

INVESTMENT ADVISER
ASSOCIATION

2006 ACTIVITY REPORT

45

	Close	NetChg	%Chg	52wk h	52wk l
TSE 300	9069.50	+299.94	+3.42	10176.70	8633.02
Financial	7725.71	+16.29	+0.21	8833.02	6452.14
Minerals	3960.04	-24.96	-0.70	4851.75	3522.45
Gold	4247.53	-28.94	-0.68	7333.82	3522.45
Forest	5784.85	+41.54	+0.72	5902.45	4711.83
Mercr	4711.83	+9.59	+0.20	5692.18	4711.83
Industrials	10827.82	+581.46	+5.67	13830.03	5229.28
Utilities	14866.60	+879.14	+6.29	17956.68	7125.27
Oil/Gas	6452.14	+35.37	+0.55	6945.21	5322.45
Consumer	15277.38	+815.85	+5.64	18907.27	12522.45
Trans	5025.27	+58.54	+1.18	6625.28	4171.45
Pipelines	4171.45	-63.93	-1.51	6228.56	3522.45
Manag	8957.98	+228.42	+2.62	9785.88	7590.24
Comm	19594.99	+740.67	+3.93	22962.91	14342.53
Real Estate	1980.73	-7.20	-0.36	2432.53	1800.00

BONDS

Bonds	Maturity	Price	Yield
10-yr 5.5%	06/09	100.400	5.54%
30-yr 8%	06/27	129.040	5.00%

INTEREST RATES

Interest Rates	Close	Net Chg	% Chg	Yield
3-mo T bill	5.33	0	0.00	5.33%
Euro-T bill	5.55	0	0.00	5.55%

Amsterdam (a)
Brussels (b)

FOREIGN MARKETS
High returns to
the stock markets

December 31, 2006

We are pleased to present this brief summary of the activities of the Investment Adviser Association.

2006 was a productive year for our organization as we continued to build upon our proud record of excellence and service to our membership. 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 (including soft dollar guidance and the ongoing study comparing the investment adviser and broker-dealer regulatory systems), and the Department of Labor (such as new filing requirements for Taft-Hartley investment managers and proposed disclosures by pension plans). The IAA also embarked on various investor education initiatives, including producing a brochure designed to educate consumers about the basic differences between investment advisers, brokers, and financial planners.
- *Compliance.* From our monthly newsletter to our growing on-line library of compliance materials, the IAA serves as an invaluable resource for our member firms on every major legal, regulatory and compliance issue affecting investment advisory firms. The IAA legal staff responds directly to hundreds of questions each year from our member firms, representing a unique service to IAA members. Among other initiatives during 2006, the IAA worked cooperatively with the Investment Company Institute to produce materials designed to assist members in conducting annual sub-adviser due diligence reviews.
- *Education.* The IAA sponsors numerous conferences, workshops, and other meetings in an effort to assist our members on a wide variety of business issues. During 2006, such events included the Association's annual conference in Boston, a succession planning workshop in Chicago, a technology/operations conference in Atlanta, and the IAA/IA Week Compliance Summit in Washington, DC.

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 IAA represents the interests of its membership
with regulators and policy makers in Washington,
DC and around the globe.*

investment education

Following is a sampling of initiatives and issues the IAA has been actively involved with during the past year (please refer to the "Comments and Statements" section of the IAA web site – www.investmentadviser.org – for a compendium of comment letters, testimony, and other position papers authored by the Association):

- The IAA worked on a number of significant and unprecedented **investor education** initiatives during 2006. For example, the IAA worked with the Consumer Federation of America, the North American Securities Administrators Association (representing state securities regulators), the CFA Institute, and the Financial Planning Association to create the Coalition for Investor Education. The Coalition published a brochure in May 2006, entitled *Cutting Through the Confusion*. The brochure is designed to educate consumers about the basic differences between investment advisers, brokers, and financial planners. It is being disseminated widely and appears on numerous web sites that address investor education issues, including the SEC and AARP web sites. Similarly, the IAA has added a new investor education section to its web site. The section includes informational materials entitled *What Is an Investment Adviser?* These materials include: (1) an explanation of the legal definition of investment adviser, business practices, fee structures, regulatory oversight, disclosure and qualifications, and an investment adviser's fiduciary duty; (2) a discussion about the differences between advisers and other financial service providers, such as brokers; and (3) a list of issues and questions investors should consider in hiring an adviser.

rules for brokers and investment advisers

- The Association continued its involvement in developments relating to the interplay of **rules for brokers and investment advisers**, including the broker-dealer exception under the Investment Advisers Act. The SEC's controversial rule relating to the broker-dealer exception was adopted in April 2005, and implementation of the rule began early in 2006. The SEC rule is being challenged in court and a decision is expected early in 2007. In September, the SEC announced that it awarded a contract to the RAND Corporation to "conduct factual research and analysis for a major study comparing how the

different regulatory systems that apply to broker-dealers and investment advisers affect investors." The IAA expects to be involved in providing information regarding this study and will continue its efforts to clarify the rules in this important area.

- Since the founding of the IAA in 1937, the Investment Adviser Association (formerly the Investment Counsel Association of America) has prescribed certain principles of conduct for investment advisers. Over the years, many of these principles have been used by Congress and the SEC as the basis for legislation and regulations governing the conduct of investment advisers and by the U.S. Supreme Court in defining the *standards* of fiduciary conduct applicable to all investment advisers. In February, the IAA Board of Governors approved revisions of the **IAA Standards of Practice**. Based on the work and recommendations of a committee comprised of principals representing a wide variety of IAA member firms, the revised *Standards* underscore the Association's commitment to the highest level of ethical and professional responsibility. Notably, the revised *Standards* list a number of specific duties that generally flow from an investment adviser's fiduciary duty. IAA members are encouraged to disseminate the *Standards* to current and prospective clients.
- The Association and its membership have been active in the ongoing debate involving soft dollars during the past few years, including testifying before Congress, writing numerous comment letters, and providing information to the SEC and its staff regarding **soft dollar** practices. In July, the SEC issued final interpretive guidance on the scope of "brokerage and research services" under the soft dollar safe harbor and an additional SEC rulemaking is expected in 2007 relating to disclosure and recordkeeping requirements. During 2006, the IAA filed comment letters with the UK's Financial Services Authority and the Canadian Securities Administrators on proposed soft dollar rules and interpretations.
- The IAA has assumed a proactive role in dealing with a variety of issues relating to SEC examinations. During the past 3 years, the SEC has made dramatic changes to its inspection program. Changes include

The IAA plays a critical role in serving as the

spokesperson for the investment advisory profession.

converting the inspection program's focus to a risk-based approach and dramatically expanding the scope of documents requested. In March, the Association wrote a letter to the Director of the SEC Office of Compliance Inspections and Examinations that sets forth a number of constructive suggestions for improving **deficiency letters** that are issued during the course of SEC examinations. The IAA letter notes that deficiency letters must be "consistent, transparent, and fair" and that the process should be based on "articulated rules and regulations that are applied prospectively." The IAA has met with OCIE staff to follow up on these suggestions and expects that modifications will be made during the coming year.

The Association has played a leading role in a number of issues pending before the **Department of Labor**. In September, the IAA submitted a comment letter to the DOL regarding proposed revisions to **Form 5500**, which would effectively require investment advisers to provide detailed unbundled soft dollar and commission information to pension plan clients. The IAA noted that the information requested would not be useful to plan sponsors and that the DOL should defer to SEC soft dollar rulemaking. IAA staff and members have communicated with DOL officials to provide further information.

- The IAA continued its advocacy regarding the DOL's **Form LM-10**, on which investment advisers are required to file reports on gifts and entertainment provided to union trustees of Taft-Hartley plans. In January, the IAA and other industry groups wrote a joint letter to the DOL arguing against retroactive imposition of LM-10 requirements on financial services providers and urging the DOL to issue a notice and comment rulemaking. During 2006, the IAA held various meetings with DOL officials and others on the subject. The IAA and other groups recently met with Department officials to urge them to extend the relaxed attestation requirements of LM-10 for another year.
- The Association also continued its longstanding pursuit at the DOL and in Congress of relief to permit advisers to save costs for their ERISA clients by **cross-trading** where appropriate. The IAA worked to include a provision in the Pension Protection Act

of 2006 that permits cross trading for ERISA plans, though Congress limited this relief to plans with at least \$100 million in assets. The Association recently participated in a panel before the ERISA Advisory Council to advocate further cross-trading relief. In November, the Council included portions of the IAA's requests in making recommendations to the Secretary of Labor.

□ The IAA continued its efforts to achieve appropriate and effective **hedge fund regulation**. The IAA previously supported the SEC's controversial rule, adopted by a split decision of the Commission in December 2004, requiring certain hedge fund managers to register under the Investment Advisers Act. In June, the DC Circuit Court of Appeals invalidated the SEC hedge fund registration rule. In the time since the court ruling, the SEC has been working to consider alternative rules and is now poised to adopt various measures related to hedge fund regulation, such as increasing the monetary threshold for so-called "accredited investors" who may participate in hedge funds. The IAA expects that Congressional committees will convene hearings in 2007 to examine whether legislative action is appropriate in this area.

□ The IAA expects an active **regulatory agenda in 2007**. SEC officials have indicated a number of regulatory initiatives. As noted above, action is expected on a new rule relating to soft dollar disclosure requirements as well as on the study of broker-dealer and investment adviser regulatory issues. Additional action items include: (1) re-proposing the rule (originally proposed in April 2000) making significant revisions to Form ADV Part 2; and (2) initiating a top-to-bottom review of the recordkeeping rule under the Advisers Act. The IAA expects that the U.S. Department of Treasury may issue a final rule in 2007 requiring all investment advisers to develop and implement anti-money laundering programs. Finally, the IAA expects to have an active agenda with Department of Labor issues, including cross-trading ERISA accounts, LM-10 reports filed by investment managers of Taft-Hartley plans, Form 5500 filing requirements for pension plans, and gifts and entertainment issues under ERISA.



COMPLIANCE

The IAA serves as a unique and valuable resource on legal, regulatory, and compliance issues. The compliance responsibilities of all investment advisory firms have been transformed in recent years, with the promulgation of sweeping 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. In addition to the IAA legal staff's availability to discuss questions with members, the IAA has developed an expanding array of services and resources designed to assist members in addressing compliance issues.

*The Investment Adviser Association is an indispensable
and invaluable resource on legal, regulatory and
compliance issues.*

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 2006, the IAA legal staff responded to hundreds of 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, industry practices, and future changes in the regulatory environment. The **IAA legal staff** also serves as a valuable resource for members who wish to receive current information about the scope and nature of SEC inspections. Led by IAA General Counsel Karen Barr, the IAA legal staff serves as a valuable tool and resource for all IAA member firms.

The Members Only area of the IAA web site contains a growing library of useful and relevant information. Resources include the *IAA On-Line Compliance Guide*, a comprehensive set of outlines developed by the IAA legal staff that provides guidance on developing various compliance controls. The guide covers more than 25 different areas of adviser compliance, from advisory contracts to compliance policies for specific rules such as soft dollars, proxy voting, codes of ethics, and the compliance program rule. The IAA web site also contains the *IAA Investment Adviser*, a compilation of IAA and other memoranda on the regulation of investment advisers (such as Form ADV, state filing issues, custody, advertising, personal trading, soft dollars, trading practices, global issues, and technology). The IAA legal staff has been working to integrate the contents of the *IAA On-Line Compliance Guide* and *IAA Investment Adviser* and expects to complete this work early in 2007. Additional resources on the IAA web site include archived legal and regulatory updates and past issues of the *IAA Newsletter*.

- The IAA has been involved in creating a number of resources that assist member firms in understanding their regulatory obligations as well as gaining an appreciation for optional approaches and **best practices**. Examples include the *Investment Adviser Guide for Proxy Voting Policies and Procedures* (updated in October 2004) and the *Best Practices for Investment Adviser Codes of Ethics* (published in July 2004). In 2006, the IAA worked cooperatively with the Investment Company Institute – the trade organization representing mutual funds – to create materials that are intended to assist members in conducting annual **sub-adviser due diligence** reviews. These materials are being used by IAA member firms and others to promote greater consistency in how such annual reviews are implemented. In addition, early in 2006, the IAA published a **Risk Assessment Guide**, along with a sample questionnaire and identification chart. These resources are designed to assist investment advisory firms in conducting the annual reviews required under the SEC's compliance program rule.

Risk Assessment Guide

The IAA hosts a number of conferences, workshops, seminars, conference calls, and other educational meetings designed to assist member firms in understanding and dealing with their legal, regulatory, and compliance obligations. In February 2006, the IAA and *IA Week* cosponsored the annual two-day "compliance summit" that features current and comprehensive information about all major topics facing investment adviser compliance professionals. In the fall of 2006, the IAA hosted its annual compliance workshops in eight different cities. In August, the Association sponsored a conference call to discuss business continuity planning. The IAA intends to expand on these educational efforts in 2007 and beyond.

- The IAA expects to be involved in a number of **emerging issues** during 2007. Examples of these issues include identity theft, proposals to revamp the books and records rule, gifts and entertainment issues, matters relating to the custody rule, various SEC inspection issues, and international regulations that affect investment advisers.

emerging issues

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, it 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 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 2006:

technology/operations conference

- In April, the IAA held its **annual conference** in Boston. Entitled “Achieving Success,” the program featured presentations by Dr. Marvin Zonis, SEC Commissioner Paul Atkins, Robert Pozen, Jim Ware, and other distinguished speakers addressing a wide range of issues. The conference also included an optional workshop on succession planning issues, cosponsored with the Boston Security Analysts Society. 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. All member firms are encouraged to attend the 2007 annual conference that will take place in Austin, Texas on April 25-27.

In November, the Association sponsored a **technology/operations conference** in Atlanta. The program featured discussions on benchmarking, data management, account reconciliation, back office trends, security controls, client reporting, post-trade processing, and compliance issues, as well as breakout sessions tailored to specific firms. Prior to the conference, the IAA conducted a joint tech/ops survey with SEI Investments that is designed to identify current tech/ops practices and identify emerging issues and concerns.

succession planning workshop

In November, the Association convened a **succession planning workshop** in Chicago. The half-day workshop featured panel discussions from leading experts on incentive alignment and valuation issues, as well as various case studies presented by investment management executives. In light of the continuing interest in these important topics by numerous IAA member firms, the workshop will be offered as an optional meeting prior to the 2007 annual conference in Austin.

- The **IAA Board of Governors** met in February (Washington, D.C.), April (Boston), June (Los Angeles), September (New York), and November (Chicago). In conjunction with its quarterly meetings, the IAA Board generally hosts working luncheons for IAA members, featuring speakers on topics of particular interest to member firms. During the past year, the Association’s volunteer Board of Governors continued its efforts to increase the

benefits and services of the Association and to promote the IAA and the investment advisory profession.

In February, the IAA and *IA Week* cosponsored the eighth annual **IA Compliance and Best Practices Summit** in Washington, DC. More than 400 persons, representing a wide range of advisory firms, participated in the two-day meeting. Designed to provide current and practical information on relevant legal, regulatory, and compliance issues affecting investment advisory firms, the conference has become the leading program for compliance professionals. The conference featured presentations and discussions by SEC officials, chief compliance officers, and legal experts on numerous hot topics, including: conducting the annual compliance review, soft dollars, disclosure issues, SEC inspections, e-mail and other recordkeeping issues, performance advertising and marketing, anti-money laundering, and business continuity planning. The ninth annual IAA/*IA Week* compliance summit will be held on March 22-23 in Washington, DC.

compliance workshops

- During the fall of 2006, the Association again conducted its **compliance workshops** for member firms – the tenth year the IAA has sponsored such meetings. More than 325 attendees participated in the workshops which took place in Atlanta, Boston, Chicago, Houston, Los Angeles, New York, San Francisco, and Washington, DC. The IAA legal staff and investment management attorneys from the law firms of Bell Boyd & Lloyd, Dechert, Kirkpatrick & Lockhart Nicholson Graham, Morgan Lewis & Bockius, Pickard and Djinis, Lorna A. Schnase, and WilmerHale discussed a range of current issues, including annual compliance reviews, soft dollars, separately managed accounts and subadviser issues, and gifts and entertainment. Each workshop featured a presentation by a representative of the SEC regarding current inspection priorities and compliance issues. Earlier in the year, the Association held **regional compliance meetings** in San Francisco, Chicago, Boston, New York, and Washington, DC. These meetings provide a forum for compliance professionals to conduct informal discussions on a range of issues and concerns.

regional compliance meetings

As the Association’s membership continues to grow, the IAA will be looking for ways to build upon its educational programs. Members are encouraged to submit ideas for **future initiatives**.

future initiatives

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 its advocacy, compliance, and educational programs, the IAA provides a wide range of additional services and benefits to its membership.

moves in the opposite direction, rose to 4.21 percent from 4.17 percent on Thursday.

The euro was quoted at \$1.3106 in late New York trading, down from \$1.3203 on Thursday. The dollar traded at 101.91 yen, down from 102.45. Japan's Nikkei stock average rose 0.71 percent. Britain's FTSE 100 closed up 0.43 percent, France's CAC-40 climbed 0.53 percent, and Germany's DAX index gained 0.48 percent.

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

- In July, the Association and National Regulatory Services published the sixth annual report entitled ***Evolution/ Revolution: A Profile of the U.S. Investment Advisory Profession***. This leading report provides a snapshot of the investment advisory profession based on information submitted to the SEC by all registered advisory firms and analyzes core characteristics of the industry. For example, the 2006 report found that the number of SEC-registered investment advisers continues to grow, from 8,614 in 2005 to 10,290 in 2006. Similarly, total assets under management reported by these firms showed significant growth, from \$26.8 trillion in 2005 to \$31.4 trillion in 2006. The report analyzed new registrations by hedge fund advisers while noting that the subsequent invalidation of the SEC hedge fund rule likely will have an adverse effect on such registrations. The 2006 report notes that the vast majority of SEC-registered advisers are small businesses – more than 6,400 firms report assets under management of less than \$1 billion. The report also found that the largest investment advisory firms continue to control the lion's share of managed assets, noting that the 415 advisory firms managing \$10 billion or more collectively manage 82% of all discretionary assets.
- The **IAA Newsletter** is a key component of the Association's efforts to keep its membership fully informed about its activities and to highlight significant legal, regulatory, and compliance developments. Any employee of an IAA member firm who wishes to be included on the newsletter mailing list should simply contact the IAA office. In addition to the monthly newsletter, the Association publishes conference brochures, educational materials, and other resources.
- The **IAA web site** (www.investmentadviser.org) is a growing and dynamic resource for all IAA member firms and others. 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, an employment listings area, as well as sections on investor education and the IAA *Standards of Practice*. The IAA is currently in the process of converting its software and associated web site capabilities. These enhancements will enable the Association to expand its communication with member firms and facilitate greater access to IAA services.

- The IAA has developed a **Service Provider Directory** that is available only to member firms. The directory is designed to assist members 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.

Chartered Investment Counselor

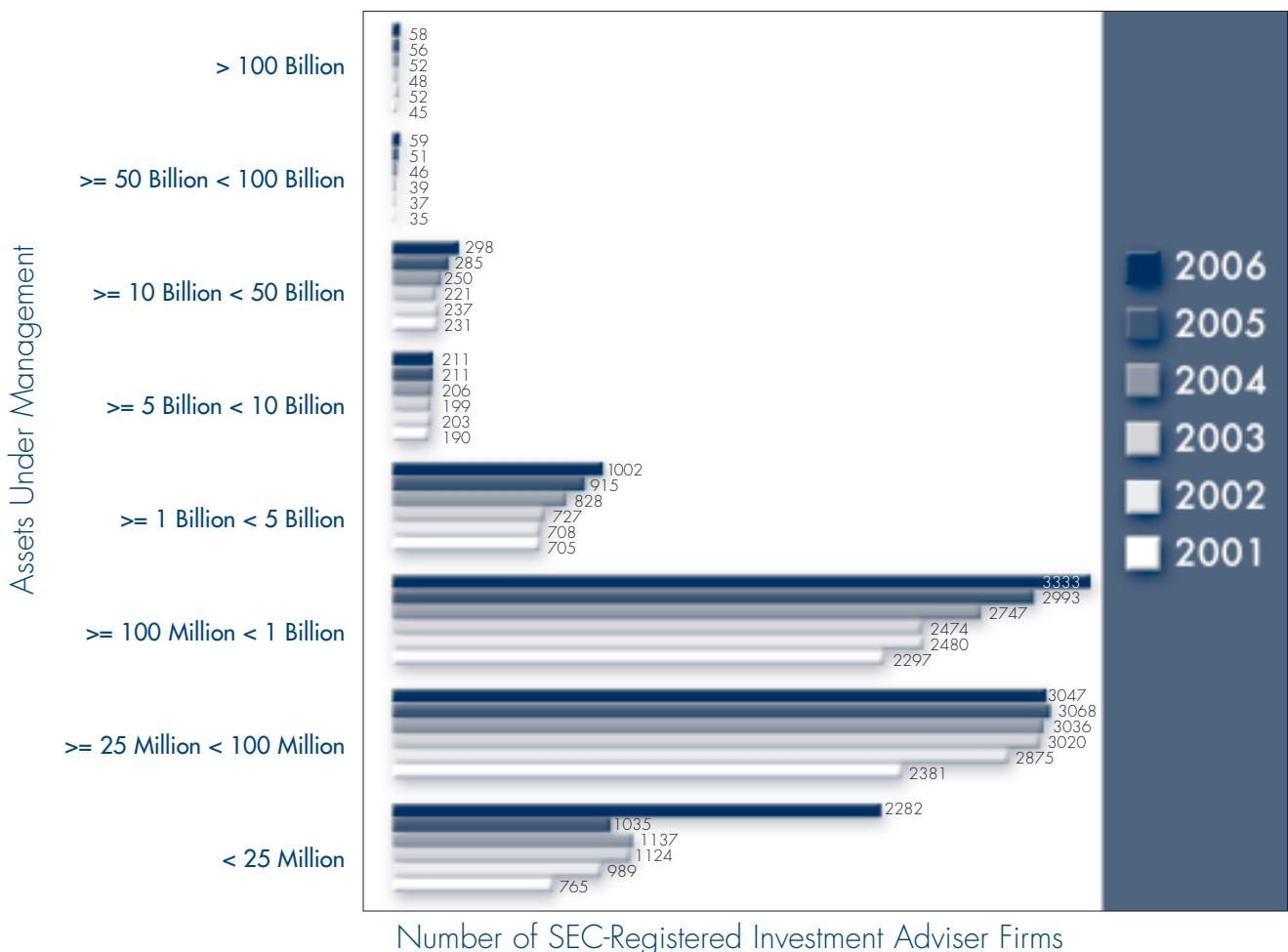
- The **Chartered Investment Counselor** (CIC) designation, sponsored by the IAA, recognizes individuals who have met significant education and experience qualifications in performing investment counseling and portfolio management functions. Virtually all states now recognize the CIC charter for purposes 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 also available to members on the IAA web site.

Directory of Firm Personnel

Membership of the Investment Adviser Association currently stands at more than 475 SEC-registered investment advisory firms, marking the highest level in the Association's 69-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.

Number of SEC-Registered Investment Adviser Firms



Source: "Evolution/Revolution: A Profile of the U.S. Investment Advisory Profession." Investment Adviser Association and National Regulatory Services (July 2006).

Board of Governors Investment Adviser Association

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