

# Form ADV Wrap Fee Program Brochure Morgan Stanley Smith Barney LLC

Strategic Portfolios Program

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**This wrap fee program Brochure provides information about the qualifications and business practices of Morgan Stanley Smith Barney LLC (“MSSB”). If you have any questions about the contents of this Brochure, please contact us at (914) 225-1000. The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority.**

**Additional information about MSSB also is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). Registration with the SEC does not imply a certain level of skill or training.**

## Item 2: Material Changes

This section identifies and discusses material changes to the ADV Brochure since the version of the Brochure dated March 28, 2014. For more details on any particular matter, please see the item in this ADV Brochure referred to in the summary below.

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

**Fees.** Effective July 1, 2014, there is a minimum annual MSSB Fee (calculated quarterly) for each Strategic Portfolios account that was opened after June 30, 2009. This minimum is the lesser of 2% or \$250 per year. This minimum will not apply to any account that (when added to any other Consulting Group accounts with which it is related for billing purposes) has a total of \$500,000 or more in assets as of the end of the previous billing quarter. (Item 4.A)

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## Item 4: Services, Fees and Compensation

Morgan Stanley Smith Barney LLC (“MSSB”, “we”, “us” or “our”) is a registered investment adviser, a registered broker-dealer and a member of the New York Stock Exchange. MSSB is one of the largest financial services firms in the U.S. with branch offices in all 50 states and the District of Columbia.

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

We reasonably expect to provide services as a “fiduciary” (as that term is defined in Section 3(21)(A) of the Employee Retirement Income Security Act of 1974 (“ERISA”) and/or Section 4975 of the Internal Revenue Code of 1986, as amended (the “Code”)), with respect to “Retirement Accounts”. For purposes of this Brochure, the term “Retirement Account” will be used to cover (i) “employee benefit plans” (as defined under Section 3(3) of ERISA), which include pension, profit-sharing or welfare plans sponsored by private employers, as well as similar arrangements sponsored by governmental or other public employers; (ii) individual retirement accounts “IRAs” (as described in Section 4975 of the Code); and (iii) Coverdell Educational Savings Accounts.

All clients’ assets are custodied at MSSB (except for “sweep” assets custodied at the Sweep Banks pursuant to the Bank Deposit Program). *Please see Item 4.C (Services, Fees and Compensation -- Additional Fees – Cash Sweeps -- Bank Deposit Program) below, for more information.*

### A. General Description of Program and Services

The Strategic Portfolios program is currently closed to new business. In the Strategic Portfolios program, the client’s account is managed by MSSB (acting through its Private Portfolio Group (“PPG”) division) without the involvement of any Sub-Managers.

The program seeks as its primary investment objective long-term capital appreciation. The portfolios are individually managed based on the implementation of the Dow Dividend Strategy (the “Dow Strategy”). The Dow Strategy uses a disciplined approach to identify and maintain a select portfolio of stocks from the 30 components of the Dow Jones Industrial Average (“DJIA”). The Dow Strategy uses dividend yield as the primary criterion for portfolio selection. Generally, the Dow Strategy invests in the ten highest yielding stocks in the DJIA. Individual accounts are invested on a daily basis (as clients select Strategic Portfolios for their accounts), purchasing the ten highest-yielding DJIA stocks as of the time of the immediately previous re-balance for the strategy (*i.e.*, on or around the beginning of that calendar year). Accounts are generally restructured and rebalanced annually, on or around the beginning

of each calendar year. Generally, PPG will allow a full year to elapse before the next rebalancing (to allow for long term capital gain treatment). There may be some circumstances when MSSB will deviate from the discipline and make adjustments to the portfolios.

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

### Account Opening

To enroll in the Strategic Portfolios program, you (in consultation with your Financial Advisor) must complete an investment questionnaire and you must enter into the program client agreement (“Client Agreement”).

You may also be required to execute a brokerage account agreement. All the terms of the Client Agreement and the brokerage account agreement will set forth our mutual obligations regarding the investment advisory program described in this Brochure.

### Investment Restrictions

In the Strategic Portfolios program, you may request reasonable restrictions on the management of your account (may request that certain specified securities, or certain categories of securities, not be purchased for your account). This request may be made orally or in writing, but MSSB may require that any such request (or any changes to the request) be in writing. MSSB will accept reasonable restrictions on specific common equity and fixed income securities, as well as on certain categories of equity securities (e.g., tobacco companies). MSSB will determine in its reasonable judgment how to implement such restrictions, and may implement restrictions differently in accounts that have elected tax management services (if applicable). If you restrict a category of securities, we will determine in our discretion which specific securities fall within the restricted category. In doing so, we may rely on outside sources (e.g. standard industry codes and research provided by independent service providers). In this program, the portion of the account that would have been invested in any restricted security or category of securities will be invested in cash or cash equivalents. This will impact the performance of the account relative to an account that is fully invested in securities.

Although we will accept reasonable restrictions as described above, we will not have any obligation to manage your account in accordance with any investment guidelines, policy statements or other documents unless we specifically agree to do so, in writing.

### Trade Confirmations, Account Statements and Performance Reviews

MSSB is the custodian and provides you with written confirmation of securities transactions, and account statements at least quarterly. You may waive the receipt of trade confirmations after the completion of each trade in favor of alternative methods of communication where available.

We will provide periodic reviews of your account. These reviews show how your account investments have performed, both on an absolute basis and on a relative basis compared to recognized indices (such as Standard & Poor's indices). You may access these reports through MSSB's online account services site. To access these reports in the online account service site, please go to <https://www.morganstanleyclientserv.com>, log on, and select "Account Documents". If, however, you would like to receive these reports by mail, please call 1-888-454-3965.

### **Consulting Group Trust Services**

In the Strategic Portfolios program, MSSB may offer fully integrated wealth management solutions, which may include trusts. MSSB will not accept an appointment as, nor will it act as, a trustee (an MSSB affiliate, such as Morgan Stanley Private Bank, National Association, may be serving as trustee for existing accounts and is closed to new accounts). In order to offer to you complete solutions, MSSB has created the Consulting Group Trust Services Program ("CG Trust Services") with external trust companies (including external banks which may serve as a corporate trustee) to provide trustee services for the assets in your account while you receive investment advisory services from MSSB.

To receive trustee services through CG Trust Services, you and your attorney will create separate agreements with an external trust company to govern the trust and you will appoint a trustee to act on your behalf; in certain situations, you may appoint separate administration and investment trustees. You or your designees will sign these separate agreements and may pay a separate fee to your attorney. External trust companies and MSSB typically charge separate fees to CG Trust Services client accounts for their respective services, which may be higher than fees charged to clients outside of the CG Trust Services Program for comparable services. In certain limited circumstances, MSSB will compensate an external trust company for the services it provides to a client account. Neither MSSB nor your Financial Advisor will be paid by the external trust company. In certain circumstances, MSSB or an affiliate may pay compensation to or receive an indirect economic benefit from an unrelated third party (see: "Client Referrals and Other Compensation", Item 9 below).

As part of CG Trust Services, you or your selected trustee, with investment authority, may delegate investment discretion directly to MSSB or receive non-discretionary investment advisory services through the programs offered by Consulting Group. Additionally, certain external trust companies have contractually agreed to use the services (including MSSB custody services) described in this Brochure for each CG Trust Services client (and in some cases, former CG Trust Services clients), unless the client has issued contrary instructions, and so long as such use of MSSB services will not cause the external trust company to violate any duty or obligation. Regardless of the external trust company you select, unless you have appointed another custodian, you can custody your assets at MSSB through CG Trust Services. Accounts outside of CG Trust Services may be subject to different custody arrangements.

MSSB has made arrangements to have a number of external trust companies participate in CG Trust Services, as described above. While these arrangements are designed to enhance the administrative and operational experience of clients who appoint such an external trust company and MSSB to service the same

assets, these arrangements could pose a conflict of interest for MSSB and its representatives by creating an incentive for them to introduce their clients to those external trust companies that have such arrangements with CG Trust Services over other external trust companies.

The decision to participate in CG Trust Services and the selection of the trustee and attorney are your decision and responsibility. MSSB and its affiliates do not provide tax and legal advice (see: "Tax and Legal Considerations", in this Item 4(A) below). For additional information and to determine eligibility for CG Trust Services, please contact your Financial Advisor.

### **Risks**

All trading in an account is at your risk. The value of the assets held in an account is subject to a variety of factors, such as the liquidity and volatility of the securities markets. Investment performance of any kind is not guaranteed, and MSSB's or a Financial Advisor's past performance with respect to other accounts does not predict future performance with respect to any particular account. You should consult with your Financial Advisor regarding the specific risks associated with the investments in your account.

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

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

### **Tax and Legal Considerations**

Consult your independent tax or legal advisor with respect to the services described in this Brochure, as MSSB and its affiliates do not provide tax or legal advice.

### **Fees**

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

There is a minimum annual MSSB Fee (calculated quarterly) for each Strategic Portfolios account that was opened after June 30, 2009. This minimum is the lesser of 2% or \$250 per year. This minimum will not apply to any account that (when added to any other Consulting Group accounts with which it is related for

billing purposes) has a total of \$500,000 or more in assets as of the end of the previous billing quarter.

**Fees are Negotiable.** Fees for the Strategic Portfolios program described in this Brochure are negotiable based on a number of factors including the type and size of the account and the range of services provided by the Financial Advisor.

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

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

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

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

**ERISA Fee Disclosure for Qualified Retirement Accounts.** In accordance with Department of Labor regulations under Section 408(b)(2) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), MSSB is required to provide certain information regarding our services and compensation to assist fiduciaries and plan sponsors of those Retirement Accounts that are subject to the requirements of ERISA in assessing the reasonableness of their plan's contracts or arrangements with us, including the reasonableness of our compensation. This information (the services we provide as well as the fees) is provided to you at the outset of your

relationship with us and is set forth in this Brochure and in your advisory contract with us (including the Fee table and other exhibits), and then at least annually to the extent that there are changes to any investment-related disclosures for services provided as a fiduciary under ERISA.

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

## B. Comparing Costs

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

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

## C. Additional Fees

If you open an account in one of the program described in this Brochure, you will pay an asset-based "wrap" fee as described above. This "wrap" fee includes the services provided by MSSB, as described in this Brochure, custody of securities and trade execution through MSSB, as well as compensation to any Financial Advisor.

The program fees do not cover:

- "mark-ups," "mark-downs," and dealer spreads (A) that MSSB or its affiliates may receive when acting as principal in certain transactions where permitted by law or (B) that other broker-dealers may receive when acting as principal in certain transactions effected through MSSB and/or its affiliates acting as agent, which is typically the case for dealer market transactions (e.g., fixed income and over-the-counter equity)
- brokerage commissions or other charges resulting from transactions not effected through MSSB or its affiliates
- MSSB account establishment or maintenance fees for its IRA and Versatile Investment Plans ("VIP"), which are described in the respective IRA and VIP account and fee documentation (which may change from time to time)
- account closing/transfer costs
- processing fees or



- certain other costs or charges that may be imposed by third parties (including, among other things, odd-lot differentials, transfer taxes, foreign custody fees, exchange fees, supplemental transaction fees, regulatory fees and other fees or taxes that may be imposed pursuant to law).

## Cash Sweeps

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

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

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

You acknowledge that MSSB may with 30 days written notice (i) make changes to these sweep terms; (ii) make changes to the terms and conditions of any available sweep investment; (iii) change, add or delete the products available as a sweep option; or (iv) transfer your sweep investment from one sweep product to another.

Clients that are considered Retirement Accounts should read Exhibit A to this Brochure (“Affiliated Money Market Funds Fee Disclosure Statement and Float Disclosure Statement”).

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

## Bank Deposit Program

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

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

Terms of the Bank Deposit Program are further described in the Bank Deposit Program Disclosure Statement, which will be provided to you upon your first investment in the Bank Deposit Program. You may also obtain the Bank Deposit Program Disclosure Statement as well as current interest rates applicable to your account, by contacting your Financial Advisor or through MSSB’s web sites at [http://www.morganstanley.com/wealth-](http://www.morganstanley.com/wealth-investmentstrategies/pdf/BDP_disclosure.pdf)

[investmentstrategies/pdf/BDP\\_disclosure.pdf](http://www.morganstanley.com/wealth-investmentstrategies/pdf/BDP_disclosure.pdf) and [www.morganstanley.com/wealth-investmentstrategies/ratemonit.or.asp](http://www.morganstanley.com/wealth-investmentstrategies/ratemonit.or.asp). You acknowledge and understand that we may amend the list of Sweep Banks at any time with 30 days written notice to you. If you are participating in the Bank Deposit Program, please read the Bank Deposit Program Disclosure Statement carefully.

Please note the following: (i) you are responsible to monitor the total amount of deposits you have at each Sweep Bank in order to determine the extent of FDIC insurance coverage available to you; and (ii) MSSB and its affiliates are not responsible for any insured or uninsured portion of your deposits at any of the Sweep Banks.

If BDP is your Sweep Investment, you should be aware that each Sweep Bank will pay MSSB a fee equal to the percentage of the average daily deposit balances in your Deposit Account at the Sweep Banks. Your Financial Advisor will not receive a portion of these fees or credits. In addition, MSSB will not receive cash compensation or credits in connection with the BDP for assets in the Deposit Accounts for Retirement Accounts or Coverdell Education Savings accounts. Also, the affiliated Sweep Banks have the opportunity to earn income on the BDP assets through lending activity, and that income is usually significantly greater than the fees MSSB earns on affiliated Money Market Funds. Thus, MSSB has a conflict of interest in selecting or recommending BDP as the sweep fund, rather than an eligible Money Market Fund.

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

## Money Market Funds.

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

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

Each of these Money Market Funds is a separate investment with different investment objectives. Their fees, expenses, minimum investment requirements, dividend policies and procedures may vary. Before you invest in any Money Market Fund, read its prospectus carefully. Money Market Fund shares are neither insured nor protected by the FDIC. Investment in any Money Market Fund is a purchase of securities issued by the Money Market Fund, not a bank deposit.

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

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

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

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

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

## **D. Compensation to Financial Advisors**

If you invest in the program described in this Brochure, a portion of the fees payable to us in connection with your account is allocated on an ongoing basis to your Financial Advisor. The amount allocated to your Financial Advisor in connection with accounts opened in program described in this Brochure may be more than if you participated in other MSSB investment advisory programs, or if you paid separately for investment advice, brokerage and other services. The rate of compensation we pay Financial Advisors with respect to program accounts may be higher than the rate we pay Financial Advisors with respect to transaction-based brokerage accounts. Your Financial Advisor may therefore have a financial incentive to recommend one of the program described in this Brochure instead of other MSSB programs or services.

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

## **Item 5: Account Requirements and Types of Clients**

**Account Minimums.** In the Strategic Portfolios program, MSSB generally imposes an investment minimum of \$50,000 for new accounts. MSSB, in its sole discretion, may waive this minimum for any one or more accounts. As indicated in Item 4.A above, the Strategic Portfolios program is currently closed to new clients.

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

## **Item 6: Portfolio Manager Selection and Evaluation**

### **A. Selection and Review of Portfolio Managers for the Program**

#### **Selection and Review of Portfolio Manager**

In the Strategic Portfolios program, the client’s account is managed by MSSB (acting through its Private Portfolio Group division) without the involvement of any Sub-Managers. The portfolios are individually managed based on the implementation of a disciplined strategy (the Dow Dividend Strategy). The individual portfolio manager who implements this strategy for all clients is an employee of the MSSB Private Portfolio Group. *See Item 4.A above for a description of the services offered in the Strategic Portfolios program.*

Because the program is closed to new clients, MSSB calculates individual account performance for each client, but does not currently calculate aggregate performance across accounts. No third party reviews this performance calculation.

### **B. Conflicts of Interest**

#### **Conflicts of Interest – MSSB Acting as Portfolio Manager; Advisory vs. Brokerage Accounts**

In the Strategic Portfolios program, MSSB acts as the portfolio manager, and is compensated accordingly as described above. MSSB and your Financial Advisor retain a greater portion of the advisory fee in the Strategic Portfolios program, than in a program in which an unaffiliated investment manager acts as your portfolio manager. MSSB and your Financial Advisor may earn more compensation if you invest in a program described in this Brochure than if you open a brokerage account to buy individual securities (although, in a brokerage account, you would not receive all the benefits of the program described in this Brochure). This creates a conflict of interest for MSSB as Financial Advisors and MSSB have a financial incentive to recommend the program described in this Brochure. We address this conflict of interest by disclosing it to you and by requiring Financial Advisors’ supervisors to review your account at account-opening to ensure that it is suitable for you in light of matters such as your investment objectives and financial circumstances.



## Other Conflicts of Interest

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

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

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

**Trade Allocations.** MSSB may aggregate the securities to buy or sell for more than one client to obtain favorable execution to the extent permitted by law. MSSB is then responsible for allocating the trade in a manner that is equitable and consistent with its fiduciary duty to its clients (which could include, e.g., pro rata allocation, random allocation or rotation allocation). For block trade orders executed by MSSB, the price to each client is the average price for the aggregate order.

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

**Restrictions on Securities Transactions.** There may be periods during which MSSB or investment managers are not permitted to initiate or recommend certain types of transactions in the securities of issuers for which MSSB or one of its affiliates is performing broker-dealer or investment banking services or have confidential or material non-public information. Furthermore, in certain investment advisory programs, MSSB may be compelled to forgo trading in, or providing advice regarding, Morgan Stanley Parent (as defined in Item 9 below) securities, and in certain related securities. These restrictions may adversely impact your account performance.

MSSB, the investment managers and their affiliates may also develop analyses and/or evaluations of securities sold in a program described in this Brochure, as well as buy and sell

interests in securities on behalf of its proprietary or client accounts. These analyses, evaluations and purchase and sale activities are proprietary and confidential, and MSSB will not disclose them to clients. MSSB may not be able to act, in respect of clients' account, on any such information, analyses or evaluations.

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

**Research Reports.** Morgan Stanley & Co. LLC ("MS&Co.") does business with companies covered by its research groups. Furthermore, MS&Co. and its affiliates, and client accounts, may hold a trading position (long or short) in the securities of companies subject to such research. Therefore, MS&Co. has a conflict of interest that could affect the objectivity of its research reports.

**Certain Trading Systems.** MSSB may effect trades or securities lending transactions on behalf of client accounts through exchanges, electronic communication networks or other alternative trading systems ("Trading Systems"), including Trading Systems with respect to which MSSB or its affiliates may have a non-controlling direct or indirect ownership interest or right to appoint a board member or observer. If MSSB directly or indirectly effects client trades or transactions through Trading Systems in which MSSB or its affiliates have an ownership interest, MSSB or its affiliates may receive an indirect economic benefit based on their ownership interest. In addition, subject at all times to its obligations to obtain best execution for its customers' orders, it is contemplated that MSSB will route certain customer order flow to its affiliates. Currently, MSSB and/or its affiliates (including affiliates of MS&Co.) may own over 5% of the equity interests of certain Trading Systems or their parent companies, including BATS Global Markets, Inc., which owns and operates BATS Exchange, Inc., BATS Trading Limited and Direct Edge (commonly known as "BATS"); BIDS Holdings LP and BIDS Holdings GP LLC (commonly known as "BIDS"); BOX Holdings Group LLC; Eris Exchange Holdings LLC; Equilend; iSWAP Limited; MTS Associated Markets; MuniCenter (TheDebtCenter, LLC); OTCDeriv Limited; Source Holding Ltd; TradeWeb Markets LLC; and Turquoise Global Holdings Ltd. The Trading Systems on which MSSB trades or effects securities lending transactions for client accounts and in which MSSB or its affiliates own interests may change from time to time. You may contact your Financial Advisor for an up-to-date list of Trading Systems in which MSSB or its affiliates own interests and on which MSSB and/or MS&Co. trade for client accounts.

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

Certain Trading Systems through which MSSB and/or MS&Co. may directly or indirectly effect client trades execute transactions on a "blind" basis, so that a party to a transaction does not know the identity of the counterparty to the transaction. It is possible that an order for a client account that is executed

through such a Trading System could be automatically matched with a counterparty that is (i) another investment advisory or brokerage client of MSSB or one of its affiliates or (ii) MSSB or one of its affiliates acting for its own proprietary accounts.

***Payment Arrangements with Private Portfolio Group Vendor.***

The Strategic Portfolios program is managed by PPG and PPG implements the Strategic Portfolios investments, as described in this ADV Brochure. A vendor which PPG utilizes to provide trade analysis has agreed to reduce the fees it charges to PPG for this trade analysis, in proportion to the number of firms that trade with PPG and who subscribe to the vendor's services. Although all firms that trade with PPG subscribe to this vendor's services, this could create a conflict of interest for MSSB in that PPG's fees paid to this vendor would be further reduced if PPG increased the number of firms it trades with. PPG has not and will not consider this potential reduction in the fees it pays in any way, either in determining the number of firms it will trade with or in continuing to contract with this vendor.

***Transaction-Related Agreements with MS&Co. and Affiliates.***

In connection with creating MSSB, certain agreements were entered into between or involving some or all of MSSB, MS&Co. and their affiliates. Some of these agreements, including the following, remain in effect even though MSSB is now a wholly owned subsidiary of Morgan Stanley Parent (as defined in Item 9 below):

- ***Order Flow.*** An agreement that, subject to best execution, MSSB will transmit an agreed percentage of client orders for the purchase and sale of securities to MS&Co. and its affiliates. MSSB has a conflict of interest in transmitting client orders to these entities.
- ***Distribution.*** MSSB may market and promote certain securities and other products underwritten, distributed or sponsored by MS&Co. or its affiliates. MSSB has a conflict of interest in offering, recommending or selling any such security or other product to its clients.

***Affiliated Sweep Investments.*** MSSB has a conflict of interest in selecting or recommending BDP or Money Market Funds as the Sweep Investment. *See Item 4.C above (Services, Fees and Compensation -- Additional Fees – Cash Sweeps – Bank Deposit Program and Money Market Funds), for more information.*

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

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

***Consulting Group Trust Services.*** MSSB has made arrangements to have a number of external trust companies

participate in CG Trust Services. Please see Item 4.A above, for a full description of services and potential conflicts of interest.

## **C. MSSB Acting as Portfolio Manager**

### **Description of Advisory Services**

In the Strategic Portfolios program, MSSB (acting through its Private Portfolio Group division) acts as the portfolio manager. *See Item 4.A above for a description of the services offered in the Strategic Portfolios program.*

### **Tailoring Services for Individual Clients**

In the program described in this Brochure, you may place reasonable restrictions on the investments in your account (as discussed above in Item 4.A).

### **Wrap Fee Programs**

In the Strategic Portfolios program, MSSB acts as both the wrap fee program sponsor and the portfolio manager. MSSB does not act as portfolio manager in any programs which are not wrap fee programs but are otherwise similar to Strategic Portfolios. In the Strategic Portfolios program, MSSB receives the entire wrap fee. *See Item 4.A above, for more information.*

### **Performance-Based Fees**

The program described in this Brochure does not charge performance-based fees.

### **Methods of Analysis and Investment Strategies**

In the Strategic Portfolios program, MSSB manages the client accounts based on the implementation of the Dow Dividend Strategy. Investing in securities involves risk of loss that you should be prepared to bear.

### **Policies and Procedures Relating to Voting Client Securities**

#### ***Electing Who Votes Proxies.***

In the Strategic Portfolios program, clients who do not elect to vote proxies themselves direct MSSB to vote the proxies, and authorize MSSB to further delegate all proxy voting rights to a third party proxy voting and advisory service (the "Proxy Voting Service"). If the Proxy Voting Service does not have a recommendation for any particular proxy vote, MSSB will vote the proxy as it determines is appropriate.

Unless you authorize MSSB to vote proxies, we will forward to you, or your designee, any proxy materials that we receive for securities in your account. Unless we vote proxies for you, we cannot advise you on particular proxy solicitations. If MSSB votes proxies for you, you cannot instruct MSSB on how to cast any particular vote.

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

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

recommendations in effect from time to time), from your Financial Advisor.

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

## **Item 7: Client Information Provided to Portfolio Manager**

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

## **Item 8: Client Contact with Portfolio Manager**

You may contact your Financial Advisor at any time during normal business hours.

## **Item 9: Additional Information**

### **Disciplinary Information**

This section contains information on certain legal and disciplinary events.

In this section, “MSDW” means Morgan Stanley DW Inc., a predecessor broker-dealer of MS&Co. and registered investment adviser that was merged into MS&Co. in April 2007. MS&Co. and Citigroup Global Markets Inc. (“CGM”) are predecessor broker-dealer firms of MSSB. “Citi” means Citigroup Inc., a former indirect part owner of MSSB.

- On May 31, 2005, the SEC issued an order in connection with the settlement of an administrative proceeding against Smith Barney Fund Management LLC (“SBFM”) and CGM relating to the appointment of an affiliated transfer agent for the Smith Barney family of mutual funds (“Smith Barney Funds”). SBFM was an affiliate of CGM during the applicable period.

The SEC order found that SBFM and CGM willfully violated section 206(1) of the Investment Advisers Act of 1940 (“Advisers Act”). Specifically, the order found that SBFM and CGM knowingly or recklessly failed to disclose to the Boards of the Smith Barney Funds in 1999 when proposing a new transfer agent arrangement with an affiliated transfer agent that: First Data Investors Services Group (“First Data”), the Smith Barney Funds’ then-existing transfer agent, had offered to continue as transfer agent and do the same work for substantially less money than before; and Citigroup Asset Management (“CAM”), the Citi business unit that includes the Smith Barney Funds’ investment manager and other investment advisory companies, had entered into a side letter with First Data under which CAM agreed to recommend the appointment of First Data as sub-transfer agent to the affiliated transfer agent in exchange, among other things, for a guarantee by First Data of specified amounts of asset management and investment banking fees to CAM and CGM. The order also found that SBFM and CGM willfully violated section 206(2) of the Advisers Act by virtue of the omissions discussed above and other misrepresentations and omissions in the materials provided to the Smith Barney Funds’ Boards, including the failure to make clear that the affiliated transfer agent would earn a high profit for performing limited functions while First Data continued to perform almost all of the transfer agent functions, and the suggestion that the proposed arrangement

was in the Smith Barney Funds’ best interests and that no viable alternatives existed. SBFM and CGM did not admit or deny any wrongdoing or liability. The settlement did not establish wrongdoing or liability for purposes of any other proceeding.

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

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

- In a LAWC dated August 1, 2005, the NASD found that MSDW failed to establish and maintain a supervisory system, including written procedures, reasonably designed to review and monitor MSDW’s fee-based brokerage business, between January 2001 and December 2003. Without admitting or denying the allegations, MSDW consented to the described sanctions and findings and was censured and fined \$1.5 million, and agreed to the payment of restitution to 3,549 customers in the total amount of approximately \$4.7 million, plus interest.
- The SEC alleged that MS&Co. violated the Exchange Act by inadvertently failing to timely produce emails to the SEC staff pursuant to subpoenas in the SEC’s investigation into MS&Co.’s practices in allocating shares of stock in IPOs and an investigation into conflicts of interest between MS&Co.’s research and investment banking practices. Without admitting or denying the allegations, MS&Co. consented to a final judgment on May 12, 2006 in which it was permanently restrained and enjoined from violating the Exchange Act. MS&Co. agreed to make payments aggregating \$15 million, which amount was reduced by \$5 million contemporaneously paid by MS&Co. to the NASD and the NYSE in related proceedings. MS&Co. also agreed to notify the SEC, the NASD and the NYSE that it has adopted and implemented policies and procedures reasonably designed to ensure compliance with the Exchange Act. MS&Co. also agreed to provide annual training to its employees responsible for preserving or producing electronic communications and agreed to retain an independent consultant to review and comment on the implementation and effectiveness of the policies, procedures and training.
- On June 27, 2006, the SEC announced the initiation and concurrent settlement of administrative cease and desist proceedings against MS&Co. and MSDW for failing to

maintain and enforce adequate written policies and procedures to prevent the misuse of material nonpublic information. The SEC found that from 1997 through 2006, MS&Co. and MSDW violated the Exchange Act and the Advisers Act by failing to (1) conduct any surveillance of a number of accounts and securities; (2) provide adequate guidance to MS&Co.'s and MSDW's personnel charged with conducting surveillance; and (3) have adequate controls in place with respect to certain aspects of "Watch List" maintenance. The SEC's findings covered different areas from the 1997 through 2006 time period. MS&Co. and MSDW were ordered to pay a civil money penalty of \$10 million and agreed to enhance their policies and procedures.

- On August 21, 2006, MS&Co. and MSDW entered into a LAWC relating various finds that, at various times between July 1999 and 2005, MS&Co. violated a number of NASD and SEC rules. The violations related to areas including trade reporting through the Nasdaq Market Center (formerly Automated Confirmation Transaction Service (ACT)), Trade Reporting and Compliance Engine (TRACE) and Order Audit Trail System (OATS); market making activities; trading practices; short sales; and large options positions reports. The NASD also found that, at various times during December 2002 and May 2005, MSDW violated NASD rules and Municipal Securities Rulemaking Board ("MSRB") rules related to areas including trade reporting through TRACE, short sales, and OATS. The NASD further found that, in certain cases, MS&Co. and MSDW violated NASD Rule 3010 because their supervisory systems did not provide supervision reasonably designed to achieve compliance with securities laws, regulations and/or rules.

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

- On May 9, 2007, the SEC issued an Order ("May 2007 Order") settling an administrative action with MS&Co. In this matter, the SEC found that MS&Co. violated its duty of best execution under the Exchange Act. In particular, the SEC found that, during the period of October 24, 2001 through December 8, 2004, MS&Co.'s proprietary market-making system failed to provide best execution to certain retail OTC orders. In December 2004, MS&Co. removed the computer code in the proprietary market-making system that caused the best execution violations. MS&Co. consented, without admitting or denying the findings, to a censure, to cease and desist from committing or causing future violations, to pay disgorgement of approximately \$5.9 million plus prejudgment interest on that amount, and to pay a civil penalty of \$1.5 million. MS&Co. also consented to retain an Independent Compliance Consultant to review its policies and procedures in connection with its market-making system's order handling procedures and its controls relating

to changes to those procedures, and to develop a better plan of distribution.

- On July 13, 2007, the NYSE issued a Hearing Board Decision in connection with the settlement of an enforcement proceeding brought in conjunction with the New Jersey Bureau of Securities against CGM. The decision held that CGM failed to (1) adequately supervise certain branch offices and Financial Advisors who engaged in deceptive mutual fund market timing on behalf of certain clients from January 2000 through September 2003 (in both proprietary and non-proprietary funds); (2) prevent the Financial Advisors from engaging in this conduct; and (3) make and keep adequate books and records. Without admitting or denying the findings, CGM agreed to (a) a censure; (b) establishing a \$35 million distribution fund for disgorgement payments; (c) a penalty of \$10 million (half to be paid to the NYSE and half to be paid to the distribution fund); (d) a penalty of \$5 million to be paid to the State of New Jersey; and (e) appointing a consultant to develop a plan to pay CGM's clients affected by the market timing.
- On September 27, 2007, MS&Co. entered into a LAWC with the Financial Industry Regulatory Authority ("FINRA"). FINRA found that, from October 2001 through March 2005, MSDW provided inaccurate information to arbitration claimants and regulators regarding the existence of pre-September 11, 2001 emails, failed to provide such emails in response to discovery requests and regulatory inquiries, failed adequately to preserve books and records, and failed to establish and maintain systems and written procedures reasonably designed to preserve required records and to ensure that it conducted adequate searches in response to regulatory inquiries and discovery requests. FINRA also found that MSDW failed to provide arbitration claimants with updates to a supervisory manual in discovery from late 1999 through the end of 2005. MS&Co. agreed, without admitting or denying these findings, to establish a \$9.5 million fund for the benefit of potentially affected arbitration claimants. In addition, MS&Co. was censured and agreed to pay a \$3 million regulatory fine and to retain an independent consultant to review its procedures for complying with discovery requirements in arbitration proceedings relating to its retail brokerage operations.
- On October 10, 2007, MS&Co. became the subject of an Order Instituting Administrative and Cease-And-Desist Proceedings ("October 2007 Order") by the SEC. The October 2007 Order found that, from 2000 until 2005, MS&Co. and MSDW failed to provide to their retail customers accurate and complete written trade confirmations for certain fixed income securities in violation of the Exchange Act and MSRB rules. In addition, MS&Co. was ordered to cease and desist from committing or causing any future violations, and was required to pay a \$7.5 million penalty and to retain an independent consultant to review MS&Co.'s applicable policies and procedures. MS&Co. consented to the issuance of the October 2007 Order without admitting or denying the SEC's findings.
- On December 18, 2007, MS&Co. became the subject of an Order Instituting Administrative Cease-and-Desist Proceedings ("December 2007 Order") by the SEC. The December 2007 Order found that, from January 2002 until August 2003, MSDW (1) failed to reasonably supervise four

Financial Advisors, with a view to preventing and detecting their mutual fund market-timing activities and (2) violated the Investment Company Act of 1940 by allowing multiple mutual fund trades that were placed or amended after the close of trading to be priced at that day's closing net asset value. The December 2007 Order also found that, from 2000 through 2003, MSDW violated the Exchange Act by not making and keeping records of customer orders placed after the market close and orders placed for certain hedge fund customers in variable annuity sub-accounts. Without admitting or denying the SEC's findings, MS&Co. agreed to a censure, to cease and desist from future violations of the applicable provisions, to pay a penalty of approximately \$11.9 million, to disgorge profits related to the trading activity (including prejudgment interest) of approximately \$5.1 million and to retain an independent distribution consultant.

- In May 2005, MS&Co. and MSDW discovered that, from about January 1997 until May 2005, their order entry systems did not check whether certain secondary market securities transactions complied with state registration requirements known as Blue Sky laws. This resulted in the improper sale of securities that were not registered in 46 state and territorial jurisdictions. MS&Co. and MSDW conducted an internal investigation, repaired system errors, self-reported the problem to all affected states and the New York Stock Exchange, identified transactions which were executed in violation of the Blue Sky laws, and offered rescission to affected customers. MS&Co. settled the state regulatory issues in a multi-state settlement with the 46 affected state and territorial jurisdictions. Under the settlement, MS&Co. consented to a cease and desist order with, and agreed to pay a total civil monetary penalty of \$8.5 million to be divided among, each of the 46 state and territorial jurisdictions. The first order was issued by Alabama on March 19, 2008, and orders are expected to be issued by subsequent states over the coming months.
- On August 13, 2008, MS&Co. agreed on the general terms of a settlement with the NYAG and the Office of the Illinois Secretary of State, Securities Department ("Illinois") (on behalf of a task force of the North American Securities Administrators Association ("NASAA")) with respect to the sale of auction rate securities ("ARS"). MS&Co. agreed, among other things, to repurchase at par approximately \$4.5 billion of illiquid ARS held by certain clients of MS&Co. which were purchased prior to February 13, 2008. Additionally, MS&Co. agreed to pay a total fine of \$35 million. Final agreements were entered into with the NYAG on June 2, 2009 and with Illinois on September 17, 2009. The Illinois agreement serves as the template for agreements with other NASAA jurisdictions.
- On November 13, 2008, in connection with the settlement of a civil action arising out of an investigation by the SEC into CGM's underwriting, marketing and sale of ARS, CGM, without admitting or denying the allegations of the SEC's complaint, except as to those relating to personal and subject matter jurisdiction, which were admitted, consented to the entry in the civil action of a Judgment As To Defendant Citigroup Global Markets Inc. ("November 2008 Judgment"). Thereafter, on December 11, 2008, the SEC filed its civil action in the federal district court for the Southern District of New York ("Court"). The November

2008 Judgment, which was entered on December 23, 2008 (i) permanently enjoined CGM from directly or indirectly violating section 15(c) of the Exchange Act; (ii) provides that, on later motion of the SEC, the Court is to determine whether it is appropriate to order that CGM pay a civil penalty pursuant to section 21(d)(3) of the Exchange Act, and if so, the amount of the civil penalty; and (iii) ordered that CGM's Consent be incorporated into the November 2008 Judgment and that CGM comply with all of the undertakings and agreements in the Consent, which include an offer to buy back at par certain ARS from certain customers. The SEC's complaint alleged that (1) CGM misled tens of thousands of its customers regarding the fundamental nature of and risks associated with ARS that CGM underwrote, marketed and sold; (2) through its financial advisers, sales personnel and marketing materials, CGM misrepresented to customers that ARS were safe, highly liquid investments comparable to money market instruments; (3) as a result, numerous CGM customers invested in ARS funds they needed to have available on a short-term basis; (4) in mid-February 2008, CGM decided to stop supporting the auctions; and (5) as a result of the failed auctions, tens of thousands of CGM customers held approximately \$45 billion of illiquid ARS, instead of the liquid short-term investments CGM had represented ARS to be. CGM reached substantially similar settlements with the NYAG and the Texas State Securities Board ("TSSB"), although those settlements were administrative in nature and neither involved the filing of a civil action in state court. The settlements with the NYAG and the TSSB differed somewhat from the settlement with the SEC in that the state settlements (a) made findings that CGM failed to preserve certain recordings of telephone calls involving the ARS trading desk; and (b) required CGM to refund certain underwriting fees to certain municipal issuers. In addition, as part of the settlement with New York, CGM paid a civil penalty of \$50 million. CGM also agreed in principle to pay to states other than New York with which it enters into formal settlements a total of \$50 million. CGM paid \$3.59 million of this \$50 million to Texas as part of the settlement with that state. CGM expects it will reach settlements with the remaining states.

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

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

## Other Financial Industry Activities and Affiliations



Morgan Stanley (“Morgan Stanley Parent”) is a financial holding company under the Bank Holding Company Act of 1956. Morgan Stanley Parent is a corporation whose shares are publicly held and traded on the New York Stock Exchange. Prior to June 28, 2013, MSSB was owned by a joint venture company which was indirectly owned 65% by Morgan Stanley Parent and 35% by Citi. On June 28, 2013, Morgan Stanley Parent purchased Citi’s 35% interest in MSSB. Accordingly, MSSB is now a wholly owned indirect subsidiary of Morgan Stanley Parent.

**Activities of Morgan Stanley Parent.** Morgan Stanley Parent is a global firm engaging, through its various subsidiaries, in a wide range of financial services including:

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

**Broker-Dealer Registrations.** As well as being a registered investment advisor, MSSB is registered as a broker-dealer.

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

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

These restrictions may adversely impact client account performance.

*See Item 6.B above for conflicts arising from our affiliation with MS&Co. and its affiliates.*

**Related Investment Advisors and Other Service Providers.** MSSB has related persons that are the investment advisers to mutual funds in various investment advisory programs (including Morgan Stanley Investment Management Inc., Morgan Stanley Investment Management Limited and Consulting Group Advisory Services LLC). If you invest your assets in an affiliated mutual fund, MSSB and its affiliates earn more money than if you invest in an unaffiliated mutual fund. Generally, for Retirement Accounts, MSSB rebates or offsets fees so that MSSB complies with IRS and Department of Labor rules and regulations.

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

Morgan Stanley Distribution Inc. serves as distributor for these open-end investment companies, and has entered into selected dealer agreements with MSSB and affiliates. Morgan Stanley Distribution Inc. also may enter into selected dealer agreements with other dealers. Under these agreements, MSSB and affiliates, and other selected dealers, are compensated for sale of fund shares to clients on a brokerage basis, and for shareholder servicing (including pursuant to plans of distribution adopted by the investment companies pursuant to Rule 12b-1 under the Investment Company Act of 1940).

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

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

*See Item 4.C above for a description of cash sweep investments managed or held by related persons of MSSB.*

See Item 6.B above for a description of various conflicts of interest.

## **Code of Ethics**

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

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

- An Employee who wishes to conduct business activity outside of his or her employment with MSSB, regardless of whether that Employee receives compensation for this activity, must first obtain written authorization from his or her supervisor. (Outside activities include serving as an officer or director of a business organization or non-profit

entity, and accepting compensation from any person or organization other than MSSB.)

- Employees are generally prohibited from giving or receiving gifts or gratuities greater than \$100 per recipient per calendar year to or from persons or organizations with which MSSB has a current or potential business relationship, clients, or persons connected with another financial institution, a securities or commodities exchange, the media, or a government or quasi-governmental entity.
- Employees cannot enter into a lending arrangement with a client (unless they receive prior written approval from their supervisor and MSSB's Compliance Department).
- MSSB maintains a "Restricted List" of issuers for which it may have material non-public information or other conflicts of interest. Employees cannot, for themselves or their clients, trade in securities of issuers on the "Restricted List" (unless they receive prior written approval from the Compliance Department).
- Certain Employees, because of their potential access to non-public information, must obtain prior written approval or provide pre-trade notification before executing certain securities transactions for their personal securities accounts. All Employees must also follow special procedures for investing in private securities transactions.
- Certain Employees are subject to further restrictions on their securities transaction activities (including Financial Advisors and other MSSB employees who act as portfolio managers in MSSB investment advisory programs).

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

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

## **Reviewing Accounts**

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

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

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

## **Client Referrals and Other Compensation**

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

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

## **Financial Information**

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

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

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

## Exhibit A: Affiliated Money Market Funds Fee Disclosure Statement and Float Disclosure Statement

### Sweep Vehicles in Retirement Accounts and CESAs

Since the dates below (“Effective Dates”), the following “Retirement Plan Accounts” (IRAs, Employee Benefit Trusts (“EBTs”), Retirement Plan Manager (“RPM”) accounts) and Versatile Investment Program (“VIP”) accounts) and Coverdell Education Savings Accounts (“CESAs”) have generally been effecting temporary sweep transactions of new uninvested cash balances into Deposit Accounts established under the Bank Deposit Program:

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

Before the Effective Dates, MSSB affected such sweep transactions using the Morgan Stanley money market funds listed in the table below as follows:

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

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

*Now, as an alternative to the Deposit Account, Retirement Plan Accounts and CESAs can choose to sweep into ILAF.*

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

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

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

### Interest Earned on Float

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

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

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

Generally, with respect to such assets awaiting investment:

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

### MSSB as an ERISA fiduciary

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

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

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

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

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

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

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

The fund expense information below reflects the most recent information available to us as of February 12, 2015, and is subject to change. Please refer to the funds’ current prospectuses, statements of additional information and annual reports for more information.

<b>Fund</b>	<b>Advisory Fee</b>	<b>Distribution and Service Fees</b>	<b>Other Expenses</b>	<b>Total Annual Fund Operating Expenses</b>	<b>Total Annual Fund Operating Expenses After Fee Waivers and/or Expense Reimbursements</b>
Active Assets Money Trust	0.25%	0.10%	0.07%	0.42%	0.18%
Active Assets Government Securities Trust	0.45%	0.10%	0.11%	0.66%	0.08%
Active Assets Institutional Government Securities Trust	0.10%	None	0.08%	0.18%	0.17%
Active Assets Institutional Money Trust	0.10%	None	0.08%	0.18%	0.17%
Morgan Stanley Liquid Asset Fund Inc.	0.23%	0.10%	0.12%	0.45%	0.19%
Morgan Stanley U.S. Government Money Market Trust	0.36%	0.10%	0.10%	0.56%	0.10%