

EQUUS II INC
Form PRE 14A
May 10, 2005

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No. __)

Filed by the Registrant Filed by Party other than the Registrant

Check the appropriate box:

Preliminary proxy statement

Confidential, for use of the Commission only (as permitted by Rule 14a-6(e)(2))

Definitive proxy statement

Definitive additional materials

Soliciting materials pursuant to Rule 14a-11(c) or Rule 14a-12

EQUUS II INCORPORATED

(Name of Registrant as Specified in Its Charter)

Hank Nicodemus, 2727 Allen Parkway, 13th Floor, Houston, TX 77019

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(Name of Person(s) Filing Proxy Statement)

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No fee required.

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(1) Title of each class of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

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(3) Filing Party:

(4) Date Filed:

EQUUS II INCORPORATED

Notice of the 2005

Annual Meeting of Stockholders

Meeting Date: June 14, 2005
Meeting Time: 9:00 a.m., CDT
Location: Meeting Room No. 1, Ground Level,
Worham Tower
2727 Allen Parkway
Houston, Texas 77019

Agenda

To approve a new management agreement between Moore, Clayton Capital Advisors, Inc and the Fund;

To elect 10 directors, each for a term of one year;

To ratify the appointment of the Fund's independent auditor for fiscal 2005; and

To transact such other business as may properly come before the annual meeting.

Voting

All holders of record of shares of the Fund's common stock (NYSE: EQS) at the close of business on May 2, 2005 (the Record Date), or their legal proxy holders, are entitled to vote at the meeting and any postponements or adjournments of the meeting.

Please submit a proxy as soon as possible so that your shares can be voted at the meeting in accordance with your instructions. You may submit your proxy by mail. For specific instructions, please refer to the Questions and Answers, beginning on page 2 of this proxy statement and the instructions on the proxy card.

We are distributing this proxy statement and proxy form to stockholders on or about May __, 2005.

By order of the Board of Directors,

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HARRY O. NICODEMUS IV

Secretary

May __, 2005

Houston, Texas

EQUUS II INCORPORATED

2727 Allen Parkway, 13th Floor

Houston, Texas 77019

PROXY STATEMENT

This proxy statement contains information relating to the annual meeting of Equus II Incorporated (*EQS* or the *Fund*) to be held on Tuesday, June 14, 2005, beginning at 9:00 a.m., local time, at Meeting Room No. 1, Ground Level, Wortham Tower, 2727 Allen Parkway, Houston, Texas 77019, and at any postponements or adjournments thereof, and is furnished in connection with the solicitation of proxies by our Board of Directors to be voted at the annual meeting. This proxy statement is being mailed to stockholders on or about May____, 2005.

ABOUT THE MEETING

What is the purpose of the annual meeting?

At our annual meeting, stockholders will act upon the matters outlined in the notice of meeting on the cover page of this proxy statement, including the approval of a new management agreement between the Fund and Moore, Clayton Capital Advisors, Inc. (*MCCA* or the *Proposed New Adviser*) (see Item 1), the election of directors (see Item 2), the ratification of the Fund's independent auditor (see Item 3), and one shareholder proposal (see Item 4). In addition, the Fund's management will report on the performance of the Fund during 2004 and respond to questions from stockholders.

What are the Board's recommendations?

Unless you give other instructions on your proxy card, the persons named as proxy holders on the proxy card will vote in accordance with the recommendations of the Board. The Board's recommendation is set forth together with the description of each item in this proxy statement. In summary, the Board recommends a vote:

for approval of the new management agreement (see Item 1);

for election of the nominated slate of directors (see Item 2); and

for ratification of the appointment of PricewaterhouseCoopers LLP as the Fund's independent auditor (see Item 3).

With respect to any other matter that properly comes before the meeting, the proxy holders will vote as recommended by the Board or, if no recommendation is given, in their own discretion.

What vote is required to approve each item?

Election of Directors. The affirmative vote of a plurality of the votes cast at the meeting is required for the election of directors. A properly executed proxy marked "Withheld" with respect to the election of one or more directors will not be voted with respect to the director or directors indicated, although it will be counted for purposes of determining whether there is a quorum. The ten persons receiving the highest number of "For" votes will be elected.

Approval of Proposed Management Agreement. The affirmative vote of the lesser of 67% or more of the votes cast at the meeting or 50% of the outstanding shares of the Fund is required to approve the new management agreement. A properly executed proxy marked **Abstain** with respect to this proposal will not be voted in favor of or against the proposal although it will be counted as voted for purposes of determining whether there is a quorum. Accordingly, an abstention will have the effect of a negative vote.

Other Items. For each other item, the affirmative vote of the holders of a majority of the shares represented in person or by proxy and entitled to vote on the item will be required for approval. A properly executed proxy marked **Abstain** with respect to any such matter will not be voted in favor of or against such matter, although it will be counted as voted for purposes of determining whether there is a quorum. Accordingly, an abstention will have the effect of a negative vote.

If you hold shares in **street name** through a broker, bank, or other nominee, your broker, bank, or nominee may not be permitted to exercise voting discretion with respect to some of the matters to be acted upon. Thus, if you do not give your broker or nominee specific instructions, your shares may not be voted on those matters and will not be counted in determining the number of shares necessary for approval. Shares represented by such **broker non-votes** will, however, be counted in determining whether there is a quorum.

How are votes counted?

In the election of directors, you may vote **For** all of the nominees or your vote may be **Withheld** with respect to one or more of the nominees. For the other proposals, you may vote **For**, **Against**, or **Abstain**. If you **Abstain**, it has the same effect as a vote **Against**. If you sign your proxy card or broker voting instruction card with no further instructions, your shares will be voted in accordance with the recommendations of the Board.

Am I required to approve or reject all of the proposals as a group, or can I vote **Yes** for some proposals and **No** for others?

Each of the proposals discussed in this proxy statement is subject to a separate vote, and you should accept or reject each proposal on its own merits.

What will the Board do if either proposal 1 or 2 is approved, but both proposals are not approved?

The approval of the new management agreement and the election of the ten director nominees are expressly conditioned on each other. In other words, if all ten director nominees receive a sufficient number of votes but the new management agreement does not, then the director nominees will not take office and the new management agreement will not become effective.

Who is entitled to vote at the meeting?

If you owned shares of the Fund on the Record Date, you are entitled to receive notice of and to participate in the annual meeting. A list of stockholders on the Record Date will be available for inspection at the Fund's office at 2727 Allen Parkway, 1st Floor, Houston, Texas for ten days before the meeting.

What are the voting rights of holders of the Fund's common stock?

You may cast one vote per share of the Fund's common stock that you held on the Record Date on each proposal considered at the annual meeting. These shares include shares that are: (1) held directly

in your name as the stockholder of record and (2) held for you as the beneficial owner through a stockbroker, bank, or other nominee.

Who can attend the meeting?

All stockholders as of the Record Date, or their duly appointed proxies, may attend the meeting. Each stockholder may be asked to present valid identification. Cameras, recording devices, and other electronic devices will not be permitted at the meeting.

Please note that if you hold your shares in street name (that is, through a broker, bank, or other nominee), you will need to bring a copy of a brokerage statement reflecting your stock ownership as of the Record Date.

Parking is available at local garages; the fee for parking is \$0.75 per hour.

What constitutes a quorum?

The presence at the meeting, in person or by proxy, of the holders of a majority of the shares of common stock outstanding on the Record Date will constitute a quorum, permitting the meeting to conduct its business. As of the Record Date, 6,506,692 shares of the Fund's common stock, representing the same number of votes, were outstanding. Thus, the presence of holders of the Fund's common stock representing at least 3,253,346 votes will be required to establish a quorum.

Proxies received but marked as abstentions and broker non-votes that are voted on any matter will be included in the calculation of the number of shares considered to be present at the meeting.

What is the difference between holding shares as a stockholder of record and as a beneficial owner?

Many stockholders of the Fund hold their shares through a stockbroker, bank or, other nominee rather than directly in their own name. As summarized below, there are some distinctions between shares held of record and those owned beneficially.

Stockholder of Record. If your shares are registered directly in your name with the Fund's transfer agent, American Stock Transfer & Trust Company, you are considered, with respect to those shares, the stockholder of record, and these proxy materials are being sent directly to you by the Fund. As the stockholder of record, you have the right to grant your voting proxy directly to the Fund or to vote in person at the annual meeting. We have enclosed a proxy card for you to use.

Beneficial Owner. If your shares are held in a stock brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares held in street name, and these proxy materials are being forwarded to you by your broker or nominee who is considered, with respect to those shares, the stockholder of record. As the beneficial owner, you have the right to direct your broker on how to vote and are also invited to

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attend the annual meeting. However, since you are not the stockholder of record, you may not vote these shares in person at the annual meeting. Your broker or nominee has enclosed a voting instruction card for you to use in directing the broker or nominee regarding how to vote your shares.

How can I vote my shares in person at the annual meeting?

Shares held directly in your name as the stockholder of record may be voted in person at the annual meeting. If you choose to do so, please bring the enclosed proxy card or proof of identification.

Even if you plan to attend the annual meeting, we recommend that you vote your shares in advance as described below so that your vote will be counted if you later decide not to attend the annual meeting. Shares held in street name may be voted in person by you only if you obtain a signed proxy from the record holder giving you the right to vote the shares.

How can I vote my shares without attending the annual meeting?

Whether you hold shares directly as the stockholder of record or beneficially in street name, you may direct your vote without attending the annual meeting by completing and mailing your proxy card or voting instruction card in the enclosed pre-paid envelope. Please refer to the enclosed materials for details.

Can I change my vote after I return my proxy card?

Yes. You may change your proxy instructions at any time prior to the vote at the annual meeting. You may accomplish this by granting a new proxy card or new voting instruction card bearing a later date (which automatically revokes the earlier proxy instructions) or by attending the annual meeting and voting in person. Attendance at the annual meeting will not cause your previously granted proxy to be revoked unless you specifically so request.

What does it mean if I receive more than one proxy or voting instruction card?

It means your shares are registered differently or are in more than one account. Please provide voting instructions for all proxy and voting instruction cards you receive.

Where can I find the voting results of the annual meeting?

We will announce preliminary voting results at the annual meeting and publish the final results in our quarterly report on Form 10-Q for the quarter ended June 30, 2005.

Who can I call if I have a question?

If you have any questions about this proxy statement, please call us at 713-529-0900 between 9:00 a.m. and 5:00 p.m., Central Daylight Time, Monday through Friday.

STOCK OWNERSHIP

Who are the largest owners of the Fund's stock?

Based on a review of filings with the Securities and Exchange Commission (SEC), the Fund is aware of three beneficial owners of more than 5% of the outstanding shares of the Fund's common stock: Sam P. Douglass, Karpus Management, Inc., and Nolan Lehmann.

How much stock do the Fund's directors and executive officers own?

The following table shows the amount of the Fund's common stock beneficially owned (unless otherwise indicated) as of March 31, 2005, by (1) any person known to the Fund to be the beneficial owner of more than 5% of the outstanding shares of the Fund's common stock, (2) each director and nominee for director of the Fund, and (3) all officers and directors as a group. The number of shares beneficially owned by each entity, person, director, or executive officer is determined under the rules of the SEC and the information is not necessarily indicative of beneficial ownership for any other purpose.

Under such rules, beneficial ownership includes any shares as to which the individual has the sole or shared voting power or investment power and also any shares that the individual has the right to acquire as of March 31, 2005, 60 days after March 31, 2005, through the exercise of any stock option or other right. Unless otherwise indicated, each person has the sole investment and voting power, or shares such powers with his spouse, with respect to the shares set forth in the table.

Name	Amount and Nature of Beneficial Ownership				Percent of Class Outstanding
	Sole Voting and Investment Power	Options Exercisable Within 60 Days ⁽¹⁾	Other Beneficial Ownership	Total	
Sam P. Douglass ⁽²⁾	22,814	237,600	428,380 ⁽²⁾	688,794	10.4%
Karpus Management, Inc. ⁽⁴⁾	517,158	0	0	517,158	7.9%
Nolan Lehmann ⁽⁵⁾	197,951	202,700	48,537 ⁽⁶⁾	449,188	6.9%
Gregory J. Flanagan	9,267	19,801	1,289 ⁽⁷⁾	30,357	*
Robert L. Knauss	791	19,801	512 ⁽⁸⁾	21,104	*
Brad Orvieto	2,479	3,666	0	6,145	*
Gary R. Petersen	2,317	19,801	0	22,118	*
John W. Storms	9,237	18,701	0	27,938	*
Francis D. Tuggle	4,457	18,501	0	22,958	*
Edward E. Williams	47,781	19,801	0	67,582	1.0%
All directors and officers as a group (12 persons)	311,252	785,039	478,718	1,575,009	24.2%

* Indicates less than one percent.

⁽¹⁾ Reflects the number of shares that could be purchased by exercise of options available on April 30, 2005, or within 60 days thereafter under the 1997 Stock Incentive Plan.

⁽²⁾ Mr. Douglass address is 2727 Allen Parkway, 1st Floor, Houston, Texas 77019.

⁽³⁾ Includes (a) 33,149 shares held directly and in retirement accounts by Paula T. Douglass, Mr. Douglass wife, (b) 174,457 shares held by trusts for the benefit of members of Mr. Douglass family of which Mr. Douglass is the trustee and a lifetime beneficiary, a trust of which Mr. Douglass is the beneficiary, and a trust of which Mrs. Douglass is the beneficiary, and (c) 220,774 shares held by Equus Corporation International, a Delaware corporation of which Mr. Douglass is the Chairman of the Board and Chief Executive Officer. Mr. Douglass disclaims beneficial ownership of all shares not directly owned by him.

⁽⁴⁾ The address of Karpus Management, Inc. is 183 Sullys Trail, Pittsford, New York 14534. The address of and number of shares beneficially owned by Karpus Management, Inc. is based on the Schedule 13D/A filed by Karpus Management, Inc. with the SEC on April 7, 2005.

⁽⁵⁾ Mr. Lehmann s address is 2727 Allen Parkway, 1st Floor, Houston, Texas 77019.

⁽⁶⁾ Includes (a) 6,778 shares held by Jeanne Lehmann, Mr. Lehmann s spouse and (b) 41,759 shares held by Lehmann Investments, L.P., of which Mr. Lehmann is the general partner. Mr. Lehmann disclaims beneficial ownership of all shares not owned directly by him.

⁽⁷⁾ Includes 1,289 shares held by Mr. Flanagan s spouse.

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- ⁽⁸⁾ Includes 512 shares held by the Robert L. Knauss Defined Plan (the Knauss Plan) of which Mr. Knauss is a control person. Mr. Knauss disclaims beneficial ownership of the shares held by the Knauss Plan.

Section 16(a) Beneficial Ownership Reporting Compliance

Under the federal securities laws, the Fund's directors, executive (and certain other) officers, and any persons holding more than ten percent of the Fund's common stock are required to report their ownership of the Fund's common stock and any changes in that ownership to the Fund and the SEC.

Specific due dates for these reports have been established by regulation and the Fund is required to report in this proxy statement any failure to file by these dates in 2004. Based upon a review of filings with the SEC and written representations that no other reports were required, we believe that all of our directors and executive officers complied during 2004 with the reporting requirements of Section 16(a) of the Securities Exchange Act of 1934, with the exception of a Form 3 to report the election of James Philip Walters as an executive officer of the Fund which was filed late.

As of March 30, 2005, we believe that all directors and officers are current in their filings. In making these statements, the Fund has relied on the written representations of its directors, officers and ten percent holders and copies of reports that they have filed with the SEC.

GOVERNANCE OF THE FUND

What are the duties of the Board of Directors?

The Board provides overall guidance and supervision with respect to the operations of the Fund and performs the various duties imposed on the directors of business development companies by the Investment Company Act. Among other things, the Board supervises the management arrangements of the Fund, the custodial arrangements with respect to portfolio securities, the selection of accountants, fidelity bonding, and transactions with affiliates. All actions taken by the Board are taken by majority vote unless a higher percentage is required by law or unless the Investment Company Act or the Fund's Restated Certificate of Incorporation or bylaws require that the actions be approved by a majority of the directors who are not interested persons (as defined in the Investment Company Act). The Investment Company Act requires that a majority of the Fund's directors be individuals who are not interested persons of the Fund.

Who are the current members of the Board?

The members of the Board of Directors on the date of this proxy statement and the committees of the Board on which they serve, are identified below.

<u>Director</u>	<u>Audit Committee</u>	<u>Compensation Committee</u>	<u>Committee of Independent Directors</u>	<u>Committee to Study Methods for Enhancement of Shareholder Value</u>	<u>Governance and Nominating Committee</u>
Sam P. Douglass					
Gregory J. Flanagan		*	*	Chair	
Robert L. Knauss	Chair		*		*
Nolan Lehmann					
Brad Orvieto			*	*	*
Gary R. Petersen		Chair	*		*
John W. Storms	*	*	*		Chair
Dr. Francis D. Tuggle	*		*	*	
Dr. Edward E. Williams			Chair	*	

What committees has the Board established?

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The Board has five standing committees: an Audit Committee, a Governance and Nominating Committee, a Compensation Committee, a Committee of Independent Directors, and a Committee to Study Methods for the Enhancement of Shareholder Value.

Audit Committee

The functions of the Audit Committee are described below under the heading *Report of the Audit Committee*. The charter of the Audit Committee was attached to the 2004 proxy statement and is available on the Fund's website (www.equuscap.com). The Audit Committee met five times during 2004.

Each member of the Audit Committee is independent within the meaning of SEC regulations and the listing standards of the New York Stock Exchange (NYSE). Mr. Knauss, the chair of the Committee, is qualified as an audit committee financial expert within the meaning of SEC regulations and the Board has determined that he has accounting and related financial management expertise within the meaning of the listing standards of the NYSE.

Committee of the Independent Directors

The functions of the Committee of the Independent Directors are to: recommend to the full Board approval of any management, advisory, or administration agreements; recommend to the full Board any underwriting or distribution agreements; review the fidelity bond and premium allocation; review any joint insurance policies and premium allocation; review and monitor the Fund's compliance with procedures adopted pursuant to certain rules promulgated under the Investment Company Act; and carry out such other duties as the independent directors shall, from time to time, conclude are necessary in the performance of their duties under the Investment Company Act.

The Committee of Independent Directors met as needed at regularly scheduled Board Meetings. The Committee consists of all directors who are not interested persons of the Fund (as defined in the Investment Company Act).

Compensation Committee

The function of the Compensation Committee is to determine and issue stock options for officers of the Fund under the Equus II Incorporated 1997 Stock Incentive Plan (the 1997 Stock Incentive Plan), which is the only form of compensation paid by the Fund to its officers for serving as such. The charter of the Compensation Committee is available on the Fund's website (www.equuscap.com). The Committee met one time during 2004. All members of the Committee are independent within the meaning of the listing standards of the New York Stock Exchange.

Governance and Nominating Committee

The Governance and Nominating Committee is responsible for developing and implementing policies and practices relating to corporate governance. The Committee selects individuals for nomination to the Board of Directors of the Fund. In addition, the Committee develops and reviews background information on candidates for the Board and makes recommendations to the Board regarding such candidates. The Committee also prepares and supervises the Board's annual review of director independence and the Board's performance self-evaluation. The Committee met two times during 2004.

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All of the members of the Committee are independent within the meaning of SEC regulations and the listing standards of the NYSE. No member of the Committee is an interested person of the Fund as defined in the Investment Company Act.

Committee to Study Methods for the Enhancement of Shareholder Value

The function of the Committee to Study Methods for the Enhancement of Shareholder Value is to recommend to the Board plans and actions that might increase the value at which our common stock trades on the NYSE. The Committee held one meeting during 2004.

How does the Board select nominees for the Board?

The Governance and Nominating Committee considers candidates for Board membership suggested by its members and other Board members, as well as management and stockholders. A stockholder who wishes to recommend a prospective nominee for the Board should notify the Fund's Secretary or any member of the Governance and Nominating Committee in writing in care of Equus II Incorporated, 2727 Allen Parkway, 13th Floor, Houston, Texas 77019. To be considered by the Nominating and Governance Committee, stockholder nominations must be submitted before our fiscal year-end and must be accompanied by a description of the qualifications of the proposed candidate and a written statement from the proposed candidate that he or she is willing to be nominated and desires to serve if elected. The Governance and Nominating Committee will also consider whether to nominate any person nominated by a stockholder pursuant to the provisions of the Fund's bylaws relating to stockholder nominations as described in *Additional Information Advance Notice Procedures*, below. Nominees for director who are recommended by stockholders will be evaluated in the same manner as any other nominee for director.

Once the Governance and Nominating Committee has identified a prospective nominee, the Committee makes an initial determination as to whether to conduct a full evaluation of the candidate. This initial determination is based on whatever information is provided to the Committee with the recommendation of the prospective candidate, as well as the Committee's own knowledge of the prospective candidate, which may be supplemented by inquiries to the person making the recommendation or others. The preliminary determination is based primarily on the need for additional Board members to fill vacancies or expand the size of the Board and the likelihood that the prospective nominee can satisfy the evaluation factors considered by the Committee. If the Committee determines, in consultation with the other Board members as appropriate, that additional consideration is warranted, it may gather additional information about the prospective nominee's background and experience. The Chairman of the Committee and our Chairman of the Board will then interview a qualified candidate. A qualified candidate is then invited to meet the remaining members of the Committee and the other directors. The Committee then determines, based on the background information and information obtained in interviews, whether to recommend to the Board that a candidate be nominated to the Board.

Richard F. Bergner, Charles M. Boyd, Alan D. Feinsilver, Henry W. Hankinson, Anthony R. Moore, and James M. Walsh, who are being submitted to our stockholders for election as directors for the first time at the annual meeting, were identified and recommended to the Nominating and Governance Committee by Moore Clayton & Co., Inc.

The Committee believes a prospective nominee for director should, at a minimum, satisfy the following standards and qualifications and evaluates prospective nominees accordingly:

the ability of the prospective nominee to represent the interests of the stockholders of the Fund;

the prospective nominee's standards of integrity, commitment, and independence of thought and judgment;

the prospective nominee's ability to dedicate sufficient time, energy, and attention to the diligent performance of his or her duties, including the prospective nominee's service on other public company boards; and

the extent to which the prospective nominee contributes to the range of talent, skill, and expertise appropriate for the Board.

The Committee also considers such other relevant factors as it deems appropriate, including the current composition of the Board, the balance of management and independent directors, and the need for Audit Committee expertise. After completing this evaluation and interview, the Committee makes a recommendation to the full Board as to the persons who should be nominated by the Board, and the Board determines the nominees after considering the recommendation and report of the Committee.

How does the Board determine which directors are considered independent?

The Board undertook its annual review of director independence in March 2005. During this review, the Board considered transactions and relationships between each director or any member of his immediate family and the Fund, including those reported under *Other Indirect Interests* below. The Board also examined transactions and relationships between directors or their affiliates and members of the Fund's senior management or their affiliates. The purpose of this review was to determine whether any such relationships or transactions were inconsistent with a determination that the director is independent.

As a result of this review, the Board affirmatively determined that all of the directors nominated for election at the annual meeting are independent of the Fund and its management with the exception of Sam P. Douglass and Nolan Lehmann. Messrs. Douglass and Lehmann are considered inside directors because of their employment as senior executives of the Fund.

How often did the Board meet during 2004?

During 2004, the Board met in person four times. Each director attended at least 75% of all meetings held by the Board or the committees of the Board on which he served. The Fund does not have a policy about directors' attendance at the annual meeting of stockholders. All directors attended the Fund's annual meeting of stockholders in May 2004.

How are directors compensated?

During 2004, each director who was not an officer of the Fund received an annual fee of \$20,000, plus \$2,000 for each meeting of the directors attended, \$1,000 for participation in each meeting conducted by telephonic conference, and \$1,000 for each committee meeting attended, and reimbursement for all out-of-pocket expenses relating to attendance at such meetings. The independent directors do not receive any additional compensation from the Fund or portfolio companies for any additional services rendered. Officers and directors of the Fund who are affiliated with management may serve as directors of portfolio companies and in such capacities may receive and retain directors' fees and other compensation directly from the portfolio companies. Officers of the Fund do not receive cash compensation directly from the Fund, but are employed by and receive a salary from ECMC. The Fund established the 1997 Stock Incentive Plan to provide incentive compensation to its directors, officers, and employees.

The directors who were not officers of the Fund were paid an aggregate of \$281,000 and \$242,333 as compensation for the years ended December 31, 2004 and 2003, respectively.

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Under the 1997 Stock Incentive Plan, each non-officer director serving at the time was granted an option to purchase 5,500 shares of the Fund's common stock on November 4, 1997 (Mr. Orvieto was granted an option to purchase 5,500 shares following his

election to the Board). In addition, each individual elected as a non-officer director is, on the first business day following the annual stockholders meeting, granted a stock option to purchase 2,200 shares of the Fund's common stock at the closing sales price for shares of the Fund's common stock on that date. In May 2004, the Fund granted options to purchase an aggregate 13,200 shares of stock at \$7.72 per share to its directors. The Fund currently has no bonus, profit-sharing, pension, or retirement plan.

Under the 1997 Stock Incentive Plan the Fund may grant stock options to eligible directors and officers for up to the number of shares of the Fund's common stock equal to 20% of the outstanding shares. At December 31, 2004, the Fund had outstanding stock options covering an aggregate of 809,000 shares. The Compensation Committee is responsible for granting awards of stock options under the 1997 Stock Incentive Plan.

Dollar Range of Equity Securities Beneficially Owned by Directors

Name of Director or Nominee	Dollar Range of Equity Securities in the Fund ⁽¹⁾	Aggregate Dollar Range of Equity Securities in All Funds Overseen or to be Overseen by Director or Nominee in Family of Investment Companies
Sam P. Douglass	Over \$100,000	Over \$100,000 ⁽²⁾
Gregory J. Flanagan	\$50,001-\$100,000 ⁽³⁾	\$50,001-\$100,000 ⁽²⁾ (3)
Robert L. Knauss	\$1-\$10,000 ⁽³⁾	\$1-\$10,000 ⁽²⁾ (3)
Nolan Lehmann	Over \$100,000	Over \$100,000 ⁽²⁾
Brad Orvieto	\$10,001-\$50,000 ⁽³⁾	\$10,000-\$50,000 ⁽²⁾ (3)
Gary R. Peterson	\$10,001-\$50,000 ⁽³⁾	\$10,001-\$50,000 ⁽²⁾ (3)
John W. Storms	\$50,001-\$100,000 ⁽³⁾	\$50,001-\$100,000 ⁽²⁾ (3)
Dr. Francis D. Tuggle	\$10,001-\$50,000 ⁽³⁾	\$10,001-\$50,000 ⁽²⁾ (3)
Dr. Edward E. Williams	Over \$100,000 ⁽³⁾	Over \$100,000 ⁽²⁾ (3)

(1) Based on closing price of the Fund's common stock on March 31, 2005.

(2) Includes only shares of the Fund. No director or nominee for director of the Fund is a director of another fund in the Equus family of investment companies.

(3) Excludes options exercisable within 60 days that are not in-the-money.

Compensation

The following table sets forth all compensation paid to the directors, and for each of the three highest paid officers who have aggregate compensation from the Fund in 2004 in excess of \$60,000:

Name	Aggregate Compensation from the Fund	Pension or Retirement Benefits Accrued as Part of Fund Expenses	Long-term Compensation Awards Number of Securities Underlying Options
Sam P. Douglass*	\$ 0 ⁽¹⁾	\$ 0	0
Gregory J. Flanagan	43,000	0	2,200
Robert L. Knauss	47,500	0	2,200
Nolan Lehmann*	0 ⁽¹⁾	0	0
Brad Orvieto	35,500	0	2,200
Gary R. Petersen	43,500	0	2,200
John W. Storms	38,500	0	2,200
Francis D. Tuggle	38,000	0	2,200
Edward E. Williams	35,000	0	2,200

* Designates an interested person.

⁽¹⁾ Mr. Douglass and Mr. Lehmann do not receive a salary from the Fund.

Other Indirect Interests

Dr. Williams may be paid additional sums by Equus Capital Corporation, a wholly owned subsidiary of ECMC (ECC), in connection with ECC s redemption of its Series C preferred stock. ECC has liquidated substantially all of its assets, but is retaining some cash for taxes, operating expenses, and contingencies. At December 31, 2004, the aggregate value of the assets held by ECC was \$1,971,964, of which Dr. Williams had a 5.3% interest.

Options Granted During 2004

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Morgan Stanley Finance LLC

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All Payments on the Securities Based on the Worst Performing of the Russell 2000® Index and the Dow Jones Industrial AverageSM

Principal at Risk Securities

Russell 2000® Index Overview

The Russell 2000® Index is an index calculated, published and disseminated by FTSE Russell, and measures the composite price performance of stocks of 2,000 companies (the “Russell 2000 Component Stocks”) incorporated in the U.S. and its territories. All 2,000 stocks are traded on a major U.S. exchange and are the 2,000 smallest securities that form the Russell 3000® Index. The Russell 3000® Index is composed of the 3,000 largest U.S. companies as determined by market capitalization and represents approximately 98% of the U.S. equity market. The Russell 2000® Index consists of the smallest 2,000 companies included in the Russell 3000® Index and represents a small portion of the total market capitalization of the Russell 3000® Index. The Russell 2000® Index is designed to track the performance of the small capitalization segment of the U.S. equity market. For additional information about the Russell 2000® Index, see the information set forth under “Russell 2000® Index” in the accompanying index supplement.

Information as of market close on March 29, 2019:

Bloomberg Ticker Symbol:	RTY	52 Week High (on 8/31/2018):	1,740.753
Current Index Value:	1,539.739	52 Week Low (on 12/24/2018):	1,266.925
52 Weeks Ago:	1,529.427		

The following graph sets forth the daily index closing values of the RTY Index for the period from January 1, 2014 through March 29, 2019. The related table sets forth the published high and low index closing values, as well as the end-of-quarter index closing values, of the RTY Index for each quarter in the same period. The index closing value of the RTY Index on March 29, 2019 was 1,539.739. We obtained the information in the table and graph below from Bloomberg Financial Markets, without independent verification. The historical index closing values of the RTY Index should not be taken as an indication of future performance, and no assurance can be given as to the value of the RTY Index at any time, including on the determination dates.

**RTY Index Daily Index Closing Values
January 1, 2014 to March 29, 2019**

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Russell 2000® Index	High	Low	Period End
2014			
First Quarter	1,208.651	1,093.594	1,173.038
Second Quarter	1,192.964	1,095.986	1,192.964
Third Quarter	1,208.150	1,101.676	1,101.676
Fourth Quarter	1,219.109	1,049.303	1,204.696
2015			
First Quarter	1,266.373	1,154.709	1,252.772
Second Quarter	1,295.799	1,215.417	1,253.947
Third Quarter	1,273.328	1,083.907	1,100.688
Fourth Quarter	1,204.159	1,097.552	1,135.889
2016			
First Quarter	1,114.028	953.715	1,114.028
Second Quarter	1,188.954	1,089.646	1,151.923
Third Quarter	1,263.438	1,139.453	1,251.646
Fourth Quarter	1,388.073	1,156.885	1,357.130
2017			
First Quarter	1,413.635	1,345.598	1,385.920
Second Quarter	1,425.985	1,345.244	1,415.359
Third Quarter	1,490.861	1,356.905	1,490.861
Fourth Quarter	1,548.926	1,464.095	1,535.511
2018			
First Quarter	1,610.706	1,463.793	1,529.427
Second Quarter	1,706.985	1,492.531	1,643.069
Third Quarter	1,740.753	1,653.132	1,696.571
Fourth Quarter	1,672.992	1,266.925	1,348.559
2019			
First Quarter (through March 29, 2019)	1,590.062	1,330.831	1,539.739

The “Russell 2000® Index” is a trademark of FTSE Russell. For more information, see “Russell 2000 Index” in the accompanying index supplement.

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Principal at Risk Securities

Dow Jones Industrial AverageSM Overview

The Dow Jones Industrial AverageSM is a price-weighted index composed of 30 common stocks that is published by S&P Dow Jones Indices LLC, the marketing name and a licensed trademark of CME Group Inc., as representative of the broad market of U.S. industry. For additional information about the Dow Jones Industrial AverageSM, see the information set forth under “Dow Jones Industrial AverageSM” in the accompanying index supplement.

Information as of market close on March 29, 2019:

Bloomberg Ticker Symbol:	INDU	52 Week High (on 10/3/2018):	26,828.39
Current Index Value:	25,928.68	52 Week Low (on 12/24/2018):	21,792.20
52 Weeks Ago:	24,103.11		

The following graph sets forth the daily index closing values of the INDU Index for the period from January 1, 2014 through March 29, 2019. The related table sets forth the published high and low index closing values, as well as the end-of-quarter index closing values, of the INDU Index for each quarter in the same period. The index closing value of the INDU Index on March 29, 2019 was 25,928.68. We obtained the information in the table and graph below from Bloomberg Financial Markets, without independent verification. The historical index closing values of the INDU Index should not be taken as an indication of future performance, and no assurance can be given as to the value of the INDU Index at any time, including on the determination dates.

INDU Index Daily Index Closing Values

January 1, 2014 to March 29, 2019

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Dow Jones Industrial AverageSM	High	Low	Period End
2014			
First Quarter	16,530.94	15,372.80	16,457.66
Second Quarter	16,947.08	16,026.75	16,826.60
Third Quarter	17,279.74	16,368.27	17,042.90
Fourth Quarter	18,053.71	16,117.24	17,823.07
2015			
First Quarter	18,288.63	17,164.95	17,776.12
Second Quarter	18,312.39	17,596.35	17,619.51
Third Quarter	18,120.25	15,666.44	16,284.70
Fourth Quarter	17,918.15	16,272.01	17,425.03
2016			
First Quarter	17,716.66	15,660.18	17,685.09
Second Quarter	18,096.27	17,140.24	17,929.99
Third Quarter	18,636.05	17,840.62	18,308.15
Fourth Quarter	19,974.62	17,888.28	19,762.60
2017			
First Quarter	21,115.55	19,732.40	20,663.22
Second Quarter	21,528.99	20,404.49	21,349.63
Third Quarter	22,412.59	21,320.04	22,405.09
Fourth Quarter	24,837.51	22,557.60	24,719.22
2018			
First Quarter	26,616.71	23,533.20	24,103.11
Second Quarter	25,322.31	23,644.19	24,271.41
Third Quarter	26,743.50	24,174.82	26,458.31
Fourth Quarter	26,828.39	21,792.20	23,327.46
2019			
First Quarter (through March 29, 2019)	26,091.95	22,686.22	25,928.68

“Dow Jones,” “Dow Jones Industrial Average,” “Dow Jones Indexes” and “DJIA” are service marks of Dow Jones Trademark Holdings LLC. See “Dow Jones Industrial AverageSM” in the accompanying index supplement.

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Principal at Risk Securities

Additional Terms of the Securities

Please read this information in conjunction with the summary terms on the front cover of this document.

Additional Terms

If the terms described herein are inconsistent with those described in the accompanying product supplement, index supplement or prospectus, the terms described herein shall control.

With respect to the RTY Index, FTSE Russell, or any successor thereof

Underlying

Index publisher: With respect to the INDU Index, S&P Dow Jones Indices LLC, or any successor thereof

With respect to the RTY Index, the index closing value on any index business day shall be determined by the calculation agent and shall equal the closing value of the RTY Index, or any successor index reported by Bloomberg Financial Services, or any successor reporting service the calculation agent may select, on such index business day. In certain circumstances, the index closing value for the RTY Index shall be based on the alternate calculation of the RTY Index described under “Discontinuance of an Underlying Index; Alteration of Method of Calculation” in the accompanying product supplement. The closing value of the RTY Index reported by Bloomberg Financial Services may be lower or higher than the official closing value of the RTY Index published by the underlying index publisher for the RTY Index.

Index closing value:

With respect to the INDU Index, the index closing value on any index business day shall be determined by the calculation agent and shall equal the official closing value of such underlying index, or any successor underlying index, published at the regular official weekday close of trading on such index business day by the underlying index publisher for such underlying index. In certain circumstances, the index closing value for the INDU Index shall be based on the alternate calculation of such underlying index described under “Discontinuance of an Underlying Index; Alteration of Method of Calculation” in the accompanying product supplement.

Downside threshold level:

The accompanying product supplement refers to the downside threshold level as the “trigger level.”

Jump securities with auto-callable feature:

The accompanying product supplement refers to these jump securities with auto-callable feature as the “auto-callable securities.”

In the event that the maturity date is postponed due to postponement of the final determination date, the issuer shall give notice of such postponement and, once it has been determined, of the date to which the maturity date has been rescheduled (i) to each registered holder of the securities by mailing notice of such postponement by first class mail, postage prepaid, to such registered holder’s last address as it shall appear upon the registry books, (ii) to the trustee by facsimile, confirmed by mailing such notice to the trustee by first class mail, postage prepaid, at its New York office and (iii) to the depositary by telephone or facsimile confirmed by mailing such notice to the depositary by first class mail, postage prepaid. Any notice that is mailed to a registered holder of the securities in the manner herein provided shall be conclusively presumed to have been duly given to such registered holder, whether or not such registered holder receives the notice. The issuer shall give such notice as promptly as possible, and in no case later than (i) with respect to notice of postponement of the maturity date, the business day immediately preceding the scheduled maturity date and (ii) with respect to notice of the date to which the maturity date has been rescheduled, the business day immediately following the final determination date as postponed.

Issuer notices to registered security holders, the trustee and the depositary:

In the event that the securities are subject to early redemption, the issuer shall, (i) on the business day following the applicable determination date, give notice of the early redemption of the securities and the applicable early redemption payment, including specifying the payment date of the applicable amount due upon the early redemption, (x) to each registered holder of the securities by mailing notice of such early redemption by first class mail, postage prepaid, to such registered holder’s last address as it shall appear upon the registry books, (y) to the trustee by facsimile, confirmed by mailing such notice to the trustee by first class mail, postage prepaid, at its New York office and (z) to the depositary by telephone or facsimile confirmed by mailing such notice to the depositary by first class mail, postage prepaid and (ii) on or prior to the early redemption date, deliver the aggregate cash amount due with respect to the securities to the trustee for delivery to the depositary, as holder of the securities. Any notice that is mailed to a registered holder of the securities in the manner herein provided shall be conclusively presumed to have been duly given to such registered holder, whether or not such registered holder receives the notice.

The issuer shall, or shall cause the calculation agent to, (i) provide written notice to the trustee, on which notice the trustee may conclusively rely, and to the depositary of the amount of cash,

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if any, to be delivered with respect to each stated principal amount of the securities, on or prior to 10:30 a.m. (New York City time) on the business day preceding the maturity date, and (ii) deliver the aggregate cash amount due with respect to the securities, if any, to the trustee for delivery to the depository, as holder of the securities, on the maturity date.

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Additional Information About the Securities

Additional
Information:

Minimum
ticketing size: \$1,000 / 1 security

Tax considerations: Although there is uncertainty regarding the U.S. federal income tax consequences of an investment in the securities due to the lack of governing authority, in the opinion of our counsel, Davis Polk & Wardwell LLP, under current law, and based on current market conditions, each security should be treated as a single financial contract that is an “open transaction” for U.S. federal income tax purposes.

Assuming this treatment of the securities is respected and subject to the discussion in “United States Federal Taxation” in the accompanying product supplement for auto-callable securities, the following U.S. federal income tax consequences should result based on current law:

§ A U.S. Holder should not be required to recognize taxable income over the term of the securities prior to settlement, other than pursuant to a sale or exchange.

§ Upon sale, exchange or settlement of the securities, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized and the U.S. Holder’s tax basis in the securities. Such gain or loss should be long-term capital gain or loss if the investor has held the securities for more than one year, and short-term capital gain or loss otherwise.

In 2007, the U.S. Treasury Department and the Internal Revenue Service (the “IRS”) released a notice requesting comments on the U.S. federal income tax treatment of “prepaid forward contracts” and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether

these instruments are or should be subject to the “constructive ownership” rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, possibly with retroactive effect.

As discussed in the accompanying product supplement for auto-callable securities, Section 871(m) of the Internal Revenue Code of 1986, as amended, and Treasury regulations promulgated thereunder (“Section 871(m)”) generally impose a 30% (or a lower applicable treaty rate) withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities or indices that include U.S. equities (each, an “Underlying Security”). Subject to certain exceptions, Section 871(m) generally applies to securities that substantially replicate the economic performance of one or more Underlying Securities, as determined based on tests set forth in the applicable Treasury regulations (a “Specified Security”). However, pursuant to an IRS notice, Section 871(m) will not apply to securities issued before January 1, 2021 that do not have a delta of one with respect to any Underlying Security. Based on our determination that the securities do not have a delta of one with respect to any Underlying Security, our counsel is of the opinion that the securities should not be Specified Securities and, therefore, should not be subject to Section 871(m).

Our determination is not binding on the IRS, and the IRS may disagree with this determination. Section 871(m) is complex and its application may depend on your particular circumstances, including whether you enter into other transactions with respect to an Underlying Security. If withholding is required, we will not be required to pay any additional

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amounts with respect to the amounts so withheld. You should consult your tax adviser regarding the potential application of Section 871(m) to the securities.

Both U.S. and non-U.S. investors considering an investment in the securities should read the discussion under “Risk Factors” in this document and the discussion under “United States Federal Taxation” in the accompanying product supplement for auto-callable securities and consult their tax advisers regarding all aspects of the U.S. federal income tax consequences of an investment in the securities, including possible alternative treatments, the issues presented by the aforementioned notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

The discussion in the preceding paragraphs under “Tax considerations” and the discussion contained in the section entitled “United States Federal Taxation” in the accompanying product supplement for auto-callable securities, insofar as they purport to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitute the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the securities.

Trustee: The Bank of New York Mellon

Calculation agent: MS & Co.

Use of proceeds and hedging: The proceeds from the sale of the securities will be used by us for general corporate purposes. We will receive, in aggregate, \$1,000 per security issued, because, when we enter into hedging transactions in order to meet our obligations under the securities, our hedging counterparty will reimburse the cost of the agent’s commissions. The costs of the securities borne by you and described beginning on page 3 above comprise the agent’s commissions and the cost of issuing, structuring and hedging the securities.

On or prior to the pricing date, we hedged our anticipated exposure in connection with the securities by entering into hedging transactions with our affiliates and/or third party dealers. We expect our hedging counterparties to have taken positions in the stocks constituting the underlying indices and in futures and/or options contracts on the underlying indices or the component stocks of the underlying indices listed on major securities markets. Such purchase activity could have increased the initial index value of an underlying index, and, as a result, could have increased (i) the level at or above which such underlying index must close on the determination dates so that the securities are

redeemed prior to maturity for the early redemption payment (depending also on the performance of the other underlying index) and (ii) the downside threshold level for such underlying index, which is the level at or above which such underlying index must close on the final determination date so that you are not exposed to the negative performance of the worst performing underlying index at maturity (depending also on the performance of the other underlying index). These entities may be unwinding or adjusting hedge positions during the term of the securities, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the final determination date approaches. Additionally, our hedging activities, as well as our other trading activities, during the term of the securities could potentially affect the value of either underlying index on the determination dates, and, accordingly, whether we redeem the securities prior to maturity and the amount of cash you will receive at maturity, if any. For further information on our use of proceeds and hedging, see “Use of Proceeds and Hedging” in the accompanying product supplement.

Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) (a “Plan”), should consider the fiduciary standards of ERISA in the context of the Plan’s particular circumstances before authorizing an investment in the securities. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

**Benefit plan
investor**

considerations: In addition, we and certain of our affiliates, including MS & Co., may each be considered a “party in interest” within the meaning of ERISA, or a “disqualified person” within the meaning of the Internal Revenue Code of 1986, as amended (the “Code”), with respect to many Plans, as well as many individual retirement accounts and Keogh plans (such accounts and plans, together with other plans, accounts and arrangements subject to Section 4975 of the Code, also “Plans”). ERISA Section 406 and Code Section 4975 generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the securities are

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acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the securities are acquired pursuant to an exemption from the “prohibited transaction” rules. A violation of these “prohibited transaction” rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for such persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions (“PTCEs”) that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the securities. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers). In addition, ERISA Section 408(b)(17) and Code Section 4975(d)(20) provide an exemption for the purchase and sale of securities and the related lending transactions, *provided* that neither the issuer of the securities nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and *provided further* that the Plan pays no more, and receives no less, than “adequate consideration” in connection with the transaction (the so-called “service provider” exemption). There can be no assurance that any of these class or statutory exemptions will be available with respect to transactions involving the securities.

Because we may be considered a party in interest with respect to many Plans, the securities may not be purchased, held or disposed of by any Plan, any entity whose underlying assets include “plan assets” by reason of any Plan’s investment in the entity (a “Plan Asset Entity”) or any person investing “plan assets” of any Plan, unless such purchase, holding or disposition is eligible for exemptive relief, including relief available under PTCEs 96-23, 95-60, 91-38, 90-1, 84-14 or the service provider exemption or such purchase, holding or disposition is otherwise not prohibited. Any purchaser, including any fiduciary purchasing on behalf of a Plan, transferee or holder of the securities will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the securities that either (a) it is not a Plan or a Plan Asset Entity and is not purchasing such securities on behalf of or with “plan assets” of any Plan or with any assets of a governmental, non-U.S. or church plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code (“Similar Law”) or (b) its purchase, holding and disposition of these securities will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violate any Similar Law.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the securities on behalf of or with “plan assets” of any Plan consult with their counsel regarding the availability of exemptive relief.

The securities are contractual financial instruments. The financial exposure provided by the securities is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the securities. The securities have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the securities.

Each purchaser or holder of any securities acknowledges and agrees that:

(i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (A) the design and terms of the securities, (B) the purchaser or holder’s investment in the securities, or (C) the exercise of or failure to exercise any rights we have under or with respect to the securities;

(ii) we and our affiliates have acted and will act solely for our own account in connection with (A) all transactions relating to the securities and (B) all hedging transactions in connection with our obligations under the securities;

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(iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are not assets and positions held for the benefit of the purchaser or holder;

(iv) our interests are adverse to the interests of the purchaser or holder; and

(v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Each purchaser and holder of the securities has exclusive responsibility for ensuring that its purchase, holding and disposition of the securities do not violate the prohibited transaction rules of ERISA or the Code or any Similar Law. The sale of any securities to any Plan or plan subject to Similar Law is in no respect a representation by us or any of our affiliates or representatives that such an investment meets all relevant legal requirements with respect to investments by plans generally or any particular plan, or that such an investment is appropriate for plans generally or any particular plan. In this regard, neither this discussion nor anything provided in this document is or is intended to be investment advice directed at any potential Plan purchaser or at Plan purchasers generally and such purchasers of these securities should consult and rely on their own counsel and advisers as to whether an investment in these securities is suitable.

However, individual retirement accounts, individual retirement annuities and Keogh plans, as well as employee benefit plans that permit participants to direct the investment of their accounts, will not be permitted to purchase or hold the securities if the account, plan or annuity is for the benefit of an employee of Morgan Stanley, Morgan Stanley Wealth Management or a family member and the employee receives any compensation (such as, for example, an addition to bonus) based on the purchase of the securities by the account, plan or annuity.

Additional considerations:

Client accounts over which Morgan Stanley, Morgan Stanley Wealth Management or any of their respective subsidiaries have investment discretion are not permitted to purchase the securities, either directly or indirectly.

Supplemental information

MS & Co. expects to sell all of the securities that it purchases from us to an unaffiliated dealer at a price of \$992.50 per security, for further sale to certain fee-based advisory accounts at the price to

regarding plan of
distribution;
conflicts of
interest:

public of \$1,000 per security. MS & Co. will not receive a sales commission with respect to the securities.

MS & Co. is an affiliate of MSFL and a wholly owned subsidiary of Morgan Stanley, and it and other affiliates of ours expect to make a profit by selling, structuring and, when applicable, hedging the securities.

MS & Co. will conduct this offering in compliance with the requirements of FINRA Rule 5121 of the Financial Industry Regulatory Authority, Inc., which is commonly referred to as FINRA, regarding a FINRA member firm's distribution of the securities of an affiliate and related conflicts of interest. MS & Co. or any of our other affiliates may not make sales in this offering to any discretionary account. See "Plan of Distribution (Conflicts of Interest)" and "Use of Proceeds and Hedging" in the accompanying product supplement for auto-callable securities.

Validity of the
securities:

In the opinion of Davis Polk & Wardwell LLP, as special counsel to MSFL and Morgan Stanley, when the securities offered by this pricing supplement have been executed and issued by MSFL, authenticated by the trustee pursuant to the MSFL Senior Debt Indenture (as defined in the accompanying prospectus) and delivered against payment as contemplated herein, such securities will be valid and binding obligations of MSFL and the related guarantee will be a valid and binding obligation of Morgan Stanley, enforceable in accordance with their terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally, concepts of reasonableness and equitable principles of general applicability (including, without limitation, concepts of good faith, fair dealing and the lack of bad faith), *provided* that such counsel expresses no opinion as to (i) the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law on the conclusions expressed above and (ii) any provision of the MSFL Senior Debt Indenture that purports to avoid the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law by limiting the amount of Morgan Stanley's obligation under the related guarantee. This opinion is given as of the date hereof and is limited to the laws of the State of New York, the General Corporation Law of the State of Delaware and the Delaware Limited Liability

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Company Act. In addition, this opinion is subject to customary assumptions about the trustee's authorization, execution and delivery of the MSFL Senior Debt Indenture and its authentication of the securities and the validity, binding nature and enforceability of the MSFL Senior Debt Indenture with respect to the trustee, all as stated in the letter of such counsel dated November 16, 2017, which is Exhibit 5-a to the Registration Statement on Form S-3 filed by Morgan Stanley on November 16, 2017. Morgan Stanley Wealth Management clients may contact their local Morgan Stanley branch office or our principal executive offices at 1585 Broadway, New York, New York 10036 (telephone number (866) 477-4776). All other clients may contact their local brokerage representative. Third-party distributors may contact Morgan Stanley Structured Investment Sales at (800) 233-1087.

Contact:

Where you can find more information: Morgan Stanley and MSFL have filed a registration statement (including a prospectus, as supplemented by the product supplement for auto-callable securities and the index supplement) with the Securities and Exchange Commission, or SEC, for the offering to which this communication relates. You should read the prospectus in that registration statement, the product supplement for auto-callable securities, the index supplement and any other documents relating to this offering that Morgan Stanley and MSFL have filed with the SEC for more complete information about Morgan Stanley, MSFL and this offering. You may get these documents without cost by visiting EDGAR on the SEC web site at www.sec.gov. Alternatively, Morgan Stanley, MSFL, any underwriter or any dealer participating in the offering will arrange to send you the prospectus, the product supplement for auto-callable securities and the index supplement if you so request by calling toll-free 1-(800)-584-6837.

You may access these documents on the SEC web site at www.sec.gov as follows:

Product Supplement for Auto-Callable Securities dated November 16, 2017

Index Supplement dated November 16, 2017

Prospectus dated November 16, 2017

Terms used but not defined in this document are defined in the product supplement for auto-callable securities, in the index supplement or in the prospectus.

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