Evolution Revolution

A Profile of the U.S. Investment Advisory Profession

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Investment Counsel Association of America

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Introduction

Last year, the Investment Counsel Association of America and National Regulatory Services joined forces to issue a report based on the first-ever electronic filings of Form ADV, Part 1 made by SEC-registered investment advisers. This report builds on and updates the information we provided last year, using the latest information available from the Investment Adviser Registration Depository (IARD). By comparing data from 2001 with more recent information, we can measure differences in various responses submitted by investment advisers and attempt to identify significant trends and developments taking place in the advisory profession.

The advent of an electronic filing system marks a watershed event for the investment advisory profession in several important respects:

- The process of transitioning from paper filings to an electronic environment has now been completed and clearly must be described as an enormous success. Despite the difficulty and scope of the task, thousands of investment advisers accomplished the transition without any significant difficulty. In our view, investment advisers generally have experienced administrative efficiencies and reduced costs in filing and amending Form ADV, Part 1 using the IARD one-stop paperless filing system. Assuming the IARD is properly managed, we believe that even greater efficiencies and cost reductions are possible in future years.[1]

- The IARD has the potential to improve the ability of the SEC to conduct more focused and efficient inspections of investment advisers, and to utilize information that may be helpful in evaluating and developing regulatory policies. Such increased scrutiny by regulators may be viewed as a positive development for investment advisory firms that seek to distinguish themselves on the basis of superior compliance and the lack of disciplinary problems.

- In September 2001, the SEC unveiled the Investment Advisers Public Disclosure (IAPD) web site: www.adviserinfo.sec.gov. The IAPD site allows anyone with Internet access to examine Form ADV, Part 1 information filed by each SEC-registered investment adviser (as well as an ever-increasing number of state-registered advisers). This extraordinary development greatly enhances disclosure and transparency. It also encourages investors to compare information filed by competing firms and thus underscores the necessity for all investment advisers to promote and implement a strong internal compliance culture and to adopt policies and procedures that mitigate any potential conflicts of interest.

Our preliminary analysis of the 2002 IARD data reveals several key findings:

- The number of entities that had filed Form ADV, Part 1 on the IARD as of May 15, 2002 was 7,581, marking a significant increase from the 6,649 entities that had filed one year ago. We believe a significant portion of this increase is attributable to entities that should have completed their initial filings last year.[2] Nonetheless, even taking this into consideration, it appears that the growth in SEC-registered advisers continues to be surprisingly strong.

- Discretionary assets under management (AUM) attributable to all SEC-registered investment advisers as of May 15, 2002 totaled $19.7 trillion, compared to almost $18 trillion one year ago. We find this gain to be very surprising in light of declining market conditions during the past year. Even taking into consideration that these numbers overstate actual AUM (due to the fact that more than one adviser may report the same client AUM), the fact remains that AUM have risen significantly during the past year. We believe that only a minor portion of the $1.7 trillion increase is attributable to the increase in the number of entities that should have filed Form ADV, Part 1 earlier last year. Instead, we suspect that the increase is attributable to a combination of factors: positive investment returns for some firms, new entrants in the investment advisory business, as well as growth in new clients and new accounts.

- In last year's report, we provided data on the large number of SEC-registered investment advisers that are affiliated with other entities, including brokerage firms, investment companies, insurance companies, and accountants. We noted then that the data supported our assumption that there was an "accelerating trend" toward affiliation of investment advisers with other entities. However, in reviewing this year's data, we find that the percentage of registered entities that are independent has remained the same as last year (39%). We suspect that the downturn in the market has somewhat dampened the enthusiasm of financial services providers to pursue affiliations with each other.

- The vast majority of entities that filed on the IARD as of May 15, 2002 (6,397 or 84%) selected AUM of more than $25 million as the basis for SEC registration. However, we note that there are a significant number of entities that claim SEC registration as an investment adviser based on some other criteria, including 303 internationally based advisers.

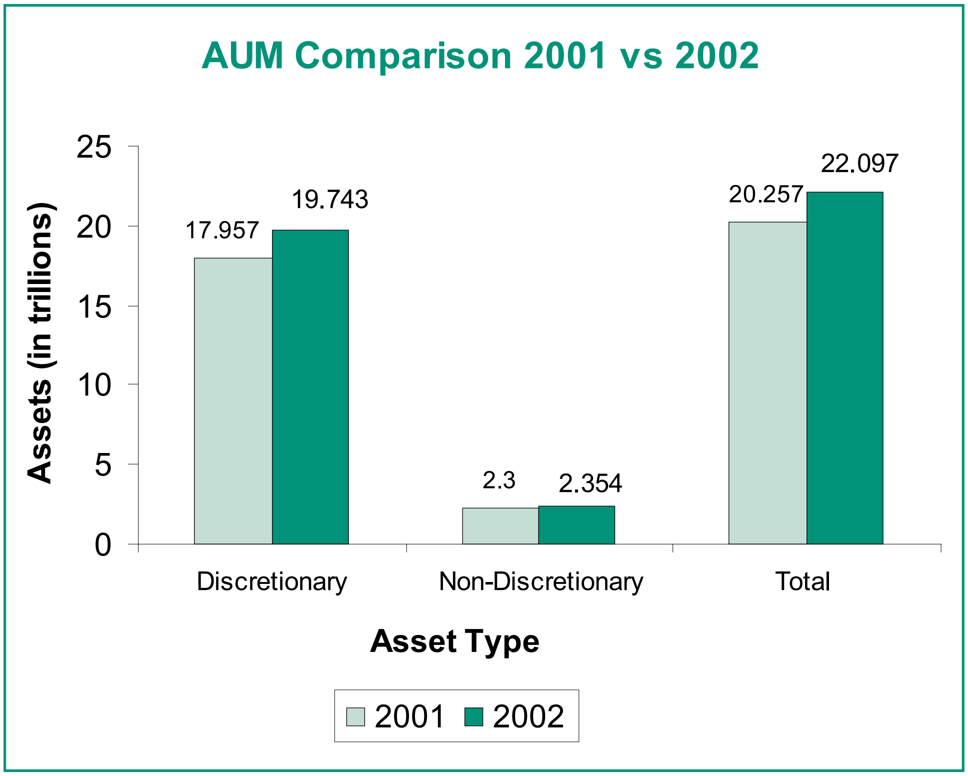
- Finally, we note that the vast majority of SEC-registered investment advisers has continued to report no disciplinary history. Last year, 5,402 (81%) of all registered advisers reported no disciplinary history; this year, 6,221 (82%). However, we continue to underscore the need for continued vigilance by all investment advisers in such matters and to emphasize that awareness of legal, regulatory, and compliance issues is a key to successful asset management.

The ICAA and NRS are pleased to present this joint report. We welcome any thoughts or observations that augment or challenge any of our findings.

Universe Of SEC-Registered Investment Advisers

Pursuant to the National Securities Markets Improvement Act of 1996, investment advisers that manage less than $25 million in assets under management (AUM) are generally regulated by the states whereas investment advisers that manage in excess of $25 million are regulated by the SEC.[3] SEC-registered advisers are *required* to register with the SEC by filing Form ADV, Part 1 via the Investment Adviser Registration Depository (IARD). State-registered advisers may be permitted to utilize the IARD for state registration purposes, but are not uniformly required to do so.[4]

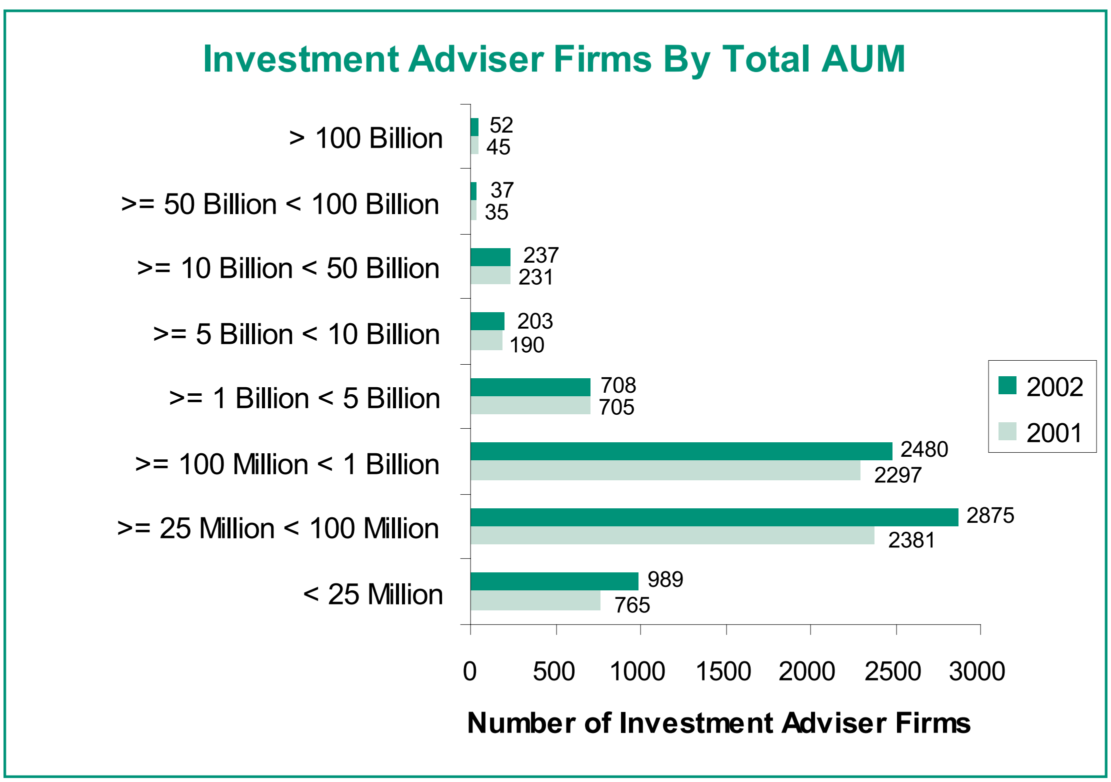
As of May 15, 2002, 7,581 SEC-registered entities had filed Form ADV, Part 1 using the IARD. This is a surprisingly large increase from the 6,649 entities that completed the first-ever round of electronic filings, as we reported just one year ago.[5] Approximately one-half of this increase (453 firms) represents filings by entities that had applied for IARD accounts last year but had not filed Form ADV electronically at that time.[6] Even subtracting 453 firms from this year's total, the number of SEC-registered investment advisers has increased by 7.2% during the past year, representing significant growth in newly registered investment advisory firms.



ASSETS UNDER MANAGEMENT

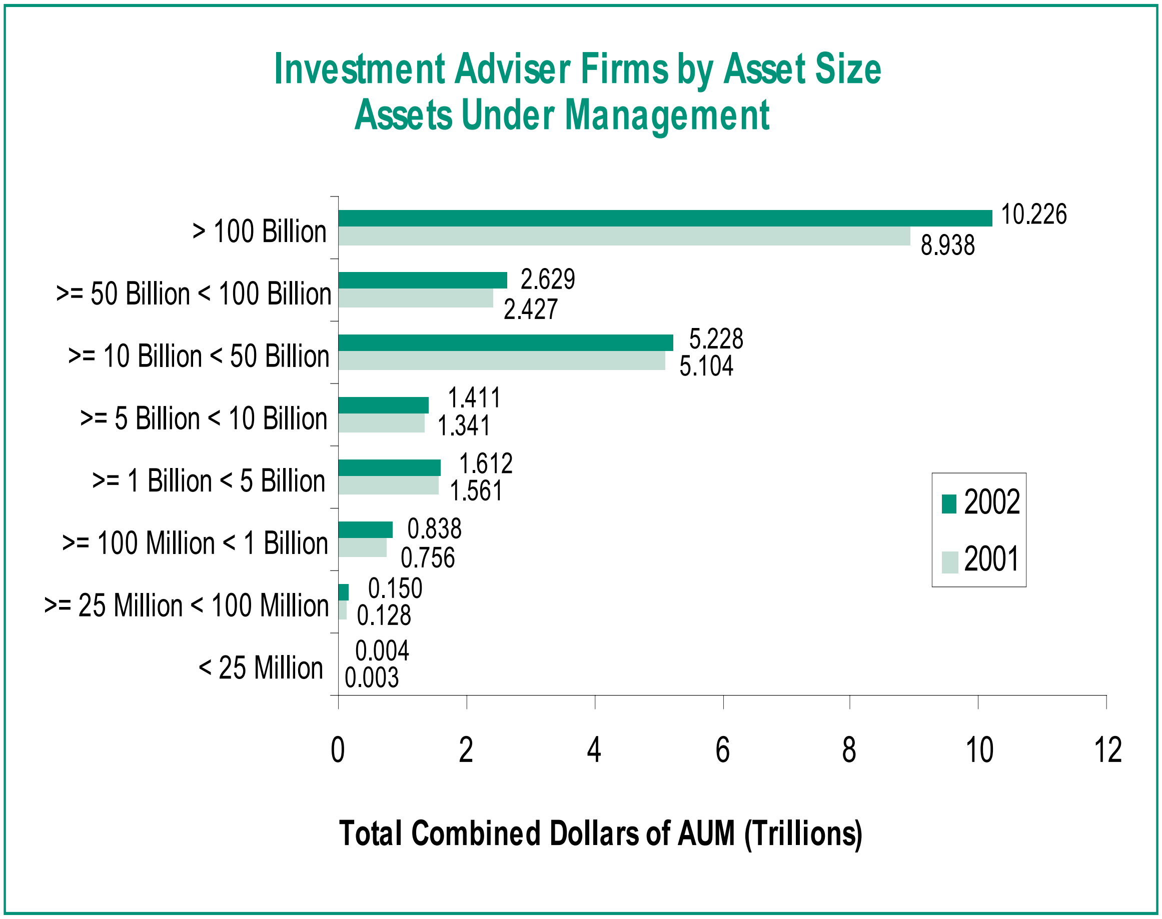
We were surprised to learn that aggregate assets under management reported by investment advisers have increased during the past year. As reflected in the chart, the 6,649 entities that filed Form ADV in 2001 using the IARD collectively reported discretionary AUM of $17.957 trillion and non-discretionary AUM of $2.3 trillion, totaling $20.257 trillion.[7] By comparison, the 7,581 entities that filed Form ADV in 2002 using the IARD collectively reported discretionary AUM of $19.743 trillion and non-discretionary AUM of $2.354 trillion, totaling $22.097 trillion. While the greatest portion of this increase in AUM was reported by the largest firms (*i.e.,* firms that manage in excess of $100 billion), nearly every category of investment advisory firms reported a net positive increase during the last year.[8]

The 10% aggregate growth in discretionary AUM seems particularly surprising considering the fact that all major U.S. stock indices declined by double digit percentages during the same period of time. Although data required by Form ADV do not allow us to measure or confirm our assumptions in this regard, we suspect that the growth in AUM during the past year is attributable to a combination of three factors: an influx of new accounts and additional funds managed by investment advisers;[9] positive investment returns in certain



accounts managed by investment adviser professionals;[10] and a significant increase in the number of investment advisers that have filed via the IARD.[11]

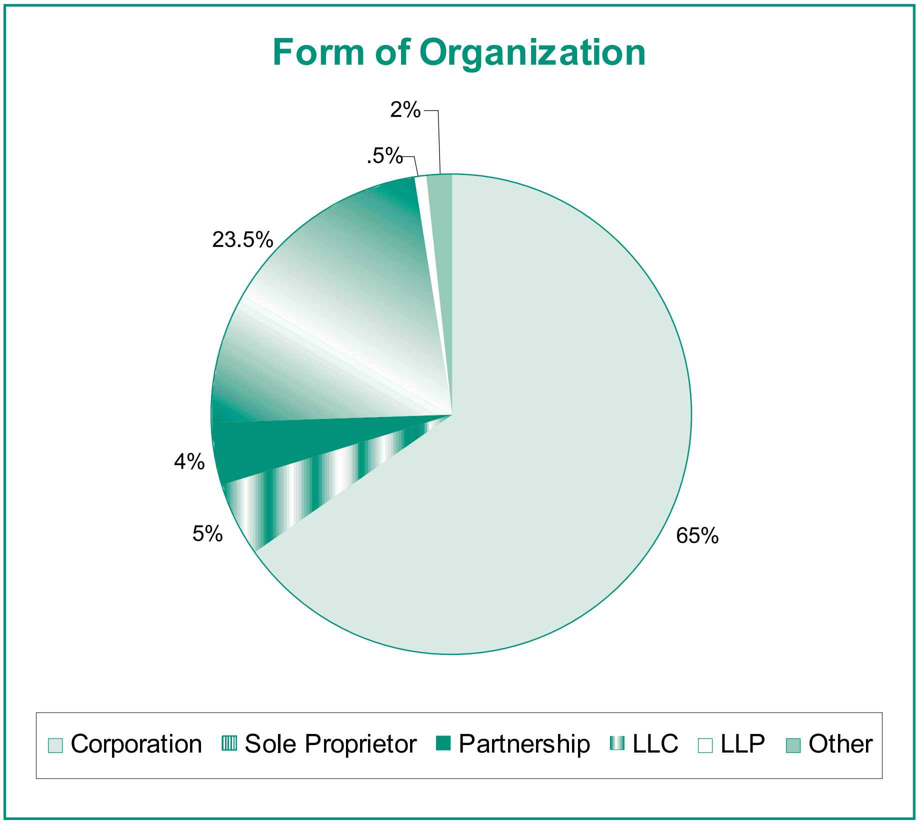
Not surprising is the fact that the largest firms continue to dominate the investment advisory profession, at least in terms of assets under management. A total of 284 firms reported discretionary AUM of more than $10 billion in 2002. These 284 largest firms reported $16.255 trillion in discretionary AUM, representing 82% of total discretionary AUM reported by all registrants.[12] As previously noted, the largest firms also collectively reported a significant increase in AUM.[13] While the number of firms with discretionary AUM of more than $10 billion grew only slightly – from 276 in 2001 to 284 in 2002 – this category of advisory firm clearly made the most significant gain in market share in terms of AUM.



Finally, we note that there are 989 entities that reported less than $25 million in AUM, an increase of 29% over last year. It is our belief that this number must represent three types of entities: (1) investment advisers that previously reported AUM of more than $25 million and are now indicating that they will withdraw from registration; (2) newly formed investment advisers that believe their AUM will exceed $25 million within 120 days of filing Form ADV; and (3) entities that claim adviser registration on some basis other than AUM of at least $25 million. Of the 989 firms with less than $25 million in total assets, 601 investment advisers reported zero assets under management. Most of these 601 firms are pension consultants, control affiliates, and newly formed advisers.

Characteristics Of Investment Advisory Firms

Form of Organization



As shown in the pie chart (left), the vast majority of investment advisory firms are, as has historically been the case, organized as corporations - 4,925 (65%). The number of advisory firms organized as corporations has grown by 387 since last year. By comparison, the growth in advisory firms organized as limited liability companies increased by a robust 457 over the same period. This underscores the increasing popularity of this liability and tax-friendly alternative form of business organization. Statistically, 23.5% of SEC-registered investment advisers are organized as limited liability companies.

International Business

A total of 460 (6%) investment advisers report that they are registered with a foreign financial regulatory authority, holding steady compared with last year.

Employees

Being small continues to be big in the advisory profession. As was the case in 2001, most advisory firms employ relatively few individuals. A total of 3,681 (48.5%) firms reported that they have only one to five employees. In addition to being a significant increase over the 3,092 that so reported in 2001, the one to five employee reporting range is the only range in which a significant year-over-year increase occurred. By way of contrast, the number of firms employing between 501 and 1000 persons declined. We noted last year that "while the profession has been populated by 'small shops' since its inception, the downstreaming of information technology and information to small business over the last decade has served to maintain, if not extend, this demographic." The hardening of the extended decline experienced in the equity markets may also have been a contributing factor to this trend. In fact, 5,122 (67.5%) of all registered investment advisers have ten or fewer employees. On the other end of the range, 258 (3.4%) investment advisory firms employ more than 250 persons, 95 of which employ more than 1,000 persons.

As was the case last year, 2.5% of SEC-registered investment advisers reported that none of their employees perform investment advisory functions. A total of 4,921 (65%) firms have one to five employees performing investment advisory functions and 1,114 (15%) employ between six and ten

Employees of Investment Adviser Firms			
Number of Employees	# of IA Firms containing "x" number of employees	# of IA Firms whose employees perform investment advisory functions	# of IA Firms whose employees are registered representatives of a broker-dealer
0		198	4,308
1 to 5	3,681	4,921	2,044
6 to 10	1,441	1,114	440
11 to 50	1,663	1,003	503
51 to 250	538	252	168
251 to 500	98	50	44
501 to 1,000	65	20	35
More than 1,000	95	23	39

advisory personnel. On the other hand, only 43 (.6%) firms have more than 500 employees performing investment advisory functions. 4,308 (57%) investment advisers do not employ any individuals who are registered representatives of a broker-dealer; 2,044 (27%) employ between one and five registered representatives. Of 74 (1%) firms that employ more than 500 registered representatives, only 57 are dually registered.

Solicitors

As was the case in 2001, the data reveal a broad range of third-party marketing practices by investment advisers: 4,754 (63%) of investment advisory firms do not employ third-party solicitors to acquire advisory clients; 2,307 (30%) investment advisers have between one and five firms or persons soliciting advisory clients on their behalf. These statistics are virtually unchanged from the data reported in 2001. On the other end of the spectrum, only 24 firms reported that they use more than 250 third-party solicitors.

Advisory Activities

The IARD data reflect that 823 (11%) of investment advisers act as portfolio managers for wrap fee programs and 352 (5%) act as sponsors of wrap fee programs. This represents no change from the percentages reported last year. A total of 257 firms (73%) reported that they act as sponsors of wrap fee programs and also reported themselves to be dual registrants, up from 50.9% in 2001. In addition, 181 investment adviser firms reported that they both sponsor wrap fee programs and serve as portfolio managers for such programs. The following chart shows the various types of advisory services provided by SEC-registered advisers.

Investment Advisory Services	
Type of Advisory Activity	# of IA Firms providing advisory services
Financial Planning Services	2,501
Portfolio management for individuals and/or small businesses	5,639
Portfolio management for investment companies	1,470
Portfolio management for businesses or institutional clients (other than investment companies)	4,564
Pension consulting services	1,137
Selection of other advisers	1,597
Publication of periodicals or newsletters	526
Security ratings or pricing services	34
Market timing services	233
Other	1,013

Note: This information was obtained from NRS' IA-*info* product (4/15/2002) due to deficiencies in the NASD's aggregation of IARD data at the time of data collection for this report. The information reported above is based on 7,524 registered advisers versus the 7,581 registered advisers at the time of the data download used for the other segments of this report.

Other Business Activities

A significant number of registered investment advisers continue to be involved in non-advisory activities: 642 (8.5%) investment advisers are dually registered as broker-dealers; 912 advisers (12%) are also registered representatives of a broker dealer; 338 (4.5%) advisers are registered as a futures commission merchant, commodity pool operator or commodity trading adviser; 982 (13%) advisers are also insurance brokers or agents; 81 (1%) advisers are either a bank or a separately identifiable department or division of a bank; 1,848 (24%) advisers sell products or provide services other than investment advice to advisory clients. A total of 63% of all advisory firms indicated that they are not actively engaged in any business other than giving investment advice.[14]

Financial Services Industry Affiliations

The IARD data reflect that registered investment advisers are affiliated with diverse segments of the financial services industry. The year-over-year numbers do not indicate any obvious or dramatic shifts or trends. As depicted below, approximately one-third of registered advisers are affiliated with broker-dealers, with a similar percentage linked with other investment advisers.

This year's statistics on investment adviser affiliations with financial services industry entities are as follows:

- 2,631 (35%) are affiliated with broker-dealers
- 1,549 (20%) are affiliated with investment companies
- 2,683 (35%) are affiliated with other investment advisers
- 856 (11%) are affiliated with futures commission merchants, commodity pool operators, or commodity trading advisers
- 1,099 (14%) are affiliated with banks or thrifts
- 633 (8%) are affiliated with accountants or accounting firms
- 411 (5%) are affiliated with lawyers or law firms
- 1,635 (21%) are affiliated with insurance companies or agencies

- 505 (6%) are affiliated with pension consultants
- 467 (6%) are affiliated with real estate firms
- 976 (12%) are affiliated with sponsors or syndicators of limited partnerships

Consistent with the foregoing data on affiliations, more than one-third (39%) of all investment advisers are independent, *i.e.*, they are not affiliated with any other financial industry entity. Of these firms, 2,182 (29%) are not only independent, but also are not engaged in any business other than providing investment advisory services.[15]

It is also worth noting that 2,543 (34%) advisers reported that they or their related persons are general partners in an investment-related partnership or manager of an investment-related LLC. This response would seem to reflect the proliferation in hedge investment partnerships in recent years, which apparently has not abated notwithstanding the onset of a prolonged bear market.[16]

Clientele of Investment Advisers

Of the ranges available in Form ADV to select for number of clients, the most prevalent category chosen by advisers was 26-100 clients, reported by 27% of advisers. 694 firms (9%) had more than 500 clients. Of these 694 firms, 252 serve as portfolio managers in wrap fee programs and 115 provide financial planning services to more than 500 clients. Approximately 18% of advisers had only 1 to 10 clients. Curiously, 365 investment advisory firms reported that they had *no* advisory clients during the most recently completed fiscal year. However, of the 365 firms with zero clients, 115 claimed to have assets under management.[17] Most of the firms that reported no advisory clients and no assets under management were newly formed advisers or advisers that control, are controlled by, or are under common control with SEC-registered advisers with the same place of business.[18]

The following chart depicting the types of clients served by investment advisers illustrates the broad diversity of advisory businesses. Fully 38% of all SEC registrants have *no* retail clients.[19] Indeed, aggregating the "none" and "up to 10%" responses to the retail category, 53% of investment advisers have little or no retail business. Approximately 24% of advisers have no individual clients at all – either retail or high net worth. On the other hand, 804 (10.6%) indicated that they have *no* institutional

Percentages of Various Client Types

Types of Clients [21]	None	Up to 10%	11-25%	26-50%	51-75%	More than 75%
Individuals (other than high net worth individuals	2,887	1,160	766	980	858	930
High net worth individuals	2,049	1,302	939	1,250	1,036	1,005
Banking or thrift institutions	6,782	613	75	51	10	50
Investment companies (including mutual funds)	6,081	707	167	136	64	426
Pension and profit sharing plans (other than plan participants)	2,808	2,870	934	502	203	264
Other pooled investment vehicles (*e.g.* hedge funds)	5,962	801	166	157	79	416
Charitable organizations	4,221	2,797	393	129	22	19
Corporations or other businesses not listed above	3,815	2,967	465	17	52	105
State or municipal government entities	6,474	765	160	99	33	50
Other	6,891	396	104	57	29	104

clients.[20] Of note, 1,500 (20%) investment advisers reported that they provide advisory services to investment companies (mutual funds). These percentages are virtually unchanged from those we reported last year.

Compensation

Virtually all investment advisers - 94% - are compensated for at least some of their investment advisory services to clients based on a percentage of assets under management. Approximately 31% of firms also provide services based on hourly charges. 37% offer fixed fee arrangements. Notably, only 12% are compensated on a commission basis. Finally, 23% of investment advisers have performance-based fee arrangements with at least some clients. This information regarding compensation arrangements is virtually the same as that reported last year.[22]

Participation or Interest In Client Transactions

Form ADV, Part 1 requests information about an investment adviser's participation or interest in client transactions. However, because the questions solicit responses regarding the adviser *or any of its related persons*, it is difficult to determine whether the responses apply to the specific entity filing the form or to the firm's advisory affiliates and any person under common control with the adviser.

Proprietary Interest in Client Transactions

- 8.5% of advisers or their related persons engage in principal transactions (*i.e*. buying securities from an advisory client or selling securities the adviser owns to a client).
- 71% of advisers or their related persons buy or sell securities they also recommend to clients (personal or proprietary trading).
- 23.6% recommend securities in which the advisory firm or a related person has an interest.

Sales Interest in Client Transactions

- 9.2% of advisers or their related persons engage in agency cross transactions.
- 19.9% recommend securities to clients where the advisory firm or a related person serves as underwriter, partner, or purchaser representative of the issuer.
- 12% recommend securities to clients for which the firm or a related person has any other sales interest (other than commissions as a broker).

Investment or Brokerage Discretion

- 6,417 (85%) investment advisers or related persons have discretionary authority to select securities to be bought or sold for a client's account.
- 6,404 (84%) have discretionary authority to determine the amount of securities to be bought or sold.
- 5,028 (66%) have discretionary authority to select brokers.
- 4,566 (60%) have discretionary authority to determine the commission rates paid to brokers.
- 4,895 (65%) have discretionary authority to determine the broker or dealer that will be used.
- 4,365 (58%) receive research or other products or services other than execution from a broker or third party in connection with securities transactions (*i.e.* soft dollars).
- 3,234 (43%) compensate employees or third parties for client referrals.

Custody

The IARD data confirm that the vast majority of SEC-registered advisers do *not* have custody of client accounts or securities. A total of 832 (11%) advisers reported that they have custody over client cash or bank accounts.[23] A total of 750 (10%) advisers reported that they have custody over client securities.

In addition, 13% of investment advisers have related persons that have custody over their clients' cash, bank accounts, or securities. Approximately 40% of these related persons are registered broker-dealers.

These statistics may actually overstate the number of advisers that have custody of client funds due to possible adviser confusion over the somewhat elusive definition of "custody." For example, some advisers may indicate they have custody under certain fee billing arrangements even though they are in compliance with the key SEC no-action letters, which are often the only source of guidance on this topic. The data relating to custody may change in future years. On July 18, 2002, the SEC issued a proposed rule that would result in sweeping changes to the current rule on custody (Rule 206(4)-2 of the Investment Advisers Act). Adoption of a final rule, which may occur later this year, promises to clarify the circumstances under which an adviser has custody of client assets.

Disclosure Information

It is difficult to draw definitive conclusions from the disclosure information provided in Form ADV, Part 1 for several reasons. The details contained in the disclosure reporting pages have not been made available to us in aggregate form from IARD filings. Also, the information is reported for the advisory firm and its employees, officers, directors, and affiliates for the past ten years, whether or not affiliated with the firm during that time. Thus, the information reported does not necessarily reflect the actions of the firm actually filing the Form ADV. The same disciplinary event at one firm may be reported by multiple separate affiliates. Also, the same disciplinary event may generate affirmative answers to several different questions. It is thus impossible from the current data to discern the number of separate events reported.

Nevertheless, we have the following observations:

- 6,221 (82%) registered investment advisers reported no disciplinary history at all, up one percent from last year.
- 1,360 (18%) firms reported at least one answer in the affirmative to the disciplinary questions, either related to them or to an advisory affiliate. Of these firms, 104 advisers reported only pending charges, with no final outcomes.

The questions that generated by far the most "yes" responses were consistent with last year. However, comparing the number of "yes" responses to the total number of firms, the actual percentage of "yes" responses to these disciplinary questions was down from the 2001 data:

- Has any federal, state, or foreign regulatory agency (other than the SEC or CFTC) found you or any advisory affiliate to have been involved in a violation of investment-related regulations or statutes? 621 "yes" responses (8% vs. 8.6% reported in 2001)
- Has any federal, state, or foreign regulatory agency (other than the SEC or CFTC) entered an order against you or any advisory affiliate in connection with an investment-related activity? 599 "yes" responses (7.9% vs. 8.4% reported in 2001)

- Has any self-regulatory organization or commodities exchange found you or any advisory affiliate to have been involved in a violation of its rules? 552 “yes” responses (7.3% vs. 7.4% reported in 2001)
- Has the SEC or CFTC found you or any advisory affiliate to have been involved in a violation of SEC or CFTC regulations or statutes? 370 “yes” responses (4.9% vs. 5.1% reported in 2001)

Basis for SEC Registration

The vast majority of advisers registered with the SEC (84%) selected assets under management of more than $25 million as the basis for registration, a decrease of 2% from last year. Approximately 1,267 firms indicated more than one basis for SEC registration. A total of 936 (12%) firms selected neither “assets under management” nor “adviser to registered investment company” as the basis for registration.[24] A total of 827 of these 936 firms reported less than $25 million in total assets under management. These firms are permitted to register with the SEC under one of the exemptions the SEC adopted under rules promulgated pursuant to authority granted to it by Congress. A total of 61 firms have used the multi-state exemption for SEC registration. In addition, 303 foreign advisers have registered with the SEC, compared with 229 last year. A total of 109 newly formed advisers have filed Form ADV, Part 1 with the SEC with the expectation that they will soon manage more than $25 million in assets.[25]

This year’s statistics on advisers’ selections for the basis for registration with the SEC are as follows:

- 6,397 selected assets under management of $25 million or more
- 84 selected principal office and place of business in U.S. Virgin Islands or Wyoming
- 303 selected principal office and place of business outside the U.S.
- 1,180 selected adviser to registered investment company
- 4 selected nationally recognized statistical rating organization (NRSRO)
- 308 selected pension consultant
- 442 selected investment adviser controls, is controlled by, or is under common control with SEC-registered investment adviser with same principal office and place of business
- 109 selected newly formed adviser expecting to be eligible within 120 days
- 61 selected multi-state adviser
- 8 selected SEC exemptive order
- 102 selected are no longer eligible for SEC registration

Endnotes

[1] Additional challenges remain with respect to the proposed Part 2 of Form ADV, a narrative brochure that will describe a broad variety of business practices and processes. The SEC has not yet issued a final rule on this important disclosure document and the press of other business may prevent the Commission from acting on this rule in the near future. NASD, operator of the IARD system, has not even begun to develop IARD capability for Form ADV, Part 2.

[2] Last year we reported that 673 firms may have set up IARD accounts without having filed Form ADV, Part 1 at that time. *See Evolution/Revolution: A Profile of the U.S. Investment Advisory Profession* (July 2001) at n. 7 (hereafter "2001 Report"). *See also* n. 6 *infra*.

[3] Pursuant to a variety of exemptions, certain types of advisers that do not manage in excess of $25 million are permitted to register with the SEC.

[4] Unfortunately, a number of states have not yet required state-registered investment advisers to use the IARD. We understand that approximately 6,500 of the estimated 15,000 state-registered investment advisers have filed Form ADV, Part 1 via the IARD.

[5] According to the SEC's 1999 annual report, there were 6,360 SEC-registered investment advisers in 1999.

[6] As noted in our July 2001 report, there were more than 673 entities that had applied for IARD accounts but had not filed Form ADV at that time. We assumed that the vast majority of these entities represented investment advisers that should have filed Form ADV, Part 1 by the end of April 2001 but were simply dilatory in making the transition from paper filings to an electronic environment. It now appears that 453 of these entities have filed Form ADV, Part 1 via the IARD.

[7] The AUM reported by investment advisers in all three categories (discretionary, non-discretionary, and total) overstates actual AUM because more than one investment adviser can "claim" and report the same AUM. For example, an adviser that allocates assets among mutual funds on a discretionary basis will report a subset of the same assets that the advisers to these mutual funds report. Similarly, a sub-adviser to a fund may count the same AUM as the primary manager of the fund.

[8] Advisers managing more than $100 billion reported aggregate discretionary AUM of $8.185 trillion in 2001 and $9.249 trillion in 2002. Advisers managing between $50 – 100 billion reported discretionary AUM of $1.923 trillion in 2001 and $2.482 trillion in 2002. Advisers managing between $10 – 50 billion reported discretionary AUM of $4.567 trillion in 2001 and $4.524 trillion in 2002. Advisers managing $5 – 10 billion reported discretionary AUM of $1.192 trillion in 2001 and $1.218 trillion in 2002. Advisers managing $1 – 5 billion reported discretionary AUM of $1.311 trillion in 2001 and $1.432 trillion in 2002. Advisers managing $100 million — $1 billion reported discretionary AUM of $666 billion in 2001 and $710 billion in 2002. Advisers managing $25 – 100 million reported discretionary AUM of $105 billion in 2001 and $120 billion in 2002. Advisers managing less than $25 million reported AUM of $5.7 billion in 2001 and $7.4 billion in 2002.

[9] Indeed, $1.2 trillion of the $1.8 trillion increase in total AUM is attributable to growth in existing firms that filed last year via IARD. The number of firms trending up in assets (2,283) and remaining virtually unchanged (1,349) were less than the number of firms that saw shrinking assets (2,625). However, these growing firms clearly must have grown at a greater rate than the firms that decreased in asset size.

[10] *See, e.g.,* "Institutional money managers trounce stock market in '01." *Pensions & Investments* (May 27, 2002).

[11] The primary growth in AUM does *not* appear to be a result of the 453 entities that had applied for IARD accounts but had not filed last year; the 453 entities reported only $259 billion in total AUM.

[12] This is the same percentage that we reported last year in this regard. The 276 largest firms (*i.e.,* those managing discretionary AUM of more than $10 billion) reported aggregate discretionary AUM of $14.675 trillion in 2001, representing 82% of the $17.957 trillion discretionary AUM reported by all registrants.

[13] *See* note 8 *supra*. Upon reflection, we believe our 2001 report did not clearly distinguish between discretionary and total AUM. We have attempted to clarify this difference in this report.

[14] The 72% statistic we used in last year's report was derived from determining how many advisers did not check any boxes in response to Item 6A in Form ADV, Part 1, which lists specific types of businesses. This year's 63% statistic was derived from determining how many advisers did not check any boxes in response to Item 6A or 6B1, which asks whether the adviser is actively engaged in any other business not listed in Item 6A. It is difficult to determine under what circumstances advisers decided to check the Item 6B1 box, but, upon reflection, we believe its inclusion in the statistic regarding other active business is probably warranted.

[15] Consistent with the calculation discussed in note 14, *supra,* this statistic was derived by including all advisers who did not check any boxes in response to Items 6A, 6B1, and 7A.

[16] There are about 6,000 hedge funds – nearly double the number four years ago – that manage roughly $550 billion. *See "Hedge Funds Better Placed for Bear Market,"* by Svea Herbst-Bayliss (Reuters, July 28, 2002).

[17] There are two possible reasons for an investment adviser to report assets under management with no clients. First, the investment adviser manages its own money and/or its family's money with no advisory fees exchanging hands. Second, the investment adviser inaccurately filled out Form ADV.

[18] The data show that 86 of these firms were newly formed and 94 firms were of the "common control" variety.

[19] As defined in Form ADV, Part 1, Item 5D(1), retail clients are individuals other than high net worth individuals, *i.e.,* individuals with less than $750,000 managed by the adviser or less than $1.5 million net worth.

[20] These figures include the 197 registrants that marked the "none" response for *every* type of client listed in Item 5D, including "other."

[21] Investment advisers have the ability to select more than one client type on Form ADV, Part 1, Item 5(D).

[22] Last year, 95% of investment advisers reported that they were compensated based on assets under management, 30% provided services based on hourly charges, 36% offered fixed fee arrangements, 12% were compensated based on commissions, and 23% had performance-based arrangements.

[23] Under Section 203A(a)(1) of the Advisers Act, enacted as part of the National Securities Markets Improvement Act, advisers with $25 million in assets under management and advisers to registered investment companies are required to register with the SEC. Other advisers are prohibited from registering with the SEC unless the Commission has used its exemptive authority to permit a person or class of persons to so register.

[24] *See* Section 203A(c) of the Advisers Act. It is difficult to ascertain the various classes of registrant into which each firm falls because Item 2A of Form ADV, Part 1 does not require firms to check *every* basis for registration that applies. For example, 1,500 firms indicated that they advise at least some mutual funds in response to Item 5D, but only 1,180 firms selected this as the basis for registration.

[25] A total of 92 of these firms reported no assets under management at the time of filing.

Investment Counsel Association of America

The Investment Counsel Association of America is a not-for-profit organization that exclusively represents the interests of federally registered investment adviser firms. The Association was founded in 1937 and played a major role in the enactment of the Investment Advisers Act of 1940, the federal law regulating the investment advisory profession. Today, the ICAA consists of about 300 SEC-registered investment advisory firms that collectively manage in excess of $3 trillion in assets for a wide variety of institutional and individual clients. For more information please visit www.icaa.org.

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