NRS Part of ACCUITY

INVESTMENT ADVISER ASSOCIATION

2016

Evolution Revolution

A Profile of the Investment Adviser Profession

The Investment Adviser Association (IAA), based in Washington, DC, is the leading organization solely dedicated to representing the interests of SEC-registered investment advisory firms. The IAA's members collectively manage assets of nearly $20 trillion for a wide variety of individual and institutional clients, including trusts, endowments, pension plans, private funds, mutual funds, and corporations. In addition to serving as the voice of the advisory profession on Capitol Hill and before the SEC, DOL, CFTC, and other U.S. and international regulators, the IAA provides extensive compliance and educational services and resources to its membership. For more information, visit www.investmentadviser.org.

1050 17th Street NW, Suite 725
Washington DC 20036-5514
202-293-4222

Karen L. Barr
President & CEO
karen.barr@investmentadviser.org

Robert C. Grohowski
General Counsel
robert.grohowski@investmentadviser.org

Herb Perone
Vice President of Communications & Marketing
herb.perone@investmentadviser.org

Laura L. Grossman
Assistant General Counsel
laura.grossman@investmentadviser.org

Garrett Honea
Member Services & IT Manager
garrett.honea@investmentadviser.org

Alex R. Ioannidis
Member Services & Marketing Coordinator
alex.ioannidis@investmentadviser.org

Owned by the RELX Group, National Regulatory Services (NRS) is part of Accuity, the global standard for payment efficiency and compliance solutions. NRS is the US leader in compliance and registration products and services for investment advisers, broker-dealers, hedge funds, investment companies and insurance institutions. NRS has the practical expertise, proven capability and unparalleled reach to deliver integrated and effective compliance solutions to a wide range of users within the financial services industry. NRS delivers these solutions through three interrelated offerings—comprehensive education, best-in-class technology and expert consulting services—enabling our clients to meet their regulatory requirements and minimize risk. For more information, visit www.nrs-inc.com.

P.O. Box 71, 29 Brook St.
Lakeville, CT 06039
860-435-0200

John Gebauer
President
jgebauer@nrs-inc.com

Marilyn Miles
Vice President, Consulting
mmiles@nrs-inc.com

Larry Nakamura
Associate Director, Consulting
lnakamura@nrs-inc.com

Amber Tatman
Consultant
atatman@nrs-inc.com

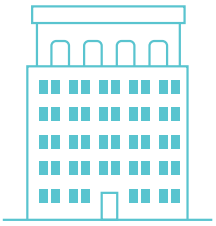
Max Dubecky
IT Operations and Support Manager
mdubecky@nrs-inc.com

Brandon Stevenson
Sr. Technical Support Representative
bstevenson@nrs-inc.com

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

The 2016 "Typical"* SEC-Registered Investment Adviser

Most of its clients are individuals



Highly likely to have at least one pension/profit sharing plan as a client

$317 million

in regulatory assets under management

9

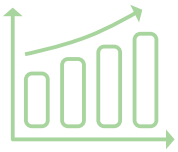
employees

26-100

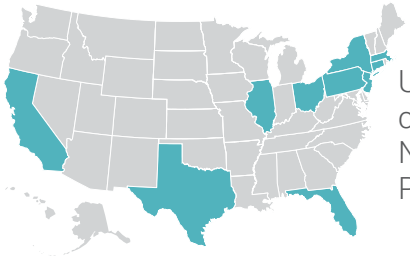
clients

103

accounts



Exercises discretionary authority over most accounts



U.S.-based limited liability company headquartered in NY, CA, TX, IL, MA, PA, CT, FL, NJ, or OH

Does not have actual physical custody of client assets or securities

*(median)

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Table of Contents

Executive Summary 6
Number of Investment Advisers 8
Regulatory Assets Under Management 10
Industry Concentration 12
Clients of Investment Advisers 14
Investment Adviser Compensation 23
Custody of Client Assets 24
Employees of Investment Advisory Firms 26
Other Characteristics of Investment Advisory Firms 30
Location of Investment Advisers 33
Disciplinary Information 34

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

The Investment Adviser Profession:
Serving More Clients, Adding More Jobs

The Investment Adviser Association and National Regulatory Services are pleased to present our 16th annual *Evolution Revolution* report, the most comprehensive profile of SEC-registered investment advisers available. This year's report contains data on 11,847 firms that manage $66.8 trillion for more than 36.4 million clients. This dynamic profession continues to be critically important to investors, our economy, and the capital markets.

The investment adviser industry remains a powerful job creator, adding an impressive 30,540 high-quality jobs to the economy. Investment advisers now employ a total of 781,335 non-clerical workers, a 4.1 percent increase since 2015. That job growth is reflected in firms of all sizes.

And federally registered investment advisers are now serving more clients than ever. Automated investment advice, particularly for retirement plan participants, is a significant driver of that growth. The trend toward automated advice —both as a standalone model and incorporated into "human touch" businesses—is likely to continue, driven by investor demographics, fee pressure, and increasing costs.

Long-time *Evolution Revolution* readers will notice that we have expanded our research into this client data, with some interesting results. The vast majority of advisers—more than 87 percent—report that the majority of their clients are of a single client category. Nearly 51 percent say more than half of their clients are individuals, for instance, while 29 percent report that most of their clients are pooled vehicles such as mutual funds, hedge funds, or private equity funds. While it remains true that the industry serves a wide range of client types, this specialization has important implications for client service, operations, and regulatory approaches.

2016 Evolution Revolution provides a full portrait of the SEC-registered investment adviser profession, presenting data on these major themes as well as on industry concentration, compensation, non-core business activities, financial industry affiliations, geographic concentrations, disciplinary information, and more.

It is our hope that our 2016 report provides information and analysis of value not just to investment advisers but to the public, policymakers, and the millions of clients SEC-registered advisers serve.

Karen L. Barr
President & CEO
IAA

John Gebauer
President
NRS

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Executive Summary

The number of SEC-registered investment advisers continues to grow. The universe of SEC-registered investment advisers continues to grow, albeit more slowly than last year. This report contains data on 11,847 federally registered advisers, reflecting a net increase of 3.3 percent since the 2015 report (compared to 5.3 percent the prior year).

The industry continues to experience strong across-the-board job growth. In 2016, SEC-registered advisers added 30,540 jobs to the economy for a reported total of 781,335 non-clerical employees—a 4.1 percent increase since 2015. Of these employees, 386,532 provide investment advisory services (including research)—a healthy increase of 10,023 since 2015. Job growth is reflected in firms of all sizes, rather than being concentrated in firms of a specific size.

The vast majority of SEC-registered investment advisers are small businesses. Small businesses are the core of the investment adviser industry. In 2016, 56.8 percent (6,725) of advisory firms reported that they employ 10 or fewer non-clerical employees and 87.8 percent (10,404) reported employing 50 or fewer individuals. Industry-wide, the median number of employees is nine.

The aggregate RAUM managed by SEC-registered advisers remains substantial—$66.8 trillion—but is flat relative to last year. RAUM managed by advisers grew a slight 0.2 percent from $66.7 trillion in 2015 to $66.8 trillion this year. This lack of RAUM growth is likely primarily a function of flat markets in the past year.

SEC-registered investment advisers serve more than 36.4 million clients—up substantially from last year. The number of clients served by investment advisers grew by 22.4 percent since 2015, continuing a strong trend and underscoring the vitality of the investment adviser profession. The increase is primarily attributable to the rise of automated advice for retirement plan participants and the gaining popularity of web-based and app-based savings and investment models. The number of advisers reporting that they provide advice exclusively through an interactive website rose by 47 firms—nearly 60 percent—to 126.

Individuals comprise the largest categories of advisory clients, with pension plan clients coming in second. Almost 61 percent of advisers serve either high net worth individuals, non-high net worth individuals, or both, while 46.6 percent reported at least one client is a pension or profit-sharing plan (not including plan participants or state or local pension plans).

Most investment advisers focus their services on one category of client. More than 87 percent of advisers report that the majority of their clients are attributable to a single category of client. For example, almost 51 percent of advisers report that more than half of their clients are individuals. Another 29 percent of all advisers report that most of their clients are pooled vehicles (registered or unregistered). Many of these advisers serve pools exclusively: 2,093 report that 100 percent of their clients are private funds, while 301 advisers report that 100 percent of their clients are registered funds. Finally, more than seven percent of advisers specialize in non-pooled institutional clients.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

The number of private funds and registered private fund advisers is growing. In 2016, 4,448 advisers reported advising 32,445 private funds with total gross asset value of $10.5 trillion (up from 4,350, 30,342, and $10.4 trillion respectively in 2015). Hedge funds and private equity funds are equally represented (35.8 percent each) in this space.

The largest firms manage more than half the assets, but smaller firms are growing faster. The 121 firms with RAUM over $100 billion manage 53.7 percent of total industry RAUM, but for the first time in recent history there are fewer of them, with less RAUM. By contrast, the 8,565 firms (72.3 percent) with RAUM under $1 billion manage just 3.4 percent of total industry RAUM, but they grew year-over-year both in number and RAUM.

What's in a Name? A Note on Terminology

The terms "investment adviser," "financial advisor," and "adviser" are used imprecisely in the press and by market participants and are often employed when referring to a wide range of financial services professionals, including agents representing life insurance companies and registered representatives of a broker-dealer. This is unfortunate and adds to the general public's confusion regarding the different types of providers in the financial services industry. Throughout this report, the term "investment adviser" refers to an entity that is registered as such with the SEC, based on the definition set forth in the Investment Advisers Act of 1940.[1]

That said, the term "investment adviser" describes a broad range of companies and people in the business of giving advice about investing in securities. In addition to investment adviser, they may use other titles such as investment manager, wealth adviser, financial planner, investment counsel, asset manager, wealth manager, or portfolio manager. Investment advisers typically provide ongoing management of investments based on the client's objectives, often with the client giving the adviser authority to make investment decisions without having to get prior approval from the client for each transaction (called discretionary authority).

The terms "broker" and "broker-dealer" refer to companies in the business of buying and selling securities (called trading) on behalf of customers. Individual salespeople employed by brokerage firms are registered representatives of the brokerage firm. But these individuals also use many other titles, including financial consultant, financial professional, financial advisor, advisor, wealth manager, and investment consultant.

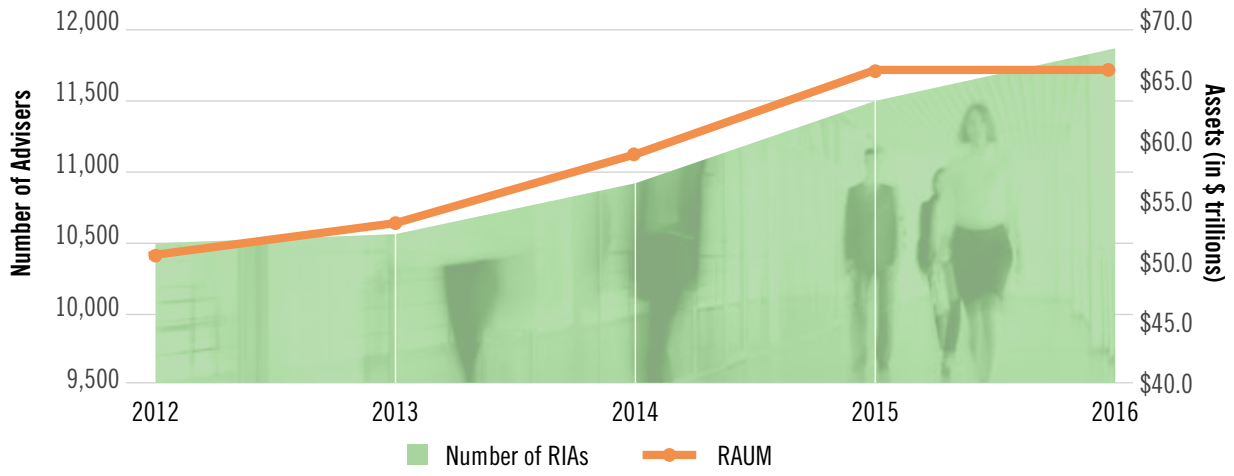
[1] Section 202 of the Investment Advisers Act defines an investment adviser as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities…" Section 202 also excludes certain entities under certain circumstances, including banks, bank holding companies, broker-dealers, and publishers of bona fide news publications.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Number of Investment Advisers

This report contains data on 11,847 SEC-registered investment advisers, which represents a net increase of 374 advisers or 3.3 percent since the 2015 report. This increase continues the trend from the previous year, when there was a 5.3 percent increase in advisers. The aggregate RAUM managed by SEC-registered advisers is $66.8 trillion, a slight 0.2 percent increase from $66.7 trillion in 2015.

Chart 1: Resilient Industry Continues to Grow Despite Flat Markets



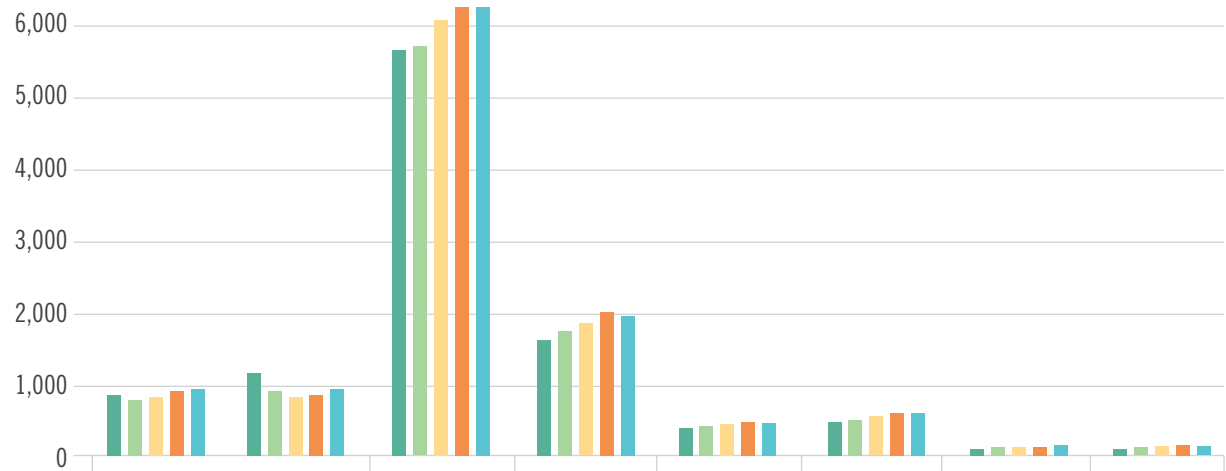
	2012	% Change	2013	% Change	2014	% Change	2015	% Change	2016	% Change
# of Advisers	10,511	(8.9)%	10,533	0.2%	10,895	3.4%	11,473	5.3%	11,847	3.3%
RAUM	49.4	12.8%	54.8	10.9%	61.7	12.6%	66.7	8.1%	66.8	0.2%

The growth in the number of advisers and RAUM demonstrates continued resilience of the industry, even when markets are flat, as they have generally been during the past year.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Chart 2: Number of SEC-Registered Investment Advisers by RAUM Category

2012–2016



	<$25m	$25-<100m	$100m-<1b	$1b-<5b	$5b-<10b	$10b-<50b	$50b-<100b	≥$100b
2012	852	1,245	5,680	1,656	414	485	89	90
2013	815	974	5,867	1,747	429	498	104	99
2014	838	863	6,085	1,868	452	574	103	112
2015	914	895	6,372	2,002	462	596	104	128
2016	987	994	6,585	1,998	450	596	116	121

Form ADV data provides a further breakdown of advisers in various RAUM categories. This data shows that more than half of all SEC-registered advisers have RAUM between $100 million and $1 billion, as has been the case for the past several years.

The RAUM categories from $0 to $100 million showed the biggest percentage increases during the period, adding 172 advisers since 2015.[2] The category comprising advisers with RAUM between $100 million and $1 billion saw the largest total increase by number of advisers, increasing by 213 or 3.3 percent.

The number of Internet advisers increased by 47 since last year's report, to 126, resulting in a 59.5 percent increase.

[2] Effective July 1, 2017, an adviser having less than $100 million in RAUM whose place of business is in Wyoming will be required to register with the State of Wyoming instead of the SEC. As of April 8, 2016, 36 advisers that have their principal office and place of business in Wyoming were registered with the SEC.

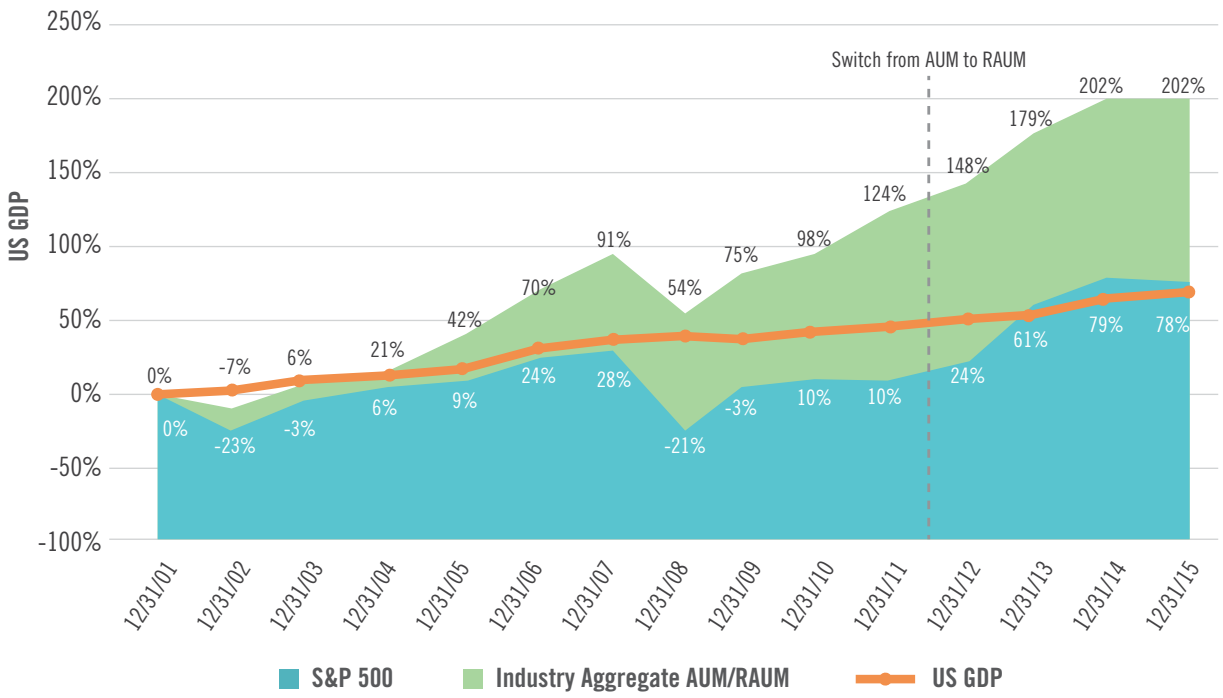
© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Regulatory Assets Under Management

Regulatory assets under management (RAUM) reported in 2016 increased from $66.7 trillion in 2015 to $66.8 trillion, a one-year growth of approximately $148 billion or 0.2 percent.

The historical growth of the industry's aggregate assets under management (AUM) or RAUM (depending on the prevailing regulations) has been quite impressive at least since our first report in 2001. The total industry aggregate AUM/RAUM has grown 202 percent since 2001—a compound annual growth rate (CAGR) of 8.2 percent. By way of comparison, during the same period, the S&P 500 Index and the US Gross Domestic Product produced cumulative growth of 78 percent (4.2 percent CAGR) and 69 percent (3.8 percent CAGR), respectively.

Chart 3: Total RAUM has Grown at a Faster Pace than the Overall Economy



Since the first edition of *Evolution Revolution*, we have reported that the vast majority of assets are managed on a discretionary rather than a non-discretionary basis. This year, 91.4 percent of the total reported RAUM are discretionary assets, a 0.1 percent increase over last year and consistent with the historical values that have stayed in a range from 87.9 percent to 92.1 percent.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

RAUM is the best metric available to measure the relative size of the investment adviser market on a year-to-year basis. RAUM is rigorously calculated by each adviser according to the same rules. As an absolute measure, however, RAUM has several flaws. First, as we've reported in past years, the aggregate RAUM reported across the industry overstates actual RAUM because more than one adviser can "claim" the same assets. For example, an adviser that allocates assets among mutual funds on a discretionary basis and the adviser to those funds will both correctly include those assets in their RAUM calculation. Similarly, a sub-adviser to a fund will count the assets it sub-advises as RAUM, as will the primary manager of the fund. In addition, we note that the RAUM figure includes assets in addition to those actually currently invested for clients. For example, RAUM includes uncalled capital commitments and proprietary assets.[3]

[3] Additionally, the timing of Form ADV filings can impact the accuracy of the aggregate RAUM. Form ADV requires advisers to calculate and report their RAUM within 90 days of the filing. Most advisers calculate their RAUM as of December 31, but some choose another day. Depending on the timing of the RAUM calculations made by each adviser, the aggregate RAUM may include some temporal variations in market value.

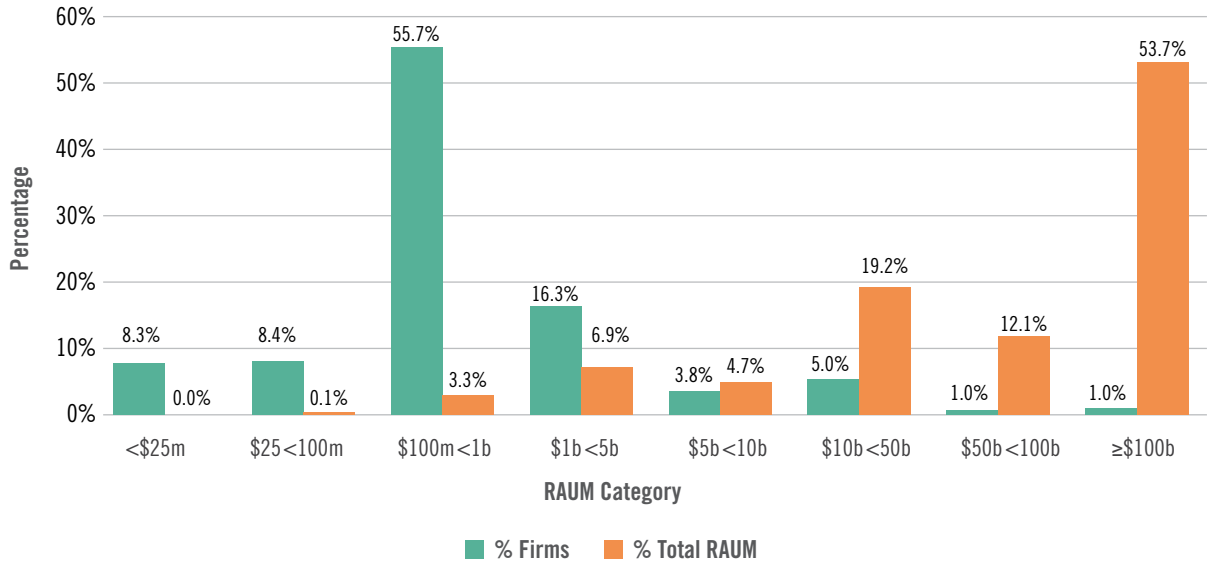
© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Industry Concentration

As reported in previous years, a relatively small number of very large advisers manage a high percentage of total RAUM. This year, 121 advisers reported managing $100 billion in RAUM or more—a net 5.5 percent decrease in the number of advisers from last year. Despite accounting for only 1 percent of SEC-registered advisers, these 121 firms collectively managed more than half (53.7 percent) of all reported RAUM.

On the other end of the spectrum, 72.3 percent of all advisers managed less than $1 billion RAUM, and they collectively managed only 3.4 percent of all reported RAUM.

Chart 4: The RAUM Barbell—The Largest Firms Manage More than Half the Assets

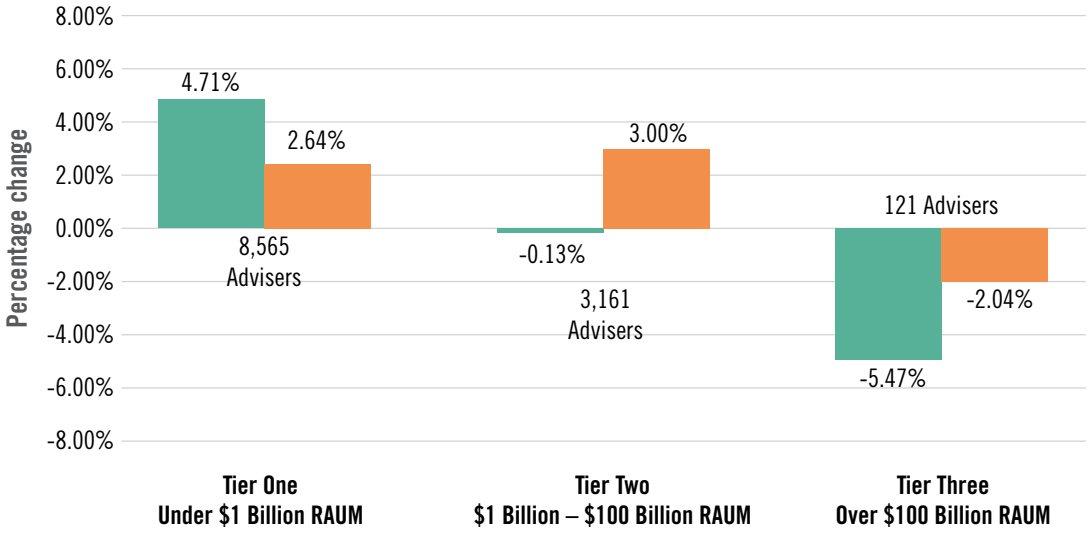


© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

While there is no significant change in the disproportionately large percentage of total RAUM that is managed by a comparatively small number of advisers, the data reveals additional trends of interest. The industry appears to show signs of emerging segmentation into three tier groups based on RAUM size. These groups show high correlation in terms of direction and rate of change in RAUM and the number of advisers in the group, as explained below.

Advisers with RAUM under $1 billion (Tier One) showed an increase in the number of advisers and RAUM—the only one of the three tier groups to demonstrate growth in both categories. Advisers with RAUM between $1 billion and $100 billion (Tier Two) experienced a decrease in the number of advisers but an increase in RAUM. Advisers with RAUM over $100 billion (Tier Three) showed a decrease in the number of advisers and a decrease in RAUM—the first decrease in the number of advisers and in RAUM in five years for advisers in this tier.

Chart 5: Growth Rates by Tier Groups—Smaller Advisers are Growing Faster



	Tier One Under $1 Billion RAUM	Tier Two $1 Billion – $100 Billion RAUM	Tier Three Over $100 Billion RAUM
Number of Firms	4.71%	-0.13%	-5.47%
Total RAUM	2.64%	3.00%	-2.04%

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

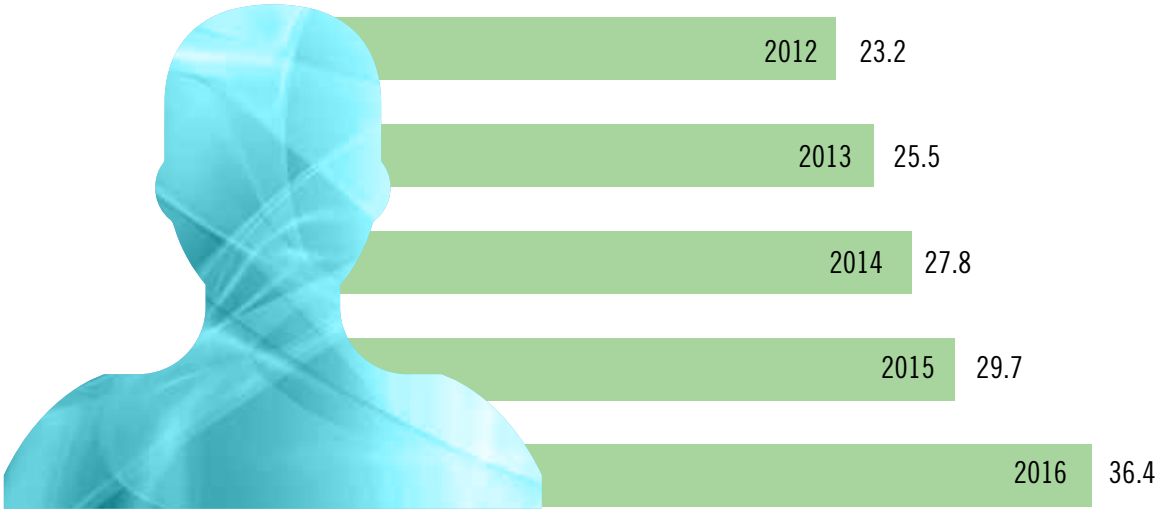
Clients of Investment Advisers

Form ADV requires advisers to report their approximate number of clients and the types of those clients by number and RAUM. This data provides several insights into the industry.

Advisers by Number of Clients

SEC-registered advisers in 2016 reported a total of more than 36.4 million clients, up very significantly from the 29.7 million clients reported in 2015.[4] This represents a 22.4 percent increase over last year, and continues a very strong trend in the past several years that underscores the continuing health and growth of the advisory profession. In fact, SEC-registered advisers have reported an increase of almost 11 million clients in the past three years alone.

Chart 6: Record Number of Clients
(in millions)



[4] The Form ADV data shows that advisers had 36,401,005 clients, up from 29,738,992 clients in 2015. This data has limitations. For example, for purposes of this section, we only use Form ADV responses that provided a specific number of clients. Advisers are required to provide a specific number only if they have more than 100 clients, and advisers are permitted to round to the nearest 100. In addition, the number of reported clients for certain advisers may include individuals eligible to receive investment advisory services on the basis of retirement plan participation.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

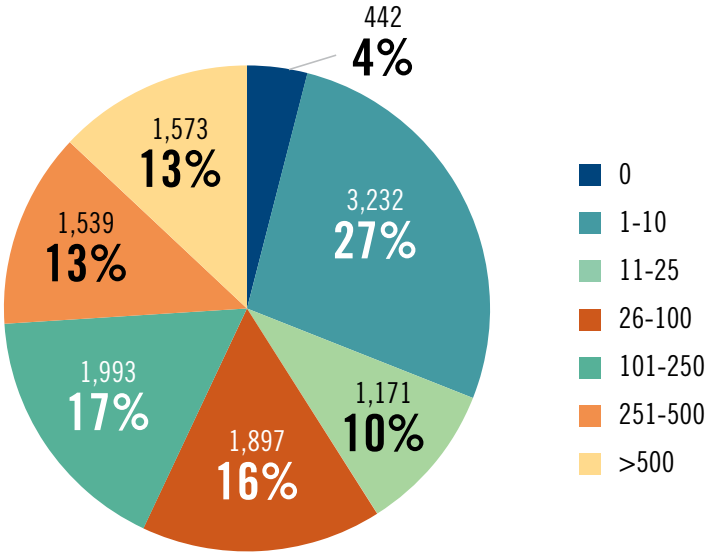
A substantial part of this increase can be attributed to two trends, both related to the rise of automated investment advice models—the provision of automated advice to retirement plan participants and the growth among advisers using websites and/or mobile device apps to reach a greater number of clients with lower investment balances.

- ***Retirement plan participants.*** Three advisers, each of which specialize in providing services and advice to retirement plan participants, account for over 39 percent of all reported clients—nearly 14.2 million among them. These three advisers reported more than 4.1 million additional clients in 2016, which we understand is a combination of new clients and changes to methodology. This accounts for nearly 62 percent of the overall growth in adviser clients in 2016.

- ***Web- and app-based advisers.*** The gaining popularity of advisers that attract clients with web-based and app-based savings and investment models also contributed to growth in the number of clients. In fact, in addition to the three advisers noted above, six more of the top 100 advisers by number of clients fit this description. These six other advisers alone collectively reported nearly 1.2 million additional clients in 2016, which represented over 17.5 percent of the overall growth in adviser clients. And, more generally, the number of advisers reporting that they provide advice exclusively through an interactive website rose by nearly 60 percent to 126.

Despite the top-line growth in the number of clients, it is still true that most advisers have 100 or fewer clients. As in past years, the median number of clients reported by registered advisers in 2016 is between 26 and 100.

Chart 7: Advisers by Number of Clients—Most Advisers Have 100 or Fewer Clients



The substantial number of advisers with fewer than 10 clients can be explained, at least in part, by the fact that pooled investment vehicles like mutual funds and private funds count as a single client for reporting purposes. 3,232 advisers, representing 27.3 percent of all advisers, reported having between 1 and 10 clients. Of these, 2,301 (71.1 percent) also report that more than 75 percent of their RAUM comes from registered investment companies, business development companies, or private funds.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Advisers by Category and Type of Client

Form ADV requires advisers to report client types by indicating the approximate percentage that each type of client comprises of an adviser's total number of clients. For example, an adviser might indicate that 11 to 25 percent of its clients are high net worth individuals, 26 to 50 percent are charitable organizations, and 26 to 50 percent are pension and profit sharing plans. Form ADV includes 12 identified client types and a catch-all "other" category, and asks for separate responses based on the number of clients and based on the adviser's RAUM.

The 12 specific client types fall into three distinct categories: individuals, pools, and institutions.

Individuals

- High net worth individuals
- Other individuals

Pools

- Investment companies
- Business development companies
- Pooled investment vehicles other than investment companies (private funds)

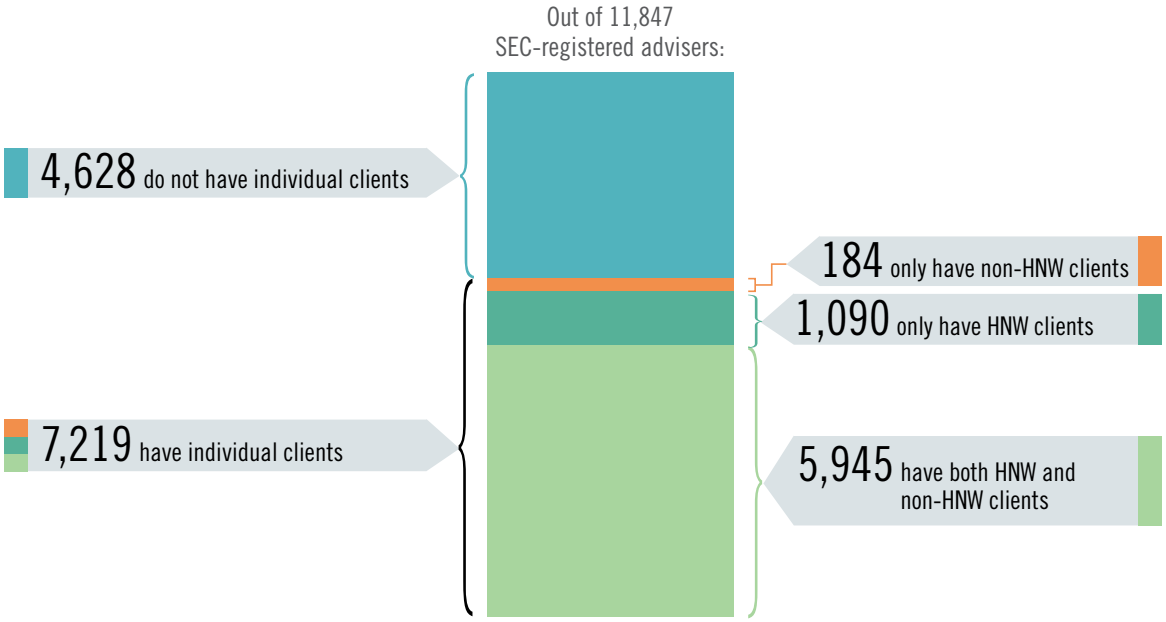
Institutions

- Banking or thrift institutions
- Pension and profit sharing plans
- Charitable organizations
- Corporations or other businesses
- State or municipal government entities
- Other investment advisers
- Insurance companies

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Individuals remain important to a great many investment advisers and continue to comprise the largest type of advisory clients. 7,219 advisers (60.9 percent) report that they have high net worth clients, non-high net worth clients, or both. Consistent with prior years, the 2016 data indicate that 7,035 (59.4 percent) of SEC-registered advisers have at least some high net worth clients and that 6,129 (51.7 percent) have at least some non-high net worth clients.[5] These two types of client categories listed on Form ADV are the only ones that exceed the 50 percent mark for all advisers. This dominance of individual clients continues despite the Dodd-Frank Act changes that shifted a significant number of smaller advisers to state registration and required SEC registration of certain private fund advisers.

Chart 8: Most Advisers Serve Individuals



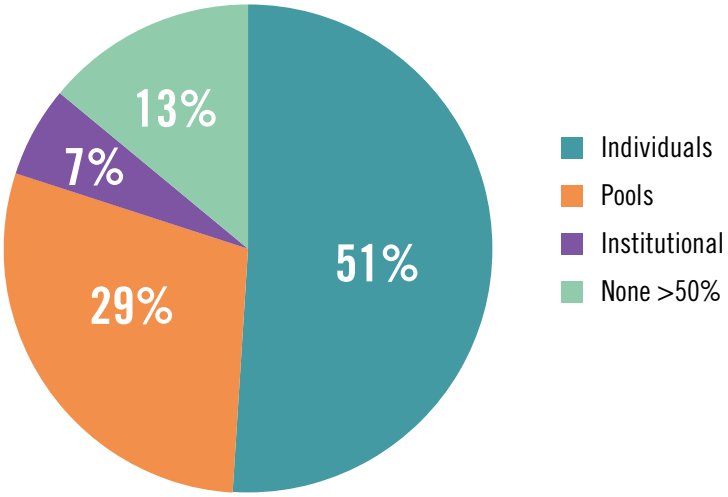
Many advisers have pension clients as well. In 2016, nearly half of all investment advisers (46.6 percent) reported that at least one client is a pension or profit sharing plan. This data relates to advisers to the plans only; it does not include advisers to plan beneficiaries or participants in 401(k) plans or individual retirement accounts.

[5] For purposes of this reporting item, high net worth clients have at least $1 million managed by the adviser or have a total net worth (including assets held jointly with his or her spouse) exceeding $2 million (excluding the value of a person's primary residence for purposes of the net worth test).

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Another way to look at this data is by focusing on advisers that report that the majority of their clients are attributable to a single category of client. More than 87 percent of advisers fit this description, gathering the majority of their clients from a single category.

Chart 9: Almost Nine out of 10 Advisers Have the Majority of their Clients from a Single Category



The following pages take a closer look at these statistics, focusing on individuals, pools, and institutions.

A Note on Methodology

This part of *Evolution Revolution* focuses on advisers that report that more than half of their clients are individuals, pools, or institutions. The statistics in this section are a combination of direct and other responses to Form ADV because advisers report ranges of client types: whether none, up to 10 percent, 11 to 25 percent, 26 to 50 percent, 51 to 75 percent, 76 to 99 percent, or 100 percent of the adviser's clients are attributable to any particular client type.

Some of the data is clearly evident from the reported ranges. For example, an adviser might report that 100 percent of its clients are high net worth individuals. Other data is more difficult to discern, such as where an adviser reports a combination of ranges. In order to categorize advisers for purposes of this section, we assumed that each adviser had the lowest possible percentage of clients in each of its reported ranges. For example, an adviser that indicated that 26 to 50 percent of its clients were high net worth individuals was assigned 26 percent to that client type. Advisers were included in the statistics in this section only where it was clear from this process that they had a majority of clients from a particular category.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

A Closer Look at Advisers to Individual Clients

A total of 5,982 advisers report more than half of their clients are individuals. This represents almost 51 percent of all advisers.

The vast majority of these advisers primarily serve a combination of high net worth (HNW) and non-HNW individuals. Only 659 advisers primarily serve HNW individuals or other individuals, but not both.

Chart 10: Advisers with a Majority of Individual Clients

	HNW	Non-HNW	Combination
>50%	159	13	1,815
>75%	255	43	2,905
100%	118	71	603
Total	532	127	5,323

Note that relatively few of these advisers, however, exclusively serve individual clients. Only 118 advisers reported that 100 percent of their clients were HNW individuals, and only 71 reported that 100 percent were non-HNW individuals. 603 advisers exclusively serve a combination of HNW and non-HNW individual clients.

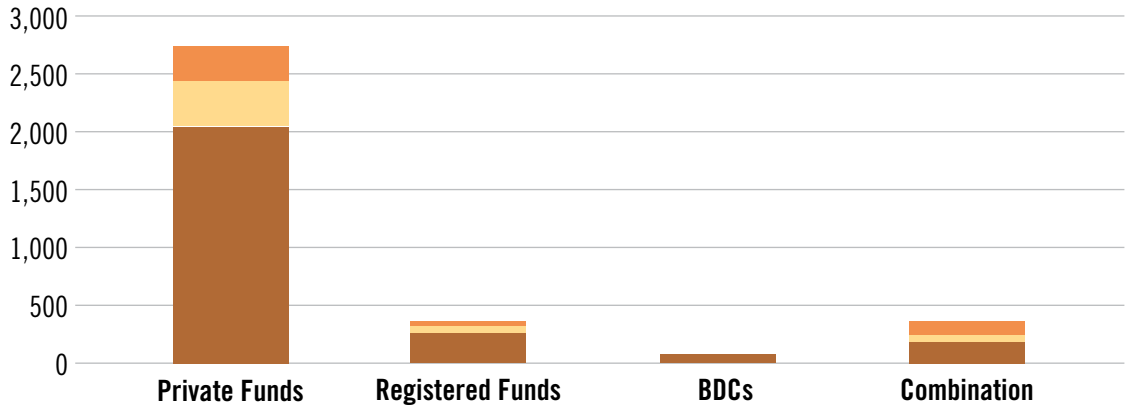
© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

A Closer Look at Advisers to Pools

A total of 3,486 advisers report more than half of their clients are some type of pool, which represents over 29.4 percent of all advisers.

2,706 of these primarily serve private funds, 363 primarily serve registered funds, and 34 primarily serve business development companies. An additional 383 advisers reported that some combination of pools accounted for more than 50 percent of their clients.

Chart 11: Advisers with a Majority of Pool Clients



	Private Funds	Registered Funds	BDCs	Combination
>50%	243	22	–	135
>75%	370	40	–	83
100%	2,093	301	34	165
Total	2,706	363	34	383

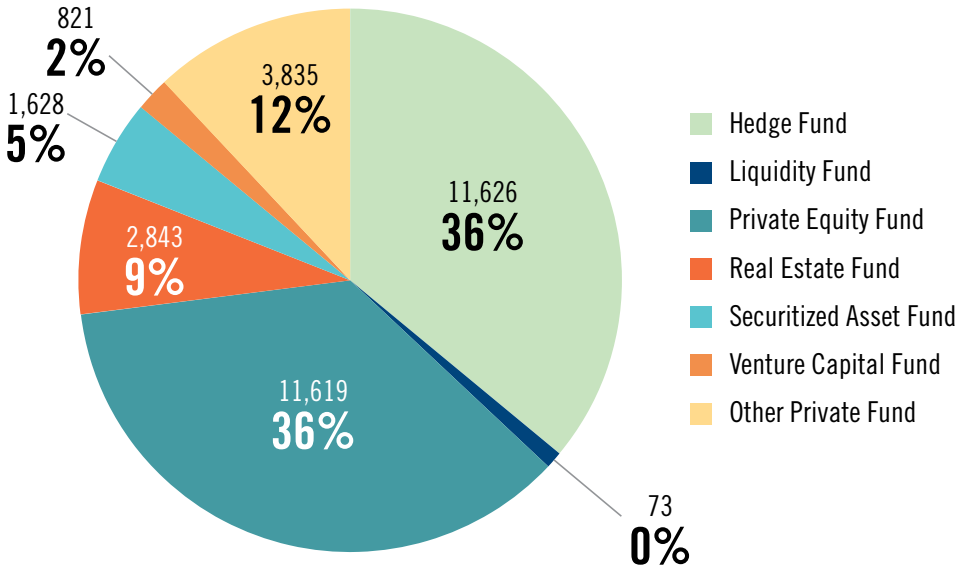
In contrast to the advisers that have a majority of individual clients, many of these advisers exclusively serve pools. In fact, 301 advisers report that 100 percent of their clients are registered funds, 34 report that 100 percent of their clients are business development companies, and 2,093 report that 100 percent of their clients are private funds. 165 more advisers exclusively serve some combination of pools.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Form ADV provides additional detailed data on advisers to private funds. In 2016, 4,448 advisers (37.5 percent) reported advising 32,445 private funds, 25.8 percent of which are funds of funds. The raw numbers of private funds increased slightly from 2015, but as a percentage of the now-larger industry, the percentage declined slightly (in 2015 there were 4,350 advisers or 38 percent, advising 30,342 private funds, 26.1 percent of which were funds of funds).[6]

Hedge funds and private equity funds continue to represent the largest portions of the private funds group, comprising 71.6 percent of all reported private funds, with hedge funds and private equity funds each comprising 35.8 percent. The total gross asset value of reported private funds is approximately $10.5 trillion (a 1.9 percent increase above $10.4 trillion in 2015), more than 15.8 percent of all reported RAUM with an average gross asset value of $325 million. The median gross asset value, on the other hand, is $51.5 million. The difference between the median and average is attributable to a relatively small number of very large private funds. The number of beneficial owners of private funds also continues to vary 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 14, while the average number is 53.

Chart 12: Hedge Funds and Private Equity Funds Remain Most Popular Types of Private Funds



[6] Section 7.B(1) of Schedule D of Form ADV, Part 1 asks private fund advisers questions relating to each fund's type, gross asset value, number of owners, service providers, and a number of other areas. 4,448 advisers reported being "an adviser to any private fund" and 4,229 advisers reported advising at least one private fund. 678 advisers reported advising at least one private fund that is reported by another adviser.

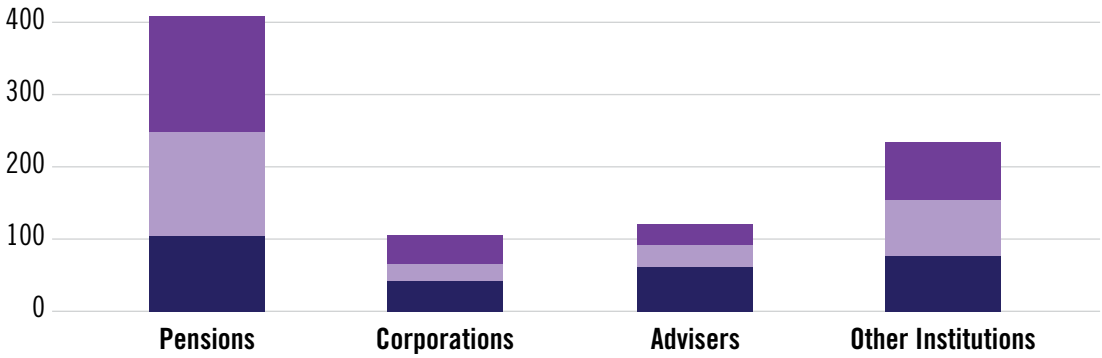
© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

A Closer Look at Advisers to Institutional Clients

A total of 863 advisers report more than half of their clients are institutions. This represents over seven percent of all advisers.

As noted above, nearly half of all advisers serve at least one pension client. The importance of pension clients is evident here as well, as 413 advisers primarily serve pension clients—far more than any other single type of institutional client. 114 advisers primarily serve other investment advisers, and 106 primarily serve corporations. Other institutional clients include banks, insurance companies, charities, and governmental entities.

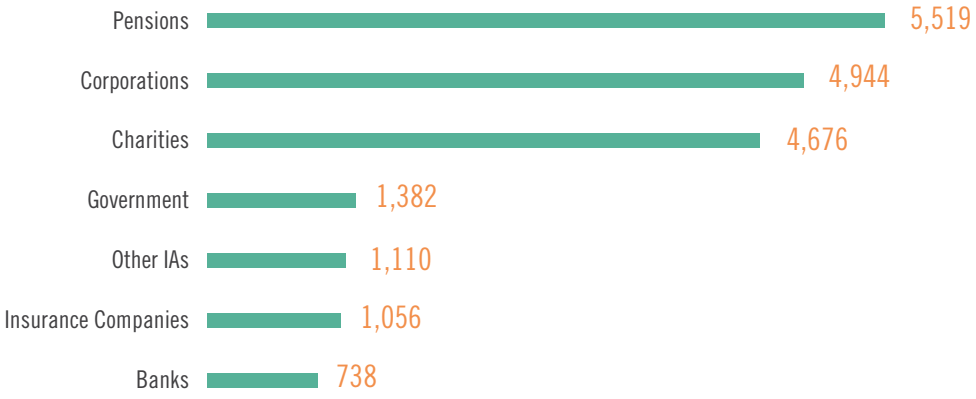
Chart 13: Advisers with a Majority of Institutional Clients



	Pensions	Corporations	Advisers	Other Institutions
>50%	163	43	24	84
>75%	143	26	29	73
100%	107	37	61	73
Total	413	106	114	230

An adviser often may have relatively fewer institutional clients with relatively larger investment mandates. Focusing on the number of advisers that report *more than half* of their clients are from a single client category is instructive—but the overall importance of institutional clients becomes clearer by looking at the number of advisers that report at *least one* institutional client of a particular type.

Chart 14: Advisers with at Least One Institutional Client



© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Investment Adviser Compensation

Although advisers may be compensated in a number of ways, asset-based fees continue to dominate in the investment advisory profession. Consistent with our prior reports, 95 percent of advisers indicate that they are compensated based on a percentage of their assets under management. The other types of compensation arrangements largely mirror the percentages seen in recent years.

Chart 15: Asset-Based Fees Continue to Dominate Adviser Compensation Arrangements

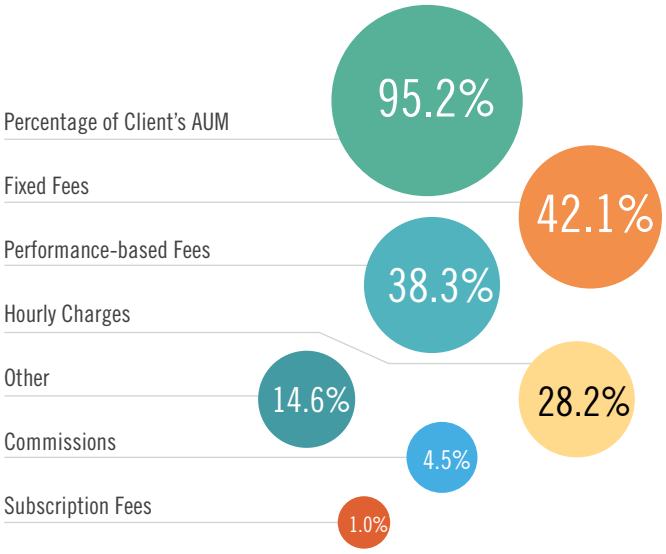


Chart 16: Investment Adviser Compensation (Past Three Years)

Category of IA Compensation	2014		2015		2016	
	# of Advisers	% of Advisers	# of Advisers	% of Advisers	# of Advisers	% of Advisers
Percentage of Client's AUM	10,332	94.8%	10,902	95.0%	11,274	95.2%
Hourly Charges	3,057	28.1%	3,224	28.1%	3,345	28.2%
Subscription Fees	119	1.1%	116	1.0%	122	1.0%
Fixed Fees	4,521	41.5%	4,765	41.5%	4,992	42.1%
Commissions	546	5.0%	531	4.6%	530	4.5%
Performance-based Fees	4,200	38.5%	4,415	38.5%	4,540	38.3%
Other	1,559	14.3%	1,667	14.5%	1,731	14.6%

In addition, 4,540 advisers charge performance-based fees. This is not surprising, given that there are 4,448 private fund advisers. Performance-based fees are nearly universal in the private fund context.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Custody of Client Assets

Form ADV includes a number of questions about the custody of client assets. These questions—and the investment adviser custody rule[7]—appear to continue to be a source of widespread confusion and inconsistent interpretations in the asset management industry. Indeed, a 2013 *Risk Alert* published by the SEC's Office of Compliance Inspections and Examinations (OCIE) emphasized that non-compliance with the custody rule, as amended in 2009, was one of the most common issues found in routine investment adviser examinations and that, in fact, many advisers failed to realize they even had custody as defined in the rule. These issues persist today.

The confusion stems from the fact that while advisers in general are prohibited from having physical custody of client assets, advisers are also deemed to have custody under certain other circumstances. Many of the questions in Form ADV relate to advisers that are deemed to have custody, although to complicate matters further, advisers that are deemed to have custody for certain types of reasons (such as the ability to deduct fees) are not required to answer certain custody questions[8] on Form ADV and are therefore not reflected in the data we discuss below, unless otherwise indicated. Moreover, the questions in Item 9 of Form ADV, Part 1 are confusing in their use of the terms "you" and "your related persons," leading us to conclude that some advisers are double counting, and other questions embed double negatives. There also continues to be confusion about the difference between having "custody" and being a "custodian," resulting in frequent misinterpretations.

Given this backdrop, Chart 17 shows that the number of advisers reporting that they or a related person had or were deemed to have custody increased by 202 (4.1 percent) to 5,156 in 2016 compared to 4,954 in 2015.

[7] Rule 206(4)-2 under the Advisers Act requires an adviser with custody of client assets (with some exceptions) to: (1) maintain the assets with a "qualified custodian" (generally a bank or broker-dealer); (2) if the adviser opens the custodial account on behalf of the client, provide certain information to the client; (3) have a reasonable belief, after due inquiry, that the qualified custodian sends account statements directly to clients; and (4) undergo an annual surprise exam by an independent public accountant to verify client assets.

[8] According to a March 5, 2014 Form ADV, Item 9 Completion Reminder, advisers that have custody solely because they deduct fees from client accounts would respond "no" in Item 9.A, would likely respond "no" in Items 9.B., and 9.D., and likely would not need to provide information in Items 9.C. or 9.E. However, in Item 9.F., these advisers likely would need to indicate that there is at least one person acting as qualified custodian for their clients in connection with advisory services they provide to clients.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Chart 17: Custody of Client Assets Remains Consistent

Category	2014		2015		2016	
	# of Advisers	% of Advisers	# of Advisers	% of Advisers	# of Advisers	% of Advisers
Adviser has custody of client cash/bank accounts	3,396	31.2%	3,666	32.0%	3,796	32.0%
Adviser has custody of client securities	3,337	30.6%	3,610	31.5%	3,746	31.6%
Related person(s) has custody of client cash/bank accounts	3,171	29.1%	3,321	28.9%	3,526	29.8%
Related person(s) has custody of client securities	3,118	28.6%	3,290	28.7%	3,477	29.3%
Adviser and/or related person(s) has custody of advisory client assets (answered yes to any of the above)	4,703	43.2%	4,954	43.2%	5,156	43.5%

About a third of investment advisers (3,936 or 33.2 percent) reported having custody of client cash, bank accounts, and/or securities.[9] However, only 74 advisers—about 0.6 percent of all advisers—reported acting as a "qualified custodian" in connection with their advisory services, meaning that they had actual physical custody of client assets. In fact, given the prohibition on having physical custody, each of these advisers is also either a broker-dealer or bank and acts as a custodian in one of those other capacities. The longer-term data shows that this already uncommon practice is becoming increasingly rare. The universe of 74 firms reflects a five percent decrease in 2016 and a 38 percent decrease since 2011, when 120 firms reported acting in such a capacity.[10]

Similarly, the number of advisers reporting that a related person acts as a qualified custodian also continued to trend downward (by 4.5 percent), to 384 advisers in 2016. Of these, 181 firms reported being able to demonstrate that the related person is operationally independent. These firms are not required to obtain a surprise examination for client funds or securities maintained at the related qualified custodian.

It is worth noting that private fund advisers report a high incidence of custody of client assets because a firm that acts as both adviser and general partner (or has a related person that serves as general partner) to a limited partnership is deemed to have custody. In fact, of advisers that identified themselves as advisers to private funds, 86.9 percent also reported that they or a related person have custody of client assets.

[9] As shown in the first two rows of Chart 17, advisers separately report whether they have custody of (1) client cash or bank accounts and (2) client securities. There is substantial overlap in this data, as nearly all advisers that report having custody of client cash or bank accounts also report having custody of securities.

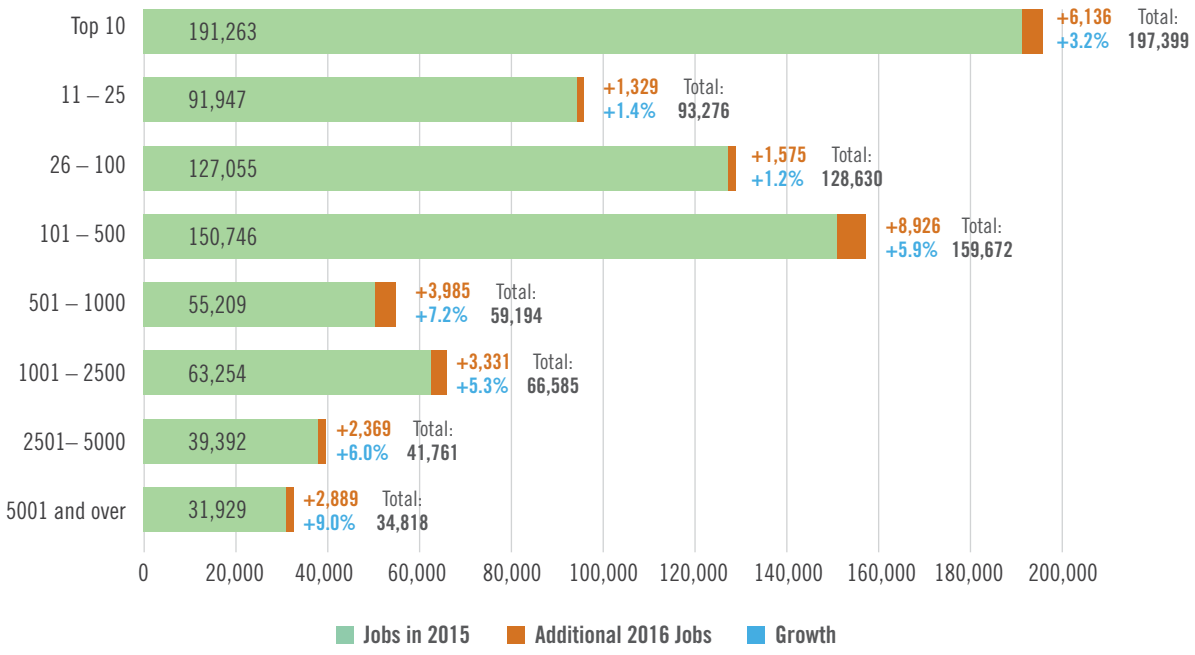
[10] The SEC's 2009 amendments to the custody rule required advisers to provide responses to additional questions on custody in their first annual updating amendment to Form ADV after January 1, 2011.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Employees of Investment Advisory Firms

In 2016, SEC-registered advisers added 30,540 additional jobs for a reported total of 781,335 non-clerical employees, a 4.1 percent increase in employment from 2015. Of these employees, 386,532 provide investment advisory services (including research)—a healthy increase of 10,023 over 2015. The increase in jobs appears to have positively impacted the asset management industry across the board, rather than being concentrated in firms of a specific size.[11]

Chart 18: Every Adviser Cohort Experienced Job Growth



[11] The data has some limitations, particularly in the smallest cohort, which includes 105 advisers that reported zero employees. In addition, some job growth may be attributable to firms that were previously state-registered.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Chart 19: Investment Adviser Non-Clerical Employees

Number of Employees	# of Advisers		
	2014	2015	2016
1 to 5	3,680	3,855	3,965
6 to 10	2,536	2,721	2,760
11 to 50	3,365	3,513	3,679
51 to 250	986	1,033	1,070
251 to 500	146	162	170
501 to 1,000	85	93	104
More than 1,000	97	96	99

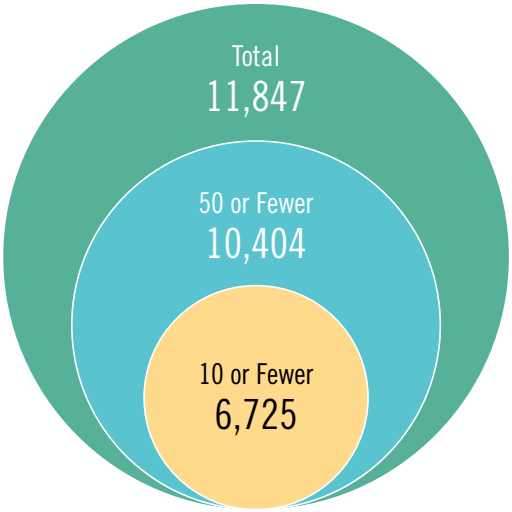
Chart 20: Record Number of Non-Clerical Jobs Industry-wide

	# of Employees		
	2014	2015	2016
Total	719,638	750,795	781,335
Average	66	65	66
Median	9	8	9

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

The data confirm that the vast majority of SEC-registered investment advisers are small businesses. In fact, 56.8 percent (6,725) reported that they employ 10 or fewer non-clerical employees, and 87.8 percent (10,404) reported that they employ 50 or fewer non-clerical employees. These segments increased by 149 and 315 advisers, respectively, but due to growth across all segments, both of these percentages are very similar to those reported in 2015 (57.3 percent and 87.9 percent). The number of advisers reporting that they have no non-clerical employees stayed essentially flat, going from 103 to 105.

Chart 21: The Vast Majority of Advisers are Small Businesses with 50 or Fewer Non-Clerical Employees



SEC-registered investment advisers collectively reported employing 386,532 individuals who perform investment advisory functions and 380,853 employees who are also registered representatives of a broker-dealer. The number of employees in these categories increased by 2.7 percent and 5.8 percent, respectively, and in addition, the percentage of advisers that reported no registered representative (8,346) increased by 0.3 percent from 70.1 percent to 70.4 percent in 2016.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Chart 22: Activities by Investment Adviser Employees

Number of Employees	# of advisers with employees who:				
	Perform investment advisory functions	Are registered representatives of a broker-dealer	Are registered with more than 1 state as investment adviser representatives	Are registered with more than 1 state as investment adviser representatives for another adviser	Are licensed agents of an insurance company
0	217	8,346	5,622	10,667	9,103
1 to 5	5,975	1,795	4,048	889	1,891
6 to 10	2,440	559	1,014	132	295
11 to 50	2,483	741	842	111	315
51 to 250	566	242	206	39	136
251 to 500	78	54	41	3	32
501 to 1,000	38	46	26	2	30
More than 1,000	50	64	48	4	45
Total	386,532	380,853	273,378	20,999	245,422
Average	33	32	23	2	21
Median	5	0	1	0	0

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Other Characteristics of Investment Advisory Firms

Other Business Activities

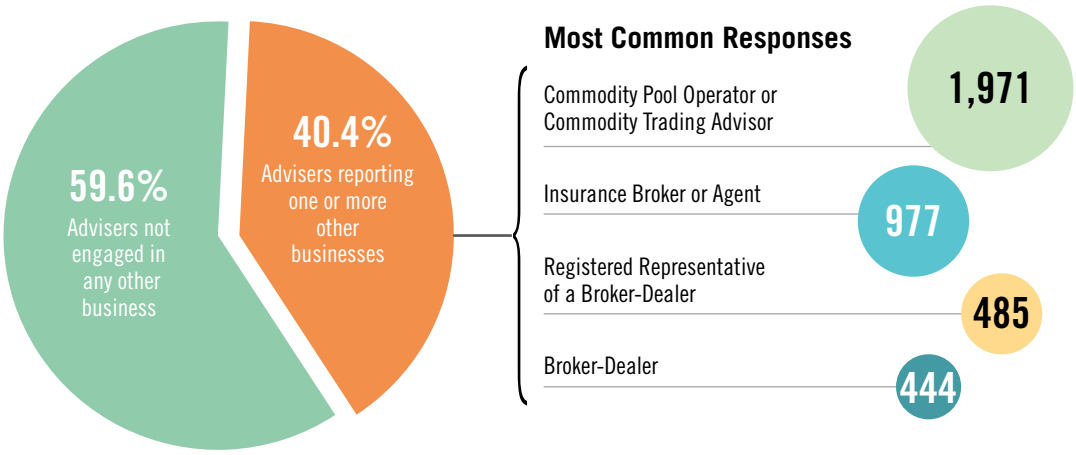
As in years past, most advisers are primarily focused on providing investment advice to clients. In 2016, 7,065 advisers (59.6 percent) reported that they are not actively engaged in any other business other than rendering investment advice about securities, a proportion that is relatively unchanged compared to 2015.

Of those advisers that are actively engaged in another business activity, the most common is to be engaged in business as a commodity pool operator (CPO) or commodity trading advisor (CTA). Over the last five years, this category has grown by 96.3 percent, from 1,004 in 2012 to 1,971 this year, which is more than double the number in the next closest category.[12] In 2016, 16.6 percent (1,971) of advisers reported being engaged in business as a CPO or CTA, an increase of 124.

The number of dual registrants (entities that are both SEC-registered investment advisers and SEC-registered broker-dealers) fell by 12 to 444, while the number of advisers actively engaged in business as a registered representative of a broker-dealer grew by 13 to 485, which is consistent with previous years and longer-term trends.[13] For more on dual registrants, see "Financial Industry Affiliations" below.

The number of advisers that are also an insurance broker or agent increased modestly (up four percent from 937 to 977) but remains the second most common other business activity. And certain business activities are distinctly more popular than others. In fact, four of the 14 categories—CPO/CTA, broker-dealer, registered representative of a broker-dealer, and insurance broker or agent—collectively represent more than 85 percent of all reported Other Business Activities of investment advisers in 2016.

Chart 23: Most Advisers Focus on Providing Investment Advice About Securities



[12] This trend is likely the result of (1) the Dodd-Frank Act's inclusion of "swaps" in the definition of commodity pool; and (2) the 2011 clarification in Form ADV that this question applies to both registered and exempt CPOs/CTAs.

[13] The number of investment advisers that are registered representatives may be lower than what is reported. A registered representative of a broker-dealer is referred to in FINRA rules as a "person associated with a broker or dealer" or "associated person of a broker or dealer," which is defined to include certain natural persons. As a result, Item 6.A(2) is only available to advisers that are sole proprietors. It is likely that many advisers organized as corporations or other business entities mistakenly check this item.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Financial Industry Affiliations

Form ADV requires investment advisers to disclose information relating to their affiliations, and activities with other persons within the financial industry. In 2016, 2,667 advisers (22.5 percent) reported only one industry affiliation, 1,998 (16.9 percent) reported two affiliations, 1,206 (10.2 percent) reported three affiliations, and 1,703 (14.4 percent) reported between 4 and fourteen affiliations. All of these statistics are similar to what was reported last year.

Chart 24: Financial Industry Affiliations

Related person is:	Number of Advisers	Percentage of Advisers
Other investment adviser (including financial planners)	4,445	37.5%
Sponsor, general partner, managing member (or equivalent) of pooled investment vehicles	4,394	37.1%
Broker-dealer, municipal securities dealer, or government securities broker or dealer	2,438	20.6%
Commodity pool operator/trading advisor (whether registered or exempt)	2,186	18.5%
Insurance company or agency	1,934	16.3%
Banking or thrift institution	821	6.9%
Accountant or accounting firm	814	6.9%
Trust company	813	6.9%
Sponsor of syndicator or limited partnerships (or equivalent), excluding pooled investment vehicles	659	5.6%
Pension Consultant	658	5.6%
Real estate broker or dealer	553	4.7%
Lawyer or Law firm	455	3.8%
Registered municipal advisor	357	3.0%
Futures commission merchant	229	1.9%
Registered security-based swap dealer	72	0.6%
Major security-based swap participant	9	0.1%

In 2016 4,273 advisers (36.1 percent) reported no financial industry affiliations. The most common affiliation among investment advisers is with other investment advisers, with 4,445 (37.5 percent) reporting such an affiliation, and gaining three percent (138) since 2015. However, in a close second, reporting 4,394 affiliations, 37.1 percent of investment advisers claimed an affiliation with sponsors, general partners, or managing members (or equivalent) of pooled investment vehicles—a change of six percent (241) up from 4,153 in 2015. 939 (7.9 percent) advisers reported an affiliation with a sponsor, general partner, or managing member (or equivalent) of a pooled investment vehicle as their only affiliation.

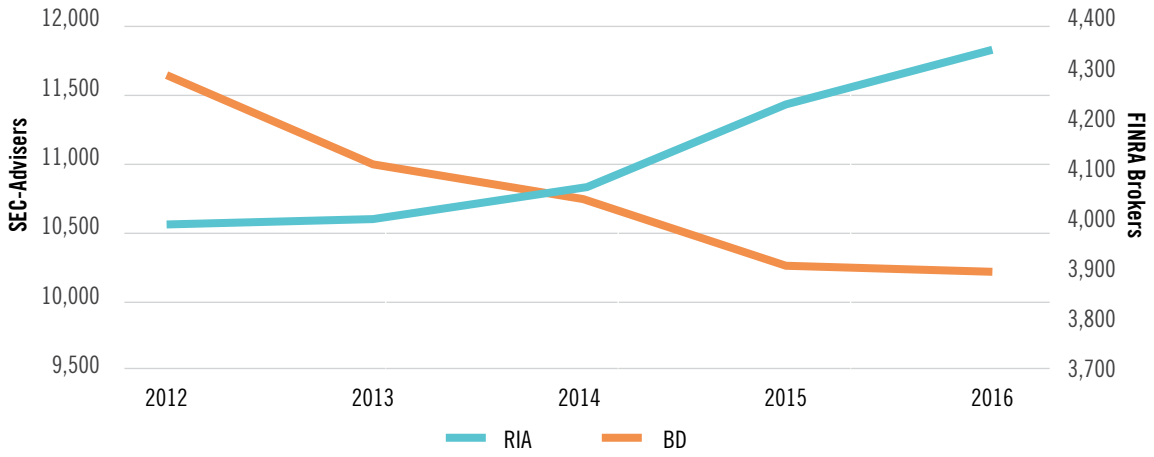
© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Included in the numbers cited under "Other Business Activities" and "Financial Industry Affiliations" are broker-dealer relationships, where investment advisers are either dually registered as broker-dealers or are affiliated (through common ownership and/or control) with broker-dealers.

A small percentage of advisers, only 444 in total (3.7 percent) are dually registered (those entities registered both as SEC-registered investment advisers and SEC/FINRA broker-dealers). This year, the number of dual registrants dropped three percent, continuing the downward trend from past years.

Those advisers affiliated with broker-dealers increased again slightly this year to 2,438, continuing the trend from the previous year (2,323 in 2014 and 2,381 in 2015). At the same time, we continue to see the number of FINRA member broker-dealers on a steady decline. Over the last five years membership in the SRO has fallen 8.1 percent from 4,289 to 3,941, though the decline in the number and rate of year over year change has slowed significantly in recent years. This is a stark contrast to the growth in the number of SEC-registered investment advisers, which has increased by 12.7 percent over the same 5-year period.

Chart 25: Number of Advisers Rises While Number of Broker-Dealers Falls



	2012	2013	2014	2015	2016
RIA	10,511	10,533	10,895	11,473	11,847
BD	4,289	4,146	4,068	3,947	3,941

Interestingly, as of March 2016, the number of securities registered representatives appears to have reversed its five-year growth trend, dropping slightly from 643,322 in 2015 to 641,157.[14] More than half of these securities registered representatives are employed by SEC-registered dual registrants (as noted above, SEC-registered advisers reported employing 380,853 registered representatives in 2016).

[14] Source: https://www.finra.org/newsroom/statistics.

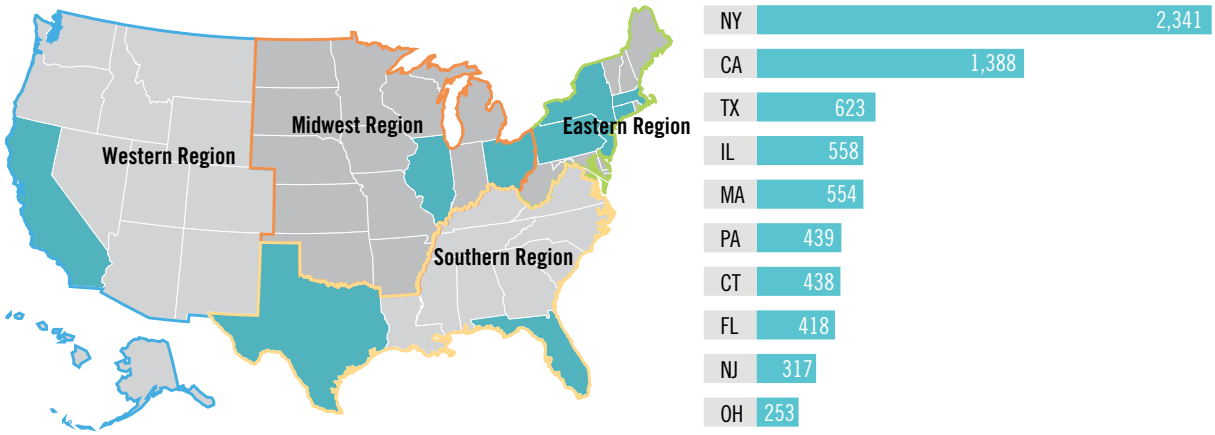
© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Location of Investment Advisers

Investment advisers continue to find states such as New York, California, Texas, Illinois, and Massachusetts to be desirable locations for their main offices, ostensibly resulting from proximity to financial markets, growing financial hubs, and large population centers. Bordering states such as New Jersey, Connecticut, and Pennsylvania have also found favor with investment advisers, likely because of the combination of proximity to New York financial markets, affluent suburbs, and local specialization.

The top ten states for SEC-registered advisers remain unchanged from 2015, although Illinois and Massachusetts traded places at fourth and fifth, respectively.

Chart 26: Top Ten States for Advisers



Regionally, the Eastern region of the United States reported the largest increase at an average of 4.2 percent per state; the South was a close second at an average increase of 3.7 percent per state. The West was third with an increase of 3.5 percent per state, and the Midwest, while still reporting an average increase, followed the other regions with an average increase of 2.6 percent per state. These regional trends appear to support the tendency of advisers to locate near financial markets, major population centers and, increasingly, locations popular for leisure and retirement lifestyles.

Emerging trends in recent years reveal that investment advisers located outside of the United States are increasingly seeking SEC registration. The number of such foreign advisers increased 8.5 percent since 2015 and over 29.7 percent since 2012. As advances in technology have rendered location less significant in terms of client service and expectations and as the trend toward globalization inexorably continues forward, one might conclude that location is likely to be an area of increasing interest in the future.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Disciplinary Information

It is difficult to draw meaningful conclusions from the disciplinary disclosure information provided in Form ADV, Part 1. For example, Form ADV, Part 1, Item 11 contains many "true or false" questions relating to a fairly broad set of questions relating to disclosable disciplinary events by the adviser, its employees, officers, directors and advisory affiliates. Determining the details contained in the disciplinary disclosure reporting pages for Form ADV, Part 1, Item 11 requires delving deep into the specifics of each disclosure event to have a clear understanding of what was involved. Also, the information required to be disclosed 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. However, firms can specify whether any of the events reported involve the firm or its supervised persons. 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.

Subject to these limitations, we make the following observations:

- 10,273 of registered investment advisers (86.7 percent) reported no disciplinary history at all, which is comparable to last year, when 9,936 advisers (86.6 percent) reported no disciplinary history.
- Less than one percent of advisers reported that it or an advisory affiliate had been charged with a felony. Of the 103 firms that did so, only 65 (0.5 percent of all advisers) reported having been convicted or having pled guilty or nolo contendere ("no contest") to the charges in court.
- 164 firms or advisory affiliates (1.4 percent) reported that the SEC or the Commodity Futures Trading Commission (CFTC) found them to have made a false statement or omission, and 517 firms (4.4 percent) reported that they have been involved in a violation of SEC or CFTC regulations or statutes. Only 16 firms reported that they or an advisory affiliate have been found by the SEC or CFTC to have been the cause of an investment-related business having its authorization to conduct business denied, suspended, revoked, or restricted.
- 518 firms or advisory affiliates (4.4 percent) reported that the SEC or the CFTC imposed a civil money penalty on the adviser or its affiliate or were ordered to cease and desist from an activity.
- Of the 1,595 advisers reporting at least one disciplinary event, about half—776 advisers (51.3 percent)—attributed the disclosure event(s) to its affiliate and not directly to the adviser or its supervised persons.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Explanation of Report Data

Evolution Revolution and its findings are based on Form ADV, Part 1 data filed by all SEC-registered investment advisers as of April 8, 2016. Advisers are required to file specific information electronically using the Investment Adviser Registration Depository (IARD) system.

More than 17,000 investment advisers are registered with the states.[15] This report focuses solely on SEC-registered investment advisers.

Form ADV, Part 1 has significant limitations and anomalies. Please consult the text of Form ADV (available on the SEC's website at http://www.sec.gov/about/forms/formadv.pdf) for a more thorough understanding of the underlying data included in this report.

The 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 percent. 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.

When obvious errors have been found in the reported data, we have made certain corrections or omissions to avoid skewed results.

Several items in Form ADV, Part 1 are commonly misunderstood and answers are misreported. For example, Item 1.O asks "Did you have $1 billion or more in assets on the last day of your most recent fiscal year?" meaning the adviser's balance sheet assets, but many registrants respond based on their RAUM. Other areas that are commonly misinterpreted include how to calculate RAUM, custody, and disciplinary history questions.

The Form ADV, Part 1 data underlying the findings in *2016 Evolution Revolution* and additional information is contained in the report's Appendix, which is available online at https://www.investmentadviser.org (https://goo.gl/CWg3qy) or http://www.nrs-inc.com/About-Us/White-Papers/.

[15] *See* http://www.nasaa.org.

© 2016 Investment Adviser Association and National Regulatory Services. All rights reserved. Printed in U.S.A.

Investment Adviser Association
1050 17th Street, NW
Suite 725
Washington, DC 20036-5514
P 202.293.4222
F 202.293.4223 www.investmentadviser.org

National Regulatory Services
29 Brook Street
P.O. Box 71
Lakeville, CT 06039
P 860.435.0200
F 860.435.0031 info@nrs-inc.com