

MEMORANDUM

TO: File No. S7-45-10

FROM: Jessica Kane
Office of Municipal Securities

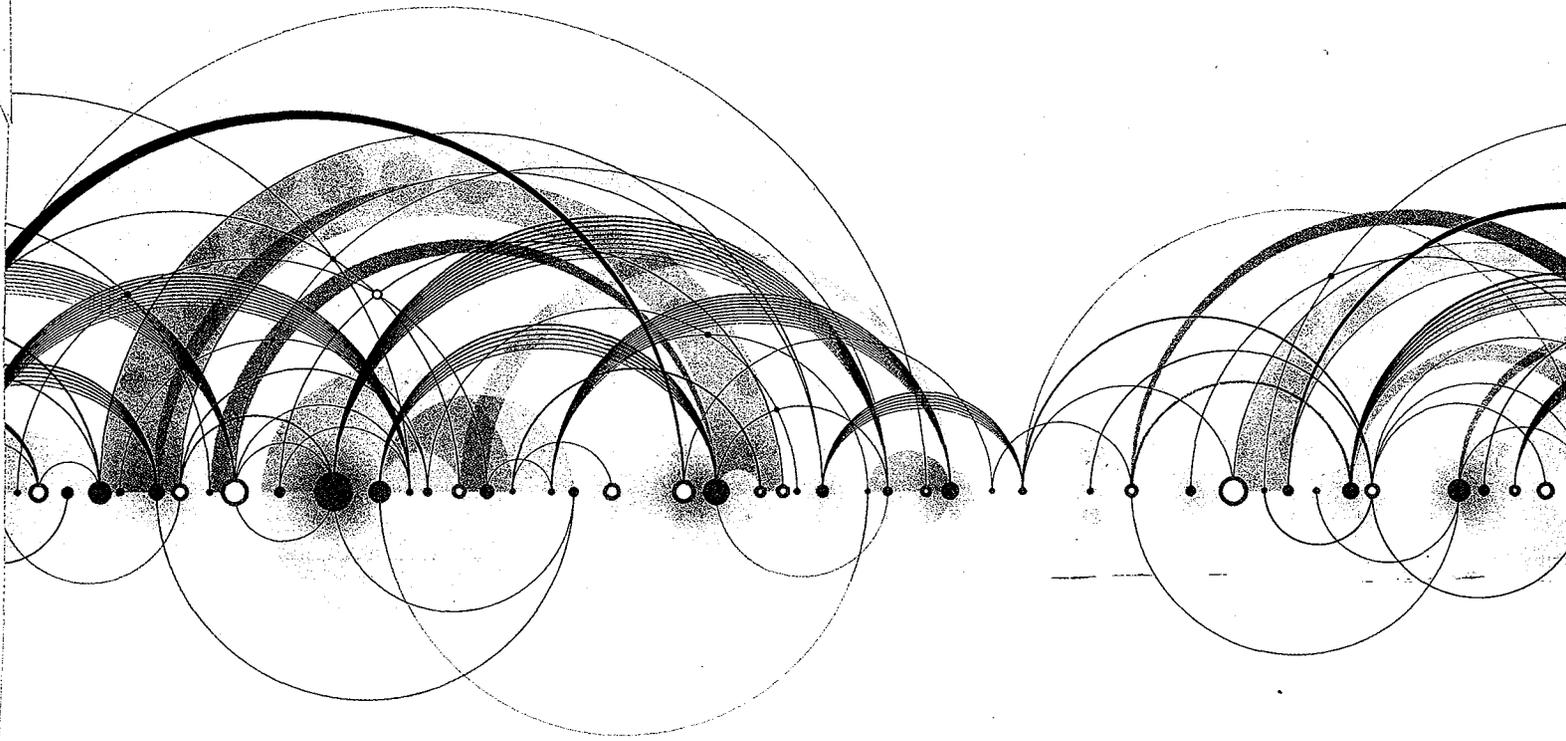
DATE: April 5, 2013

RE: Meeting with Representatives of the Investment Adviser Association
("IAA")

On April 1, 2013, John J. Cross III, Dave Sanchez, and Jessica Kane (Office of Municipal Securities), Jennifer Dodd and Yue Ding (Division of Trading and Markets), and Daniel Kahl, Melissa Rovers, and Vanessa Meeks (Division of Investment Management) met with the following representatives from IAA: Monique Botkin (IAA); Karen Barr (IAA); Victor Siclari (BNY Mellon); and Ed Papantonio (The Prudential Insurance Company of America). The participants discussed the Commission's proposed rules for the registration of municipal advisors.

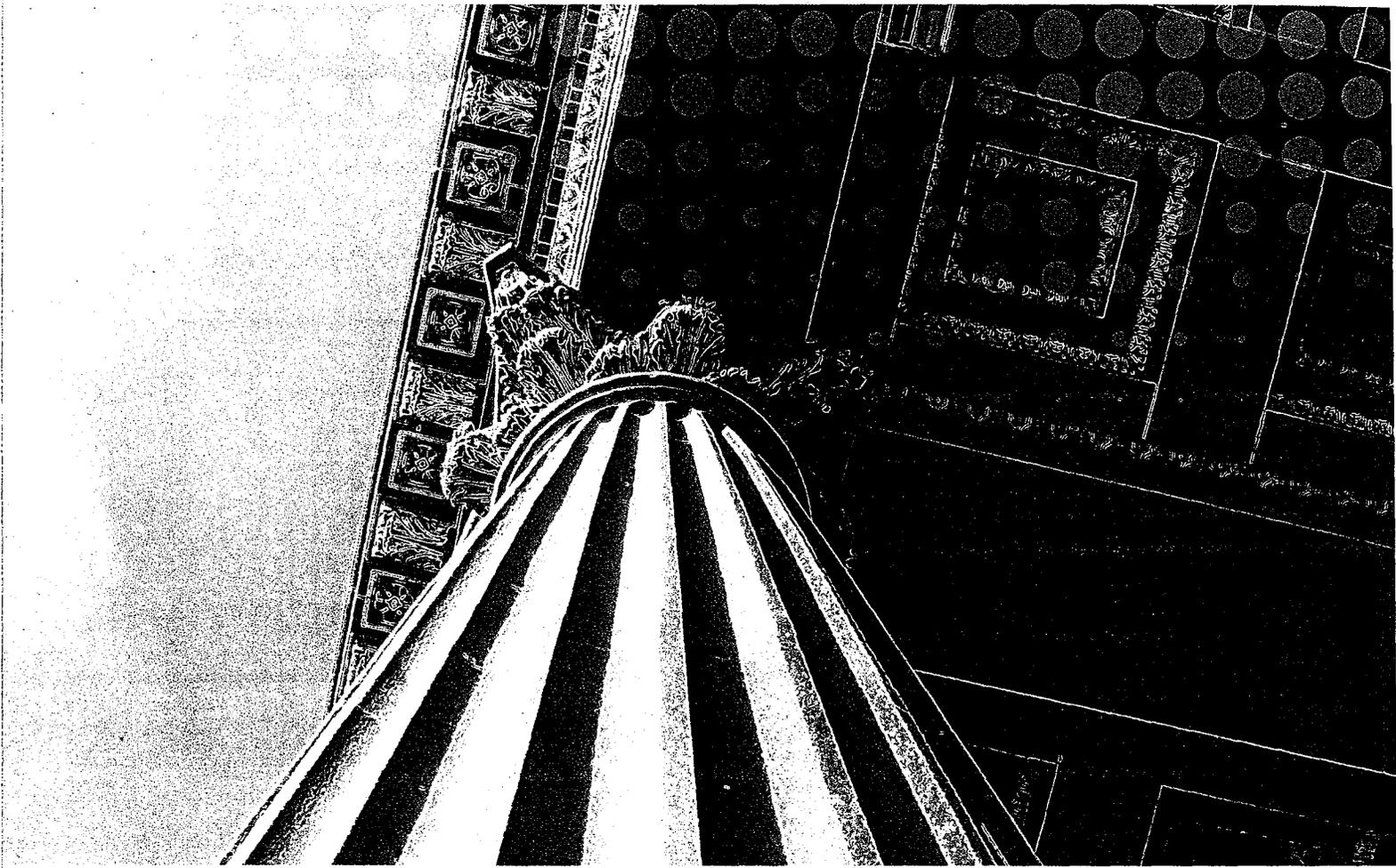
The attached materials were provided.

2012 ACTIVITY REPORT



INVESTMENT ADVISER
ASSOCIATION

75 Years
1937-2012



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INVESTMENT ADVISER ASSOCIATION

December 31, 2012

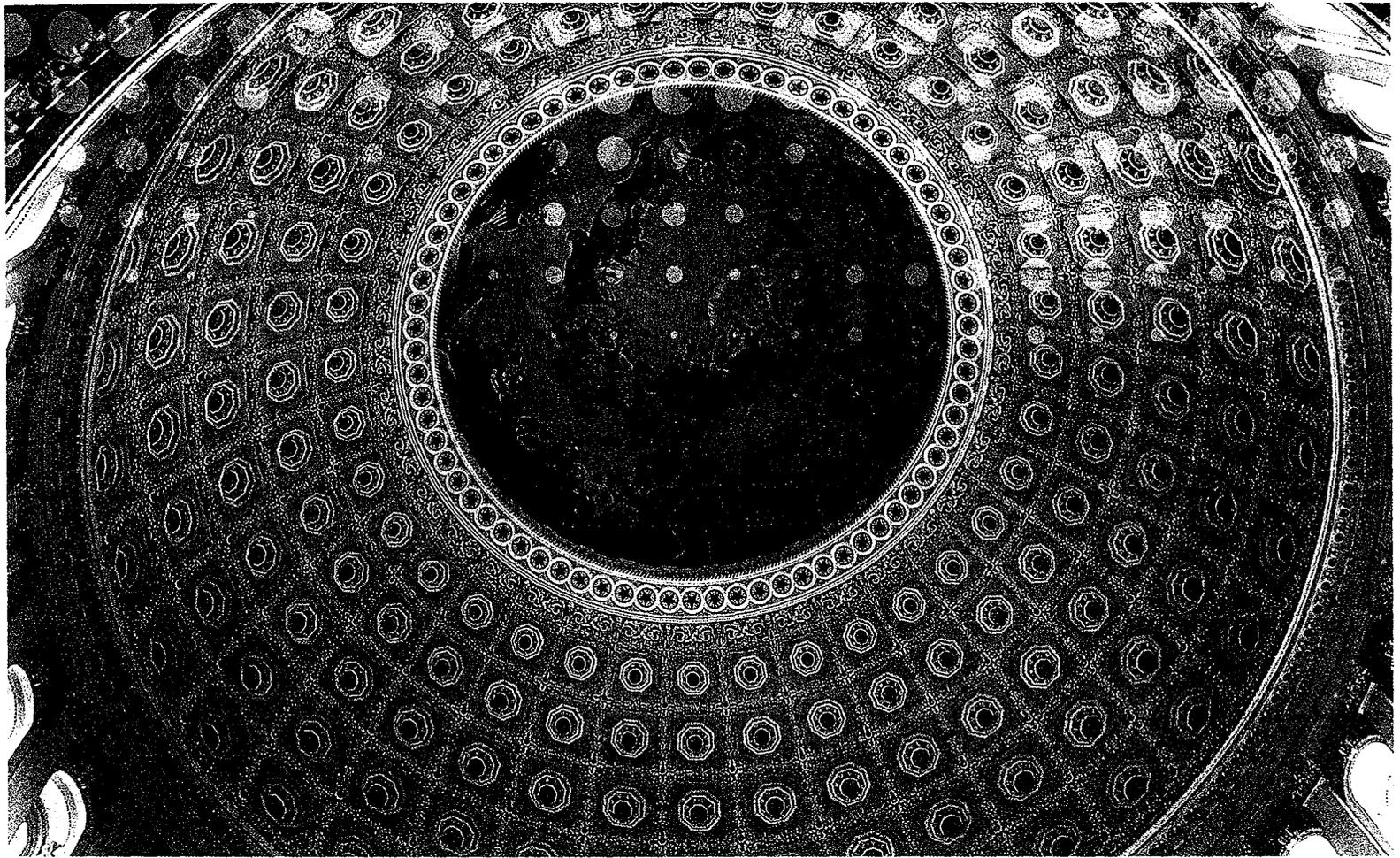
2012 marked the IAA's 75th anniversary. 2012 also represented one of the most daunting legislative and regulatory environments in the Association's history. The highest priority of the IAA's advocacy program was to oppose legislation that would authorize the SEC to designate one or more self-regulatory organizations, likely the Financial Industry Regulatory Authority (FINRA), for thousands of advisory firms. Thanks to the IAA's persuasive advocacy and the hard work of many IAA members and other like-minded groups, the legislation did not come to a vote this year. While the threat of action still exists, we are pleased that our efforts made a difference in this important debate.

In addition to its work on Capitol Hill, the IAA was actively involved in regulatory initiatives of the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), Department of Labor (DOL), international regulators, and other policy makers. The IAA also sponsored educational conferences, workshops, and webinars and produced substantive reports and surveys to keep its membership apprised of relevant issues and developments.

Moving forward, the IAA's role in representing investment advisers' interests is critical. Further legislative and regulatory actions will have profound consequences for the investment advisory community. We urge you to sustain the work of the IAA to ensure that your views on relevant issues are heard and understood.

We truly appreciate your continued support of the IAA and look forward to working with all members as we strive to build on the IAA's proud record of serving its membership. As always, we welcome your suggestions and invite you to participate in the various activities of your organization.

Board of Governors
Investment Adviser Association



IAA BOARD OF GOVERNORS

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Fidelity Investments

ADVOCACY



The Investment Adviser Association is the leading organization solely dedicated to representing the interests of SEC-registered investment adviser firms. The IAA serves as the voice of the investment advisory profession on the key policy and regulatory issues affecting our members. As the legislative and regulatory landscape has become more challenging and complex, IAA members and staff have engaged in constructive dialogue with the U.S. Congress, the SEC, the DOL, the CFTC, the Department of Treasury, international regulators, and other industry organizations regarding a broad spectrum of legislative and regulatory initiatives of critical importance to investment advisers.

Legislative Advocacy

Working closely with its members, the IAA successfully represented investment advisers' interests before Congress. As a result of effective legislative advocacy before Congress, the IAA successfully opposed FINRA's concerted lobbying effort to gain regulatory, examination, and enforcement jurisdiction over thousands of investment advisers. The IAA and its members led a broad-based campaign to oppose H.R. 4624, the **"Investment Adviser Oversight Act of 2012,"** sponsored by House Financial Services Committee Chairman Spencer Bachus (R-Ala.), that would have authorized the SEC to designate one or more self-regulatory organizations (SROs) for advisers. The IAA's efforts led to the Chairman's decision, announced on July 25, not to consider this legislation in his committee.

The Bachus legislation, introduced on April 25 with FINRA's strong support, echoed one of the options cited in a January 2011 SEC staff report to Congress mandated by the Dodd-Frank Act on "enhancing investment adviser examinations." The SEC staff report listed three legislative options to enhance oversight of investment advisers: (1) enact legislation to authorize the SEC to impose "user fees" on advisory firms to fund SEC examinations; (2) enact legislation to authorize the SEC to designate one or more SROs to oversee investment advisers; or (3) enact legislation to expand FINRA's jurisdiction to firms that are

dually registered as both broker-dealers and investment advisers. On July 25, Rep. Maxine Waters (D-Calif.) introduced **H.R. 6204, the "Investment Adviser Examination Improvement Act of 2012,"** that—consistent with the SEC staff report's first alternative—would authorize the SEC to impose user fees on SEC-registered advisory firms to fund an enhanced examination program for advisers by the agency.

At a June 6 hearing before the House Financial Services Committee, **the IAA testified in opposition to the SRO legislation** and, in lieu of an SRO, in favor of adviser user fees in order to provide the SEC with the resources necessary to allow for more frequent inspections of investment advisory firms. On the following day, IAA members from 15 states came to Washington, D.C. to attend meetings with their Senators, Representatives, and their staffs during IAA's **Fifth Annual Lobbying Day on Capitol Hill.** Schwab Advisory Services and TD Ameritrade Institutional also participated in this event and were instrumental in opposing efforts to enact H.R. 4624.

The IAA met regularly with lawmakers on the Senate Banking Committee and the House Financial Services Committee throughout the year and worked closely with consumer groups, state securities regulators, and other industry groups to maintain the SEC's primary role as the

CELEBRATING 75 YEARS

1937

Investment Counsel Association of America (ICAA) founded in New York by a group of fifteen investment counselors, led by Dwight C. Rose (Brundage, Story & Rose), in response to the SEC's investigation of investment trusts ordered by Congress.

1940

ICAA members help draft and ultimately support compromise legislation subsequently enacted as the Investment Advisers Act of 1940.

“ In these uncertain times, the IAA seeks to understand how various proposed changes may affect members and communicates that to Congress and the SEC. The IAA staff is a knowledgeable group of professionals who are dedicated to being advocates for the investment advisory profession.”

most appropriate regulator for investment advisers. Through Member Alerts, email and phone calls, IAA also successfully engaged its membership in grassroots advocacy in opposition to the SRO bill. IAA communications regarding the proposal resulted in almost 700 written communications to members of Congress.

Regulatory Advocacy

During 2012, the IAA effectively represented the shared interests of the investment advisory profession in a wide range of regulatory activities that affect investment advisers.

SEC and Dodd-Frank Advocacy

The SEC adopted final amendments to **Form ADV, Part 1** in 2011 to be implemented during 2012. The IAA submitted substantial comments to the proposed amendments to Part 1 of Form ADV and raised concerns with the SEC staff about various aspects of the proposal. The final rule responded to a number of IAA comments. Under the revised rule, all advisers were required to file

a new Form ADV, Part 1 by March 30, 2012 to indicate whether they were eligible to remain registered with the SEC. They were also required to provide their “regulatory assets under management” and respond to additional questions regarding their employees, clients, advisory services, affiliations, custody, and soft dollar arrangements. In addition, advisers to private funds, such as hedge funds, were required to provide information about their business operations, as well as information about their conflicts of interest, investment strategies, and service providers (including auditors, prime brokers, custodians, administrators, and marketers). In the first quarter of 2012, the IAA and its members continued to discuss issues with the SEC staff pertaining to the transition to the new filing requirements as well as the numerous interpretive issues raised by the revised form.

In the fall of 2012, the **Government Accountability Office (GAO)** invited the IAA to provide data and cost information about complying with the Advisers Act **custody rule** and related recordkeeping rule requirements. Section 412 of the Dodd-Frank Act required the GAO to study the custody rule costs and issue a report to Congress

CELEBRATING 75 YEARS

1946

ICAA changes from an association of individuals to one of member firms.

1948

The SEC, identified as a non-essential agency during WWII, moves its offices back to Washington, D.C., following its temporary relocation to Philadelphia in 1942.

1953

The New York Curb Exchange changes its name to the American Stock Exchange.

by July 2013. Under the statute, the GAO must evaluate the costs to SEC-registered investment advisers with custody of funds or securities of clients to comply with the Advisers Act custody and related record-keeping rules, as well as the additional costs that advisers would incur if the audit exemption from the surprise exam for pooled investment vehicles were eliminated. In connection with the study, the IAA provided initial information to the GAO regarding the costs of the custody rule and will continue to provide information regarding initial and ongoing operational costs, auditing fees to conduct the surprise exam and the internal control report, and legal fees to help interpret and apply the custody rule.

In January 2011, the SEC staff delivered to Congress its "Study on Investment Advisers and Broker-Dealers," pursuant to Section 913 of the Dodd-Frank Act. The SEC staff recommended establishing a **fiduciary standard** for broker-dealers when providing investment advice about securities to retail customers consistent with the standard that currently applies to investment advisers. In addition to the standard of care, the study recommended **harmonization** of certain aspects of the regulatory regimes for broker-dealers and investment advisers when they are performing the same or substantially similar functions, including advertising, the use of and disclosures related to finders and solicitors, supervisory requirements, licensing and registration requirements for firms and associated persons, and books

and records requirements. During the year, the IAA and other organizations met again with the SEC Task Force responsible for the study to ensure that the fiduciary duty for advisers is not diluted by the creation of a new uniform fiduciary duty for broker-dealers. In addition, in March 2012, the IAA and other organizations submitted a letter to the SEC to outline the critical characteristics of a framework for rulemaking that would achieve the goal of enhancing investor protection and to respond to a proposed framework for rulemaking submitted by broker-dealer representatives.

In April 2012, President Obama signed the Jumpstart Our Business Startups Act (**JOBS Act**) into law, which required the SEC to adopt a rule eliminating the prohibition on general solicitation and advertising for certain Regulation D private placements and Rule 144A offers. In August, the SEC proposed rules to implement the JOBS Act requirements. In October, the IAA submitted a **comment letter** supporting the SEC's flexible proposal to permit issuers to use reasonable steps to verify the accredited investor status of investors. The proposal is still pending.

During 2012, large hedge fund and liquidity fund advisers began to file **Form PF** to be used by the SEC and the Financial Stability Oversight Council (FSOC). Other private fund advisers with more than \$150 million in private fund assets will be required to file in early 2013. The IAA continued its advocacy

1954

The Dow breaks the 400 barrier, reaching 402 on December. 29.

1954

Floyd L. McElroy (Loomis, Sayles & Co.), ICAA President, persuades members of the Southern California Investment Counselors' Association to join the ICAA, raising the combined total membership to 54 firms.

in 2012 discussing Form PF interpretive issues with SEC staff as private fund advisers began implementing this significant new requirement. In the months preceding the first filing deadlines for Form PF, the IAA held conference calls with members and discussed various compliance issues with the SEC staff. In May, IAA staff held a webinar to discuss Form PF requirements and interpretive questions. The IAA will continue to monitor developments in this area, including interpretive relief needed for dually-registered investment advisers filing both Form PF with the SEC and **Form CPO-PQR** as commodity pool operators (CPOs) with the **CFTC**.

In June 2012, the SEC **extended the compliance date** for advisers to comply with the third-party solicitor provisions of Advisers Act **"pay to play"** rule 206(4)-5. The original compliance date of June 13, 2012 had to be extended because the SEC had not adopted final rules to define "municipal advisor," one of the critical terms in the Advisers Act pay to play rule. The pay to play rule will limit the ability of advisers to pay third parties unless they are SEC-registered investment advisers, or broker-dealers or "municipal advisors" (each to be subject to their own forthcoming pay to play rule). Prior to the SEC's action in June, the IAA **sought relief** from the SEC to extend the compliance date for advisers.

In February 2012, the IAA submitted a comment letter to the SEC and the various banking regulators on proposed rules to

implement Section 619 of the Dodd-Frank Act known as the **"Volcker Rule."** The IAA urged the agencies to clarify their proposed rules to determine whether a trade is an impermissible proprietary trade under the rule or a permissible act of market making. The IAA expressed concern from the buy side perspective that uncertainty regarding market making activities could adversely affect liquidity for investors in the market. The comment letter further urged the agencies to exclude non-U.S. retail funds from the "covered fund" definition and clarify the permissible activities of sponsors of covered funds.

Dodd-Frank Act

The IAA also responded to a number of other rulemakings implementing the **Dodd-Frank Act**.

The IAA submitted letters to the SEC and CFTC regarding the **Red Flags Rules**, which generally require "financial institutions" and "creditors" offering or maintaining "covered accounts" to implement a written identity theft prevention program complete with policies, procedures, monitoring, and training. The Dodd-Frank Act transferred jurisdiction for Red Flags Rules from the Federal Trade Commission (FTC) to the SEC and CFTC, which proposed implementing rules in February. The SEC noted in its release that most registered investment advisers are unlikely to hold transaction accounts and thus would not qualify as

CELEBRATING 75 YEARS

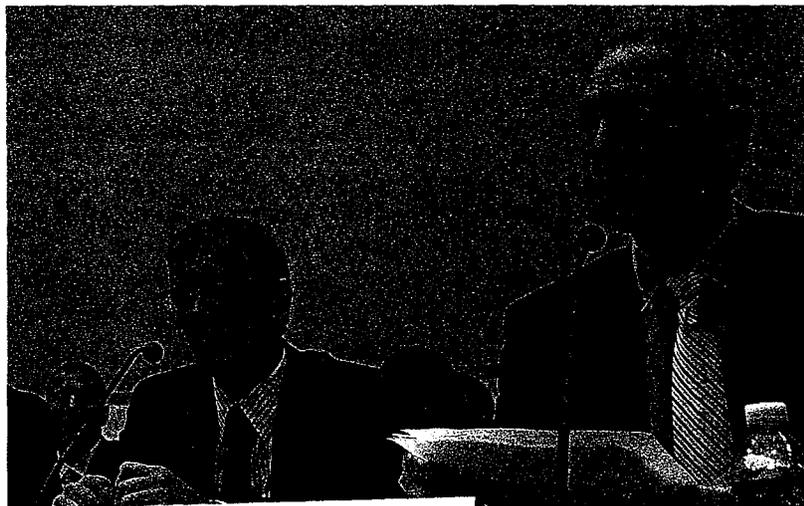
1960

President Eisenhower signs legislation amending the Investment Advisers Act of 1940 leading to promulgation of new SEC requirements, including new registration forms, rules for keeping books and records, reporting security transactions by advisers and their employees, and advertising.

financial institutions under the rule as proposed. The IAA generally supported the agencies' proposed implementation of the red flags rules and guidance in a manner consistent with the FTC and other agencies' joint rulemakings in the area with certain modifications.

In February, the SEC adopted amendments to rule 205-3, which allows advisers to charge performance fees to **qualified clients**, as defined in the rule. The amendment also affects state licensing requirements for investment adviser representatives (IARs) in that advisers do not count natural persons who are "qualified clients" for purposes of the thresholds in the IAR definition. The amendments added to the rule the increased dollar thresholds set by SEC order in 2011, and a new provision that excludes the value of a person's primary residence (and most indebtedness secured by the property) for purposes of the definition's net worth test. The final amendments, which became effective in May, reflect comments made by the IAA in its 2011 comment letter, including transition relief grandfathering existing clients.

In September 2012, the SEC extended the deadline for its temporary rulemaking for **municipal advisors** from September 30, 2012 to September 30, 2013. The SEC had proposed the permanent municipal advisor registration regime in December 2010 to replace the temporary registration regime the SEC adopted in October 2010



as required by the Dodd-Frank Act. The IAA continues to advocate on behalf of its members the issues raised in its February 2011 comment letter requesting that the SEC implement the Dodd-Frank statutory exception for SEC-registered investment advisers from the definition of "municipal advisor" in a manner consistent with the plain language of the Act.

In November 2012, the IAA staff met via conference call with the **GAO** to discuss the GAO's study of the definition of "**accredited investor**" for natural persons to invest in private funds, as required by the Dodd-Frank Act. Prior to the call, the IAA sought member input and provided feedback to the GAO regarding the current definition's net worth and net income standards.

In 2012, the IAA continued to address issues relating to **SEC examinations**. During the past year, the SEC has made significant changes to its inspection program

1962

The Dow Jones Industrial Average experiences its second-largest point decline, falling 5.7% on May 28.

1962

ICAA membership stands at 55 firms

including working with regional offices to improve nationwide consistency, developing a nationwide examination manual, hiring staff with specialized expertise, and enhancing a risk-based approach to exams. The IAA staff and several IAA members met with OCIE staff on a number of occasions this year to discuss member experiences with and potential improvements to the SEC examination program for advisers. The meetings also included discussion about potential initiatives that could help address the number of advisers that are examined and the manner in which the SEC evaluates and communicates the overall effectiveness of the examination program.

CFTC Advocacy

In 2012, the IAA was very active in representing the interests of its membership before the **Commodity Futures Trading Commission** with respect to potential registration of firms as commodity pool operators (CPOs) and commodity trading advisers (CTAs). In February, the CFTC adopted final regulations that repealed one of the exemptions from registration applicable to operators or advisers of private funds that trade commodity interests, such as futures contracts, commodity options, and (as of October 2012) swaps. In addition, the CFTC significantly narrowed the exemption for registered investment companies and proposed a rule to harmonize SEC and CFTC requirements for mutual funds and their operators/advisers that will now be

required to register with the CFTC. The IAA had opposed the CFTC's proposal, which would have also repealed an exemption from registration for pools with a *de minimis* amount of trading in commodity interests and with certain sophisticated investors (rule 4.13(a)(3)). The CFTC decided to retain the *de minimis* exemption in its final rules. In April 2012, the IAA submitted a comment letter to the CFTC on its proposal to **harmonize CFTC and SEC rules**. In particular, the IAA requested that the CFTC harmonize rules from both agencies in the areas of record-keeping, the timing of annual audit reports, mandatory performance reporting requirements, disclosure document updating, and delivery requirements for disclosure documents and account statements.

In April 2012, the IAA and other associations jointly requested that the CFTC grant CPOs an **extension of time to comply with the CPO and CTA registration requirements**. The associations requested that the CFTC extend the compliance date for CPOs or CTAs of new commodity pools from April 24 to December 31, 2012. The associations also requested that the CFTC extend the date by which a CPO claiming the *de minimis* exemption must take into account any swaps traded on behalf of the pool to ten months from the publication of the final rules on the definition of swaps and margin requirements for swaps. In May, the IAA had a series of **meetings with CFTC Commissioners and staff** to discuss both the requests for extension of time and the

CELEBRATING 75 YEARS

1963

The Supreme Court decides the Capital Gains case on advisers' fiduciary duty, citing ICAA Standards of Practice.

1968

The Nasdaq electronic handling of price quotations for over-the-counter stocks is introduced.

IAA's harmonization letter. In July, the **CFTC granted the IAA's first request**, providing no-action relief for CPOs and CTAs that were exempt or excluded from registration prior to April 24, 2012 but, because of the recent amendments to CFTC rules, would have needed to register and satisfy compliance obligations. In the no-action letter, CFTC staff stated it would not take enforcement action against CPOs or CTAs for commodity pools launched after the issuance of the CFTC's July 2012 letter, as long as the CPOs and CTAs register by December 31, 2012 under a series of conditions.

The CFTC's new regulations raised a host of **interpretive and transition issues** for IAA members analyzing whether they need to register with the CFTC or whether they could claim an exemption, and what the process would involve. Throughout the spring of 2012, the IAA worked with members to develop and submit a series of **frequently asked questions** and requested responses to the CFTC staff. The IAA met with CFTC staff to discuss these various issues. In August 2012, the CFTC issued a series of responses to frequently asked questions, including many of the questions posed by the IAA. The IAA was involved in a number of additional joint letters to the CFTC requesting various types of interpretive and transition relief. In addition to being subject to CFTC regulations, registered CPOs and CTAs are required to become members of, and are subject



to oversight by, the **National Futures Association (NFA)**, the SRO for the futures (and now swaps) industry. The IAA has engaged in a dialogue with the NFA on a host of transition and compliance issues for investment advisers registering as CPOs and CTAs, including with respect to required licensing and examinations for certain personnel. The NFA has provided transitional assistance and relief in a number of areas and has waived the testing requirement for personnel of firms only engaging in swaps activity at this time.

In July 2012, the IAA also submitted requests for guidance to the CFTC staff regarding various scenarios presented by **funds of funds**. The CFTC had rescinded its previous guidance for CPOs of funds of funds to assess whether they had to register or could meet the *de minimis* exemption. In its August FAQs, the CFTC staff stated that CPOs of funds of funds could continue to rely on the old guidance until the CFTC adopts revised guidance. However, the old guidance is fairly limited and there is a wider range of fund of funds structures for which

1970

The New York Stock Exchange allows corporate memberships.

1971

The NYSE and the AMEX consolidate key automation and service facilities in a new jointly owned corporation, the Securities Industry Automation Corporation (SIAC).

“While there are many services the IAA provides to member firms, the most significant for me are the tireless advocacy efforts on behalf of IAA member firms and all registered investment advisers.”

additional interpretive guidance is needed. As the December 31 deadline for registration approached without the revised guidance, the IAA submitted a letter requesting the CFTC to **extend the compliance date for fund of funds operators and advisers** to register or claim an exemption with respect to funds of funds until the later of: (i) six months from the date the CFTC or its staff issues final guidance replacing Appendix A; or (ii) June 30, 2013. On November 29, the CFTC granted the IAA's request for extension of time.

The CFTC's definition of "swap" became effective as of October 12, triggering the requirement for firms to consider swaps activities in their analyses of whether they must register as CPOs or CTAs or whether they may take advantage of various exemptions. The Treasury Department, however, had not finalized a proposed determination to exempt **foreign exchange swaps** and **foreign exchange forwards** from the definition of "swap." In September 2012, the IAA and other organizations submitted letters to both the CFTC and Treasury Department requesting that the CFTC or Treasury provide relief that these FX products would not be treated as "swaps" until the effective date of Treasury's determination. The IAA also participated in joint meetings and

calls with CFTC Commissioners and staff and Treasury staff to discuss the urgency of the relief needed. On October 11 and 12, the CFTC issued no-action letters effectively delaying the requirement to consider any swaps, including FX products, until December 31, 2012 in the CPO/CTA registration and exemption analyses. On November 16, the Treasury Department issued its final determination exempting FX swaps and forwards from the definition of "swap" for certain purposes.

In July 2012, the CFTC issued proposed guidance on how Title VII of the Dodd-Frank Act regarding swaps rules and regulations applies to **cross-border swaps transactions** taking place outside the U.S. The IAA filed a comment letter with the CFTC in September 2012 urging the CFTC to define "U.S. person" for purposes of application of the Title VII rules similarly to the definition of U.S. person in Regulation S of the Securities Act applicable to securities transactions offshore. The IAA also requested the CFTC to apply substituted compliance with similar global regulations more flexibly.

In February 2012, the CFTC adopted "legally segregated operationally commingled" (**LSOC**) rules for **segregation of cleared**

CELEBRATING 75 YEARS

1972

The Dow reaches 1,003 on November 16, surpassing 1,000 points for the first time.

1974

The Employee Retirement Income Security Act (ERISA) is enacted.

1975

ICAA membership falls to lowest level in 13 years, mostly due to mergers, acquisitions, and other firm takeovers.

swaps collateral by futures commission merchants and derivatives clearing organizations, as required by the Dodd-Frank Act. The IAA participated in industry meetings to discuss LSOC operational issues and other potential models for **full physical segregation** of customer collateral. This initiative is ongoing.

DOL Advocacy

During 2012, the Association continued its advocacy regarding a number of issues pending before the **Department of Labor**. In February, the DOL issued a final rule under **ERISA section 408(b)(2)** that requires investment advisers to retirement plans to provide advance written disclosure concerning their services and compensation, both direct and indirect. The rule became effective on July 1, 2012, and disclosures were required to be provided to existing clients by that date. In addition, IAA staff joined other trade associations in meeting with officials at the DOL and Office of Management and Budget and in submitting letters to the agencies concerning one of the DOL's frequently asked questions under its **participant fee disclosure** regulation. The original FAQ would have imposed complicated monitoring responsibilities on plan sponsors that offer brokerage windows under their participant-directed plans, such as 401(k) plans. The DOL revised the FAQ in July. The IAA will continue to monitor DOL developments that affect investment advisers.

International Regulatory Advocacy

During 2012, the IAA continued its active involvement in the international arena. The **IAA International Committee** marked the start of its fifth year with an in-person meeting, at which members gathered in Washington, D.C. to exchange information about international developments. In addition to discussion among members and staff, outside counsel briefed members on the European Union's short selling regulation as well as the Foreign Account Tax Compliance Act (FATCA). CFTC staff also attended to discuss cross-border application of swaps regulation and the on-going effort of the CFTC in cooperating with European authorities to build a uniform framework for international regulation. Currently, there are more than 90 members of the International Committee representing more than 50 IAA member firms. The Committee meets on a quarterly basis to discuss important international investing, compliance, and market access issues.

With the support of the International Committee, the IAA has continued to engage in international regulatory advocacy efforts and submitted comment letters to non-US governmental bodies. On April 10, the IAA submitted two comment letters to the **Canadian Securities Administrators** expressing concern regarding two distinct approaches proposed by two sets of provinces to regulate **Investment Fund**

1975

ICAA opens its first office in New York and hires its first part-time employee. ICAA publishes "Standards of Measurement and Use for Investment Performance Data."

1977

ICAA membership reaches 80 firms.

Managers (IFMs) based outside of Canada that distribute investment funds to Canadian residents. The IAA's comment letters supported both a uniform standard across the provinces and application of the narrower approach to subjecting non-resident managers to Canadian registration. That approach would analyze whether the firm's activities in the jurisdiction create a substantial connection with that jurisdiction. The two groups of jurisdictions issued final rules on July 5. Though uniformity was not achieved, one of the Canadian jurisdictions switched to the IAA-recommended narrower interpretation.

The IAA continues to monitor regulatory developments in the **European Union**, including the **Alternative Investment Fund Managers Directive (AIFMD)**, the proposed amendments to the **Markets in Financial Instruments Directive (MiFID)**, and related proposals concerning remuneration, as well as country-specific changes to investment adviser and private fund regulation around the world.

These are a sampling of initiatives and issues the IAA was actively involved with during 2012. 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.

Advocacy in 2013

The IAA will remain fully engaged in serving and protecting the interests of its membership during 2013 on both the legislative and regulatory fronts. In **Congress**, the IAA will continue to lead the charge against legislation authorizing an SRO, likely to be FINRA, for investment advisers. In connection with these efforts, the IAA will maintain its strong support for sufficient resources for and organizational efficiencies at the SEC. The IAA also anticipates monitoring congressional activities related to fiduciary duty and "harmonization" of the laws governing brokers and investment advisers, as well as structural changes within the SEC, Dodd-Frank Act implementation, and market regulation issues. The IAA expects to advance its maturing **government relations** program and to encourage its members to be proactive in educating policy makers about the issues facing the investment advisory profession.

The IAA anticipates a robust **regulatory advocacy** agenda in 2013. New leadership at the SEC may portend new initiatives or a re-ordering of existing activities. At a minimum, the SEC has a great deal of **Dodd-Frank Act** rulemaking remaining for completion in 2013, including: (1) fiduciary duty rulemaking; (2) other potential harmonization proposals; (3) finalizing rules requiring advisers to disclose how they voted proxies

CELEBRATING 75 YEARS

1979

With Gail Edwards as its new Executive Director, ICAA launches drive to expand membership, producing steady growth of additional member firms.

1980

ICAA initiates its Chartered Investment Counselor (CIC) designation program.

on certain executive compensation matters; (4) adopting rules (jointly with others) regarding disclosure of, and prohibitions against certain executive compensation structures and arrangements; (5) issuing a study on short selling; (6) establishing a municipal advisor registration regime (with its corresponding effect on the compliance date for the third-party solicitor provisions of the pay to play rule); (7) approving SRO rules governing pay to play for third party solicitors; and (8) finalizing the Volcker rule. The SEC must also complete its somewhat controversial rulemaking implementing the **JOBS Act**. The SEC is planning to consider various initiatives related to the securities markets, including high frequency trading and market disruptions. In addition, ongoing implementation of recent SEC rulemakings will require additional advocacy with SEC Commissioners and staff. For example, the IAA expects to communicate with SEC staff to assist members in interpreting and implementing Form PF requirements and related matters such as corresponding international private fund reporting. The IAA intends to pursue its regular dialogue with SEC staff regarding the SEC's evolving **inspection and examination program**. The IAA will also continue its involvement in two **GAO studies** of the costs of the custody rule and the definition of accredited investor. Further, the IAA expects to pursue proactively improvements to existing regulatory requirements for advisers.

The IAA will be actively engaged in addressing a wide range of **CFTC and NFA** regulatory matters related to CPO and CTA registration and transition. These issues are likely to include guidance for funds of funds, harmonization of inconsistent regulatory requirements among agencies applicable to investment advisers, and interpretive issues raised by the diverse business models and practices subject to a new regulatory regime. The IAA is also likely to be involved in CFTC regulations applicable to derivatives transactions from a buy side perspective, including clearing, trading, and reporting requirements and protections afforded to client collateral.

In 2013, the IAA expects to engage in key **international** regulatory matters, including European initiatives on authorization of private fund managers, short selling regulations, and restrictions on remuneration. The U.S. **Department of Labor** is likely to continue its focus on initiatives affecting investment advisers, including fee and expense disclosure requirements to both plan participants and plan sponsors and the definition of "fiduciary." In addition, the **Department of Treasury** will pursue its initiatives to implement the Foreign Account Tax Compliance Act (FATCA) as well as the requirement to file a Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1 (FBAR). •

1981

Over the next 10 years, ICAA intensifies its advocacy efforts related to federal and state legislative and administrative developments affecting investment adviser firms, including such matters as the SEC's 1983 Brochure Rule, the Insider Trading and Securities Fraud Enforcement Act, and development of the ICAA Specimen Advisory Agreement. During this time, the ICAA works with the Association of Investment Management and Research (AIMR) in further developing Performance Measurement Standards.

COMPLIANCE



The IAA serves as a vital resource on legal, regulatory, and compliance issues. The compliance environment has become increasingly complex with both the Dodd-Frank Act and the expanding reach of the CFTC imposing additional layers of regulation on advisers. Further, both the SEC enforcement division's asset management unit and DOL's consultant/adviser program are focused more closely on advisers. The IAA provides a wide range of resources and services to help its members understand these developments. In addition to the availability of the IAA legal staff to provide information regarding legal, regulatory, and compliance developments, during the past year, the IAA has provided a broad array of services and resources designed to assist members in addressing compliance issues.

During 2012, the IAA legal staff responded to more than 1,000 **requests for information** about legal, regulatory, and compliance issues from IAA member firms. IAA member firms contacted the IAA legal staff for up-to-date information about the dynamic legislative and regulatory environment, industry practices, and evolving changes in law and regulations from the SEC, DOL, CFTC, Treasury, and various state and foreign entities. The IAA legal staff provided information to member firms on a wide array of topics including: SEC reporting requirements for advisers on revised Form ADV, ERISA and Department of Labor disclosure requirements, private fund adviser reporting on Form PF, CFTC and NFA compliance, SEC custody rule issues, pay to play requirements (federal and state), SEC inspections, state filing issues, advertising requirements, and numerous international matters. In addition, the IAA sent more than 30 **IAA Alerts** to members addressing late-breaking legislative and regulatory developments.

The IAA provides members with extensive industry-related resources on its web site (www.investmentadviser.org). The **Members Only section** of the IAA web site contains an expanding library of useful and relevant information. Resources include **legal, regulatory, and compliance materials, comprehensive materials** written or compiled by the IAA legal staff that cover every major area of adviser compliance issues, including electronic

delivery, pay to play, portfolio management, disclosure, privacy, and testing, as well as compliance policies for specific rules such as codes of ethics and the compliance program rule. Each topic area includes: (1) IAA guidance on the subject (including any relevant compliance control from the IAA compliance guide), (2) IAA comment letters and statements, (3) outlines, articles and memoranda from a variety of sources, and (4) links to selected rules and other regulatory guidance. Also on the web site is information relating to **SEC and DOL examinations** (including helpful documents, such as sample document request letters). The web site also provides archived legal and regulatory updates, current and past issues of the monthly **IAA Newsletter**, and reports and brochures, including the **Investment Management Compliance Testing Surveys** and **Evolution/Revolution reports**, and archived webinars, some of which are available at no charge for members. Collectively, the broad range of IAA compliance resources represents an outstanding value for IAA member firms.

During 2012, the IAA continued to update and expand the IAA's **compliance materials** in order to inform member firms about relevant issues and to provide substantive and practical assistance. The IAA added significant resources to its web site in 2012 regarding new regulatory requirements, including a new section devoted to **CFTC and NFA regulations and compliance**.



CELEBRATING 75 YEARS

1985

The Association's membership reaches 150 firms.

1987

The market drops 22.6% on October 19, resulting in the formation of a Presidential Task Force tasked with studying issues that led to the market's volatility.

“ Our company relies often on the IAA legal staff for competent and professional information on the compliance issues we face. We benefit greatly from their assistance, as part of the package of benefits the IAA offers to member firms.”

In addition, the IAA updated the following compliance controls to reflect rule revisions and other new developments: Advertising, Marketing and Other Communications, Advisory Fees, Monitoring and Testing, Pay to Play Prohibitions/Political Contributions, Relationships with Pension and Other Investment Consultants, Soft Dollars, Valuation and Pricing, and Wrap Fee/ Separately Managed Account Programs. The IAA also updated its state pay to play, notice filing, and investment adviser representative (IAR) registration charts as well as FAQs on the Large Trader rule.

The IAA continues to provide substantial information to assist members in complying with new rule requirements. In March, the IAA published extensive **frequently asked questions** regarding the substantially revised **Form ADV, Part 1** and responded to myriad questions from member firms about the revisions. The IAA provided resources regarding **CFTC and NFA** compliance requirements, including the new web site section, convened a **CFTC Working Group** that held numerous calls, and responded to the many member questions regarding

CFTC and NFA regulatory requirements. In April, the IAA published a new compliance control concerning the final rule under section 408(b)(2) of ERISA, entitled **Required Compensation Disclosures for Advisers Under ERISA**. Since the DOL rule was adopted, the IAA has responded to dozens of member questions pertaining to the implementation of the rule requirements. The IAA has also provided information with respect to implementation of Form PF. For example, prior to the first date for filing Form PF for large private fund advisers in July 2012, the IAA held a number of conference calls with IAA members to discuss related compliance and implementation issues. In June 2012, as a result of SEC amendments to the third-party solicitor provisions of the Advisers Act pay to play rule, the IAA updated the **IAA pay to play compliance guide and the IAA's frequently asked questions about the pay to play rule**. During the year, the IAA also continued to provide information about developments related to **state and local pay to play prohibitions** and maintains compliance information for members about state and local laws that could impact



CELEBRATING 75 YEARS

1995

The ICAA Investment Adviser, a two-volume compilation of compliance, enforcement, and regulatory materials, is made available to all ICAA members. The ICAA issues guidelines urging members to adopt codes of ethics, including personal trading policies and procedures.

1996

President Clinton signs into law the National Securities Markets Improvement Act of 1996 (NSMIA), including the Investment Adviser Supervision Coordination Act, which preempts the authority of States over larger investment adviser firms. ICAA strongly supported the Coordination Act.



1997

In its 60th year, ICAA hires David Tittsworth as Executive Director and Karen Barr as General Counsel, and moves its office to Washington, D.C. The Association begins publishing a monthly newsletter and launches its web site.

1998

The SEC, anticipating potential computer system failures in the year 2000, requires publicly traded companies and securities firms to update their computer systems and disclose any "Y2K" related risks.

advisers' and their employees' political contributions, "lobbyist" registration and reporting requirements, and other restrictions.

In June 2012, the IAA released the results of its **seventh annual compliance testing survey**—the most comprehensive compliance testing survey available. Jointly conducted by the IAA, ACA Compliance Group, and Old Mutual Asset Management, the survey included in-depth questions about firms' compliance testing in the areas of performance advertising, pay to play, special trading issues, and oversight of third-party service providers. The survey also contained trend update questions about social media, whistleblowing, gifts and entertainment, and insider trading. The results reflect responses from an online

survey of 555 compliance professionals, representing a wide range of SEC-registered investment adviser firms. The survey provides new, updated, and practical testing ideas and benchmarks that can be used by advisers to assess the effectiveness of their compliance programs. The survey revealed that 67% of CCO respondents also perform non-CCO functions (as compared with 75% in 2010). An increased percentage of firms reported that they have adopted written policies and procedures governing employees' use of social networking web sites—80% in 2012 as compared with 64% of firms in 2011. Finally, the top areas of compliance concern for 2012 identified by respondents included social media, insider trading, regulatory reporting, advertising/marketing, and valuation.

“ The IAA has an extensive library of compliance and legal resources that I rely on for up-to-date and comprehensive treatment of issues impacting investment advisers.”



CELEBRATING 75 YEARS

1999

The Dow surpasses 10,000 points for the first time, closing at 10,007 on March 29.

2000

ICAA develops best practice guidelines for policies and procedures related to pay to play in response to SEC's proposed pay to play rule, and recommends that the SEC adopt a rule requiring advisers to adopt a code of ethics that includes such procedures. David Tittsworth testifies at SEC Roundtable on Investment Adviser Regulatory Issues.

The IAA legal team continued to increase the information available to members regarding **international issues**. For example, the IAA monitored and informed its members about the new European short selling regulation, as implemented by the European Securities and Markets Authority (ESMA), and each country's home regulator's rules regarding short sales of certain securities. The IAA continued to update its member chart discussing **short selling regulations** in various jurisdictions across the globe. IAA staff provided members with memoranda on a number of other international topics and developments, including ESMA and FSA Discussion Papers on Implementing Measures for the **AIFM Directive**, and the regulation of fund managers in Singapore and the United Arab Emirates. The IAA prepared memoranda and arranged for outside speakers to address the International Committee concerning the potential impact of the Foreign Account Tax Compliance Act (**FATCA**) on investment vehicles, such as hedge funds, funds of funds, and private funds. The IAA notified members of the October 2012 IRS delay of FATCA's due diligence requirements. Similarly, to assist members who hold either a financial interest in or "signature

or other authority" over a foreign financial account, the IAA kept members apprised of a further extension of the requirement to file a Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1 (**FBAR**) until June 30, 2013.

The IAA expects to be involved in a number of **emerging compliance issues** during 2013. For example, the IAA expects to continue to hold calls with members to discuss compliance and interpretive questions arising from Form PF. The IAA will also continue its CFTC Working Group calls and communications as members register with the CFTC and NFA and come into compliance with a new regulatory regime. The IAA will engage in implementation issues related to various Treasury Department reporting requirements, issues arising from firm and employee use of social media, evolving SEC inspection issues, compliance with ERISA disclosure requirements, international regulations that affect investment advisers, and continued implications of provisions of the Dodd-Frank Act affecting investment advisers. The IAA also anticipates involvement in compliance issues arising from the JOBS Act when the related rules are finalized. •

2000

The Investment Advisor Registration Depository (IARD) implements the electronic filing system for advisers to register with the SEC. ICAA and several of its members participate in pilot program to ensure the smooth launch of the IARD, which began accepting Form ADV Part 1 filings in January 2001.

2001

ICAA and NRS publish the first Evolution Revolution report providing data on the universe of SEC-registered investment advisers.

EDUCATION



The IAA conducted numerous conferences, workshops, and webinars during the year in an effort to keep members fully informed about relevant issues that affect the investment advisory profession. These events covered a wide range of business, compliance, and regulatory issues. In addition, the IAA published reports, surveys, and other educational materials that serve to inform all member firms. The IAA also serves as a unique and respected networking resource that facilitates and encourages the exchange and development of ideas among industry peers. As the IAA continues to grow its membership and resources, it will be able to offer an expanded range of educational benefits to serve an increasingly diverse membership.

In April, the IAA held its **2012 Annual Conference** in San Francisco. The conference opened with two concurrent workshops. One workshop focused on the institutional market. Entitled *Growth in a Time of Uncertainty: The U.S. Asset Management Industry in 2015*, the workshop was facilitated by representatives from McKinsey & Co. and Callan Associates. The other workshop centered on issues affecting wealth management firms. The wealth management workshop was facilitated by representatives of Charles Schwab & Co. General sessions featured top industry leaders in the Bay Area: Dr. Meir Statman, Glenn Klimek Professor of Finance, Leavey School of Business, Santa Clara University, spoke on Behavioral Finance, and *"What Investors Really Want."* Jason C. Hsu, Chief Investment Officer of Research Affiliates LLC, presented a discussion on The *"3-D" Hurricane* (debt, deficit and demographics). David Richman, National Director at the Eaton Vance Advisor Institute, offered practical insights to help advisors build deeper client relationships in a presentation entitled *The Charismatic Advisor*. Mike Murphy, one of the Republican Party's most successful political media consultants, discussed the 2012 political campaign. SEC Commissioner Luis Aguilar provided his personal perspectives on current issues and developments facing the agency. Chip Roame, Managing Principal of Tiburon Strategic Advisors, drew upon his firm's extensive ongoing research to provide an understanding of consumer wealth

and attitudinal changes. Robert Horrocks, Chief Investment Officer of Matthews International Capital Management addressed some of the common misperceptions about investing in Asia. And Jeffrey Cleveland, Senior Economist, Payden & Rygel, provided an optimistic discussion called *"Myth versus Reality: Challenging Popular Economic Myths to Help Guide Investment Strategy."* A panel discussion on how firms can effectively integrate social media into their business rounded out the 2012 program. As always, the popular breakout sessions allowed firms to interact in smaller groups to discuss issues of mutual concern.

The IAA Annual Conference continues to provide an excellent opportunity for senior executives to meet with each other and share ideas on a variety of industry matters. All member firms are encouraged to attend the **2013 Annual Conference** in New Orleans on May 1-3.

In March 2012, the IAA held its annual **IA Compliance Conference** in the Washington, D.C. area, featuring comprehensive information about all major topics facing investment adviser compliance professionals, including the Whistleblower Rule, CCO Liability, Private Fund Adviser issues, CFTC, ERISA, Pay to Play, Code of Ethics, SEC Enforcement, Annual Review, the possibility of an SRO for the investment adviser industry, Form ADV Parts 1 and 2, Social Media, and SEC Exams. More than

CELEBRATING 75 YEARS

2002

7,320 investment advisory firms are registered with the SEC.

2003

Association membership surpasses the 300 milestone, reaching 310 member firms by year's end.

“The IAA’s monthly newsletter contains current legal and regulatory updates and information regarding Congressional events that allows my firm to be apprised of actions that may impact the industry.”

200 compliance professionals, 65 speakers and 20 exhibiting firms participated in the conference.

In the fall of 2012, the IAA hosted its 16th annual series of **Compliance Workshops** in eight cities. The workshops addressed a range of current regulatory and compliance issues facing investment advisory firms, including the latest regulatory developments, monitoring and testing compliance programs, advertising and social media, enforcement and exams, and private fund hot topics. The workshops featured expert investment management attorneys and IAA legal staff, as well as regional SEC staff who addressed the significant changes underway in the SEC’s examination and enforcement program. In addition, national law firms prepared extensive written materials for IAA members. More than 415 attendees participated in the workshops. The IAA secured **CLE accreditation** for its compliance workshops to help attorneys meet state bar education requirements.

Earlier in the year, the IAA sponsored seven **educational webinars**. These webinars covered various topics including ERISA, Form ADV, an update on the Pay to Play rule, the Whistleblower Rule, and Form

PF, and two webinars on CFTC issues. IAA webinars offer a time-efficient and cost-effective educational medium for members as well as potential members, and will continue to play a useful role in the IAA’s educational offerings in the future.

In February, the IAA held a widely attended **briefing call** on significant regulatory and legislative developments anticipated in 2012.

The IAA continued its co-sponsorship of the **Investment Adviser Certified Compliance Professional** (IACCP) program and the related Investment Adviser Core Compliance Program. In 2004, National Regulatory Services (NRS) began the IACCP program “to advance the compliance profession and to acknowledge the heightened role of compliance professionals in today’s environment.” The IACCP is a professional education program and certification process that consists of five primary requirements: (1) education (generally successful completion of 40 hours of course work); (2) professional work experience (generally two years); (3) passing the certifying examination; (4) adhering to the program’s Code of Ethics; and (5) fulfilling continuing education requirements

CELEBRATING 75 YEARS

2004

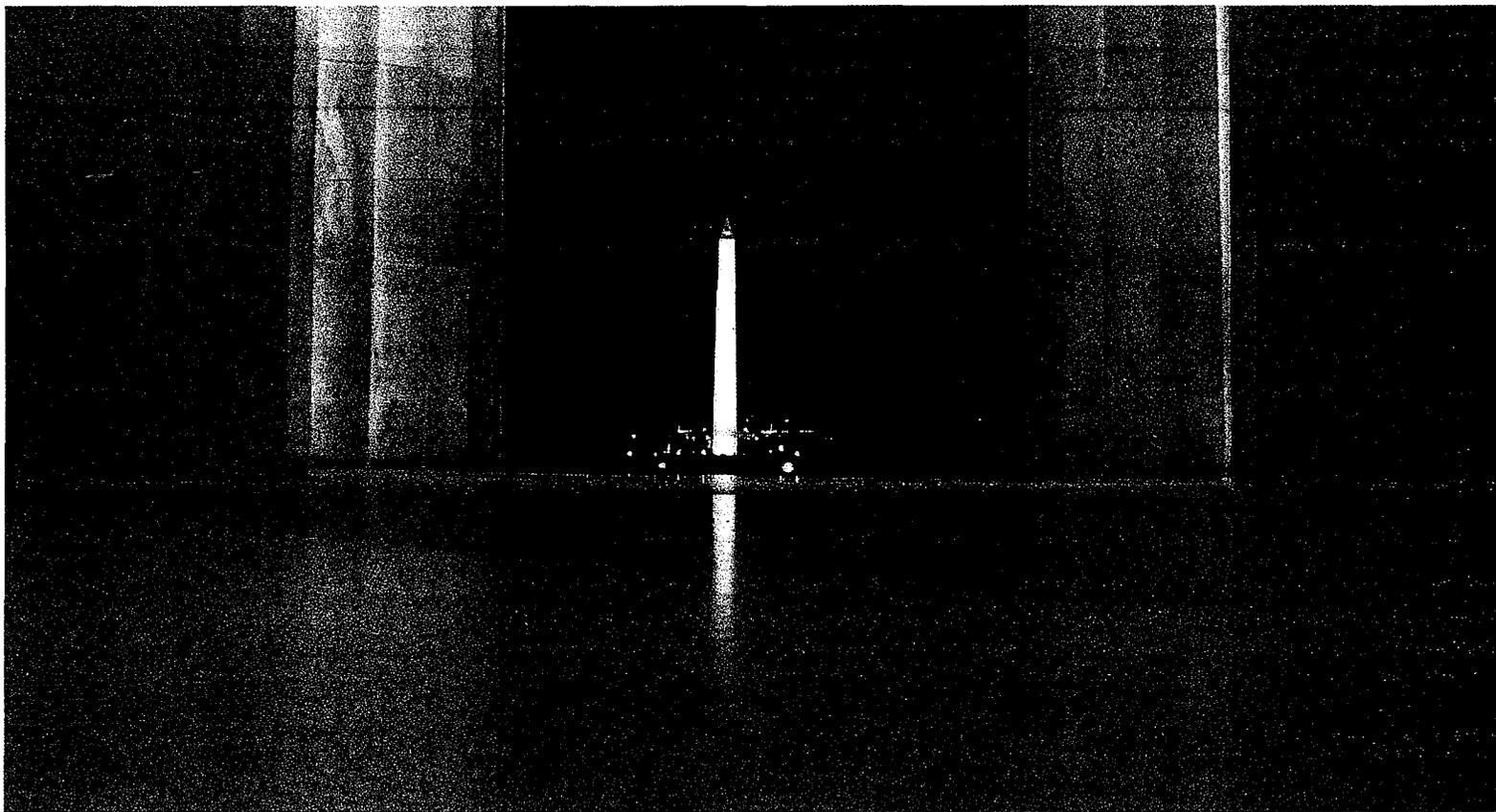
ICAA issues best practices for codes of ethics to assist members in updating their existing codes and to incorporate compliance with the SEC’s new rule requiring codes of ethics.

2005

ICAA votes at its annual meeting in Seattle, Washington to change its name to the Investment Adviser Association (IAA).

to maintain the IACCP designation. The IAA assists NRS in supporting and maintaining the quality of the IACCP program by reviewing and drafting materials, moderating and speaking at IACCP training sessions, and drafting questions for the certifying examination. The IAA helps increase the visibility of the IACCP on its web site and in the *IAA Newsletter*.

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. •



2007

The IAA contracts to cosponsor the Investment Adviser Compliance Certification Professional (IACCP) designation with National Regulatory Services.

2009

IAA's David Tittsworth testifies before Congressional House Financial Committee on fiduciary duty and the possibility of adopting legislation harmonizing regulation between investment advisers and broker dealers. IAA begins offering the first Associate Memberships for the year 2010.

MEMBERSHIP



Membership of the Investment Adviser Association currently stands at more than 550 SEC-registered investment advisory firms that collectively manage over \$10 trillion for a wide variety of individual and institutional clients. The IAA staff and volunteer leaders are 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.

The IAA volunteer **Board of Governors** met in February (Washington, D.C.), June (New York), September (Chicago), and December (San Francisco). During the year, one area of focus for the Board of Governors was the review of the Association's strategic plan (including advocacy issues, government relations, financial issues, and membership growth and retention), to ensure that the organization remains responsive to the needs of its membership in accordance with its mission.

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. In addition to the monthly newsletter, the Association publishes conference brochures, educational materials, and other resources.

The IAA disseminated electronic **Member Alerts** to keep members informed of significant late-breaking developments and the Association's programs and activities. The IAA expects to expand the use of these and other educational tools throughout 2013.

The **IAA web site** (www.investmentadviser.org) is a 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*. Going forward, the IAA expects to make further enhancements that will permit greater communication among member firms and facilitate greater access to IAA services.

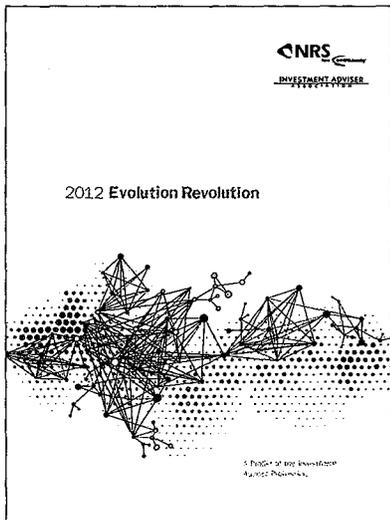
The **IAA Associate Member program**, introduced in 2010, is a growing aspect of the Association's activities. Associate membership is available to firms that are not eligible for regular membership, including state-registered advisers, law firms, consultants, accounting firms, service providers, and others who wish to support the activities of the IAA. The program assists the Association in its primary mission of serving the interests of the

“As a smaller firm operating in an increasingly difficult business environment, we appreciate the IAA's quality services and their level of professionalism.”

investment advisory profession. Associate members receive the *IAA Newsletter* and Member Alerts, and are listed on the IAA web site.

The online **Service Provider Directory** is available in the Members Only section of the web site. 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.

profession based on information submitted to the SEC by all registered advisory firms and analyzes core characteristics of the industry. Among other findings, the 2012 report notes that the total number of investment advisers registered with the SEC declined to 10,511, from 11,539 in 2011. This significant decline is driven by provisions of the Dodd-Frank Act. The report notes that total regulatory assets under management (RAUM) reported by all registered investment advisers in 2012 was \$49.4 trillion, a significant increase partly attributable to rule changes. Consistent with previous years, the 2012 report finds that a very small number of large advisers manage the highest percentage of total RAUM—in 2012, the 90 largest advisers (those with \$100 billion RAUM or more), reported that they manage nearly half (48.9%) of all reported assets under management. And despite the shift of mid-size advisers to state registration, small firms continue to comprise the largest category of SEC-registered investment advisers. In 2012, approximately 74% of advisers reported less than \$1 billion in AUM. •



In November, the IAA and National Regulatory Services published the 12th annual report entitled **2012 Evolution/Revolution: A Profile of the Investment Adviser Profession**. This leading report provides a snapshot of the investment advisory

CELEBRATING 75 YEARS

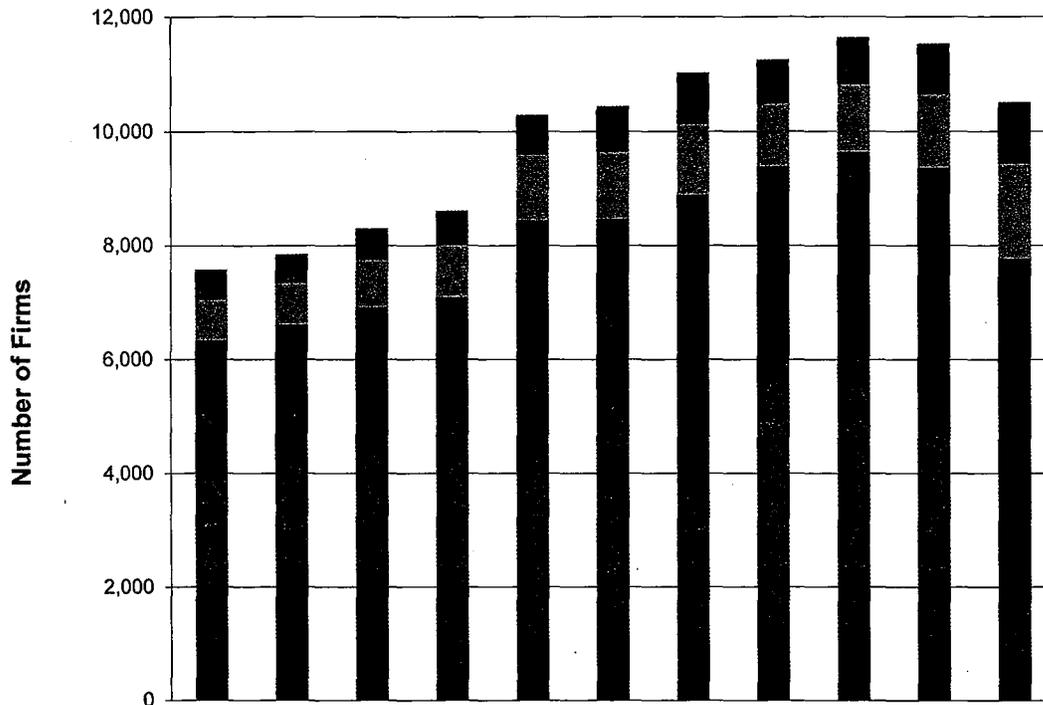
2009

The Dow closes at 6,547 on March 9, its lowest point since reaching an all-time market high of 14,165 on October 9, 2007. During the 17-month period, the market suffered a 53.7% drop in value.

2010

In response to the financial crisis that began in 2008, Congress passes and President Obama signs the Dodd Frank Act into law, effective July 21, 2010.

SEC Registered Investment Adviser Firms



Regulatory Assets Under Management	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
\$100B and More	52	48	52	56	62	75	82	61	64	78	90
\$50B < \$100B	37	39	46	51	65	77	90	65	81	83	89
\$10B < \$50B	237	221	250	285	334	367	409	346	363	404	486
\$5B < \$10B	203	199	206	211	237	284	327	301	318	331	414
\$1B < \$5B	708	727	828	915	1,149	1,173	1,235	1,096	1,176	1,276	1,655
\$100M < \$1B	2,480	2,474	2,747	2,993	3,812	3,904	4,096	3,780	4,108	4,600	5,680
\$25M < \$100M	2,875	3,020	3,036	3,068	3,492	3,489	3,720	4,258	4,228	3,651	1,245
Less than \$25M	989	1,124	1,137	1,035	1,139	1,077	1,071	1,350	1,305	1,116	852
Total Firms	7,581	7,852	8,302	8,614	10,290	10,446	11,030	11,257	11,643	11,539	10,511

Source: "2012 Evolution/Revolution: A Profile of the Investment Adviser Profession." Investment Adviser Association and National Regulatory Services (2012)

2011

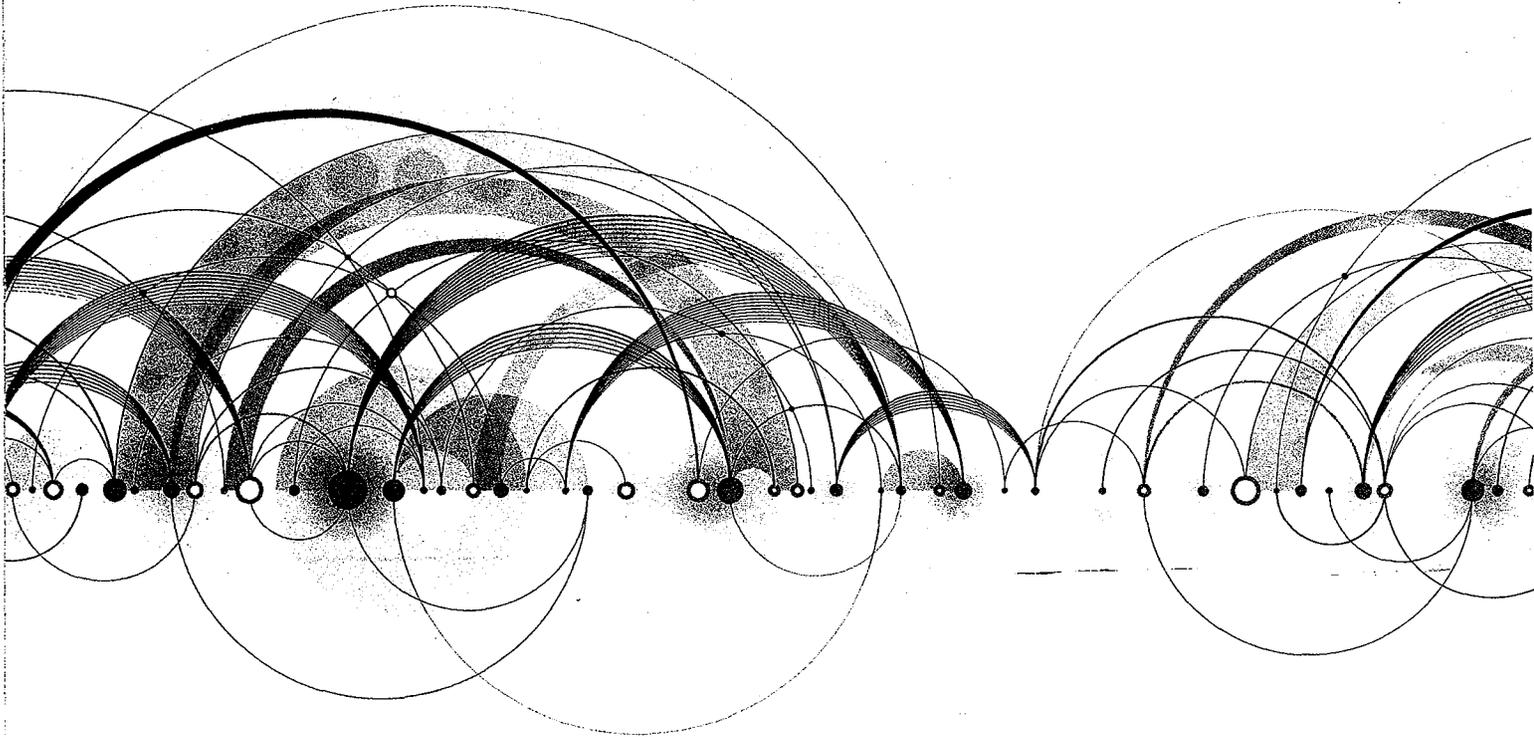
IAA's David Tittsworth testifies before Congress in opposition to imposition of a possible requirement that SEC registered investment advisers be required to belong to a self-regulatory organization.

2012

The Association celebrates its 75th anniversary and IAA membership surpasses 550 firms.

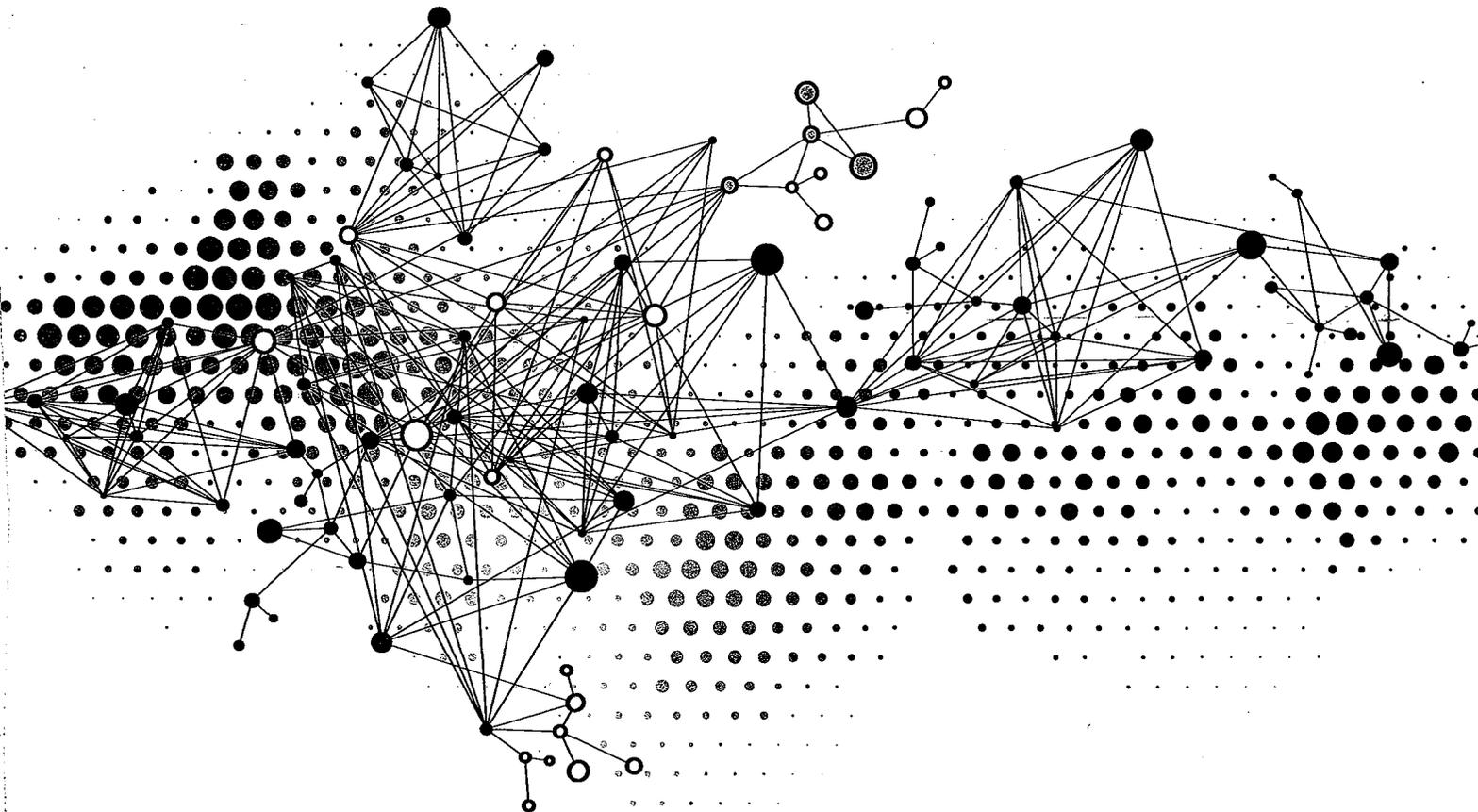
INVESTMENT ADVISER
ASSOCIATION

1050 17th Street, N.W., Suite 725
Washington, DC 20036-5514
T: (202) 293-4222
F: (202) 293-4223
www.investmentadviser.org



www.investmentadviser.org

2012 Evolution Revolution



A Profile of the Investment
Adviser Profession

**INVESTMENT ADVISER
ASSOCIATION**

1050 17th Street, NW, Suite 725
Washington, DC 20036-5514
202.293.4222
Fax 202.293.4223
www.investmentadviser.org

David G. Tittsworth
Executive Director
202.293.4222
david.tittsworth@investmentadviser.org

Karen L. Barr
General Counsel
202.293.4222
karen.barr@investmentadviser.org

Garrett Honea
Member Services Manager
202.293.4222
garrett.honea@investmentadviser.org



29 Brook Street, PO Box 71
Lakeville, CT 06039
860.435.0200
Fax 860.435.0031
www.nrs-inc.com

John Gebauer
Managing Director
860.435.0200
jgebauer@nrs-inc.com

Rick Cortese
Executive Consultant
860.435.0200
rcortese@nrs-inc.com

Max Dubecky
Technical Support Manager
860.435.0200
mdubecky@nrs-inc.com

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Introduction

The Investment Adviser Association and National Regulatory Services are pleased to present our twelfth annual *Evolution Revolution* report – a profile of the SEC-registered investment adviser profession. This report identifies significant trends and developments based on information that investment advisers are required to file with the U.S. Securities and Exchange Commission.

This year's report reflects significant changes in the composition of the investment advisory profession primarily driven by requirements of the Dodd-Frank Act. On one hand, the so-called "switch" in the Dodd-Frank Act (increasing the dividing line between SEC- and state-registered advisers from \$25 million AUM to \$100 million RAUM) has resulted in about 2,400 SEC-registered advisers switching to state registration and regulation. On the other hand, provisions of the Dodd-Frank Act requiring the registration of certain "private fund advisers" under the Investment Advisers Act appear to have resulted in the addition of more than 1,500 new investment advisory firms. In addition, the SEC has made changes to Form ADV, Part 1, the basic registration form for investment advisory firms. The revised form contains additional questions regarding employees, clients, advisory services, affiliations, custody, and soft dollars; contains a new method for calculating AUM; and for private fund advisers, contains substantial new information about the adviser and each private fund it advises.

We hope our report will contribute to a better understanding of the diverse investment advisory profession. We welcome your feedback and comments.

Explanation of Report Data

This report is based on Form ADV, Part 1 data filed by all SEC-registered investment advisers as of July 16, 2012. Advisers are required to file information electronically using the Investment Adviser Registration Depository (IARD) system.¹

Form ADV, Part 1 has significant limitations and anomalies. Please consult the text of Form ADV (available on the SEC's web site) for a more thorough understanding of the underlying data included in this report.

RAUM vs. AUM

All asset figures for this year are reported as Regulatory Assets Under Management (RAUM), a new definition this year. For details, see the Regulatory Assets Under Management section on page 5.

¹ IAA and NRS have independently tabulated all data in this report. Whenever a number is rounded, it is rounded from the original data source. This method of rounding creates more accurate percentages, but may create complementary percentages that do not sum to 100%. Advisers that reported ineligibility for SEC registration (771) and advisers that had not filed an updated Form ADV on or after November 2011 (179) are removed from the population of this report. Unless otherwise stated in this report, a null response to a "Yes or No" question is considered a "No," and a null response to any other question is not included in the data set.

Executive Summary

Following are key findings of our 2012 report:

- **Number of Investment Advisers.** Since our 2011 report, the number of investment advisers registered with the SEC declined by more than 1,000 to 10,511. The number of SEC-registered advisers at the time of last year's report was 11,539. A decline was expected as a result of various provisions of Title IV of the Dodd-Frank Act, which amended the Investment Advisers Act of 1940 by increasing the threshold for SEC registration from \$25 million to \$100 million in regulatory assets under management (RAUM).² This change produced a significant decline in the number of "mid-size" advisers (*i.e.*, those reporting RAUM between \$25 million and \$100 million), from 3,651 advisers in 2011 to 1,245 advisers in 2012. The deregistration of "mid-size" advisers was partially offset, however, by the registration of more than 1,500 private fund advisers pursuant to the Dodd-Frank Act requirement that private fund advisers with RAUM in excess of \$150 million register with the SEC.³
- **Regulatory Assets Under Management.** SEC-registered investment advisers in 2012 reported \$49.4 trillion in aggregate RAUM. While this amount represents a substantial increase of 12.8% in 2012, from \$43.8 trillion in 2011, the methodology for calculating RAUM has changed significantly, making a comparison of last year's AUM to this year's RAUM less telling. This year's increase is also partially attributable to the Dodd-Frank Act's requirement that private fund advisers with RAUM of at least \$150 million register with the SEC. These factors led to an increase in reported assets, even with the reduction in the number of registered advisers.
- **Asset Concentration.** As in years past, a very small number of large advisers manage the highest percentage of total RAUM. This year, the 90 largest advisers, those reporting \$100 billion RAUM or more, manage nearly half (48.9%) of all reported regulatory assets under management. This same category of advisers accounts for less than 1.0% of the number of registered advisers. Further, the 664 firms with at least \$10 billion in RAUM manage 82.7% of all reported assets, while representing only 6.3% of all registered advisers.
- **Small Advisers.** Despite the shift of "mid-size" advisers to state registration, small businesses continue to comprise the largest category of SEC-registered investment advisers. In 2012, approximately 74.0% of advisers reported less than \$1 billion in RAUM. While this represents a decrease from last year's total of 81.2%, the difference is attributable to "the switch" from SEC to state registration for many smaller advisers. Additionally, 35.1% of advisers reported having five or fewer full- and part-time, non-clerical employees. More than half (58.4%) reported having ten or fewer such employees, and 88.7% have 50 or fewer such employees. Similarly, 54.4% of firms reported having five or fewer employees engaged specifically in investment advisory functions (including research), and 74.6% reported having ten or fewer.

² Pursuant to the Dodd-Frank Act, the new RAUM threshold applies only to advisers located in states with regular investment adviser examination programs and only to advisers required to register in the state where they maintain their principal place of business. Wyoming has no registration or examination program for advisers located within the state, and New York has not certified the existence of an examination program for "mid-size" advisers. Based on these and other exemptions, 523 smaller advisers that otherwise would have moved to state registration remain with the SEC as "mid-size" advisers. Additionally, the new threshold of \$100 million provides for a \$10 million "buffer," within which advisers may choose to register either with the SEC or their respective state(s). This buffer limits the frequency with which advisers reporting between \$90 million and \$110 million in RAUM must switch their registrations.

³ 1,532 newly registered advisers reported they advise at least one private fund. See n. 9, *infra*.

- **Custody.** While most investment advisers still do not report that they or their related person have custody of client assets or securities (other than being deemed to have custody by virtue of deducting fees), the percentage of those that do increased dramatically to 42.4% (from 29.8% in 2011) of all SEC-registered investment advisers. This change was primarily due to the double impact of the “mid-size” adviser and private fund adviser registration provisions of the Dodd-Frank Act. This year, 4,456 advisers reported \$6.6 trillion in custodied assets attributable to their own firms and \$7.7 trillion in custodied assets attributable to related persons. Only 1.0% of advisers (106) reported acting as a qualified custodian in connection with their advisory services – that is, only 1.0% have actual physical custody of client assets. Given the fact that a firm that acts as both adviser and general partner to a limited partnership is deemed to have custody, private fund advisers reported a high incidence of custody of client assets. Indeed, of advisers that reported hedge funds or other pooled investment vehicles as clients or identified themselves as an adviser to private funds, 77.9% also reported that they or a related person have custody of client assets.
- **Private Fund Advisers.** In 2012, 36.7% (3,856)⁴ of all registered advisers reported advising at least one private fund, with a total of 26,202 private funds reported. More than 25% of reported private funds are funds of funds. The median number of private funds advised is three, while the average is approximately seven. The total gross asset value of all reported private funds is \$8.1 trillion, 16.4% of all reported RAUM in 2012, with a median gross asset value of \$47.7 million. Hedge funds and private equity funds comprise the two largest categories of private funds, with hedge funds comprising 40.8% of all private funds and private equity funds comprising 33.1% of all private funds.

This year, the number of registered advisers reporting that more than 75% of their clients are hedge funds and other pooled investment vehicles increased by 87.8%, from 1,200 advisers in 2011 to 2,254 advisers in 2012. Of those advisers, 1,863 reported that 100% of their clients are hedge funds and other pooled investment vehicles. Even more advisers (2,333) reported that the assets of hedge funds and other pooled investment vehicles comprised more than 75% of their total RAUM. This enormous increase in the number of advisers specializing in hedge funds is attributable to the Dodd-Frank Act’s elimination of the private fund exemption upon which hedge fund advisers had previously relied: 1,346 of these advisers are newly registered.

- **Mutual Fund Advisers.** The number of registered investment advisers that report advising mutual funds has remained relatively constant over the 12 years that we have been compiling this report. In 2012, 16.0% of advisers reported having at least one investment company client, and about 3.7% (about 388 advisers) reported that between 75% and 100% of their clients are investment companies. This year, 4.5% (476 advisers) reported that more than 75% of their RAUM are attributable to investment company clients, while 6.0% reported that more than 50% of their RAUM are attributable to these clients.
- **Firms Subject To Executive Compensation Rules.** Pursuant to Section 956 of the Dodd-Frank Act, the SEC and other federal regulators are seeking to limit excessive incentive-based compensation arrangements for

⁴3,979 advisers reported being “an adviser to any private fund” in Form ADV, Part 1, Item 7B; 3,856 reported advising at least one private fund in Form ADV, Schedule D 7B1; and in Form ADV, Schedule D 7B2, 559 advisers reported advising at least one private fund that is reported by another adviser.

registered investment advisers with at least \$1 billion in balance sheet assets. In response to a new question on Form ADV, Part 1 this year designed to identify such investment advisers, 284 advisers reported having at least \$1 billion in total balance sheet assets on the last day of their most recent fiscal year.

- *Soft Dollars.* Form ADV also includes a new question on soft dollars this year, asking registrants that receive soft dollars in connection with client securities transactions whether all of those soft dollar benefits are eligible “research or brokerage services” under section 28(e) of the Securities Exchange Act. In 2012, 4,866 investment advisers reported receiving some form of soft dollars in connection with client securities transactions. Most of those advisers (90.8%) reported that such soft dollar benefits were eligible research or brokerage services.
- *Typical Adviser.* The investment advisory profession is extremely diverse, with advisers of varying sizes providing a broad range of services. However, using median values, we can sketch the profile of a “typical” SEC-registered investment adviser. Due at least in part to the Dodd-Frank Act changes discussed above, the data comprising the profile of a typical adviser have changed over the past year. In 2012, the median number of employees increased and median RAUM nearly doubled last year’s median AUM. The median number of accounts, on the other hand, decreased from 133 to 92.

The 2012 “Typical” SEC-Registered Investment Adviser

- U.S. based limited liability company or corporation
- Exercises discretionary authority over most accounts
- \$270.1 million in regulatory assets under management (median)
- 8 employees (median)
- 26-100 clients (median)
- 92 accounts (median)
- Clients include individuals, high net worth individuals, pension and profit sharing plans

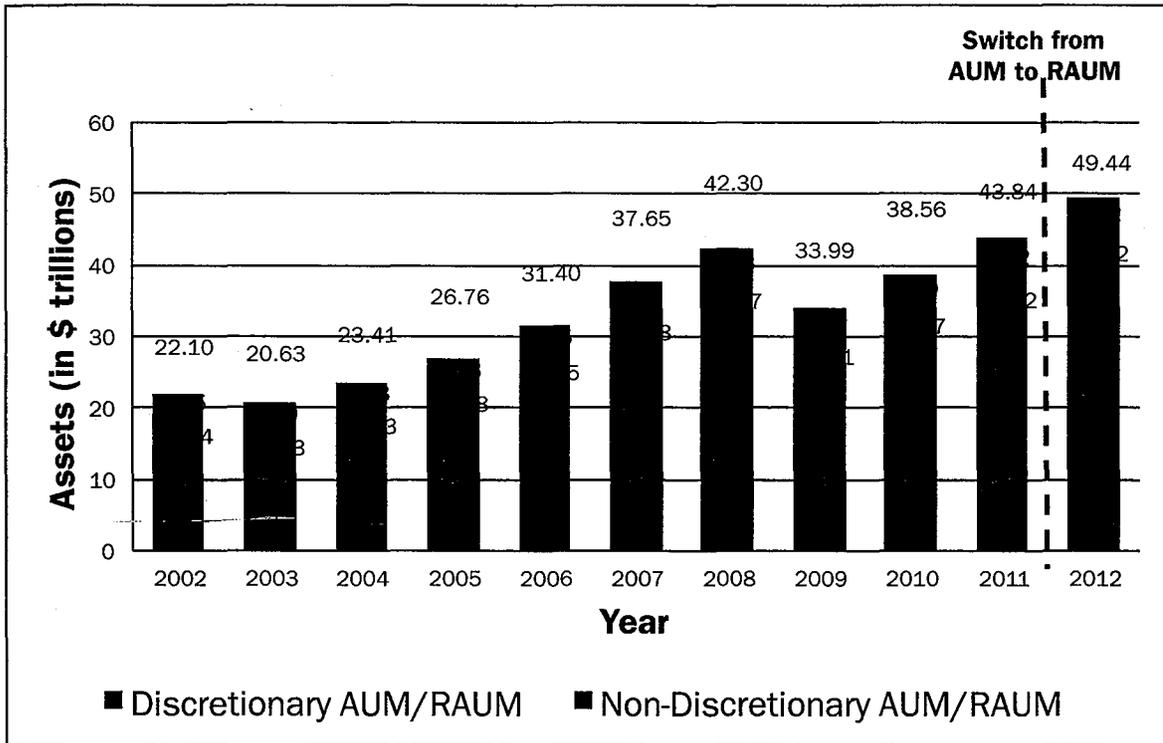
Regulatory Assets Under Management

Advisers reported total regulatory assets under management (RAUM) of \$49.4 trillion in 2012, an increase of approximately \$5.6 trillion, or 12.8%, from \$43.8 trillion in 2011. In 2012, however, the methodology for calculating RAUM differed significantly from the methodology used to calculate assets under management (AUM) in previous years. As part of the SEC's Dodd-Frank Act revisions to Form ADV, Part 1, the SEC created a uniform method to calculate assets under management for regulatory purposes. The SEC changed the terminology used in Part 1 to "regulatory assets under management" to recognize the regulatory purposes of the uniform calculation and differentiate it from other AUM disclosures. The new methodology requires advisers to calculate assets on a gross, rather than net, basis, and requires advisers to include assets that were previously excluded from the calculation of AUM, such as proprietary assets, assets managed without compensation, and assets of foreign clients, thereby increasing the reported amounts of assets for investment advisers. For this reason, a comparison of reported RAUM in 2012 to reported AUM from prior years is somewhat misleading.

Additionally, the SEC instructions for Form ADV, Part 1 continue to permit more than one adviser to report the same assets and accounts under certain circumstances (e.g., sub-advisory relationships). Therefore, as in prior years, the aggregate figure reported by all advisers is overstated.

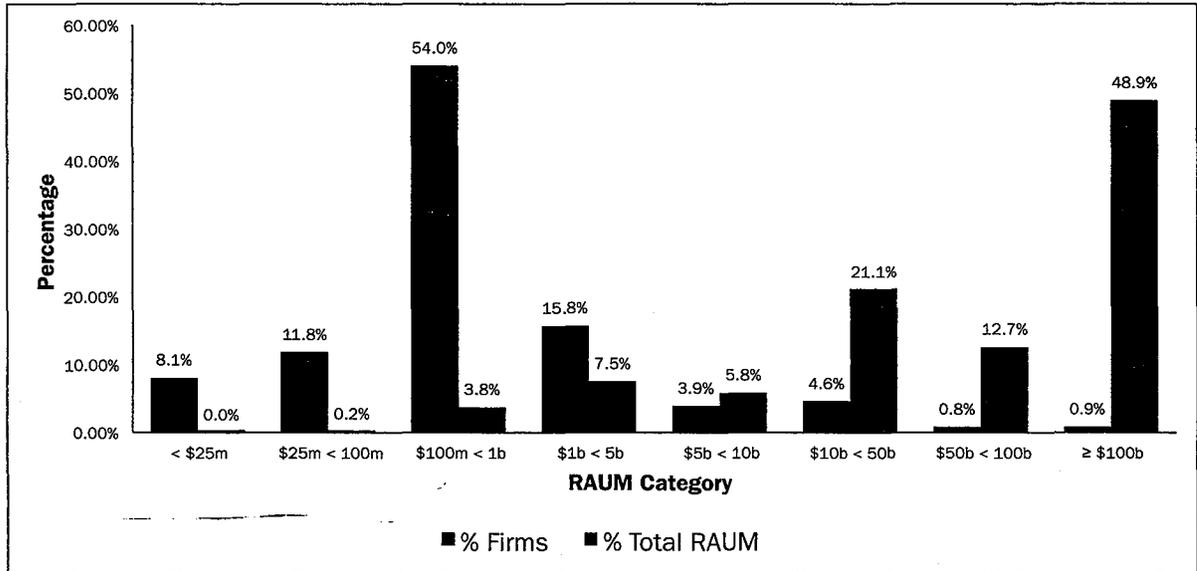
SEC-registered advisers reported that they manage client assets on a discretionary basis for 13.9 million accounts and on a non-discretionary basis for 5.2 million accounts. The percentage of total RAUM classified as non-discretionary has decreased from 11.4% in 2011 to 8.3% this year. This decrease may be due to the "the switch" to state regulation by smaller firms that are more likely to have retail non-discretionary accounts, coupled with the influx of private fund advisers, which manage their funds on a discretionary basis.

Chart 1: Regulatory Assets Under Management Comparison 2002-2012



Similar to previous years, regulatory assets under management are highly concentrated in a very small number (90) of very large advisers (those with RAUM of at least \$100 billion). In 2012, these advisers, which comprise only 0.7% of SEC-registered investment advisers, collectively reported that they manage almost half (48.9%) of all reported RAUM. Advisers with less than \$1 billion RAUM, on the other hand, manage about 3.9% of all reported RAUM, while making up 74.0% of all SEC-registered advisers.

Chart 2: Concentration of Regulatory Assets Under Management by RAUM Category



Number of Investment Advisers

As expected, the total number of registered advisers decreased in 2012, from 11,539 advisers in 2011 to 10,511 in 2012. The largest decrease came from the “mid-size” advisers category (*i.e.*, investment advisers with RAUM of \$25-\$100 million), which experienced a decrease of 2,406 advisers. While some of these advisers may have moved from one RAUM category to another since our 2011 report, 2,359 advisers in this category that were registered at the time of our 2011 report have actually deregistered in the past year. This sizeable deregistration of “mid-size” advisers is largely attributable to the Dodd-Frank Act’s increase in the threshold for SEC registration from \$25 million to \$100 million in RAUM. Even taking into account routine de-registrations, it is fair to conclude that the vast majority of this decrease is attributable to the new threshold. While earlier SEC reports estimated that the “switch” would result in the de-registration of a much larger number of SEC-registered advisers,⁵ the actual number was smaller due to a combination of several factors, including: (a) the new definition of “regulatory assets under management” which tends to increase an adviser’s RAUM; (b) the \$90 million RAUM “buffer” established by the SEC; and (3) the fact that “mid-size” advisers domiciled in the State of New York will remain subject to SEC registration.⁶ More recent SEC reports have indicated that the total number of SEC-registered advisers will settle around 10,700 after the “switch” is complete - down about 15% from the post-private fund adviser registration/pre-“switch” high level mark of 12,623 earlier this year.⁷

The decrease in “mid-size” advisers was partially offset by newly registering private fund advisers. Over the past year, 1,532 private fund advisers registered with the SEC for the first time, bringing the number of private fund advisers to 3,979.⁸ Much of this increase in private fund advisers is the result of the Dodd-Frank Act’s elimination of a previously relied-upon exemption from registration for private fund advisers. In 2012, 1,269 newly-registered advisers reported that more than 75% of their clients are hedge funds and other pooled investment vehicles. Likewise, 1,311 newly-registered advisers report that more than 75% of their RAUM are attributable to hedge funds and other pooled investment vehicles.⁹

⁵ See *Study on Enhancing Investment Adviser Examinations* (Jan. 14, 2011), at p.16. <http://www.sec.gov/news/studies/2011/914studyfinal.pdf>.

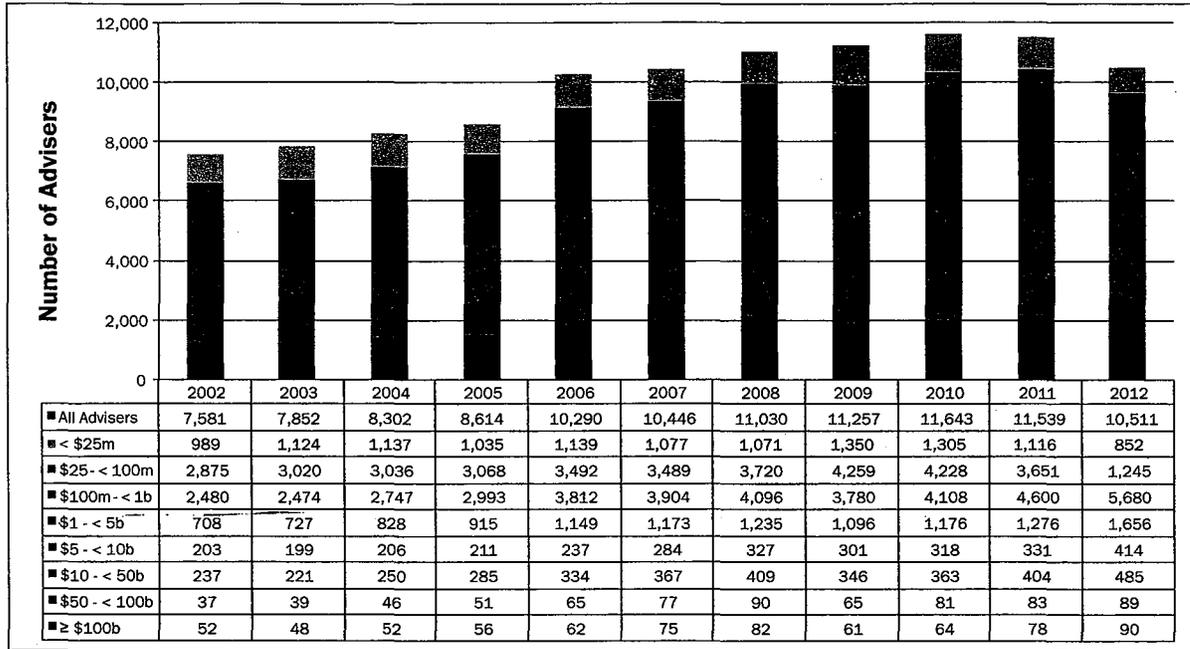
⁶ 294 advisers selecting “mid-size” adviser as the basis for SEC registration are domiciled in New York, with an additional 75 firms selecting this basis with no identified principal place of business (their answers are not public because they are private residences).

⁷ The SEC recently reported that 11,002 advisers are SEC-registered as of October 1, 2012, but that 293 of these advisers are likely to be de-registered. See *More Than 1,500 Private Fund Advisers Registered With the SEC Since Passage of the Financial Reform Law*, Press Rel. 2012-214, (Oct. 19, 2012), available at: <http://www.sec.gov/news/press/2012/2012-214.htm>; *Dodd-Frank Act Changes to Investment Adviser Registration Requirements* (October 2012), available at: <http://www.sec.gov/divisions/investment/imissues/df-ia-registration.pdf>. See also *Dodd-Frank Act Changes to Investment Adviser Registration Requirements—Preliminary Results* (June 2012) (for 12,623 figure) available at <http://www.sec.gov/divisions/investment/imissues/df-ia-registration.pdf>.

⁸ See n.4, *supra*.

⁹ There are numerous ways to measure the number of newly registered private fund advisers, depending on the time frame and the data chosen from Form ADV. This report uses the time period May 1, 2011 (the data from our 2011 report) to July 16, 2012 (the data used in this report). During this time frame, 1,532 newly registered advisers responded affirmatively to Item 7B asking whether the registrant is an adviser to any private fund. One could also describe private fund advisers as those that “specialize” in private funds (as opposed to managing one or more private funds as a small part of a multi-faceted business, for example). By that measure, 1,346 newly registered advisers reported that between 75-100% of their clients are private funds and other pooled vehicles and/or that more than 75% of RAUM is attributable to such funds. Of these advisers, 1,149 reported 10 or fewer clients and 164 reported 11-25 clients, demonstrating that these advisers were likely relying previously on the private adviser exemption (for advisers to fewer than 15 clients) that was rescinded by Dodd-Frank. Using the time period July 21, 2011 to October 1, 2012, the SEC reported that 1,504 newly registered advisers advised at least one private fund. See n. 7, *supra* (SEC Press Rel. 2012-214).

Chart 3: Number of SEC-Registered Investment Advisers by RAUM Category



The chart below highlights changes in the number of advisers by RAUM category. Between 2011 and 2012, the number of advisers with RAUM between \$25 million and \$100 million decreased by 65.9%, compared to a 13.7% decrease from 2010-2011 and less than 1.0% from 2009-2010. The categories between \$100 million and \$50 billion RAUM, on the other hand, experienced accelerated growth during the past year, likely as a result of the introduction of more than 1,400 private fund advisers in that category pursuant to Dodd-Frank and the new RAUM definition.

Chart 4: Change in the Number of Advisers by RAUM Category

RAUM Category	2011-2012		2010-2011		2009-2010	
	Net Change	Percent Change	Net Change	Percent Change	Net Change	Percent Change
< \$25m	-264	-23.7%	-189	-14.5%	-44	-3.3%
\$25 < 100m	-2,406	-65.9%	-577	-13.6%	-31	-0.7%
\$100m < 1b	1,080	23.5%	492	12.0%	328	8.7%
\$1 < 5b	380	29.8%	100	8.5%	80	7.3%
\$5 < 10b	83	25.1%	13	4.1%	17	5.6%
\$10 < 50b	81	20.0%	41	11.3%	17	4.9%
\$50 < 100b	6	7.2%	2	2.5%	16	24.6%
≥ \$100b	12	15.4%	14	21.5%	3	4.9%
All Advisers	-1,028	-8.9%	-104	-0.9%	386	3.4%

Custody of Client Assets

In December 2009, the SEC approved amendments to the investment adviser custody rule that dramatically overhauled the regime that had been in place since 2003. Advisers were required to comply with the new rule by March 2010 and to respond to detailed new custody questions in their first annual updating amendment of Form ADV, Part 1 after January 1, 2011. Under the amended custody rule, an adviser with custody of client assets is (with some exceptions) required to: (1) maintain the assets with a “qualified custodian” (generally a bank or broker-dealer); (2) have a reasonable belief, after due inquiry, that the qualified custodian sends account statements directly to clients; and (3) undergo an annual surprise exam by an independent public accountant.

In addition, an adviser that maintains physical custody of client assets as a qualified custodian, or with an affiliate (related person) that acts as a qualified custodian of client assets in connection with advisory services the adviser provides to clients, is required to have its surprise exam conducted by an independent accountant registered and subject to inspection by the Public Company Accounting Oversight Board (PCAOB). An adviser that serves as a qualified custodian or with an affiliate that serves as a qualified custodian in connection with advisory services the adviser provides to clients is also required to obtain, or have its affiliate obtain, an internal control report from an independent PCAOB accountant, attesting to the qualified custodian’s controls related to safekeeping of client assets.

There are two exceptions to the surprise exam requirement: (1) advisers deemed to have custody because their affiliate has custody of client assets are excepted from the surprise exam requirement if they can demonstrate that they are “operationally independent” from their affiliate; and (2) advisers that are deemed to have custody over client assets solely because they have authority to deduct fees are not required to undergo an annual surprise exam by an independent public accountant.

Further, advisers to pooled investment vehicles that are audited annually and that distribute audited financial statements to pool investors within certain time frames are deemed to have complied with the surprise exam requirement and are not required to undergo a surprise exam in addition to the annual audit.

The SEC’s 2009 Form ADV amendments requested significant detail about custody practices in order to gather data and determine compliance with these new requirements. The SEC’s revisions to Part 1 that went into effect earlier this year added a few more custody data points, including information about the numbers of qualified custodians used by advisers and the number of related custodians that are “operationally independent.”

The 2012 data indicate significant increases in the number and percentage of firms with custody due to the implementation of two Dodd-Frank provisions. “Mid-size” advisers, which are less likely to have custody (only 10.1% of mid-size advisers reported custody in 2011), have left the ranks of SEC-registered advisers, while many advisers to private funds, previously exempt from registration and more likely to have custody, are now included. Given the fact that a firm that acts as both adviser and general partner to a limited partnership is deemed to have custody, private fund advisers report a high incidence of custody of client assets. Indeed, of advisers who reported hedge funds or other pooled investment vehicles as clients or identified themselves as an adviser to private funds, 77.9% also reported that they or a related person have custody of client assets.

Chart 5: Custody of Client Assets

Category	2012		2011	
	# of Advisers	% of Advisers	# of Advisers	% of Advisers
Adviser has custody of client cash/bank accounts	3,076	29.26%	2,371	20.55%
Adviser has custody of securities	3,032	28.85%	2,313	20.55%
Related person(s) has custody of client cash/bank accounts	2,937	27.94%	1,982	17.18%
Related person(s) has custody of securities	2,910	27.69%	1,942	16.83%
Adviser and/or related person(s) has custody of advisory client assets (answered yes to any of the above)	4,456	42.39%	3,436	29.78%

The total number of investment advisers that reported having custody of client cash, bank accounts, and/or securities is 3,200 (30.4%) of all SEC-registered advisers.¹⁰ This percentage increased from 21.6% in 2011. The total number of advisers that reported that they or their related persons had custody is 42.4%, up significantly from 29.8% in 2011. As seen in the chart below, the largest advisers in terms of RAUM are generally more likely to have custody of client assets. The data also show that advisers with less than \$1 billion in RAUM are least likely to have custody. The average amount of custodied assets per investment adviser increased by 16.4%, while the average number of clients decreased by 8.2% as compared to 2011. Of the \$49.4 trillion managed by advisers, \$6.6 trillion is custodied by advisers and \$7.7 trillion is custodied by related persons.¹¹

¹⁰ This figure represents investment advisers that responded affirmatively to "do you have custody of any advisory clients' cash or bank accounts [or] securities?" This figure, however, likely also includes some related persons with custody of client assets because custody rule 206(4)-2 states that "you have custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to clients."

¹¹ The SEC data have been adjusted to correct for one adviser that apparently swapped responses to Items 9.A(2)(a) and 9.A(2)(b) of Form ADV, Part 1A. The adviser reported \$2 in custodied assets and 11,573,000 clients. There may be other erroneous answers, as a number of advisers reported more custodied assets than RAUM.

Chart 6: Value of Assets and Number of Clients for Custody Accounts

AUM Category	Number of Advisers	Advisers with Custody		Custodied Assets		Clients	
		Number	Percent	Total Value	Average	Number	Average
< \$25m	852	79	9.3%	85,311,592,738	1,079,893,579	260,498	3,297
\$25 < 100m	1,245	204	16.4%	7,326,726,683	35,915,327	14,377	70
\$100m < 1b	5,680	1,612	28.4%	316,017,439,665	196,040,595	95,965	60
\$1 < 5b	1,656	764	46.1%	849,682,683,599	1,112,150,109	240,197	314
\$5 < 10b	414	214	51.7%	742,209,802,886	3,468,270,107	471,256	2,202
\$10 < 50b	485	236	48.7%	1,847,535,924,411	7,828,542,053	1,017,643	4,312
\$50 < 100b	89	44	49.4%	1,064,373,115,286	24,190,298,075	581,982	13,227
≥ \$100b	90	47	52.2%	1,695,247,933,395	36,069,104,966	2,791,083	59,385
All Advisers	10,511	3,200	30.4%	6,607,705,218,663	2,064,907,881	5,473,001	1,710

The required controls employed by investment advisers reporting that they, or a related person, have custody of advisory client assets are shown below. Once again, the impact of the increase in the number of advisers to private funds is clearly seen in this data when compared to 2011. The percentage of advisers that reported that an independent public accountant annually audits the pooled investment vehicle they manage and the audited financial statements are distributed to the investors in the pools – the control most commonly used by private fund advisers – increased from 18.5% to 33.9%.

Chart 7: Controls Required by Custody Rule

Control	2012		2011	
	# of Advisers	% of Advisers	# of Advisers	% of Advisers
A qualified custodian(s) sends account statements at least quarterly to the investors in the pooled investment vehicle(s) you manage.	1,141	10.86%	922	7.99%
An independent public accountant audits annually the pooled investment vehicle(s) that you manage and the audited financial statements are distributed to the investors in the pools.	3,566	33.93%	2,130	18.46%
An independent public accountant conducts an annual surprise examination of client funds and securities.	1,343	12.78%	1,176	10.19%
An independent public accountant prepares an internal control report with respect to custodial services when you or your related persons are qualified custodians for client funds and securities.	485	4.61%	447	3.87%

The number of advisers that reported acting as a qualified custodian decreased by 11.7% (120 to 106) from 2011 to 2012, but the number reporting that a related person acts as a qualified custodian increased (14.1%) from 368 to 420. Overall, 2,823 advisers reported using an aggregate 12,265 qualified custodians (including related custodians), for an average of four and median of two custodians used per adviser.¹² Only 14 advisers reported using more than 50 qualified custodians and only 86 reported more than 20.

Out of the advisory firms that reported at least one related person acting as a qualified custodian for clients, 186¹³ reported being able to demonstrate that the related person is operationally independent.¹⁴ These firms are not required to obtain a surprise examination for client funds or securities maintained at the related qualified custodian.

Firms that are required to have an accountant conduct a surprise exam, annual audit, or internal control utilize no more than 1,276 accountants.¹⁵ 3,034 of the reports prepared by these accountants contained unqualified opinions (*i.e.*, a “clean” audit or report), while 397 of the reports had not been provided as of the time of filing. Surprisingly, the data indicate that 399 of the audit or internal control reports did not include an unqualified opinion. While this appears to imply there was a qualified opinion included in these cases, the phrasing of the Form ADV question may be sufficiently unclear to permit such an inference.¹⁶

¹² The remaining firms that indicated having custody of client funds or securities reported using 0 qualified custodians.

¹³ This figure excludes advisers that reported their related person was not acting as a qualified custodian (Schedule D 7A8a) even if that related person was reported to be operationally independent (Schedule D 7A8b).

¹⁴ These 186 firms may include multiple firms that are affiliated with each other and are reporting with respect to the same operationally independent qualified custodian within the affiliated group.

¹⁵ 3,331 advisers submitted information regarding 4,095 accountants. Of these accountants, 3,894 were reported to be PCAOB-registered and 3,805 were reported to be subject to PCAOB inspection. There were 1,276 unique names in the list of accountants, though this likely overstates the number of unique accountants as names for the same accountant may have been submitted in slightly different iterations.

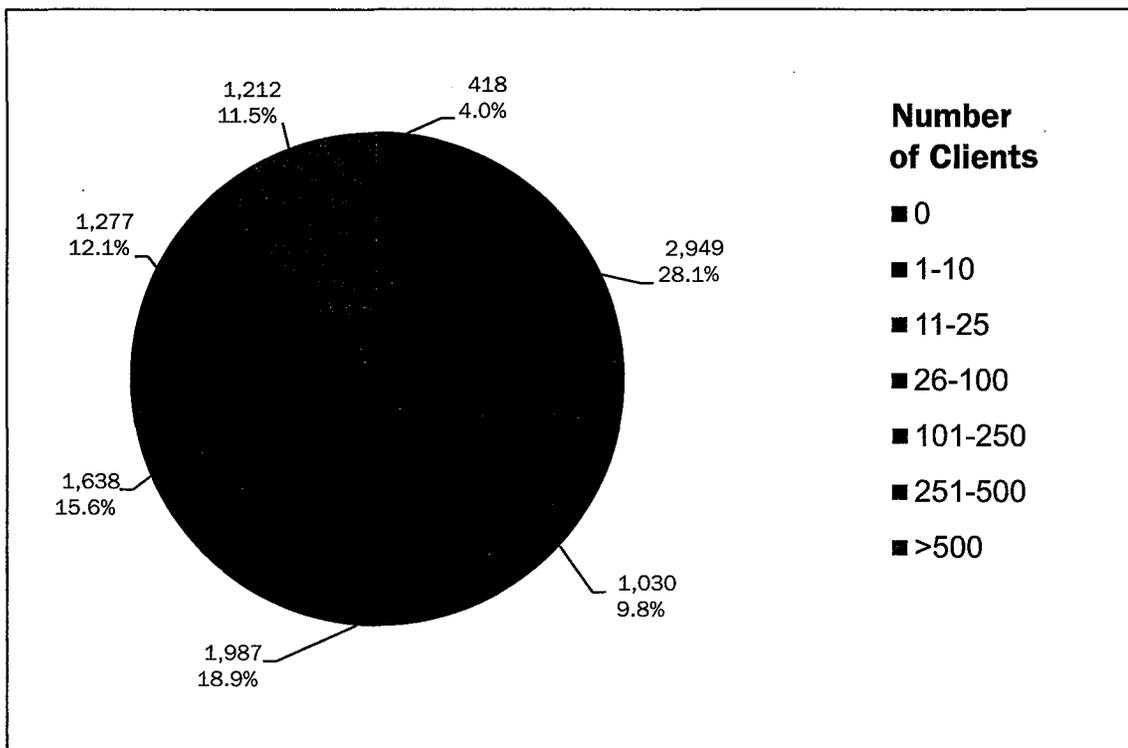
¹⁶ Schedule D, Item 9.C(6) asks “Does any report prepared by the independent public accountant that audited the pooled investment vehicle or that examined internal controls contain an unqualified opinion?” Note that we removed null responses from this data set rather than counting them as “No.”

Clients of Investment Advisers

Newly revised questions on Form ADV, Part 1 provide additional detail on the number and types of advisory clients reported by SEC-registered investment advisers. Previously, advisers were only required to provide responses indicating ranges of clients. Now, advisers that have more than 100 clients are required to submit their total numbers of clients (rounded to the nearest 100). In addition, advisers are now required to report on the percentage of RAUM represented by type of client as well as numbers of such clients.

SEC-registered advisers reported a total of at least 23,225,455 clients.¹⁷ By any measure, this represents an enormous number of both individual and institutional clients that rely on the services of investment advisers. While those reporting between 1 and 10 clients comprise the largest group at approximately 28.1%, a significant portion also report between 26 and 100 clients, as well as more than 100 clients. The median number of clients reported by registered advisers in 2012 is between 26 and 100.

Chart 8: Number and Percentage of Advisers by Number of Clients



¹⁷ Advisers were only required to provide a specific number if they have more than 100 clients. This figure does not include advisers reporting 100 or fewer clients.

Individual clients continue to comprise the largest categories of advisory clients. Consistent with prior years, the 2012 data indicate that 6,298 (59.9%) of SEC-registered advisers have at least some high-net worth clients and that 5,401 (51.4%) have at least some “retail” clients. More than half of all registered advisers reported having both non-high net worth and high net worth individuals as clients.¹⁸ These are the only two categories from which more than half of all advisers reported clients. Given the changes in SEC registration requirements for “mid-size” advisers, as well as the influx of private fund advisers, the continued dominance of individual and high-net worth individual clients in 2012 is interesting. The changes resulting from the Dodd-Frank Act decreased the population of smaller advisers, brought in a number of previously exempted private fund advisers, and increased the overall average size of reporting advisers. Nonetheless, individuals and high-net worth individuals continue to comprise the largest categories of clients among registered advisers.

Types of non-individual clients are more specialized. Nearly half (48.7%) report that at least one client is a pension or profit sharing plan. On the other hand, only 770 investment advisers (7.3%) reported any banking/thrift institution clientele; only 871 (8.3%) reported any insurance company clients; only 1,301 (12.4%) reported any state or municipal government clients; and only 1,679 (16.0%) reported any investment company clients.

¹⁸ For purposes of this reporting period, high-net worth clients have at least \$750,000 managed by the adviser or have a total net worth (including assets held jointly with his or her spouse) exceeding \$1.5 million. However, effective September 2011, the SEC raised the thresholds to \$1 million and \$2 million respectively and, effective May 2012, required advisers to exclude the value of a person's primary residence for purposes of the net worth test.

Chart 9: Types of Clients by Percentage of Clientele

Type of Client	Percentage of Clientele							Total Reporting > 0	Percent of All Advisers
	None	Up to 10%	11-25%	26-50%	51-75%	76-99%	100%		
Individuals (other than high net worth individuals)	5,110	1,075	859	1,175	1,096	1,129	67	5,401	51.4%
High net worth individuals	4,217	1,280	1,140	1,487	1,167	1,086	134	6,294	59.9%
Banking or thrift institutions	9,741	606	71	38	15	13	27	770	7.3%
Investment companies (including mutual funds)	8,832	870	206	151	64	80	308	1,679	16.0%
Business development companies	10,393	72	13	7	1	0	25	118	1.1%
Pooled investment vehicles (other than investment companies)	6,247	1,022	336	360	292	391	1,863	4,264	40.6%
Pension and profit sharing plans (but not the plan participants)	5,392	3,560	713	425	170	146	105	5,119	48.7%
Charitable organizations	6,247	3,700	391	129	17	18	9	4,264	40.6%
Corporations or other businesses not listed above	6,026	3,657	515	199	59	23	32	4,485	42.7%
State or municipal government entities	9,210	922	204	105	21	19	30	1,301	12.4%
Other investment advisers	9,609	615	125	80	17	16	49	902	8.6%
Insurance companies	9,640	688	97	38	13	19	16	871	8.3%
Other	9,491	567	171	111	39	53	79	1,020	9.7%

Changes in Form ADV, Part 1 now require advisers to report the approximate percentage of regulatory assets attributable to each category of client. The data allow for a comparison of the number of various types of clients to the percentage of total RAUM that each client type represents. Interestingly, the numbers line up relatively closely across the two measures.

Chart 10: Types of Clients by Percentage of RAUM¹⁹

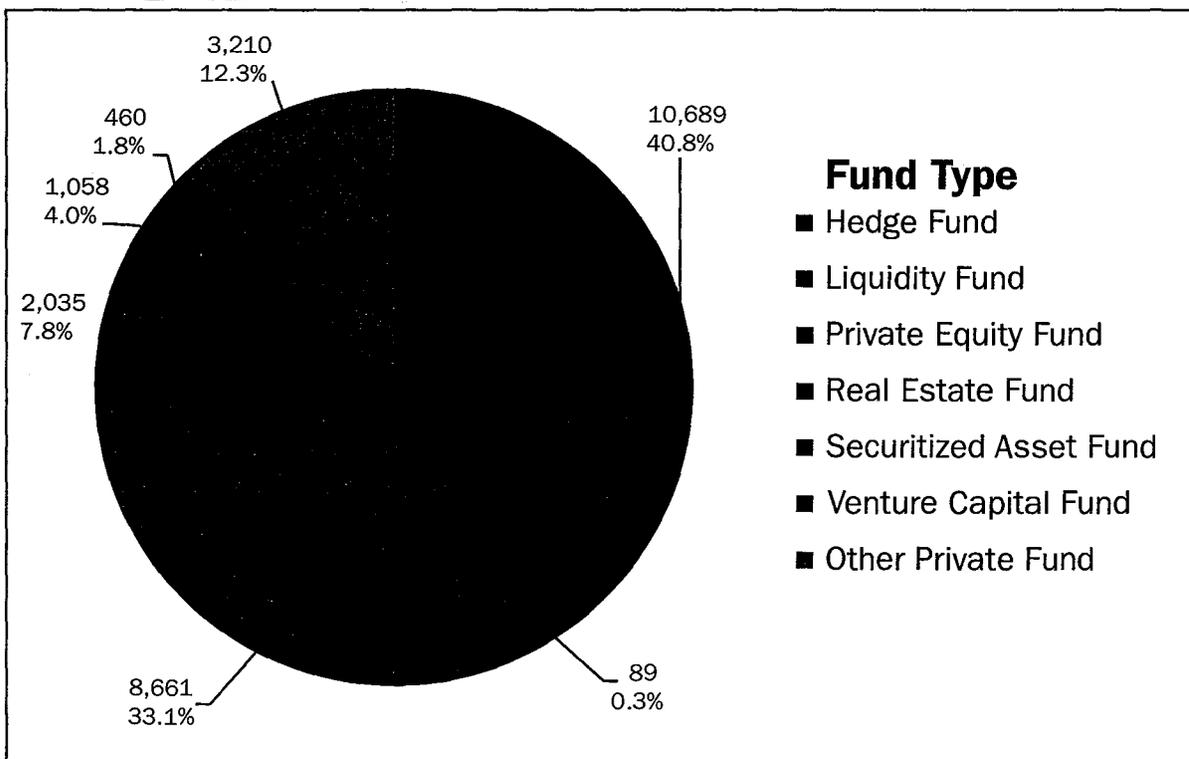
Type of Client	Percentage of RAUM					Total Reporting > 0	Percent of All Advisers
	None	Up to 25%	Up to 50%	Up to 75%	> 75%		
Individuals (other than high net worth individuals)	5,203	2,952	1,023	735	598	5,308	50.5%
High net worth individuals	4,348	2,253	1,282	1,337	1,291	6,163	58.6%
Banking or thrift institutions	9,813	559	46	36	57	698	6.6%
Investment companies (including mutual funds)	8,938	714	229	154	476	1,573	15.0%
Business development companies	10,408	68	4	3	28	103	1.0%
Pooled investment vehicles (other than investment companies)	6,297	1,253	331	297	2,333	4,214	40.1%
Pension and profit sharing plans (but not the plan participants)	5,613	3,900	484	228	286	4,898	46.6%
Charitable organizations	6,357	3,946	136	46	26	4,154	39.5%
Corporations or other businesses not listed above	6,274	3,868	207	84	78	4,237	40.3%
State or municipal government entities	9,287	955	147	52	70	1,224	11.6%
Other investment advisers	9,723	620	73	31	64	788	7.5%
Insurance companies	9,700	670	50	37	54	811	7.7%
Other	9,551	683	85	58	134	960	9.1%

¹⁹ Despite the fact that the actual text of Form ADV, Part 1 misstates questions relating to RAUM attributable to types of clients (the form asks advisers to report percentages of RAUM "up to 25%" and "up to 50%" and "up to 75%" instead of "26-50%," "51-75%," etc.), it appears that advisers have based their responses on how the questions should have been phrased.

Private Funds

This is the first year that advisers must report on the details of the private funds they advise. Section 7.B.(1) of Schedule D asks advisers questions relating to each fund's type, gross asset value, number of owners, service providers, and a number of other areas. In 2012, 3,856 (described in footnote 4) advisers (36.7%) reported advising 26,202 private funds, approximately 26.7% of which are funds of funds. Hedge funds and private equity funds represent the largest portions of this group, comprising nearly 75% of all reported private funds, with hedge funds making up 40.8% and private equity funds making up approximately 33.1%. The total gross asset value of reported private funds is approximately \$8.1 trillion, more than 16.4% of all reported RAUM, with an average gross asset value of \$308.9 million. The median gross asset value, on the other hand, is approximately \$47.7 million. The difference between the median and the average is attributable to a small number of very large private funds. The number of beneficial owners of private funds also varies widely, with most funds reporting few owners and a small number of funds reporting a very large number of beneficial owners. The median number of beneficial owners is 15, while the average number of beneficial owners is 4,265.

Chart 11: Number and Percentage of Private Funds by Fund Type



Investment Adviser Compensation

Advisers are compensated in a number of ways, and the data from 2012 reflect some interesting trends compared to last year. Consistent with the past several years, approximately 95% of advisers reported that they are compensated based on a percentage of their client's AUM. Advisers reporting compensation based on hourly charges fell significantly from 36.5% in 2011 to 27.7% of advisers in 2012. This decrease is likely the result of the Dodd-Frank Act's impact on the number of smaller advisers—those more likely to charge hourly based fees—registered with the SEC. Advisers reporting compensation based on performance-based fees, on the other hand, increased from 27.0% in 2011 to 38.9% in 2012. The increase in the number of advisers receiving performance-based compensation is attributable to the growth in the number of advisers to private funds, the majority of which receive performance-based compensation.

Chart 12: Investment Adviser Compensation

Category of IA Compensation	2012		2011		2010		2009	
	Number of Advisers	Percent of All Advisers	Number of Advisers	Percent of All Advisers	Number of Advisers	Percent of All Advisers	Number of Advisers	Percent of All Advisers
Percentage of Client's AUM	9,986	95.0%	11,036	95.6%	11,110	95.42%	10,760	95.6%
Hourly Charges	2,911	27.7%	4,215	36.5%	4,289	36.84%	4,087	36.3%
Subscription Fees	128	1.2%	145	1.3%	164	1.41%	170	1.5%
Fixed Fees	4,303	40.9%	5,314	46.1%	5,281	45.36%	4,963	44.1%
Commissions	646	6.1%	954	8.3%	1,038	8.92%	1,048	9.3%
Performance Based Fees	4,090	38.9%	3,116	27.0%	3,233	27.77%	3,238	28.8%
Other	1,383	13.2%	1,304	11.3%	1,305	11.21%	1,240	11.0%

Other Characteristics of Investment Advisory Firms

Employees

Responses to revised questions on Form ADV, Part 1 (Item 5) provide new information on the number of persons employed by SEC-registered investment advisers. Previously, advisers were only required to provide responses indicating ranges of certain employees. Now, advisers are required to submit exact numbers of their full-time and part-time employees (excluding clerical workers) and employees who perform investment advisory services (including research). Advisers also are required to provide information on the number of employees who are also registered representatives of a broker-dealer, state-licensed investment adviser representatives, and licensed agents of an insurance company or agency.

Chart 13: Investment Adviser Non-Clerical Employees

Number of Employees	Number of Advisers	
	2012	2011
1 to 5	3,687	5,742
6 to 10	2,456	2,193
11 to 50	3,180	2,525
51 to 250	870	777
251 to 500	127	133
501 to 1,000	100	75
More than 1,000	89	94
Total Employees	759,438	
Average Employees	72	Not Available
Median Employees	8	

SEC-registered advisers reported a total of 759,438 non-clerical employees. Of these employees, 343,434 provide investment advisory services (including research). Advisers collectively reported a total of 345,018 employees who are also registered representatives of a broker-dealer, although 70.1% of advisers (7,367) reported no registered representatives.

Despite the significant number of smaller advisers that have switched to state regulation, the data confirm that most investment advisers are small businesses. 6,143 (58.4%) reported that they employ 10 or fewer non-clerical employees and 9,323 (88.7%) reported that they employ 50 or fewer non-clerical employees.

Chart 14: Activities by Investment Adviser Employees

Number of Employees	Number of advisers with employees who:				
	perform investment advisory functions	are registered representatives of a broker-dealer	are registered with one or more state(s) as investment adviser representative	are registered with one or more state(s) as investment adviser representative for another adviser	are licensed agents of an insurance company
Zero	217	7,367	5,566	9,541	8,362
1 to 5	5,496	1,646	3,372	738	1,537
6 to 10	2,123	514	767	106	197
11 to 50	2,085	619	552	96	201
51 to 250	450	217	151	23	109
251 to 500	63	47	31	2	35
501 to 1,000	33	41	28	1	25
More than 1,000	42	58	42	2	42
Total Employees	343,434	345,018	222,112	11,387	224,845
Average Employees	33	33	21	1	21
Median Employees	5	0	0	0	0

Other Business Activities

Due to the recent changes in Part 1 of Form ADV, the data about advisers' other business activities are more detailed than in previous years.

For example, the data now include the number of commodity pool operators/trading advisors in a separate category from futures commission merchants. The information shows that only a few (31) investment advisers are also futures commission merchants; it is far more common for advisers to be commodity pool operators or commodity trading advisors (although there is no breakdown of the latter group of 1,004 advisers). This number represents a nearly three-fold increase from 2011, when only 355 advisers reported acting as commodity pool operators/trading advisors or futures commission merchants.

Chart 15: Other Business Activities of Investment Advisers

Firm's Non-Advisory Business	Number of Advisers	Percentage of Advisers
Broker-dealer	480	4.6%
Registered representative of a broker-dealer	530	5.0%
Commodity pool operator or commodity trading advisor	1,004	9.6%
Futures commission merchant	31	0.3%
Real estate broker, dealer, or agent	57	0.5%
Insurance broker or agent	889	8.5%
Bank	19	0.2%
Trust company	19	0.2%
Registered municipal advisor	56	0.5%
Registered security-based swap dealer	0	0.0%
Major security-based swap participant	1	0.0%
Accountant or accounting firm	126	1.2%
Lawyer or law firm	17	0.2%
Other financial product salesperson	179	1.7%

Interestingly, the number of advisers that are also actively engaged in business as a broker-dealer (i.e., dual registrants) decreased significantly (14.4%) from 561 in 2011 to 480 in 2012. Presumably, many smaller dual registrants switched to state registration. Similarly, presumably due to the “switch,” the number of advisers who reported on Form ADV that they engage in insurance activities decreased significantly. In 2011, there were 1,433 such SEC-registered advisers; in 2012 there were only 889. The “switch” may have also contributed to the decrease in advisers reporting that they sell “other” financial products from 232 in 2011 to 179 in 2012 as well as the decrease in firms reporting that they sell products or provide services other than investment advice to advisory clients (from 2,884 in 2011 to 1,643 in 2012).

Remaining constant over time is that most advisers focus on providing investment advice to clients. 7,215 (68.6%) advisers are not actively engaged in any other business other than giving investment advice about securities.

Financial Industry Affiliations

Form ADV requires advisers to disclose information relating to their affiliations with other persons in the financial industry. This year, changes to Form ADV added new categories created by the Dodd-Frank Act (e.g., municipal advisors, swap dealers) and broke down the previous years' categories of affiliations into more specific groups, such as separating the reporting of affiliations with futures commission merchants from those with commodity pool operators/trading advisors. The average adviser in 2012 reported an average of two affiliations, with a median number of affiliations of one. 2,562 advisers (24.4%) reported only one financial industry affiliation, 1,734 (16.5%) advisers reported two affiliations, 864 (8.2%) advisers reported three affiliations, and 1,437 (13.7%) advisers reported 4-12 affiliations.

Chart 16: Financial Industry Affiliations

Related person is:	Number of Advisers	Percentage of Advisers
Broker-dealer, municipal securities dealer, or government securities broker or dealer	2,361	22.5%
Other investment adviser (including financial planners)	3,793	36.1%
Registered municipal advisor	352	3.3%
Registered security-based swap dealer	13	0.1%
Major security-based swap participant	24	0.2%
Commodity pool operator/trading advisor (whether registered or exempt)	1,300	12.4%
Futures commission merchant	275	2.6%
Banking or thrift institution	906	8.6%
Trust company	635	6.0%
Accountant or accounting firm	766	7.3%
Lawyer or law firm	494	4.7%
Insurance company or agency	1,716	16.3%
Pension consultant	564	5.4%
Real estate broker or dealer	500	4.8%
Sponsor or syndicator of limited partnerships (or equivalent), excluding pooled investment vehicles	751	7.1%
Sponsor, general partner, managing member (or equivalent) of pooled investment vehicles	3,200	30.4%

In 2012, 3,903 (37.1%) advisers reported having no financial industry affiliations. An additional 819 advisers reported an affiliation with a sponsor, general partner, or managing member of a pooled investment vehicle as their only affiliation, perhaps simply reflecting the integrated structure of private fund adviser complexes. As in past years, the most common affiliation among registered investment advisers is with another investment adviser, with 36.1% reporting such an affiliation.

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 for Form ADV, Part 1, Item 11 are not available in aggregate form. Also, the information is provided for the advisory firm and its employees, officers, directors, and advisory affiliates for the past 10 years, whether or not these persons or entities were affiliated with the reporting firm during that time. In addition, the same disciplinary event at one firm may be reported by multiple separate affiliates, and the same disciplinary event may generate affirmative answers to several different questions. The SEC did, however, add one helpful clarifying question this year: firms must now indicate whether any of the events reported involve the firm or its supervised persons.

Subject to these limitations, we make the following observations:

- 9,064 (86.2%) of registered investment advisers reported no disciplinary history at all, which is comparable to last year, when 10,014 (86.8%) advisers reported no disciplinary history. While newly registered advisers made up a total of nearly 21% of the total number of investment advisers, the number of newly registered advisers reporting disciplinary history makes up only 13.1% of the 1,447 advisers now reporting such history.
- Of the 1,447 advisers reporting at least one disciplinary event, 865 advisers reported that at least one of the events involved the firm or its supervised persons (as opposed to an affiliate, for example).²⁰
- Of the 2,205 advisers newly registered since our last report, 190 (9.4% of new advisers) reported a disciplinary event. 110 (5.0% of new advisers) reported that the event involved them or a supervised person. Private fund advisers make up 1,532 (69.5%) of all newly registered advisers and accounted for 130 of the 190 (68.4%) new advisers that reported a disciplinary event.

²⁰ Note, however, that 47 advisers reported that the event involved them or a supervised person but did not mark any particular disciplinary events. These advisers are included in the aggregate number of advisers with no disciplinary history.

Appendix: Form ADV, Part 1 Responses 2012

The following represents the aggregate data from Form ADV, Part 1 filed by all SEC-registered investment advisers as of July 16, 2012. The presentation generally follows the order in which Form ADV, Part 1 asks its questions with a brief description of the item, but does not include data from Schedules A through D or disciplinary reporting pages (DRPs).

Advisers that reported ineligibility for SEC registration and advisers that had not filed an updated Form ADV on or after November 2011 are removed from the population of this report. Unless otherwise stated in this report, a null response to a "Yes or No" question is considered "No," and a null response to any other question is not included in the data set.

Last year's Evolution Revolution report contained an appendix of data derived from Evolution Revolution reports for the previous 11 years. Form ADV, Part 1 has been revised so significantly since last year (including new and amended questions and changed item numbers) that presenting a year-to-year comparison to 2012 in a similar format would not be meaningful. For historical information before 2012, please see: https://www.investmentadviser.org/web/docs/Publications_News/Reports_and_Brochures/IAA-NRS_Evolution_Revolution_Reports/evolution_revolution_2011.pdf.

or:

<http://www.nrs-inc.com/About-Us/White-Papers/Evolution-Revolution-2011/>.

Form ADV Item/Question	Value on 7/16/12 ¹
Total Number of Advisers	10,511
Registration Status: New	164
Registration Status: Approved	10,347
Adviser Exempt from ADV Part 2	379
1: Number of IAs by	
Has a Web Site	8,572
Has a Foreign Registration	861
Is a Public Reporting Co.	109
Has more than \$1B in Assets	284
2A: Number of IAs by Basis of SEC Registration	
RAUM	8,674
Mid-Size Exception	523
Wyoming IA	39
Foreign IA	583
IA to Registered Investment Company	1,212
Business Development Co.	28
Pension Consultant IA	272

Form ADV Item/Question	Value on 7/16/12 ¹
IAs under Common Control	523
Newly Formed IA	144
Multi-State IA	144
Internet IA	63
Exempt	3
No Longer Eligible	771 ⁵
3A: Number of IAs by Form of Organization	
Corporation	4,008
Sole Proprietorship	123
LLP	118
Partnership	154
LLC	5,331
LP	560
Other	217
3B: Number of IAs by Fiscal Year End	
January	31
February	16

Form ADV Item/Question	Value on 7/16/12 ¹
March	221
April	26
May	25
June	163
July	17
August	11
September	154
October	55
November	30
December	9,762
5A: Number of IAs by Number of Non-Clerical Employees	
0-5	3,687
6-10	2,456
11-50	3,180
51-250	870
251-500	127
501-1000	100
More than 1000	89
Total Non-Clerical Employees	759,438
Average Non-Clerical Employees	72
Median Non-Clerical Employees	8
5B1: Number of IAs by Employees Performing Investment Advisory Functions	
0	217
1-5	5,496
6-10	2,123
11-50	2,085
51-250	450
251-500	63
501-1000	33
More than 1000	42
Total	343,434
Average	33
Median	5

Form ADV Item/Question	Value on 7/16/12 ¹
5B2: Number of IAs by Employees Who Are Registered Representatives of a Broker-Dealer	
0	7,367
1-5	1,646
6-10	514
11-50	619
51-250	217
251-500	47
501-1000	41
More than 1000	58
Total	345,018
Average	33
Median	0
5B3: Number of IAs by Employees Who Are Registered Investment Adviser Representatives	
0	5,566
1-5	3,372
6-10	767
11-50	552
51-250	151
251-500	31
501-1000	28
More than 1000	42
Total	222,112
Average	21
Median	0
5B4: Number of IAs by Employees Who Are Registered Investment Adviser Representatives for Another IA	
0	9,541
1-5	738
6-10	106
11-50	96
51-250	23
251-500	2
501-1000	1
More than 1000	2
Total	11,387
Average	1

Form ADV Item/Question	Value on 7/16/12 ¹
Median	0
5B5: Number of IAs by Employees Who Are Licensed Agents of an Insurance Company or Agency	
0	8,362
1-5	1,537
6-10	197
11-50	201
51-250	109
251-500	35
501-1000	25
More than 1000	42
Total	224,845
Average	21
Median	0
5B6: Number of IAs by Number of Firms or Other Persons Soliciting Advisory Clients on Their Behalf	
0	7,561
1-5	2,523
6-10	199
11-50	162
51-250	48
251-500	7
501-1000	5
More than 1000	4
Total	32,160
Average	3
Median	0
5C1: Number of IAs by Number of Advisory Clients	
0	418
1-10	2,949
11-25	1,030
26-100	1,987
More than 100	4,127
More than 100: Total Clients	23,225,455 ²
More than 100: Average Clients	5,540
More than 100: Median Clients	300
5C2: Number of IAs by Foreign Client Percentage	
0%	6,681

Form ADV Item/Question	Value on 7/16/12 ¹
1-10%	1,442
11-25%	376
26-50%	691
51-75%	530
76-89%	197
90-100%	590
Average Percentage	14
Median Percentage	0
5D1A: Number of IAs by Percentage of Retail Clients	
None	5,106
up to 10%	1,075
11-25%	859
26-50%	1,175
51-75%	1,096
76-99%	1,129
100%	67
5D1B: Number of IAs by Percentage of High-Net Worth Clients	
None	4,213
up to 10%	1,280
11-25%	1,140
26-50%	1,487
51-75%	1,167
76-99%	1,086
100%	134
5D1C: Number of IAs by Percentage of Banking/Thrift Institution Clients	
None	9,736
up to 10%	606
11-25%	71
26-50%	38
51-75%	15
76-99%	13
100%	27
5D1D: Number of IAs by Percentage of Investment Co. Clients	
None	8,828
up to 10%	870

Form ADV Item/Question	Value on 7/16/12 ¹
11-25%	206
26-50%	151
51-75%	64
76-99%	80
100%	308
5D1E: Number of IAs by Percentage of Business Development Company Clients	
None	10,388
up to 10%	72
11-25%	13
26-50%	7
51-75%	1
76-99%	0
100%	25
5D1F: Number of IAs by Percentage of Other Pooled Investment Vehicle Clients	
None	6,242
up to 10%	1,022
11-25%	336
26-50%	360
51-75%	292
76-99%	391
100%	1,863
5D1G: Number of IAs by Percentage of Pension & Profit Sharing Plan Clients	
None	5,388
up to 10%	3,560
11-25%	713
26-50%	425
51-75%	170
76-99%	146
100%	105
5D1H: Number of IAs by Percentage of Charitable Organization Clients	
None	6,242
up to 10%	3,700
11-25%	391
26-50%	129

Form ADV Item/Question	Value on 7/16/12 ¹
51-75%	17
76-99%	18
100%	9
5D1I: Number of IAs by Percentage of Corporate or Other Business Clients Not Listed Above	
None	6,022
up to 10%	3,657
11-25%	515
26-50%	199
51-75%	59
76-99%	23
100%	32
5D1J: Number of IAs by Percentage of State or Municipal Government Entity Clients	
None	9,205
up to 10%	922
11-25%	204
26-50%	105
51-75%	21
76-99%	19
100%	30
5D1K: Number of IAs by Percentage of Other IA Clients	
None	9,604
up to 10%	615
11-25%	125
26-50%	80
51-75%	17
76-99%	16
100%	49
5D1L: Number of IAs by Percentage of Insurance Co. Clients	
None	9,635
up to 10%	688
11-25%	97
26-50%	38
51-75%	13
76-99%	19
100%	16

Form ADV Item/Question	Value on 7/16/12 ¹
5D1M: Number of IAs by Percentage of Other Clients	
None	8,416
up to 10%	567
11-25%	171
26-50%	111
51-75%	39
76-99%	53
100%	79
5D2A: Number of IAs by Percentage of RAUM from Retail Clients	
None	5,198
Up To 25%	2,952
Up to 50%	1,023
Up to 75%	735
More than 75%	598
5D2B: Number of IAs by Percentage of RAUM from High-Net Worth Clients	
None	4,346
Up To 25%	2,253
Up to 50%	1,282
Up to 75%	1,337
More than 75%	1,291
5D2C: Number of IAs by Percentage of RAUM from Banking/Thrift Institution Clients	
None	9,808
Up To 25%	559
Up to 50%	46
Up to 75%	36
More than 75%	57
5D2D: Number of IAs by Percentage of RAUM from Investment Company Clients	
None	8,933
Up To 25%	714
Up to 50%	229
Up to 75%	154
More than 75%	476

Form ADV Item/Question	Value on 7/16/12 ¹
5D2E: Number of IAs by Percentage of RAUM from Business Development Co. Clients	
None	10,403
Up To 25%	68
Up to 50%	4
Up to 75%	3
More than 75%	28
5D2F: Number of IAs by Percentage of RAUM from Other Pooled Investment Vehicle Clients	
None	6,292
Up To 25%	1,253
Up to 50%	331
Up to 75%	297
More than 75%	2,333
5D2G: Number of IAs by Percentage of RAUM from Pension & Profit Sharing Plan Clients	
None	5,609
Up To 25%	3,900
Up to 50%	484
Up to 75%	228
More than 75%	286
5D2H: Number of IAs by Percentage of RAUM from Charitable Organization Clients	
None	6,352
Up To 25%	3,946
Up to 50%	136
Up to 75%	46
More than 75%	26
5D2I: Number of IAs by Percentage of RAUM from Corporate or Other Business Clients Not Listed Above	
None	6,270
Up To 25%	3,868
Up to 50%	207
Up to 75%	84
More than 75%	78
5D2J: Number of IAs by Percentage of RAUM from State or Municipal Government Entity Clients	
None	9,282
Up To 25%	955

Form ADV Item/Question	Value on 7/16/12 ¹
Up to 50%	147
Up to 75%	52
More than 75%	70
5D2K: Number of IAs by Percentage of RAUM from Other IA Clients	
None	9,718
Up To 25%	620
Up to 50%	73
Up to 75%	31
More than 75%	64
5D2L: Number of IAs by Percentage of RAUM from Insurance Company Clients	
None	9,695
Up To 25%	670
Up to 50%	50
Up to 75%	37
More than 75%	54
5D2M: Number of IAs by Percentage of RAUM from Other Clients	
None	8,529
Up To 25%	683
Up to 50%	85
Up to 75%	58
More than 75%	134
5E: Number of IAs by Compensation Arrangements	
Percentage of AUM	9,986
Hourly Charges	2,911
Subscription Fees	128
Fixed Fees	4,303
Commissions	646
Performance	4,090
Other	1,383
5F: Number of IAs Providing Continuous and Regular Supervisory or Management Services to Securities	
5F1	10,154
5F2: Number of IAs by RAUM Category	
Discretionary RAUM: 0	1,121
Discretionary RAUM: 1<25m	496

Form ADV Item/Question	Value on 7/16/12 ¹
Discretionary RAUM: 25<100m	1,518
Discretionary RAUM: 100m<1b	4,959
Discretionary RAUM: 1<5b	1,450
Discretionary RAUM: 5<10b	369
Discretionary RAUM: 10<50b	428
Discretionary RAUM: 50<100b	88
Discretionary RAUM: 100b or more	82
Non-Discretionary RAUM: 0	6,144
Non-Discretionary RAUM: 1<25m	1,549
Non-Discretionary RAUM: 25<100m	987
Non-Discretionary RAUM: 100m<1b	1,340
Non-Discretionary RAUM: 1<5b	356
Non-Discretionary RAUM: 5<10b	66
Non-Discretionary RAUM: 10<50b	56
Non-Discretionary RAUM: 50<100b	8
Non-Discretionary RAUM: 100b or more	5
Total RAUM: 0	550
Total RAUM: 1<25m	302
Total RAUM: 25<100m	1,245
Total RAUM: 100m<1b	5,680
Total RAUM: 1<5b	1,656
Total RAUM: 5<10b	414
Total RAUM: 10<50b	485
Total RAUM: 50<100b	89
Total RAUM: 100b or more	90
5F2: Assets by RAUM Category	
Discretionary RAUM: 1<25m	\$4,575,466,327
Discretionary RAUM: 25<100m	\$99,487,139,990
Discretionary RAUM: 100m<1b	\$1,631,236,561,703
Discretionary RAUM: 1<5b	\$3,281,799,984,856
Discretionary RAUM: 5<10b	\$2,579,455,595,589
Discretionary RAUM: 10<50b	\$9,131,390,047,745
Discretionary RAUM: 50<100b	\$6,095,038,937,834
Discretionary RAUM: 100b or more	\$22,498,969,585,329
Discretionary RAUM: Total	\$45,321,953,319,373
Discretionary RAUM: Average	\$4,311,859,321
Discretionary RAUM: Median	\$208,883,394

Form ADV Item/Question	Value on 7/16/12 ¹
Non-Discretionary RAUM: 1<25m	\$12,775,158,634
Non-Discretionary RAUM: 25<100m	\$54,755,968,326
Non-Discretionary RAUM: 100m<1b	\$416,646,474,653
Non-Discretionary RAUM: 1<5b	\$778,044,973,618
Non-Discretionary RAUM: 5<10b	\$469,792,851,828
Non-Discretionary RAUM: 10<50b	\$1,115,288,259,557
Non-Discretionary RAUM: 50<100b	\$606,636,822,825
Non-Discretionary RAUM: 100b or more	\$666,727,145,924
Non-Discretionary RAUM: Total	\$4,120,667,655,365
Non-Discretionary RAUM: Average	\$392,033,836
Non-Discretionary RAUM: Median	\$0
Total RAUM: 1<25m	\$2,695,073,714
Total RAUM: 25<100m	\$84,137,740,886
Total RAUM: 100m<1b	\$1,858,118,424,674
Total RAUM: 1<5b	\$3,726,846,487,756
Total RAUM: 5<10b	\$2,890,715,791,139
Total RAUM: 10<50b	\$10,420,967,551,905
Total RAUM: 50<100b	\$6,258,477,269,353
Total RAUM: 100b or more	\$24,200,662,635,311
Total RAUM: Total	\$49,442,620,974,738
Total RAUM: Average	\$4,703,893,157
Total RAUM: Median	\$270,100,000
5F2: Number of IAs by Number of Accounts	
Discretionary Accounts: 0	764
Discretionary Accounts: 1-14	3,262
Discretionary Accounts: 15-50	1,067
Discretionary Accounts: 51-100	603
Discretionary Accounts: 101-500	2,302
Discretionary Accounts: >500	2,156
Discretionary Accounts: Total	13,904,345
Discretionary Accounts: Average	1,369
Discretionary Accounts: Median	50
Non-Discretionary Accounts: 0	5,787
Non-Discretionary Accounts: 1-14	1,915
Non-Discretionary Accounts: 15-50	824
Non-Discretionary Accounts: 51-100	394
Non-Discretionary Accounts: 101-500	778

Form ADV Item/Question	Value on 7/16/12 ¹
Non-Discretionary Accounts: >500	456
Non-Discretionary Accounts: Total	5,234,258
Non-Discretionary Accounts: Average	515
Non-Discretionary Accounts: Median	0
Total Accounts: 0	193
Total Accounts: <15	3,216
Total Accounts: 15-50	1,135
Total Accounts: 51-100	632
Total Accounts: 101-500	2,448
Total Accounts: >500	2,530
Total Accounts: Total	19,138,603
Total Accounts: Average	1,885
Total Accounts: Median	92
5G: Number of IAs by Advisory Services	
Financial Planning	3,441
PM for Individuals/ Small Bus.	6,498
PM for Investment Co.	1,453
PM for Pooled Investment Vehicles	3,819
PM for Bus./Institutional Clients	5,542
Pension Consulting Services	1,711
Selection of Other Advisers	3,033
Publications	671
Security Ratings or Pricing	38
Market Timing Services	101
Educational Seminars/Workshops	451
Other	1,978
5H: Number of IAs by Number of Clients Provided	
Financial Planning Services	
0	2,469
1-10	801
11-25	429
26-50	411
51-100	451
101-250	540
251-500	289
>500	163

Form ADV Item/Question	Value on 7/16/12 ¹
5I: Number of IAs Participating in a Wrap Fee Program and:	
sponsoring the wrap fee program	627
acting as pm for the wrap fee program	1,193
5J: Number of IAs Providing Investment Advice Only with Respect to Limited Types of Investments	
5J	3,297
6: Number of IAs by Other Business Activities	
Broker-Dealer	480
Registered Rep. of a Broker-Dealer	530
Commodity Pool Operator/Trading Adviser	1,004
Futures Commission Merchant	31
Real Estate Broker, Dealer, or Agent	57
Insurance Broker or Agent	889
Bank	19
Trust Company	19
Registered Municipal Advisor	56
Registered Securities-Based Swap Dealer	0
Major Security-Based Swap Participant	1
Accountant or Accounting Firm	126
Lawyer or Law Firm	17
Other Financial Product or Salesperson	179
Other Non-Advisory Business Not Listed	1,123
Non-Advisory Business Is Primary	441
Advisory Clients Sold Non-Advisory Services	1,643
7: Number of IAs by Financial Industry Affiliations & Private Fund Reporting	
Broker-Dealer or Muni./Gov. Broker or Dealer	2,361
Other IA	3,793
Registered Municipal Advisor	352
Registered Securities-Based Swap Dealer	13
Major Security-Based Swap Participant	24

Form ADV Item/Question	Value on 7/16/12 ¹
Commodity Pool Operator/Trading Adviser	1,300
Futures Commission Merchant	275
Banking or Thrift Institution	906
Trust Company	635
Accountant or Accounting Firm	766
Lawyer or Law Firm	494
Insurance Broker or Agent	1,716
Pension Consultant	564
Real Estate Broker or Dealer	500
Sponsor or Syndicator of LPs	751
Sponsor, GP, or Managing Mem. of Pooled Investment Vehicles	3,200
Adviser to any Private Fund	3,979
8: Number of IAs by Participation or Interest in Client Transactions	
Principal Transactions	919
8A2	7946 ³
8A3	2877 ³
Agency Cross Transactions	511
8B2	2697 ³
8B3	1224 ³
8C1	9657 ³
8C2	9648 ³
8C3	7358 ³
8C4	6517 ³
8D	826 ³
Recommend Brokers or Dealers to Clients	6,744
Recommend Related B/D to Clients	874
Soft Dollars	4,866
Soft Dollars under 28E of the 1934 Act	4,417
Compensate for Client Referrals	4,202
Receive Compensation for Client Referrals	1,075
9A: Number of IAs with Custody of Client Assets	
Cash or Bank Accounts	3,076

Form ADV Item/Question	Value on 7/16/12 ¹
Securities	3,032
Funds Amount: 1<25m	640
Funds Amount: 25<100m	473
Funds Amount: 100m<1b	1,166
Funds Amount: 1<5b	447
Funds Amount: 5<10b	106
Funds Amount: 10<50b	99
Funds Amount: 50<100B	18
Funds Amount: >100b	7
Total Funds Amount	\$6,614,340,395,951
Average Funds Amount	\$ 2,237,598,239 ⁴
Median Funds Amount	\$200,000,000 ⁴
Accounts: 0	386
Accounts: 1-14	2,223
Accounts: 15-50	419
Accounts: 51-100	124
Accounts: 101-500	112
Accounts: >500	110
Accounts: Total	17,048,711
Accounts: Average	5,706 ⁴
Accounts: Median	5 ⁴
9B: Number of IAs by Related Persons with Custody of Client Assets	
Cash or Bank Accounts	2,937
Securities	2,910
Funds Amount: 1<25m	575
Funds Amount: 25<100m	439
Funds Amount: 100m<1b	1,242
Funds Amount: 1<5b	498
Funds Amount: 5<10b	122
Funds Amount: 10<50b	112
Funds Amount: 50<100B	20
Funds Amount: >100b	8
Total Funds Amount	\$7,712,753,691,194
Average Funds Amount	\$ 2,557,279,075 ⁴
Median Funds Amount	\$236,729,293 ⁴
Accounts: 0	188

Form ADV Item/Question	Value on 7/16/12 ¹
Accounts: 1-14	2,341
Accounts: 15-50	338
Accounts: 51-100	98
Accounts: 101-500	111
Accounts: >500	141
Accounts: Total	18,353,710
Accounts: Average	6,059 ⁴
Accounts: Median	5 ⁴
9C: Number of Advisers by Custody Controls	
Q.C. Sends Statements to Pooled Investors	1,141
Pooled Investments Annual Audit	3,566
Surprise Exam	1,343
Internal Control Report	485
9D: Acting as Qualified Custodian for Advisory Clients	
Acting as a Qualified Custodian	106
Related Person Acting as a Qualified Custodian	420
9F: Qualified Custodians of Custodied Client Assets	
Advisers Responding >0 to Question	2,823
Qualified Custodians: Aggregate	12,265
Qualified Custodians: Average Reported	4 ⁴
Qualified Custodians: Median Reported	2 ⁴
11: Number of IAs by Disciplinary History	
No Disciplinary History	9,064
Event Involves Adviser or Its Supervised Person	865
11A1	35 ³
11A2	88 ³
11B1	38 ³
11B2	36 ³
11C1	168 ³
11C2	383 ³
11C3	14 ³
11C4	373 ³
11C5	368 ³
11D1	218 ³
11D2	722 ³

Form ADV Item/Question	Value on 7/16/12 ¹
11D3	25 ³
11D4	574 ³
11D5	200 ³
11E1	60 ³
11E2	598 ³
11E3	8 ³
11E4	146 ³
11F	20 ³
11G	133 ³
11H1a	136 ³
11H1b	127 ³
11H1c	111 ³
11H2	219 ³

Notes:

1. For purposes of this chart, null responses are not considered.
2. 64 IAs provided a number even though they selected a range of less than 100.
3. Because of the question's length, we have only provided the question location in Form ADV. Please see Form ADV, Part 1 at <http://www.sec.gov/about/forms/formadv-part1a.pdf> for this question.
4. Average or median is of adviser subset only, not all advisers.
5. Advisers that reported ineligibility for SEC registration (771) and advisers that had not filed an updated Form ADV on or after November 2011 (179) are removed from the population of this report.

**INVESTMENT ADVISER
ASSOCIATION**

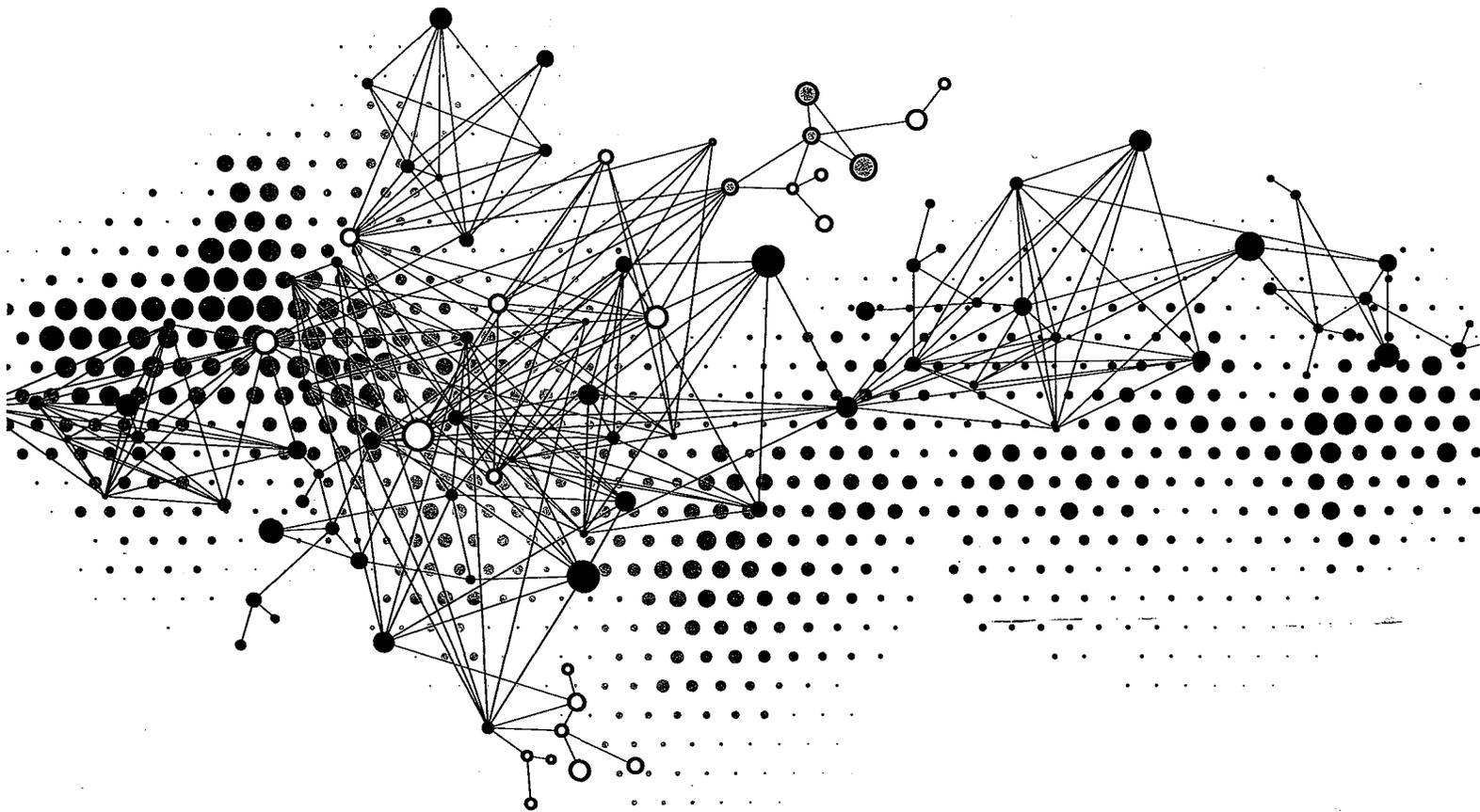
The Investment Adviser Association (IAA) is a non-profit association based in Washington, D.C. that represents the interests of SEC-registered investment advisory firms. The IAA's membership consists of approximately 550 SEC-registered investment adviser firms that collectively manage assets of more than \$10 trillion for a variety of institutional and individual clients. The IAA provides a range of advocacy, compliance, and educational services and resources to its growing membership.

For more information, visit:
www.investmentadviser.org



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National Regulatory Services
29 Brook Street
PO Box 71
Lakeville, CT 06039

P (860) 435.0200
F (860) 435.0031

info@nrs-inc.com

INVESTMENT ADVISER
ASSOCIATION

1050 17th Street, NW, Suite 725
Washington, DC 20036-5514

P (202) 293.4222
F (202) 293.4223

www.investmentadviser.org



Issue Number 244

NEWSLETTER

SEC Seeks Data on Potential Uniform Fiduciary Standard of Conduct for Investment Advisers and Broker-Dealers and “Harmonization” of Rules

On March 1, the SEC issued a request for data and other information regarding a potential uniform fiduciary standard of conduct for investment advisers and broker-dealers when providing personalized investment advice about securities to retail customers. The SEC also is seeking data concerning potential harmonization of other aspects of the regulation of investment advisers and broker-dealers.

The SEC's request follows a January 2011 staff study recommending that the SEC address retail customer confusion about the standard of conduct required of investment advisers and broker-dealers and enhance retail customer protections. This study was required by Section 913 of the Dodd-Frank Act. That provision also authorizes the SEC to adopt rules establishing a uniform fiduciary standard of conduct for investment advisers and broker-

“Clients receiving investment advice should be provided the same fiduciary protections regardless of which type of entity is providing the advice. We look forward to assisting the SEC in its consideration of this important issue.”

— David Tittsworth,
IAA Executive Director

dealers when providing personalized investment advice about securities to retail customers, but does not require the SEC to adopt such rules.

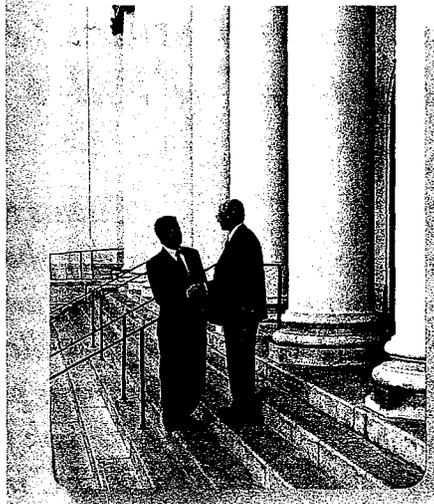
In its current request, the SEC seeks assistance in determining whether to

engage in rulemaking regarding both the fiduciary standard and harmonization. The SEC requests detailed data concerning: (1) the current market for personalized investment advice, including the characteristics of, and services provided to, retail customers of broker-dealers as compared to those who obtain advice from investment advisers; (2) a uniform fiduciary standard of conduct, as well as alternative approaches, including the costs and benefits of such approaches; (3) changes in the marketplace resulting from these approaches, including the treatment of proprietary products and principal trades; and (4) account conversions to advisory accounts.

According to the release, the SEC also is considering the following areas for further harmonization: (1) advertising and other communications; (2) the

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OCIE Risk Alert Highlights Custody Deficiencies Found During Examinations

The SEC Office of Compliance Inspections and Examinations (OCIE) recently issued a National Exam Program Risk Alert. A review of its recent examinations for custody rule issues found that more than 140 exams (1/3 of exams reviewed) included violations of the custody rule. To help reduce the number of future custody rule violations, the SEC released the risk alert and advised advisers to review their practices to comply with the custody rule.

As the alert notes, "an adviser has custody [of client assets] if it or its related person [directly or indirectly] holds clients funds or securities or has any authority to obtain possession of them." If an adviser is deemed to have custody, it must satisfy all relevant requirements of the custody rule.

The risk alert groups deficiencies into four categories: (1) failure by advisers to recognize when they have custody, (2) failure to satisfy surprise exam requirements, (3) failure to satisfy "qualified custodian" requirements, and (4) failure to fully comply with the requirements of the independent "audit approach" for pooled investment vehicles to avoid the requirement of a surprise exam.

For the first category, OCIE specifically noted seven situations where advisers failed to recognize they had custody, including situations involving bill paying services, online access to client accounts, and even physical possession of assets. For the second category—surprise exams—the alert noted failures to file a Form ADV-E within 120 days after the date of the exam chosen by the accountant and situations where because exams were conducted at the same time as prior years, the exam was not considered a surprise.

The risk alert notes for the third category—"qualified custodian" requirements—that issues include commingling of assets, keeping securities certificates in a bank safe deposit box controlled by the adviser, and custodial statements lacking required information. For the fourth category—review of "audit approaches"—OCIE found that accountants were not always independent as the custody rule requires; the adviser could not demonstrate that it distributed audited financial statements to all fund investors; and the auditor was not registered with and subject to examination by the Public

Company Accounting Oversight Board (PCAOB).

OCIE staff referred some violations to the Enforcement Division, and advisers' curative steps included editing or changing compliance procedures, altering business practices, or increasing resources devoted to custody.

It is clear the SEC is using the alert as a way to encourage advisers to take the time and opportunity to review their current policies and procedures, and implement remedial measures if necessary.

See *Significant Deficiencies Involving Adviser Custody and Safety of Client Assets*, National Exam Program Risk Alert, Volume III, Issue 1 (Mar 4, 2013), available at <http://www.sec.gov/about/offices/ocie/custody-risk-alert.pdf>. The SEC also released an Investor Bulletin to educate clients about the custody rule and suggest steps clients could take to exercise diligence in this area. The Risk Alert, Investor Bulletin, and press release are available at <http://www.sec.gov/news/press/2013/2013-33.htm>. If you have further questions, contact the IAA legal staff. ■

Rep. Waters to Reintroduce Investment Adviser User Fee Legislation

In a March 13 interview with *Investment News*, U.S. Rep. Maxine Waters (D-Calif.)—ranking Democrat on the House Financial Services Committee—disclosed that she will soon re-introduce legislation that will authorize the SEC to assess user fees on investment advisers to fund more frequent adviser examinations.

The IAA has supported user fees to ensure that the SEC has sufficient resources for effective investment adviser oversight and as an alternative to the adviser SRO proposal pushed by FINRA in the last Congress.

Rep. Waters told *Investment News* that she would be reintroducing the proposal that she sponsored in the last

Congress "very shortly." According to the article, she said that the SEC needs the user fee option to fund exams because the agency's current examination rate—which is approximately 9%—is inadequate.

"We want to make sure we do

Continued on page 4

SEC Division of Investment Management Releases Social Media Guidance for Mutual Funds

On March 15, the SEC's Division of Investment Management released guidance to "clarify the obligations of mutual funds and other investment companies to seek review of materials posted on their social media sites." The Guidance stems from concern that, in response to FINRA's required review of ads used by mutual funds, firms are submitting materials for FINRA review that do not in fact need to be submitted.

The SEC staff explains that the Guidance has examples of communications that are and are not subject to FINRA review to help understand what needs to be filed. To determine whether a communication needs to be filed, the SEC considers the "content, context, ... [and] presentation of the ... communication, ... [and analyzes]

the underlying substantive information transmitted to the social media user."

Examples of items that do not trigger the filing include "an incidental mention of a specific investment company [unrelated] to a discussion of the investment merits of the fund" or an "incidental use of the word 'performance' in connection with a discussion of an investment company or family of funds, without specific mention of some or all of the elements of a fund's return." Examples that *do* require filing include "a discussion of fund performance that provides specific mention of some or all of the elements of a fund's return... or promotes a fund's returns" or "a communication initiated by the issuer that discussed the investment merits of the fund."

The Guidance is part of the SEC's effort to improve transparency. The Division of Investment Management will issue in the future more staff views on relevant and timely legal issues. See *SEC Issues Guidance Update on Social Media Filings by Investment Companies*, SEC Rel. No. 2013-40 (Mar. 2013), available at <http://www.sec.gov/news/press/2013/2013-40.htm>. See also *IM Guidance Update: Filing Requirements for Certain Electronic Communications*, IM Guidance Update, No. 2013-01 (Mar. 2013) available at <http://www.sec.gov/divisions/investment/guidance/im-guidance-update-filing-requirements-for-certain-electronic-communications.pdf>. For more information, contact the IAA legal staff. ■

Rep. Waters to Reintroduce Investment Adviser User Fee Legislation —continued from page 3



U.S. Rep. Maxine Waters (D-Calif.)

everything we can to increase funding so [the SEC] can do their job," Waters said.

Although the precise timing of the bill's introduction is unclear, the bill is expected to mirror closely Rep. Waters' "Investment Adviser Examination Improvement Act of 2012." Key provisions of that legislation specify that:

- User fees may only be collected from SEC-registered advisers and used to defray the costs of inspections and examinations; state-registered advisers are exempt.
- User fees may only be used to fund inspections for a given fiscal year that are in excess of the number of inspections conducted by the SEC

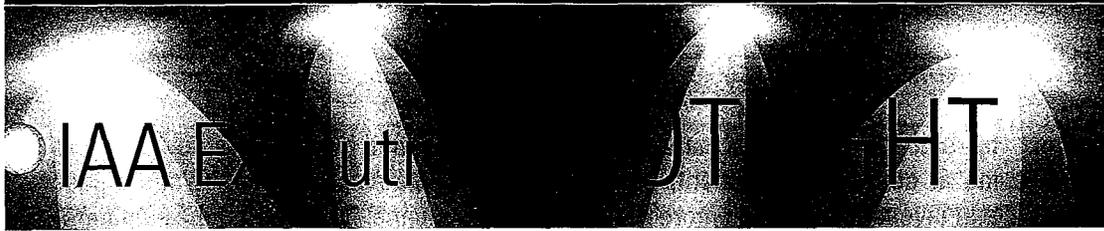
in FY 2011. This base year date is likely to be changed to 2012.

- The fee calculation formula used to determine the fees to be paid annually by individual advisory firms will be established by SEC rulemaking.
 - The fee calculation formula will take into account the estimated costs and planned frequency of inspections, and factors including the adviser's size and assets under management (AUM), number and types of clients, and other objective factors, such as risk characteristics, as determined by the Commission.
 - The Commission will review the fee calculation annually and, if it determines that it needs to be revised, it may do so—following notice and comment—before

fees are assessed for the following fiscal year.

- The U.S. Government Accountability Office (GAO) will conduct an audit of the use of the fees and the fee calculation formula, including any adjustments, once every two years and issue a report to the House Financial Services Committee and the Senate Banking Committee.
- Funds derived from the user fees are not "public funds" and are available to the SEC without regard to Congressional appropriation, apportionment, or other fiscal year limitation.

Please contact IAA Vice President for Government Relations Neil Simon if you have any questions or concerns about Rep. Waters' investment adviser user fee legislation. ■



Linda Wondrack is EVP, Head of Asset Management Compliance at Fidelity Investments. She has served on the IAA Board of Governors for the past nine years. Five years into her career, Ms. Wondrack began attending law school at night, eventually earning her J.D., while working full time. A native of central New York state, she and her husband reside in Boston.

IAA: As your final term on the IAA Board of Governors comes to a close, what are some of the changes that you and other board members have helped to oversee these past nine years?

Wondrack: The IAA experienced considerable growth in its membership. This growth coincided with significant new regulatory compliance requirements and the requirement for additional firm categories, such as hedge funds and other advisers, to register with the SEC. The structure of the IAA Board also changed. We established additional committees to better serve the growing diversity of IAA members, and we developed a comprehensive strategic plan that was implemented in my second term. The board also developed a decision-rights matrix to better delineate the roles the board has delegated to the management of the IAA.

IAA: How did the Board respond to the downturn in the economy back in 2008?

Wondrack: The board was very focused on membership during that time. We did lose some members, given the economic woes and the pressures on businesses, but the financial management of the Association remained impressive. The Board maintained a

strong capital position throughout, which meant that the IAA was well-positioned to start reinvesting in the membership with renewed advocacy efforts and enhanced member programs and services.

IAA: Has your career progressed as you had imagined?

Wondrack: I knew going into college that I wanted to be involved with international business, as I enjoy travel and had some foreign language background. I had been a finance major and had interviews with some of the top financial services firms around graduation time. The opportunities really appealed to me, so I moved to Boston after graduation as a way to get into the world of finance. It was the mid-80s—the boom years—and funds were taking off. I consider myself lucky to have been in the middle of it. I started in sales and quickly realized that that it wasn't for me. I then took a job at another firm in the "blue sky" department, when we had fund state laws to comply with. This transition gave me so many opportunities to get involved with different aspects of compliance and the growing world of mutual funds and institutional business. I really took to compliance because it introduced me to many different aspects of the business and its related issues.

IAA: You've been through a number of company mergers and acquisitions. What has that experience been like?

Wondrack: Most of my work experience has been with companies that were going through some type of major change. It's been interesting to see

Linda Wondrack's compliance career has spanned numerous firm mergers and acquisitions. This spring marks the end of her third and final term of service on the IAA Board of Governors.

all of the different approaches. Some were acquisitions, some were mergers, and some were integrations. It's given me access and opportunity that I never would have had otherwise. I've seen many different ways to integrate and to acquire firms and I've learned a lot. It's kind of my side job! As part of the team to help implement these changes, I've had the opportunity to travel overseas, including to places like Sydney, Singapore, Hong Kong, and Tokyo. I've learned how to succeed in bringing groups together to embrace change, even in different cultures. So, in a very real way, you could say that I've pursued my desire to engage in international business.

IAA: How has regulation of the industry evolved over the years and how has that impacted compliance officers?

Wondrack: The Dodd-Frank Act has certainly changed the current state of the regulatory environment. But there have been many other pivotal changes as well. After 9/11, new compliance rules centered on anti-money laundering, the Compliance

Continued on page 6

Program rules, and in 2004, a number of additional regulations had an impact on all facets of the investment advisory business. Now compliance officers have to address many issues, including banking regulations and global regulations. These rules affect firms differently, depending on where they are in the spectrum, but the issues are complex. The cumulative effect of these regulations is that compliance leaders have a much more prominent and strategic role within the advisory firm management structure, bringing them into the C-level positions.

IAA: What are some of the major challenges that you see investment advisers facing over the next several years?

Wondrack: The industry is going to have to deal with the ever increasing regulatory environment, the impact of low interest rates, and rebuilding the confidence and trust of the investors

to return to the equity markets. Looking at consumer sentiment, I can see that investors are much more cautious. Part of the challenge in addressing this hesitancy is the amount of information coming at people every day, which makes it more difficult for advisers to dispel any misinformation and regain that trust with investors.

IAA: Outside of work, you also have an interest in horses and riding. Share with us a little about that.

Wondrack: Like most every little girl I wanted a pony. But I couldn't convince my father to buy the farm across the street and keep a pony in the barn. My interest was rekindled when I was in law school and working crazy hours. In the middle of my four years of study, I had gotten married. There was a horse farm down the street from where we lived and I began taking riding lessons once a week. When I finished law

school, I had more time to do riding and it became more of a hobby and a passion of mine. Now, during the summers, I'm an adult amateur dressage competitor. The highlight of my riding was last summer when my horse and I did very well in some competitions.

IAA: Thank you for your valuable service as a member of the IAA Board of Governors.

Wondrack: I have appreciated the opportunity to support the IAA and the industry. The Association offers so many helpful resources for investment advisers. I have seen first-hand how the IAA helps to open the doors for members to meet with and inform regulators and legislative representatives about the issues. The IAA is in very good hands and I look forward to seeing it continue to grow. ■

SEC Staff Issues Additional FAQs on Form PF

On March 8, the SEC staff, in consultation with the Office of Financial Research at the Department of Treasury, issued additional FAQs clarifying certain items and addressing how to respond to a variety of questions in Form PF. For example:

Related Persons (FAQ A.5): Filers are not required to identify all of their related persons in Question 1(b). Form PF permits but does not require related persons to report on a single Form PF information with respect to such related persons and the private funds they advise as a matter of convenience for affiliated entities. Filers are only required to identify a related person in Question 1(b) if the filer is reporting information on its Form PF with respect to that related person.

Fund of Funds (FAQ F.4): Filers

should not disregard a private fund or equity investments in other private funds when responding to Questions 15 and 16 regarding the reporting fund's beneficial owners.

Regulatory Assets Under Management (RAUM) and Gross Asset Value Definitions (FAQ G.2): For purposes of calculating regulatory assets under management in Question 3 and for purposes of calculating a reporting fund's gross asset value in Question 8, filers should treat short positions, derivatives, repurchase agreements, total return swaps, and other financial instruments as follows: If the private fund has a balance sheet, the filer may rely on the gross assets reflected on the balance sheet to calculate RAUM and "gross asset value." Thus, filers do not need to assess the value of these finan-

cial instruments in a manner different from that required under the applicable accounting standard. (See SEC's FAQs on Form ADV and IARD (Form ADV: Item 7.B)).

Master-Feeder Arrangement (FAQ H.1): If a filer reports private funds in a master-feeder arrangement on an aggregated basis for purposes of Form ADV, Section 7.B.1, the filer must report the master-feeder arrangement on an aggregated basis on Form PF. Filers should file an other-than-annual amendment to their Form ADV to reflect such a change before filing Form PF.

Questions 26 and 30—Reporting Derivatives Exposure (FAQ 26.4): Filers should follow the requirement in the definition of "interest rate derivative"

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2013 IAA Compliance and Regulatory Webinars

The IAA 2013 webinar series addresses important legal, regulatory, and compliance topics for investment advisers. Register for these webinars online at www.investmentadviser.org and click on "Events."



Live Webinar: Compliance Issues for National Futures Association (NFA) Members

Wednesday, April 3, 1:30 - 2:45 pm ET

Presenters:

- Cary J. Meer, *Partner, K&L Gates LLP*
- Lawrence B. Patent, *Partner, K&L Gates LLP*
- Matt Pendell, *Manager, Compliance, National Futures Association*
- Laura L. Grossman, *Assistant General Counsel, IAA (Session Moderator)*

This webinar will address compliance issues for investment advisers relevant to members of the NFA. Some of the topics to be covered include:

- Commodity Pool Operator and Commodity Trading Advisor General Compliance Obligations
- Transition to Commodity Futures Trading Commission Regulation 4.7(b)
- NFA Bylaw 1101
- Compliance Procedures
- Forms CPO-PQR and CTA-PR and Forms NFA-PQR and NFA-PR
- Ability to Register as a CPO and Still Rely on CFTC Regulation 4.13(a)(3) for Some Pools

Live Webinar: Key Compliance Issues for Private Fund Advisers

Wednesday, May 22, 1:00 - 2:15 pm ET

Presenters:

- Mark Perlow, *Partner, K&L Gates LLP*
- Maryellen Maurer, *Deputy CCO, TPG Global LLC*
- Alpa Patel, *Senior Counsel, Private Funds Branch, Office of Investment Adviser Regulation, Division of Investment Management, SEC*
- Monique S. Botkin, *Assistant General Counsel, IAA (Session Moderator)*

Advisers to private funds, including hedge funds and private equity funds, face complex compliance challenges in complying with the Investment Advisers Act and other federal securities laws. This webinar will focus on key compliance issues for private fund advisers, including:

- How to implement the new Form PF filing requirement
- How to prepare for an SEC "presence exam" focused on private fund issues
- Ways to address unique private fund issues, including portfolio management and side-by-side management, valuation, performance advertising, custody, conflicts of interest and disclosure, fees and expenses, trade allocation, side letters, side pockets, recordkeeping requirements, and monitoring and testing the compliance program
- The SEC's potential new JOBS Act rule that would eliminate the general solicitation and advertising ban for private placements under Rule 506

Live Webinar: Compliance Issues for Smaller Investment Advisers

Thursday, June 6, 1:30 - 2:45 pm ET

Presenters:

- Mari-Anne Pisarri, *Partner, Pickard and Djinis LLP*
- Will Edick, *Partner, Pickard and Djinis LLP*
- Paul Glenn, *Special Counsel, IAA (Session Moderator)*

The topics covered in this webinar will address compliance issues most relevant to smaller SEC-registered investment advisers. Areas to be addressed:

- Compliance policies and procedures, chief compliance officers, annual reviews, monitoring and testing
- Preparing for an SEC examination, oversight review, or other "visit"
- Overseeing service providers, lawyers, compliance consultants, and vendors
- Identifying and dealing with problem clients, employees, and others

Recorded Webinar: Final Regulations under the Foreign Account Tax Compliance Act (FATCA): Implications for Foreign Funds

Tuesday, March 19, 1:00 pm ET

Presenters:

- Roger S. Wise, *Partner, K&L Gates*
- Mary Burke Baker, *Government Affairs Advisor, K&L Gates*
- Kathy D. Ireland, *Associate General Counsel, IAA (Session Moderator)*

The webinar presenters will address the implications of FATCA for foreign financial institutions (FFIs), which include certain foreign funds. Topics to be covered:

- FATCA withholding on U.S. sources
- FFI agreements
- FFI responsibilities, including due diligence and reporting of U.S. taxpayer accounts
- Intergovernmental agreements
- Phase-in of FATCA requirements

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	Live	Recording	Both
Members and Associate Members	\$125	\$125	\$200
Non-Members	\$175	\$175	\$300

? Questions about the Webinar Series?
For questions regarding the 2013 IAA Compliance and Regulatory Webinars, email IAAServices@investmentadviser.org or call (202) 293-4222.

On March 7-8, the IAA hosted its annual Investment Adviser Compliance Conference. More than 200 attendees engaged with SEC regulators, industry experts, and other legal and compliance professionals during the two-day event. The conference focused on recent legal, regulatory, and compliance developments and provided practical information to help investment advisers navigate evolving issues in today's dynamic environment.

Former SEC Chairman Highlights Effects of the Dodd-Frank Act

Former SEC Chairman **Harvey L. Pitt** delivered the keynote address to open the conference.

Pitt addressed progress on Dodd Frank implementation and the difficulties faced by the SEC—in addition to investment advisers—in coping with all the requirements.

"The SEC's also shamefully underfunded," said Pitt. "Dodd-Frank set the SEC up for failure. It imposed dramatically expanded authority on the Agency it can't possibly implement. ... [H]ard facts remain—even these well-designed plans aren't enough. The SEC must find ways to cope with its new compliance obligations."

Pitt also addressed changes and threatened changes for investment advisers to face. "IAs face new challenges requiring them to rethink existing business models. To survive now, IAs need nimbleness and flexibility to respond creatively to many troubling trends—including a distressed global economy, changing capital markets and onerous new regulations."

He closed by providing advice for

investment adviser compliance professionals in dealing with the future.

The conference's lunches featured OCIE Director **Carlo di Florio** and Director of the Division of Investment Management **Norm Champ**.

Norm Champ addressed the SEC's Division of Investment Management (IM) Regulatory Initiative Process, reviews of Advisers Act rules, advertising, Form ADV, and other IM work. His complete remarks are available on the SEC web site at <http://www.sec.gov/news/speech/2013/spch030813nc.htm>.

Carlo di Florio addressed OCIE priorities for 2013, work of the office's risk analysis group, tips-complaints-and-referrals data, work of the Quantitative Analytics Group, and policy examination issues. He addressed challenging new and emerging issues such as newly registered advisers, alternative investments, and distribution fees. The policy examinations topics include money market funds, compliance with pay to play, swaps, and compliance with the custody rule.



Former SEC Chairman, Harvey L. Pitt opens conference.



Carlo di Florio, director of SEC Office of Compliance Inspections and Examinations, discusses OCIE priorities.

Plenary Sessions

Enforcement Issues. IAA General Counsel **Karen Barr** moderated the first panel of the conference, which focused on **Enforcement Issues for Advisers**. Panelists discussed the latest trends and significant enforcement actions involving investment advisers and cases of insider trading, conflicts of interest, improper fees, and other securities violations. **Julie Riewe**, Deputy Chief in the Asset Management Unit of the SEC's Division of Enforcement, addressed SEC enforcement priorities including matters relating to valuation and performance fees as well as appropriate disclosures to clients. **Richard Marshall**, Partner at Ropes & Gray, discussed SEC enforcement matters, issues relating to the new whistleblower program, and advice in addressing SEC concerns that can turn into enforcement cases. **Mary**

Keefe, Managing Director and Director of Compliance at Nuveen Asset Management, provided practical suggestions for compliance officers in dealing with potential SEC enforcement issues.

Advertising and Social Media. **Elizabeth Reza**, partner at Ropes & Gray, moderated a panel on **Performance Advertising and Social Media**. Panelists **Michael**

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Caccese, Partner at K&L Gates, **Tracy Soehle**, Director and Regulatory Counsel at Affiliated Managers Group, and **Sarah Buescher**, Branch Chief in the SEC's Division of Investment Management—discussed SEC advertising requirements, best practices, pitfalls, and other compliance issues involved in performance advertising (including Global Investment Performance Standards—GIPS) and the use of social media by investment advisers.

Hot Topics for Advisers. **David Tittsworth**, IAA Executive Director and Executive Vice President, led a panel discussing late-breaking developments in legal, regulatory, and compliance issues facing investment advisory firms. **Diane Blizzard**, Associate Director for Regulatory Policy and Investment Adviser Regulation in the SEC's Division of Investment Management (IM), outlined IM priorities and expected regulatory developments including a Red Flags Rule relating to a jurisdiction transfer for SEC registered entities from the Federal Trade Commission to the SEC. **Elizabeth Knoblock**, partner at Mayer & Brown, provided lessons learned and potential pitfalls from the 2010 Ted Urban case. **Thomas Lemke**, General Counsel and Managing Director at Legg Mason, discussed creative strategies to encourage enthusiasm for compliance issues among employees—including email training.

Key Developments on Capitol Hill. **Neil Simon**, IAA Vice President for



SEC's Director of the Division of Investment Management, Norm Champ, reviews Advisers Act rules.

ers and, though it has temporarily suspended its aggressive lobbying efforts, it is laying the foundation for a future push. For this reason, they implored advisers to support the IAA's advocacy efforts and become involved in "grassroots lobbying."

SEC Exams. **Benjamin Haskin**, partner at Willkie Farr & Gallagher, moderated a panel on discussing issues relating to SEC Examinations. **Andrew Bowden**, Deputy

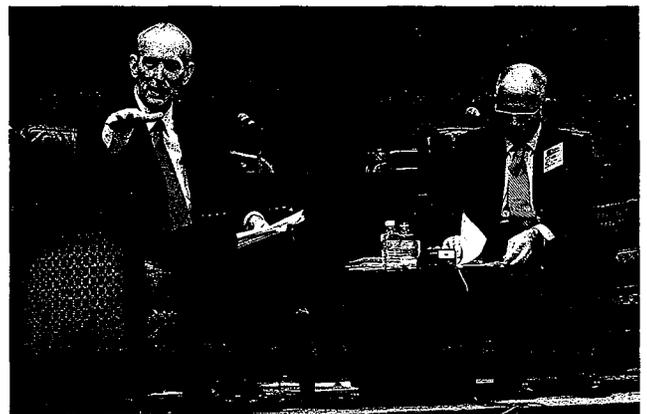


Drew Bowden, SEC's Deputy Director of OCIE, discussed compliance lines of defense.

Government Relations, and **David Tittsworth**, IAA Executive Director, discussed recent legislative developments that have the potential to require investment advisers to either pay user fees to the SEC for exams or to become members of a self-regulatory organization. According to them, FINRA remains intent upon gaining authority over

emphasized the five lines of defense for an advisory firm: management, compliance staff, executive personnel, boards of directors, and the firm's "tone of compliance." **Lewis Collins**, Senior Vice President and Senior Counsel for Affiliated Managers Group, provided helpful insight from the standpoint of the advisers' compliance staff hosting SEC examinations.

Brokerage and Trading Issues. IAA Assistant General Counsel **Monique Botkin** moderated a panel entitled **Brokerage and Trading Issues for Advisers**



SEC's David Tittsworth and Neil Simon discuss Capitol Hill developments.

designed to inform investment advisers of changing markets and brokerage relationships. **Mari-Anne Pisarri**, partner at Pickard & Djinis, **Joseph McGill**, Executive Director and Chief Compliance Officer at UBS Global Asset Management, and **Mavis Kelly**, Assistant Director in the SEC's Office of Compliance Inspections and Examinations, discussed topics including: trading practices, soft dollars, testing, trading allocations, directed brokerage, error correction, and agency/principal-cross trades.

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Code of Ethics and Personal Trading. **Jennifer Klass**, partner at Morgan Lewis, moderated a panel that included **John Walsh**, Partner at Sutherland, **Nancy Morris**, Chief Compliance Officer at Wellington Management Company, and **Daniel Kahl**, Assistant Director in the Office of Investment Adviser Regulation in the Division of Investment Management. This panel discussed issues surrounding investment advisers' codes of ethics, restrictions on personal trading, and best practices for monitoring, testing, and enforcing codes of ethics.

Ask the Experts. IAA General Counsel **Karen Barr** moderated the final panel of the conference in which panelists addressed challenging questions submitted by attendees. The panel included **Kenneth Berman**, partner at Debevoise & Plimpton, **Mari-Anne Pisarri**, partner at Pickard & Djinis, and **David Vaughan**, a partner at Dechert. This panel provided helpful insights on difficult issues relating to soft dollars, hedge funds, Form PF, international investors in hedge funds, Form ADV, trading errors reimbursement, technology, and books and records requirements for social media.

Breakout Sessions

ERISA. IAA Associate General Counsel **Kathy Ireland** moderated a panel discussion on ERISA compliance issues. Panelists included **Michael Hadley**, partner at Davis & Harman, and **Joe Canary** from the Office of Regulations and Interpretations of the Employee Benefits Security Administration in the Department of Labor. The panelists discussed the various disclosure

requirements applicable to ERISA accounts, including the 2012 final rule under ERISA section 408(b)(2), the significance of fiduciary status under ERISA, the situations that can raise prohibited transaction issues, and ERISA bonding requirements.

CFTC Compliance. **Cary Meer**, partner at K&L Gates, moderated a panel entitled **CFTC Compliance: CPO and CTA Registration and Derivatives Regulation** with **Andrew Jacobsen**, Vice President & Assistant General Counsel with JP Morgan Asset Management, and **Regina Thoele**, Senior Vice President of Compliance with the National Futures Association. The panelists discussed CFTC and NFA regulatory requirements, including disclosure, reporting, and recordkeeping, as well as compliance programs and the regulation of marketing and advertising. They noted that as a result of recent rule changes effective December 31, 2012, 700 new CPOs became NFA members. The panelists also discussed the CFTC's expected harmonization release for registered investment companies and private funds, registering and licensing associated persons of the CPO, compliance with NFA Bylaw 1101, exemptions and exclusions from registering as a CPO or CTA, and reporting on Form CPO-PQR, Form CTA-PR, and NFA quarterly filings.

New Client Relationships. IAA Special Counsel **Paul Glenn** led a panel on compliance issues for establishing new client relationships. The panel included **Heather Traeger**, partner at O'Melveny & Myers, **Lori Renzulli**, Chief Compliance Officer and Chief Counsel at Harding Loevner, and **Lisa Sheeler**, Vice President and Assistant General Counsel at MFS Investment Manage-

ment. The discussion identified the wide range of issues firms encounter in setting up client relationships, including the negotiation of investment management agreements, deducting fees from client accounts, and custody relationships.

Disclosure. IAA Assistant General Counsel **Laura Grossman** moderated the disclosure workshop focused on Form ADV, advisory contracts, and requests for proposals (RFPs). Panelists included **Monica Parry**, of counsel at Bingham, **Christopher Marzullo**, General Counsel and Chief Compliance Officer at Brandywine Global Investment Management, and **Melissa Rovers**, Branch Chief in the Office of Investment Adviser Regulation in the Division of Investment Management at the SEC. The discussion focused on practical tips to identify conflicts of interest, evaluate conflicts disclosures in Form ADV Part 2A, make Form ADV Part 2A disclosures consistent with other materials, and recognize common Form ADV Part 1A reporting errors. The panelists analyzed various conflicts scenarios.

CCO Workshops

Large Firms. **James Anderson**, partner with WilmerHale, led a discussion targeting large firms with more than \$10 billion of assets under management. Other panelists included **John Gilner**, Vice President and Chief Compliance Officer at T. Rowe Price Associates, **Lawrence Lafer**, Chief Compliance Officer at BNY Mellon Asset Management, and **Rosa Licea-Mailloux**, Senior Vice President and Associate General Counsel at Natixis Global Associates. The panelists discussed compliance issues

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6th Annual IAA Lobbying Day

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Go to www.investmentadviser.org and click on "Events"

Date: Tuesday, June 4, 2013

Time: Briefing Luncheon at 11am
Meetings on the Hill from 1pm – 5pm
Reception from 5pm – 6:30pm

Location: Capitol Hill in Washington, D.C.
(Luncheon and Reception at the Washington Court Hotel)

Questions

Looking for more information?
Contact Neil Simon, IAA VP for Government Relations
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It's time to make your voice heard on June 4!

Join with other IAA members in speaking up and educating our elected representatives about critical issues affecting investment advisers—including FINRA's ongoing effort to gain authority over advisers. When you unite forces with IAA members, Lobbying Day can make a huge difference for the future of our industry and your business.

IAA staff will make it easy for you.

Staff will arrange a **personalized schedule** for you to meet with members of Congress and their staff. At the **briefing luncheon** you'll hear about and receive the **summary of key issues**, which will equip you to address the critical discussion items.

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significant to large investment advisers, including compliance with multiple regulatory regimes, insider trading, the Foreign Corrupt Practices Act (FCPA), pay to play rules, and soft dollar issues across multiple trading desks.

Medium Firms. **Dee Anne Sjögren**, partner at Thompson Coburn, moderated a discussion for medium sized firms, those with assets under management between \$1 billion and \$10 billion. Other panelists included **Marla Chidsey-Roeser**, Director of Compliance at Convergent Wealth Advisors, **Jonathan Roberts**, Senior Vice President and Chief Compliance Officer at Klingenstein Fields & Co., and **Judy Babb Werner**, Chief Compliance Officer at Gardner Lewis Asset Management. The panelists discussed current issues

and developments and offered suggestions for dealing with evolving compliance obligations, including engaging with a peer group, and using technology to manage deadlines.

Small Firms. **Shane Hansen**, partner at Warner Norcross & Judd, moderated the panel for small firms with less than \$1 billion of assets under management. Other panelists included **Steven Wilkes**, CFA, President and Portfolio Manager with Hutchinson Capital Management, and **Susan Rudzinski**, Compliance Director at Convergent Capital Management. The panel discussed a firm's distinctive characteristics, risk management, compliance controls, forensic testing, and annual review.

Private Fund Advisers. **Mark Perlow**, partner at K&L Gates moderated

a panel dedicated to issues facing private fund advisers. Panelists included **Kenneth Linton**, Senior Associate General Counsel at Franklin Templeton Investments, **Stephen Tate**, Senior Vice President and Counsel with Putnam Investment Management, and **Alpa Patel**, Senior Counsel, Private Fund Adviser Regulation in the SEC's Office of Investment Adviser Regulation in the Division of Investment Management. The panel discussed implementation issues for private funds filing Form PF, including related persons, aggregation, parallel structures, fund of funds, systems issues, and the definition of hedge fund. The SEC staff reminded the audience to submit Form PF questions to FormPF@sec.gov and to watch for SEC staff updates to the Form PF Frequently Asked

Continued on back cover



“ Compliance Corner

Insider Trading

Writings on the Wall: Considerations in Designing and Implementing Effective Information Barriers

— *By: Kerry S. Burke, Covington & Burling LLP, and Brandon K. Gay, The Carlyle Group**

In the post-Dodd-Frank world, the Securities and Exchange Commission (the “SEC”) has directed more of its attention to insider trading activities by investment advisers, including those to private funds, and their employees, through the use of the SEC’s enforcement resources and during adviser examinations.¹ As a practical matter, the implementation and enforcement of a comprehensive compliance program is an important defense against potential liability for insider trading. Each component of the adviser’s insider trading compliance program must (i) be reasonably designed to protect against violations of the insider trading proscriptions set forth in the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and the Investment Advisers Act of 1940, as amended (the “Advisers Act”), and (ii) address the adviser’s specific business needs and circumstances. There is no standardized approach to designing a compliance program, and therefore, an adviser’s insider trading policies may include a variety of different measures to protect against the misuse of material, non-public information (“MNPI”). One such measure is a permanent “information barrier” designed to separate and isolate departments or personnel with access to MNPI from those making investment decisions, thereby restricting the flow of information throughout the adviser’s firm. In this article, we highlight some key decision points in crafting well-designed information barriers

and additional considerations related to their implementation.

Background

“Insider trading” refers to trading or recommending a trade while in the possession of MNPI in violation of a relationship of trust or confidence or a duty to keep the information confidential. The prohibition against insider trading is derived from the general antifraud provisions under the federal securities laws, found most particularly in Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent practices in connection with the purchase or sale of a security. These prohibitions extend to trading while in possession of MNPI. However, Rule 10b5-1 under the Exchange Act provides an affirmative defense to insider trading liability for an entity that can prove: (i) the individual making the investment decision on behalf of the entity did not know the MNPI and (ii) the entity implemented reasonable policies and procedures designed to prevent insider trading. When used in conjunction with other compliance measures, an effective information barrier may limit the dissemination of MNPI and facilitate a showing that the individual who made the decision to purchase or sell the security did not have knowledge of the MNPI.

Additionally, advisers registered with the SEC are required under Section 204A of the Advisers Act to establish, maintain and enforce written policies

and procedures reasonably designed to prevent the misuse of MNPI by the adviser and certain of its personnel. The Advisers Act does not describe specific types of policies and procedures that would be considered “reasonably designed” and therefore, sufficient to avoid liability; however, the SEC staff has emphasized that any such policies and procedures must be tailored to the nature and circumstances of the adviser’s business. Beyond liability under the federal securities laws, even the appearance of insider trading poses significant reputational risks for advisers. As such, advisers have numerous legal and other incentives to craft compliance programs designed to prevent insider trading and other misappropriations of confidential information.

The design of policies and procedures does not lend itself to a standardized approach and typically involves a combination of measures to restrict the internal flow of MNPI, including physical segregation of different departments, restricted access to files and computer passwords and the use of code words for discussing sensitive information. Many advisers also may consider implementing information barriers. In the broker-dealer context, the SEC staff has issued guidance summarizing the core elements of an adequate information barrier, as well as items a broker-dealer should consider when administering one.² These include:

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- substantive supervision and control over interdepartmental communications;
- restriction on and review of securities trading;
- well-documented compliance procedures and the actions taken pursuant thereto; and
- increased levels of review or trading restrictions when the firm is in possession of MNPI.

Naturally, the implementation of these components will vary from firm-to-firm. The SEC staff also suggested that, in certain circumstances, an adviser should consider maintaining informational barriers.ⁱⁱⁱ Much of the staff's guidance for broker-dealers is relevant to any information barrier designed by an adviser.

Crafting Information Barriers

As is the case with many adviser compliance measures, there is no "one size fits all" approach to designing an effective information barrier. Given this flexibility, advisers likely will face a number of difficult decision points in developing appropriately-tailored informational restrictions, including those discussed below.

Permanent vs. Temporary Barriers

A permanent information barrier may not be appropriate for all advisers in light of their size or the scope of their activities. For instance, more limited informational restrictions may be beneficial in connection with a specific investment that raises novel MNPI concerns only for a prescribed period of time. Here, an adviser may be well served to institute temporary and targeted restrictions that specifically address the high-risk individuals, subjects or scenarios. There are potential trade-offs with this more limited approach, however. For example, establishing a series of particularized barriers may require the adviser's compliance department to engage in more frequent

training, monitoring and testing than if the adviser erects from the outset a permanent barrier.

"Above the Wall"

To ensure the integrity of the adviser's information barriers, an adviser typically limits (i) the number of personnel permitted "above the wall" and (ii) the investment discretion afforded to such individuals. A "control group" of compliance personnel are designated as "above the wall" so that they may monitor the flow of information throughout the firm and facilitate "wall crossings" (*i.e.*, permitting otherwise restricted communications). The decision to designate non-compliance personnel, such as a firm's senior professionals, as "above the wall" is trickier. Given the likely pervasive access to MNPI inherent in managing an advisory firm, it may be necessary to place such professionals "above the wall" simply to permit them to do their day jobs. However, an information barrier may not be effective if there is significant overlap across the adviser's operations with respect to the key individuals with access to the greatest volume of MNPI, in which case it would be a business necessity in almost all cases to designate such individuals "above the wall" to provide them with access to the relevant confidential information.^{iv}

Categorical Pre-clearance

Another difficult consideration is whether to categorically permit personnel on opposite sides of the information barrier to discuss certain topics or types of information without pre-approval, for instance, macro-level information on industry sectors, geographies and market conditions. Here, there is a tension between maintaining and enforcing effective restrictions and permitting an exchange of ideas that could be beneficial to advisory clients. Relatedly, a control group may determine that recurring issuer/security-specific communications do not require pre-clearance if both

sides of the information barrier have the same level of information and trading restrictions for the issuer/security. Notwithstanding these practical realities, the SEC staff does not endorse the use of categorical exclusions from information barriers.^v Thus, advisers should tread thoughtfully (and perhaps lightly) in this area.

Multiple Purposes

Information barriers may serve numerous regulatory purposes other than preventing insider trading. For instance, firms may establish information barriers to avoid aggregating and matching securities positions with those of affiliates for purposes of certain provisions of Sections 13 and 16 of the Exchange Act.^{vi} Firms also may avail themselves of certain exemptions from the requirement to otherwise aggregate commodities interest positions with those positions of certain affiliates.^{vii} It is critical that advisers carefully consider the various regulatory risks they intend to address by implementing an information barrier because different regulations may impose more or less stringent compliance obligations. For example, an adviser likely must (i) erect a "higher wall" (*e.g.*, further limit the number of above the wall personnel and wall crossings with respect to particular securities) and (ii) obtain a third-party assessment of the operation of the information barrier to protect against aggregation under Sections 13 and 16.^{viii}

Compliance Assistance

Regardless of scope, ensuring compliance with information barriers can be a full-time job for an adviser's compliance personnel. Compliance tasks may include (i) monitoring e-mails, (ii) chaperoning telephone conversations and other discussions and (iii) reviewing documents for inadvertent disclosure of MNPI or other restricted information. Inadequate compliance support to execute these tasks can jeopardize the

Continued on page 14

integrity of an information barrier. As such, advisers may consider a range of tools, such as e-mail review software and third-party assistance, to ease the burden on the compliance department.

Practical Tips

In light of the key decision points above, the following items are practical tips an adviser may consider to ensure a well-functioning permanent information barrier that does not overly disrupt the adviser's day-to-day business activities.

Need to Know Principle

Often, it may be difficult to determine the appropriate parameters of an information barrier. An overarching principle in safeguarding and restricting information should be whether particular personnel have a need to know or access information. While it is helpful to restrict MNPI, access to other types of information also could be limited to prevent the appearance of conflicts of interest or other problem areas.

Physical Restrictions

Physical barriers often are the primary mechanism by which advisers restrict access to information. Generally, these include some measure of segregation between personnel with routine or recurrent access to MNPI and those without such access. However, it may not be feasible or practical for every firm to utilize separate offices or floors, or to erect walls or other physical restrictions. In these circumstances, an adviser should avail itself of other tools to ensure appropriate barriers are implemented, including restricted computer access and periodic e-mail monitoring.

Senior Management Buy-In

A critical aspect of any effective compliance program is buy-in from senior management, and information barriers are no different. Management can set a helpful tone by emphasizing the existence and importance of com-

pliance with the firm's information barriers during strategy meetings, when evaluating potential deals and in other firm communications.

Clear Scope of Pre-Clearance Mandate

The control group should provide clear guidance regarding the scope of pre-clearance or approved wall-crossings. Unless otherwise specified in advance, approval to communicate across an information barrier regarding a particular issuer, security, position or scenario typically should be limited to specific, narrowly-defined topics. A lack of clear guidance may create a perception that all communications across the information barrier have been approved.

Document Exceptions

As there is no "one size fits all" approach to crafting an information barrier, there similarly will be situations that may not cleanly fit within the defined boundaries of the barrier. The compliance department should be involved in assessing the applicability of the information barrier to thorny situations and whether to permit exceptions to the policy. In these circumstances, it usually will be beneficial to document the nature of the exception and the reasoning underlying it.

Conclusion

Given the SEC's enhanced focus on insider trading, advisers should think critically about the potential risks associated with free-flowing information throughout their firms. While information barriers may not be appropriate in all cases, a well-crafted information barrier—in conjunction with a robust compliance program and routine monitoring—can provide a level of assurance that a firm is taking seriously the potential risks associated with insider trading and responding appropriately.

**Kerry S. Burke is a partner in Covington & Burling LLP's corporate and securities practice area and Brandon K. Gay is an Associate Vice President and Counsel at The Carlyle Group. Ms. Burke and Mr. Gay are resident in their firms' Washington, D.C. offices and may be reached at kburke@cov.com, or (202) 662-5297, and (202) 729-5734, or brandon.gay@carlyle.com, respectively. The information contained in this article is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein. The views expressed here belong to the authors and do not necessarily reflect the views of The Carlyle Group. © 2013 Covington & Burling LLP. All Rights Reserved. ■*

ⁱ See, e.g., SEC Press Release, "Hedge Fund Manager to Pay \$44 Million for Illegal Trading in Chinese Bank Stocks" (Dec. 12, 2012).

ⁱⁱ See SEC Division of Market Regulation, Broker-Dealer Policies and Procedures Designed to Segment the Flow and Prevent the Misuse of Material Nonpublic Information (March 1990); SEC Office of Compliance Inspections and Examinations: Staff Summary Report on Examinations of Information Barriers: Broker-Dealer Practices under Section 15(g) of the Securities Exchange Act of 1934 (Sept. 27, 2012) (the "2012 Report"). See also NASD/NYSE Joint Memo on Chinese Wall Policies and Procedures (1991).

ⁱⁱⁱ See Compliance Alert (July 7, 2008), available at <<http://www.sec.gov/about/offices/ocie/compliance0708.htm>>.

^{iv} Such an approach is not without risk, as the SEC staff recently has highlighted the compliance risks attendant to an above the wall designation. See 2012 Report at 18.

^v See 2012 Report at 21.

^{vi} See SEC Release No. 34-39538 (Jan. 12, 1998) (the "Beneficial Ownership Reporting Release").

^{vii} For instance, the Commodity Futures Trading Commission's ("CFTC") "independent account controller" exemption permits affiliates to disaggregate commodities interest positions if they develop and enforce written procedures to preclude the affiliated entities from having knowledge of, gaining access to, or receiving data about, trades of the other. CFTC Rule 150.3.

^{viii} See Beneficial Ownership Reporting Release at 19-20.



*Kerry S. Burke,
Partner, Covington
& Burling LLP*



*Brandon K. Gay,
Associate vice
President and Counsel,
The Carlyle Group*

Supreme Court Rules on Two Cases Affecting Claims Against Advisers

On February 27, the United States Supreme Court issued opinions in two cases that affect when and how claims can be brought against advisers. First, the Court ruled that the SEC must bring actions within five years after a fraud has occurred. Second, the Court ruled that plaintiffs are not required to prove materiality of alleged fraudulent statements before securing class action certification.

Statute of Limitations. In *Gabelli v. SEC*, No. 11-1274, slip op. (U.S. Feb. 27, 2013), available at http://www.supremecourt.gov/opinions/12pdf/11-1274_aplc.pdf, the Court held that the SEC cannot bring a civil fraud case more than five years after the end of the fraudulent activity.

In *Gabelli*, the SEC had charged an investment adviser's chief executive officer and its portfolio manager in a civil action for allegedly allowing an investor to engage in "market timing" in exchange for increased investments from the investor. According to the defendants, the SEC alleged the market timing ended in August 2002 but did not file charges until April 2008. The defendant claimed that the statute of limitations had expired because the five year window ended in 2007. The SEC argued for a "discovery" standard—that is, the five year statute of limitations starts to run after discovery of the fraud.

If the standard were five years after discovery of the fraud, the SEC could have claimed the statute of limitations did not start until the SEC discovered the fraud, which was later.

The Supreme Court held that the discovery rule only applies to private

plaintiffs bringing fraud claims. The SEC, however, has continual rights to inspect investment advisers and the SEC has a purpose of rooting out fraud with many legal tools to aid in that pursuit. Additionally, the Court noted that the discovery rule helps fraud victims get reparation, and *Gabelli* involves penalties "intended to punish" instead of merely providing compensation.

For advisers, the ruling limits the time in which the SEC can file charges and may prompt the SEC to expedite investigations to bring any appropriate charges within its statute of limitations.

Class Action Certifications. Also on February 27, the court decided *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, No. 11-1085, slip op. (U.S. Feb. 27, 2013), available at http://www.supremecourt.gov/opinions/12pdf/11-1085_9o6b.pdf. There, the Supreme Court decided that plaintiffs are not required to prove materiality before securing class certification.

The *Amgen* matter involved alleged misrepresentations and misleading omissions that inflated the bio-tech firm's stock price. After the state retirement system purchased the stock, more accurate and truthful information about the bio-tech firm was released, the stock declined, and the retirement system lost money and then sued.

The *Amgen* biotechnology firm contested a class-action securities fraud claim brought by a state retirement system because the firm had failed to first prove materiality of the statements and omissions. The Court sought to resolve a split among federal courts "over whether district courts must require plaintiffs to prove, and must allow defendants to present evidence rebutting, the element of materiality before certifying a class

action" for securities fraud.

The Ninth Circuit Court of Appeals had found that the retirement plan had met the standard that questions of law or fact common to class members predominates over questions affecting only individual members. The bio-tech firm asserted that the retirement system needed to "do more than plausibly plead that the [bio-tech firm's] alleged misrepresentations or omissions... would have no impact on [the firm's] stock price in an efficient market." The Supreme Court found that the certification of the class status was proper because the plaintiff met the required showing that "questions common to the class predominate, not that those questions will be answered, on the merits, in favor of the class."

SEC Commissioner Aguilar Advocates for Smart Regulation of U.S. Capital Markets

On February 22, SEC Commissioner Luis Aguilar spoke to the Practising Law Institute's SEC Speaks in 2013 Program—"Addressing Market Instability through Informed and Smart Regulation." Aguilar emphasized the SEC's role as the country's capital markets regulator and its responsibility to protect investors by proactively preventing market disruptions and addressing changes in structure of capital markets. Aguilar addressed the intense evolution of securities markets over the past two decades as exchanges adopt technology-enabled automated systems and as trading volume dramatically increases. The market's increased reliance on technology and automated systems has produced system-wide problems like

Continued on page 16

the flash crash of May 2010 which, in turn, erodes investor confidence.

Aguilar highlighted recent SEC efforts to curb market dysfunction by adopting a number of regulatory measures, including rules requiring pre-trade risk controls, a ban on stub quotes, and a prohibition on naked access. Aguilar stressed, however, his belief that serious concerns remain: the asymmetry between exchanges, alternative trading systems, and dark pools; and the transformation of exchanges from not-for-profit organizations to for-profit companies. To address these and other issues arising from the market's evolution, Aguilar suggested the possibility of implementing a "kill switch" to limit or shut down orders, the exercise of live simulations, and robust testing for trading software. While stating that individual measures would be ineffective in eliminating risk, Aguilar underscored the value of a multi-layered approach to market regulation with multiple, independent, and coordinated risk checks—to protect investors, maintain fair and efficient markets, and facilitate capital formation. See *Addressing Market Instability through Informed and Smart Regulation*, SEC Commissioner Aguilar Speech (Feb 22, 2013), available at <http://www.sec.gov/news/speech/2013/spch022213laa.htm>.

FinCEN Prepares Anti-Money Laundering Rule for Advisers

On February 27, Financial Crimes Enforcement Network (FinCEN) Director Jennifer Shasky Calvey confirmed in a speech that her agency is coordinating efforts with the SEC to develop and re-propose anti-money laundering (AML) rules and to propose suspicious activity reporting (SAR) requirements for SEC-registered investment advisers. In 2003, FinCEN proposed rules to require investment advisers to have an AML program, but ultimately withdrew the earlier proposal in 2008 as part of its overall effort to increase efficiency and

effectiveness in administering the Bank Secrecy Act. The proposed rules could bring advisers under the compliance requirements of the Bank Secrecy Act, which require financial institutions to work with government agencies to detect and prevent money laundering and other behavior by reporting suspicious activity. A copy of Director Shasky Calvey's remarks is available at <http://www.fincen.gov/newsroom/speech/html/20130227.html>.

Investment Advisers Settle SEC Charges of Misleading Investors as to Private Fund's Asset Value

On March 11, the SEC charged two affiliated investment advisers with misleading investors in a fund of private equity funds as to the fund's value. The advisers allegedly provided marketing materials and reports stating that holdings of some private equity funds were valued "based on the underlying manager's estimated values" when in fact the advisers valued an investment at a "markup," which rendered the performance data false.

According to the SEC, the advisers "misleadingly [wrote] up the value of illiquid investments" and this case provides a "clear warning that the SEC will not tolerate lax disclosure practices in the marketing of private equity funds." For example, the SEC asserted that in one quarter, the markup raised the internal rate of return nearly 35 percent.

The SEC also found that the firms' policies and procedures were lacking because they were not reasonably designed to ensure that valuations provided to investors were presented in a manner consistent with written representations. To settle the charges the adviser agreed to certain undertakings including a censure, cease and desist order, retention of an independent consultant to review the firm's valuation policies and procedures, and payment of more than \$3 million—over \$617,000 to the SEC, \$2.26 million to investors, and \$132,089 to the Commonwealth of

Massachusetts in a related action.

See *SEC Charges New York-Based Private Equity Fund Advisers with Misleading Investors about Valuation and Performance*, SEC Rel. No. 2013-38 (Mar 11, 2013), available at <http://www.sec.gov/news/press/2013/2013-38.htm>. See also *In Re Oppenheimer Asset Management Inc. and Oppenheimer Alternative Investment Management, LLC*, SEC Order Rel. No. 3566, File No. 3-15238 (Mar. 11, 2013), available at <http://www.sec.gov/litigation/admin/2013/33-9390.pdf>.

SEC Charges Private Investment Firm with Improperly Soliciting Investments through a Solicitor That Should Have Registered as a Broker

On March 11, the SEC announced charges against a New York-based holding company of private investment partnerships investing in real estate mortgage opportunities and a solicitor of fund subscriptions for violating federal securities laws by improperly soliciting more than \$500 million in investments. The SEC claimed the solicitor operated as a paid consultant for the private investment holding company, soliciting prospective clients for the firm between February 2008 and March 2011. The solicitor, however, never registered with the SEC as a broker and went "far beyond" what should have been his limited role of making introductions in acting as a "finder." The SEC Order alleges the solicitor overstepped his role by sending "private placement memoranda, subscription documents, and due diligence materials to potential investors." Moreover, the former senior managing director at the holding company of the private equity partnerships allegedly aided and abetted the solicitor's violations by providing key information to the solicitor while ignoring red flags about the improper conduct. The parties agreed to settle the SEC's charges with the entry

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of their respective SEC orders.

In its press release, the SEC noted that broker-dealers are subject to oversight and examination as a means of both monitoring conduct and protecting investors. But here, investors in the private investment partnerships were denied these protections because the solicitor acted outside the boundaries of the law and “the firm ignored the essence of his activities.” *See SEC Charges Private Equity Firm, Former Executive, and Consultant for Improperly Soliciting Investments*, SEC Rel. No. 2013-36 (Mar. 11, 2013), available at <http://www.sec.gov/news/press/2013/2013-36.htm>.

As part of the settlement, the holding company agreed to pay a penalty of \$375,000, the firm’s executive agreed to certain undertakings including entry of a cease and desist order, a nine-month suspension from serving in a supervisory capacity at an SEC registered firm, and the payment of a \$75,000 penalty. *See SEC Order In Re Ranieri Partners LLC and Donald W. Phillips*, SEC Order 3563, File No. 3-15234 (Mar. 8, 2013) available at <http://www.sec.gov/litigation/admin/2013/34-69091.pdf>. The solicitor entered into a settlement calling for a cease and desist order, a bar from association with an SEC-registered firm, specific requirements as to any future application for relief, and disgorgement of \$2,418,370 with pre-judgment interest of \$410,248—which amounts were waived based on sworn representations as to financial condition. *See In Re William M. Stephens*, SEC Order 3-15233 (Mar. 8, 2013) available at <http://www.sec.gov/litigation/admin/2013/34-69090.pdf>.

SEC Charges Illinois Pension Fund Over Misleading Investors

On March 11, the State of Illinois (State) settled charges with the SEC that in raising \$2.2 billion, the State “misled bond investors about the State’s approach to funding its pension obliga-

tions.” The SEC claimed the State never informed investors about the impact of certain State pension funding issues. Specifically, investors never knew that the State’s funding plan drastically underfunded the State’s pension obligations.

The State had enacted a fifty year funding plan in 1994 but funding pursuant to that plan proved inadequate. The State pension plan encountered “significant stress on the pension systems and on the State’s ability to meet its competing obligations.” The SEC did, however, note that in 2009 the State made corrections and enhancements to its disclosure system.

According to the SEC’s release, the action against Illinois is the second time the SEC charged a state with securities law violations stemming from public pension disclosures. The first was in 2010 against New Jersey related to underfunding the two largest pension plans in New Jersey. *See SEC Charges Illinois for Misleading Pension Disclosures*, SEC Rel. No. 2013-37 (Mar. 11, 2013), available at <http://www.sec.gov/news/press/2013/2013-37.htm>. *See In Re State of Illinois*, SEC Rel. No. 9389, File No. 3-15237 (Mar. 11, 2013), available at <http://www.sec.gov/litigation/admin/2013/33-9389.pdf>.

DOL Issues Tips for ERISA Plan Fiduciaries on Target Date Funds

In February 2013, the Department of Labor (DOL) issued tips to assist ERISA plan fiduciaries in selecting and monitoring target date funds (TDFs) and other investment options in 401(k) and similar plans. Many plan sponsors use TDFs as their qualified default investment alternative (QDIA) because of features such as automatic rebalancing as one gets closer to his or her retirement date.

The tips are aimed at helping plan fiduciaries select the appropriate TDF for a particular plan because TDFs can differ significantly. DOL recommends that fiduciaries:

- Have a process to compare and se-

lect TDFs as well as a periodic review process;

- Understand the fund’s investments, especially the allocation across asset classes and how the allocation changes over time;
- Understand the TDF’s fees and expenses;
- Determine whether a custom TDF would be more appropriate for the plan;
- Educate employees about the funds and communicate any changes and updates;
- Use available resources to evaluate TDFs; and
- Document the entire process on an on-going basis.

Target Date Retirement Funds—Tips for ERISA Plan Fiduciaries is available at <http://www.dol.gov/ebsa/pdf/fsTDF.pdf>.

CFTC Reminds Swap Counterparties of CICI Deadline

On March 15, the CFTC’s Division of Market Oversight and Office of Data and Technology issued an Advisory reminding swap counterparties that April 10 is the deadline to obtain a legal entity identifier (LEI), currently known as a CFTC Interim Compliant Identifier (CICI). The CFTC’s swap data record-keeping and reporting rules require swap counterparties to use CICIs. This identifier is required for swap counterparties that are subject to the CFTC’s jurisdiction, even if they are not required to report swap data. Swap dealers and major swap participants already are required to have CICIs. A CICI can be obtained from the CICI Utility operated by DTCC-SWIFT which is available at www.ciciutility.org.

The Advisory also reminds swap counterparties that obtained CICIs through third-party registration to self-certify the CICI data record before April 10. Swap counterparties that obtained

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CICIs through self-registration or assisted registration with permission do not need to self-certify now. However, all swap counterparties must periodically recertify their CICIs after issuance.

The Advisory suggests that each swap counterparty visit www.ciciutility.org, check its CICI status, and self-register for a CICI or self-certify its third-party-registered CICI. The full text of the Advisory is available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/dmo_odtadvisory.pdf. Please contact a member of the IAA legal team with any questions.

Massachusetts Proposes Changes to Investment Adviser Representative Filing Requirements

On March 15, the Massachusetts Securities Division proposed to amend its regulations with respect to investment adviser representative (IAR) applications. The Division also proposed amendments to update Form ADV filing requirements and other regulations to reflect developments over the past few years (e.g., electronic filing of Part 2). The proposal would require an applicant, as part of each initial application for IAR registration, to submit to the Division a signed and notarized Criminal Offender Record Information (CORI) Acknowledgement Form. The form would authorize the Division to conduct

a review of the applicant and assess that information in the application process. Because the CRD/IARD system is not designed to accept the CORI Form, firms would be required to file the form directly with the Division.

The Commonwealth of Massachusetts will hold a hearing on May 15, and comments on the proposal are due by that day. For more information on the topic or to send comments, see the Request for Comment and the proposed regulatory language available on the Commonwealth of Massachusetts web site at <http://www.sec.state.ma.us/sct/sctidx.htm>.

If you have any questions, comments, or suggestions, please contact the IAA legal team.

SEC Charges U.S. Virgin Islands-Based Adviser with Fraud

On February 21, the SEC brought administrative charges against an investment adviser based in the U.S. Virgin Islands. The adviser allegedly perpetrated fraud by using money from some clients in a Ponzi-like scheme to raise at least \$80 million to pay the interest and principal due to other clients.

The SEC proceedings charged the adviser with fraud for failing to disclose kickbacks he received for making loans to companies from investor funds. The adviser used client funds to invest in microcap stocks of the companies

that owed him money and other thinly-traded companies. From 2007, the adviser invested clients' funds directly in highly illiquid securities of some of those companies including promissory notes issued by various closely-held private companies. The SEC claimed that when the promissory notes used to finance the companies matured and the companies could not repay clients' investments, the adviser dipped into other client funds to purchase the promissory notes and used that money to pay the firm's other clients. The adviser never apprised his clients of these activities, the conflicts involved, and extra compensation he received—allegedly more than \$3.35 million and approximately 500,000 shares of stock in a microcap company. The SEC charged the adviser with willful federal securities laws violations.

In a parallel action, the U.S. Attorney's Office for the Southern District of New York simultaneously announced criminal charges against the adviser. See *SEC Order In Re James S. Tagliaferri*, SEC Rel. No. 3555 (Feb 21, 2013), available at <http://www.sec.gov/litigation/admin/2013/34-68963.pdf>. SEC Rel. No. 2013-25 (Feb 21, 2013) is available at <http://www.sec.gov/news/press/2013/2013-25.htm>.

A complete copy of each month's Legal and Regulatory Update column is available in the Members Only section of the IAA web site. ■



IN THE KNOW **IAA Online Communities Launch**

The IAA is proud to announce the launch of the new, members-only Online Communities forum. Members should have received an announcement and invite email, guiding users through the first time log-in and welcome process. All users have been added to groups based on interests and attributes. Each group features discussion topics and additional resources. Groups and

communications preferences can be modified upon log-in. We encourage all members to use this new resource for discussion and collaboration on issues related to both the investment advisory business and the Association.

To log-in, go to <http://iaa.ep2.memberfuse.com> or select "Online Communities" under the Members Only section of the IAA web site

(www.investmentadviser.org). Online Communities uses the same username and password as the IAA Members Only section.

If you would like more information about Online Communities or have trouble logging in, please email Member Services at iaaservices@investmentadviser.org or call the office at (202) 293-4222. ■

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to the Events page on the IAA web-site.



The IAA Annual Conference falls between the two weekends of the New Orleans Jazz Fest. Be sure to book your air travel and room reservations early for best availability.



SEC Staff Issues Additional FAQs on Form PF—continued from page 6

and report the exposure in terms of 10-year bond equivalents (rather than as stated in Instruction 15).

Question 35—Reporting Open Short Positions (FAQ 35.1): Filers reporting relevant open positions should report a short position that represents more than 5% of the reporting fund's net asset value as a negative value.

Question 44—Reporting Aggregate Value of Derivatives (FAQ 44.2): Filers should report the absolute value of outstanding derivatives positions (*i.e.*, not a negative number) when reporting

aggregate value for all derivatives positions of a fund for Questions 13(b) or 44.

The FAQs also addressed questions regarding relying advisers/SPVs, calculating derivatives trade volume, measuring exposures to sub-asset classes, restrictions on investor withdrawals and redemptions, side-pocket arrangements, investor liquidity, and NAICS codes. A memorandum fully summarizing these FAQs is available on the Members Only section of the IAA web site.

The SEC staff Form PF FAQs are

available at <http://www.sec.gov/divisions/investment/pfrd/pfrdfaq.shtml>. Questions for the SEC staff regarding Form PF may be emailed to the SEC at FormPF@sec.gov. A link to FINRA's technical "Frequently Asked Questions" regarding the PFRD System is available at <http://www.iard.com/pfrd/usersupport.asp>. Please contact Monique Botkin at monique.botkin@investmentadviser.org or any member of the IAA legal team at (202) 293-4222 with any questions about Form PF. ■



INTERNATIONAL DEVELOPMENTS



March 2013 IAA International Committee Meeting

The IAA International Committee met by conference call on March 14, to discuss a number of legal issues affecting investment advisers that do business overseas. Included among the topics discussed were the remuneration and other provisions of the Alterna-

tive Investment Fund Managers Directive (AIFMD), the status of the proposed Markets in Financial Instruments Directive (MiFID) II, and overseas developments in the areas of short selling and soft dollars. **Stephen Moller**, a partner at the law firm of K&L Gates, provided

an update on the European Market Infrastructure Regulation (EMIR), which governs derivatives, central counterparties, and trade repositories.

The next International Committee call will take place on Thursday, June 20, 2013. ■



Second Financial Services Authority Consultation on UK Implementation of the Alternative Investment Fund Managers Directive

On March 19, the UK Financial Services Authority issued the second of two consultation papers concerning its implementation of the Alternative Investment Fund Managers Directive (AIFMD). The paper does not cover all of the UK issues remaining under the Directive, but the FSA and HM Treasury intend to accomplish full transposition by the July 22 effective date of AIFMD.

The consultation paper expands on the FSA's prior discussions of delegation and the "letter-box entity" concept. Article 82 of the Delegated Regulation issued by the European Securities and

Markets Authority, which is binding on the UK and other EU Member States, includes a detailed description of the circumstances under which an authorized AIFM may delegate its responsibilities to another entity. The Regulation also establishes criteria for determining whether the delegation causes the AIFM to become a "letter-box" entity that no longer actually manages the fund.

According to the consultation paper, in assessing a UK AIFM's delegation of portfolio management and/or risk functions to another entity, the FSA's successor entity, the Financial Conduct

Authority (FCA), intends to take account of the criteria in Article 82. The FCA will not automatically presume, however, that a UK-authorized AIFM is a "letter-box entity" merely because the investment management tasks that have been delegated versus those retained by the AIFM have reached a particular percentage threshold. Instead, the FCA will undertake a qualitative rather than a quantitative assessment, and address, among other things, whether the AIFM exercises effective oversight over risk and portfolio management,

Continued on page 21

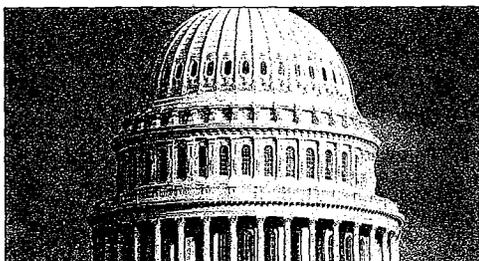
carries out effective due diligence for a prospective delegate, and supervises the delegate in an active rather than a passive way. The FCA currently does not plan on issuing guidance on how it will assess these arrangements, but will review delegation structures on a case-by-case basis.

In addition, the FCA will not review

or supervise existing delegation arrangements during the one-year transition period after July 22, 2013, either with respect to the "letter-box entity" test, or delegation in general. Beginning on July 22, 2014, however, the FCA will review and supervise both existing and proposed delegation arrangements.

Comments on the consultation pa-

per will be accepted through May 10, 2013, and the complete discussion paper is available at <http://www.fsa.gov.uk/static/pubs/cp/cp13-09.pdf>. Please contact IAA Associate General Counsel Kathy Ireland at kathy.ireland@investmentadviser.org or (202) 293-4222 if you have questions or comments concerning the consultation paper. ■



UPCOMING COMPLIANCE DATES

The following compliance dates are listed as a reminder for *IAA Newsletter* readers. If you have questions or need more information about any of the dates, please contact the IAA legal staff.

April 1: (2013 only, normally March 31) Calendar-year-filers' (including exempt reporting advisers') deadline to file an "annual updating amendment" to **Form ADV** which includes state notice filings (90 days after the end of the fiscal year). This year because March 31 is a Sunday when the IARD system is closed, April 1 is the effective due date.

April 1: (2013 only, normally March 31) All other CPOs must file **Form CPO-PQR** (i.e., 90 days after December 31, 2012 for filers with a December 31 year-end).*

April 1: (2013 only, normally March 31) CPOs must file with the NFA and distribute an **Annual Report**, certified by an independent public accountant, to each participant in each pool it operates (90 days after the end of the pool's fiscal year).* CPOs can submit a request for extension for a fund-of-funds.

April 10: Swap counterparties (counterparties to a swap that is subject to the CFTC's jurisdiction and are not swap dealers or major swap participants) must obtain

a **CFTC Interim Compliant Identifier (CICI)** as its legal entity identifier (LEI) for recordkeeping and swap data reporting. See related item in Legal and Regulatory Update in this newsletter.

April 30: All other private fund advisers with a December 31 fiscal year end must **file Form PF**.

April 30: Calendar-year-filers' deadline for delivering to clients a current **brochure** with a summary of material changes or a summary of material changes with an offer to provide the brochure (120 days after the end of the fiscal year).

May 30: Large CPOs (with an effective date of registration of January 1, 2013) must **file Form CPO-PQR** for the quarter ending March 31, 2013.

*These deadlines apply to CPOs and CTAs that were registered with the CFTC and members of NFA in 2012. Newly registered CPOs and CTAs as of January 1, 2013 are subject to subsequent deadlines.

Please contact the IAA legal staff if you have any questions. ■

SEC Seeks Data on Potential Uniform Fiduciary Standard of Conduct—continued from front cover

use of finders and solicitors; (3) supervision; (4) licensing and registration; (5) continuing education requirements; (6) books and records (including the retention of all records relating to a firm's "business as such"); and (7) other potential areas, including business conduct rules and "scaling" requirements on the basis of size.

The IAA has long maintained that

financial professionals providing investment advice should be required to act in the best interests of their clients. "Clients receiving investment advice should be provided the same fiduciary protections regardless of which type of entity is providing the advice. We look forward to assisting the SEC in its consideration of this important issue," said IAA Executive Director David Tittsworth.

The IAA intends to submit comments on the request for data, which must be submitted by July 5. The text of the request for data is available at <http://www.sec.gov/rules/other/2013/34-69013.pdf>. Members should contact Kathy Ireland at kathy.ireland@investmentadviser.org or other members of the IAA legal team with any questions, comments, or available data. ■

Cosponsored by the IAA, the Investment Adviser Certified Compliance Professional (IACCP) program was established by National Regulatory Services in 2004 and is designed to advance investment adviser compliance as a profession. Requirements of the certification program include education, work experience, examination, ethics, and continuing education requirements.

To learn more about the program or view the complete 2013 schedule, go to the IAA web site under "Events" and IACCP, or see <http://www.nrs-inc.com/Education-Solutions/Investment-Adviser-Certified-Compliance-Professional/>. For more information contact IAA Special Counsel Paul Glenn, (202) 293-4222.

UPCOMING EVENTS

- April 4 Selected Advisers Act Anti-Fraud Rules: Custody, Political Contributions, Solicitors and Proxy Voting Requirements *Online 1:00 pm - 3:00 pm (ET)*
- April 9 Investment Company Regulatory Update *Online 1:00 pm - 3:00 pm (ET)*
- April 16 Compliance Programs Rules and Strategies for Managing Your Annual Review *Online 1:00 pm - 3:00 pm (ET)*
- April 23 Registered Reps Who Are Independently Registered as IAs/Outside Business Activities *Online 1:00 pm - 3:00 pm (ET)*

- May 8 Professional Ethics: Ethical Decision-Making for Compliance Professionals *(approved for IACCP CE Ethics credit) Online and Ft. Lauderdale 10:00 am - Noon pm (ET)*
- May 8 Critical Skills for High-Performance Compliance Professionals: Business Continuity Procedures in the Aftermath of Disaster *Online and Ft. Lauderdale 1:00 pm - 3:00 pm (ET)*
- May 21 Mandates Beyond the Advisers Act: Anti-Money Laundering and Data Security *Online 1:00 pm - 3:00 pm (ET)*
- May 30 Investment Adviser Regulatory Update *Online 1:00 pm - 3:00 pm (ET)*

- June 4 IACCP Examination Study Session *Online 1:00 pm - 4:00 pm (ET)*
- June 11 **Form ADV Part 1: Annual Updating Amendment and More** *New York 8:30 am - 10:30 am (ET)*
- June 11 **Form ADV Part 2: Identifying and Disclosing Conflicts** *New York 10:45 am - 12:45 pm (ET)*
- June 11 **Investment Adviser Performance and Advertising** *New York 2:00 pm - 4:00 pm (ET)*
- June 12 **Trading Practices, Portfolio Compliance and Related Enforcement Cases** *New York 8:30 am - 10:30 am (ET)*
- June 12 **Trading Compliance - Best Execution, Soft Dollars and Directed Brokerage** *New York 10:45 am - 12:45 pm (ET)*
- June 12 **Two Trading Compliance Challenges: Valuation and Trade Errors** *New York 2:00 pm - 4:00 pm (ET)*
- June 18 Safely Embracing the Power of Social Media *Online 1:00 pm - 3:00 pm (ET)*
- June 25 A Tailored Compliance Testing Program for Investment Advisers *Online 1:00 pm - 3:00 pm (ET)*

- July 11 How the Industry (and the Regulators) are Dealing with the New FINRA Suitability Rules *Online 1:00 pm - 3:00 pm (ET)*
- July 16 Defensible Due Diligence for Investment Advisers including Private Fund Advisers *Online 1:00 pm - 3:00 pm (ET)*
- July 23 **Introduction to the Advisers Act: Framework, Registration, Exclusions and Exemptions; Exempt Reporting Advisers; Private Fund Advisers and More** *Chicago 8:30 am - 10:30 am (CT)*
- July 23 **Books and Records Requirements for Investment Advisers** *Chicago 10:45 am - 12:45 pm (CT)*
- July 23 **Insider Trading, Advisory Contracts and ADV Delivery Requirements for Investment Advisers** *Chicago 2:00 pm - 4:00 pm (CT)*
- July 24 **Understanding Fiduciary Duties and a Sweep of Anti-Fraud Provisions of the Advisers Act** *Chicago 8:30 am - 10:30 am (CT)*
- July 24 **Selected Advisers Act Anti-Fraud Rules: Custody, Political Contributions, Solicitors and Proxy Voting Requirements** *Chicago 10:45 am - 12:45 pm (CT)*
- July 24 **Compliance Programs Rules and Strategies for Managing Your Annual Review** *Chicago 2:00 pm - 4:00 pm (CT)*

INSIDE

the Beltway



FINRA Continues Drumbeat for SRO Oversight of Advisers

FINRA CEO **Richard Ketchum** is continuing to make the case for FINRA being given authority over investment advisers.

The following three paragraphs, printed in their entirety (*emphasis supplied*), are from a Washington, D.C. speech made by Ketchum before the Consumer Federation of America on March 14:

—It's also vital that we continue to work toward a uniform fiduciary standard for broker-dealers and investment advisers when they provide personalized investment advice about securities to retail customers. FINRA has explicitly supported a fiduciary standard of care for both channels, and we were pleased when the January 2011 SEC Staff Study on Investment Advisers and Broker-Dealers recommended SEC rulemaking to establish such a standard. On March 1st of this year, the SEC took another important step to move the ball forward, by asking for quantitative data and economic analysis to assist its consideration of what the appropriate standard of care should be.

But the SEC didn't stop there. The request also addresses whether investors would be better off if the rules were harmonized in other areas of broker-dealer and investment adviser regulation, such as advertising, supervision, licensing of firms, qualification of individuals, and books and records, to name a few. The SEC is right to continue the conversation about harmonizing more

than just the standard of conduct.

FINRA believes, however, that a fiduciary standard, alone or coupled with other regulatory harmonization, is not a guarantee against misconduct. Compliance must be regularly and vigorously examined and enforced to ensure the protection of investors. As the 2011 SEC Staff Study notes, "to fully protect the interests of retail investors, the Commission should couple the fiduciary duty with effective oversight." The SEC's ability to examine advisers remains inadequate. And, sadly, the SEC continues to find serious problems when it conducts exams. In fact, the SEC issued a Risk Alert and Investor Bulletin on March 4th after finding widespread non-compliance with the investment adviser custody rule. If investors are to be protected, investment advisers need to be examined regularly and vigorously. It's as simple as that, and it is not happening under our current system.

Although FINRA has temporarily scaled back its aggressive lobbying on Capitol Hill to gain adoption of legislation authorizing the SEC to make advisers subject to SRO oversight, it is clear that FINRA has launched a concerted effort to lay the foundation for a future legislative push. Indeed, as stated in the opening paragraph in a March 14 *Wall Street Journal* article on Ketchum's speech, "The head of Wall Street's self-regulator has said that pushing for his agency to be put in charge of policing investment advisers wasn't a high priority this year. But he seems to be doing it anyway."

Senate Banking Committee Approves White for SEC, Cordray to CFPB

The Senate Banking Committee in a bipartisan vote on March 19 approved the nomination of **Mary Jo White** to become a member of the SEC. The committee vote was 21-1. Senator Sherrod Brown (D-Ohio) was the lone no vote.

In February, President Obama nominated the former federal prosecutor and defense attorney to fill out former SEC Chairman Mary Schapiro's term ending in June 2014 and to get her own full term ending in June 2019. The President also chose White to chair the commission. However, the committee only voted on the 2014 term. If approved by the full Senate, White will replace Commissioner Elisse Walter as SEC Chairman.

A full Senate confirmation vote for White is expected shortly after the Senate returns from its Spring recess the week of April 8.

At the same meeting, the Senate Banking Committee also voted along party lines today to advance **Richard Cordray's** bid to serve a full term as director of the Consumer Financial Protection Bureau (CFPB). The committee vote was 12-10.

Cordray was installed at the CFPB through a recess appointment in January 2012; his term expires at the end of the year without confirmation by the full Senate. But 43 Republicans have pledged to block Cordray or any other nominee to lead the CFPB unless the authorizing statute for the consumer agency is revised to provide for its governance by a commission and funding through the congressional

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MAILING ADDRESS:

1050 17th Street, N.W., Suite 725
Washington, DC 20036

TELEPHONE:

(202) 293-4222

FAX:

(202) 293-4223

INTERNET:

www.investmentadviser.org

E-MAIL ADDRESSES:**Alex Aderton**

Director of Membership and Marketing
alex.aderton@investmentadviser.org

Karen L. Barr

General Counsel
karen.barr@investmentadviser.org

Valerie M. Baruch

Associate General Counsel
valerie.baruch@investmentadviser.org

Monique S. Botkin

Assistant General Counsel
monique.botkin@investmentadviser.org

Lisa Gillette

Director of Meetings and Events
lisa.gillette@investmentadviser.org

Paul D. Glenn

Special Counsel
paul.glenn@investmentadviser.org

Laura L. Grossman

Assistant General Counsel
laura.grossman@investmentadviser.org

Garrett Honea

Member Services and IT Manager
garrett.honea@investmentadviser.org

Alex R. Ioannidis

Member Services Coordinator
alex.ioannidis@investmentadviser.org

Kathy D. Ireland

Associate General Counsel
kathy.ireland@investmentadviser.org

Linda Mackey

Director of Finance and Operations
linda.mackey@investmentadviser.org

Megan Olson

Member Services Coordinator
megan.olson@investmentadviser.org

Andrea T. Owens

Operations Coordinator
andrea.owens@investmentadviser.org

Neil A. Simon

Vice President for Government Relations
neil.simon@investmentadviser.org

David G. Tittsworth

Executive Director
david.tittsworth@investmentadviser.org

appropriations process.

Because Democrats are opposed to these changes, further action on Cor-dray's nomination is highly unlikely.

Bill Introduced to Exempt PE Advisers from SEC Registration

Rep. Robert Hurt (R-Va.) introduced legislation on March 13 that would exempt private equity fund advisers from registering with the SEC under the Advisers Act by repealing provisions of the Dodd-Frank Act.

Hurt's bill (H.R. 1105) is co-sponsored by Representatives Jim Himes (D-Conn.), Jim Cooper (D-Tenn.) and Scott Garrett (R-NJ). It mirrors the Small Business Capital Access and Job Preservation Act that was introduced in 2011. That measure was approved by the House Financial Services Committee but never made it to the House floor.

Supporters of the bill say the legislation frees up private equity funds from unnecessary and burdensome requirements and that private equity firms should be given exemptions similar to those afforded venture capital firms under the Dodd-Frank Act.

House Financial Services Committee to Vote on Government Sponsored Enterprise (GSE) Reform

House Financial Services Committee Chairman Jeb Hensarling (R-Tex.) said at a March 19 hearing that his committee will soon vote on a bill to replace taxpayer-owned mortgage companies Fannie Mae and Freddie Mac.

Hensarling said such a bill will "once and for all abolish Fannie and Freddie," which still owe more than \$130 billion in bailouts to taxpayers.

Rep. Maxine Waters (D-Calif.), the top Democrat on the committee, said she hopes to reach some sort of bipartisan agreement. "We have not seen a proposal come forward," Waters said. "I would hope that this committee ... would provide the leadership necessary to reform the GSEs."

Hensarling said he was tired of the many proposals offered since the two companies entered conservatorship in 2008 that have "simply gathered dust." "After four-and-a-half years, inaction is no longer an option," he said.

Contact Neil Simon, IAA Vice President for Government Relations, to share your views or to obtain more information about these and other government relations matters. ■

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Questions on the SEC website. The panel also discussed the SEC's JOBS Act proposed rulemaking eliminating the prohibition on general solicitation and general advertising in private Rule 506 offerings sold to accredited investors. Ms. Patel also noted the SEC staff is reviewing the Advisers Act advertising rule for private fund advisers. Finally, the panel discussed the SEC's current "presence exam" initiative for private fund advisers focusing on valuation, custody, portfolio management,

conflicts of interest, fees and expenses, and performance advertising. The panel also noted that areas of focus include undisclosed sources of revenue, trading and investment allocation, expense allocations, soft dollars, disclosures, testing the compliance program, and documentation of testing.

The IAA sincerely thanks all of the attendees, speakers, exhibitors, and those who worked hard to make the 2013 IAA Investment Adviser Compliance Conference a success. ■