legg Mason Private Portfolios Program will be terminated).

MSSB will notify you if and when your account will be converted (and of any impact that the conversion will have on your account), prior to any Conversion Cut that impacts you.

To determine whether your account is a SB Channel account, a MS Channel account or a Converted Account, please contact your Financial Advisor.

Until the Conversion is complete, clients’ assets will be custodied at either CGM (for SB Channel accounts) or MSSB (for Strategic Portfolios Converted Accounts).

A. General Description of Programs and Services

Legg Mason Private Portfolios Program

The Legg Mason Private Portfolios program is only offered through the SB Channel, and is currently closed to new business.

In the Legg Mason Private Portfolios program, an MSSB Financial Advisor assists the client in reviewing investment objectives and in the client’s selection of an investment management portfolio (an “Investment Management Portfolio”) with respect to which Legg Mason Private Portfolio Group, LLC (“LMPPG”) and one or more sub-managers (the “Sub-Managers”) act as discretionary investment manager and provide other services, as described below. LMPPG is a subsidiary of Legg Mason, Inc. Each Investment Management Portfolio is comprised of one or more investment strategies (“Strategies”) offered by LMPPG or the Sub-Managers. LMPPG may delegate some or all of its functions to the Sub-Managers. The Sub-Managers are not affiliated with MSSB, but they may be (and generally are) affiliated with Legg Mason, Inc. and LMPPG.

Some clients may select an Investment Management Portfolio that includes an allocation to an active fixed income Exchange Traded Fund (“ETF”) model (an “ETF Model”). Any ETF Model is defined by (and may be changed from time to time by) a Sub-Manager. Neither MSSB nor any affiliate recommends such ETF Model or shall (i) perform any due diligence or research on such ETF Model, or (ii) review, evaluate or make any independent determination as to the merits of any ETF

Model, asset allocation used for an ETF Model or ETF included within any ETF Model.

With the assistance of a Financial Advisor, clients can also customize an Investment Management Portfolio.

MSSB, through its Private Portfolio Group division, acts as the “Overlay Manager” as described below. In its capacity as the Overlay Manager, MSSB generally provides portfolio implementation services for equity investments in client accounts.

CGM (as clearing broker for MSSB for SB Channel accounts) or MSSB (for Strategic Portfolios Converted Accounts) provides custody, execution and related services.

The client enters into an investment advisory agreement with MSSB that authorizes MSSB to act as the Overlay Manager, and to retain LMPPG and one or more Sub-Managers on the client’s behalf. MSSB separately contracts with LMPPG, which arranges for the provision of the Sub-Managers’ services. For accounts involving equity investments, the Sub-Managers (or LMPPG) generally provide a model portfolio (“Model Portfolio”) for one or more Strategies, to MSSB as the Overlay Manager. The Model Portfolio specifies securities to be bought and sold (and percentage allocations for each security) for each Strategy, and MSSB effects trades in client accounts in the program based on these instructions. *Please see “MSSB’S Role as Overlay Manager in the Legg Mason Private Portfolios Program” in this Item 4.A below, for more information on that topic.* For accounts involving fixed income investments, the Sub-Managers (or LMPPG) implement their own Strategies directly. In addition to single-style Investment Management Portfolios, LMPPG offers multi-style Investment Management Portfolios, including portfolios that include both equity and fixed income styles.

The Sub-Managers available in the program currently are the following investment management firms: ClearBridge Advisors, LLC, Western Asset Management Company, Brandywine Global Investment Management, LLC, Global Currents Investment Management, LLC, Legg Mason Capital Management, Inc. and Causeway Capital Management. Information related to LMPPG and to the Sub-Managers that are affiliated with LMPPG (as well as a list of the pre-defined Investment Management Portfolios that may be available in the program) is contained in the LMPP Form ADV Firm Brochure (the “Legg Mason Brochure”), which is available upon request through a client’s Financial Advisor or at www.smithbarney.com/ADV. MSSB and LMPPG may agree from time to time to make additional Sub-Managers and Strategies available in the program, including Sub-Managers that are affiliated with LMPPG and Sub-Managers that are not affiliated with LMPPG. Which Sub-Manager(s) are involved in managing a client’s account, and which Strategies will be utilized, will depend on the Investment Management Portfolio and Strategies selected by the client.

In most cases, MSSB will obtain the concurrence of the client before selecting an Investment Management Portfolio for the client.

MSSB’s Role as Overlay Manager in the Legg Mason Private Portfolios Program

MSSB generally performs its role as Overlay Manager through its MSSB Private Portfolio Group division.

As Overlay Manager, MSSB provides the following portfolio implementation and coordination services (as applicable) with respect to client accounts invested in the Legg Mason Private Portfolios program:

- i. implementing investment instructions furnished to MSSB by LMPPG or the Sub-Managers concerning the securities to be purchased, held, or sold for client accounts, and determining the amount of securities to be purchased or sold for client accounts, in accordance with rules and procedures agreed to by MSSB, LMPPG and the Sub-Managers;
- ii. placing orders for and arranging for the purchase or sale of securities with broker-dealers to implement the investment instructions of LMPPG and the Sub-Managers and/or communicating the amount of securities to be purchased or sold for client accounts to LMPPG and the Sub-Managers for execution with broker-dealers selected by LMPPG or the Sub-Managers;
- iii. placing orders for the purchase, sale, or redemption of shares of mutual funds and ETFs to implement the investment instructions of LMPPG and/or Sub-Managers;
- iv. rebalancing client accounts among two or more Sub-Manager investment Strategies; and
- v. managing client accounts consistent with asset allocation selections made by clients.

MSSB is directed by LMPPG’s and the applicable Sub-Manager’s instructions as to the securities to purchase and sell for client accounts.

Strategic Portfolios Program

The Strategic Portfolios program is only available to clients in the SB Channel and to clients with Converted Accounts, and is currently closed to new business. In the Strategic Portfolios program, the client’s account is managed by MSSB (acting through its Private Portfolio Group division) without the involvement of any Sub-Managers.

The program seeks as its primary investment objective long-term capital appreciation. The portfolios are individually managed based on the implementation of the Dow Dividend Strategy (the “Dow Strategy”). The Dow Strategy uses a disciplined approach to identify and maintain a select portfolio of stocks from the 30 components of the Dow Jones Industrial Average (“DJIA”). The Dow Strategy uses dividend yield as the primary criterion for portfolio selection. Generally, the Dow Strategy invests in the ten highest yielding stocks in the DJIA. Individual accounts are invested on a weekly basis, purchasing the ten highest-yielding DJIA stocks at the time of account inception. Accounts are generally restructured and rebalanced annually, on or around the first business day of each calendar year. There may be some circumstances when MSSB will deviate from the discipline and make adjustments to the portfolios.

Applicable law or regulation may prohibit MSSB from purchasing the stock of Morgan Stanley or Citi or securities where MSSB affiliates are performing investment banking or other services, for portfolios if such stock were to meet the selection criteria described above. In such event, MSSB may substitute one or more other stocks (for example, the 11th highest yielding stock in the DJIA) for the stock(s) that it is

unable to purchase, and/or increase the weightings of the remaining stocks that fit the Dow Strategy's selection criteria.

Account Opening

To enroll in the Legg Mason Private Portfolios or Strategic Portfolios programs, you (or your Financial Advisor on your behalf) must complete an investment questionnaire and you must enter into the program client agreement ("Client Agreement").

Restrictions

In each of these programs, you may impose reasonable restrictions on account investments. For example, you may restrict MSSB from buying specific securities or a category of securities (e.g., tobacco companies). If you restrict a category of securities, LMPPG or the Sub-Manager (for Legg Mason Private Portfolios) and we (for Strategic Portfolios) will determine which specific securities fall within the restricted category. In doing so, LMPPG, the Sub-Manager or we may rely on outside sources (e.g. standard industry codes and research provided by independent service providers). Any restrictions you impose on individual securities have no effect on mutual fund or ETF holdings since mutual funds and ETFs operate in accordance with the investment objectives and strategies described in their prospectuses. In these programs, the portion of the account that would have been invested in any restricted security or category of securities will be invested in cash or cash equivalents. This will impact the performance of the account relative to an account that is fully invested in securities.

Trade Confirmations, Account Statements and Performance Reviews

CGM as clearing broker for MSSB (for SB Channel accounts) or MSSB (for Strategic Portfolios Converted Accounts) 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.

We will provide periodic reviews of your account. These reviews show how your account investments have performed, both on an absolute basis and on a relative basis compared to recognized indices (such as Standard & Poor's indices). You may access these reports through MSSB's online account services site. To enroll your account in the online account service site, SB Channel clients should go to <https://www.smithbarney.com/app-bin/reg/servlets/Registration> and clients with Converted Accounts should go to <https://www.morganstanleyclientserv.com/FreeContent/Enrollments/Identification.aspx> and follow the step-by-step instructions. If, however, you would like to receive these reports by mail, please call 1-888-454-3965.

Risks

All trading in an account is at your risk. The value of the assets held in an account is subject to a variety of factors, such as the liquidity and volatility of the securities markets. Investment performance of any kind is not guaranteed, and MSSB's or a Financial Advisor's past performance with respect to other accounts does not predict future performance with respect to any particular account. In addition, certain investment strategies

that mutual funds, ETFs or Sub-Managers may use in the programs have specific risks, including those associated with investments in common stock, fixed income securities, American Depositary Receipts, mutual funds, ETFs and foreign securities. You should consult with your Financial Advisor regarding the specific risks associated with the investments in your account. Also, please review the Legg Mason Brochure for a discussion of the material risks associated with any Strategy you may have selected. You may obtain this at www.smithbarney.com/ADV or by asking your Financial Advisor.

Risks 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 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. In that event, the fund's holdings are liquidated and distributed to the fund's shareholders. This liquidation process could take up to one 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.

For other risks relating to the particular Strategy you hold in your account, please see the Legg Mason Brochure, which you can obtain from your Financial Advisor or at www.smithbarney.com/ADV.

Tax Considerations

Changing your Investment Management Portfolio in Legg Mason Private Portfolios may result in sales of securities and subject you to additional income tax obligations. Consult your independent tax advisor, as MSSB and its affiliates do not provide tax or legal advice.

In the Legg Mason Private Portfolios program, your Financial Advisor may agree with you to implement a client-developed investment strategy that you believe is sensitive to your particular tax situation. Neither we nor any of our affiliates provide tax advice and, therefore, we and they are not responsible for developing, evaluating or the efficacy of any such tax-sensitive strategy. You need to develop any such strategy in consultation with a qualified tax adviser. Certain

tax-sensitive strategies can involve risks. Among others, tax-efficient management services involve an increased risk of loss because your account may not receive the benefit (e.g., realized profit, avoided loss) of securities transactions that would otherwise take place in accordance with the Financial Advisor's investment management decisions for the account.

Fees

Legg Mason Private Portfolios.

You pay a single asset-based fee, charged quarterly, that covers the services provided by MSSB, LMPPG and the Sub-Managers you select. This is a "wrap" fee. The maximum annual fee rates are:

- 2.97% for equity, balanced and multi-style accounts, and
- 2.82% for fixed income accounts.

We, on your behalf, pay part of the fee we receive from you to LMPPG, for LMPPG's and the Sub-Managers' services provided to you. The portion of the asset-based fee paid by MSSB to LMPPG depends upon the asset class, the investment style, the total amount of assets allocated to LMPPG in the program and the assets in a client account. MSSB generally pays LMPPG based on the following table, where the assets in the client account are less than \$5 million at account inception:

Account Type	Annual LMPPG Fee
All Cap Large Cap Equity Balanced	0.34% - 0.38%
Multi-Cap Growth Mid Cap International	0.36% - 0.40%
Small Cap SMID Cap	N/A
Municipal Fixed Income Core Fixed Income	0.22% - 0.23%
Hybrid Fixed Income	0.35%

Different fees will be applicable in some circumstances, such as where the assets in the client account are greater than \$5 million at account inception. Also, LMPPG pays a portion of its fee with respect to a client account to each Sub-Manager involved in providing investment management services for such account.

The fees listed herein are subject to change without notice. In the case of equity, balanced and multi-style accounts, MSSB segregates 0.47% of the fee which is charged to clients, or in the case of fixed income accounts 0.32% of the fee, and applies all or a portion of it to the asset-based fee paid to LMPPG. When MSSB's payment to LMPPG is less than the segregated amount (0.47% or 0.32% respectively), MSSB retains a larger portion of the fee charged to clients. Thus, MSSB has an incentive to recommend investment styles for which LMPPG is paid less, because MSSB will retain a higher fee. When MSSB's payment is greater than the segregated amount, MSSB supports the fee to LMPPG and in effect retains a lesser portion of the fee charged to clients. No portion of the segregated amount is paid

to Financial Advisors, who therefore have no direct financial incentive to recommend one LMPPG investment style over another. However, Financial Advisors' compensation is directly affected by the size of the client's annual fee. MSSB may be compensated where it (and not LMPPG) provides implementation services, and in that case LMPPG in effect is paid less. Since MSSB pays its fee from the fee that MSSB receives from the account, MSSB may have an incentive to recommend an investment style for which MSSB provides implementation services.

Strategic Portfolios.

Clients invested in Strategic Portfolios pay MSSB an annual fee of 0.30% of assets invested. Clients may be eligible for a discount from the standard fee if they have assets that meet specific break points. *Please see "Breakpoints" below in this Item 4.B, for more information.*

Fees are Negotiable. Fees for the programs described in this brochure are negotiable based on a number of factors including the type and size of the account and the range of services provided by the Financial Advisor. In special circumstances, and with the client's agreement, the fee charged to a client for an account may be more than the maximum annual fee stated in this section.

When Fees are Payable. The fee is payable as described in the Client Agreement. Generally, the initial fee is due in full on the date you open your account at MSSB and is based on the market value of the account on that date. The initial fee payment covers the period from the opening date through the last business day of the next full billing quarter and is prorated accordingly. Thereafter, the fee is generally paid quarterly in advance based on the account's market value on the last business day of the previous billing quarter and is due on the tenth business day of the following billing quarter. The Client Agreement authorizes CGM (as custodian and clearing broker for MSSB for SB Channel accounts) or MSSB (as custodian for Strategic Portfolios Converted Accounts) to deduct fees when due from the assets contained in the account.

Breakpoints. Fee rates in the Legg Mason Private Portfolios and Strategic Portfolios programs may be expressed as a fixed rate applying to all assets in the account, or as a schedule of rates applying to different asset levels, or "breakpoints." When the fee is expressed as a schedule of rates corresponding to different breakpoints, discounts, if any, are negotiated separately for each breakpoint. As the value of account assets reaches the various breakpoints, the incremental assets above each threshold are charged the applicable rates. The effective fee rate for the account as a whole is then a weighted average of the scheduled rates, and may change with the account asset level.

Accounts Related for Billing Purposes. When two or more investment advisory accounts are related together for billing purposes, you can benefit even more from existing breakpoints. If you have two accounts, the "related" fees on Account #1 are calculated by applying your total assets (i.e. assets in Account #1 + assets in Account #2) to the Account #1 breakpoints. Because this amount is greater than the amount of assets solely in Account #1, you may have a greater proportion of assets subject to lower fee rates, which in turn lowers the average fee rate for Account #1. This average fee rate is then multiplied by the actual amount of assets in Account #1 to determine the dollar fee for Account #1. Likewise, the total assets are applied to the

Account #2 breakpoints to determine the average fee rate for Account #2, which is then multiplied by the actual amount of assets in Account #2 to determine the dollar fee for Account #2.

Only certain accounts may be related for billing purposes, based on the law and MSSB's policies and procedures. Even where accounts are eligible to be related under these policies and procedures, they will only be related if this is specifically agreed between you and the Financial Advisor.

Other. A portion of the fee will be paid to your Financial Advisor. See Item 4.D below (*Compensation to Financial Advisors*), for more information.

B. Comparing Costs

Depending on the level of trading and types of securities purchased or sold in your account, if purchased separately, you may be able to obtain transaction execution at a higher or lower cost at MSSB or elsewhere than the fee in these programs. However, such transactions could not be executed on a discretionary basis in a brokerage account. Clients who participate in the Legg Mason Private Portfolios and Strategic Portfolios programs pay a fee based on the market value of the account for a variety of services, and accordingly may pay more or less for such services than if they purchased such services separately (to the extent that such services would be available separately to the client). Furthermore, the same or similar services to those available in the Legg Mason Private Portfolios and Strategic Portfolios programs may be available at a lower fee in programs offered by other investment advisors. In addition, CG offers other programs that do not offer the services of an Overlay Manager, LMPPG or Sub-Managers. The fees in those programs may be higher or lower than the fees in the Legg Mason Private Portfolios and Strategic Portfolios programs.

You should consider these and other differences when deciding whether to invest in an investment advisory or a brokerage account and, if applicable, which advisory programs best suit your individual needs.

C. Additional Fees

If you open an account in one of the programs described in this brochure, you will pay an asset-based "wrap" fee as described above. This "wrap" fee includes the services provided by MSSB, LMPPG and the Sub-Managers as described in this brochure, custody of securities and trade execution with or through CGM (for SB Channel accounts) or through MSSB (for Strategic Portfolios Converted Accounts), as well as compensation to any Financial Advisor.

The program fees do not cover:

- the costs of investment management fees and other expenses charged by mutual funds and ETFs (see below for more details)
- "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 or CGM 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).

Mutual Funds and ETFs

LMPPG or Sub-Managers may purchase, or direct the Overlay Manager to purchase, mutual funds for your Legg Mason Private Portfolios account. These mutual funds may include:

- mutual funds available only to managed account clients and that do not charge fund-level investment advisory, management or administration fees ("Managed Account Funds") or
- other mutual funds.

The Managed Account Fund shares will be redeemed, and other mutual fund shares held in your account may be redeemed, on a manager change or account termination, or on a transfer of such shares out of your advisory account. For a taxable account, there will be tax consequences associated with the redemption.

On termination of your account for any reason, or the transfer of mutual fund shares out of your advisory account, if, at the time of termination or transfer, your account includes mutual funds in share classes that are not available in non-advisory accounts, we may convert these funds to a share class that is available in non-advisory accounts (even though the expense ratio for that share class may be higher than the expense ratio for the share class of the fund previously held in your account). The non-advisory mutual fund share class generally has higher operating expenses than the corresponding advisory share classes, which may negatively impact investment performance.

If LMPPG or a Sub-Manager uses an open or closed end mutual fund or an ETF, any such fund may pay its own separate investment advisory fees and other expenses to the fund manager or other service provider. In addition, an open-end mutual fund may charge distribution or servicing fees. In both cases, these fees or expenses will be in addition to the fee you pay to us on your account.

Cash Sweeps

Generally, some portion of your account will be held in cash. If CGM (SB Channel accounts) or MSSB (Strategic Portfolios Converted Accounts) 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”). These money market funds are managed by Morgan Stanley Investment Advisors Inc. or another MSSB affiliate except for:
 - *SB Channel retirement and Coverdell Education Savings accounts*: The “sweep” money market funds are managed by an unaffiliated manager.

If you do not select a Sweep Investment when you open your account, your Sweep Investment will be BDP if you are eligible (Strategic Portfolios Converted Accounts) or selected by your Financial Advisor (SB Channel accounts).

In the SB Channel, retirement accounts cannot use BDP as their Sweep Investment.

Clients with accounts that are both (a) Strategic Portfolios Converted Accounts and (b) 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. You acknowledge and understand that 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, Citi and their affiliates are 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 fund, 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 may or may not be 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.

If account cash balances are invested in Money Market Funds sponsored or managed by MSSB affiliates, we receive and retain fund fees up to 0.18% from those Money Market Funds or those Money Market Funds' affiliates. Therefore, MSSB has a conflict of interest in recommending that a portion of your account is invested in Money Market Funds. 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. Compensation to Financial Advisors

If you invest in one of the programs described in this brochure, a portion of the fees payable to us in connection with your account is allocated on an ongoing basis to your Financial Advisor. The amount allocated to your Financial Advisor in connection with accounts opened in programs described in this brochure may be more than if you participated in other MSSB investment advisory programs, or if you paid separately for investment advice, brokerage and other services. The compensation we pay Financial Advisors with respect to program accounts is typically higher than the compensation we pay Financial Advisors with respect to transaction-based brokerage accounts. 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 agree to 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 in the Legg Mason Private Portfolios, Strategic Portfolios and other advisory programs, 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.

Item 5: Account Requirements and Types of Clients

Account Minimums. In the Legg Mason Private Portfolios program, the minimum account size for equity accounts generally is \$50,000 and the minimum account size for fixed income and balanced accounts generally is \$100,000. The minimums may be greater for some Sub-Manager Strategies. In the Strategic Portfolios program, MSSB generally imposes an investment minimum of \$50,000 for new accounts. MSSB, in its sole discretion, may waive any one or more of these

minimums for any one or more accounts. As indicated in Item 4.A above, both the Legg Mason Private Portfolios and the Strategic Portfolios programs are currently closed to new clients.

Types of Clients. MSSB's clients include individuals, trusts, 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.

Item 6: Portfolio Manager Selection and Evaluation

A. Selection and Review of Portfolio Managers for the Programs

Selection and Review of Sub-Managers

In the Legg Mason Private Portfolios program, we offer a wide range of investment Strategies provided by Sub-Managers that we have selected and approved. Item 4.A above describes the basis on which we recommend particular Sub-Managers and Strategies to particular clients. This Item 6.A describes more generally how we select and terminate Sub-Managers and Strategies from the Legg Mason Private Portfolios program. If Sub-Managers have more than one Strategy, we may include only some of those Strategies in the program, and may assign different statuses to different Strategies.

Our Consulting Group Investment Advisor Research department ("CG IAR") evaluates Sub-Managers and Strategies. CG IAR may delegate some or all of its functions to an affiliate or third party. Sub-Managers and Strategies may only participate in the Legg Mason Private Portfolios 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 (or you can ask your Financial Advisor for these lists). In this program, only some of the Sub-Managers and Strategies may be available.

As well as requiring Sub-Managers and Strategies to be on the Focus List or Approved List, we look at other factors in determining which Sub-Managers and Strategies we offer in the Legg Mason Private Portfolios program, including:

- whether the Sub-Manager is affiliated with Legg Mason, Inc.
- program needs (such as whether we have a sufficient number of Sub-Managers and Strategies available in an asset class)
- client demand and
- the Sub-Manager's or Strategies' minimum account size.

We automatically terminate Sub-Managers and Strategies in the Legg Mason Private Portfolios program if CG IAR downgrades them to "Not Approved." We may terminate Sub-Managers and Strategies from the program for other reasons (e.g., the Sub-Manager or Strategy has a low level of assets under management in the program, the Sub-Manager or Strategy has limited capacity for further investment, or the Sub-Manager or Strategy is not complying with our policies and procedures).

Focus List. To be considered for the Focus List, Sub-Managers provide 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 Strategy's reported performance with the performance of a cross-section of actual accounts calculated by CG IAR. CG IAR personnel may also interview the Sub-Manager or Fund and its key personnel, and examine its operations. Following this review process, Sub-Managers and Strategies are placed on the Focus List if they meet the required standards for Focus List status.

CG IAR periodically reviews Sub-Managers and Strategies on the Focus List. CG IAR considers a broad range of factors (which may include investment performance, staffing, operational issues and financial condition). Among other things, CG IAR personnel interview each Sub-Manager periodically to discuss these matters. If CG IAR is familiar with a Sub-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 Sub-Manager and compare this performance to overall performance data provided by the Sub-Manager, and then investigate any material deviations.

Approved List. The process for considering Sub-Managers and Strategies 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 Sub-Manager and Strategy in a third party database. (Not all Sub-Managers and Strategies 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 Sub-Manager additional information requests. CG IAR then determines whether the Sub-Manager and Strategy meets the standards for Approved List status. Furthermore, CG IAR may evaluate a Sub-Managers or Strategy under the evaluation process for the Focus List but then decide to instead put it on the Approved List.

CG IAR periodically evaluates Sub-Managers and Strategies 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 Sub-Manager or Strategy 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 Sub-Manager or Strategy no longer meets the criteria under either evaluation process and therefore the Sub-Manager or Strategy will no longer be recommended in MSSB investment advisory programs. We notify affected clients of these downgrades. You cannot retain downgraded Sub-Manager or Strategy in your Legg Mason Private Portfolios account and

must select a replacement from the Approved List or Focus List, 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 Sub-Managers or Strategies 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.

In the Legg Mason Private Portfolios program, MSSB generally specifies a replacement Sub-Manager or Strategy. In selecting the replacement Sub-Manager or Strategy, CG IAR generally looks for a Sub-Manager or Strategy in the same asset class, and with similar attributes and holdings to the terminated Sub-Manager or Strategy. The replacement Sub-Manager or Strategy will typically be on the Focus List.

Watch Policy. CG IAR has a "Watch" policy for Sub-Managers and Strategies on the Focus List and Approved List. Watch status indicates that, in reviewing a Sub-Manager or Strategy, CG IAR has identified specific areas of the Sub-Manager's or Strategy's business that (a) merit further evaluation by CG IAR and (b) may, but are not certain to, result in the Sub-Manager or Strategy becoming "Not Approved." Putting a Sub-Manager or Strategy on Watch does not signify an actual change in CG IAR opinion nor is it a guarantee that CG IAR will downgrade the Sub-Manager or Strategy. The duration of a Watch status depends on how long CG IAR needs to evaluate the Sub-Manager or Strategy and for the Sub-Manager or Strategy 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 Sub-Managers and Strategies 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 LMPPG and Sub-Managers. LMPPG or some Sub-Managers on the Approved List or Focus List may have business relationships with us or our affiliates. For example, LMPPG or a Sub-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 Sub-Manager or Strategy on the Approved List or Focus List.

Calculating Sub-Managers' Performance

Sub-Managers' Performance. In the Legg Mason Private Portfolios program, we generally present 10 years of a Sub-Manager's performance history in reports available to clients. This performance history is based on the Sub-Manager's performance in either the MS Channel Fiduciary Services program or the SB Channel Fiduciary Services or Fiduciary Services Legg Mason program. We calculate this performance using both asset-weighted and equal-weighted monthly performance returns for the investment manager composite data.

We do not have a third party review this composite return data. Instead, we perform a monthly reconciliation on the individual accounts in the composite. We compare the monthly performance returns for individual accounts to the monthly performance returns for their peer accounts in the same investment style. We then review any outstanding "outliers"

that have significantly higher or lower monthly performance returns than the average peer account in the same investment style.

If we do not have a performance track record for 10 years based on our own program data, we generally show performance data supplied by the Sub-Manager for earlier periods so you can see 10 years of performance. In this case, the Sub-Manager determines the standards used to calculate this data.

B. Conflicts of Interest

Conflicts of Interest – MSSB Acting as Portfolio Manager

In the Strategic Portfolios program, MSSB acts as the portfolio manager as described above. MSSB and your Financial Advisor retain a greater portion of the advisory fee in the Strategic Portfolios program, than in a program such as Legg Mason Private Portfolios in which an unaffiliated investment manager acts as your portfolio manager. MSSB and your Financial Advisor are 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 (although, in a brokerage account, you would not receive all the benefits of the programs described in this brochure). Financial Advisors and MSSB therefore have a financial incentive to recommend one of the programs described in this brochure. 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.

Other Conflicts of Interest

As well as the conflicts of interest arising from MSSB acting as portfolio manager, MSSB has various other conflicts of interests relating to the programs described in this brochure.

Payments from Investment Managers. Investment managers participating in MSSB-sponsored internal training and education conferences and meetings may make payments to, or for the benefit of, MSSB or its Financial Advisors to offset the expenses incurred for these events. These investment managers may be Sub-Managers. On request, your Financial Advisor can provide you with a schedule of these payments.

While we provide scholarship opportunities to all managers of separately managed accounts in our investment advisory programs, certain investment managers (referred to as "Global Partners") dedicate significant financial and staffing resources to these activities. Global Partners may receive additional opportunities to sponsor MSSB events and promote their Strategies and funds to Financial Advisors and clients. This could lead Financial Advisors to focus on Strategies offered by our Global Partners when recommending products to clients instead of those from other investment managers that do not commit similar resources to educational, marketing and other promotional efforts. MSSB selects investment managers to be Global Partners based on quantitative and qualitative criteria.

Investment managers may also sponsor their own educational conferences and pay expenses of Financial Advisors attending these 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 to occasionally 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 do not permit any gifts or entertainment conditioned on achieving a sales target. On request, your Financial Advisor can provide you with an annual estimate of the aggregate value of gifts and entertainment that investment managers pay or provide to MSSB or particular Financial Advisors.

We address conflicts of interest by ensuring that any payments described in this "Payments from Investment Managers" section do not relate to any particular transactions or investment made by MSSB clients with investment managers. Investment managers participating in the programs described in this brochure are not required to make any of these types of payments. The payments described in this section comply with FINRA rules relating to such activities.

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. MSSB, MS&CO., 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, [LMPPG or a Sub-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. MSSB, LMPPG or a Sub-Manager may aggregate the securities to buy or sell for more than one client to obtain favorable execution to the extent permitted by law. MSSB, LMPPG or a Sub-Manager is then responsible for allocating the trade in a manner that is equitable and consistent with its fiduciary duty to its clients (which could include, *e.g.*, pro rata allocation, random allocation or rotation allocation). For block trade orders executed by MSSB or CGM, the price to each client is the average price for the aggregate order. MSSB performs these trade allocation functions as part of its duties as Overlay Manager, as described in Item 4.A above.

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, 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 for investment management firms in

the programs described in this brochure. MSSB, investment managers, MS&Co., CGM 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 MSSB, investment managers, MS&Co., CGM and their affiliates perform 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 investment 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 they 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, MS&Co., and/or CGM 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:

- **Clearing.** An agreement providing that, subject to best execution, MS&Co. and CGM (or their applicable affiliates) will act as fully-disclosed clearing brokers for MSSB, which will act as an introducing broker. MSSB may have a conflict of interest in introducing client trades to MS&Co. and CGM. (As of the date of this brochure, MSSB is the clearing broker for most of the MS Channel's investment advisory programs and for Converted Accounts. MS&Co. is the clearing broker for some MS Channel clients, typically those with accounts administered by the MS Channel's Private Wealth Management division. CGM is the clearing broker for SB Channel clients.)
- **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.

Nonpublic Information. In the course of investment banking or other activities, MSSB, LMPPG, the Sub-Managers, and each of their respective affiliates and Agents may from time to time acquire confidential or material nonpublic information that may prevent them, for a period of time, from purchasing or selling particular securities for the account. You acknowledge and agree that MSSB, LMPPG, the Sub-Managers, and each of their respective affiliates and Agents will not be free to divulge or to act upon this information with respect to their advisory or brokerage activities, including their activities with regard to the account. This may adversely impact the investment performance of the account.

Benefits to Financial Advisors. Client understands that Financial Advisors or employees of MSSB affiliates may receive a financial benefit from LMPPG or any Legg Mason Private Portfolios Sub-Manager in the form of compensation for trade executions for the accounts of LMPPG or a Sub-Manager or accounts that are managed by LMPPG or such Sub-Manager, or through referrals of brokerage or investment advisory accounts to the Financial Advisor or employees of MSSB affiliates by LMPPG or a Sub-Manager. These Sub-Managers may include a Sub-Manager recommended to clients by the Financial Advisor or employees of MSSB affiliates in any of the Consulting Group programs.

Other Investment Products Available. Client understands that LMPPG or Sub-Managers may offer to the public other investment products such as mutual funds with similar investment styles and holdings as those investment products offered through the Consulting Group programs. Such products may be offered at differing fees and charges that may be higher or lower than the fees imposed by MSSB under a Consulting Group program. Clients should discuss all investment options with their Financial Advisor or other MSSB affiliated contact.

Compensation to Citi Affiliate. Citi is a part owner of MSSB. Global Transaction Services, a business unit of Citi, receives compensation for providing administrative and back office services to investment management firms, mutual funds and hedge funds (collectively "Investment Management Firms"). These Investment Management Firms may include LMPPG and Sub-Managers.

Block Trades. MSSB may direct some block trades to MSSB for execution, which blocks may include trades for other clients of MSSB and/or LMPPG/the Sub-Manager. Although MSSB executes these block trades at no commission, MSSB may obtain a benefit from executing these block trades, as a result of the increased trading volume attributable to these blocks.

C. MSSB Acting as Portfolio Manager

Description of Advisory Services

In the Strategic Portfolios program, MSSB (acting through its Private Portfolio Group division) acts as the portfolio manager. MSSB does not act as a portfolio manager in the Legg Mason Private Portfolios program. *See Item 4.A above for a description of the services offered in the programs described in this brochure.*

Tailoring Services for Individual Clients

In both programs described in this brochure, you may place reasonable restrictions on the investments in your account (as discussed above in Item 4.A). In the Legg Mason Private Portfolios program, MSSB does not have discretion to select securities or investment Strategies for you. Therefore, in this program, you will select the Sub-Managers and Strategy(ies) for your account with the assistance of your Financial Advisor. *See Item 4.A above, for more information.*

MSSB tailors its advisory services to individual clients in the Legg Mason Private Portfolios program by advising the clients as to appropriate Sub-Managers and Strategies.

Wrap Fee Programs

In the Strategic Portfolios program, MSSB acts as both the wrap fee program sponsor and the portfolio manager. MSSB does not act as portfolio manager in any programs which are not wrap fee programs but are otherwise similar to Strategic Portfolios. In the Strategic Portfolios program, MSSB receives the entire wrap fee.

In the Legg Mason Private Portfolios program, MSSB does not act as the portfolio manager. *See Item 4.A above, for more information.*

Performance-Based Fees

The programs described in this brochure do not charge performance-based fees.

Methods of Analysis and Investment Strategies

In the Strategic Portfolios program, MSSB manages the client accounts based on the implementation of the Dow Dividend Strategy.

In the Legg Mason Private Portfolios program, Financial Advisors may use any investment strategy when providing investment advice to you. Financial Advisors may use asset allocation recommendations of the Morgan Stanley Smith Barney Global Investment Committee as a resource but, if so, there is no guarantee that any strategy will in fact mirror or track these recommendations. *Please see Item 4.A. above, for more information.* Investing in securities involves risk of loss that you should be prepared to bear.

Policies and Procedures Relating to Voting Client Securities

Electing Who Votes Proxies. In the Legg Mason Private Portfolios program, MSSB does not have, and will not accept, authority to vote client securities. Clients who do not elect to vote proxies themselves direct LMPPG to vote the proxies.

In the Strategic Portfolios program, clients who do not elect to vote proxies themselves direct MSSB to vote the proxies, and authorize MSSB to further delegate all proxy voting rights to Institutional Shareholder Services (the "Proxy voting Service"), a third party provider of corporate governance services, or another proxy voting service satisfactory to MSSB.

If you have any questions about a particular proxy solicitation, please contact your Financial Advisor.

Unless you authorize LMPPG or MSSB to vote proxies, we will forward to you, or your designee, any proxy materials that we receive for securities in your account. Unless we vote proxies

for you, we cannot advise you on particular proxy solicitations. If LMPPG or MSSB vote proxies for you, you cannot instruct them on how to cast any particular vote.

We will not provide advice or take action with respect to legal proceedings (including bankruptcies) relating to the securities in your account, except to the extent required by law.

MSSB's Proxy Voting Policies and Procedures. If you have delegated proxy voting authority to MSSB as provided above, you may obtain information as to how we voted proxies for your account during the particular annual period, from your Financial Advisor. You may also obtain a copy of MSSB's relevant proxy voting policies and procedures (including a copy of the Proxy Voting Service's policy guidelines and vote recommendations in effect from time to time), from your Financial Advisor.

We retain books and records relating to our proxy voting activities on behalf of client accounts as required by law.

Item 7: Client Information Provided to Portfolio Managers

Legg Mason Private Portfolios

At and subsequent to account opening, you provide information (the "Client Information") to MSSB (through your Financial Advisor). The Client Information includes information regarding your investment objectives, financial information, risk tolerance and any reasonable restrictions you may impose on management of your account. In the Legg Mason Private Portfolios program, MSSB will provide some or all of the Client Information to LMPPG and to the Sub-Managers at the time the account is opened and upon request thereafter.

Strategic Portfolios

In Strategic Portfolios, MSSB is the portfolio manager, and receives the Client Information from you.

Item 8: Client Contact with Portfolio Managers

In the programs described in this brochure, you may contact your Financial Advisor at any time during normal business hours.

Although clients are not prohibited from directly contacting LMPPG or the Sub-Managers, clients are encouraged to use their Financial Advisors as their primary contact.

Item 9: Additional Information

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

Other Financial Industry Activities and Affiliations

Morgan Stanley Parent indirectly owns 51% of MSSB. Morgan Stanley Parent is a financial holding company under the Bank Holding Company Act of 1956. Citi indirectly owns 49% of MSSB. Both Morgan Stanley Parent and Citi are corporations whose shares are publicly held and traded on the New York Stock Exchange.

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.

Broker-Dealer and FCM Registrations. As well as being a registered investment advisor, MSSB is registered as a broker-dealer and a futures commission merchant.

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.

See Item 6.B above for conflicts arising from our affiliation with MS&Co., Citi and their affiliates.

Code of Ethics

The MSSB US Investment Advisory Code of Ethics ("Code") applies to MSSB's 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 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.

See Item 6.B above, for a discussion of Conflicts of Interest.

Reviewing Accounts

At account opening, your Financial Advisor and his or her Branch Manager (or the Branch Manager's designee) confirms that, the account and the investment Strategies are suitable investments for you.

Your Financial Advisor is then responsible for reviewing your account on an ongoing basis.

In the Legg Mason Private Portfolios program, the Overlay Manager conducts various checks on a periodic basis (e.g.

identifying and reviewing accounts with a high cash balance, or inactive accounts).

See Item 4.A above for a discussion of account statements and Investment Monitors.

Client Referrals and Other Compensation

See "Payments from Investment Managers" in Item 6.B above.

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.

Financial Information

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

We do not have any financial conditions that are reasonably likely to impair our ability to meet its contractual commitments to clients.

MSSB and its predecessors have not been the subject of a bankruptcy petition during the past 10 years.

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

(APPLIES ONLY TO STRATEGIC PORTFOLIOS CONVERTED RETIREMENT PLAN ACCOUNTS AND CESAs)

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:

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

- 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.

Fund	Advisory Fee	Distribution and Service Fees	Other Expenses	Total Annual Fund Operating Expenses	Total Annual Fund Operating Expenses After Fee Waivers and/or Expense Reimbursements
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%