

LEGG MASON  
INVESTMENT  
COUNSEL

**FORM ADV DISCLOSURE BROCHURE**

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**This brochure provides information about the qualifications and business practices of Legg Mason Investment Counsel, LLC (“LMIC”). If you have questions about the contents of this brochure, please contact us at (410) 454-2171. 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.**

**Legg Mason Investment Counsel, LLC is a registered investment adviser. Additional information about Legg Mason Investment Counsel, LLC is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). Investment adviser registration does not imply a certain level of skill or training.**

## ITEM 2. MATERIAL CHANGES

This brochure reflects the following material changes made since the last annual update of the brochure, dated June 28, 2013:

1. Legg Mason Investment Counsel Special Investment Series Fund (“SIS Fund”). LMIC revised Items 10 and 11 of the brochure to disclose conflicts of interest associated with LMIC recommendations and decisions to invest client assets in the SIS Fund, a private investment fund for which LMIC is the manager and investment manager.
2. Brokerage Practices. LMIC revised Item 12 to make the following significant changes:
  - A. Broker-Dealer Selection. LMIC revised disclosure to reflect (i) that LMIC typically gives significant consideration to research in selecting broker-dealers to execute equity trades, and (ii) a streamlined list of factors LMIC’s traders consider in selecting broker-dealers to execute trades.
  - B. Use of Client Commissions to Obtain or Pay for Research. LMIC (i) revised disclosure on how it considers research in selecting broker-dealers, and (ii) disclosed that it may cause clients to pay commissions enabling LMIC to obtain research, even if clients separately pay their custodians asset-based fees for services that include trade execution. LMIC follows this approach for clients that pay asset-based fees to Charles Schwab & Co., Inc.
3. Directed Brokerage. LMIC revised Item 12 to (i) disclose that, for client accounts in wrap fee programs, LMIC may trade with only the program’s designated broker if it determines that using other brokers is too difficult as an operational matter or if the program sponsor does not permit trades with other brokers, and (ii) disclose and restate certain matters clients should be aware of when they direct LMIC to use a specific broker. LMIC follows the approach in clause (i) for the Manager Select Account and Manager Access Select programs of LPL Financial LLC and the Managed Assets Program of Independent Portfolio Consultants, Inc.

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## ITEM 4. ADVISORY BUSINESS

### A. Firm Description

Legg Mason Investment Counsel, LLC ("LMIC") is a wholly-owned subsidiary of Legg Mason Investment Counsel & Trust Company, N.A. ("LMIC&T"), which in turn is a wholly-owned subsidiary of Legg Mason, Inc.

LMIC has been in the business of providing investment advisory services since 2005. Prior to 2005, the business now conducted by LMIC was conducted by certain offices of the Scudder Private Investment Counsel unit of Deutsche Investment Management Americas Inc. LMIC acquired these offices at the end of 2004.

LMIC provides active equity and active fixed income discretionary and non-discretionary investment advisory services. LMIC provides financial planning services and family office services in certain situations (as described in Item 8 of this Brochure) and may also provide other types of investment advisory services. LMIC provides investment advisory services through the following departments:

- High Net Worth Department
- Institutional Department
- Socially Responsive Investment Department
- Global Total Return Department
- Multi-Cap Core Department
- Wrap Department
- Arthur Karafin Investment Advisors Department\*

\*LMIC maintains a separate Form ADV brochure for its Arthur Karafin Investment Advisors Department ("AKIA"). Clients of, and persons considering entering into an investment advisory relationship with, AKIA should refer to that brochure (not this brochure) for information about AKIA. Request a copy of AKIA's separate brochure by calling AKIA at (215) 981-0110.

High Net Worth Department. LMIC's High Net Worth Department manages equity, fixed income, and balanced portfolios for high net worth individual, family and trust clients, and seeks to maximize performance while managing risk. Portfolio managers work directly with clients to develop Investment Policy Statements and tailor portfolios to reflect individual client considerations including time horizon, risk tolerance, restrictions on investing in specific securities or types of securities, income needs and tax situation. Portfolio managers primarily focus on liquid mid- to large-cap stocks and investment grade fixed income securities and, using third-party managers, may supplement with strategies they believe complement these core assets. LMIC refers to this as a "smart architecture" approach. For certain client accounts, the High Net Worth Department may provide a mutual fund investment program in which LMIC directs the investment of client assets in mutual funds.

Institutional Department. LMIC's Institutional Department manages institutional client accounts except for those institutional accounts managed by the Socially Responsive Investment, Global Total Return, Multi-Cap Core, and Wrap Departments of LMIC.

**Socially Responsive Investment Department.** LMIC's Socially Responsive Investment ("SRI") Department manages LMIC client accounts that select a socially responsive investment strategy. The SRI Department employs specialized research and applies customized social guidelines to align a client's ethical investing goals with their financial goals. The SRI Department specializes in constructing social investing policies and guidelines, supported by both proprietary investment research and social research analysis, to eliminate companies that do not meet a client's requirements and to select investments that do meet these requirements. The SRI Department also manages two mutual funds, including the Legg Mason Investment Counsel Social Awareness Fund.

**Global Total Return Department.** LMIC's Global Total Return Department manages global equity accounts of individual and institutional clients that select the Department's Global Total Return investment strategy.

**Multi-Cap Core Department.** LMIC's Multi-Cap Core ("MCC") Department manages equity accounts of individual and institutional clients that select the Department's MCC investment strategy.

**Wrap Department.** LMIC may enter into arrangements with investment advisory firms ("sponsors") under which LMIC's Wrap Department provides discretionary investment advisory services to clients through a wrap fee program. In wrap fee programs, sponsors offer clients services, which may include brokerage-custody and investment advice, for fees that are not directly related to transactions in client accounts (e.g., asset-based fees instead of trade-by-trade commissions). LMIC's Wrap Department provides investment management services to wrap fee program clients based upon the information and guidelines provided by the sponsor. LMIC does not manage wrap fee program accounts any differently than other accounts managed in the same investment strategy. In wrap fee programs, LMIC either receives a portion of the wrap fee charged to the client by the program's sponsor or receives a separate fee from the client.

The Wrap Department currently provides the following investment strategies: International ADR Equity Wrap, Large Cap Value Equity Wrap, Quality Growth Equity Wrap, Balanced Wrap and Intermediate Duration Fixed Income Wrap.

## **B. Non-Discretionary Investment Advice**

LMIC typically provides discretionary investment management services, which involve LMIC selecting investments for client accounts. However, LMIC has agreed to provide certain clients with non-discretionary investment advisory services. When LMIC provides non-discretionary investment advisory services, the client decides whether or not to approve LMIC's non-discretionary investment advice. If LMIC has agreed to implement approved non-discretionary advice, then LMIC will implement the advice after receiving the client's approval.

LMIC's non-discretionary investment advisory services may include:

- providing another financial firm (the client) with, and continuously monitoring and updating, a model investment portfolio that the client, in turn, may implement for accounts of its own clients;
- continuously monitoring and making investment recommendations for specific client accounts; or

- reviewing and making investment recommendations for client accounts at periodic intervals.

### **C. Tailoring of Investment Advisory Services to Client Needs**

LMIC tailors the investment advisory services it provides to client needs in multiple ways. In addition to making available a wide range of investment advisory services, LMIC Departments (excluding the Wrap Department) tailor their investment advisory services to client needs by creating and updating investment policy statements, or by agreeing to client-developed investment guidelines reflecting client investment objectives and guidelines. As noted above, LMIC's Wrap Department manages client accounts in accordance with the strategy the client or its sponsor firm selects and other information and guidelines the sponsor firm provides. All LMIC Departments, including the Wrap Department, accommodate written client-imposed restrictions on specific securities and types of securities if they determine that such restrictions are reasonable.

### **D. Assets Under Management**

As of April 30, 2014, LMIC, including AKIA, managed approximately \$7.9 billion in assets, consisting of approximately \$7.8 billion of assets managed on a discretionary basis (AKIA managed approximately \$923 million of these assets) and approximately \$76 million of assets managed on a non-discretionary basis (AKIA managed none of these assets). LMIC assets managed on a non-discretionary basis include assets for which LMIC provides non-discretionary investment advice only if such advice is continuous and only if LMIC implements such advice in the event it is accepted or approved by the client.

The LMIC assets under management reported above do not include client assets managed by Legg Mason Investment Counsel & Trust Company, N.A. ("LMIC&T"), the affiliate that together with LMIC comprises the "Legg Mason Investment Counsel" business unit. In marketing materials, this business unit may disclose the collective assets under management of LMIC and LMIC&T as its assets under management. Refer to Item 10 of this brochure for additional information regarding the relationship between LMIC and LMIC&T.

## ITEM 5. FEES AND COMPENSATION

### A. How LMIC is Compensated

Generally, clients agree to pay LMIC compensation for its investment advisory services based on a percentage of the assets LMIC manages. LMIC generally considers client requests to negotiate a fixed dollar fee instead, but in its sole discretion may refuse to agree to fixed-dollar fees.

LMIC's standard fee schedules for its Departments and different types of clients and accounts are set forth below.

#### Standard Annual Fee Schedule for High-Net-Worth Clients

##### Equity/Balanced Accounts

1.00% on first \$3 million under management  
0.70% on next \$7 million under management  
0.50% on next \$30 million under management  
0.40% on the balance

Minimum account or client relationship size: \$2 million  
Minimum annual fee: \$20,000

##### Fixed Income Accounts

0.50% on the first \$3 million under management  
0.35% on the next \$7 million under management  
0.25% on the next \$30 million under management  
0.20% on the balance

Minimum account or client relationship size: \$5 million  
Minimum annual fee: \$10,000

#### Standard Annual Fee Schedule for Institutional Accounts

##### Equity/Balanced Accounts

0.75% on the first \$10 million under management  
0.60% on the next \$15 million under management  
0.50% on the next \$25 million under management  
0.40% on the balance

Fixed Income Accounts

0.30% on the first \$10 million under management  
0.20% on the next \$15 million under management  
0.15% on the next \$25 million under management  
0.10% on the balance

Minimum annual fee for Equity/Balanced Accounts: \$37,500  
Minimum annual fee for Fixed Income Accounts: \$10,000

**Standard Annual Fee Schedule  
for Accounts Managed by the Socially Responsive Investment  
and Global Total Return Departments**

The Socially Responsive Investment and Global Total Return Departments generally follow the standard fee schedules, including minimum account or relationship sizes and minimum annual fees, set forth above for High-Net-Worth and Institutional client accounts.

**Standard Annual Fee Schedule for Accounts Managed by the  
Multi-Cap Core Department**

For client accounts managed by LMIC's Multi-Cap Core Department, LMIC's annual fees generally are based on the market value of each account as follows:

1.00% on the first \$10 million under management  
0.85% on the next \$15 million under management  
0.75% on the balance

The Multi-Cap Core Department generally requires the minimum account or relationship sizes and minimum annual fees set forth above for High-Net-Worth and Institutional clients.

**Fees for Accounts Managed by the Wrap Department**

Generally, in a wrap fee program, a client pays a single fee to the program sponsor. This fee typically covers investment management fees and costs of custody and brokerage transactions executed by the sponsor or by a broker-dealer designated by the sponsor. Clients with accounts in a wrap fee program should contact the program's sponsor for information regarding fees and expenses associated with program accounts.

In a wrap fee program, the sponsor pays LMIC, from the single fee the sponsor charges to the client, a fee for managing client accounts in the program. The rate of LMIC's fee typically is based on the amount of client assets LMIC manages in the program.



### **Standard Annual Fee Schedule for Investments in Mutual Funds, Private Investment Funds and Other Collective Investment Funds**

As described in Item 8 of this brochure, LMIC may invest client assets in affiliated and unaffiliated mutual funds, exchange-traded funds (“ETFs”), private investment funds and other collective investment funds (collectively, “Funds”), including funds that invest in other funds and funds managed by LMIC or its affiliates (“Affiliated Funds”). As described in Item 11 of this brochure, LMIC may be subject to a conflict of interest when it invests client assets in Affiliated Funds.

When LMIC invests client assets in Funds, other than money market funds, LMIC’s standard approach is to charge the client an asset allocation fee on these assets. LMIC’s standard asset allocation fee is the lesser of (a) an annual rate of 0.50%, or (b) the lowest marginal fee rate then applicable to assets in the client’s account under the client’s fee schedule. The client will also bear its proportionate share of the internal fees and expenses of Funds in which the client’s assets are invested, including investment management fees the Funds pay to their investment managers. Not all clients have agreed to the asset allocation fee described above.

LMIC makes certain exceptions to the standard approach described in the above paragraph. Specifically, when LMIC invests client assets in Affiliated Funds managed by LMIC, it does not charge account-level fees on these assets but instead only receives an investment management fee from the Affiliated Fund. In addition, for certain types of client accounts subject to fee-related legal restrictions, LMIC does not charge account-level fees on investments in Affiliated Funds managed by LMIC or Affiliated Funds managed by affiliates of LMIC.

### **Fees for Family Office Services**

As described in Item 8 of this brochure, LMIC may provide family office services. If the client agrees, LMIC may charge fees for these services that are separate from, and in addition to, fees it charges for investment management services and other investment advisory services. LMIC fees for family office services generally are calculated based on one or more of the following factors: account value, account activity (e.g., disbursements processed), and estimates of LMIC employee time devoted to performing the services.

### **B. Negotiability of Fees and Account/Relationship Minimum Waivers**

LMIC generally considers client requests to negotiate fee rates and minimum fees lower than the standard fees set forth in Section A above. In addition, LMIC generally considers client requests to waive minimum account/relationship sizes. However, LMIC in its sole discretion may refuse to agree to lower fee rates or to waive account/relationship minimums.

### **C. Fee Billing**

Billing Methods. LMIC’s standard forms of agreements include client authorization of LMIC to collect (or debit) LMIC’s agreed-upon fees directly from the client’s account. LMIC collects its fee in this situation by sending the custodian of the client’s account an invoice setting forth the amount of the fee payable to LMIC or by electronically causing the custodian to pay LMIC its fees. LMIC considers client requests to instead collect fees by billing the client directly and has agreed to such billing for

certain clients. However, LMIC in its sole discretion may refuse requests for this alternative billing method.

Arrears and Advance Fee Billing; Frequency. Generally, LMIC agrees to charge fees quarterly in arrears – i.e., billing of fees at the end of the quarter during which LMIC provided the services covered by the fees. However, LMIC has agreed, and may in the future agree, with certain clients to bill fees in advance or at monthly, semi-annual or other intervals. Where LMIC provides tax services, it generally bills fees for such services on an annual basis.

For a client that agrees to advance billing, LMIC will refund the client a portion of the investment advisory fees previously paid for the billing period in the event the client or LMIC terminates the client's investment advisory agreement with LMIC during such period. LMIC calculates refunds in these circumstances by:

1. Dividing the number of days left (after termination) in the period for which the client paid the fee by the total number of days in the period; and
2. Multiplying the result by the dollar amount of the pre-paid fee.

LMIC pays fee refunds by mailing checks to client custodians for deposit into the accounts previously managed by LMIC or, if the client requests, directly to the client.

Where LMIC manages client accounts as a subadviser to another firm or as part of a wrap fee program in which another firm collects and pays LMIC its investment advisory fees, clients should contact such other firm for information on potential fee refunds in the event LMIC's investment advisory relationship is terminated.

#### **D. Other Fees and Expenses**

In addition to the fees LMIC charges for its services, a client generally will incur brokerage and trade execution costs for securities transactions LMIC effects or recommends for the client's account. These costs are imposed by the broker-dealer firms used to execute such transactions and are not covered by the fees LMIC charges. For wrap fee programs, if the transactions are executed by the program sponsor or its designated broker, these costs often are included in the fee the client pays to the sponsor. If the transactions are not executed by the sponsor or its designated broker, however, then these costs typically are in addition to the fees the client pays to the sponsor. For more information on brokerage, refer to Item 12 of this brochure.

A client may also incur any one or more of the costs listed below.

- Fees for account custody services and related services such as security transfers and wire transfers.
- Fees for investment advisory services a firm other than LMIC provides. These may include services such as the other firm's evaluation, recommendation and monitoring of LMIC, and financial planning and asset allocation services provided by the other firm. Unless LMIC otherwise agrees with a client, LMIC will pay the fees of any subadvisers or other subcontractors LMIC retains to manage client account assets or otherwise provide services.

- Fees for account reporting by a firm other than LMIC, such as the client's custodian or, in the case of wrap fee programs, the sponsor firm.
- Any SEC fees, transfer taxes or other governmental charges based on securities transactions.
- Conversion and foreign exchange fees and charges associated with purchases and sales of American Depositary Receipts ("ADRs") in non-U.S. markets for ordinary shares underlying the ADRs.
- Internal fees and expenses of any mutual fund, ETF, private investment fund or other collective investment fund ("Fund") purchased or held for the client's account, as well as sales charges (initial or deferred) on investments in Fund shares or on any annuities held in the account.

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**ITEM 6. PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT**

Not Applicable.

**ITEM 7. TYPES OF CLIENTS**

LMIC provides investment advisory services to the following types of clients: high-net-worth individuals and families, endowments, foundations, other charitable organizations, public/government-related clients, pension and profit sharing plans, investment companies, corporations, individual retirement plans, trusts, estates, and other taxable individual plans.

For new client accounts and relationships, LMIC generally imposes the minimums described in Item 5 of this brochure. As described in Item 5, LMIC in its sole discretion may waive otherwise applicable minimums for any one or more clients.

In addition, LMIC reserves the right to refuse or terminate business for any reason, even if such business would meet applicable standard LMIC account and relationship minimums.

## ITEM 8. METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS

### A. Introduction

LMIC makes available a variety of investment strategies. LMIC's main investment strategies, including LMIC's methods of investment analysis, are described below in Section B of this Item 8. As described in Item 4 of this brochure, LMIC often customizes its investment strategies to reflect unique client investment objectives, guidelines and needs. As a result, the investment strategy descriptions in this brochure may not fully apply to all clients depending on the nature of customization LMIC applies in managing their accounts.

Each investment strategy involves risk of loss, which clients should be prepared to bear. The investment strategy descriptions set forth in Section B of this Item 8 identify the main risks for the strategies. Appendix B to this brochure explains these risks. It is not practical to identify all possible risks and one or more risks that this brochure does not identify for an investment strategy nevertheless may result in losses for clients. For all investment strategies, there is no assurance or guarantee that client investment objectives will be met.

Section C of this Item 8 sets forth certain additional information about services LMIC may provide.

### B. Investment Strategies

#### *Core Equity (Equity Institutional)*

LMIC's Core Equity investment capability is the construction of large-to-mid capitalization primarily domestic equity portfolios. LMIC may refer to its Core Equity investment capability as "Equity Institutional." A Core Equity or Equity Institutional client account or account portion typically contains 30-60 individual stock holdings. LMIC's Core Equity philosophy is described below:

- LMIC is an active manager that focuses on high or improving quality stocks, employing a bottom-up approach.
- LMIC employs independent proprietary research in an attempt to discover unrecognized sources of value.
- LMIC focuses on companies it believes have a demonstrable competitive advantage in an attempt to enhance long-term opportunities and maximize returns.
- LMIC emphasizes high-quality or improving-quality securities in an attempt to reduce fundamental risk and avoid significant loss.
- LMIC seeks to identify promising sectors that offer above-average opportunities and diversification benefits.

#### Core Equity Selection Process

##### Step 1

Narrowing the field from thousands of possibilities to a portfolio of stocks that LMIC believes

represents superior investment potential requires intensive research and a disciplined process. LMIC draws from a broad universe of companies with equity market capitalizations greater than \$1.0 billion, including ADRs of non-U.S. domiciled companies.

**Step 2**

With the goal of establishing the dynamic LMIC Investment Universe comprised of high or improving quality companies exhibiting a durable or improving competitive advantage, LMIC Research employs a number of quantitative and qualitative protocols. Each LMIC research analyst has sector responsibility and recommends companies they believe have high or improving financial quality and demonstrable competitive advantage for addition to the LMIC Investment Universe. Industry-specific quantitative fundamental screens developed by LMIC Research and intensive fundamental research performed by the analysts serve as the foundation of this process.

Qualitative factors such as identifying beneficiaries of a durable niche or global theme are also employed to determine the best candidates for the LMIC Investment Universe.

**Step 3**

Companies in the LMIC Investment Universe that LMIC's research analysts favorably rank or that LMIC's quantitative valuation tools rank favorably may be selected for inclusion on LMIC's Focus List by LMIC's Equity Strategy Working Group, which is comprised of LMIC portfolio managers and research analysts. The Focus List is a list of the equity securities LMIC portfolio managers may purchase for client accounts. LMIC Research employs risk/reward valuation disciplines to identify and rank companies it believes have the highest probability of outperformance potential relative to risk and market expectations.

**Step 4**

Portfolio managers construct customized portfolios from the Focus List based on client investment policy considerations. In the case of institutional tax-exempt accounts, a committee of portfolio managers responsible for these types of accounts meets frequently to determine coordinated portfolio actions.

**Equity Sell Discipline**

Stocks can become sale candidates based on a combination of factors.

Fundamental Factors include:

- Competitive position deteriorates
- Profitability is threatened by unfavorable developments in the company or industry, permanently affecting the company's ability to earn high returns and generate cash flow
- Concerns develop regarding the quality and stability of management

Quantitative Factors include:

- Valuation measures become unattractive as a stock becomes expensive relative to corporate growth rate
- Prospective corporate profitability and cash generation no longer justify the present valuation

Other Factors Include:

- Overweighting in portfolio – Risk Management
- The portfolio manager identifies an alternative investment believed to be superior

**Main Risks.** The main risks associated with LMIC's Core Equity (Equity Institutional) investment strategy are General Investment Risk, Mid Cap Risk, Industry and Issuer Concentration Risk, and Non-U.S. Investment Risk. See Appendix B to this brochure for explanations of these risks.

### ***Core Fixed Income***

LMIC's Core Fixed Income strategy seeks to maximize total return and minimize risk through:

- An investment strategy customized to client goals, needs and risk preferences
- A conservatively managed risk profile
- Tax sensitive management (if applicable)

LMIC reviews and tailors portfolios based on client guidelines, objectives and preferences for the following (if applicable):

- Tax Status
- Income Needs
- Time Horizon
- Liquidity Needs
- Quality Constraints
- Special Considerations

Based on these inputs, a specific investment strategy is constructed addressing:

- Portfolio Maturity
- Option Adjusted Duration
- Term Structure
- Sector and Industry Weighting

LMIC's Core Fixed Income investment strategy described above is the foundation for the following LMIC fixed income investment strategies: Intermediate Duration Fixed Income, Full Range Duration Fixed Income and Intermediate Municipal Fixed Income.

**Full Range Duration Fixed Income and Intermediate Duration Fixed Income.** LMIC uses a total rate of return, disciplined, relative value approach for these fixed income strategies. LMIC's objective is to provide long-term, consistent, superior returns through active portfolio management while achieving attractive risk/reward ratios. Using fundamental analysis and an assessment of relative value within the context of current market conditions, LMIC forecasts future movements in interest rates, changes in the shape of the yield curve and changes in sector spreads in order to derive portfolio strategy. Results generally derive from an emphasis on security selection, sector allocation and yield curve management rather than from interest rate forecasts. LMIC believes the long-term key to successful security selection is sound, fundamental credit and security structure analysis. LMIC's duration and term-structure decisions are top-down while sector weighting decisions are bottom up. When provided by LMIC's Wrap Department, the Intermediate Duration Fixed Income strategy is referred to as the "Intermediate Duration Fixed Income Wrap" strategy.



**Intermediate Municipal Fixed Income.** For this fixed income strategy, LMIC uses tax-sensitive fixed income management customized to the client's state of residence, seeking to maximize after-tax return consistent with prudent investment risk. LMIC's objective is to add value through analysis of security structure and issuer fundamentals. LMIC establishes duration targets based on its outlook for the economy, fiscal and monetary policy, and international events, although average portfolio maturity generally will not exceed 15 years. LMIC also incorporates factors affecting the municipal market, such as supply and demand trends and legislative developments.

**Main Risks.** The main risks associated with the above-noted LMIC fixed income investment strategies are General Investment Risk, Credit Risk, Interest Rate Risk, Extension Risk, Prepayment Risk and Illiquidity Risk. An additional risk for Intermediate Municipal Fixed Income is Geographic Concentration Risk if municipal securities from a particular state are emphasized. See Appendix B to this brochure for explanations of these risks.

### ***Balanced***

LMIC believes that the foundation of any balanced investment plan begins and ends with the synchronization of the client's objectives and preferences with the overall asset allocation. Each client's time horizon, risk tolerance, asset base, investment objectives, cash flow needs, and tax position are unique to them. Asset allocation is a dynamic process that must adapt as client circumstances and market conditions change.

For clients that select LMIC's balanced investment strategy, LMIC creates guidelines and a framework for strategic and tactical asset allocation ranges for the following variants of the strategy:

- Balanced Growth
- Balanced Growth & Income
- Balanced Income

LMIC allocates accounts in these balanced categories across equity and fixed income investments and cash equivalents.

**Main Risks.** The main risk of balanced accounts are a combination of the main risks described above for LMIC's Core Equity investment strategy and Core Fixed Income strategy. See Appendix B to this brochure for explanations of these risks.

### ***SRI Investment Strategies***

LMIC's Socially Responsive Investment ("SRI") Department offers socially responsive equity, balanced and fixed income investment strategies for which certain non-SRI investment strategies described or identified in this Item 8 serve as the foundations. In developing and implementing these SRI investment strategies for client accounts, the SRI Department seeks competitive risk-adjusted returns, while reflecting the unique social goals of each client. The SRI Department's dedicated team of social research analysts conducts proprietary social research on domestic and international companies and issues. The social research team evaluates each security considered for purchase using a comprehensive social analysis method. The social research team applies customized guidelines to help LMIC's portfolio managers eliminate companies that do not meet the client's specific social requirements and select investments that do. When providing fixed income investment strategies, the

team generally applies social research analysis only to corporate issuers and not to governmental issuers.

**Main Risks.** The main risks associated with SRI investment strategies are the main risks associated with the non-SRI investment strategies that serve as the foundation of the SRI investment strategies.

### ***Global Total Return***

LMIC's Global Total Return Department offers the Global Total Return equity investment strategy. This strategy is a concentrated strategy focused on investment in companies serving rapidly expanding markets and capitalizing on themes that are currently visible. The strategy seeks to add value through the portfolio managers' judgment and discipline rather than replicating a global index. Global Total Return has both a growth and income goal; the ability to show sustainable dividend growth is a key criterion for equity selection.

Through rigorous, fundamental analysis, the Global Total Return portfolio managers seek to invest in companies that:

- Are well-established with experienced managements and quality corporate governance practices
- Have leading, long-lasting competitive positions in their industry
- Generate substantial and stable cash flows
- Demonstrate the potential for sustained dividend growth
- May be of any market capitalization, although investment in companies with market caps below \$500 million will be limited.

Stocks become sale candidates if cash flows deteriorate, the country has deteriorating political or economic situations, the stock appreciates to more than 10% of the portfolio, desired valuation is not reached within a reasonable timeframe, or an unanticipated event changes the portfolio managers' outlook on the stock.

**Main Risks.** The main risks associated with the Global Total Return equity investment strategy are General Investment Risk, Industry, Issuer and Geographic Concentration Risk, Non-U.S. Investment Risk, Mid Cap Risk, and Small Cap Risk.

### ***Multi-Cap Core Equity***

LMIC's Multi-Cap Core Department offers the Multi-Cap Core Equity investment strategy. The investment team invests primarily in small and mid-capitalization companies for client accounts that select this strategy. The investment team may also make investments in large capitalization companies for such accounts and may invest primarily in such companies when it believes market conditions warrant such an approach. The investment team stresses current earnings in selecting stocks for this strategy, believing that stock performance ultimately follows earnings performance. The investment team generally will not consider a company for investment unless it has a history of real earnings and the prospect of a positive ongoing earnings stream. Based on the team's interpretation of various fundamental factors, the team may concentrate the strategy's investments in certain sectors. Also, the

team generally will consider selling an investment in a company if the company falls short of the team's forecasted earnings.

**Main Risks.** The main risks for the Multi-Cap Core Equity investment strategy are General Investment Risk, Small Cap Risk, Mid Cap Risk, Industry and Industry Concentration Risk and High Volatility Risk. See Appendix B for explanations of these risks. The investment team seeks to reduce risks that are issuer-specific by investing no more than 5% (calculated at time of investment) of the equity portion of a client account in an individual stock. Also, the team seeks to reduce risk by focusing on high quality company investments with earnings streams.

### ***Large Cap Value Equity Wrap***

LMIC's Wrap Department offers the Large Cap Value Equity Wrap investment strategy, which seeks to outpace the long-term returns of the Russell 1000 Value Index, while adhering to a value-based investment philosophy. Utilizing investment strategy and ideas generated by LMIC's affiliate, Brandywine Global Investment Management, LLC ("Brandywine"), LMIC structures a portfolio in this strategy with regard to diversification, balance and general economic sensitivity, focusing on strong companies and industry leaders.

Companies are identified with consistent value characteristics such as low P/E, low P/B and low P/C from which to build a portfolio. Initial screens highlight stocks that are cheap. Current and historical valuations are compared, along with other measures of value, to find stocks priced below normal valuation. Fundamental analysis seeks to identify stocks with the ability to return to normal value.

**Main Risks.** The main risks associated with the Large Cap Value Equity investment strategy are General Investment Risk, Industry and Issuer Concentration Risk, and Non-U.S. Investment Risk.

### ***International ADR Equity Wrap***

LMIC's Wrap Department offers the International ADR Equity Wrap investment strategy, which seeks to outperform the total return of the MSCI EAFE (net) Index over a fully market cycle of 3 to 5 years. This investment strategy is based on investment strategy and ideas generated by LMIC's affiliate, ClearBridge Investments, LLC ("ClearBridge"). ClearBridge engages in both quantitative and fundamental analysis and identifies publicly-traded securities with market capitalizations greater than \$100 million from developed and emerging countries. ClearBridge seeks ADRs of foreign companies that are trading below normal valuation levels and that have catalysts in place to spur a return to normal valuation. An ADR in this strategy becomes a sale candidate if it appreciates to its target price based upon ClearBridge's estimate of the intrinsic value of the company's business, the risk/reward tradeoff of a new investment appears more favorable, or a successful recovery fails to materialize causing a fundamental change in ClearBridge's assessment of the security's upside potential.

**Main Risks.** The main risks associated with the International ADR Equity investment strategy are General Investment Risk, Non-U.S. Investment Risk, Small Cap Risk and Mid Cap Risk. See Appendix B for explanations of these risks.

### ***Quality Growth Equity Wrap***

LMIC's Wrap Department offers the Quality Growth Equity Wrap investment strategy, which seeks to outperform the S&P 500 Index through rigorous stock selection based upon proprietary research and fundamental analysis combined with a top-down approach to portfolio construction. LMIC bases sector weightings, which may differ significantly from those of the S&P 500 Index, on fundamental factors such as the macroeconomic background, the political/regulatory environment, and demographic trends, combined with quantitative factors such as relative sector growth, relative strength and valuation. Fundamental research drives individual stock selection and focuses on companies with market capitalizations greater than \$1 billion.

Main Risks. The main risks associated with the Quality Growth Equity Wrap investment strategy are General Investment Risk, Mid Cap Risk, Industry and Issuer Concentration Risk and Non-U.S. Investment Risk. See Appendix B to this brochure for explanations of these risks.

### ***Select Third Party Managers for Non-Core Asset Classes***

To complement LMIC's core investment strategies, LMIC employs third party investment managers who focus on specific asset classes or styles of management and who LMIC believes execute those strategies particularly well. LMIC typically accesses third party managers via mutual funds, private investment funds or other collective investment vehicles, including without limitation real estate investment trusts ("REITs"), managed by such managers. LMIC may also access such managers by retaining them as subadvisers to manage client assets. LMIC often uses third party managers for the following asset classes:

- Small Cap Equity
- Developed International Equity
- Emerging Markets Equity
- Commodities
- Alternative Investments
- Real Estate
- High Yield (Junk Bond) or Distressed Debt

Manager Selection Process. LMIC's manager selection process focuses on philosophy, process and people, which LMIC believes are the three determinants of the investment performance LMIC seeks for clients. LMIC's Third Party Committee, a group of LMIC investment professionals, is charged with selecting third-party managers, which may be affiliated or unaffiliated with LMIC. The Committee members consider both quantitative and qualitative factors, including past returns, volatility and risk levels, fees (12b-1 distribution fees generally are not acceptable), soundness of investment philosophy, investment personnel experience, ability to interact with LMIC to facilitate LMIC servicing of clients, durability of manager business model, and correlation characteristics with other investment strategies represented in client accounts. The relative importance they assign to different factors may vary depending upon the asset class and style being considered. The Third Party Committee or an LMIC investment professional designated by the Committee tracks investment performance of selected third-party managers.

LMIC investment analysts screen manager databases such as Morningstar for performance characteristics and risk attributes over multiple timeframes. The analysts look for consistent, above-

average returns versus the relevant benchmark(s) and peer group(s) as measured by total return and risk-adjusted return.

In addition, LMIC seeks consistency of philosophy and process. LMIC uses screens to avoid or eliminate managers that exhibit philosophical inconsistencies.

For selected managers, significant and protracted underperformance versus benchmarks and peer groups, changes in investment personnel, changes in corporate ownership, significant style drift or negative regulatory action will trigger a formal review to determine whether approval should be removed or whether a better manager within the applicable style or asset class is available.

LMIC's Third Party Committee at least annually reviews and confirms the continued appropriateness of third party managers, including those that are affiliated with LMIC.

When LMIC uses third party managers in connection with its Core Equity investment strategy, the strategy may be referred to as "Core Equity Plus."

**Main Risks.** LMIC's use of third party managers, whether affiliated or unaffiliated with LMIC, may subject clients to the investment risks identified and explained on Appendix B to this brochure, depending on the types of investments and investment strategies used by such managers. Such risks may include, without limitation, Below Investment Grade Risk, Emerging Market Risk, REIT and Real Estate Risk, Derivatives Risk, Private Placement Risk, Non-U.S. Investment Risk, Small Cap Risk, Mid Cap Risk, and Short Selling Risk.

### **C. Certain Additional Information**

**Family Office Services.** LMIC provides family office services to certain clients. Family office services may include (i) administrative services such as interacting with custodians to effect disbursements for clients, (ii) special services such as administering payrolls for clients and concierge services, and (iii) tax preparation and reporting services. Family office services may also include one-time or ongoing investment manager evaluation or recommendation services. LMIC will have a conflict of interest when evaluating or recommending any of its affiliates as an investment manager, but intends to perform such evaluations and make such recommendations solely in the interests of clients. LMIC may delegate certain family office services to third parties or may refer clients directly to the providers of such services. LMIC will not be responsible for a third party's provision of services.

**Financial Planning.** LMIC provides financial planning services to certain clients. Financial planning services typically involve preparing, recommending and helping to implement a multifaceted financial road map for a client based on the client's specific financial circumstances and objectives. The program may cover present and anticipated cash flows, assets and liabilities and may include liquid and illiquid financial investment assets, privately-held business assets, trusts, insurance, and anticipated retirement and/or other employee benefit plans. LMIC may support a recommended financial program by providing any one or more of several financial services, including: investment advisory/management (including concentrated holdings strategies); executive compensation plan supervision; estate and tax planning; trust advisory; generational planning and philanthropic planning.

A client's financial plan is updated and revised periodically or as circumstances warrant. LMIC may provide financial planning services together with certain third parties that have expertise in certain specialties, such as insurance. LMIC is not responsible for advice or services provided by such third parties.

**Fund Investments--Generally.** Unless otherwise agreed with a client, LMIC may invest any client account partly or wholly in shares of mutual funds, exchange-traded funds (“ETFs”), private investment funds and other collective investment funds (collectively, “Funds”), including funds that invest in other funds and funds managed by LMIC or its affiliates (“Affiliated Funds”). Although LMIC generally does not charge account-level fees on client assets invested in Affiliated Funds it manages, LMIC may have a conflict of interest when it invests client assets in such Affiliated Funds, as described in Item 11 of this brochure. In addition, as described in Item 11, LMIC will have a conflict of interest when it invests client assets in other Affiliated Funds.

Situations in which an LMIC portfolio manager may invest client accounts in Funds, including Affiliated Funds, include (i) to provide diversified investment exposure for smaller client accounts or account portions, and (ii) to provide investment exposure in areas where LMIC believes a Fund manager has greater expertise. See “**Select Third Party Managers for Non-Core Asset Classes**” above in Item 8 of this brochure for information on how LMIC selects Funds, other than Affiliated Funds managed by LMIC.

Affiliated Funds that LMIC manages are not subject to the selection process LMIC uses for other Funds. LMIC typically invests client assets in such Affiliated Funds to provide diversified investment exposure as described above or in response to a client request. The main risks of investments in the Affiliated Funds LMIC manages are as set forth below. See Appendix B to this brochure for explanations of these risks.

LMIC Social Awareness Fund & LMIC Variable Social Awareness Portfolio. General Investment Risk, Non-U.S. Investment Risk, Mid Cap Risk, Small Cap Risk, Credit Risk, Interest Rate Risk, Illiquidity Risk, and Prepayment Risk.

LMIC Financial Services Fund. General Investment Risk, Financial Services Risk, Concentration Risk, Non-U.S. Investment Risk, Mid Cap Risk, Small Cap Risk, Illiquidity Risk.

LMIC Maryland Tax-Free Income Trust. General Investment Risk, Credit Risk, Interest Rate Risk, Concentration Risk, Illiquidity Risk, Prepayment Risk.

**LMIC’s Mutual Fund Program.** LMIC may also invest client assets in mutual funds as part of a mutual fund investment program in which LMIC maintains and periodically updates multiple model portfolios, each reflecting a different combination of investment objectives, risk tolerance, and recommended asset allocation. For accounts in the program, LMIC will satisfy recommended asset allocations using unaffiliated mutual funds selected by LMIC’s Third Party Committee. LMIC expects to periodically rebalance accounts in the program as it deems necessary and advisable to reflect factors such as changes in recommended asset allocations and account investments moving outside a recommended asset allocation range because of market action or account withdrawals or contributions. The standard fee schedule for accounts in this program will be as described in Item 5 of this brochure for Mutual Funds, Private Investment Funds and Other Collective Investment Funds.

**Margin Loans.** A client’s custodian may permit a client to take out a loan secured by assets in the client’s account. Such loans are referred to as “margin loans.” Clients should understand that, if they obtain margin loans secured by assets in their accounts, the custodian generally will be able to liquidate all or part of the account at any time to repay any portion of the loan, even if the timing of the

liquidation is disadvantageous to the client and disrupts LMIC's management of the account. LMIC does not have any responsibility for (i) a client's decision to take out a margin loan, (ii) the terms of any margin or related agreement to which a client is a party, or (iii) the sale, liquidation, or disposition of securities in the client's account in order to satisfy the client's obligations under such an agreement.

## **ITEM 9. DISCIPLINARY INFORMATION**

There are no reportable legal or disciplinary events for LMIC or its employees.



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**ITEM 10. OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

LMIC has the following business arrangements with affiliates that clients may wish to consider:

- (1) Legg Mason Investor Services, LLC. Legg Mason Investor Services, LLC (“LMIS”), a limited purpose broker-dealer, serves as the principal underwriter for investment companies LMIC manages as a subadviser. LMIC and LMIS are wholly owned subsidiaries of Legg Mason, Inc. A small number of LMIC’s employees, including certain members of management, are registered with FINRA as registered representatives of LMIS and may actively market LMIC-subadvised mutual funds. However, employees do not receive sales commissions from LMIS.
- (2) Legg Mason Investment Counsel Investment Companies. Pursuant to agreements with its affiliate, Legg Mason Partners Fund Advisor, LLC (“LMPFA”), LMIC serves as investment subadviser to the Legg Mason Investment Counsel Maryland Tax-Free Income Trust, the Legg Mason Investment Counsel Financial Services Fund, the Legg Mason Investment Counsel Social Awareness Fund and the Legg Mason Investment Counsel Variable Social Awareness Portfolio. LMIC receives a fee from LMPFA for the investment subadvisory services it provides to these investment companies. As a result, LMIC will have an incentive to maximize its affiliates’ fee revenue, and potentially its own, by investing client assets in these investment companies and in investment companies managed by its affiliates instead of investment companies managed by unaffiliated firms. LMIC addresses this conflict of interest as described in Item 11 of this brochure.
- (3) Brandywine Global and ClearBridge. LMIC has entered into agreements with its affiliates, Brandywine Global Investment Management, LLC (“Brandywine Global”) and ClearBridge Investments, LLC (“ClearBridge”) pursuant to which Brandywine Global and ClearBridge each provide LMIC with model investment portfolios in exchange for compensation from LMIC. LMIC pays this compensation and uses these model investment portfolios to provide the Large Cap Value Equity Wrap and International ADR Equity Wrap investment strategies (described in Item 8 of this brochure) to clients.
- (4) Legg Mason Investment Counsel Special Investment Series Fund, LLC. LMIC has established the Legg Mason Investment Counsel Special Investment Series Fund, LLC (the “SIS Fund”), a private investment fund of which LMIC is the manager and investment manager. LMIC established the SIS Fund to provide eligible clients an efficient means of accessing investments that might otherwise be available only to investors at significantly larger minimum investment amounts. Eligible clients may grant LMIC the discretion to increase or decrease their initial investment in the SIS Fund. LMIC charges the SIS Fund a fund-level fee and does not charge clients that invest in the Fund account-level fees with respect to account assets invested in the Fund. If the fund-level fee rate is greater than the client’s account-level fee rate, LMIC will have an incentive to increase a client’s investment in the SIS Fund and to recommend that a client initially invest in the Fund. In addition, LMIC will have an incentive to make such investments and recommendations in order to spread the organizational costs and other internal expenses of the SIS Fund over a larger number of investors and thereby reduce the impact of such costs and expenses on clients that invest. LMIC addresses these conflicts of interest as described in Item 11 of this brochure.

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- (5) Legg Mason Investment Counsel & Trust Company, N.A. LMIC shares its management, investment and other personnel, as well as other resources, with its direct parent company, Legg Mason Investment Counsel & Trust Co., N.A. (“LMIC&T”), which is a wholly-owned subsidiary of Legg Mason, Inc. LMIC&T is a nationally-chartered trust company that is regulated by the U.S. Office of the Comptroller of the Currency. LMIC&T provides its clients with trustee and investment advisory services. LMIC and LMIC&T together comprise the “Legg Mason Investment Counsel” business unit and their business and investment operations are significantly integrated. Conflicts may arise between the interests of LMIC&T clients and LMIC clients in connection with the allocation of partially filled trade orders. As described in Item 12 of this brochure, LMIC and LMIC&T address the possibility of such conflicts by allocating partially-filled trade orders in a manner designed to treat all clients fairly.
- (6) LMM LLC Services Arrangement. LMIC has an arrangement with LMM LLC (“LMM”), an affiliated investment adviser, pursuant to which LMIC provides LMM with certain non-advisory business services. These services include assistance with trading, operations, compliance, and technology. LMIC and LMM also share certain LMIC employees that are involved in providing compliance and trading services.

## ITEM 11. CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING

### A. Code of Ethics

LMIC is committed to maintaining the highest standards of professional conduct and ethics. LMIC employees are subject to the LMIC Code of Ethics (the “Code”), which is based on the principle that LMIC personnel owe a fiduciary duty to clients and must avoid activities, interests and relationships that might interfere with making decisions in the best interests of clients. The Code includes: (1) mandatory standards of business conduct; (2) a requirement to comply with applicable federal securities laws; (3) reporting of personal securities accounts and transactions to LMIC’s Compliance Department, subject to certain exceptions; and (4) a requirement to report violations of the Code to LMIC’s Compliance Department. The Code also imposes preclearance and blackout requirements on employee personal securities transactions in certain situations (AKIA personnel are exempt from these requirements but their personal securities transactions are subject to maximum daily size limits intended to prevent such transactions from adversely affecting any trades AKIA effects in the same or related securities for AKIA clients).

Existing and prospective clients may request a copy of the Code by mailing a written request to:

Legg Mason Investment Counsel, LLC  
100 International Drive, 5<sup>th</sup> Floor  
Baltimore, MD 21202  
Attention: Compliance Department

### B. Discussion of Potential Conflicts of Interest Associated with Employee Personal Trading

Subject to the requirements of LMIC’s Code, LMIC employees may make personal investments in the same securities LMIC invests in for client accounts, as well as in securities that LMIC does not invest in for client accounts. Employees may also make personal investments in related securities or financial instruments, such as options, futures and warrants. LMIC employees may make personal investments at or about the same time LMIC is making the same investments or related investments for client accounts. These possibilities involve potential conflicts between client interests and the personal interests of the employees – i.e., the potential that employee trades in a security will compete with client trades for the same or related securities or otherwise adversely affect the prices obtainable for client trades. LMIC believes that, for the liquid larger cap securities that constitute LMIC’s primary investments for clients, the risk of employee personal trading and associated conflicts disadvantaging clients is small or nonexistent because neither employee trades nor client trades generally are large enough to significantly affect market prices.

LMIC addresses the potential conflicts presented by employee personal trading by prohibiting employee personal trades that have a higher risk of affecting securities prices. Specifically, the Code prohibits personal trades of all sizes in certain, generally less liquid securities (equity securities of certain small cap companies, municipal fixed income securities) when LMIC has open orders at its trading desk for the same or related securities, subject to certain exceptions described in the Code. LMIC subjects personal trades in certain generally more liquid securities, such as corporate bonds and

equity securities of larger cap companies, to this prohibition only if the trade size exceeds de minimis amounts specified in the Code.

### **C. Discussion of Potential Conflicts of Interest Associated with Affiliated Fund Investments**

As part of LMIC's investment advisory services, LMIC may invest client assets in shares of mutual funds, private investment funds or other collective investment vehicles for which LMIC or one or more LMIC affiliates act as investment manager, distributor or other service provider ("Affiliated Funds"). See Item 8 of this brochure for information on the circumstances in which LMIC may invest client assets in Affiliated Funds.

Although LMIC does not charge account-level fees on client assets it invests in Affiliated Funds managed by LMIC, LMIC will have a conflict of interest when making such an investment if the aggregate fee rate payable by such Affiliated Fund to LMIC and its affiliates exceeds the rate of the account-level fee LMIC would receive if LMIC did not make the investment.

If permitted by applicable laws, LMIC does charge account-level fees on client assets it invests in Affiliated Funds managed by its affiliates. These account-level fees are paid to LMIC and are in addition to the Affiliated Fund-level fees that LMIC's affiliates receive from these investments. The aggregate fees received by LMIC and its affiliates from such investments typically will exceed the account-level fees that LMIC would receive if LMIC did not make such an Affiliated Fund investment.

In the above scenarios, LMIC will have an incentive to make and hold investments in Affiliated Funds for clients in order to maximize the aggregate compensation to LMIC and its affiliates. In addition, as described in paragraph (4) of Item 10 of this brochure, LMIC will have an incentive to recommend and make client investments in the SIS Fund in order to reduce the impact of that Affiliated Fund's organizational costs and other expenses on the Fund's performance. LMIC addresses the conflicts of interest presented by these incentives by selecting Affiliated Funds (and unaffiliated Funds) for investment based solely on the best interests of clients and without regard for the amount of compensation payable to LMIC and its affiliates in connection with such investments. As described in Item 8 of this brochure, LMIC's Third Party Committee at least annually reviews Affiliated Funds (other than Affiliated Funds managed by LMIC) that it has selected for investment to determine whether they continue to be appropriate investments. In addition, LMIC makes investments in Affiliated Funds managed by LMIC only to provide diversified investment exposure for smaller client accounts or in response to client requests for such investments. LMIC will comply with laws applicable to the investment of client assets in Affiliated Funds.

## ITEM 12. BROKERAGE PRACTICES

This Item 12 contains information on:

- How LMIC selects broker-dealers to execute securities trades for client accounts, including how LMIC uses client commissions to pay for and obtain research services (Sections A and B below);
- The types of research services LMIC receives from executing broker-dealers and how LMIC uses these services to benefit client accounts (Section B below);
- The conflict of interest LMIC is subject to when it considers research in selecting broker-dealers to execute trades and how LMIC addresses this conflict (Section B below);
- LMIC's directed brokerage practices, including the potential consequences of a client directing LMIC to use a specific broker-dealer to execute trades (Section C below);
- The circumstances in which LMIC may combine securities trades of multiple clients into aggregated trade orders, including potential costs to clients when LMIC does not aggregate trades (Section D below);
- LMIC's recommendation of executing broker-dealers and custodians to clients and related conflicts of interest LMIC may have (Section E below); and
- LMIC's Trade Error Correction Policy (Section F below).

### A. How LMIC Selects Which Broker-Dealers to Use

To the extent practical and consistent with client directions and applicable laws, LMIC seeks to obtain best execution when selecting broker-dealers to execute securities trades for client accounts. LMIC defines best execution as placing trades such that, considering all appropriate circumstances, the value of LMIC's investment decisions is maximized over time for clients. For equity securities trades, commission cost is one factor considered, but is not determinative. In seeking best execution for such trades, LMIC typically gives significant consideration to research it receives from broker-dealers, as described in this Section A and in Section B below. LMIC does not consider research in selecting broker-dealers to execute fixed income securities trades.

LMIC generally selects broker-dealers to execute securities trades only if LMIC's Investment Policy Committee (the "Committee") has approved the broker-dealer. The Committee, which meets quarterly, oversees LMIC's brokerage practices and is comprised of LMIC's Chief Executive Officer, Chief Investment Officer, Head Trader, Chief Administrative Officer, Chief Compliance Officer, and selected LMIC portfolio managers.

LMIC investment and trading personnel may propose broker-dealers for Committee approval for reasons that include the broker-dealer's execution capabilities, expertise and personnel, and also research provided by the broker-dealer (in the case of broker-dealers proposed for equity securities

trading). The Committee typically considers these factors, as applicable, and also information regarding the proposed broker-dealer's financial position.

Unless otherwise noted, orders LMIC portfolio managers place with LMIC's Trading Desk to buy or sell securities are considered not-held orders, and are placed for execution with an approved broker-dealer at the discretion of an LMIC trader. The factors LMIC traders consider when selecting broker-dealers to execute securities trades and seeking best execution generally are as follows:

- Competitiveness of commission rates for equity trades and of spreads for fixed income trades.
- Research provided – as described in Section B below, considered via (i) ratings of executing broker-dealers assigned by LMIC research analysts, (ii) target commission amounts LMIC sets for soft dollar arrangements, or (iii) LMIC portfolio manager broker-dealer preferences (LMIC considers research only for equity trades LMIC effects as a discretionary manager).
- Speed and accuracy of trade execution.
- Broker-dealer commitment of own capital as necessary.
- Ability to execute block trades without significant market impact (see Section D below).
- Electronic trading, reporting and clearing capabilities.
- Back office clearing and settlement capabilities and responsiveness.
- Specialty abilities in particular markets and securities.
- Broker-dealer familiarity with LMIC investment focus.
- Broker-dealer provision of useful market information.

Not all factors are considered for every trade. LMIC determines the reasonableness of commissions charged by considering commission rates then prevailing in the market for similar-sized trades in similar securities, as well as the overall quality of the trade execution services provided for the benefit of LMIC's clients. In addition, as described in Section B below, LMIC considers the value of research it receives.

LMIC's fixed income traders seek best execution for fixed income securities trades by placing dealers in competitive situations and utilizing offers and bids from numerous local and national broker-dealers. The fixed income traders review the market environment, the new issue calendar, and secondary offerings to help determine a competitive price for the bonds they are trading. Generally, LMIC contacts at least three broker-dealers when buying or selling a fixed income security. By seeking to hit the highest bid when selling securities, or selecting the broker-dealer with the lowest-priced offers, LMIC generally seeks to ensure that clients obtain best execution on fixed income securities trades.

The Committee conducts a quarterly review of LMIC trading for clients, which includes review of (i) LMIC's allocation of transactions and commissions to broker-dealers, (ii) commission rates paid, (iii) LMIC research analysts' ratings of broker-dealers (see Section B below), (iv) soft dollar arrangement-related transactions (see Section B below), and (v) LMIC traders' ratings of executing broker-dealers on certain best execution-related factors.

## **B. LMIC's Use of Client Commissions to Obtain and Pay For Research**

As noted in Section A above, LMIC regularly receives research from broker-dealers it uses to execute securities trades for client accounts. For equity trades, LMIC generally considers the value of such research in selecting broker-dealers to execute trades and in determining the reasonableness of the

commissions charged (in addition to other factors described in Section A above). LMIC considers the value of research by considering:

- soft dollar arrangements LMIC has established,
- ratings LMIC's research analysts assign to executing broker-dealers based on research services these broker-dealers have provided, or
- for certain equity investment strategies, research-based broker-dealer preferences communicated by the strategy's portfolio manager.

For certain equity securities trades, LMIC's traders consider target commission amounts that are part of soft dollar arrangements LMIC has established with certain executing broker-dealers. Each arrangement includes an annual target commission amount that LMIC seeks, but is not obligated, to cause client accounts to pay the broker-dealer in return for trade execution and research that is used to benefit clients as described below. The soft dollar arrangements are structured to comply with the safe harbor under Section 28(e) of the Securities Exchange Act of 1934, which permits an investment adviser to pay more than the lowest available commission in return for trade execution and eligible research if the investment adviser determines in good faith that the commissions paid are reasonable in relation to the value of the brokerage and research provided, viewed in terms of the specific trade or the investment adviser's overall responsibilities to client accounts. LMIC's Investment Policy Committee approves and periodically reviews the arrangements, including the target commission amounts and research services, and periodically reviews the arrangements to determine that the commissions paid meet this reasonableness standard.

For certain equity securities trades for which LMIC does not consider soft dollar arrangements, LMIC's traders consider ratings LMIC's research analysts periodically assign to certain of LMIC's approved executing broker-dealers based upon research the broker-dealers have provided to them that aids in furthering LMIC's performance of its investment-decisionmaking responsibilities to clients.

For equity securities trades in certain LMIC investment strategies, LMIC does not consider soft dollar arrangements or analyst ratings in selecting broker-dealers to execute equity securities trades, but instead may consider research-based preferences communicated by the strategy's portfolio manager.

The commissions LMIC causes client accounts to pay to obtain or pay for research (and trade execution services) as described in this Section B typically are higher than they would be if LMIC did not consider research in selecting brokers to execute trades. LMIC does not require that research obtained or paid for with commissions be used only to benefit the accounts that paid the commissions, and accounts may not benefit from research paid for by their commissions. LMIC generally uses research obtained or paid for with commissions to benefit a broad range of client accounts. LMIC does not seek to allocate the benefits of research obtained or paid for with commissions to client accounts in proportion to the commissions such accounts paid for such research.

However, LMIC generally seeks to cause a broad range client accounts to pay commissions to obtain or pay for research so that client accounts do not receive the benefits of the research without having to contribute to its cost. An exception to this approach applies for clients for whom the use of a specific executing broker is directed, as described in Section C below. Although accounts of these clients



generally do not contribute to the cost of research obtained or paid for with LMIC client commissions, these accounts typically do receive the benefits of such research.

For a client that pays its custodian an asset-based fee for services that include trade execution, LMIC's practice of seeking to have a broad range of client accounts contribute to the cost of research through commissions may result in the client paying commissions that are in addition to the asset-based fee. This is because LMIC may cause equity trades for accounts of these clients to be executed with broker-dealers that provide research and charge transaction-based commissions, even though these accounts could have had such trades executed by their custodian firms at no additional charge. LMIC follows this approach for clients that pay asset-based fees to Charles Schwab & Co., Inc. for custody and trade execution services. See also Item 14 of this brochure. LMIC believes this approach, while involving higher costs for clients with such accounts, is fair and consistent with best execution since these accounts generally benefit from the research LMIC obtains and pays for with client commissions.

When LMIC uses client commissions to pay for or obtain research, LMIC receives a benefit since it does not have to produce the research itself or pay for the research with its own money. As a result, LMIC may have an incentive to select a broker-dealer based on its interest in receiving research, rather than on clients' interest in receiving best execution.

The research LMIC obtains and pays for with client commissions may only include:

- Advice as to the value of securities, the advisability of investing in, purchasing or selling securities, and the availability of securities or purchasers or sellers of securities; and
- Analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy and the performance of accounts.

Specific types of research LMIC obtains and pays for with client commissions consist of: (i) fundamental, quantitative and technical issuer, industry, sector, market, economic and policy research reports and analyses, (ii) portfolio strategy research, and (iii) meetings and calls with company management representatives and analysts. The research is generated by either an executing broker-dealer or a third party.

Under LMIC's policy, research paid for with client commissions must be eligible under the Section 28(e) safe harbor and must be used only to provide lawful and appropriate assistance to LMIC's performance of its investment decision-making responsibilities. LMIC's Investment Policy Committee may allocate a portion of an eligible research service subject to a soft dollar arrangement to client commissions (i.e., soft dollars) and a portion to hard dollars (i.e., LMIC's own money). A research service for which LMIC makes such an allocation may be referred to as a "mixed-use" service. Any allocation for a mixed-use service will be in proportion to LMIC's good faith estimate of the value of the service for investment decision-making assistance purposes and the value of the service for non-28(e)-eligible purposes, such as client communications. The Committee will have a conflict of interest in making this allocation, given that LMIC by definition will pay hard dollar costs out of its own pocket. The Committee will record in writing all mixed-used service allocation decisions and will periodically review such decisions to confirm that they continue to be appropriate.



### C. LMIC's Practices When a Client Directs Brokerage

If a client or wrap fee program sponsor directs LMIC to use a specific broker-dealer to execute securities trades, LMIC will place trades for the applicable account(s) with such broker-dealer. In certain wrap fee programs, sponsor or client directions to use a specific broker-dealer may be subject to LMIC's right to execute trades with different broker-dealers (i.e., trade away) if LMIC believes doing so would provide better execution or would satisfy a similar standard. However, if LMIC determines that trading away is too difficult as an operational matter or is not permitted by the program sponsor, LMIC will treat the direction as a direction to use the specified broker-dealer without regard for best execution and will cause trades to be executed only with this broker-dealer. LMIC follows this approach for the Manager Select Account and Manager Access Select programs of LPL Financial LLC and the Managed Assets Program of Independent Portfolio Consultants, Inc.

LMIC will treat a direction to use a specific broker-dealer as a decision by the client/sponsor to retain, to the extent of the direction, the discretion that otherwise would be given by the client to LMIC to select broker-dealers to effect transactions and the other terms of the trade for the client's account. In some cases, the client/sponsor may have negotiated the commissions to be charged by the designated broker-dealer.

When clients or their wrap fee program sponsors direct LMIC to use a specific broker-dealer to execute securities trades:

- LMIC will not negotiate the broker-dealer's trade execution services or compensation for such services on behalf of the client account.
- LMIC will not be in a position to, and will not, monitor for best price and execution of trades the broker-dealer executes for the client account.
- The prices and execution quality achieved for the account may be less favorable, including more costly to the client account, than the prices and execution quality LMIC achieves for other client accounts. In other words, directed brokerage may cost clients more money.
- LMIC will not be able to aggregate trade orders of such client accounts with trade orders of other client accounts, and this may prevent LMIC from being able to reduce trading costs for directed brokerage accounts.
- LMIC generally will place trades for such accounts after placing trades for client accounts that do not direct LMIC to use a specific broker-dealer. This may result in directed brokerage accounts receiving worse prices on securities trades than other accounts. Also, due to wrap fee program operational requirements, LMIC tends to complete placing trades for accounts in wrap fee programs after trades for other directed brokerage accounts are completed.

In addition, LMIC's business relationship with a sponsor firm or broker-dealer may give LMIC an incentive to recommend that a client or sponsor firm issue or continue such a direction, as described in Section E below. Conversely, LMIC's interest in receiving research paid for with client commissions, instead of LMIC's own money (see Section B above), will give LMIC an incentive to recommend that a client or sponsor firm terminate such a direction. A client or sponsor firm may terminate a direction to use a specific broker-dealer by notifying LMIC in writing.

## D. Trade Aggregation and Allocation

LMIC's policy is to treat all client accounts for which it exercises investment discretion impartially. If LMIC's trading desk receives (from one or more LMIC portfolio managers) multiple orders for the same security on the same side of the market at the same time, the trading desk typically will block the orders together in order to minimize execution costs and seek best execution. Because portfolio managers manage accounts individually, however, the trading desk often will not receive such orders at the same time and therefore will not block or aggregate the orders.

If an aggregated order is executed in multiple trades at varying prices, each client account participating in the order receives the average price. Circumstances may exist where LMIC may decide that exceptions to its standard approach of aggregating are appropriate, such as with multiple large trades that may create an adverse market impact. In addition, trades for wrap fee program clients and clients who direct their brokerage to specific brokers-dealer generally will not be aggregated with those of clients for which LMIC selects the executing broker-dealer. As a result, these clients may incur greater trading costs and receive less favorable execution.

Most of LMIC's investments are in highly liquid securities. Aggregated orders LMIC places for such securities typically are completely filled on the day the order is placed—i.e., the aggregate amount of securities desired to be purchased or sold is actually purchased or sold. However, there may be circumstances in which aggregated trade orders are only partially filled. LMIC allocates partially filled orders pro rata, based on the amounts sought for participating client accounts, or in another manner that LMIC concludes is fair and equitable to each client, including any participating LMIC&T client accounts. Pro rata allocations will be subject to any minimum acceptable amounts for each account. If the pro rata allocations result in odd block sizes, they will be rounded to the nearest acceptable block size. If the order is only partially filled and the securities would be insignificant if spread over all accounts participating in the trade, LMIC will remove an entire account objective from the trade. In this way, the amount of bonds or shares of equity securities purchased or sold is significant to the accounts participating in the trade, and accounts with the same investment objective are treated equally. If LMIC bases the allocation on reasons other than the preceding, it will maintain a record of this decision, which includes a description of the reasons that the general allocation policy was not followed.

The usual practice of LMIC portfolio managers when submitting equity securities orders to LMIC's trading desk is to specify the client account or accounts for which the order is being submitted, including the amount of equity securities to be purchased or sold for each participating account. For fixed income securities trades, a portfolio manager may also follow this approach or may initially specify only an aggregate amount of the securities desired to be purchased without specifying the accounts for which the securities are sought. This aggregate amount may be based on an acceptable position size for all accounts managed by the portfolio manager and then estimated by the portfolio manager to be eligible for the purchase. When the securities are obtained in this situation, the portfolio manager will then allocate them across such accounts, generally on a pro rata basis but subject to account-specific considerations such as (i) applicable investment restrictions, (ii) account cash position, (iii) securities of issuer already held by account, and (iv) effect on account duration. These considerations may result in certain accounts initially estimated to be eligible for the purchase receiving more or less than a pro rata allocation, including in some cases no allocation at all.

## **E. Recommendation of Broker-Dealers and Custodians**

LMIC does not generally recommend clients to direct brokerage to particular broker-dealers, except that its Multi-Cap Core (“MCC”) Department may recommend that LMIC clients establish accounts with Pershing Advisor Solutions LLC and Pershing LLC (collectively, “Pershing”) as described below.

LMIC’s MCC Department may recommend that clients establish a prime brokerage account with Pershing. If a client establishes a prime brokerage account at Pershing, Pershing generally requires that approximately 50% of the client’s trades be directed to Pershing for execution. The MCC Department has a negotiated arrangement with Pershing pursuant to which Pershing receives commissions on a sliding scale depending on the number of shares being bought or sold. Clients that establish accounts at Pershing generally receive custody services from Pershing at no additional cost.

LMIC may recommend custodians to clients. Custodians typically are banks or broker-dealers. The factors LMIC considers in selecting custodians to recommend to clients include the level of fees such custodians will charge LMIC clients for custody services, the level of custody and account servicing such custodians provide to clients, and the manner in which such custodians interact with LMIC in its capacity as the client’s investment manager.

Certain custodians may refer investment advisory business to LMIC, provide products or services to LMIC, and/or provide LMIC with access to their representatives so that LMIC can promote its investment advisory services to such representatives. In this situation, LMIC may have a conflict between recommending a custodian in the client’s interest and recommending a custodian in order to obtain favorable terms on any such products or services or preserve or obtain additional referred business or promotion-related access.

For clients referred to LMIC in connection with the Schwab Advisor Network Service of Charles, Schwab & Co., Inc. (“Schwab”), LMIC has agreed with Schwab, if consistent with LMIC’s fiduciary duties to clients (i) to recommend that such clients custody their assets at Schwab, and (ii) not to solicit such clients to transfer custody of their assets to custodians other than Schwab.

See Item 14 of this brochure for additional information on LMIC’s participation in the Schwab Advisor Network Service, including information on Non-Schwab Custody Fees LMIC may be required to pay Schwab if a client transfers custody of its account from Schwab to another custodian. Such fees will pose a conflict of interest for LMIC. LMIC will have a financial incentive to recommend the client maintain custody, and/or continue maintaining custody, of the client’s assets at Schwab.

LMIC’s practice is to recommend custodians and broker-dealers solely in the interests of clients, taking into consideration the client’s individual situation and needs..

## **F. Trade Error Correction Policy**

In the event of a trade error attributable to LMIC, LMIC’s general policy is to place the client in the position it would have been in absent the error unless otherwise directed by the client. When an error is identified prior to settlement, LMIC normally will move the trade to its error account. In such cases, the profit or loss resulting from the reversing transactions will be owned by LMIC.

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**ITEM 13. REVIEW OF ACCOUNTS**

Client accounts are reviewed at least annually by the portfolio manager for the account. Portfolio managers may review multiple accounts together as part of a larger client relationship. Each review involves monitoring each account for adherence to client imposed investment guidelines, preferences, including tax situation, and restrictions, as well as adherence to appropriate investment allocations. On a monthly basis, or other frequency specified by the client, LMIC mails to each client a portfolio statement package reflecting, among other things, portfolio analysis, summary of holdings, cost and market value for the client's account.

The frequency and scope of the review for each account is based on a combination of the following factors: (i) the type of client; (ii) the nature of the client; (iii) the size and complexity of the relationship; (iv) the type of the client mandate; (v) the type of investment product(s) utilized; (vi) general market conditions and associated factors; (vii) specific client needs and objectives; (viii) turnover in investment management personnel; and (ix) change in client committee structure or management team.

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**ITEM 14. CLIENT REFERRALS AND OTHER COMPENSATION**

LMIC compensates certain persons for client referrals in the form of a portion of the fee the client pays for LMIC's investment management services. These persons may include LMIC affiliates, other investment advisers, broker-dealers, financial planners, and individuals, including clients. If these referrals materialize into new clients, LMIC will compensate the referring party for making the introduction. Compensation is generally based on a percentage of the client's annual management fee. The range of compensation has included a recurring payment of 20 – 50% of the client's annual management fee. The payment typically is made quarterly based on LMIC's billing cycle. Clients will not be charged additional fees as a result of any LMIC referral arrangements. Investment management fees, however, are negotiable based on a number of factors and therefore a client's fee may be higher or lower than the fee paid by other clients.

**Schwab Advisor Network Service**

LMIC receives client referrals from Charles Schwab & Co., Inc. ("Schwab") through LMIC's participation in Schwab Advisor Network® ("the Service"). Schwab is a broker-dealer independent of and unaffiliated with LMIC. Schwab does not supervise LMIC and has no responsibility for LMIC's management of clients' portfolios or LMIC's other advice or services. LMIC pays Schwab fees to receive client referrals through the Service. LMIC's participation in the Service may raise potential conflicts of interest described below.

LMIC pays Schwab a Participation Fee on all referred clients' accounts that are maintained in custody at Schwab and under certain circumstances may pay Schwab a Non-Schwab Custody Fee on referred Service accounts that are maintained at, or transferred to, another custodian. The Participation Fee paid by LMIC is a percentage of the fees the client owes to LMIC or a percentage of the value of the assets in the client's account, subject to a minimum Participation Fee. LMIC pays Schwab the Participation Fee for so long as the referred client's account remains in custody at Schwab. The Participation Fee is billed to LMIC quarterly and may increase, decrease or be waived by Schwab from time to time.

LMIC has agreed to pay Schwab a Non-Schwab Custody Fee if custody of a referred client's account is not maintained by, or assets in the account are transferred from, Schwab. This Fee does not apply if the client was solely responsible for the decision not to maintain custody at Schwab. The Non-Schwab Custody Fee is a one-time payment equal to a percentage of the assets placed with a custodian other than Schwab. The Non-Schwab Custody Fee is higher than the Participation Fees LMIC generally would pay in a single year. Thus, LMIC will have an incentive to recommend that client accounts be held in custody at Schwab.

The Participation and Non-Schwab Custody Fees will be based on assets in accounts of LMIC's clients who were referred by Schwab and those referred clients' family members living in the same household. Thus, LMIC will have incentives to encourage household members of clients referred through the Service to maintain custody of their accounts and execute transactions at Schwab and to instruct Schwab to debit LMIC's fees directly from the accounts.

For accounts of LMIC's clients maintained in custody at Schwab, Schwab will receive compensation from LMIC's clients in the form of commissions on securities trades executed through Schwab or in

the form of asset-based fees. Schwab will charge asset-based fees regardless of whether LMIC selects Schwab to execute trades. As described in Section B of Item 12 of this brochure, LMIC's practice of seeking to have a broad range of client accounts contribute to the cost of research will result in clients referred through the Service paying commissions to executing brokers that are in addition to the asset-based fee they pay to Schwab.

**ITEM 15. CUSTODY**

Although LMIC does not maintain actual custody of its clients' assets, in some cases clients give LMIC the authority to debit clients' custodial accounts for management fees or to transfer money to another person's account. In these situations, under SEC regulations, LMIC is deemed to have custody of client assets, even though the client's custodian maintains actual custody of those assets. LMIC is also deemed to have custody of client assets (i) in certain situations where an LMIC employee serves as trustee or executor of a client's account, and (ii) where such assets are invested in the LMIC SIS Fund,

Clients should carefully review the account statements they receive from their custodians and compare them to the account statements they receive from LMIC. Comparing statements will allow clients to determine whether account transactions, including deductions to pay investment advisory fees, are proper and in accordance with the terms of the client's investment advisory agreement with LMIC.

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**ITEM 16. INVESTMENT DISCRETION**

LMIC's standard investment advisory agreement grants the firm discretionary authority over client accounts. This authority authorizes LMIC to make purchase and sale decisions for client accounts or to select other advisers for the client. Alternatively, LMIC clients may enter into a non-discretionary agreement with clients. Under such agreement, LMIC must consult with clients before making any purchase and sale decisions for client accounts and receive client approval for the investment decision.

Clients may place limitations on LMIC's investment authority. For example, clients may ask LMIC not to invest in securities of particular investment classes, issuers, or sectors. Clients may ask LMIC not to invest in fixed income securities below a designated credit quality rating. Clients may place limitations with respect to a portfolio's weighted average maturity or duration, or asset allocation with respect to balanced portfolios. Clients may also ask LMIC not to sell certain securities in which they have previously invested.

A client's LMIC portfolio manager generally will work with the client to create an investment policy statement that will reflect the client's investment guidelines and objectives, and state any restrictions the client and LMIC agree to place on the account. LMIC generally does not create investment policy statements for clients in wrap fee programs, but instead manages accounts of such clients with reference to investment guidelines provided by the program sponsor.

Specific client investment restrictions may limit LMIC's ability to manage those assets like other similarly managed portfolios. This may impact the performance of the account relative to other accounts and the benchmark index.



## ITEM 17. VOTING CLIENT SECURITIES

LMIC's standard investment advisory agreement grants the firm proxy voting authority. Unless directed otherwise by the client, LMIC will vote all proxies for client accounts.

LMIC has adopted and implemented policies and procedures that it believes are reasonably designed to ensure that proxies are voted in the best interest of clients, in accordance with LMIC's fiduciary duties and SEC Rule 206(4)-6 under the Investment Advisers Act of 1940 ("Advisers Act"). In addition to SEC requirements governing advisers, LMIC's proxy voting policies reflect the long-standing fiduciary standards and responsibilities for ERISA accounts. Unless a manager of ERISA assets has been expressly precluded from voting proxies, the Department of Labor has determined that the responsibility for these votes lies with the manager.

In exercising its voting authority, LMIC will not consult or enter into agreements with officers, directors or employees of Legg Mason Inc. or any of its affiliates (other than Legg Mason Investment Counsel & Trust Company, N.A., which shares personnel and other resources with LMIC as described in Item 10 of this brochure) regarding the voting of any securities owned by its clients.

For accounts where LMIC has appointed a sub-adviser to manage the client account, LMIC shall deliver any proxies it receives to the sub-adviser for its exercise of voting rights, unless such sub-adviser expressly disclaims the voting of proxies. An account owner may direct LMIC to refrain from voting a specific security, and name themselves or another person to so vote, while LMIC retains voting authority over the other securities in the account.

With respect to shares over which LMIC has voting authority, LMIC will not decline to vote proxies except in extraordinary circumstances where LMIC believes that refraining from voting is in the client's best interests. Nor will LMIC accept direction from others with regard to the voting of proxies, although LMIC will take the investment guidelines of an account into consideration in deciding how to vote on a particular issue. LMIC may vote proxies related to the same security differently for different clients.

LMIC seeks to identify any material conflicts that may arise between the interests of LMIC and its clients. LMIC will maintain a log of significant client relationships that are issuers of publicly-traded securities that might become subject to a proxy vote. LMIC employees are to inform the Proxy Voting Committee or a member of LMIC's compliance group when an employee becomes aware of a conflict of interest that arises from that employee's personal relationships or in the conduct of LMIC's business. LMIC will consider a conflict to be material if it is significant enough to potentially influence or appear to influence LMIC's decision in the voting process.

Except for extraordinary circumstances, in any such instance, the material conflict will be resolved by the Proxy Voting Committee, voting in accordance with the previously established guidelines set forth by the Proxy Voting Committee. The Proxy Voting Committee may seek the advice or recommendation of an independent third party, in its sole discretion.

The Proxy Voting Committee will meet annually to review and approve proxy voting guidelines. Proxies will not be voted without an analysis of the underlying issues involved. LMIC's proxy voting policy at all times shall be directed toward maximizing the value of the assets of managed accounts, for the benefit of the accounts' ultimate owners or beneficiaries. Any item on a proxy that would tend to inhibit the realization of maximum value shall receive a negative vote from LMIC. Examples of such

items would be any activities that could be viewed as “poison pill” maneuvers. On other matters specific to a company, such as the election of directors, the appointment of auditors, granting of options, re-pricing of options, mergers and other material issues, a decision shall be made by the proxy voting vendor in accordance with the guidelines established by the LMIC Proxy Voting Committee, consistent with the policy of maximizing value.

Clients who request that their accounts be managed according to a socially responsible mandate will have proxies voted according to the values communicated in their investment policy statement.

There are times when LMIC may be unable to vote a proxy or may choose not to vote a proxy. Examples of these times include, but are not limited to:

- A proxy ballot was never received from the custodian,
- A meeting notice was received too late,
- The fees imposed to exercise the vote are high and outweigh the benefit of voting, or
- A proxy voting service is not offered by the custodian.

For clients of LMIC, a complete record and file of all votes cast, and where appropriate, the reason therefor, shall be maintained by LMIC with a third party voting service, Institutional Shareholder Services Inc. (ISS). A proxy log will be maintained, including the following data: issuer name, exchange ticker symbol of the issuer's shares to be voted, CUSIP number for the shares to be voted, a brief identification of the matter voted on, whether the matter was proposed by the issuer or by a shareholder of the issuer, whether a vote was cast on the matter, a record of how the vote was cast and whether the vote was cast for or against the recommendation for the issuer's management team. Clients may obtain information with regard to the manner in which their proxies were voted, as well as the more detailed policies and procedures upon which this summary is based by contacting LMIC at 100 International Drive, 5th Floor, Baltimore, Maryland, 21202, Attention: Compliance Department.

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## ITEM 18. FINANCIAL INFORMATION

Not Applicable.

## APPENDIX A: PRIVACY NOTICE

Legg Mason Investment Counsel, LLC is committed to keeping nonpublic personal information about our clients secure and confidential. This notice is intended to help you understand how we fulfill this commitment.

In the course of management of client accounts, we may collect a variety of personal information, including:

- Information on applications and forms, via the telephone, and through our websites;
- Information about transactions with us, our affiliates, or others (such as your purchases, sales, or account balances); and
- Information from consumer reporting agencies.

When an account is opened, we ask for names, addresses, dates of birth (if applicable), and other information. We also request identifying documents such as drivers' licenses or passports.

Legg Mason Investment Counsel, LLC does not sell our clients' nonpublic personal information to anyone. We do not disclose your nonpublic personal information, except as permitted by applicable law or regulation. For example, we may share this information with others in order to process your transactions. We may also provide this information to companies that perform operations or administrative services on our behalf, such as tax processing or printing and mailing. We require these companies contractually to protect the confidentiality of this information and to use it only to perform the services for which we hired them.

With respect to our internal security procedures, we maintain physical, electronic, and procedural safeguards to protect and restrict access to nonpublic personal information. These controls include: (1) securing office buildings; including security personnel and identification card key access to the building and individual floors; (2) placing security cameras at the building entrance; (3) maintaining client files in locked file room; and (4) providing annual employee training. As required by federal regulation, we will take reasonable measures to protect against access to or use of nonpublic personal information by unauthorized persons when disposing of it.

If a client terminates an account with us, we still continue to adhere to our privacy policies and practices with respect to nonpublic personal information.

## APPENDIX B: EXPLANATIONS OF CERTAIN INVESTMENT RISKS

This Appendix explains the main risks of loss associated with the investment strategies described in Item 8 of the brochure. As described in Item 8, the investment strategies LMIC provides may also involve risks that are not identified or explained in the brochure or this Appendix.

In addition, depending on the nature of a Fund or the Fund's portfolio investments, an investment in the Fund may involve any one or more of the main risks explained in this Appendix B, including without limitation Below Investment Grade Risk, Non-U.S. Investment Risk, Convertible Securities Risk, REIT and Real Estate Risk, Private Placement Risk, ETF Risk, Short Selling Risk, Derivatives Risk and Financial Services Risk. Clients should refer to the Fund prospectuses or other offering documents for complete more detailed explanations of the main risks associated with investments in Funds.

**General Investment Risk.** Stocks, bonds and other equity and fixed income securities may decline in value for any one or more of several reasons. The potential reasons these securities may decline in value are almost without limit and may not be foreseeable. Some common reasons securities may decline in value include:

Actual or anticipated negative developments affecting the issuer of the securities or the assets backing the securities, including: losses, earnings, revenues, expenses, profit margins, cash flow, growth rates, component unavailability, dividend levels or other financial or business metrics that do not meet expectations; deterioration in financial position; competition; changes in technology or governmental regulation; loss of or failure to obtain customers, personnel or necessary government approvals; product failures; lawsuits, corruption; government investigations or enforcement actions; loss of intellectual property protection; and loss or reduction of benefits such as exclusive distribution or supplier rights.

Actual or anticipated negative developments affecting (a) one or more industries in which the issuer of the securities participates, (b) in the case of governmental issuers, the tax base, economy or other attributes of the country or region where the issuer is located; or (c) in the case of securities backed by specified assets, the type of assets backing the securities, such as mortgages, finance receivables, toll roads, hospitals, etc.

Broader declines in security prices, including global, regional, country-specific, asset class-specific (e.g., equity, fixed income) and investment style-specific (e.g., growth, value) price declines. Potential reasons for these declines include changes in investor preferences; actual or anticipated global, regional or country-specific political, economic, regulatory or social developments (e.g., government changes, monetary policy, inflation, demographic changes, recessions), wars, terrorism, civil unrest, labor stoppages, infrastructure problems (e.g., power outages), and disasters such as earthquakes, floods, droughts, epidemics, oil spills, nuclear incidents, tsunamis, volcano activity, hurricanes and tornadoes.

**Below Investment Grade Risk.** Below investment grade fixed income securities, which are sometimes referred to as "junk" bonds or high yield securities, are fixed income securities that are rated below Baa or BBB and unrated fixed income securities of comparable quality. These securities have a higher risk of declining in value and defaulting than investment grade (i.e., higher quality) fixed

income securities. In particular, below investment grade fixed income securities typically are more volatile and involve greater credit risk than investment grade fixed income securities. See “**High Volatility Risk**” and “**Credit Risk**” below in this Appendix A for explanations of these risks. Below investment grade fixed income securities also tend to be less liquid and more susceptible to general investment risk than investment grade fixed income securities. See “**Illiquidity Risk**” and “**General Investment Risk**” in this Appendix B for explanations of these risks.

**Concentration Risk:**

**Geographic Concentration Risk.** Geographic concentration risk is the risk of loss from concentrating investments in a particular geographic region, such as a single U.S. state or region, and not more broadly diversifying investments across multiple geographic regions. An investment management portfolio that concentrates investments in a particular geographic region will have a greater risk of loss from developments that negatively affect securities issuers with significant business or other financial exposure to the region. Examples of such developments include: regional disasters such as earthquakes, hurricanes and floods; deteriorating finances of regional governmental securities issuers (e.g., states, municipalities); regional infrastructure problems such as power outages or transport facility shutdowns or restrictions; and economic, demographic or regulatory changes that negatively affect the region’s business environment.

**Industry Concentration Risk.** Industry concentration risk is the risk of loss from concentrating investments in a particular industry and not more broadly diversifying investments across multiple industries. An investment management portfolio that concentrates investments in a particular industry will have a greater risk of loss from developments that negatively affect companies in that industry. Examples of such developments include: regulatory or other government policy changes that negatively affect the industry; changes in business methods, technologies or consumer preferences that reduce demand for the industry’s products or services; alternative product/service competition from new or pre-existing industries; and shortages of, or increased costs for, industry personnel, raw materials or product components.

**Issuer Concentration Risk.** Issuer concentration risk is the risk of loss from concentrating investments in individual securities (i.e., making larger investments in individual securities) instead of more broadly diversifying investments across a larger number of securities. An investment management portfolio that concentrates investments in individual securities will have a greater risk of loss from developments that negatively affect the issuers of those securities. See clause (i) of “**General Investment Risk**” above for examples of developments that may negatively affect the value of a particular issuer’s securities.

**Credit Risk.** Credit risk, which is sometimes referred to as “default risk”, is the risk that the value of a fixed income security will decline because of:

investor perception that the security issuer’s or guarantor’s future payment of the principal and/or interest obligation represented by the security has become less likely, increasing the likelihood of default; or actual default by the issuer or guarantor of the security.

Below investment grade fixed income securities generally involve more credit risk than investment grade fixed income securities. See “**Below Investment Grade Risk**” above for a description of below investment grade fixed income securities. Developments that negatively affect the issuer or guarantor of a fixed income security, or the specified assets backing the security, often will increase the security’s level of credit risk. See “**General Investment Risk**” above for examples of such developments.

**Extension Risk.** Extension risk is the risk that issuers of fixed income securities, including mortgage-backed and other asset-backed securities, will repay their obligations more slowly than the market anticipates in the event market interest rates rise. This repayment extension may cause the prices of these securities to fall because their interest rates are lower than market rates and they remain outstanding for longer than originally anticipated.

**High Volatility Risk.** High volatility risk is the risk of loss associated with investments that tend to fluctuate in value more than other investments. An investment management portfolio with high volatility risk typically involves more speculative investments than a portfolio that does not have such risk. More speculative investments increase the client’s risk of loss. In addition, high volatility increases the chance that a client will incur significant investment losses if and when the client or the client’s investment manager decides to sell one or more securities held in the client’s account.

**Illiquidity Risk.** Illiquidity risk is the risk that securities held in a client’s account may be difficult to sell at prices close to recent valuations because few or no market participants are willing to purchase the securities at such prices. This risk, which generally is greater during times of market turmoil, may result in increased losses (or lesser gains) relative to sales of securities for which more active trading markets exist. Illiquidity risk may also result in client accounts realizing lower prices from smaller-sized sales of securities, including municipal bonds, that usually trade in larger amounts. For example selling a single \$5,000 lot of a municipal bond for a client’s account may result in a lower per-bond price than a contemporaneous sale of a \$100,000 lot of the same bond.

**Interest Rate Risk.** Interest rate risk is the risk that market interest rates will rise, causing fixed income security prices to fall. This risk stems from the tendency of increases in market interest rates to generally make payment obligations associated with already-outstanding fixed income securities less attractive to investors and therefore the securities themselves less valuable. The risk of securities price declines caused by interest rate increases generally is higher for fixed income securities with longer-term maturities.

**Mid Cap Risk.** Mid cap risk is the additional risk of loss typically associated with investments in securities of mid cap companies. Negative company-specific developments tend to cause securities of mid cap companies to decline in value more than securities of large cap companies. See clause (i) of “General Investment Risk” above for examples of such developments. Reasons for mid cap companies’ increased risk of loss from such developments include the tendency of mid cap companies to have more limited product lines, operating histories, markets and financial resources, and also to be dependent on more limited management groups. Securities of mid cap companies also tend to be more volatile and less liquid than securities of large cap companies. See “**High Volatility Risk**” and “**Illiquidity Risk**” above.

**Non-U.S. Investment Risk.** Non-U.S. investment risk is the additional risk of loss typically associated with investments in securities of non-U.S. issuers. Investments in securities of non-U.S. issuers tend to involve greater risk than investments in U.S. issuers. This increased risk arises from



factors that include: many non-U.S. countries having securities markets that are less liquid and more volatile than U.S. securities markets; political and economic instability in some non-U.S. countries; lesser availability of issuer and market information in some non-U.S. countries; and less rigorous accounting and regulatory standards in some non-U.S. countries. In addition, currency exchange rate fluctuations may have a greater negative effect on the value of investments in securities of non-U.S. issuers.

Non-U.S. investment risk is increased for securities issuers and markets in emerging market countries. Emerging markets tend to have economic, political and legal systems that are less developed and less stable than those of the United States and other developed countries. In addition, securities markets in emerging market countries may be relatively illiquid and subject to extreme price volatility. See “**Illiquidity Risk**” and “**High Volatility Risk**” above.

**Prepayment Risk.** Issuers of many fixed income securities, including certain mortgage-backed and other asset-backed securities, have the right to pay their payment obligations ahead of schedule. If interest rates fall, an issuer may exercise this right. If this happens, the investor’s ability to reinvest the prepayment proceeds and obtain the same yield will be diminished because of the lower market interest rates. In addition, prepayment may cause the investor to lose any premium paid upon purchase of the security.

**Small Cap Risk.** Small cap risk is the additional risk of loss typically associated with investments in securities of small cap companies. Negative company-specific developments tend to cause securities of small cap companies to decline in value more than securities of large cap and mid cap companies. See clause (i) of “General Investment Risk” above for examples of such developments. Reasons for small cap companies’ increased risk of loss from such developments include the tendency of small cap companies to have more limited product lines, operating histories, markets and financial resources, and also to be dependent on more limited management groups. Securities of small cap companies also tend to be more volatile and less liquid than securities of large cap and mid cap companies. See “**High Volatility Risk**” and “**Illiquidity Risk**” above.

**Private Placement Risk.** LMIC may invest assets of certain clients in private investment funds, the shares or units of which are not publicly traded or freely transferable. Investments in private placements generally will be subject to significant Illiquidity Risk as a result, and this typically will make such investments more susceptible to losses. See “**Illiquidity Risk**” in this Appendix B for an explanation of this risk.

**REIT and Real Estate Risk.** The value of a strategy’s investments in real estate investment trusts (“REITs”), a type of Fund that invests in real estate-related assets, may change in response to changes in the real estate market. Investments in REITs may subject clients to the following additional risks:

- Declines in the value of real estate;
- Changes in interest rates;
- Lack of available mortgage funds or other limits on obtaining capital and financing;
- Overbuilding;
- Extended vacancies of properties;
- Increases in property taxes and operating expenses;
- Changes in zoning laws and regulations;



- Casualty or condemnation losses; and
- Tax consequences of the failure of a REIT to comply with tax law requirements.

These additional risks typically will be magnified for REITs that leverage their investments – i.e., use debt financing to increase real estate investment exposure above the amount of the REIT’s net assets.

**Convertible Securities Risk.** A convertible security is a bond, debenture, note, preferred stock, right, warrant or other security that may be converted into or exchanged for a prescribed amount of common stock or other security of the same or a different issuer or cash within a particular period of time at a specified price or formula. A convertible security generally entitles the holder to receive interest paid or accrued on debt securities or the dividend paid on preferred stock until the convertible security matures or is redeemed, converted or exchanged. Before conversion, convertible securities generally have characteristics similar to both debt and equity securities. Convertible securities ordinarily provide a stream of income with generally higher yields than those of common stock of the same or similar issuers. Convertible securities generally rank senior to common stock in a corporation’s capital structure but are usually subordinated to comparable nonconvertible proportionate securities.

Convertible securities generally do not participate directly in any dividend increases or decreases of the underlying securities although the market prices of convertible securities may be affected by any dividend changes or other changes in the underlying securities. Investments in convertible securities may be subject to the risks that prevailing interest rates, issuer credit quality and any call provisions may affect the value of the securities. Rights and warrants entitle the holder to buy equity securities at a specific price for a specific period of time. Rights typically have a substantially shorter term than do warrants. Rights and warrants may be considered more speculative and less liquid than certain other types of investments in that they do not entitle a holder to dividends or voting rights with respect to the underlying securities nor do they represent any rights in the assets of the issuing company. Rights and warrants may lack a secondary market.

The value of convertible securities tends to decline as interest rates rise and, because of the conversion feature, tends to vary with fluctuations in the market value of the underlying securities.

**ETF Risk.** Investments in exchange-traded funds (“ETFs”) (which may, in turn, invest in equities, bonds, and other financial vehicles) may involve duplication of certain fees and expenses. By investing in an ETF, a strategy becomes a shareholder of that ETF. As a result, investors in a strategy that invests in ETFs are indirectly subject to the fees and expenses of the individual ETFs. These fees and expenses are in addition to the fees and expenses that investors in the strategy directly bear in connection with the strategy’s own operations. If the ETF fails to achieve its investment objective, the strategy’s investment in the ETF may adversely affect its performance. In addition, because ETFs are listed on national stock exchanges and are traded like stocks listed on an exchange, the following may occur:

- The strategy may acquire ETF shares at a discount or premium to their NAV, and
- The strategy may incur greater expenses since ETFs are subject to brokerage and other trading costs.

Finally, because the value of ETF shares depends on the demand in the market, we may not be able to liquidate the ETF holdings at the most optimal time, adversely affecting the strategy’s performance.

**Short Selling Risk.** Short selling involves selling securities that are not owned by the seller and borrowing the same securities for delivery to the purchaser, with an obligation to replace the borrowed securities at a later date. Short selling allows a portfolio to profit from declines in market prices to the extent such decline exceeds the transaction costs and the costs of borrowing the securities. However, since the borrowed securities must be replaced by purchases at market prices in order to close out the short position, any appreciation in the price of the borrowed securities would result in a loss upon such repurchase. Purchasing securities to close out the short position can itself cause the price of the securities to rise further, thereby exacerbating the loss. Short-selling exposes a portfolio to unlimited risk with respect to that security due to the lack of an upper limit on the price to which an instrument can rise.

**Financial Services Risk.**

**Counterparty Risk.** The financial services industry is highly interconnected, and financial services companies have exposure to many different industries, issuers and counterparties, and often execute transactions with counterparties that also operate in the financial services industry, including brokers and dealers, commercial banks, investment banks, hedge funds and other investment funds and other institutions. Many of these transactions expose a financial services company to credit risk in the event of default of the counterparty. In addition, with respect to secured transactions, a financial services company's credit risk may be exacerbated when the collateral held by the company cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to it. A financial services company may also have exposure to other issuers in the form of holdings in unsecured debt instruments, derivative transactions and stock investments of such issuers.

**Regulatory Risk.** The financial services industry is subject to complex and extensive regulation by numerous primary Federal regulators, including: the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit and Insurance Corporation ("FDIC"). State chartered financial institutions also are subject to regulation and supervision by state bank regulatory agencies. Further, all federally insured depository institutions are subject to certain oversight and supervision by the FDIC as the insurer of deposit accounts. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities. Moreover, the laws, rules and regulations comprising such regulatory framework are constantly changing, as are the interpretation and enforcement of existing laws, rules and regulations. The regulatory framework governing the financial services industry is currently under close Congressional and regulatory agency scrutiny and is the subject of pending and contemplated legislation and rulemaking initiatives that could drastically alter the manner in which financial services companies operate and are structured.

**Banking Industry Investment Risk.** The results of operations of banking institutions may be materially affected by general economic conditions, changes in the level of interest rates, national and local cycles in real estate and the monetary and fiscal policies of the Federal government. In addition, over the last couple of years, the world's financial markets have experienced extraordinary market conditions, including the failure of the credit markets to function and extreme volatility in the securities market. As a result, U.S. and foreign financial regulators undertook unprecedented regulatory action and continue to consider and implement other measures to stabilize U.S. and global financial markets. While the U.S. financial market appears to have reached a level of stability, there continues to be a high level

of troubled depository institutions and therefore likely consolidation in the financial services industry and uncertainty in other markets that affect the U.S. market.

**Other Financial Services Company Risk.** Many of the investment considerations discussed in connection with banks, mortgage brokers and insurance companies also apply to other financial services companies. These companies are all subject to extensive regulation, rapid business changes and volatile performance dependent on the availability and cost of capital, prevailing interest rates and significant competition. General economic conditions significantly affect these companies. Credit and other losses resulting from the financial difficulty of borrowers or other third parties have a potentially adverse effect on companies in this industry.

**Derivatives Risk.** Derivatives, which may be used in Funds in which LMIC client assets are invested, are financial instruments that have a value which depends upon, or is derived from, a reference asset, such as one or more underlying securities, pools of securities, options, futures, indexes or currencies. Derivatives may result in investment exposures that are greater than their cost would suggest; in other words, a small investment in a derivative may have a large impact on a strategy's performance. The successful use of derivatives generally depends on the Fund manager's ability to predict market movements.

Derivatives are subject to a number of risks, including without limitation Illiquidity Risk, Interest Rate Risk, Credit Risk and General Investment Risk (each described elsewhere in this Appendix) and the following additional risks:

- Risk of default by the other party to the derivatives transaction;
- Risk that the derivatives transaction may result in losses that partially or completely offset gains in other positions; and
- Risk that derivative instruments may be mispriced or improperly valued and that changes in the value of the derivatives may not correlate perfectly with the underlying asset or security.