NRS™

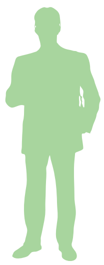
Compliance Confidence

INVESTMENT ADVISER ASSOCIATION

2019 Evolution Revolution

A Profile of the Investment Adviser Profession

The 2019 “Typical”* SEC-Registered Investment Adviser



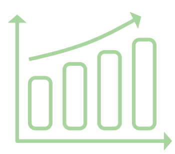
Most of its clients
are individuals

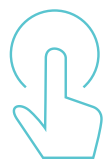
Highly likely to have at least one
pension/profit sharing plan
as a client

$341 million
in regulatory assets
under management

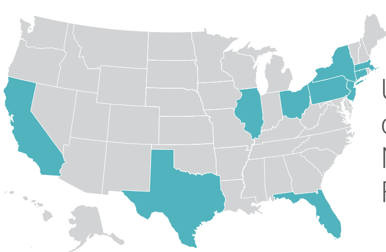
9
employees

141
accounts

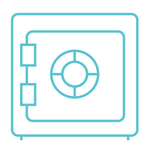




Exercises discretionary
authority over
most accounts



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



Does not have actual
physical custody of
client assets or securities

(median)

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 member firms manage more than $25 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, 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.

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The Investment Adviser Profession:

Strong, Growing, and Critically Important to Investors, our Economy, and Capital Markets

The Investment Adviser Association and National Regulatory Services are pleased to present our 19th annual *Evolution Revolution* report, the most comprehensive profile of SEC-registered investment advisers available. This year's report contains data on 12,993 firms that manage $83.7 trillion for more than 43 million clients. This dynamic profession continues to be critically important to investors, our economy, and the capital markets.

Indeed, the more than 43 million clients benefitting from investment advice is at an all-time high. To meet this expanding demand for investment advice, investment advisers employ a total of 835,124 non-clerical workers, a 16.0 percent increase over the past five years. Over 436,000 of these workers perform investment advisory functions. Thus, investment advisers remain impressive providers of high-quality jobs to the economy, including in small businesses. The investment adviser profession has always been dominated by small businesses and this year was no exception, as over 11,000 firms reported employing 50 or fewer non-clerical individuals.

This year's report comes in the wake of the SEC's adoption of its Standards of Conduct rulemaking package, which, after two decades of deliberations, is intended to raise the standard of conduct for broker-dealers, reaffirm the fiduciary duty under the Advisers Act, and reduce investors' confusion as to the services offered by and standards applicable to their financial professional. This significant development may accelerate the secular trend, as documented in this report over the years, of an increasing number of advisory firms, clients, and employees.

2019 Evolution Revolution provides a full portrait of the SEC-registered investment adviser profession, presenting data on the number of investment advisers, regulatory assets under management, employees, clients, custody of client assets, industry concentration, compensation, non-core business activities, financial industry affiliations, geographic concentrations, disciplinary information, and more.

It is our hope that our 2019 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

Karen L. Barr
President & CEO
IAA

John Gebauer
President
NRS

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 terms "investment adviser," "adviser," and "RIA" are used interchangeably to refer to an entity that is registered as an investment adviser with the SEC, based on the definition set forth in the Investment Advisers Act of 1940.[1]

In June 2019, as part of its package of rules to raise the standard of conduct for broker-dealers and address investor confusion, the SEC approved rules that require disclosures in retail communications about the registration status of broker-dealers, investment advisers, and their financial professionals, effective as of June 30 next year. Use of the term "adviser" and "advisor" in a name or title by a broker-dealer that is not also registered as an investment adviser or by an associated person that is not also supervised by an investment adviser will be presumed to be a violation of its obligation to disclose the capacity in which it is acting with respect to a recommendation.[2]

That said, the term "investment adviser" describes a broad range of companies and people who give advice about investing in securities. In addition to the term "investment adviser," these advisers 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 that are associated persons of brokerage firms are registered representatives of the brokerage firm. But these individuals, subject to the disclosure restrictions described above beginning next year, also use many other titles, including financial consultant, financial professional, financial advisor, advisor, wealth manager, and investment consultant.

Enhanced Data Reporting: A Note About New Comparisons

This year's *Evolution Revolution* report is the first one in which we can compare new information reported on the amended version of Form ADV Part 1, which became effective on October 1, 2017. We will use this information to track emerging trends.

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[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.

[2] See *Regulation Best Interest: The Broker-Dealer Standard of Conduct,* Rel. No. 34-86031 (June 5, 2019), available at https://www.sec.gov/rules/final/2019/34-86031.pdf.

Executive Summary

By all measures, the investment adviser profession is experiencing robust growth indicative of an attractive business model for financial services professionals and an expanding market for advisory services.

The number of SEC-registered investment advisers continues to grow at a steady pace – and has reached yet another record high. This report contains data on 12,993 federally registered advisers, reflecting a net increase of 3.3 percent since the 2018 report.

The advisory community continues to experience strong job growth, creating a record number of investment advisory positions. In 2019, SEC-registered advisers reported a total of 835,124 non-clerical employees – up 3.7 percent since 2018. Of these employees, more than half (436,256) provide investment advisory services (including research) – a healthy increase of over 20,000 since 2018.

The aggregate RAUM managed by SEC-registered advisers has grown to a record $83.7 trillion. RAUM managed by investment advisers grew 1.4 percent from $82.5 trillion in the 2018 report to $83.7 trillion this year, despite significant market declines in December 2018.

While all SEC-registered advisers are fiduciaries providing investment advice to clients, the profession is highly diverse in size and type of firms, services offered, and clients served.

The vast majority of SEC-registered investment advisers are small businesses. Small businesses are the core of the investment adviser community. In 2019, 56.9 percent (7,387) of advisory firms reported that they employ ten or fewer non-clerical employees, and 87.5 percent (11,367) reported employing 50 or fewer non-clerical individuals. At the opposite end of the spectrum, the largest 116 firms employ 53.3% of all non-clerical employees.

SEC-registered investment advisers serve more than 43 million clients. Individuals comprise the largest category of advisory clients. Individual clients (94.6 percent of total clients) – in particular, non-high net worth individuals (82.2 percent of total clients and 87.0 percent of individual clients) – comprise the vast majority of clients by a wide margin. High net worth individuals make up 12.3 percent of total clients. Investment advisers manage $10.5 trillion on behalf of individuals.

The bulk of RAUM resides in pooled vehicles. Registered investment companies ($28.1 trillion) and private investment vehicles ($22.2 trillion) together represent $50.3 trillion – 60.2 percent – of the total $83.7 trillion RAUM. The number of private investment vehicle clients are up by 18.9 percent.

Private equity funds are pulling away from hedge funds in popularity. In 2019, 4,520 advisers reported advising 37,873 private funds with a total gross asset value of $14.9 trillion (down, up, and up from 4,654 advisers, 36,095 private funds, and $13.3 trillion gross asset value, respectively, in 2018). While the percentage of hedge funds and private equity funds was exactly equal three years ago their popularity as a pool of choice has diverged, with private equity funds now making up nearly forty (39.9) percent of privately offered funds and hedge funds representing about thirty (30.3) percent in the private fund space.

Digital advice platforms are expanding the market for advice. Two of the top five advisers as measured by number of non-high net worth individual clients served are digital advice platforms, representing 4.8 million clients. These clients tend to have lower – and in some cases zero – account balances.

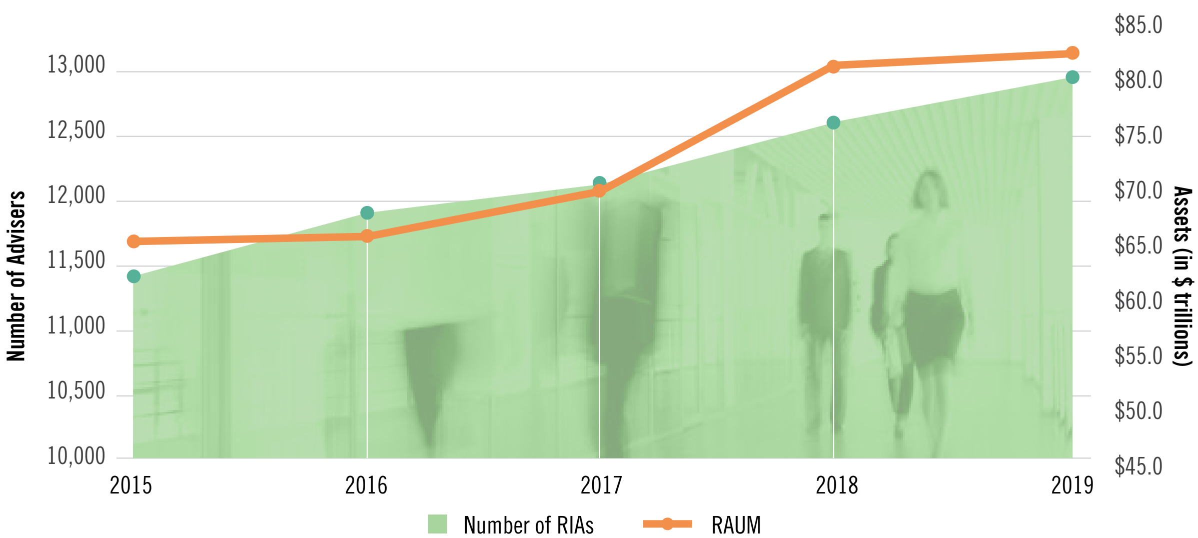
Nearly three-quarters of advisers have RAUM attributable to separately managed accounts. 9,484 advisers (73.0 percent) have RAUM attributable to separately managed account clients.

Relatively few advisers engage in borrowing or derivative transactions in SMAs. 1,594 advisers (12.3 percent) engage in borrowing transactions on behalf of any of the separately managed account clients that they advise. 1,756 advisers (13.5 percent) engage in derivative transactions on behalf of any of the separately managed account clients that they advise.

Number of Investment Advisers

This report contains data on 12,993 SEC-registered investment advisers, which represents a net increase of 415 advisers or 3.3 percent since the 2018 report. This increase continues the trend from the previous year, when there was also a 3.3 percent increase in advisers. The aggregate RAUM managed by SEC-registered advisers is $83.7 trillion, a 1.4 percent increase from $82.5 trillion in 2018.[3]

Chart 1: Industry Growth Continues

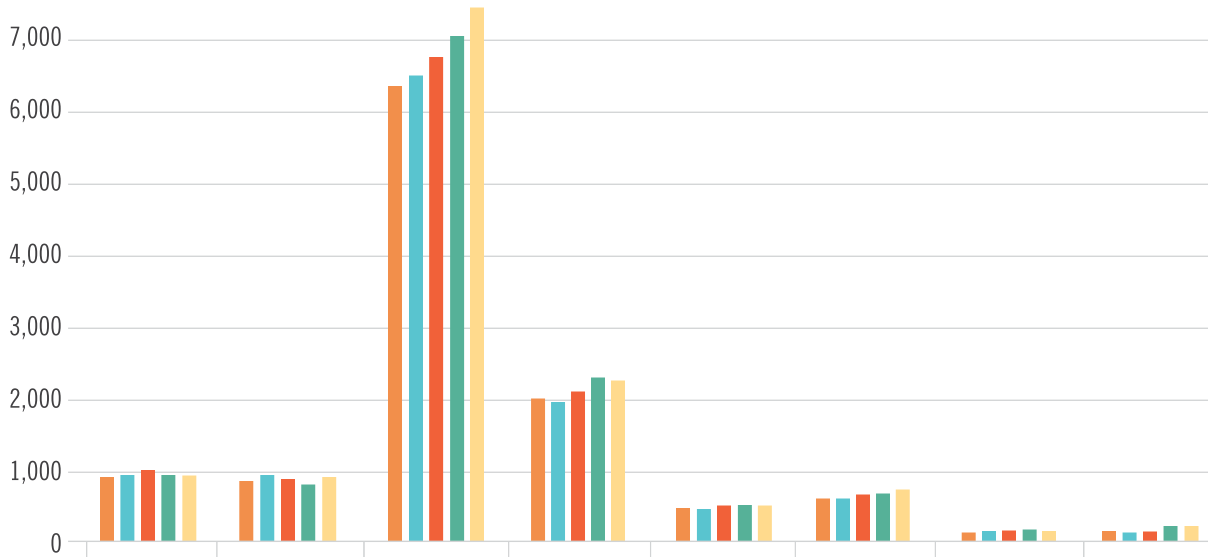


	2015	% Change	2016	% Change	2017	% Change	2018	% Change	2019	% Change
# of Advisers	11,473	5.3%	11,847	3.3%	12,172	2.7%	12,578	3.3%	12,993	3.3%
RAUM	66.7	8.1%	66.8	0.2%	70.7	5.8%	82.5	16.7%	83.7	1.4%

[3] This 1.4 percent increase may be artificially low, given that most advisers calculate their RAUM as of December 31 and a significant market decline occurred in December 2018. Although the decline was short-lived and the markets returned to previous levels by the end of February, unfortunately, this transient event coincided with the RAUM reporting period for most advisers and was a contributing factor to below average growth in RAUM this year. Also, the data do not indicate whether some of the increase is due to advisers double counting more RAUM (see discussion of why actual RAUM is overstated on page 13 of this report).

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

2015-2019



	<$25m	$25-<100m	$100m-<1b	$1b-<5b	$5b-<10b	$10b-<50b	$50b-<100b	≥$100b
2015	914	895	6,372	2,002	462	596	104	128
2016	987	994	6,585	1,998	450	596	116	121
2017	1,026	912	6,794	2,107	480	611	118	124
2018	958	852	7,064	2,302	489	644	122	147
2019	918	931	7,444	2,294	484	657	117	148

As in past years, more than half (57.3 percent) of all SEC-registered advisers have RAUM between $100 million and $1 billion. Almost three quarters (74.9 percent) of advisers have RAUM between $100 million and $5 billion. Continuing the trend from the prior year, the number of advisers with RAUM under $25 million showed the largest percentage decrease during the period, decreasing 4.2 percent from 958 to 918 advisers, after falling by 6.6 percent last year. Much of the growth during this period was among advisers in the $25 million to $1 billion range. The largest percentage increase in growth was among advisers with RAUM between $25 million and $100 million, which increased by 9.3 percent from 852 to 931. Advisers above $1 billion in RAUM were relatively flat. Mid-tier groups experienced the only substantive growth year over year. However, last year advisers over $100 billion demonstrated the largest growth, increasing by 18.5 percent.

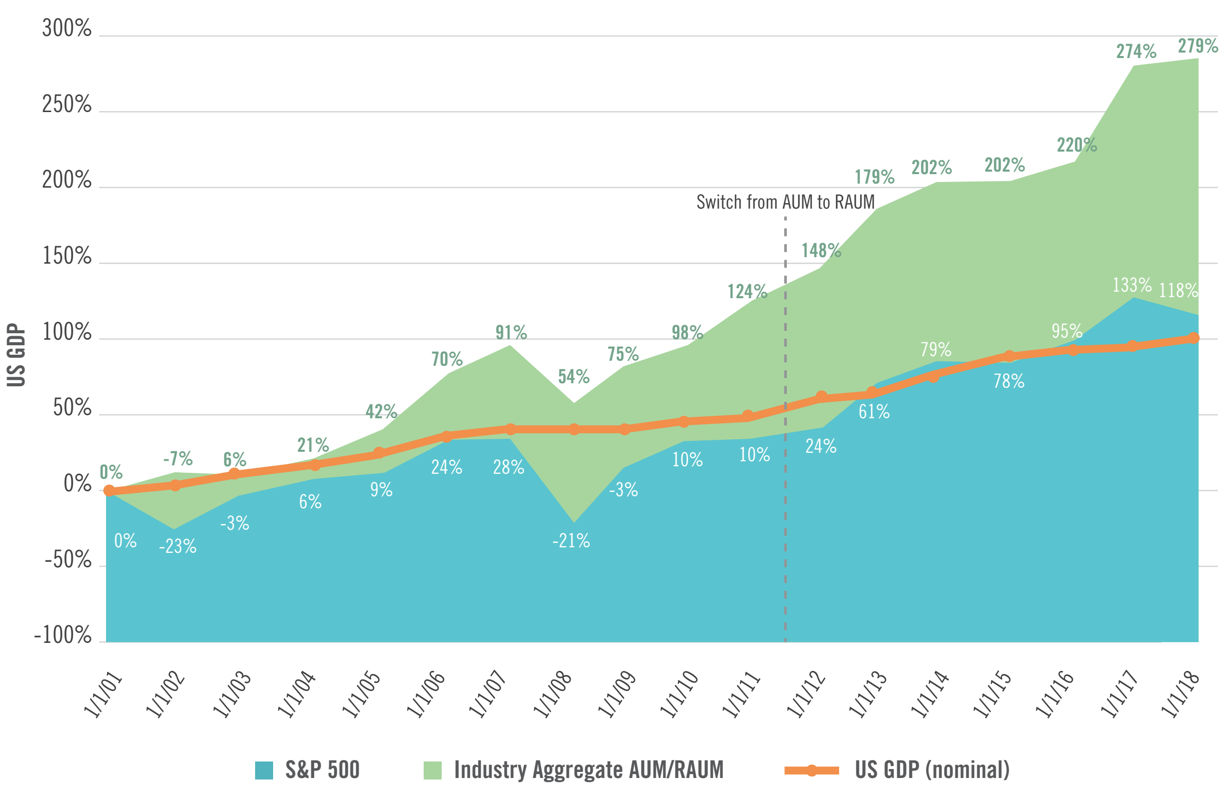
These patterns show the continued movement of firms from the lower RAUM tier groups into the mid-tier groups. Recent trends in merging smaller advisers into an adviser group may indicate a rise in "hybrid" advisers – investment advisers that are organized as an independent business but also are affiliated with a broker-dealer.

Regulatory Assets Under Management

Regulatory assets under management (RAUM) reported in 2019 increased to $83.7 trillion from $82.5 trillion in 2018, a one-year growth of approximately $1.2 trillion or 1.4 percent. This RAUM growth is likely primarily a function of sustained strong stock market performance in the past year, despite December's steep and short-lived market decline. Five firms have each surpassed $1 trillion in RAUM.[4]

The historical growth of the industry's aggregate assets under management (AUM) or RAUM (depending on the prevailing regulations) has been quite impressive since our first report in 2001. The $83.7 trillion RAUM that registered investment advisers now manage has nearly quadrupled 2001 AUM levels.[5] The total industry aggregate AUM/RAUM has grown 279 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 (nominal) produced cumulative growth of 118 percent (4.7 percent CAGR) and 94 percent (4.0 percent CAGR), respectively.

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



[4] This figure does not include firms that have combined RAUM with affiliated registered advisers in excess of $1 trillion.

[5] In 2012, the methodology for calculating RAUM changed significantly from the methodology used to calculate AUM in previous years.

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 slight 0.7 percent decrease over last year but consistent with historical values that have ranged since 2001 from 87.9 percent to 92.1 percent.

SEEING CLIENT ASSETS IN A DIFFERENT LIGHT

634 advisers elect to compute client assets that they manage using a different method for purposes of their brochure (Form ADV Part 2A) than the method used to compute their RAUM in Form ADV Part 1 (which is used for making a bright line determination about whether an adviser should register with the SEC or with the states). This is up 6.6 percent from the 595 that reported doing so last year.

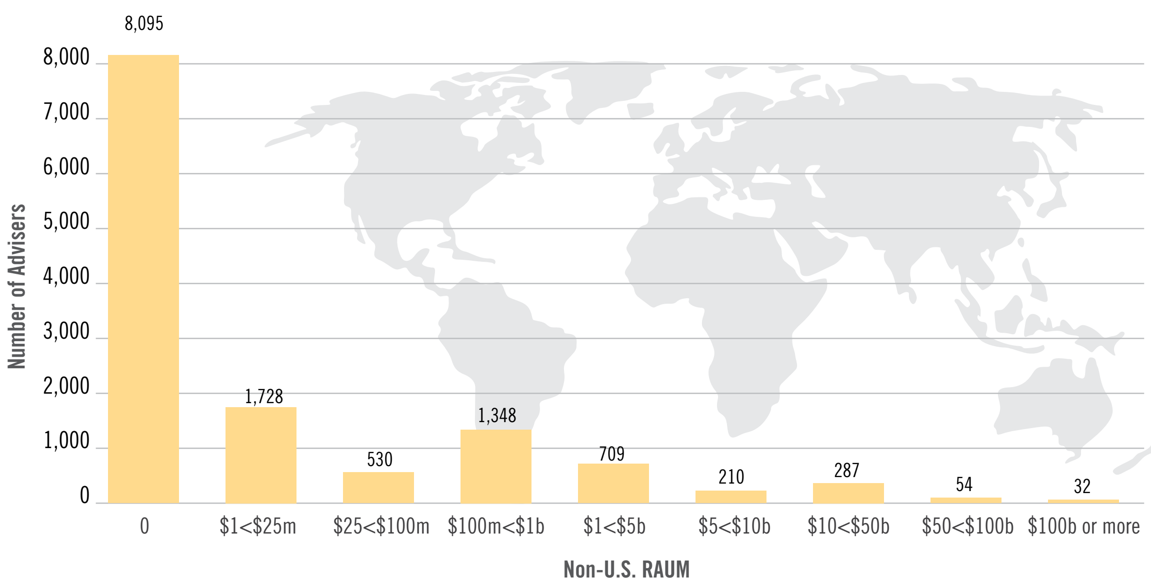
While permitted under Form ADV, if this trend continues, the value of brochure comparisons between two advisers may be diminished.

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.[6]

NON-U.S. RAUM

37.7 percent of advisers reported having RAUM attributable to clients that are non-U.S. persons, which is up from 34.2 percent in 2018. This may be Indicative of the strength and attractiveness of the U.S. financial market in comparison to other global markets.

Chart 4: RAUM Attributable to Non-U.S. Clients



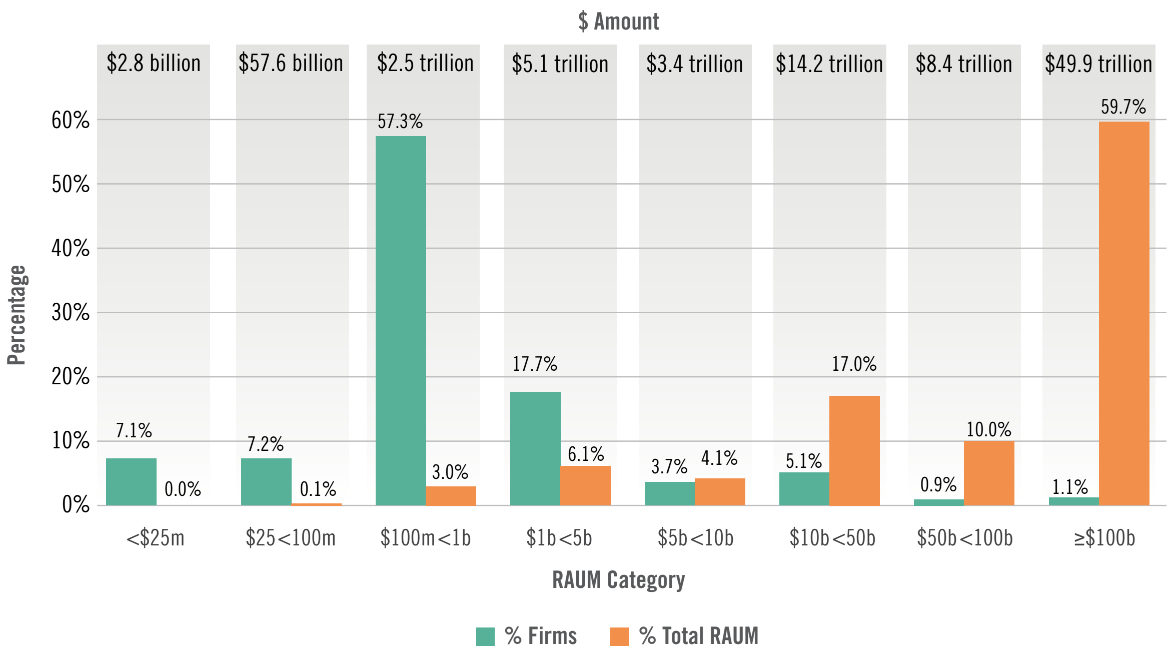
[6] Additionally, the timing of Form ADV filings can impact the accuracy of the aggregate RAUM. Form ADV requires advisers to calculate and report their RAUM within 90 days of the filing. Most advisers calculate their RAUM as of December 31, but 759 (5.8 percent) have a different fiscal year end. Depending on the timing of the RAUM calculations made by each adviser, the aggregate RAUM may include some temporal variations in market value.

Industry Concentration

The recent trend toward increased industry concentration continued this year, with a majority of all RAUM being managed by a very small group of large advisers. The number of advisers that reported managing over $100 billion in RAUM remained steady, increasing by one adviser to 148 following last year's 18.5 percent increase. Despite accounting for only 1.1 percent of SEC-registered advisers, these 148 firms collectively managed 59.7 percent of all reported RAUM, or $49.9 trillion.

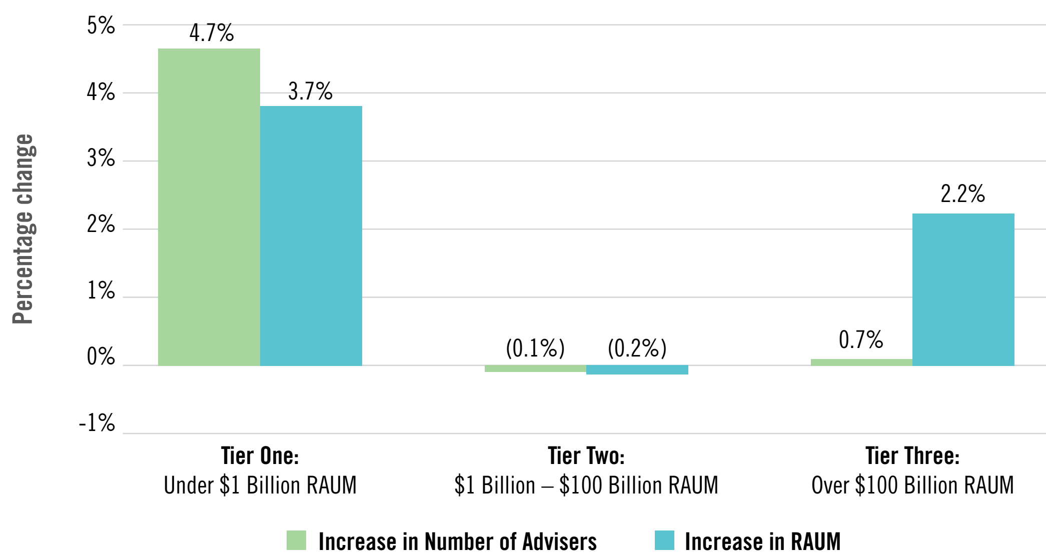
At the other end of the spectrum, 71.5 percent of all advisers managed less than $1 billion RAUM, and they collectively managed only 3.1 percent of all reported RAUM, or $2.6 trillion.

Chart 5: The Industry Barbell – The Largest Firms Manage More than Half the Assets



When viewed in tier groups of under $1 billion, $1 billion to $100 billion, and over $100 billion, the data show a continuation, but a much less dramatic one, of last year's increases across the smaller and larger tier groups in both number of advisers and RAUM, while the middle tier group decreased slightly in both number of advisers and RAUM. The smaller tier (under $1 billion) increased in number by 4.7 percent and in RAUM by 3.7 percent. The middle tier ($1 billion to $100 billion) contracted slightly in number by five advisers or 0.1 percent, while the RAUM managed by the tier group decreased by only 0.2 percent. The larger tier (over $100 billion) grew by 0.7 percent (from 147 to 148) and RAUM increased 2.2 percent.

Chart 6: Smaller and Larger Advisers Experience Relatively More Growth



Clients of Investment Advisers

Form ADV requires advisers to report the approximate number of their clients and the amount of RAUM attributable to each type of client. The data provide several insights into the industry.

Advisers by Number of Clients

SEC-registered advisers in 2019 reported a total of more than 43 million clients. 36.3 million clients are reported in 13 specific categories, and in a catch-all "other" category.[7] Advisers reported providing investment advisory services to an additional 7.3 million clients for whom they do not have RAUM (*e.g.,* certain non-discretionary accounts or a one-time financial plan). This total number of clients is up from 3.4 million last year, which may be attributed in part to digital advice platforms providing certain services (such as financial counseling) to clients that do not have managed accounts with the adviser, or having clients with unfunded or inactive accounts. In aggregate, SEC-registered advisers have reported significant client growth over the past year – 9 million clients.

WHY PINPOINTING THE EXACT NUMBER OF CLIENTS IS ELUSIVE

Form ADV data have limitations. Form ADV requires advisers to report the "approximate" number of clients in each of 13 categories – plus a catch-all "other" category – as well as the amount of total RAUM that is attributable to each type of client.

Advisers also have the option to report that they have fewer than five clients in a particular category (other than in the registered investment companies, business development companies, and pooled investment vehicles categories), rather than respond with a specific number. This option was included to address concerns regarding the potential disclosure of confidential or proprietary information. For purposes of this section, we only use Form ADV responses that provided a specific number of clients.

A separate question in Form ADV (Item 5.C.1) asks "To approximately how many clients for whom you do not have regulatory assets under management did you provide investment advisory services during your most recently completed fiscal year?" In addition to being an approximate number, this question introduces another group of clients that are not identified by type.

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.

While not exact, the recently amended Form ADV provides more precise data than under the prior version of Form ADV, which only required advisers to select a certain range of percentages. Previously, advisers were required to provide a specific number only if they had more than 100 clients, and advisers were permitted to round to the nearest 100.

[7] The Form ADV data show that advisers had 36,298,105 clients (excluding certain non-discretionary accounts), up from 31,048,690 clients in 2018. In 13,331 instances, advisers reported that they have fewer than five clients in one of the 13 categories.

Chart 7: Number of Clients (millions)

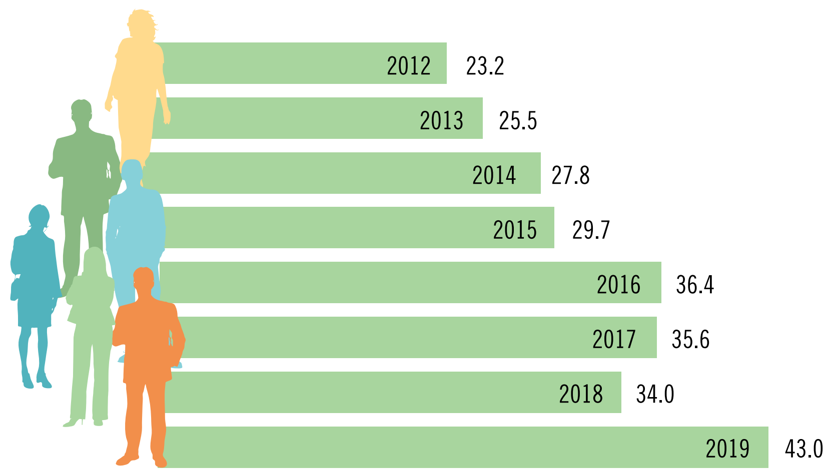
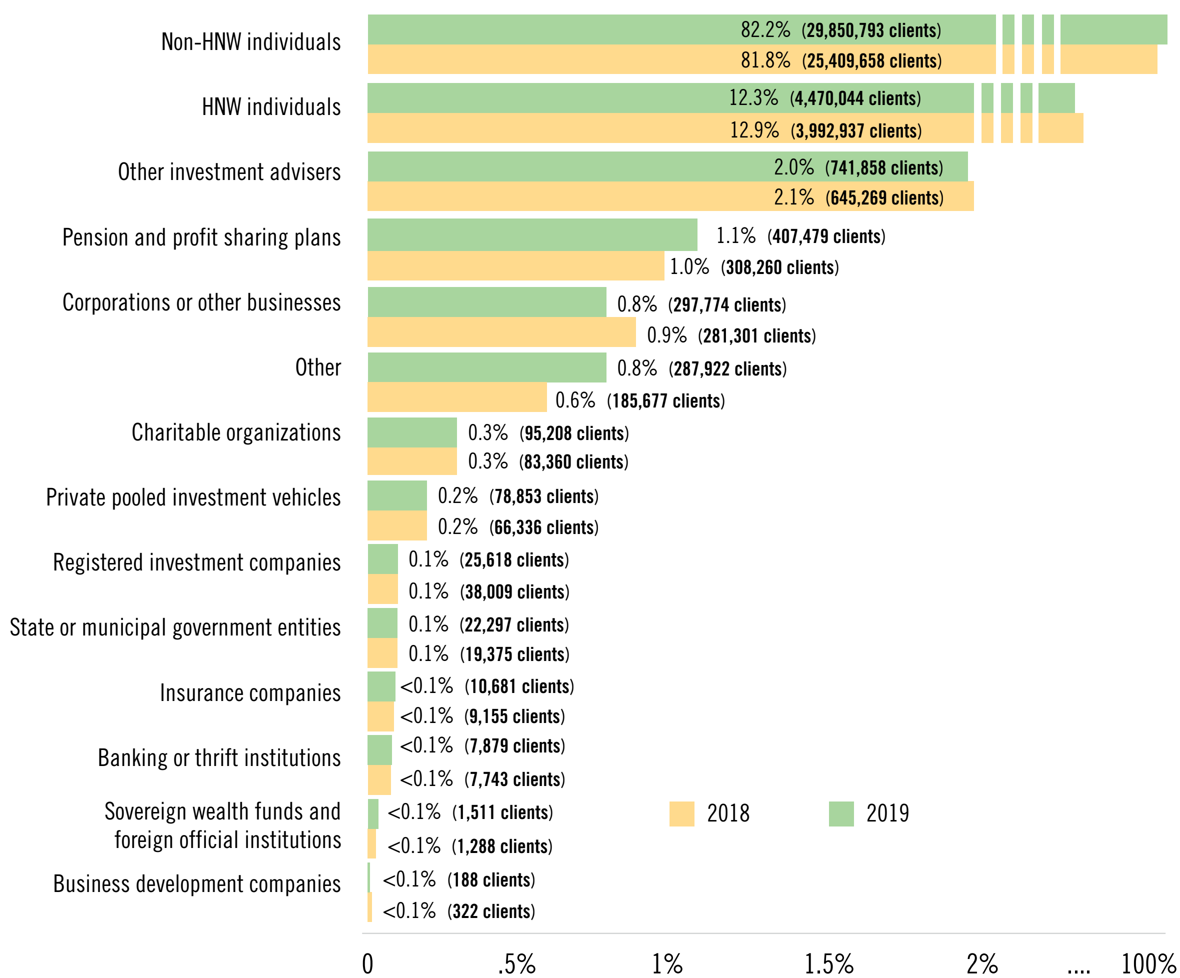


Chart 8: Number of Clients–Most Advisers Have Individual Clients



The 13 specific client types fall into three distinct categories: individuals, pools, and institutions. These categories, along with the estimated portion of the $83.7 trillion RAUM reported for each type of client,[8] are:

Individuals	
• High net worth individuals[9]	$6.0 trillion – 7.1%
• Other individuals	$4.5 trillion – 5.4%
Pools	
• Registered investment companies	$28.1 trillion – 33.6%
• Business development companies	$121 billion – 0.1%
• Pooled investment vehicles other than registered investment companies and BDCs (private funds)	$22.2 trillion – 26.6%
Institutions	
• Banking or thrift institutions	$945 billion – 1.1%
• Pension and profit sharing plans	$5.8 trillion – 6.9%
• Charitable organizations	$1.1 trillion – 1.3%
• Corporations or other businesses	$2.5 trillion – 3.0%
• State or municipal government entities	$3.3 trillion – 4.0%
• Other investment advisers	$1.1 trillion – 1.3%
• Insurance companies	$5.5 trillion – 6.5%
• Sovereign wealth funds and foreign official institutions	$1.6 trillion – 1.9%

The following pages take a closer look at advisers to individuals, pools, and institutions.

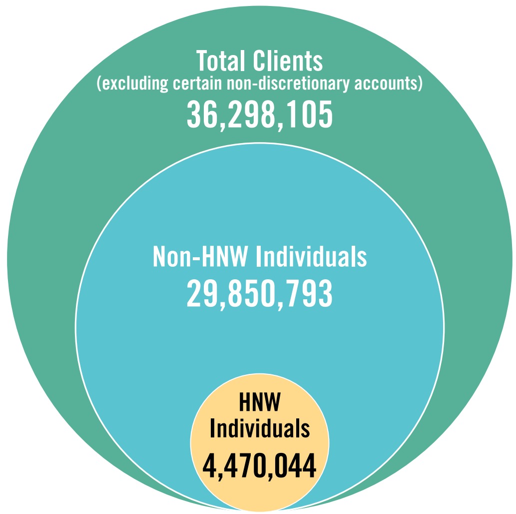
[8] These categories do not include $880 billion reported as an "other" type of client. It appears that some of the responses included as "other" could have been included in one of the specified category choices.

[9] A "high net worth individual" is an individual who is a "qualified client" as defined in Rule 205-3 under the Investment Advisers Act or who is a "qualified purchaser" as defined in Section 2(a)(51)(A) of the Investment Company Act. Generally, this means a natural person with at least $1,000,000 in assets under the management of an adviser, or whose net worth exceeds $2,100,000 (excluding the value of his or her primary residence).

A Closer Look at Advisers to Individual Clients

Individuals remain important to a great many investment advisers and continue to comprise the largest type of advisory clients.

Chart 9: Individuals Comprise the Largest Categories of Advisory Clients



Individual clients (94.6 percent) – in particular, non-HNW individuals (82.2 percent of total clients and 87.0 percent of individual clients) – comprise the bulk of clients by a wide margin. This dovetails with SEC Chairman Jay Clayton's priority of furthering the interests of retail – or "Main Street" – investors.[10] Two of the top five advisers as measured by number of non-HNW individual clients served are digital advice platforms, representing 4.8 million clients.[11] These clients tend to have lower – and in some cases zero – account balances. Other investment advisers is the next-most-prevalent type of client; however 91.9 percent of the number of clients counted in that category is attributed to a single digital advice platform, which we understand represents the number of underlying clients that it serves in its capacity as sub-adviser to other investment advisers.

[10] *See Biography - The Commission Under Chairman Clayton,* available at https://www.sec.gov/biography/jay-clayton.

[11] The number of advisers reporting that they provide advice exclusively through an interactive website increased by 19 firms – 12.4 percent – to 172.

A Closer Look at Advisers to Pools

Advisers report having a total of 104,659 clients that are some type of pool, which represents 0.3 percent of all clients.

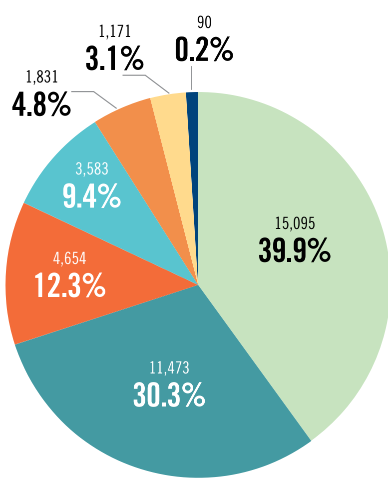
78,853 of these clients are private funds, 25,618 are registered investment companies, and 188 are business development companies. While the number of investment adviser clients that are registered investment companies is down by a significant 32.6 percent, private investment vehicle clients are up by 18.9 percent. However, the apparent decline in registered investment companies can be attributed to a reporting error by one firm last year.

Form ADV provides detailed data on advisers to private funds. In 2019, 4,520 advisers (34.8 percent) reported advising 37,873 private funds,[12] 24.3 percent of which are funds of funds. The raw numbers of private funds increased from 2018; in 2018 there were 4,654 advisers, or 37.0 percent, advising 36,095 private funds, 25.0 percent of which were funds of funds.[13]

Hedge funds and private equity funds continue to represent the largest portions of the private funds group, comprising 70.2 percent of all reported private funds, with private equity funds making up 39.9 percent and hedge funds representing 30.3 percent. While the percentage of hedge funds and private equity funds was exactly equal three years ago and began to diverge two years ago, there is now an even greater divergence, with private equity funds making even more gains (advisers reported 1,242 additional private equity funds in the past year) while hedge funds showed a small increase (the number of reported hedge funds increased in the past year by 60).

The total gross asset value of reported private funds (for which details are provided) is approximately $14.9 trillion (a 12.0 percent increase above $13.3 trillion in 2018), which is more than 17.8 percent of all reported RAUM with an average gross asset value of $393.6 million. The median gross asset value, on the other hand, is $55.0 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 beneficial 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 61.

Chart 10: Private Equity Funds Increase Gains While Hedge Fund Growth Remains Flat



	2018
Private Equity Fund	38.5% (13,890)
Hedge Fund	31.7% (11,430)
Other Private Fund	12.8% (4,600)
Real Estate Fund	9.4% (3,380)
Securitized Asset Fund	4.7% (1,707)
Venture Capital Fund	2.8% (1,012)
Liquidity Fund	0.2% (76)

[12] Advisers to private funds are only required to report detailed data on certain private funds. If the adviser is a sub-adviser, the instructions to Form ADV specify that the adviser should not provide detailed data if another SEC-registered adviser or SEC exempt reporting adviser reports detailed information for the same private fund.

[13] 758 advisers reported advising at least one private fund that is reported by another adviser (*e.g.*, sub-advisory relationships).

A Closer Look at Advisers to Institutional Clients

The most common type of institutional client is other investment advisers – over 740,000 – far more than any other single type of institutional client. The importance of pension clients is evident here as well, as advisers serve over 400,000 pension clients and profit sharing plans. Other institutional clients include corporations, banks, insurance companies, charities, governmental entities, and sovereign wealth funds.

UNWRAPPING WRAP FEE PROGRAMS

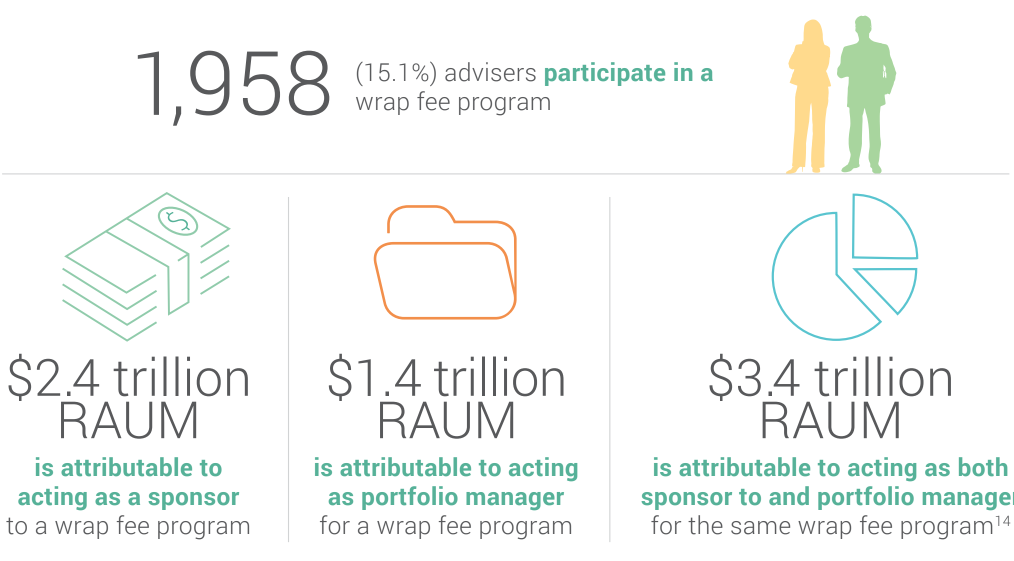
An adviser that participates in wrap fee programs must report the amount of RAUM attributable to acting as: (i) a sponsor to a wrap fee program; (ii) a portfolio manager for a wrap fee program; or (iii) both sponsor to, and portfolio manager for, the same wrap fee program.

A wrap fee program is an arrangement under which a client receives a combination of services – including investment advisory, brokerage, clearing, custodial and/or administrative services – in a bundled form, for a specified all-inclusive – or "wrap" – fee, usually based on a percentage of assets under management in the wrap fee account.

An investment adviser may be a sponsor of a wrap fee program or it may enter into arrangements with a sponsor (broker-dealer, bank, or insurance company), whereby the sponsor offers a client a choice of an adviser as a portfolio manager of the wrap fee account.

"Participating" in a wrap fee program refers to serving as the sponsor and/or a portfolio manager, as distinguished from merely placing (or recommending the placement of) client funds in one or more programs sponsored by unaffiliated third parties.

Chart 11: Wrap Fee Programs



[14] Several firms triple reported the same RAUM in each of the (i) sponsor, (ii) portfolio manager, and (iii) sponsor and portfolio manager categories, contrary to Form ADV's instructions.

A Closer Look at Separately Managed Accounts

Separately managed account (SMA) client RAUM includes *all* of the adviser's RAUM *except for* RAUM attributable to three client-type categories: registered investment companies; business development companies; and pooled investment vehicles (other than registered investment companies and business development companies). If, after excluding those three types of clients, the remaining amount is at least $10 billion in RAUM, advisers must report both mid-year and end-of-year values of the SMA RAUM, showing the percentage of RAUM attributable to each category of assets. If the remaining amount is less than $10 billion in RAUM, advisers only report end-of-year values. For purposes of this report, we focus on end-of-year values.

SEPARATING SEPARATELY MANAGED ACCOUNTS

One of the most highly-anticipated areas of amended Form ADV was that advisers are now required to report additional data about separately managed accounts. The enhanced data collected include information on the types of assets owned by SMA clients. In addition, certain advisers are required to provide information on borrowings and the use of derivatives, including gross notional exposure of derivatives in the aggregate held in client SMAs.

Because the term "separately managed account" as used in Form ADV is broader than common usage of that term, it is possible that some amounts relating to clients are under-reported.

9,484 advisers (73.0 percent) have RAUM attributable to separately managed account clients:

- 565 advisers reported having at least $10 billion in such RAUM. This is up by 35 (6.6 percent) from 2018.
- 8,919 advisers reported having less than $10 billion in such RAUM. This is up by 753 (9.2 percent) from 2018.

The approximate percentage of SMA RAUM that is attributable to each of 11 categories of assets – plus a catch-all "other" category – is as follows:

Chart 12: SMA Portfolios Include Diverse Asset Types

Asset Type	Larger Advisers End-of-Year (at least $10 billion in SMA RAUM)		Smaller Advisers End-of-Year (less than $10 billion in SMA RAUM)	
	% of SMA RAUM	# of Advisers	% of SMA RAUM	# of Advisers
(i) Exchange-Traded Equity Securities	0%	119	0%	1,215
	1% < 25%	178	1% < 25%	2,853
	26% < 50%	88	26% < 50%	1,623
	51% < 75%	64	51% < 75%	1,524
	76% < 99%	93	76% < 99%	1,514
	100%	23	100%	190
(ii) Non Exchange-Traded Equity Securities	0%	479	0%	7,692
	1% < 25%	78	1% < 25%	935
	26% < 50%	5	26% < 50%	136
	51% < 75%	2	51% < 75%	77
	76% < 99%	1	76% < 99%	43
	100%	0	100%	36
(iii) U.S. Government/Agency Bonds	0%	261	0%	5,552
	1% < 25%	275	1% < 25%	3,119
	26% < 50%	18	26% < 50%	150
	51% < 75%	8	51% < 75%	51
	76% < 99%	3	76% < 99%	37
	100%	0	100%	10
(iv) U.S. State and Local Bonds	0%	336	0%	4,922
	1% < 25%	206	1% < 25%	3,773
	26% < 50%	13	26% < 50%	146
	51% < 75%	4	51% < 75%	39
	76% < 99%	6	76% < 99%	31
	100%	0	100%	8
(v) Sovereign Bonds	0%	403	0%	8,514
	1% < 25%	139	1% < 25%	369
	26% < 50%	15	26% < 50%	17
	51% < 75%	8	51% < 75%	14
	76% < 99%	0	76% < 99%	5
	100%	0	100%	0
(vi) Investment Grade Corporate Bonds	0%	224	0%	4,977
	1% < 25%	245	1% < 25%	3,678
	26% < 50%	74	26% < 50%	198
	51% < 75%	20	51% < 75%	50
	76% < 99%	2	76% < 99%	11
	100%	0	100%	5

Asset Type	Larger Advisers End-of-Year (at least $10 billion in SMA RAUM)		Smaller Advisers End-of-Year (less than $10 billion in SMA RAUM)	
	% of SMA RAUM	# of Advisers	% of SMA RAUM	# of Advisers
(vii) Non-Investment Grade Corporate Bonds	0%	383	0%	7,742
	1% < 25%	172	1% < 25%	1,065
	26% < 50%	5	26% < 50%	68
	51% < 75%	5	51% < 75%	22
	76% < 99%	0	76% < 99%	16
	100%	0	100%	6
(viii) Derivatives	0%	475	0%	8,313
	1% < 25%	81	1% < 25%	532
	26% < 50%	3	26% < 50%	26
	51% < 75%	1	51% < 75%	10
	76% < 99%	2	76% < 99%	16
	100%	3	100%	22
(ix) Securities Issued by Registered Investment Companies or Business Development Companies	0%	321	0%	3,637
	1% < 25%	132	1% < 25%	1,621
	26% < 50%	40	26% < 50%	1,074
	51% < 75%	37	51% < 75%	1,146
	76% < 99%	26	76% < 99%	1,310
	100%	9	100%	131
(x) Securities Issued by Pooled Investment Vehicles (other than Registered Investment Companies or Business Development Companies)	0%	376	0%	7,332
	1% < 25%	141	1% < 25%	1,096
	26% < 50%	27	26% < 50%	202
	51% < 75%	12	51% < 75%	112
	76% < 99%	6	76% < 99%	101
	100%	3	100%	76
(xi) Cash and Cash Equivalents	0%	110	0%	1,189
	1% < 25%	439	1% < 25%	7,292
	26% < 50%	8	26% < 50%	306
	51% < 75%	2	51% < 75%	67
	76% < 99%	4	76% < 99%	42
	100%	2	100%	23
(xii) Other	0%	320	0%	6,771
	1% < 25%	178	1% < 25%	1,600
	26% < 50%	31	26% < 50%	156
	51% < 75%	13	51% < 75%	69
	76% < 99%	6	76% < 99%	128
	100%	17	100%	195

Larger Firms. The most prevalent asset types for the at least-$10 billion group include cash and cash equivalents, exchange-traded equity securities, bonds, and registered investment companies. Other than exchange-traded equity securities (23 firms) and registered investment companies (9 firms), it is rare for 100 percent of an adviser's RAUM to be attributable to a single asset type.

Smaller Firms. The most prevalent asset types for the under-$10 billion group include cash and cash equivalents, exchange-traded equity securities, registered investment companies, bonds, and pooled investment vehicles. Some advisers attribute 100 percent of their RAUM to a single asset type, most commonly exchange-traded equity securities (190 firms), registered investment companies (131 firms), pooled investment vehicles (76 firms), non exchange-traded equity securities (36), and derivatives (22 firms).

702 smaller advisers invest 100 percent of their clients' SMA RAUM in one of 11 asset types while 57 larger advisers invest 100 percent of their clients' SMA RAUM in one of six asset types.

The most common "other" asset types reported by both larger and smaller firms include asset-backed and mortgage-backed securities, variable annuities, securitized assets and securitized debt instruments, structured products, repurchase agreements, real estate, syndicated bank loans, and alternative investments. It is likely that some assets included as "other" could have been included in one of the specified answer choices.

Use of Borrowings and Derivatives in Separately Managed Accounts

Items in Form ADV ask about an adviser's use of borrowings and derivative transactions in client SMAs. If an adviser answers that it engages in borrowings and/or derivative transactions on behalf of its SMA clients, then it generally must provide additional details relating to borrowings and derivatives (summarized in Charts 13 and 14), unless it has less than $500 million in SMA RAUM. Different additional details are required to be reported for advisers with:

- At least $500 million but less than $10 billion in SMA RAUM
- $10 billion or more in SMA RAUM

The following pages take a closer look at the additional details that advisers reported on their use of borrowings and derivatives on behalf of their SMA clients.

How Many Advisers Engage in Borrowings or Derivative Transactions on Behalf of SMA Clients?

1,594 advisers (12.3 percent) engage in borrowing transactions on behalf of any of the SMA clients that they advise. This is up by 198 (14.2 percent) from 2018.

1,756 advisers (13.5 percent) engage in derivative transactions on behalf of any of the SMA clients that they advise. This is up by 216 (14.0 percent) from 2018.

2,417 (18.6 percent) of all advisers engage in either or both borrowings and derivative transactions on behalf of their SMA clients. This is up by 291 (13.7 percent) from 2018. However, only 894 (37.0 percent) of those advisers provided additional details relating to borrowings and/or derivatives. 1,523 (63.0 percent) of the 2,417 advisers that engage in borrowings and/or derivatives did not provide gross notional exposure (GNE) details either because they have less than $500 million in SMA RAUM (and do not report additional details), or because they met the $500 million threshold but each SMA they advised was less than $10 million, and advisers are permitted, but not required, to report additional details on those SMAs.

A Deeper Dive into Use of Borrowings and Derivatives in SMAs

654 advisers that reported having SMA RAUM of at least $500 million but less than $10 billion, and 291 advisers that have SMA RAUM of at least $10 billion, provided additional details on borrowings and/or derivatives.[15] The smaller group is up from 632 (3.5 percent) while the larger group is up from 215 (35.3 percent), respectively, in 2018.

Advisers with at least $500 million but less than $10 billion in SMA RAUM must annually report the amount of aggregate SMA RAUM and the dollar amount of borrowings attributable to those assets that correspond to three levels of GNE as of the end of the year. (See box on page 28, *Understanding Gross Notional Exposure*.)

What are Borrowings?

For purposes of the recently added SMA questions in Form ADV, **borrowings are defined by the SEC in the Glossary of Form ADV Part 1A** as including secured borrowings and unsecured borrowings, collectively.

- Secured borrowings are obligations for borrowed money in respect of which the borrower has posted collateral or other credit support. The Glossary states that secured borrowings should include reverse repos.
- Unsecured borrowings are obligations for borrowed money in respect of which the borrower has not posted collateral or other credit support.

In addition, the SEC staff issued FAQs stating that borrowings should include traditional lending activities such as client bank loans and margin accounts, other secured and unsecured borrowings, synthetic borrowings and transactions involving synthetic borrowings (*e.g.,* certain total return swaps), short sale transactions, and certain transactions involving unpaid variation margin. Advisers should not report as borrowings leverage that is embedded through the use of derivatives, securities lending, or repurchase agreements.

The SEC's broad definition of borrowings and measurement methodology make it difficult to draw conclusions about the prevalence of leverage or risk in SMAs managed by advisers.

What are Derivative Transactions?

"Derivative transactions" are not defined in Form ADV, but the Glossary defines the following terms: Interest rate derivative; Foreign exchange derivative; Credit derivative; Equity derivative; and Commodity derivative.

[15] The instructions to Schedule D, Section 5.K.(2) of Form ADV provide that advisers with $10 billion or more in SMA RAUM are to complete Question (a), and that advisers with at least $500 million but less than $10 billion in SMA RAUM are to complete Question (b). However, some advisers completed both Questions, contrary to the instructions.

Chart 13: Number of Responses Reporting Borrowings or Derivatives on Behalf of SMA Clients Among Advisers with $500 Million up to $10 Billion in SMA RAUM** (Section 5.K.(2)(b) of Schedule D)

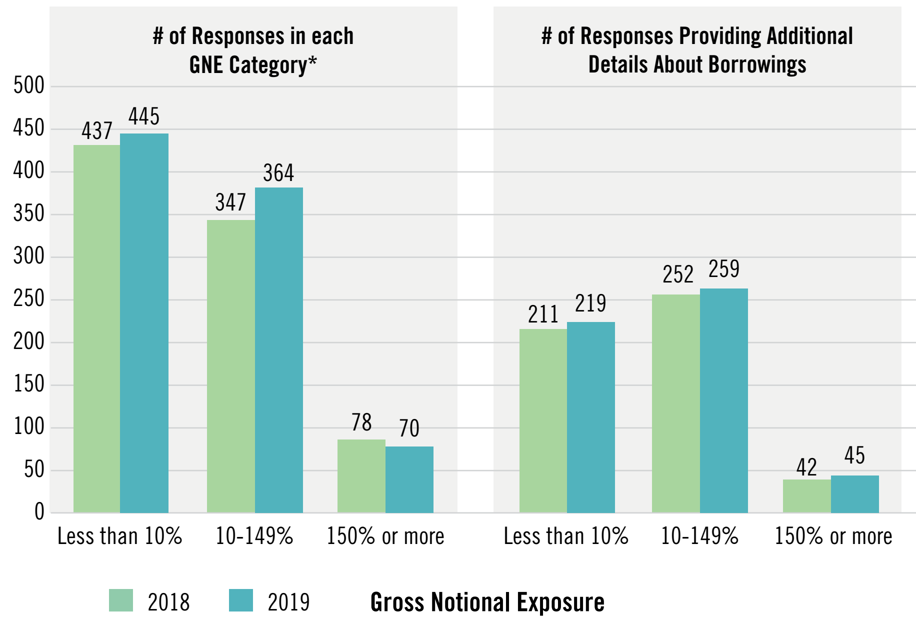


Chart 14: Number of Responses Reporting Derivative Exposures and Borrowings on Behalf of SMA Clients Among Advisers with $10 Billion or more in SMA RAUM** (Section 5.K.(2)(a) of Schedule D)

Gross Notional Exposure	# of Responses	# of Responses Providing Additional Details About Borrowings	# of Responses in each GNE category*					
			Interest Rate Derivative	Foreign Exchange Derivative	Credit Derivative	Equity Derivative	Commodity Derivative	Other Derivative
Less than 10%	248	97	63	76	25	91	8	24
10-149%	218	111	111	145	64	103	17	42
150% or more	106	50	72	81	41	56	21	26

* GNE is calculated by each client SMA. Because a single adviser may have reported more than one category of GNE, the responses do not reflect the number of advisers that engage in borrowings or derivative transactions.

** Advisers may exclude, but may also opt to include, any individual SMA with RAUM of less than $10 million in these detailed reporting Sections in Schedule D.

Understanding Gross Notional Exposure

Form ADV looks at borrowings and derivatives in terms of the gross notional exposure (GNE) of each SMA. GNE is the percentage obtained by dividing the sum of the dollar amount of any borrowings and the gross notional value of all derivatives by the RAUM of the account.

The SEC requires that the account GNE be calculated, aggregated, and reported at three levels:

- Less than 10%
- 10-149%
- 150% or more

Note: GNE is not a measure of a firm's risk and does not reflect the ways in which derivatives are used in an SMA, such as leverage, hedging positions, or offsetting long and short positions. As a result, it is not clear whether these data are meaningful without further context.

Investment Adviser Compensation

Asset-based fees continue to dominate in the investment advisory profession. In a slight increase, 95.5 percent of advisers indicate this year that they are compensated based on a percentage of their assets under management. Many compensation categories show little change year over year and it is likely that some fees included as "other" could have been included in one of the specified answer choices. Of the 1,856 (14.3 percent) advisers that report receiving "other" types of compensation arrangements, some of the more common types cited are a percentage of assets under advisement (*e.g.,* non-managed assets), various fees associated with private funds, 12b-1 fees, referral fees, percentage of client net worth, percentage of plan assets, retainers, selection of other advisers fees, seminar fees, and wrap fees.

Chart 15: Asset-Based Fees Dominate Adviser Compensation Arrangements

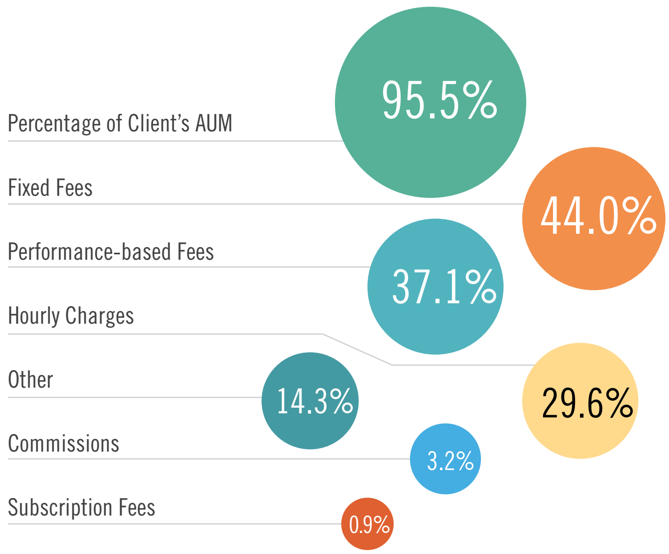


Chart 16: Investment Adviser Compensation (Past Three Years)

Category of IA Compensation	2017		2018		2019	
	# of Advisers	% of Advisers	# of Advisers	% of Advisers	# of Advisers	% of Advisers
Percentage of Client's AUM	11,592	95.2%	11,986	95.3%	12,403	95.5%
Hourly Charges	3,475	28.5%	3,647	29.0%	3,840	29.6%
Subscription Fees	115	0.9%	118	0.9%	118	0.9%
Fixed Fees	5,144	42.3%	5,445	43.3%	5,723	44.0%
Commissions	506	4.1%	459	3.6%	420	3.2%
Performance-based Fees	4,651	38.2%	4,704	37.4%	4,823	37.1%
Other	1,769	14.5%	1,830	14.5%	1,856	14.3%

The number of firms charging commissions continued to decrease, dropping yet again to 3.2 percent of all advisers in 2019, down 28.9 percent from 4.5 percent three years ago. This is perhaps a result of anticipating the since-vacated Department of Labor's Fiduciary Rule. The number of advisers reporting charging fixed fees continued to rise for various reasons likely including generational turnover as younger investors may prefer an alternative model when paying for financial advice.

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[16] – appear to continue to be a source of widespread confusion and inconsistent interpretations in the asset management industry. Indeed, a 2017 *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 five most frequent compliance topics identified in 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[17] on Form ADV and are therefore not reflected in the data we discuss below, unless otherwise indicated.

During the past two years, further confusion has stemmed from the SEC staff's Inadvertent Custody Guidance Update,[18] which (i) indicates that an adviser may have "inadvertent custody" if the client's custody agreement contains broad authority for the adviser to instruct the custodian, even where the adviser is not a party to the custody agreement and that authority is inconsistent with the adviser's agreement with the client, and (ii) called into question the industry's understanding of the authorized trading exception to the Custody Rule, which has significant implications for instruments that are not processed or do not settle on a "delivery versus payment" basis (non-DVP). However, in March 2019, the SEC staff launched an initiative to gather information on custody issues involving non-DVP trading.[19] The SEC staff is also conducting industry outreach on other changes to the Custody Rule that it may use in crafting a policy recommendation to the Commission to amend the Custody Rule.

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.

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

[17] 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, likely would 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.

[18] See SEC Division of Investment Management Guidance Update, *Inadvertent Custody: Advisory Contract Versus Custodial Contract Authority* (No. 2017-01), available at https://www.sec.gov/investment/im-guidance-2017-01.pdf.

[19] "The staff believes that questions surrounding Non-DVP trading, as well as additional questions and issues the staff has identified regarding the Custody Rule over the past 15 years, should be considered by the Commission. In this regard, amendments to the Custody Rule are on the Commission's long-term unified agenda." The letter also seeks industry input on investing in digital assets. See Letter from the SEC Division of Investment Management to the Investment Adviser Association, *Engaging on Non-DVP Custodial Practices and Digital Assets* (Mar. 12, 2019), available at https://www.sec.gov/investment/non-dvp-and-custody-digital-assets-031219-206.

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 527 (7.9 percent) to 7,162 in 2019 compared to 6,635 in 2018. In 2019 there were modest increases in the number of advisers that reported having custody of any clients' cash or bank accounts (up 9.3 percent), securities (up 6.9 percent), total advisers and their related persons having custody of clients' cash or bank accounts (up 7.9 percent), and total RAUM (including custody attributed to related persons) representing clients' cash or bank accounts (up 3.9 percent, from $13.5 trillion last year to $14.1 trillion in 2019). The number of advisers and their related persons that act as qualified custodians decreased by five.

Custodians for Separately Managed Accounts

More than half (7,693 or 59.2 percent) of advisers report that a particular custodian holds ten percent or more of the adviser's SMA RAUM, which is up by over 1,000 advisers (1,012 or 15.1 percent) from 2018. 223 advisers report that a custodian that holds ten percent or more of the adviser's SMA RAUM is a related person, up from 194 (29 advisers or 14.9 percent). 536 advisers report a non-U.S.-based custodian as holding ten percent or more of the adviser's SMA RAUM (up from 435 or 23.2 percent), representing $2.0 trillion (2.4 percent) of industry-wide RAUM.

With respect to the type of custodian, almost two-thirds (8,466 or 65.5 percent) of the responses identified custodians that are broker-dealers, which is up 0.9 percent from last year.

In the aggregate, $22 trillion of RAUM is held by custodians that each hold ten percent or more of advisers' SMA RAUM, $3.9 trillion of which (17.8 percent) is held by four large broker-dealer custodians.

Changes to the Custody Rule Are a Step Closer

It is evident from the data reported that substantial confusion with the Custody Rule remains. The regulatory framework under the Advisers Act Custody Rule is overly complex, unduly burdensome, and has caused unnecessary confusion for advisers. We note, however, that the SEC moved amendments to the Custody Rules for investment companies and investment advisers from the long-term to the short-term part of the SEC's Regulatory Flexibility Agenda in the spring of 2019:

> *The Division of Investment Management is considering recommending that the Commission propose amendments to rules concerning custody under the Investment Company Act of 1940 and the Investment Advisers Act of 1940.*

Short-term items in the proposed rule stage are items for which agencies plan to publish proposed rules within 12 months after publication of the agenda.

Chart 17: Custody of Client Assets Steadily Increasing

Category	2017		2018		2019	
	# of Advisers	% of Advisers	# of Advisers	% of Advisers	# of Advisers	% of Advisers
Adviser has custody of client cash/bank accounts	3,919	32.2%	5,236	41.6%	5,722	44.0%
Adviser has custody of client securities	3,881	31.9%	5,043	40.1%	5,390	41.5%
Related person(s) has custody of client cash/bank accounts	3,638	29.9%	3,828	30.4%	3,913	30.1%
Related person(s) has custody of client securities	3,584	29.4%	3,781	30.1%	3,860	29.7%
Adviser and/or related person(s) has custody of advisory client assets (answered yes to any of the above)	5,289	43.5%	6,635	52.8%	7,162	55.1%

Over 45 percent of investment advisers (5,974 or 46.0 percent) reported having custody of client cash, bank accounts, and/or securities, a slight increase over 2018 (5,473 or 43.5 percent).[20] However, only 78 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 show that this already uncommon practice is becoming increasingly rare. The universe of 78 firms reflects a 6.0 percent decrease in 2019 and is down 35.0 percent since 2011, when 120 firms reported acting in such a capacity.[21]

The number of advisers reporting that a related person acts as a qualified custodian stayed constant at 367 advisers in 2019. Of these, 321 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.

The number of advisers reporting than an independent public accountant conducts an annual surprise examination of client funds and securities increased by 76 or 4.5 percent to 1,749 advisers, which appears to correlate with the increase in the number of advisers that have custody.

It is worth noting that private fund advisers report a high incidence of custody of client assets because the SEC interprets "custody" as acting in a capacity that gives the adviser legal ownership of or access to client funds or securities (*e.g.,* 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, 87.8 percent also reported that they or a related person have custody of client assets.

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

[21] 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.

Employees of Investment Advisory Firms

In 2019, SEC-registered advisers reported a total of 835,124 non-clerical employees, a 3.7 percent increase in employment from 2018 and an increase of 16.0 percent over the past five years. Of these employees, 436,256 provide investment advisory services (including research) – an increase of 20,285 or 4.9 percent over 2018.[22]

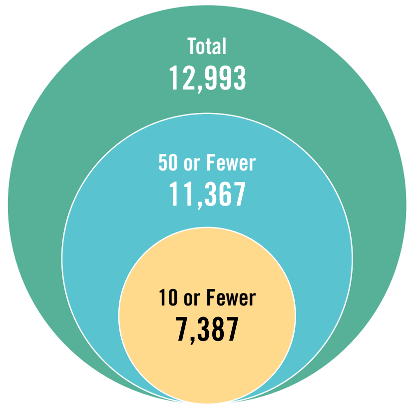
Chart 18: Investment Adviser Non-Clerical Employees

Number of Employees	2018		2019		% Change in Aggregate # of Employees
	# of Advisers	Aggregate # of Employees	# of Advisers	Aggregate # of Employees	
1 to 5	4,276	13,525	4,407	13,999	3.5%
6 to 10	2,871	22,282	2,980	23,003	3.2%
11 to 50	3,864	84,135	3,980	85,932	2.1%
51 to 250	1,171	125,856	1,214	127,818	1.6%
251 to 500	190	64,742	200	70,331	8.6%
501 to 1,000	98	71,783	96	68,800	(4.2%)
More than 1,000	108	423,300	116	445,241	5.2%
Total	12,578	805,623	12,993	835,124	3.7%
Average	—	64	—	64	—
Median	—	9	—	9	—

The data confirm that the vast majority of SEC-registered investment advisers are small businesses. In fact, 56.9 percent (7,387) reported that they employ ten or fewer non-clerical employees, and 87.5 percent (11,367) reported that they employ 50 or fewer non-clerical employees. These segments increased by 240 and 356 advisers, respectively, but due to growth across all segments but one, both of these percentages are the same or very similar to those reported in 2018 (56.8 percent and 87.5 percent). The number of advisers reporting that they have no non-clerical employees decreased slightly, going from 94 to 84.

[22] The data have some limitations, particularly in the smallest cohort, which includes 84 advisers that reported zero employees. In addition, some job growth may be attributable to firms that were previously state-registered.

Chart 19: The Vast Majority of Advisers are Small Businesses with 50 or Fewer Non-Clerical Employees



Investment advisers collectively reported employing 436,256 individuals who perform investment advisory functions and 399,013 employees who are also registered representatives of a broker-dealer. The number of employees in these categories increased by 4.9 percent and 3.7 percent, respectively, and in addition, the percentage of advisers that reported no registered representative, 72.0 percent or 9,360, increased from 71.4 percent or 8,982 in 2018.

Chart 20: 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	180	9,360	5,676	11,727	9,663
1 to 5	6,539	1,928	4,718	964	2,309
6 to 10	2,709	559	1,278	142	402
11 to 50	2,726	712	976	116	365
51 to 250	650	276	222	35	149
251 to 500	94	49	48	3	27
501 to 1,000	46	46	24	4	30
More than 1,000	49	63	51	2	48
Total	436,256	399,013	312,471	20,494	252,591
Average	34	31	24	2	19
Median	5	0	1	0	0

Although 180 advisers report that they have no employees who perform investment advisory functions, it is likely that those persons are shared with, and technically employed by, an affiliate of the firm.

Other Characteristics of Investment Advisory Firms

Other Business Activities

Although participation in most categories of other business activities decreased or stayed flat over the past year, advisers selling products or providing services other than investment advice to advisory clients increased by 4.6 percent to 2,243 advisers.

In 2019, as in previous years, a few of the other business activity categories account for the vast majority of all reported other business activities of investment advisers. The two most common activities – commodity pool operator (CPO)/commodity trading advisor (CTA) and insurance broker/agent – collectively represented 67.6 percent of all activities reported, while broker-dealer and registered representative of a broker-dealer together accounted for 19.0 percent of all other business activities reported. Participation as a CPO/CTA decreased slightly by 0.2 percent with 2,054 advisers listing CPO/CTA as an outside business activity, outpacing insurance broker/agent, which was reported by 1,064 participants, a 1.4 percent increase from last year. The number of firms reporting active engagement as registered municipal advisors dropped 11.3 percent in 2019, after remaining steady for the past three years.

The number of dual registrants (entities that are both SEC-registered investment advisers and SEC-registered broker-dealers) fell by a slight 2.2 percent to 445, while the number of advisers actively engaged in business as a registered representative of a broker-dealer (*e.g.,* sole proprietors) fell by 4.8 percent, following last year's 1.5 percent decrease, from 455 to 433. For more on dual registrants, see "Financial Industry Affiliations" below.

Financial Industry Affiliations

Form ADV requires investment advisers to disclose information regarding their affiliations and activities with other persons within the financial industry. Following last year's 1.4 percent decrease, affiliations increased slightly by 0.2 percent from 2018 to 2019, from a total of 20,760 reported affiliations in 2018 to 20,795 in 2019.

Chart 21: Financial Industry Affiliations

Related person is:	Number of Advisers	Percentage of Advisers
Sponsor, general partner, managing member (or equivalent) of pooled investment vehicles	4,713	36.3%
Other investment adviser (including financial planners)	4,274	32.9%
Broker-dealer, municipal securities dealer, or government securities broker or dealer	2,358	18.1%
Commodity pool operator/trading advisor (whether registered or exempt)	2,267	17.4%
Insurance company or agency	2,073	16.0%
Accountant or accounting firm	890	6.8%
Banking or thrift institution	758	5.8%
Trust company	735	5.7%
Sponsor or syndicator of limited partnerships (or equivalent), excluding pooled investment vehicles	620	4.8%
Pension consultant	580	4.5%
Real estate broker or dealer	507	3.9%
Lawyer or law firm	457	3.5%
Registered municipal advisor	294	2.3%
Futures commission merchant	183	1.4%
Registered security-based swap dealer	75	0.6%
Major security-based swap participant	11	0.1%

The most common affiliation reported in 2019 among investment advisers is with sponsors, general partners, or managing members (or equivalent) of pooled investment vehicles, with 4,713 (36.3%) reporting such an affiliation, up slightly (2.2 percent) since 2018.

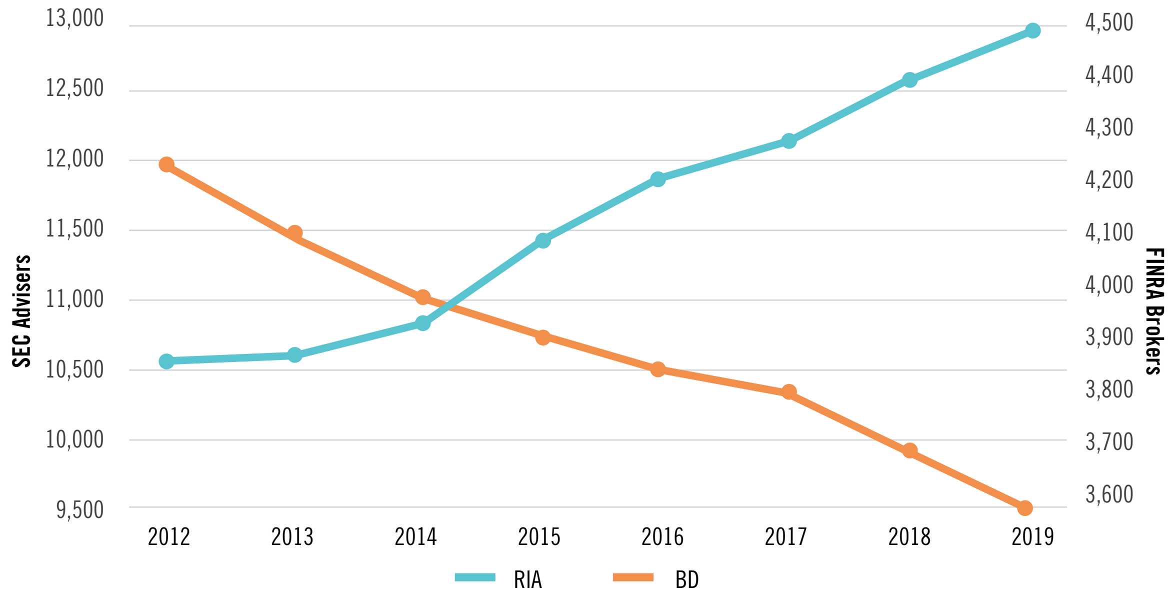
Included in the numbers cited under "Other Business Activities" and "Financial Industry Affiliations" are broker-dealer relationships, where investment advisers are either dually registered as broker-dealers or are affiliated (through common ownership and/or control) with broker-dealers. Those advisers affiliated with broker-dealers followed last year's 3.1 percent decrease with a slight (0.5 percent) decrease this year to 2,358, which is consistent with industry-wide trends. Since 2014, FINRA membership has fallen 11.3 percent from 4,068 to 3,607 in December 2018, while the number of registered representatives stayed flat, decreasing from 637,707 to 629,847, during the same period.[23]

Interestingly, the rates of attrition and addition for both FINRA firm membership and registered representatives have remained relatively constant since 2014, as FINRA member firms decreased by five to six percent each year, while the number of new member firms added during this time period remained constant at three percent each year. Similarly, the number of registered representatives decreased by six to eight percent during those years, with new registered representatives added at the rate of six to seven percent each year.

It remains to be seen whether the declining broker-dealer trend will be affected by Regulation Best Interest, or Reg BI, the SEC's new rule that was intended in part to prevent further decline. Reg BI may feed into or accelerate the secular trend of an increasing number of advisory firms, clients, and employees, or it may prompt more broker-dealers to become hybrid advisers in order to offer an advisory option.

[23] https://www.finra.org/newsroom/statistics

Chart 22: Gap Between Number of Advisers and Broker-Dealers Widens



	2012	2013	2014	2015	2016	2017	2018	2019
RIA	10,511	10,533	10,895	11,473	11,847	12,172	12,578	12,993
BD	4,289	4,146	4,068	3,943	3,835	3,813	3,712	3,607

Solicitors and Referral Compensation

Advisers were more likely to have solicitor relationships with third parties in 2019 than in prior years. The number of advisers that paid third parties for referrals increased 2.7 percent (from 3,481 in 2018 to 3,574 in 2019), while the number of advisers that had relationships in which they were paid for referring clients to third parties declined slightly by 0.9 percent (from 812 to 805).

There was a significant increase of 77.7 percent in the number of firms or other persons who solicit advisory clients on behalf of advisers (from 176,442 in 2018 to 313,625 in 2019). This increase can be attributed primarily to digital advice platforms' "refer a friend" programs in which the referring client and his or her referred client are each rewarded a fixed dollar amount per completed referral. A number of clients are thus treated as solicitors, and the number of client-solicitors generally grows in lockstep with the growth of the total client base. As noted below, the SEC staff is considering recommending amendments to the Cash Solicitation Rule. It is uncertain how an amended rule will apply to digital advisers' solicitation practices.

REFERRAL PAYMENTS

2018 saw the introduction of a new question on Form ADV, which asks advisers if they compensated their related persons (including employees and affiliates) for client referrals. The question asks for cash and non-cash compensation above and beyond the employee's regular salary. The number of firms that made referral payments to their related persons increased by 9.2 percent in the past year (from 2,238 in 2018 to 2,443 in 2019).

Websites and Social Media

Investment advisers are increasingly using multiple electronic media platforms to connect with clients and prospective clients. The number of investment advisers with at least one social media platform or website continued to increase, going from 11,070 in 2018 to 11,538 in 2019. The number of advisers with only one website fell ten percent (from 5,718 to 5,146, representing almost 40 percent of advisers), while advisers using more than one social media platform or multiple websites grew by 19 percent to nearly half (6,392 firms or 49.2 percent). Firms with multiple websites are typically those that allow their investment adviser representatives to operate their own websites. Indeed, 114 firms reported over 20 web addresses, nine firms reported over 200 web addresses, and one outlier firm reported 1,000 separate web addresses.

Social Media: A Square Peg in the Advertising Rule's Round Hole

Changes to the Advertising Rule Expected Soon

One important reason that investment advisers have been reluctant to use social media to attract clients is that almost all social media posts are subject to the SEC's stringent Advertising Rule under the Advisers Act. The Advertising Rule has not been materially amended since its adoption in 1961. The current regulatory framework governing advertising by investment advisers is unnecessarily complex, overly broad in reach, unduly prescriptive, and involves a complex maze of enforcement actions and several decades' worth of SEC staff no-action letters and interpretive releases that are difficult to decipher and apply to evolving circumstances.

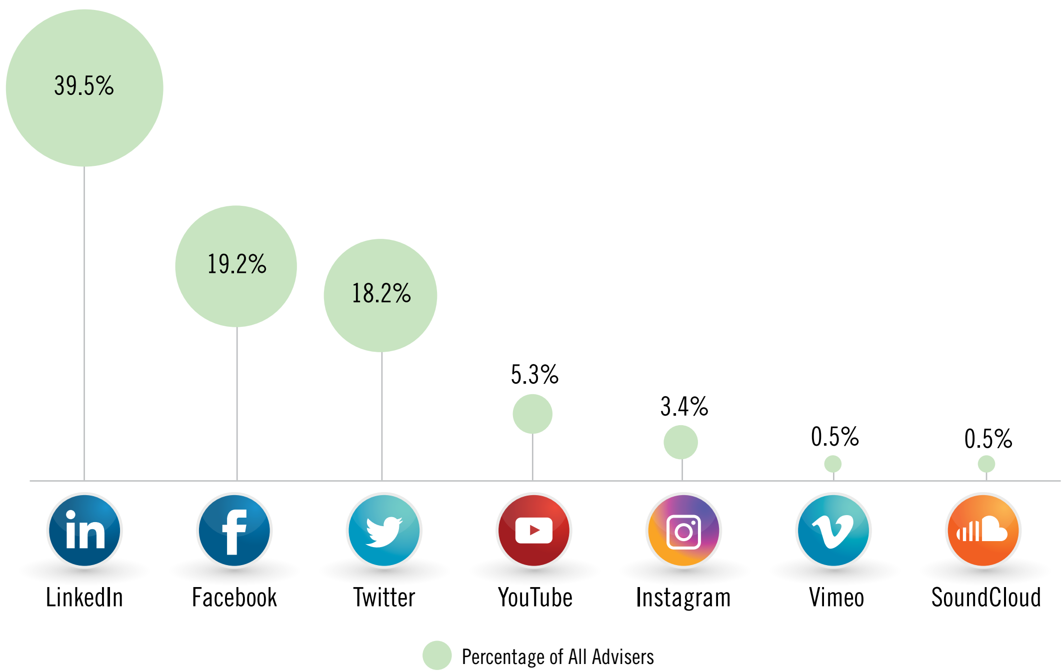
The Advertising Rule prohibits or restricts client testimonials, references to past specific profitable investment recommendations, and portfolio performance without substantial disclosure. Applying the Advertising Rule to traditional media is already a challenge, let alone to interactive environments. However, help may be on the way. Amending the Advertising Rule (Rule 206(4)-1) and Cash Solicitation Rule (Rule 206(4)-3) under the Advisers Act regarding marketing communications and practices by investment advisers is on the SEC's short-term regulatory agenda. In March 2019, the SEC's Director of Investment Management, Dalia Blass, stated at an industry conference that she "anticipate[s] that the Division will present recommendations for a proposal on modernizing the advertising and solicitation rules for investment advisers." Modernization of the Advertising Rule could make it easier for advisers to make greater use of electronic media than they have to date. We expect the SEC to publish proposed rule amendments soon.

As was the case last year, LinkedIn is the preferred social media site for advisers, with almost 40 percent of all advisers (5,146) reporting at least one LinkedIn page – a 29 percent increase since 2018. While LinkedIn is typically considered a business and professional networking platform, it does offer marketing and advertising services.

Consumer-oriented services such as Facebook and Twitter are by far the next most popular platforms among advisers, with Facebook claiming 2,501 adviser users (up 25 percent from 2018) and Twitter being used by 2,364 advisers (up 22 percent from 2018). The fact that users are increasing by such sizable numbers indicates that firms, while still generally reluctant, are starting to embrace social media as a necessary element of their marketing strategies, despite the compliance challenges they present.

Other social media platforms used by advisers include YouTube (694, up 35 percent), Instagram (442, up 76 percent), Vimeo (67, up 49 percent), and SoundCloud (66, up 53 percent).

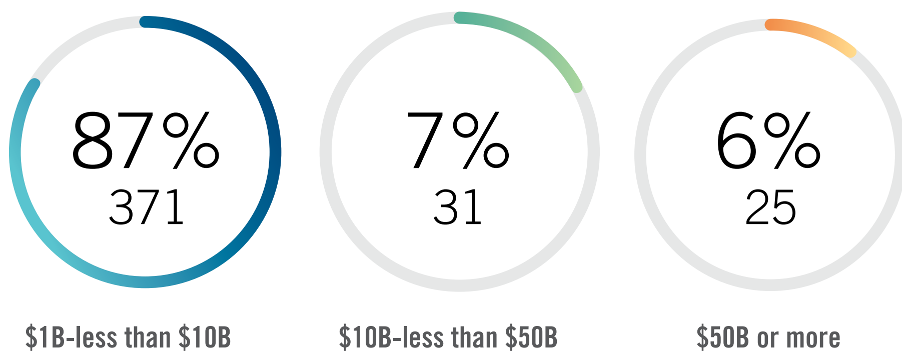
Chart 23: Investment Adviser Social Media Use



Adviser Balance Sheets

In an effort to obtain more precise data for use in SEC rulemaking arising from ongoing Dodd-Frank Act implementation, Form ADV requires advisers with assets of $1 billion or more to report their assets within one of three specified ranges. Despite the inclusion of an instruction explaining that "assets" refers to the adviser's total assets on its own balance sheet rather than the assets that it manages on behalf of clients, it appears that many advisers still respond based on their RAUM. For example, in 2019, 427 advisers claimed to have more than $1 billion on their own balance sheets, a four percent increase from the 410 firms that responded to this question in 2018. However, publicly available financial data show that very few advisers have such large balance sheets. With that caveat, here is how these 427 firms responded in 2019:

Chart 24: Advisers with Balance Sheet Assets Over $1 Billion



Umbrella Registration

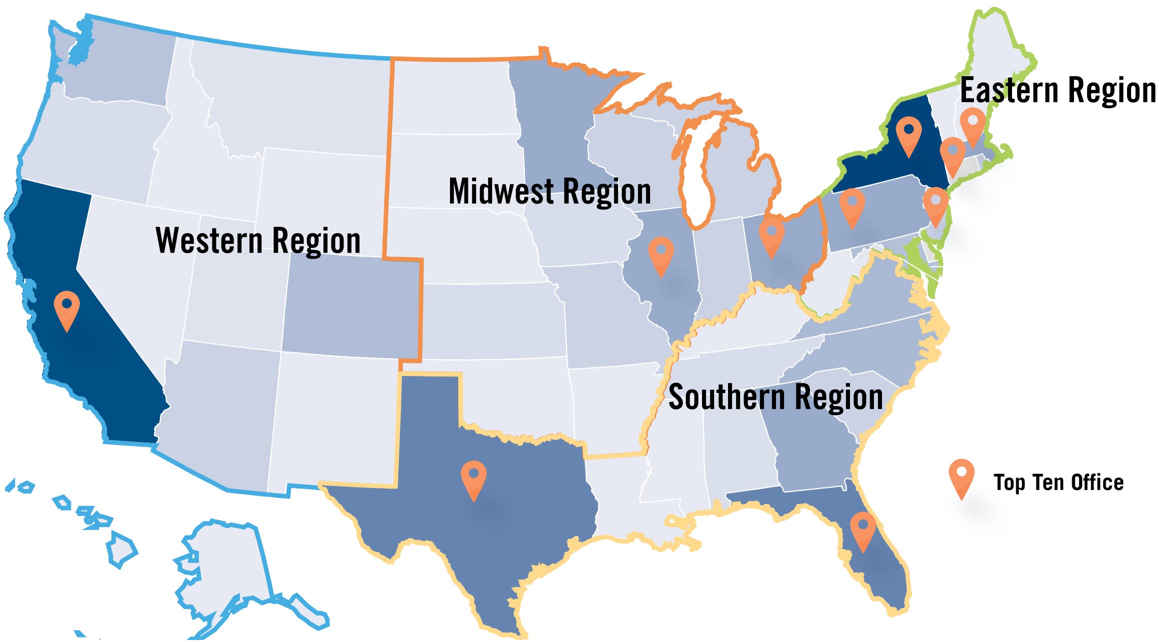
Form ADV permits a single registration for certain groups of private fund advisers operating as a single advisory business.[24] 817 advisers (6.3 percent) used Form ADV to register more than one investment adviser under an umbrella registration. 2,839 responses identifying relying advisers (*i.e.,* other advisers eligible to register with the SEC, that are controlled by or under common control with the filing adviser, and conduct a single advisory business, that rely on a filing adviser to file and amend a single Form ADV umbrella registration on its behalf) are listed, which is up by 15.6 percent from 2,455 in 2018.

[24] Conditions for using umbrella registration include:
- The filing adviser and each relying adviser: (i) advises only private funds and clients in SMAs that are qualified clients (ii) that are otherwise eligible to invest in the private funds advised by the filing or a relying adviser and (iii) whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds;
- The filing adviser has its principal office and place of business in the United States;
- Each relying adviser, its employees, and the persons acting on its behalf are subject to the filing adviser's supervision and control and are "persons associated with" the filing adviser;
- The advisory activities of each relying adviser are subject to the Investment Advisers Act and the rules thereunder, and each relying adviser is subject to examination by the SEC; and
- The filing adviser and each relying adviser operate under a single code of ethics under the Investment Advisers Act and a single set of written policies and procedures under Rule 206(4)-7 that is administered by a single CCO.

Location of Investment Advisers

Although the vast majority of advisers continue to remain in and around traditional financial centers, growth in new and emerging financial centers continues to increase. The states comprising the top ten investment adviser locations remain unchanged from the past two years, reflecting advisers' proximity to financial and population centers.

Chart 25: Office Location Density Tracks Financial and Population Centers[25]

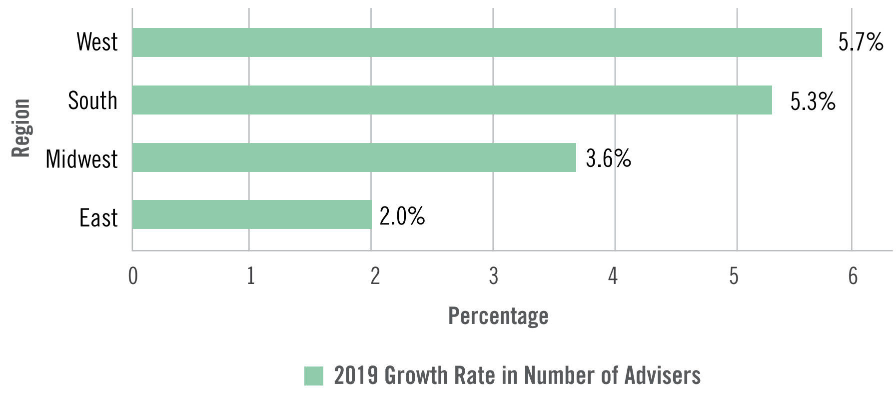


When considered on a regional basis, all regions reported an increase in advisers, led by a 5.7 percent increase in the West, which built upon last year's 5.4 percent increase in the region. The South grew at 5.3 percent following last year's 4.4 percent increase and the Midwest almost equaled last year's 3.9 percent increase by growing 3.6 percent, with only one state, Kansas, losing advisers (down 12.6 percent over 2018). The East had a 2.0 percent rate of increase, continuing the recent trend toward regional parity and away from the longstanding numerical dominance of East Coast-based advisers.

Top Ten States for Advisers (by Headquarters)	Number of Locations
NY	2,449
CA	1,585
TX	713
MA	592
IL	586
FL	509
PA	461
CT	419
NJ	328
OH	305

[25] Includes (i) principal office and place of business at which an adviser conducts investment advisory business and (ii) the adviser's 25 largest other offices in terms of numbers of employees.

Chart 26: The West Continues to Emerge

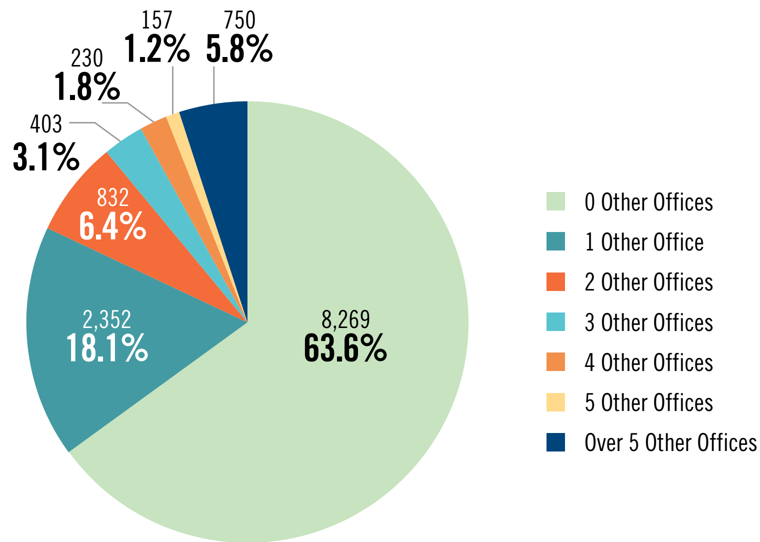


Among the tea leaves to consider when pondering future trends in this area are tax, demographic, and technological developments. Recent tax law changes reducing the deductibility of property taxes in higher-tax states (state and local tax deduction, or "SALT") may encourage advisers to consider relocating to states with more advantageous tax environments. It is also possible that advisers will follow demographic trends and choose locations in states popular among retirees or vacation destinations, as technological advances such as digital investment advice will allow virtual proximity to financial centers from other desirable locations.

Investment Advisers with Multiple Offices

4,724 investment adviser firms (36.4 percent of all advisers) reported having at least one office at which they conduct investment advisory business other than their principal office and place of business, a 6.1 percent increase from 2018. This may reflect recent trends in acquisitions of other advisory firms as a way of expanding into new locations or permitting more remote working arrangements, as well as a rise in the number of advisers that are organized as an independent business but are also affiliated with a broker-dealer. Conversely, 8,269 advisers do not have any other offices. As in 2018, just over 50 percent of advisers with multiple offices had more than one other office. The number of these firms reporting more than five other offices increased slightly from 15.1 percent to 15.9 percent. The median number of employees performing advisory functions from each office location was two (down from three the previous year).

Chart 27: Investment Advisers with Multiple Offices



The results show that many advisers with multiple offices (2,032 or 43.0 percent of this group) provide additional services at those offices.[26] The percentage of advisers that offer such additional services increased 6 percent from 2018. Of firms with other offices offering multiple services, the most common other business functions occurring at those locations were insurance (22.1 percent) and brokerage services (21.3 percent), both of which were up from 19 percent over last year. They were followed by accountant or accounting firm (7.5 percent, up from 6 percent in 2018) and CPO/CTA (which remained stable at 6.2 percent in 2018 and 2019).

Chart 28: Additional Investment-Related Activities Conducted at Branch Offices

Other Business Activity:	Number of Advisers	Percentage of Advisers with Multiple Offices
Insurance broker or agent	1,042	22.1%
Broker-dealer	1,004	21.3%
Other	614	13.0%
Accountant or accounting firm	356	7.5%
Commodity pool operator or commodity trading advisor	293	6.2%
Bank	162	3.4%
Lawyer or law firm	94	2.0%
Municipal advisor	53	1.1%

Of the 614 (13.0 percent) advisers that report conducting "other" investment-related business activities at other office locations, some of the more common types described are financial planning, wealth management/planning, client meetings, trust services, tax preparation/planning, research, pension consulting, operations, and investor relations.

[26] The Form ADV instructions for advisers that conduct additional investment-related activities at their branches is vague. It is unclear if the response should be limited to other business activities of the advisory firm itself, or if it should include all non-advisory activities conducted in the office regardless of whether those activities were under the advisory firm's supervision and control.

Disciplinary Information

It is difficult to draw meaningful statistical conclusions from the disciplinary disclosure information provided in Form ADV, Part 1, in large part because the "true or false" and "yes or no" nature of the questions is not particularly revealing. Gleaning information contained in the disciplinary disclosure reporting pages for Form ADV, Part 1, Item 11 requires delving deep into the specifics of each disclosure event, which may or may not provide clarity or facilitate "apples to apples" comparisons. Also, the information required to be disclosed is provided for the advisory firm and its employees, officers, directors, and advisory affiliates for the past ten 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:

- 11,241 investment advisers (86.5 percent) reported no disciplinary history at all,[27] which is approximately the same percentage of advisers that reported no disciplinary history the past two years.

- 128 investment advisers (1.0 percent) reported that they or an advisory affiliate were, at the time of filing, the subject of a regulatory proceeding that could result in a "yes" answer to any part of Item 11.C, 11.D, or 11.E. This is an 11.7 percent decrease from the previous year and approaches 2017 levels, when 122 firms answered the question affirmatively.

- In a 26.4 percent increase from 2018, 206 firms or advisory affiliates (1.6 percent) reported that the SEC or the Commodity Futures Trading Commission (CFTC) found them to have made a false statement or omission; 618 firms (4.8 percent) reported that they have been involved in a violation of SEC or CFTC regulations or statutes, which is a 14.2 percent increase from last year. Only 18 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, which is three more than the previous year.

- 607 firms or advisory affiliates (4.7 percent) reported that the SEC or the CFTC imposed a civil money penalty on the adviser or its affiliate or that they were ordered to cease and desist from an activity; this represents a slight increase from the prior year.

Of the 1,752 advisers reporting at least one disciplinary event, 917 advisers (52.3 percent) attributed the disclosure events to an affiliate and not directly to the adviser or its supervised persons.

[27] The 11,241 figure disregards 21 advisers that marked "yes" to Item 11 and "no" to all other Item 11 questions.

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 10, 2019. Advisers are required to file specific information electronically using the Investment Adviser Registration Depository (IARD) system.

17,543 investment advisers are registered with the states, and there are 10,480 SEC notice-filed investment advisers.[28] This report focuses solely on the 12,993 investment advisers that are registered as such with the SEC, after removing (i) 61 advisers that are using an old version of Form ADV and (ii) 119 advisers that are no longer eligible for SEC registration.

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 the 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. Areas that are commonly misinterpreted include how to calculate RAUM, reporting of $1 billion or more in the adviser's balance sheet assets, custody, and disciplinary history questions.

[28] See the North American Securities Administration Association (NASAA) *2019 Investment Adviser Section Annual Report*, available at http://www.nasaa.org/wp-content/uploads/2019/05/2019-IA-Section-Report.pdf.

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