Evolution Revolution A Profile of the Investment Advisory Profession

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Investment Counsel Association of America

National Regulatory Services

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Introduction

The Investment Counsel Association of America and National Regulatory Services are pleased to present our report on the state of the investment adviser profession. This report updates the information on SEC-registered advisers that we have presented for the last three years using the latest data from the Investment Adviser Registration Depository (IARD). These annual reports provide an opportunity to identify significant trends and developments taking place in the advisory profession.

Our analysis of the 2004 IARD data pertaining to SEC-registered entities reveals several key findings:

- The universe of SEC-registered advisers continues to grow significantly. 8,302 entities had registered with the SEC as investment advisers as of April 5, 2004, compared with 7,852 registered one year ago. In fact, the total number of SEC-registered advisers has increased 9.5% during the past three years. Such continued growth in the future may pose a significant additional burden on the SEC's resources.

- The total amount of assets managed by SEC-registered advisers reversed direction from last year's decline, and grew substantially to $23.4 trillion – even exceeding the previous high point of $22.1 trillion in 2002.

- The largest firms continue to control the lion's share of managed assets. Advisory firms that manage $10 billion or more collectively manage 82% of all reported discretionary assets under management (up from 80% in 2003), despite the fact that these firms represent only 3.7% of all registered investment advisers.

- Despite the recent high-profile mutual fund scandals, the number of firms reporting no disciplinary history has increased. However, the number of firms reporting only pending charges with no final outcome has increased by almost 30%, from 116 firms last year to 150 this year.

- The number of SEC-registered investment advisers reporting that they provide advice to hedge funds continues to grow dramatically – 23% of advisers now report that they provide such services (an 8% increase from 2003), while the number of firms that provide advice primarily to hedge funds grew by 18% during the past year, from 508 to 601. A substantial number of these firms have fewer than 10 clients and appear to have registered with the SEC on a voluntary basis.

- 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 number of SEC-registered advisers stating that they offer market-timing services declined by 9% during the past year, from 245 to 225.

Universe of SEC-Registered Investment Advisers

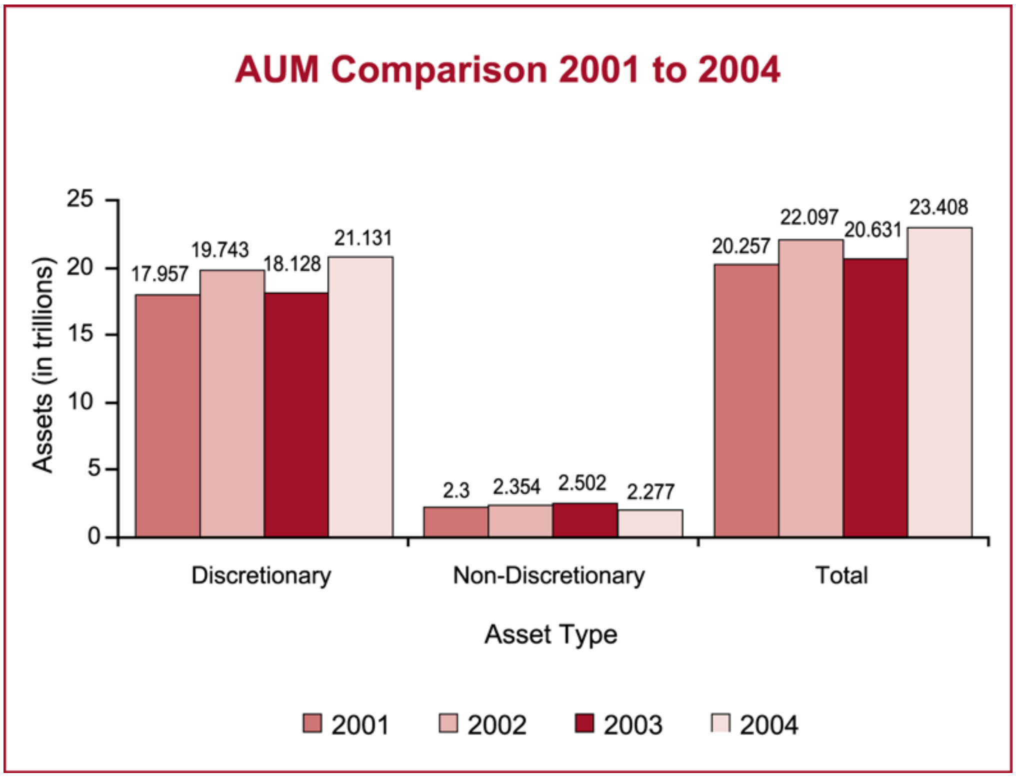
Under the National Securities Markets Improvement Act of 1996, investment advisers that manage less than $25 million in assets under management (AUM) are generally regulated by the states, whereas investment advisers that manage in excess of $25 million are regulated by the SEC.[1] SEC-registered advisers are *required* to register with the SEC by filing Form ADV, Part 1A via the Investment Adviser Registration Depository (IARD), an electronic filing system maintained by NASD. Most (but not all) states require that state-registered advisers file on the IARD system as well.[2]

This report is based on IARD data as of April 5, 2004. Because the vast majority of advisers operate on a calendar year basis,[3] and because SEC regulations require advisers to update Form ADV within 90 days after the end of the fiscal year, the report is intended to reflect the most recent data available. It bears repeating that this report reflects data only from SEC-registered investment advisers.

As of April 5, 2004, 8,302 entities were registered with the SEC as investment advisers. This represents a 5.7% increase from the 7,852 advisers registered at this time last year, which is significant growth from the 3.6% increase reported last year.[4] During the past three years, the number of advisers registered with the SEC has increased 9.5%. This robust growth, which continued even through the 2001-2002 economic downturn, indicates the continuing attractiveness of the investment adviser industry.

It is worth remembering that the National Securities Markets Improvement Act of 1996 was passed, in part, to give the SEC a smaller universe of advisers to oversee. In light of the growth in the number of SEC-registered advisers, and with the SEC considering requiring the registration of hedge fund advisers, it will be interesting to see if the Commission may consider revising the criteria for registration with the SEC.

Assets Under Management

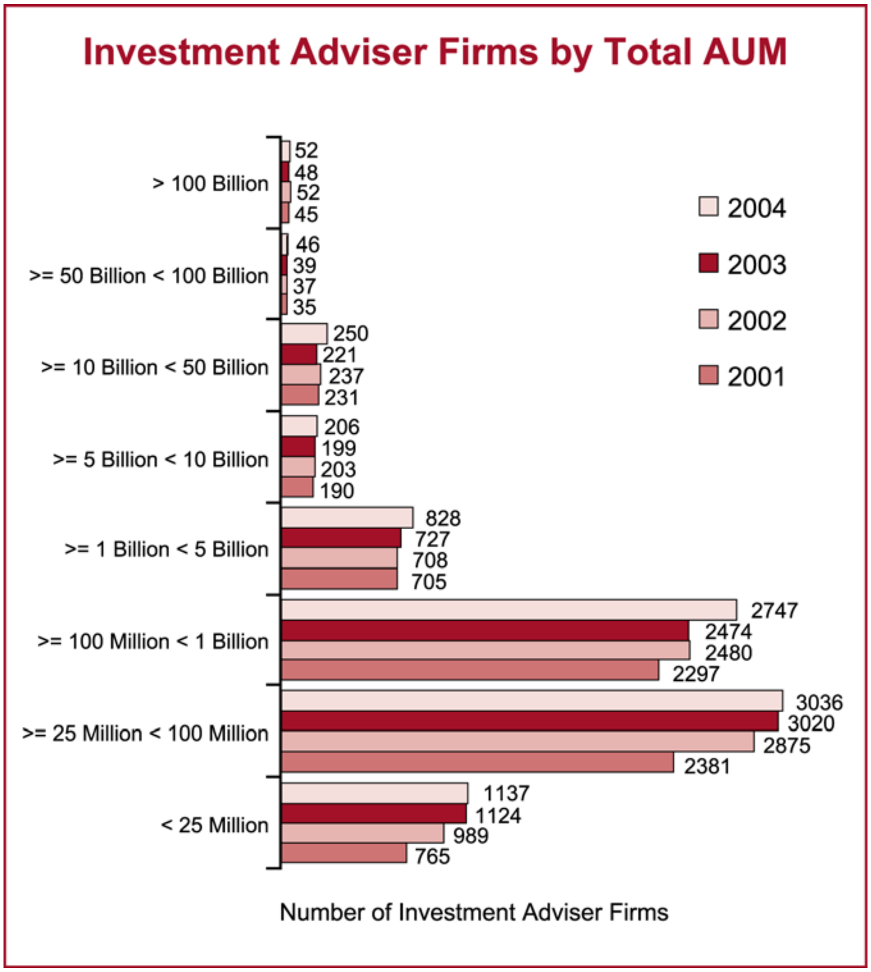


Reflecting the recovering economy, total assets under management by SEC-registered investment advisers have surged to $23.4 trillion as of April 2004.[5] This is not only an increase from the $20.6 trillion reported last year but even exceeds the 2002 total of $22.1 trillion.

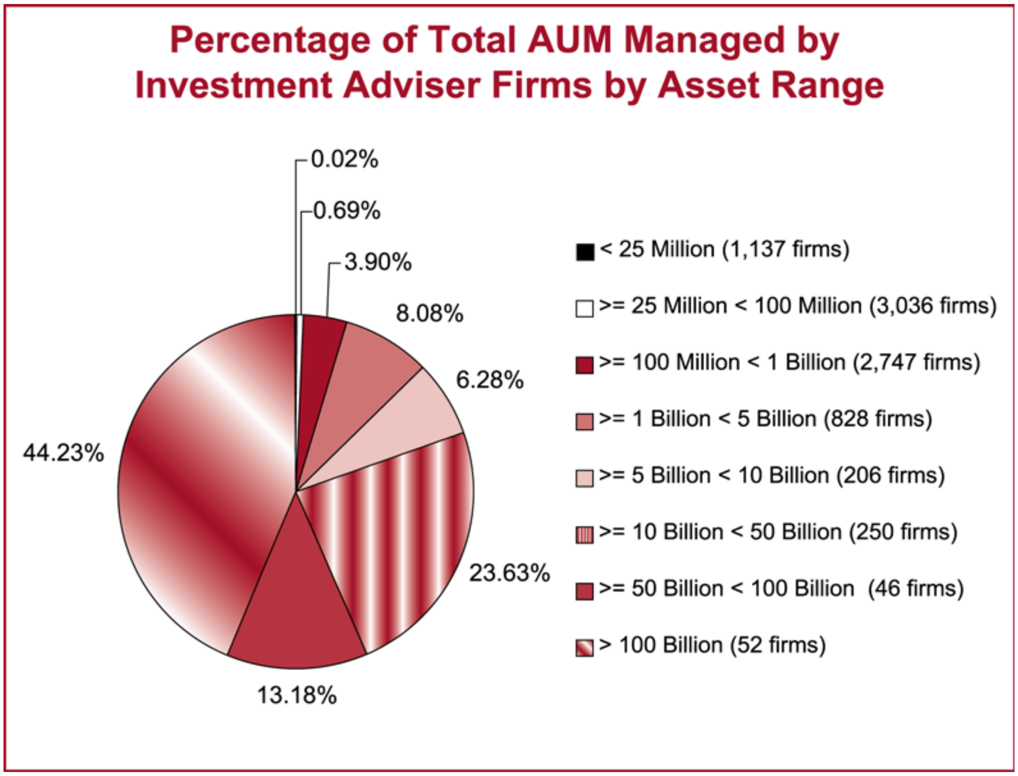
Assets held in discretionary accounts on an aggregate basis grew a significant 16.5%, from $18.128 trillion in 2003 to $21.131 trillion in 2004, representing the highest level since our reports began in 2001.[6] As discussed further below, the growth in hedge fund adviser registrations has contributed only partially to this increase. This substantial increase may reflect not only the improving economy but also the increased popularity of professionally managed accounts, as opposed to investor self-management of assets. Consistent with this hypothesis, for the first time since we began issuing reports in 2001, the amount of assets under non-discretionary management has decreased on a year-to-year basis, from $2.502 trillion in 2003 down to $2.276 trillion in 2004.

In a dramatic turnaround from last year, of firms that filed Form ADV for both 2003 and 2004, 4,940 (67.4%) reported growth in their managed assets (vs. 33% last year), 1,174 (16%) reported shrinkage of their managed assets (vs. 50% last year), and 1,214 (16.6%) (essentially flat vs. last year) reported no change at all (which may suggest that these advisers did not perform the detailed calculations required by the SEC).[7] These changes in AUM likely reflect the improvement in the equity markets during the latter half of 2003.

A relatively few large firms continue to dominate in terms of assets under management.[8] Only 312 firms reported managing over $10 billion in discretionary assets in 2004 (up significantly from 274 in 2003). However, these firms collectively accounted for $17.29 trillion in discretionary assets in 2004 (up from $14.659 trillion in 2003), representing 82% of all discretionary AUM (up from 80% in 2003). Firms in virtually all asset ranges experienced increases in discretionary assets this past year, reversing last year's trend. For example, the aggregate discretionary assets managed by firms with more than $100 billion under management increased by 20% from $7.96 trillion in 2003 to $9.6 trillion in 2004.



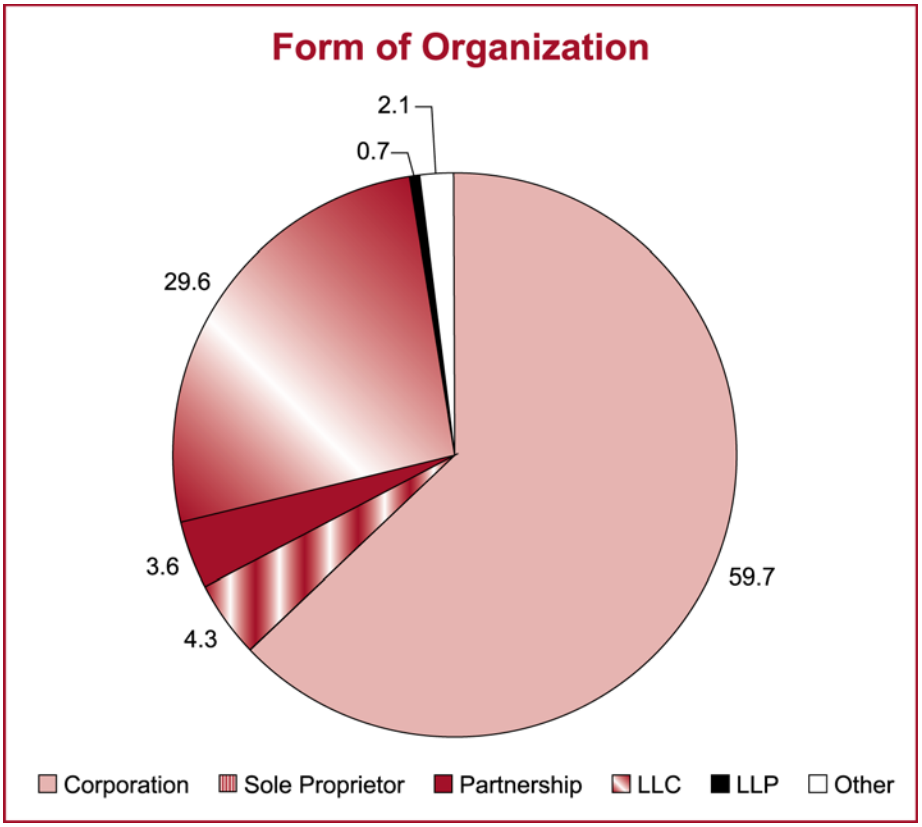
Finally, we note that there are 1,137 entities that reported assets of less than $25 million under management, as compared with 1,124 in 2003. These entities represent a significant part of the SEC universe – 13.7% of registered advisers. Of these firms, 724 claimed to have no managed assets; almost 75% of these firms are pension consultants, control affiliates, and newly formed advisers. 116 firms reported that they are now ineligible for SEC registration and will withdraw their registrations. The remaining firms qualify for SEC registration on some basis other than assets under management of $25 million or more.[9]



Characteristics of Investment Advisory Firms

Form of Organization

As shown in the pie chart, the majority of investment advisory firms are, as historically has been the case, organized as corporations - 4,960 (60%). However, the percentage of advisory firms organized as corporations has decreased by 3% since last year, on top of a 2% decrease the prior year. The number of advisory firms organized as limited liability companies has increased by the same amount – 3% - since last year, reflecting the continuing rise in popularity of this liability and tax-friendly alternative form of business organization. Statistically, 29.5% of all SEC-registered investment advisers are organized as limited liability companies, up 6% over the last two years. The percentage of firms organized as sole proprietors and partnerships have remained fairly flat since last year.



International Business

513 investment advisers (6%) report that they are registered with a foreign financial regulatory authority. This percentage level has held steady for the past three years.

Employees

Smaller firms continue to be the norm in the advisory profession and indeed the percentage of small firms has increased since last year. 50% of all firms reported having one to five employees. 68.5% of all firms have ten or fewer employees (versus 67.5% last year). Only 3% of firms report having more than 250 employees and only 97 firms reported that they employ more than 1,000 persons.

As in previous years, a small percentage of advisers (2.1%) reported that they have no employees who perform investment advisory functions.[10] 5,468 firms (66%) have between one and five employees who perform investment advisory functions, while an additional 1,211 (15%) employ between six and ten people in this capacity. These percentages are very close to those reported last year. As was the case last year, 47 firms (0.6%) employ more than 500 persons who perform investment advisory functions.

The majority of advisers (4,832 firms, or 58.2%) do not employ any persons who are also registered representatives of a broker-dealer; this figure is up from 2003, when 4,508 firms (57.4%) reported that no employees were registered representatives. 2,185 firms (26.3%) employ between one and five registered representatives. 71 firms (less than 1%) employ more than 500 registered representatives; of these firms, 54 are registered as both an investment adviser and a broker-dealer.

Despite the predominance of smaller firms, more and more advisers are maintaining an Internet presence. The number of firms that report having a web site has increased from 59.5% in 2003 to 62.4% in 2004.

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 that are registered representatives of a broker-dealer
0		176	4,832
1 to 5	4,162	5,468	2,185
6 to 10	1,521	1,211	494
11 to 50	1,795	1,066	484
51 to 250	565	270	179
251 to 500	97	64	57
501 to 1,000	65	24	32
More than 1,000	97	23	39

Solicitors

The percentage of investment advisers that use third-party solicitors has remained relatively static. 2,593 investment advisers have engaged between one and five firms or individuals to solicit on their behalf; this represents 31% of all advisers, unchanged from last year. 29 firms reported using more than 250 third-party solicitors, up from 21 in 2003. 5,078 investment adviser firms (61%) do not use third-party solicitors; this is a slight decline from last year's 62%.

Advisory Activities

The IARD information reflects that 900 investment advisers (11%) act as portfolio managers for wrap fee programs and 388 (5%) act as sponsors of wrap fee programs. These are the same percentages that we reported for the past three years. In addition, 214 investment adviser firms reported that they both sponsor wrap fee programs and serve as portfolio managers for such programs. The chart on page 8 shows the various types of advisory services provided by SEC-registered advisers.

Other Business Activities

Consistent with last year's data, a total of 62.5% of all advisory firms indicated that they are not actively engaged in any business other than giving investment advice. However, a significant number of registered investment advisers continue to be involved in non-advisory activities: 637 investment advisers (7.6%) are dually registered as broker-dealers, a slight decrease from last year; 963 advisers (11.6%) are also registered representatives of a broker-dealer[11]; 391 advisers (5%) are registered as a futures commission merchant, commodity pool operator or commodity trading adviser; 72 advisers (0.8%) are real estate brokers, dealers or agents; 1,110 advisers (13%) are also insurance brokers or agents; 82 advisers (1%) are either a bank or a separately identifiable department or division of a bank; 2,154 advisers (26%) sell products or provide services other than investment advice to advisory clients.

Investment Advisory Services

Type of Advisory Activity	# of IA Firms providing advisory services
Financial planning services	2,997
Portfolio management for individuals and/or small businesses	6,213
Portfolio management for investment companies	1,463
Portfolio management for businesses or institutional clients (other than investment companies)	5,185
Pension consulting services	1,366
Selection of other advisers	2,179
Publication of periodicals or newsletters	652
Security ratings or pricing services	42
Market timing services	225
Other	1,408

Financial Services Industry Affiliations

The IARD information reflects that a large number of registered investment advisers have related persons that are engaged in diverse segments of the financial services industry.[12] The year-over-year numbers do not indicate any obvious or dramatic shifts or trends. The percentage of firms with such affiliations decreased by approximately one percent in many categories, with firms affiliated with broker-dealers decreasing by 2%. Slightly less than one-third of registered advisers are affiliated with broker-dealers and slightly more than a third are affiliated with other investment advisers.

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

- 2,629 (32%) are affiliated with broker-dealers
- 1,592 (19%) are affiliated with investment companies
- 2,925 (35%) are affiliated with other investment advisers
- 911 (11%) are affiliated with futures commission merchants, commodity pool operators, or commodity trading advisers
- 1,178 (14%) are affiliated with banks or thrifts
- 780 (9%) are affiliated with accountants or accounting firms
- 459 (6%) are affiliated with lawyers or law firms
- 1,737 (21%) are affiliated with insurance companies or agencies
- 586 (7%) are affiliated with pension consultants
- 525 (6%) are affiliated with real estate firms
- 1,179 (14%) are affiliated with sponsors or syndicators of limited partnerships

More than one-third (40% or 3,318) of all investment advisers are independent, *i.e.*, they are not affiliated with any other financial industry entity. Of these firms, 2,402 (29% of all firms) are not only independent, but also are not engaged in any business other than providing investment advisory services.

Consistent with last year's data, 2,887 advisers (35%) reported that they or their related persons are general partners in an investment-related partnership or manager of an investment-related LLC.

Clientele of Investment Advisers

Among the ranges for reporting the number of clients provided on Form ADV, 26-100 clients was the range most selected by advisers: 2,133 investment advisers reported having between 26-100 clients. As was the case last year, this represents 26% of all SEC-registered advisers. 802 advisers (10%) had more than 500 clients; of these firms, 303 act as portfolio managers in wrap fee programs and 130 provide financial planning services to more than 500 clients. 1,487 advisers (18%) had between 1-10 clients; this percentage is unchanged from 2003. 505 firms claimed to have no advisory clients; interestingly, however, 141 of these firms claim to have assets under management.[13] Of the firms reporting no clients, 54% are newly formed advisers (that have 120 days from their date of registration to report their assets) or advisers that control, are controlled by, or are under common control with SEC-registered advisers with the same place of business.

Last year's 8% rise in the number of advisers providing advice to hedge funds or other pooled investment vehicles was matched by an additional 8% jump in 2004. The number of these firms rose from 1,762 in 2003 to 1,906 in 2004. Once again, most of this growth has occurred in firms that specialize in hedge fund management (we refer to firms in which hedge funds represent 75% or more of their clients as "hedge fund advisers"). There are now 601 hedge fund advisers registered with the SEC, representing a 15% increase over the past year. The 601 hedge fund advisers provided discretionary management for $540 billion in client assets in 2004 (up from $479 billion in 2003).

What is particularly interesting is that a great many of these hedge fund advisers may not be currently required to register with the SEC at all. A hedge fund adviser typically may claim an exemption from SEC registration if it (a) has fewer than 15 clients in a twelve-month period (with a hedge fund typically treated as one client) and (b) does not hold itself out as an investment adviser to the general public. Of the 601 hedge fund advisers, 431 (72%) report having only 1-10 clients. Why, then, have so many hedge fund advisers decided to register with the SEC? Some of these firms may have found that their institutional hedge fund investors prefer to deal with registered entities. Some may be "holding themselves out" to the public by using the Internet to communicate with prospective investors. Others may be registering now in response to the very real possibility that hedge fund advisers may soon be required to register with the SEC.[14]

The percentage of SEC-registered advisers with no retail clients decreased to 36% (down from last year's 38%).[15] Further, by aggregating the "none" and "up to 10%" categories, we see that 50% of all SEC-registered investment advisers have little or no retail business (down from 53% in 2003). Approximately 25% of advisers have no individual clients (either retail or high net worth) while approximately 11% of advisers have only individual clients.[16] These percentages have not changed since 2003.

1,489 firms reported that they provide advice to registered investment companies. This represents 18% of the total number of advisers, down from 19% in 2003 and 20% in 2002. This underscores the fact that mutual funds and investment advisers are not synonymous. In fact, the vast majority of SEC-registered investment advisers are small firms that have nothing to do with mutual funds.

Percentages of Various Client Types

Types of Clients[17]	None	Up to 10%	11-25%	26-50%	51-75%	More than 75%
Individuals (other than high net worth individuals	3,205	1,220	847	1,083	958	989
High net worth individuals	2,316	1,316	1,062	1,344	1,161	1,103
Banking or thrift institutions	7,435	675	87	45	17	43
Investment companies (including mutual funds)	6,813	704	182	133	58	412
Pension and profit sharing plans (other than plan participants)	3,274	3,174	903	496	192	263
Other pooled investment vehicles (e.g. hedge funds)	6,396	854	188	161	102	601
Charitable organizations	4,704	3,012	399	140	27	20
Corporations or other businesses not listed above	4,226	3,209	510	194	55	108
State or municipal government entities	7,130	808	173	104	31	56
Other	7,554	431	104	69	30	114

Compensation

Some trends in the methods advisers use to charge fees can be detected by reviewing the data for the past two years. As in 2002 and 2003, 94% of all advisers charged fees based on the amount of assets under management. However, more advisers have begun to charge hourly fees (33% in 2004, 32% in 2003, 31% in 2002) and fixed fees (41% in 2004, 39% in 2003, 37% in 2002). The percentage of advisers charging performance-based fees has risen from 24% in 2002 and 2003 to 25% in 2004, which may reflect the increasing number of hedge fund advisers. The number of advisers who use commissions as compensation for advisory services has stayed at 12% for the past three years.

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 impossible to determine whether the responses apply to the specific entity filing the form or whether it applies to the firm's advisory affiliates and any person under common control with the adviser. The percentages of firms reporting affirmatively regarding proprietary or sales interest in client transactions and investment or brokerage discretion have remained fairly steady over the last few years.

Interestingly, 4,774 of all advisers (58%) reported receiving research or other products other than execution from brokers or third parties in connection with securities transactions. This appears to be inconsistent with the SEC staff's 1998 report on soft dollars which stated that "almost all advisers obtain products and services" other than execution from brokers and use commissions to pay for those products and services. Further, 3,791 (69%) of the 5,475 advisers that report having discretionary authority to determine the broker-dealer to be used for client transactions also reported receiving research or other products in connection with securities transactions. The remaining 983 firms may be interpreting this question to refer generally to the receipt of products or services from a broker-dealer in connection with giving advice to clients, as opposed to only those products or services specifically tied to directing client "transactions." The inconsistencies in this data may point to the need to clarify the relevant questions on Form ADV.

Proprietary Interest in Client Transactions

- 8% 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).
- 72% of advisers or their related persons buy or sell securities they also recommend to clients (personal or proprietary trading).
- 24% recommend securities in which the advisory firm or a related person has an interest.

Sales Interest in Client Transactions

- 8% of advisers or their related persons engage in agency cross transactions.
- 21% 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

- 7,094 (85%) investment advisers or related persons have discretionary authority to select securities to be bought or sold for a client's account.
- 7,081 (85%) have discretionary authority to determine the amount of securities to be bought or sold.
- 5,475 (66%) have discretionary authority to select brokers.
- 4,931 (59%) have discretionary authority to determine the commission rates paid to brokers.
- 5,551 (67%) investment advisers or related persons recommend brokers or dealers to clients.
- 4,774 (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).
- 3,694 (44%) compensate employees or third parties for client referrals.

CUSTODY

The SEC significantly revised its custody rules in 2003. The new rules eliminated most existing no-action positions and significantly increased the number of advisers who must now state on Form ADV that they have custody, while also eliminating special requirements for advisers that are deemed to have custody.[18] Thus, while it is still clear that the majority of advisers continue to elect to not take custody of client funds or securities (other than by directly debiting advisory fees from client accounts[19]), any specific comparison with last year's numbers is virtually meaningless. For example, the number of advisers that reported having custody of client funds rose 57% in 2004, but it is unclear whether this is entirely attributable to the new rules, or if there are more advisers who would have had custody under the old rules.

In 2004, 1,330 advisers (16%) reported that they have custody of client funds. 1,263 advisers (15%) have custody of client securities.[20] 1,250 advisers (15%) have related persons who have custody of client funds, while 1,208 advisers (12%) have related persons with custody of client securities. Of the advisers reporting related persons who have custody, 392 report that the related person who has custody is a broker-dealer; this is the exact number reported in 2003.

Disciplinary Information

It is difficult to draw meaningful conclusions from the disciplinary disclosure information provided in Form ADV, Part 1 for several reasons. The details contained in the disciplinary 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 an accurate number or analysis of the separate events reported.

Subject to these limitations, we make the following observations:

- 6,900 (83%) registered investment advisers reported no disciplinary history at all, up one percent over the last two years and up 410 firms in an absolute sense since last year. This is somewhat surprising, given the spate of enforcement actions announced against mutual fund companies over the past year.
- 1,402 (17%) 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, 150 advisers reported only pending charges, with no final outcomes, up from 116 last year. This increase may well be related to the mutual fund late trading/market timing events.

The questions that generated by far the most “yes” responses were consistent with last year. However, the absolute number of firms responding affirmatively to three of these questions has decreased in each of these categories compared with last year’s data and has decreased on a percentage basis for each of the last two years. We suspect that this slight percentage decrease may be the result of the influx of new advisers with presumably clear disciplinary records.

- 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? (627 “yes” responses (7.5% vs. 7.9% in 2003 and 8.2% in 2002))
- 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? (554 “yes” responses (6.6% vs. 7.5% in 2003 and 7.9% in 2002))
- Has any self-regulatory organization or commodities exchange found you or any advisory affiliate to have been involved in a violation of its rules? (538 “yes” responses (6.5% vs. 7% in 2003 and 7.3% in 2002))
- 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? (334 “yes” responses (4% vs. 4.4% in 2003 and 4.9% in 2002))

Basis for SEC Registration

The vast majority of advisers (6,960, or 84% of reporting advisers) qualified for SEC registration because they manage more than $25 million in client assets. 1,144 firms (14%) reported less than $25 million under management. The remaining 2% presumably have more than $25 million under management but chose to qualify on a different basis. 1,106 advisers (13%) registered on the basis that they serve as an investment adviser to a registered investment company, down from 1,122 advisers (14%) in 2003. However, since 1,463 advisers reported that they provide advice to mutual funds, it appears that some mutual fund advisers did not select being an adviser to an investment company as their basis for qualification. 1,194 firms selected more than one basis for SEC registration.

The number of newly formed advisers who register with the SEC – based on the expectation that they will qualify for SEC registration within 120 days of becoming registered – continued to grow dramatically, from 109 in 2002 to 169 in 2003 to 199 in 2004.[21] The number of advisers indicating that they are no longer qualified for SEC registration declined by 22% from the same time last year.

The only categories showing a decline in firms qualified to be SEC-registered were firms that act as adviser to a registered investment company, multi-state advisers, and advisers who had obtained an SEC exemptive order.

2004 is the first year in which Form ADV included a newer qualification for advisers who provide advice primarily through the Internet. Last year, before Form ADV was updated, these Internet-based advisers were required to state that they qualified for SEC registration by virtue of an SEC exemptive order. As a result, there is a decrease this year in the number of advisers who qualify based on an SEC exemptive order. Even assuming that the decrease is entirely due to the loss of Internet-based advisers, however, the number of Internet-based advisers has apparently risen from 7 in 2003 to 17 in 2004 – a 143% increase. This should be taken with a grain of salt, however, as some of the Internet advisers may have previously indicated that they qualified as multi-state advisers.

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

- 6,960 selected assets under management of $25 million or more
- 75 selected principal office and place of business in U.S. Virgin Islands or Wyoming
- 319 selected principal office and place of business outside the U.S.
- 1,106 selected adviser to registered investment company
- 6 selected nationally recognized statistical rating organization (NRSSO)
- 317 selected pension consultant
- 462 reported that the investment adviser controls, is controlled by, or is under common control with an SEC-registered investment adviser with the same principal office and place of business
- 199 selected newly formed adviser expecting to be eligible within 120 days
- 49 selected multi-state adviser
- 6 selected SEC exemptive order
- 116 reported they are no longer eligible for SEC registration
- 17 selected Internet-based adviser

Endnotes

[1] 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 (e.g., advisers to mutual funds, Internet advisers, multi-state advisers, and pension consultants) *See also n. 9, infra.*

[2] Approximately 11,000 of the estimated 15,000 or more state-registered advisers have filed Form ADV, Part 1 on the IARD system.

[3] Approximately 89% of all SEC-registered investment advisers have a December 31 fiscal year-end.

[4] It appears that only 7,328 of the 8,302 investment adviser firms filed Form ADV with the SEC in both 2003 and 2004. This suggests that there is more than double the number of new firms (974) than the 450 suggested by first glance at the data (subtracting 7,852 from 8,302). Of course, some of these "new" firms may have simply reorganized under a new name and registration number.

[5] 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" 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 funds report. Similarly, a sub-adviser to a fund may count the same AUM as the primary manager of the fund. We do not know, however, the extent to which AUM figures are overstated.

[6] Advisers managing more than $100 billion reported discretionary AUM of $9.607 trillion in 2004 and $7.964 trillion in 2003. Advisers managing $50 - $100 billion reported discretionary AUM of $2.648 trillion in 2004 and $2.266 trillion in 2003. Advisers managing between $10 - 50 billion reported discretionary AUM of $5.035 trillion in 2004 and $4.429 trillion in 2003. Advisers managing between $5 - 10 billion reported discretionary AUM of $1.306 trillion in 2004 and $1.180 trillion in 2003. Advisers managing between $1 - 5 billion reported discretionary AUM of $1.602 trillion in 2004 and $1.468 trillion in 2003. Advisers managing between $100 million - 1 billion reported discretionary AUM of $791 billion in 2004 and $691 billion in 2003. Advisers managing $25 - 100 million reported discretionary AUM of $131 billion in 2004 and $122 billion in 2003. Advisers managing less than $25 million reported discretionary AUM of $7.58 billion in 2004 and $8.64 billion in 2003.

[7] The percentage of firms reporting total AUM in the $25-100 million range decreased by 2% (38.5% of firms in 2003 to 36.5% in 2004), also reflecting the trend of growing assets in 2004.

[8] The assets managed by large firms are even more concentrated than they first appear in the statistics. For example, of the 49 firms that manage more than $100 billion in discretionary assets, several firms are affiliated with other firms in this category. For example, there are three separately-registered entities affiliated with one another in this category alone that each manage more than $100 billion.

[9] For example, firms that are Internet investment advisers or that have their principal place of business in Wyoming, the U.S. Virgin Islands, or outside the U.S. are eligible for SEC registration even if they have less than $25 million in assets under management. *See* Investment Adviser Act section 203A(a) and rule 203A-2(f).

[10] Approximately 23% of these advisers have qualified for SEC registration because they control, are controlled by, or are under common control with an SEC-registered adviser and have the same principal office and place of business. *See* rule 203A-2(c).

[11] The way this question is phrased on Form ADV, only advisers organized as sole proprietorships could correctly answer that they are also registered representatives of a broker-dealer. The large number of responses to this question indicates that most of the advisers checking this response did not understand the question. It is likely that these advisers have employees who are registered representatives of a broker-dealer.

[12] "Related persons" include the adviser's officers, partners, directors, employees (other than those performing clerical, administrative, or support), and persons (including entities) directly or indirectly controlling or controlled by the adviser or under common control with the adviser.

[13] 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 charged. Second, the investment adviser filled out Form ADV inaccurately.

[14] SEC Chairman Donaldson has stated that a proposal to register hedge fund managers as investment advisers is needed to provide the SEC with "information about hedge funds and their managers - especially the impact their market activities have on the other participants in our equity markets." Consistent with the data presented here, Chairman Donaldson noted that "hedge funds have become one of the fastest growing segments of the investment management business." Speech by the SEC Chairman: Remarks before the Investment Counsel Association of America by William H. Donaldson, Chairman, U.S. Securities and Exchange Commission, Washington, DC (April 22, 2004).

[15] As defined in Form ADV, Part 1A, Item 5.D., 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.

[16] The figures include the 293 advisers that marked the "none" response for every type of client listed in Item 5.D, including "other."

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

[18] The amendments to rule 206(4)-2 of the Investment Advisers Act of 1940 are described in "Final Rule: Custody of Funds and Securities by Investment Advisers", SEC Release IA-2176 (September 25, 2003).

[19] While the SEC considers advisers who directly debit fees from client accounts to have custody, these advisers are not required to state that they have custody when answering the questions on Form ADV.

[20] These percentages have increased by 5% since last year, perhaps reflecting the number of firms that now must answer affirmatively to this question when they act as trustees to client trusts or as general partners to limited partnerships. Previously, such advisers could avoid stating that they had custody if they followed the conditions set forth in various SEC staff no-action letters.

[21] Of these firms, 175 reported no assets under management at the time of Form ADV filing.

Investment Counsel Association of America

The Investment Counsel Association of America is a not-for-profit organization that exclusively represents the interests of SEC-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 more than 300 SEC-registered investment advisory firms that collectively manage in excess of $4 trillion in assets for a wide variety of institutional and individual clients. For more information, please visit www.icaa.org.

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