

# **Form ADV Firm Brochure**

## **Morgan Stanley Smith Barney LLC**

**Legg Mason Private Portfolios Program**

**March 31, 2011**

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This brochure provides information about the qualifications and business practices of Morgan Stanley Smith Barney LLC (“MSSB”). If you have any questions about the contents of this brochure, please contact us at [client.services@mssb.com](mailto:client.services@mssb.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority.

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

**MorganStanley  
SmithBarney**

## **Item 2: Material Changes**

Not applicable

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## Item 4: Advisory Business

### A. Description of Advisory Firm and Principal Owners

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

In June 2009, Morgan Stanley (“Morgan Stanley Parent”) and Citigroup Inc. (“Citi”) combined the Global Wealth Management Group of Morgan Stanley & Co. Incorporated (“MS&Co.”) and the Smith Barney and related businesses of Citi affiliates. Under the terms of the agreement, Citi sold 100% of its Smith Barney, Smith Barney Australia and Quilter units for a 49% stake in the joint venture company and an upfront cash payment of \$2.7 billion. Morgan Stanley Parent exchanged 100% of its Global Wealth Management business for a 51% stake in the joint venture company. After year three, Morgan Stanley Parent and Citi will have various purchase and sale rights for the joint venture company, but Citi will continue to own a significant stake in the joint venture company at least through year five. The joint venture owns MSSB. Predecessor firms of MSSB have been in business since the late 1800’s.

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

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

MSSB is in the process of merging the SB Channel and MS Channel advisory programs. Until the programs merge, clients’ assets will be custodied at either CGM (for SB Channel clients) or MSSB (for MS Channel clients).

### B. Description of Advisory Services

The Legg Mason Private Portfolios program is only offered through the SB Channel, and is currently closed to new business. The fee plus commission version of the Legg Mason Private Portfolios program as described in this brochure was only offered for equity and balanced accounts. There is also a wrap fee version of this program, which is also offered only through

the SB Channel, and is also closed to new business. Please see the MSSB Form ADV Wrap Fee Program brochure for the Legg Mason Private Portfolios program, for more information. You may obtain this Wrap Fee Program Brochure at [www.smithbarney.com/ADV](http://www.smithbarney.com/ADV) or by asking your Financial Advisor.

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

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

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

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

CGM (as clearing broker for MSSB) provides custody, execution and related services.

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

The Sub-Managers available the program currently are the following investment management firms: ClearBridge Advisors, LLC, Western Asset Management Company, Brandywine

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

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

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

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

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

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

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

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

##### ***Tailored Advisory Services***

To enroll in the Legg Mason Private Portfolios program, you (or your Financial Advisor on your behalf) must complete an

investment questionnaire and you must enter into the program client agreement (“Client Agreement”).

Since MSSB does not have discretion to select securities or investment Strategies for you in this program, with the assistance of your Financial Advisor you will select the Sub-Managers and Strateg(ies) for your account *See Item 4.A above, for more information.*

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

#### ***Restrictions***

In this program, you may impose reasonable restrictions on account investments. For example, you may restrict MSSB from buying specific securities or a category of securities (e.g., tobacco companies). If you restrict a category of securities, LMPPG or the Sub-Manager will determine which specific securities fall within the restricted category. In doing so, LMPPG or the Sub-Manager may rely on outside sources (e.g. standard industry codes and research provided by independent service providers). Any restrictions you impose on individual securities have no effect on mutual fund or ETF holdings since mutual funds and ETFs operate in accordance with the investment objectives and strategies described in their prospectuses.

#### **D. Participation in Wrap Fee Programs By Providing Portfolio Management Services**

This Item is not applicable to MSSB, because MSSB does not participate in Wrap Fee Programs by providing portfolio management services.

#### **E. Assets Under Management**

As of January 31, 2011 MSSB managed client assets as follows:

##### Discretionary Assets Under Management:

\$155,853,600,000

##### Non-Discretionary Assets Under Management:

\$281,184,400,000

The above figures represent assets under management for MSSB as a whole (not just for the fee plus commission version of the Legg Mason Private Portfolios program which is described in this brochure).

### **Item 5: Fees and Compensation**

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

***Fees for Advisory Services.*** You pay an asset-based fee that covers the advisory services provided by MSSB, LMPPG and the Sub-Managers you select. This fee does not cover brokerage commissions or other charges resulting from effecting transactions. The standard asset based fee depends on the asset value of your account, and is as follows:

##### Asset Value of Client’s Account: Standard Fee:

First \$3 million	1.00%
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Next \$7 million	0.75%
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Balance over \$10 million	0.50%
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In addition, you pay a fee (which you agree to with MSSB and is generally on the basis of cents per share traded), to cover brokerage commissions or other charges resulting from effecting transactions through MSSB or its affiliates.

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

Account Type	Annual LMPPG Fee
All Cap	0.28%
Large Cap	
Equity Balanced	
Multi-Cap Growth	0.32%
Mid Cap	
International	
Small Cap	0.34%
SMID Cap	

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

The fees listed herein are subject to change without notice. In the case of equity, balanced and multi-style accounts, MSSB segregates 0.47% of the fee which is charged to clients, and applies all or a portion of it to the asset-based fee paid to LMPPG. When MSSB's payment to LMPPG is less than the segregated amount (0.47%), MSSB retains a larger portion of the fee charged to clients. Thus, MSSB has an incentive to recommend investment styles for which LMPPG is paid less, because MSSB will retain a higher fee. No portion of the segregated amount is paid to Financial Advisors, who therefore have no direct financial incentive to recommend one LMPPG investment style over another. However, Financial Advisors' compensation is directly affected by the size of the client's annual fee, and to the trading activity in the account (since the Financial Advisors receive part of any commission charges on the account). MSSB may be compensated where it (and not LMPPG) provides implementation services, and in that case LMPPG in effect is paid less. Since MSSB pays its fee from the fee that MSSB receives from the account, MSSB may have an incentive to recommend an investment style for which MSSB provides implementation services.

Legg Mason Private Portfolios is also available on a wrap fee basis. For information on that program, please ask your Financial Advisor for the relevant MSSB Form ADV Wrap Fee Program Brochure.

**Fees are Negotiable.** Fees for the Legg Mason Private 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. In special circumstances, and with the client's

agreement, the fee charged to a client for an account may be more than the maximum annual fee stated in this section.

## B. Payment of Fees

**Deduction of Fees from Account.** The Client Agreement authorizes CGM (as custodian and clearing broker for MSSB) to deduct fees when due from the assets contained in the account.

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

**Breakpoints.** Fee rates in the Legg Mason Private 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.

**Other.** A portion of the fee will be paid to your Financial Advisor. *See Item 5.E below (Compensation to MSSB and Financial Advisors), for more information.*

## C. Additional Fees and Expenses

If you open an account in the program described in this brochure, you will pay an asset-based fee that covers the advisory services provided by MSSB, LMPPG and the Sub-Managers you select. In addition, you pay a fee (which you agree to with MSSB and is generally on the basis of cents per share traded), to cover brokerage commissions or other charges resulting from effecting transactions through MSSB or its

affiliates. Please see Item 5.A above, for more information on these fees. Please see Item 12 below, for information on Brokerage Practices.

These fees do not cover:

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

### **Mutual Funds and ETFs**

LMPPG or Sub-Managers may purchase mutual funds for your Legg Mason Private Portfolios account. These mutual funds may include:

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

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

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

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

### **Cash Sweeps**

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

- interest-bearing bank deposit accounts established under the Bank Deposit Program (“BDP”) or
- money market mutual funds (each, a “Money Market Fund”) and, together with BDP accounts, “Sweep Investments”). These money market funds are managed by Morgan Stanley Investment Advisors Inc. or another MSSB affiliate except for:
  - *SB Channel retirement accounts:* The “sweep” money market funds are managed by an unaffiliated manager.
  - *SB Channel taxable accounts open as of the date of this brochure (March 28, 2011) and containing a Western money market fund:* You will retain your “sweep” money market fund managed by Western Asset Management Company for a transitional period. On April 1, 2011, you will also have a sweep money market fund managed by a MSSB affiliate. During April, your Western sweep fund will close and your only sweep fund will then be that managed by the MSSB affiliate. For more details on this transition, please see the separate communication we have already sent you.

If you do not select a Sweep Investment when you open your account, your Sweep Investment will be BDP if or selected by your Financial Advisor (SB Channel clients).

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

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**

If BDP is your Sweep Investment, you authorize, without any further direction, that all cash balances in your account in excess of \$1.00 be automatically deposited or swept every business day into an account at a depository institution affiliated with Citi (SB Channel).

Your BDP accounts earn interest. Your BDP deposits are 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 applicable sweep bank in the same capacity. You are responsible for monitoring the total amount of BDP and other deposits you have at any bank to determine the extent of FDIC insurance coverage available to you. MSSB, Citi and their affiliates are not responsible for any insured or uninsured portion of your deposits

at the BDP banks. BDP deposits are not covered by SIPC or excess coverage.

If BDP is your Sweep Investment, the affiliated 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.

Terms of the Bank Deposit Program are further described in the Bank Deposit Program Disclosure Statement, which is provided to you with your account opening materials. If you are participating in the Bank Deposit Program, please read the Bank Deposit Program Disclosure Statement carefully.

**Money Market Funds.** If you elect an eligible Money Market Fund, you authorize, without any further direction, that all cash balances in the account in excess of \$1.00 be automatically invested every business day into that Money Market Fund. If account cash balances are invested in Money Market Funds sponsored or managed by MSSB affiliates, we receive and retain fund fees up to 0.18% from those Money Market Funds or those money market funds' affiliates. Therefore, MSSB has a conflict of interest in recommending that a portion of your account is invested in money market funds.

## **D. Payment of Fees in Advance.**

The asset-based fee for advisory services is generally paid quarterly in advance. If you terminate your Client Agreement at any time during a billing quarter, we will refund you the pre-paid asset-based fee, pro-rata for the balance of the billing quarter.

## **E. Compensation to MSSB and 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 (including a portion of the fee to cover brokerage commissions or other charges resulting from effecting transactions through MSSB or its affiliates) is allocated on an ongoing basis to your Financial Advisor. As explained in Item 5.C above, we will also receive compensation from Money Market Funds.

In addition, MSSB is a full service investment adviser and securities broker-dealer and we offer many types of financial products to clients. These include other investment advisory products, stocks, bonds, mutual funds, options, futures, private funds, alternative investments, structured products and insurance. Both we and your Financial Advisor accept compensation for the sale of these securities and other investment products, including asset-based sales charges or service fees from the sale of mutual funds.

**1. Conflicts of Interest Relating to Compensation.** The amount allocated to your Financial Advisor in connection with accounts opened in the 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 compensation we pay Financial Advisors with respect to program accounts is typically higher than the compensation we pay Financial Advisors with respect to transaction-based brokerage accounts. Your Financial Advisor may therefore

have a financial incentive to recommend the program in this brochure instead of other MSSB programs or services.

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

Also, the fact that both we and your Financial Advisor accept compensation for the sale of securities and other investment products other than the Legg Mason Private Portfolios program presents a conflict of interest and gives us and your Financial Advisor an incentive to recommend investment products based on the compensation received, rather than on a client's needs.

We generally address these conflicts of interest by disclosing them to the client, and by acting in accordance with common law fiduciary standards where we are selling investment products (such as those described in this brochure) that are subject to those standards.

Where we recommend mutual funds in investment advisory programs, we generally recommend "no-load" funds. Where we recommend mutual funds in brokerage programs, we generally recommend funds with a "load".

**2. Purchase of Investment Products Through Other Broker-Dealers.** You have the option to purchase investment products similar or identical to those that MSSB or your Financial Advisor recommends, through other brokers or agents that are not affiliated with MSSB.

**3. Advisory Client Revenue From Commissions.** Less than 50% of our revenue from investment advisory clients results from commissions and other compensation for the sale of investment products that we recommend to our clients. More than 50% of our revenue from these clients comes from investment advisory "wrap fee" charges.

**4. Advisory Fees in Addition to Commissions or Markups.** In the Legg Mason Private Portfolios program, MSSB charges a asset-based fee for advisory services in addition to commissions or markups. *Please see Item 5.A above, for more information.* In this program, we do not reduce the advisory fees charged to offset the commissions or markups.

## **Item 6: Performance Based Fees**

This Item is not applicable to the Legg Mason Private Portfolios program, because we do not charge performance-based fees for that program.

## **Item 7: Types of Clients and Minimum Account Size**

**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.

**Minimum Account Size.** In the fee plus commission version of the Legg Mason Private Portfolios program, the minimum account size is generally \$1,000,000. MSSB, in its sole discretion, may waive this minimum for any one or more accounts.

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

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

As described in Item 4.B above, MSSB does not provide portfolio management services in the program described in this brochure. LMPPG or the Sub-Managers provide the discretionary management of your account. Financial Advisors may recommend a particular Sub-Manager or Strategy to you. Investing in securities involves risk of loss that you should be prepared to bear.

Please review the LMPP Brochure for a discussion on the method of analysis and investment strategies utilized by LMPPG and the Sub-Managers.

In the Legg Mason Private Portfolios program, we offer a wide range of investment Strategies based on Model Portfolios furnished by Sub-Managers that we have selected and approved. Item 4.B above describes the basis on which we recommend particular Sub-Managers and Strategies to particular clients. This Item 8.A describes more generally the method of analysis we use to select and terminate Sub-Managers and Strategies from the Legg Mason Private Portfolios program. If Sub-Managers have more than one Strategy, we may include only some of those Strategies in the program, and may assign different statuses to different Strategies.

Our Consulting Group Investment Advisor Research department ("CG IAR") evaluates Sub-Managers and Strategies. CG IAR may delegate some or all of its functions to an affiliate or third party. Sub-Managers and Strategies may only participate in the Legg Mason Private Portfolios program if they are on CG IAR's Focus List or Approved List discussed below. The Focus List and Approved List are at [www.morganstanleyindividual.com/accountoptions/managedmoney/manager/default.asp](http://www.morganstanleyindividual.com/accountoptions/managedmoney/manager/default.asp) (or you can ask your Financial Advisor for these lists). In this program, only some of the Sub-Managers and Strategies may be available.

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

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

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

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

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

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

CG IAR periodically evaluates Sub-Managers and Strategies on the Approved List to determine whether they continue to meet the Approved List standards.

**Changes in Status from Focus List to Approved List.** In light of the differing evaluation methodology and standards for the Focus List and Approved List, CG IAR may determine that a Sub-Manager or Strategy no longer meets the criteria for the Focus List or will no longer be reviewed under the Focus List review process, but meets the criteria for the Approved List. If so, MSSB generally notifies program clients regarding such status changes on a quarterly basis.

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

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

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

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

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

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

## **B. Material Risks of Investment Strategies**

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, a Financial Advisor's, LMPPG's or a Sub-Manager's past performance with respect to other accounts does not predict future performance with respect to any particular account. In addition, certain investment strategies that mutual funds, ETFs or Sub-Managers may use in the program have specific risks, including those associated with investments in common stock, fixed income securities, American Depository Receipts, mutual funds, ETFs and foreign securities. You should consult with your Financial Advisor regarding the specific risks associated with the investments in your account. Also, please review the Legg Mason Brochure for a discussion of the material risks associated with any Strategy you may have selected. You may obtain this at [www.smithbarney.com/ADV](http://www.smithbarney.com/ADV) or by asking your Financial Advisor.

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

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

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

For other risks relating to the particular Strategy you hold in your account, see the Legg Mason Brochure, which you can obtain from your Financial Advisor.

### **Tax Considerations**

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

In the Legg Mason Private Portfolios program, your Financial Advisor may agree with you to implement a client-developed investment strategy that you believe is sensitive to your particular tax situation. Neither we nor any of our affiliates provide tax advice and, therefore, we and they are not responsible for developing, evaluating or the efficacy of any such tax-sensitive strategy. You need to develop any such strategy in consultation with a qualified tax adviser. Certain tax-sensitive strategies can involve risks. Among others, tax-efficient management services involve an increased risk of loss because your account may not receive the benefit (e.g., realized profit, avoided loss) of securities transactions that would otherwise take place in accordance with the Financial Advisor's investment management decisions for the account.

## **C. Risks if Recommend Primarily a Particular Type of Security**

This Item is not applicable to the Legg Mason Private Portfolios program, because MSSB does not recommend primarily a particular type of security in this program.

## **Item 9: Disciplinary Information**

This section contains information on certain legal and disciplinary events.

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

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

reports; (3) erroneously executed certain sell orders on a minus tick for securities in which MS&Co. held a short position; (4) failed to timely submit RE-3 in connection with certain matters; (5) hired certain individuals subject to statutory disqualification and failed to file fingerprint cards for certain non-registered employees; (6) failed to comply with requirements concerning certain market-on-close and limit-on-close orders; and (7) failed to reasonably supervise certain activities. MS&Co. and MSDW resolved the action on January 7, 2005, by consenting, without admitting or denying guilt, to a censure, a fine of \$13 million, and a rescission offer to those clients who should have received a prospectus during the period from June 2003 to September 2004.

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

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

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

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

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

- In a LAWC dated August 1, 2005, the NASD found that MSDW failed to establish and maintain a supervisory system, including written procedures, reasonably designed to review and monitor MSDW's fee-based brokerage business, between January 2001 and December 2003. Without admitting or denying the allegations, MSDW consented to the described sanctions and findings and was censured and fined \$1.5 million, and agreed to the payment of restitution to 3,549 customers in the total amount of approximately \$4.7 million, plus interest.
- The SEC alleged that MS&Co. violated the Exchange Act by inadvertently failing to timely produce emails to the SEC staff pursuant to subpoenas in the SEC's investigation into MS&Co.'s practices in allocating shares of stock in IPOs and an investigation into conflicts of interest between MS&Co.'s research and investment banking practices. Without admitting or denying the allegations, MS&Co. consented to a final judgment on May 12, 2006 in which it was permanently restrained and enjoined from violating the Exchange Act. MS&Co. agreed to make payments aggregating \$15 million, which amount was reduced by \$5 million contemporaneously paid by MS&Co. to the NASD and the NYSE in related proceedings. MS&Co. also agreed to notify the SEC, the NASD and the NYSE that it has adopted and implemented policies and procedures reasonably designed to ensure compliance with the Exchange Act. MS&Co. also agreed to provide annual training to its employees responsible for preserving or producing electronic communications and agreed to retain an independent consultant to review and comment on the implementation and effectiveness of the policies, procedures and training.
- On June 27, 2006, the SEC announced the initiation and concurrent settlement of administrative cease and desist proceedings against MS&Co. and MSDW for failing to maintain and enforce adequate written policies and procedures to prevent the misuse of material nonpublic information. The SEC found that from 1997 through 2006, MS&Co. and MSDW violated the Exchange Act and the Advisers Act by failing to (1) conduct any surveillance of a number of accounts and securities; (2) provide adequate guidance to MS&Co.'s and MSDW's personnel charged with conducting surveillance; and (3) have adequate controls in place with respect to certain aspects of "Watch List" maintenance. The SEC's findings covered different areas from the 1997 through 2006 time period. MS&Co. and MSDW were ordered to pay a civil money penalty of \$10 million and agreed to enhance their policies and procedures.
- On August 21, 2006, MS&Co. and MSDW entered into a LAWC relating various finds that, at various times between July 1999 and 2005, MS&Co. violated a number of NASD and SEC rules. The violations related to areas including trade reporting through the Nasdaq Market Center (formerly Automated Confirmation Transaction Service (ACT)), Trade Reporting and Compliance Engine (TRACE) and Order Audit Trail System (OATS); market making activities; trading practices; short sales; and large options positions reports. The NASD also found that, at various times during December 2002 and May 2005, MSDW violated NASD rules and Municipal Securities Rulemaking Board ("MSRB") rules related to areas including trade reporting through TRACE, short sales, and OATS. The NASD further found that, in certain cases, MS&Co. and MSDW violated NASD Rule 3010 because their supervisory systems did not provide supervision reasonably designed to achieve compliance with securities laws, regulations and/or rules.
- Without admitting or denying the findings, MS&Co. and MSDW consented to the LAWC. In the LAWC, MS&Co. and MSDW were censured, required to pay a monetary fine of \$2.9 million and agreed to make restitution to the parties involved in certain transactions, plus interest, from the date of the violative conduct until the date of the LAWC. MS&Co. and MSDW also consented to (1) revise their written supervisory procedures; and (2) provide a report that described the corrective action that they completed during the year preceding the LAWC to address regulatory issues and violations addressed in the LAWC, and the ongoing corrective action that they were in the process of completing.
- On May 9, 2007, the SEC issued an Order ("May 2007 Order") settling an administrative action with MS&Co. In this matter, the SEC found that MS&Co. violated its duty of best execution under the Exchange Act. In particular, the SEC found that, during the period of October 24, 2001 through December 8, 2004, MS&Co.'s proprietary market-making system failed to provide best execution to certain retail OTC orders. In December 2004, MS&Co. removed the computer code in the proprietary market-making system that caused the best execution violations. MS&Co. consented, without admitting or denying the findings, to a censure, to cease and desist from committing or causing future violations, to pay disgorgement of approximately \$5.9 million plus prejudgment interest on that amount, and to pay a civil penalty of \$1.5 million. MS&Co. also consented to retain an Independent Compliance Consultant to review its policies and procedures in connection with its market-making system's order handling procedures and its controls relating to changes to those procedures, and to develop a better plan of distribution.
- On July 13, 2007, the NYSE issued a Hearing Board Decision in connection with the settlement of an enforcement proceeding brought in conjunction with the New Jersey Bureau of Securities against CGM. The decision held that CGM failed to (1) adequately supervise certain branch offices and Financial Advisors who engaged in deceptive mutual fund market timing on behalf of certain clients from January 2000 through September 2003 (in both proprietary and non-proprietary funds); (2) prevent the Financial Advisors from engaging in this conduct; and (3) make and keep adequate books and records. Without admitting or denying the findings, CGM agreed to (a) a censure; (b) establishing a \$35 million distribution fund for disgorgement payments; (c) a penalty of \$10 million (half to be paid to the NYSE and half to be paid to the distribution fund); (d) a penalty of \$5 million to be paid to the State of New Jersey; and (e) appointing a consultant to develop a plan to pay CGM's clients affected by the market timing.
- On September 27, 2007, MS&Co. entered into a LAWC with the Financial Industry Regulatory Authority ("FINRA"). FINRA found that, from October 2001 through March 2005, MSDW provided inaccurate information to arbitration claimants and regulators regarding the existence of pre-September 11, 2001 emails, failed to provide such emails in response to discovery requests and regulatory inquiries, failed adequately to preserve books and records, and failed to

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

- On October 10, 2007, MS&Co. became the subject of an Order Instituting Administrative and Cease-And-Desist Proceedings (“October 2007 Order”) by the SEC. The October 2007 Order found that, from 2000 until 2005, MS&Co. and MSDW failed to provide to their retail customers accurate and complete written trade confirmations for certain fixed income securities in violation of the Exchange Act and MSRB rules. In addition, MS&Co. was ordered to cease and desist from committing or causing any future violations, and was required to pay a \$7.5 million penalty and to retain an independent consultant to review MS&Co.’s applicable policies and procedures. MS&Co. consented to the issuance of the October 2007 Order without admitting or denying the SEC’s findings.

- On December 18, 2007, MS&Co. became the subject of an Order Instituting Administrative Cease-and-Desist Proceedings (“December 2007 Order”) by the SEC. The December 2007 Order found that, from January 2002 until August 2003, MSDW (1) failed to reasonably supervise four Financial Advisors, with a view to preventing and detecting their mutual fund market-timing activities and (2) violated the Investment Company Act of 1940 by allowing multiple mutual fund trades that were placed or amended after the close of trading to be priced at that day’s closing net asset value. The December 2007 Order also found that, from 2000 through 2003, MSDW violated the Exchange Act by not making and keeping records of customer orders placed after the market close and orders placed for certain hedge fund customers in variable annuity sub-accounts. Without admitting or denying the SEC’s findings, MS&Co. agreed to a censure, to cease and desist from future violations of the applicable provisions, to pay a penalty of approximately \$11.9 million, to disgorge profits related to the trading activity (including prejudgment interest) of approximately \$5.1 million and to retain an independent distribution consultant.

- In May 2005, MS&Co. and MSDW discovered that, from about January 1997 until May 2005, their order entry systems did not check whether certain secondary market securities transactions complied with state registration requirements known as Blue Sky laws. This resulted in the improper sale of securities that were not registered in 46 state and territorial jurisdictions. MS&Co. and MSDW conducted an internal investigation, repaired system errors, self-reported the problem to all affected states and the New York Stock Exchange, identified transactions which were executed in violation of the Blue Sky laws, and offered rescission to affected customers. MS&Co. settled the state regulatory

issues in a multi-state settlement with the 46 affected state and territorial jurisdictions. Under the settlement, MS&Co. consented to a cease and desist order with, and agreed to pay a total civil monetary penalty of \$8.5 million to be divided among, each of the 46 state and territorial jurisdictions. The first order was issued by Alabama on March 19, 2008, and orders are expected to be issued by subsequent states over the coming months.

- On August 13, 2008, MS&Co. agreed on the general terms of a settlement with the NYAG and the Office of the Illinois Secretary of State, Securities Department (“Illinois”) (on behalf of a task force of the North American Securities Administrators Association (“NASAA”)) with respect to the sale of auction rate securities (“ARS”). MS&Co. agreed, among other things, to repurchase at par approximately \$4.5 billion of illiquid ARS held by certain clients of MS&Co. which were purchased prior to February 13, 2008. Additionally, MS&Co. agreed to pay a total fine of \$35 million. Final agreements were entered into with the NYAG on June 2, 2009 and with Illinois on September 17, 2009. The Illinois agreement serves as the template for agreements with other NASAA jurisdictions.
- On November 13, 2008, in connection with the settlement of a civil action arising out of an investigation by the SEC into CGM’s underwriting, marketing and sale of ARS, CGM, without admitting or denying the allegations of the SEC’s complaint, except as to those relating to personal and subject matter jurisdiction, which were admitted, consented to the entry in the civil action of a Judgment As To Defendant Citigroup Global Markets Inc. (“November 2008 Judgment”). Thereafter, on December 11, 2008, the SEC filed its civil action in the federal district court for the Southern District of New York (“Court”). The November 2008 Judgment, which was entered on December 23, 2008 (i) permanently enjoined CGM from directly or indirectly violating section 15(c) of the Exchange Act; (ii) provides that, on later motion of the SEC, the Court is to determine whether it is appropriate to order that CGM pay a civil penalty pursuant to section 21(d)(3) of the Exchange Act, and if so, the amount of the civil penalty; and (iii) ordered that CGM’s Consent be incorporated into the November 2008 Judgment and that CGM comply with all of the undertakings and agreements in the Consent, which include an offer to buy back at par certain ARS from certain customers. The SEC’s complaint alleged that (1) CGM misled tens of thousands of its customers regarding the fundamental nature of and risks associated with ARS that CGM underwrote, marketed and sold; (2) through its financial advisers, sales personnel and marketing materials, CGM misrepresented to customers that ARS were safe, highly liquid investments comparable to money market instruments; (3) as a result, numerous CGM customers invested in ARS funds they needed to have available on a short-term basis; (4) in mid-February 2008, CGM decided to stop supporting the auctions; and (5) as a result of the failed auctions, tens of thousands of CGM customers held approximately \$45 billion of illiquid ARS, instead of the liquid short-term investments CGM had represented ARS to be. CGM reached substantially similar settlements with the NYAG and the Texas State Securities Board (“TSSB”), although those settlements were administrative in nature and neither involved the filing of a civil action in state court. The settlements with the NYAG

and the TSSB differed somewhat from the settlement with the SEC in that the state settlements (a) made findings that CGM failed to preserve certain recordings of telephone calls involving the ARS trading desk; and (b) required CGM to refund certain underwriting fees to certain municipal issuers. In addition, as part of the settlement with New York, CGM paid a civil penalty of \$50 million. CGM also agreed in principle to pay to states other than New York with which it enters into formal settlements a total of \$50 million. CGM paid \$3.59 million of this \$50 million to Texas as part of the settlement with that state. CGM expects it will reach settlements with the remaining states.

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

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

## **Item 10: Other Financial Industry Activities and Affiliations**

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

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

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

### **A. Broker-Dealer Registration**

As well as being a registered Investment Adviser, MSSB is registered as a Broker-Dealer.

### **B. Futures Commission Merchant and Other Registrations**

MSSB is also registered as a Futures Commission Merchant. MSSB has a related person that is registered as Commodity Pool Operator (Demeter Management Corp.) For a full listing of affiliated investment advisers please see the MSSB Form ADV Part I.

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

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

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

These restrictions may adversely impact client account performance.

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

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

**Trade Allocations.** 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 or CGM, the price to

each client is the average price for the aggregate order. MSSB performs these trade allocation functions as part of its duties as Overlay Manager, as described in Item 4.A above.

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

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

MSSB, the managers and their affiliates may also develop analyses and/or evaluations of securities sold in a program described in this brochure, as well as buy and sell interests in securities on behalf of its proprietary or client accounts. These analyses, evaluations and purchase and sale activities are proprietary and confidential, and MSSB will not disclose them to clients. MSSB may not be able to act, in respect of clients' account, on any such information, analyses or evaluations.

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

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

**Certain Trading Systems.** If MSSB directly or indirectly effects client trades through exchanges, electronic communication networks or other alternative trading systems ("Trading Systems") in which its affiliates have an ownership interest, these affiliates may receive an indirect economic benefit based on their ownership interest. Currently, affiliates of MSSB (including affiliates of MS&Co. and Citi) own over 5% of the voting securities of certain Trading Systems, including BATS Trading, Inc., operator of BATS Electronic Trading Network (commonly known as "BATS"); the entities that own and control

the Block Interest Discovery System (commonly known as "BIDS"); LavaFlow Inc.; EBX Group, LLC; ELX Futures Holdings, LLC; ELX Futures, LP; TheMuniCenter; Automated Trading Desk Financial Services LLC; Automated Trading Desk Brokerage Services LLC; Boston Options Exchange, LLC; FX Alliance Inc.; and National Securities Exchange. Other Trading Systems on which MSSB may execute trades for client accounts include Archipelago; eSpeed; Instinet; NYFIX; Track ECN; BondDesk; ValuBond; NYSE Euronext; TradeWeb; and MarketAxe. The Trading Systems on which MSSB trades for Client accounts and in which affiliates of MSSB own interests may change from time to time. You may contact your Financial Advisor for an up-to-date list of Trading Systems in which affiliates of MSSB own interests and on which MSSB and/or MS&Co. trades for client accounts.

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

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

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

- **Clearing.** An agreement providing that, subject to best execution, MS&Co. and CGM (or their applicable affiliates) will act as fully-disclosed clearing brokers for MSSB, which will act as an introducing broker. MSSB may have a conflict of interest in introducing client trades to MS&Co. and CGM. (As of the date of this brochure, MSSB is the clearing broker for most of the MS Channel's investment advisory programs. MS&Co. is the clearing broker for some MS Channel clients, typically those with accounts administered by the MS Channel's Private Wealth Management division. CGM is the clearing broker for SB Channel clients.)
- **Order Flow.** An agreement that, subject to best execution, MSSB will transmit an agreed percentage of client orders for the purchase and sale of securities to MS&Co., Citi, CGM and their affiliates. MSSB has a conflict of interest in transmitting client orders to these entities.
- **Distribution.** An agreement that, in return for the payment of certain fees and expenses, MSSB will market and promote certain securities and other products underwritten, distributed or sponsored by MS&Co., Citi or their affiliates. MSSB has a conflict of interest in offering, recommending

or purchasing any such security or other product to or for its investment advisory clients.

- **Investment Research.** An agreement that MS&Co. and CGM (or their applicable affiliates) will supply investment research prepared by their respective research groups to MSSB for its use. It is possible that MS&Co.'s research group, on the one hand, and Citi's research group, on the other hand, may reach different conclusions, and may make different recommendations, with respect to the same issuer or investment manager. This may, among other things, result in different investment decisions or recommendations regarding the same issuer or investment manager being made for or given to MSSB investment advisory clients.

**Advisory vs. Brokerage Accounts.** MSSB and your Financial Advisor are likely to earn more compensation if you invest in the 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). Financial Advisors and MSSB therefore have a financial incentive to recommend one of the programs described in this brochure. We address this conflict of interest by disclosing it to you and by requiring Financial Advisors' supervisors to review your account at account-opening to ensure that it is suitable for you in light of matters such as your investment objectives and financial circumstances.

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

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

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

**Compensation to Citi Affiliate.** Citi is a part owner of MSSB. Global Transaction Services, a business unit of Citi, receives

compensation for providing administrative and back office services to investment management firms, mutual funds and hedge funds (collectively "Investment Management Firms"). These Investment Management Firms may include LMPPG and Sub-Managers.

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

**Cash Sweeps.** See "Cash Sweeps" under Item 5.C above for information relating to the benefits to MSSB from the cash sweep options in the Legg Mason Private Portfolios program.

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

**Conferences and Training Provided to Financial Advisors by LMPP or Sub-Managers** In the advisory program described in this brochure, MSSB recommends investment advisers to clients. LMPP or Sub-Managers may provide conferences and other training sessions to the Financial Advisors.

**LMPP and Sub-Manager Management of Mutual Funds.** In addition, LMPP and Sub-Managers also manage mutual funds, alternative products or act as a sub adviser to mutual funds affiliated with MSSB. Since MSSB receives fees from the mutual fund or its adviser, MSSB has a conflict to recommend the mutual fund products instead of the investment adviser managing the account directly.

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

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

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

Investment managers are allowed to occasionally give nominal gifts to Financial Advisors, and to occasionally entertain Financial Advisors, subject to a limit of \$1,000 per employee per

year. MSSB's non-cash compensation policies set conditions for each of these types of payments, and do not permit any gifts or entertainment conditioned on achieving a sales target. On request, your Financial Advisor can provide you with an annual estimate of the aggregate value of gifts and entertainment that investment managers pay or provide to MSSB or particular Financial Advisors.

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

## **Item 11: Code of Ethics**

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

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

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

- Certain Employees, because of their potential access to non-public information, must obtain prior written approval before executing certain securities transactions for their personal securities accounts. All Employees must also follow special procedures for investing in private securities transactions.

- Certain Employees are subject to further restrictions on their securities transaction activities (including Financial Advisors and other MSSB employees who act as portfolio managers in MSSB investment advisory programs).

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

*See Item 10.C above.*

## **Item 12: Brokerage Practices**

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

MSSB does not recommend broker-dealers to effect client securities transactions in the Legg Mason Private Portfolios program. For this program, securities are executed through CGM as clearing broker for MSSB.

**1. Research and Other Soft Dollar Benefits.** This Item is not applicable to the Legg Mason Private Portfolios program, because MSSB does not receive research or soft dollar benefits from this program.

**2. Brokerage for Client Referrals.** This Item is not applicable to the Legg Mason Private Portfolios program, because MSSB does not consider, in selecting or recommending broker-dealers, whether MSSB or a related person receives client referrals from a broker-dealer or third party.

**3. Directed Brokerage.** In the fee plus commission version of the Legg Mason Private Portfolios program described in this brochure, MSSB requires that a client direct us to execute all transactions through MSSB at a rate (generally on the basis of cents per share traded), which you agree to with MSSB. Clients may avoid this conflict, since clients also have the option of utilizing the wrap fee version of the Legg Mason Private Portfolios program (in which the wrap fee would include execution through MSSB). Please see the relevant MSSB Wrap Fee Program Brochure for more information. You may obtain this Wrap Fee Program Brochure at [www.smithbarney.com/ADV](http://www.smithbarney.com/ADV) or by asking your Financial Advisor.

Not all advisors require their clients to direct brokerage. This arrangement creates a conflict of interest in that MSSB or the client might be able to obtain execution at a lower cost per share elsewhere (in which case this practice may cost clients more money)

### **B. Aggregation of Securities Transactions for Client Accounts**

In the case of trades that are driven by a change in an underlying Sub-Manager's investment model and that need to be effected for many clients, MSSB generally will seek to aggregate these trades for execution through a single broker-dealer in a block trade and then to step out those trades to MSSB for clearance and settlement in the ordinary course. MSSB has established

relationships with one or more broker-dealers that have generally agreed to execute such block trades at no additional cost to MSSB's clients.

## **Item 13: Reviewing Accounts**

### **A. Frequency and Nature of Review of Client Accounts**

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

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

In the Legg Mason Private Portfolios program, the Overlay Manager conducts various checks on a periodic basis (e.g. identifying and reviewing accounts with a high cash balance or account inactivity).

### **B. Factors Triggering a Review of Accounts**

Your Financial Advisor will review your account periodically, and in addition upon any request from you.

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

We make written Investment Monitors available to you every quarter. These reviews have tabular reports and graphical displays showing how your account investments have performed, both on an absolute basis and on a relative basis compared to recognized indices (such as Standard & Poor's indices). You may access these reports through MSSB's online account services site. To enroll your account in the online account service site, SB Channel clients should go to <https://www.smithbarney.com/app-bin/reg/servlets/Registration> and follow the step-by-step instructions. If, however, you would like to receive these reports by mail, please call 1-888-454-3965.

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

### **A. Economic Benefits From Investment Managers**

*See "Payments from Investment Managers" in Item 10.D above, for information on investment managers providing economic benefits to MSSB or Financial Advisors.*

### **B. Compensation for Client Referrals**

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

## **Item 15: Custody**

In this program, CGM (as clearing broker for MSSB) generally has custody of client funds. You will receive an account statement from CGM at least quarterly. You should carefully review each statement, and compare it with the information in

the Investment Monitors which we make available to you. *See Item 13.C above.*

## **Item 16: Investment Discretion**

This Item is not applicable to the Legg Mason Private Portfolios program, because in this program MSSB does not accept discretionary authority to manage accounts on behalf of clients. In this program, LMPPG or the Sub-Managers have discretion to manage these accounts in the Strategy selected by the client. *See Item 4.B for more information.*

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

### **A. MSSB Authority to Vote Client Securities**

This Item is not applicable to the Legg Mason Private Portfolios program, because in this program MSSB does not have, and will not accept, authority to vote client securities.

### **B. Proxies**

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

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

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.

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

## **Item 18: 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.