

INVESTMENT ADVISER ASSOCIATION

	Close	NetChg	%Chg	52wk H
TSE 300	9069.50	+299.94	+3.42	10176.70
Financial	7725.71	+16.29	+0.21	8833.02
Minerals	3560.04	-24.96	-0.70	4851.75
Gold	4247.53	-28.94	-0.68	7333.82
Forest	5784.85	+41.54	+0.72	5902.45
Metals	4711.93	+9.59	+0.20	5692.18
Industrials	10827.82	+581.46	+5.67	13830.03
Utilities	14966.60	+879.14	+6.29	17956.68
Oil/Gas	6452.14	+35.37	+0.55	6945.21
Consumer	15277.38	+815.85	+5.64	18907.27
Transp	5025.27	+58.54	+1.18	6625.28
Pipelines	4171.45	-63.93	-1.51	6228.56
Manag	8957.96	+228.42	+2.62	9765.88
Comm	19594.99	+740.67	+3.93	22862.91
Real Estate	1980.73	-7.20	-0.36	2432.53

BONDS

Bonds	Maturity	Price	Yield
10-yr 5.5%	06/09	100.400	
20-yr 8%	06/27	129.040	

INTEREST RATES

Interest Rates	Close	Net Chg	% Chg
T Bill	5.33	0	0.00
Sum Y 1-yr	5.55	0	0.00

2005 ACTIVITY REPORT

FOREIGN MARKETS

h returns to
e stock markets



LAWYERS

INDEX
COSTA ADDRESSES
1569 36 15 00
*218 *01
*381 *02
*859 *052

Index / comm.
LBB Index
GSC Index
DIT / Com / US
Noblesse / 233 / 100
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December 31, 2005

The past year was a busy and productive time for the Investment Adviser Association. Areas of significant activity included the following:

- *Advocacy.* During the past year, the IAA continued to represent the interests of its membership before various policy makers, including Congress (pension reform legislation), the SEC (for example, the new soft dollar proposal and the rule involving the broker-dealer exception rule under the Investment Advisers Act), the Department of Labor (opposing new filing requirements for Taft-Hartley investment managers), the UK's Financial Services Authority (soft dollars), state securities regulators (model rules for investment advisers), and the CFA Institute (asset manager code of ethics).
- *Compliance.* The IAA continues to provide an array of valuable resources and services for its members relating to legal, regulatory, and compliance issues. During 2005, written resources included the monthly *IAA Newsletter*, FAQs regarding the SEC's code of ethics rule, updates to the *IAA On-line Compliance Guide*, an updated version of the IAA sample advisory agreement, and involvement in a number of emerging concerns, including the SEC's new risk-based inspection program, class action lawsuits, gift and entertainment issues, and SAS-70 developments. In addition, the IAA legal staff responded to hundreds of requests for information from member firms.
- *Education.* The IAA sponsored more conferences and workshops during 2005 than ever before. These included the Association's annual conference in Seattle, the *IAA/IA Week Compliance Summit* in Washington, DC, an *Investment Leadership Conference* in Chicago, a two-day hedge fund compliance conference in Washington, DC, and a wealth management conference in Santa Monica. The IAA also held its annual round of compliance workshops, as well as regional compliance meetings in numerous cities.

The IAA and its membership will face new challenges and opportunities in the coming year. As always, we welcome your suggestions for improving our organization and invite you to participate in the various activities we sponsor. We appreciate your continued support of the Association and look forward to working with all members as we strive to build on our proud record of advocacy, compliance, education, and service.

Board of Governors
Investment Adviser Association

ADVOCACY

The Investment Adviser Association plays a critically important role as the leading advocate and representative of the investment advisory profession. The IAA serves as the profession's spokesperson on issues that affect all investment adviser firms. As the legislative and regulatory landscape has become more complicated and dynamic, the IAA has been involved in a continuing dialogue with the U.S. Congress, the SEC, the Department of Labor, the Department of Treasury, state securities regulators, and other industry organizations regarding every major initiative affecting the investment advisory profession. In addition, the IAA continues to build relationships with regulators and organizations outside the United States as an increasing number of our members are involved in global enterprises.

The Investment Adviser Association plays a critical role in representing and protecting the interests of the investment advisory profession.

Following is a sampling of initiatives and issues the IAA has been actively involved with during the past year (additional comment letters and materials are posted on the IAA's web site – www.investmentadviser.org – under “Comments & Statements”):

Regulators in the U.S. and abroad have proposed new changes in **soft dollar regulations**. In May, the IAA submitted a letter to the UK Financial Services Authority on proposed rules regarding bundled brokerage and soft commission arrangements. In November, the IAA submitted comments on the SEC's proposed interpretive release relating to the soft dollar safe harbor. In its letter, the IAA reiterated its support of the SEC's efforts to clarify the types of products and services that constitute permissible research under current law, as well to preserve third-party research under the safe harbor. The SEC's proposal follows a period of intense discussion among policy makers and interested parties, during which the IAA testified before the Senate Banking Committee. Since then, the IAA and various member firms have met with the SEC's task force to facilitate an understanding of soft dollar practices and to discuss potential policy alternatives.

- This year was no exception to the IAA's long history of advocacy in matters related to the **broker-dealer exception under the Investment Advisers Act**, including questions related to when a client account is treated as a brokerage account or an advisory account. In April – more than five years after the SEC first

initiated a rulemaking on the subject – the SEC unanimously approved a rule that addresses the application of the Investment Advisers Act to fee-based brokerage accounts. The rule permits brokers providing fee-based advice to client accounts to avoid treating the accounts as advisory accounts if: (1) the broker does not exercise discretion over the accounts; (2) any investment advice provided is “solely incidental” to brokerage services provided; and (3) the broker makes certain disclosures to customers. The rule clarifies that commission-based discretionary accounts are advisory accounts. The IAA played a leading role in improving the functional lines drawn and disclosures required in this important rulemaking by filing several letters on the subject during 2005. The IAA continues to oppose attempts by the broker-dealer industry to delay implementation of the final rule.

- The IAA actively opposed new filing requirements sought by the U.S. Department of Labor. In November, the Department of Labor issued an advisory accompanied by guidance in the form of a Q&A requiring investment managers of Taft-Hartley plans to retroactively file **Form LM-10 reports** of any payments, gifts, or entertainment made to unions and union officials, including union trustees of Taft-Hartley plans. The IAA strongly opposed the Department's actions – taken without appropriate notice and comment and imposed retroactively – in numerous meetings and comment letters. The IAA takes the position that “it is a matter of fundamental fairness that businesses be apprised of and understand

The IAA is actively involved in a continuing dialogue with regulators and other policy makers to support appropriate laws and rules governing the investment advisory profession.

their legal obligations, if any, in order to put systems in place to comply with new requirements on a prospective basis.”

□ The scope and intensity of **SEC examinations** of investment advisers has continued to evolve and increase during 2005 as the agency aggressively sought to stem abuses identified in previous years. The IAA has engaged in an ongoing discussion with SEC officials to relay concerns regarding the inspection process, including repetitive exam requests, tone of deficiency letters, *de facto* rule-making through inspections, and inspection staff requests for certification letters. In part in response to repeated concerns expressed by the IAA during the past two years, the SEC recently has moderated requests for e-mail during inspections and intends to issue written guidance regarding adviser e-mail retention.

□ The IAA has continued to monitor **state regulation of investment advisers** to ensure compliance with federal laws that preempt states from substantively regulating SEC-registered investment advisers and to promote uniformity in state securities laws. In August, the Association wrote to the North American Securities Administrators Association (NASAA) to applaud the organization’s efforts to conform state law to the Uniform Securities Act and to oppose the application of its substantive model rules to SEC-registered advisers and their employees.

□ During the past year, the IAA worked closely with the CFA Institute on issues related to the Institute’s **asset manager code of professional conduct**. In January, the IAA submitted a comment letter supporting the fundamental requirement that all investment advisers adopt and implement written codes of ethics, but cautioned that the Institute’s proposal could create unnecessary confusion and burden investment advisers that are already subject to detailed regulatory requirements under SEC rules. The IAA recommended that the Institute’s code be limited to broad principle-based concepts that emphasize the firm’s fiduciary duty and address fundamental ethical concepts related to firm’s employees. The IAA further requested

acknowledgement of competing obligations by many investment advisers to comply with the requirements of regulatory authorities in their governing jurisdictions and to clarify that adoption of the code is voluntary. After adoption of the code, the IAA worked closely with the Institute on interpretive guidance that further clarifies circumstances under which an adviser is considered to be in compliance with the code.

□ In October, the IAA filed a comment letter with the Department of Labor in response to proposed revisions to the Prohibited Transaction Class Exemption for qualified professional asset managers (**the QPAM exemption**) that address the applicability of the QPAM exemption to financial institutions managing the assets of in-house plans. The IAA urged the Department to permit advisers to use internal audit processes rather than paying each year for a third-party audit of compliance with the exemption conditions.

□ The IAA continues to represent the interests of the investment advisory profession before Congress. For example, during the past year, the IAA has been working to include a provision in proposed pension legislation to permit investment advisers to save costs for their ERISA clients by **cross-trading** where appropriate. This action is consistent with longstanding efforts of the Association to modernize rules in this area.

an active regulatory agenda in 2006

□ The IAA expects **an active regulatory agenda in 2006**. On the regulatory front, for example, the IAA expects the SEC to take action in a number of areas, including: (1) finalizing interpretive guidance that will restrict soft dollar arrangements and proposing new rules requiring greater disclosure and recordkeeping by investment advisers; (2) re-proposing a rule making significant revisions to Form ADV, Part 2; and (3) providing guidance on an investment adviser’s responsibility to retain, produce, and monitor employee e-mail. The IAA also expects the U.S. Department of Treasury to issue a final rule in 2006 requiring all investment advisers to develop and implement anti-money laundering programs.

SEC examinations

state regulation of investment advisers

QPAM exemption

cross-trading

asset manager code of professional conduct

STOCKS

13 WEEK

1 YR

186.67



COMPLIANCE

The IAA serves as a unique and valuable resource on legal, regulatory, and compliance issues. Recent events have transformed the compliance environment for all investment advisory firms, resulting in more complex regulations as well as more comprehensive inspections and aggressive enforcement by the SEC. The IAA provides a wide range of resources and services to help its members deal with these developments. First and foremost, the IAA legal staff provides timely and up-to-date information to IAA member firms and responds to hundreds of requests for information on legal, regulatory, and compliance issues. In addition, the IAA has developed an expanding array of services and resources to its membership, including its monthly newsletter, an on-line compliance guide, legal and regulatory alerts, guidelines, best practices, and FAQs on hot regulatory topics, as well as numerous quality educational meetings.

The Investment Adviser Association provides an increasing array of valuable compliance and regulatory services and benefits to its growing membership.

During the past year, the IAA has continued to provide its membership with a variety of valuable resources on current compliance, legal and regulatory issues, including the following.

- During 2005, the IAA legal staff responded to more than 1,000 **requests for information** about legal, regulatory, and compliance issues from IAA member firms. This is an important and unique aspect of the IAA's services to its membership. Many IAA member firms communicate regularly with the IAA legal staff to obtain information about the rapidly changing regulatory and compliance environment. The IAA legal staff also serves as a valuable resource for member firms that wish to receive current information about the scope and nature of SEC inspections.

The IAA legal staff develops **Frequently Asked Questions** to assist members in interpreting new regulations. In 2005, the IAA issued and updated FAQs to assist members with inquiries related to the SEC's code of ethics rule, the custody rule for investment advisers, and the disposal rule under the SEC's privacy rule (Regulation S-P). The IAA is considering developing FAQs and other forms of guidance in several other important areas.

The IAA continues to be involved in a host of **emerging compliance issues**, including class action lawsuits, gift and entertainment policies and procedures, advisers' relationships with pension consultants, subadviser due diligence, and SAS-70 developments. The IAA is also monitoring the implications of the custody rule in the class action settlement context.

- The **Members Only** area of the IAA web site continues to feature an increasing number of valuable compliance and legal resources. In addition to

archived legal and regulatory updates and past issues of the *IAA Newsletter*, the Members Only area features the *On-Line Compliance Guide*, which was developed by the IAA legal staff provide guidance on developing compliance controls. Several new compliance controls were added in 2005 and additional updates and additions are expected in 2006.

- In 2005, the IAA updated its **sample investment advisory agreement** and commentary to reflect changes in regulation and practice over the last several years. This sample agreement is available on the IAA's web site.

Another valuable compliance resource on the Members Only area of the IAA web site is the *Investment Adviser*, a compilation of legal, regulatory, and compliance materials that covers areas such as Form ADV, state filing issues, custody, advertising, personal trading, soft dollars, trading practices, global issues, technology, and many other topics. The contents of the *Investment Adviser* continue to expand to address the increasingly complex issues facing the investment advisory profession.

During 2006 the IAA will develop an **SEC examination** section on its web site in order to inform its members about practical issues related to SEC examinations. This section will include examples of recent SEC document requests for regular and sweep exams, as well as general feedback from member firms about examination experiences in particular regions.

- The IAA hosts a number of conferences, **compliance workshops**, seminars, conference calls, and other educational efforts designed to assist member firms in their compliance efforts.

sample investment advisory agreement

Members Only

EDUCATION

The IAA serves as a unique and respected networking resource that facilitates and encourages the exchange and development of ideas among industry peers. The IAA conducted numerous conferences, meetings, and workshops during the past year in an effort to keep our members fully informed about relevant issues that affect the investment advisory profession. These meetings covered a wide range of business issues. As the IAA continues to increase its membership and resources, the Association will be able to offer an expanded range of educational benefits to serve an increasingly diverse membership.



One of the most valuable benefits of belonging to the Investment Adviser Association is the ability to participate in a wide variety of meetings and programs that are specifically tailored to address the issues, challenges, and opportunities facing investment advisory firms.

Following is a summary of the educational conferences and events the Investment Adviser Association sponsored during 2005:

□ In April, the IAA held its **annual conference** in Seattle, Washington. Entitled "New Perspectives," the program featured presentations by Dr. Arthur Laffer, Mark Tibergien, Dr. Leroy Hood, Chas Burkhart, Nicholas Lardy, George Gilder, and other speakers on a wide range of business, investment, economic, and operational issues facing investment advisory firms. In addition to offering a first-class program, the IAA annual conference provides an excellent opportunity for senior executives to meet with each other to discuss issues of mutual concern. The 2006 conference will be held in Boston on April 26-28.

In October, the IAA sponsored an **investment leadership workshop** in Chicago. Entitled "Key Behaviors of High-Performance Investment Teams: Achieving World Class Decision Making," the workshop featured Jim Ware and Jim Dethmer of The Focus Consulting Group. The meeting was specifically designed to help senior executives implement strategies to enhance effective leadership and create a strong culture.

In November, the IAA and CFA Society of Los Angeles co-sponsored a **wealth management conference** in Santa Monica, California. Entitled, "Managing the Strategic Challenges," the conference included presentations on a number of issues facing wealth management firms, including: the big picture in wealth management; managing client expectations; tax efficiency and out performance; different wealth management practices; and effective marketing strategies.

□ The **IAA Board of Governors** met in February (Washington, D.C.), June (Los Angeles), September (New York), and November (Chicago). In conjunction with these quarterly meetings, the IAA Board of Governors generally hosts working luncheons for IAA members, featuring speakers on topics of particular interest to investment advisers. During the past year, the Association's volunteer Board of Governors continued its efforts to increase benefits and services of the Association and to promote the IAA and the investment advisory profession.

□ In February, the IAA and *IA Week* co-sponsored the seventh annual **IA Compliance and Best Practices Summit** in Washington, D.C. The conference is

designed to provide up-to-date and practical information on relevant legal, regulatory, and compliance issues affecting investment advisory firms. Nearly 300 attendees participated in the two-day program that featured presentations by numerous SEC officials, IAA staff, leading practitioners, and representatives of IAA member firms. The program featured discussions on numerous "hot" compliance topics, including the compliance program rule, CCO and internal control best practices, codes of ethics and personal trading, e-mail and other document retention issues, soft dollar developments, conducting an annual review, Form ADV and disclosure issues, and SEC inspections. The eighth annual *IAA/IA Week* compliance summit will be held February 27 - 28, 2006 in Washington, D.C.

□ In March through June, the IAA conducted **regional compliance meetings** in Boston, New York, Los Angeles, Chicago, Houston, Atlanta, and Washington, D.C. Attorney practitioners joined the IAA legal staff in each region for an informal discussion with member firms of some of the most pressing compliance issues, including those related to the implementation of their compliance programs and codes of ethics, ongoing monitoring and testing, and the annual review.

□ In October, November and December, the IAA again conducted **compliance workshops** for member firms – the ninth year the IAA has sponsored such meetings. More than 350 persons attended the workshops, which were held in Atlanta, Boston, Chicago, Dallas, Los Angeles, New York, San Francisco, and Washington, D.C. IAA staff and attorneys from the law firms of Dechert, Kirkpatrick & Lockhart Nicholson Graham, Morgan Lewis & Bockius, Lorna A. Schnase, and Wilmer Cutler Pickering Hale & Dorr presented information on a spectrum of the hottest compliance issues. Each workshop also featured a speaker from the SEC to discuss current inspection issues and priorities. In January, the IAA also introduced a **compliance caucus** conference call that addressed questions related to the Code of Ethics rule and included over 120 participants.

□ In November, the IAA and the CFA Institute co-sponsored a conference for **hedge fund advisers** in Washington, D.C. The two-day conference featured panel discussions by SEC staff, compliance professionals from investment advisory firms, leading law firms on the range of legal, regulatory, and compliance challenges facing hedge fund advisers.

MEMBER SERVICES

One of the primary missions of the Investment Adviser Association is to provide “benefits, services, and products that add value to member firms in their course of doing business.” In addition to strong advocacy, compliance, and educational programs in 2005, the IAA continued to provide an expanding array of information, industry surveys, services, and other benefits to its growing membership.

The Investment Adviser Association is an outstanding organization and an excellent value.

□ The IAA continues to provide comprehensive information about the investment advisory profession. In June 2005, the IAA and National Regulatory Services issued their fifth annual report entitled, “**Evolution/ Revolution: A Profile of the U.S. Investment Advisory Profession.**” The report provides a snapshot of the investment advisory profession and analyzes several core characteristics of an evolving industry. For example, the 2005 report found that the number of SEC-registered investment advisers and their assets under management continue to grow significantly. The 2005 report also found that the largest investment advisory firms continue to control the lion’s share of managed assets, noting that advisory firms managing \$10 billion or more collectively manage 83% of all reported discretionary assets under management. Interestingly, the report found that contrary to the perception that virtually all advisers engage in soft dollar arrangements, only 58% of advisers reported that they receive research and other products using client commissions. The IAA/NRS report is based on information provided by SEC-registered investment advisory firms in their electronic filings on the Investment Adviser Registration Depository (IARD) system. The IAA has developed software enabling it to analyze IARD data and will continue to look for opportunities to expand its ability to provide useful information about the investment advisory profession.

□ The **IAA Newsletter** is a major component of the Association’s efforts to keep the membership fully informed of all IAA activities and relevant industry trends and developments. In addition to reporting on all legal and regulatory developments that affect IAA member firms, the newsletter features articles on a wide range of subjects, as well as notices regarding IAA-sponsored events and meetings. Any employee of an IAA member firm who wishes to be included on the newsletter mailing list should simply contact the IAA office.

□ In November, the IAA released the results of a **compliance costs survey**. The survey was distributed to IAA members firms during the summer of 2005. More than 100 firms responded, representing a broad range of asset management firms. The survey asked questions about the number of personnel assigned to compliance functions, the number of hours spent on compliance related activities, and the costs of

compliance in both dollars and as a percentage of total costs/expenses. These questions related to 2004, as well as anticipated figures for 2005 and 2006. The survey results clearly indicated that advisory firms are significantly increasing their compliance resources to respond to new regulations and increased SEC focus on advisers.

□ The IAA’s **web site** (www.investmentadviser.org) offers a wide array of information and services. For example, the site includes: information about the IAA and the benefits of membership, an alphabetical and geographic directory of IAA member firms (including links to IAA member firm sites), a library of IAA comment letters, testimony, and other statements relating to a wide variety of policy issues, as well as an employment listings area that allows member firms to post job openings.

□ The IAA has developed a **Service Provider Directory** that is available for IAA member firms. The directory is intended to assist IAA member firms in identifying companies that specialize in providing services to investment management firms. Current listings include various legal, regulatory, and compliance categories (including law firms, best execution services, proxy voting, e-mail retention and archiving solutions, and anti-money laundering), as well as a number of operational and business categories, including technology consultants, executive recruiting, insurance, portfolio management providers, and client relationship management services. The IAA plans to continue to enhance this important service in the future.

□ The **Chartered Investment Counselor** (CIC) designation, sponsored by the IAA, recognizes individuals who have met significant education and experience qualifications in performing investment counseling and portfolio management functions. Virtually all states now recognize the CIC charter for purposes of waiving examination requirements. Information about the CIC charter is available on the IAA web site or by contacting the IAA office.

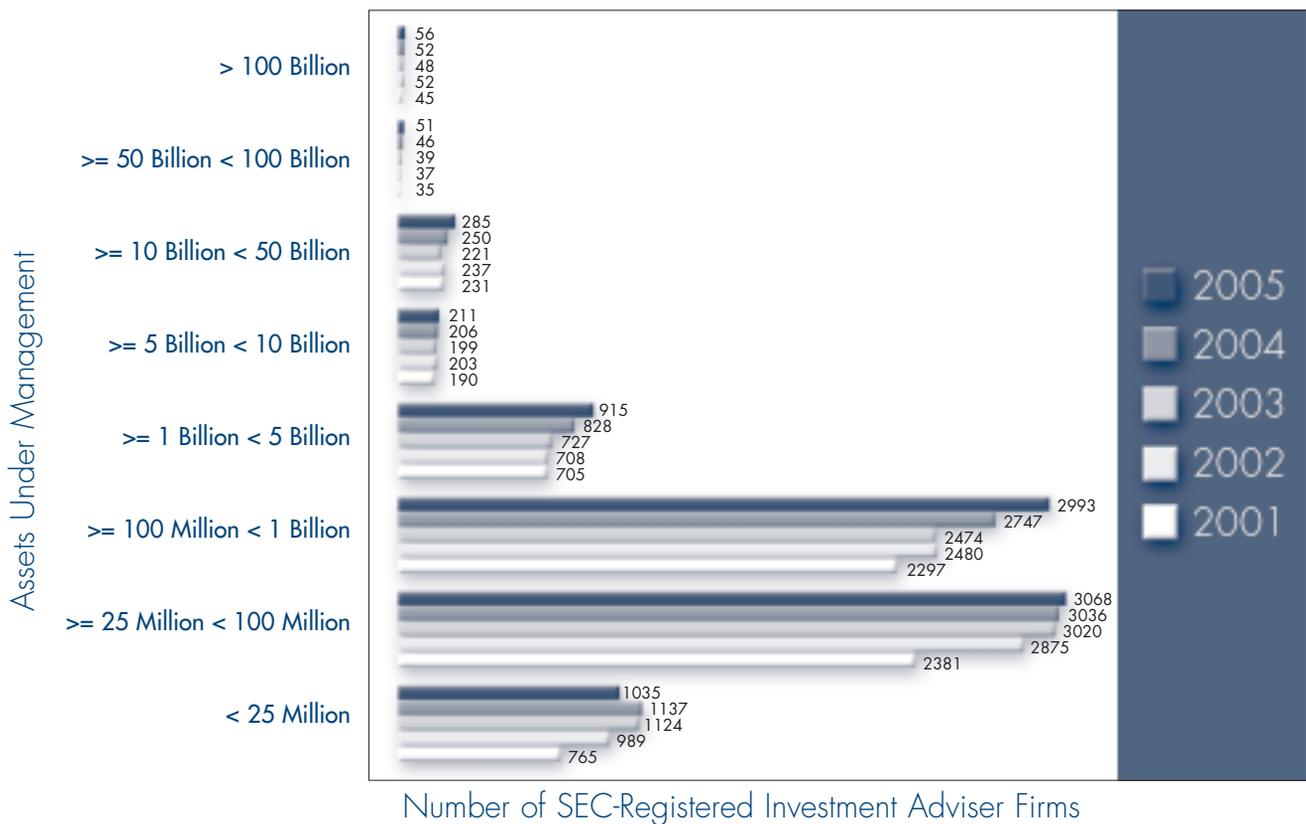
□ In December, the IAA published and distributed its **Directory of Firm Personnel**, which is published for the exclusive use of IAA member firms. The directory is available on the IAA web site.

web site
Service Provider Directory

IAA Newsletter
Chartered Investment Counselor
compliance costs survey
Directory of Firm Personnel

Membership of the Investment Adviser Association currently stands at more than 425 investment advisory firms, marking the highest level in the Association's 68-year history. The IAA is committed to continuing to build its membership in order to better represent the investment advisory profession and provide additional services and benefits to all member firms.

Investment Adviser Firms by Total AUM



Source: "Evolution/Revolution: A Profile of the U.S. Investment Advisory Profession." Investment Adviser Association and National Regulatory Services (June 2005).

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