



CONVERGENCE
OPTIMAL PERFORMANCE

**Alternative Asset Management Industry¹
Convergence Insights
Twelve Months Ended June 30, 2016**

***Q2 2016 Year-over-Year Headline
The Alternative Asset Management Industry is GROWING!***

KEY CONVERGENCE GROWTH MEASURES

- ALTERNATIVE MANAGER GROWTH:	+ 11%
- ALTERNATIVE ADVISOR GROWTH:	+ 12%
- HEADCOUNT GROWTH:	+ 16%
- PRIVATE FUND COUNT GROWTH:	+ 13%
- PRIVATE FUND ASSET GROWTH:	+ 4%
- REGULATORY ACTION GROWTH:	+ 26%
- PRODUCTIVITY DECLINE:	- 7%

This Convergence Industry report focuses on Alternative Asset Managers with 50% or more of their Regulatory Assets in Private Fund Assets (alternative assets). This segment of the industry continues to grow by all measures tracked by Convergence. Headcount growth remains robust as managers added more staff to their back-offices to deal with increasing business complexity, a challenging regulatory environment and greater reporting and transparency required by their investors. Productivity is the only factor to experience a year-over-year drop driven by productivity losses driven by slower asset growth.

Convergence's Q2 2016 update on the Alternative Asset Management Industry provides original insights into the alternatives industry. Convergence measures the overall health of the "Industry" by analyzing the data it collects and creates on 17,000+ Advisors and their 51,000+ Private Funds². During the past 6 months, RIAs filed 24,000 Form ADV updates indicating a greater level of compliance with the SEC's guidance on filing updates upon the occurrence of material changes to their business model. More Advisors are filing more frequently and updating more sections of Form ADV than ever before.

Please go to www.convergenceinc.com for more detailed information call John Phinney, George Evans or George Gainer @ 203-956-4824.

¹ An Alternative Asset Manager is defined as an RIA that discloses advising one or more Private Funds. In this report, Convergence focuses on Managers who advise 50% or more of their Regulatory Assets under Management in Private Funds.

² Private Funds include Hedge, Private Equity, Real Estate, Venture Capital, Structured Asset, Liquidity and Other Funds

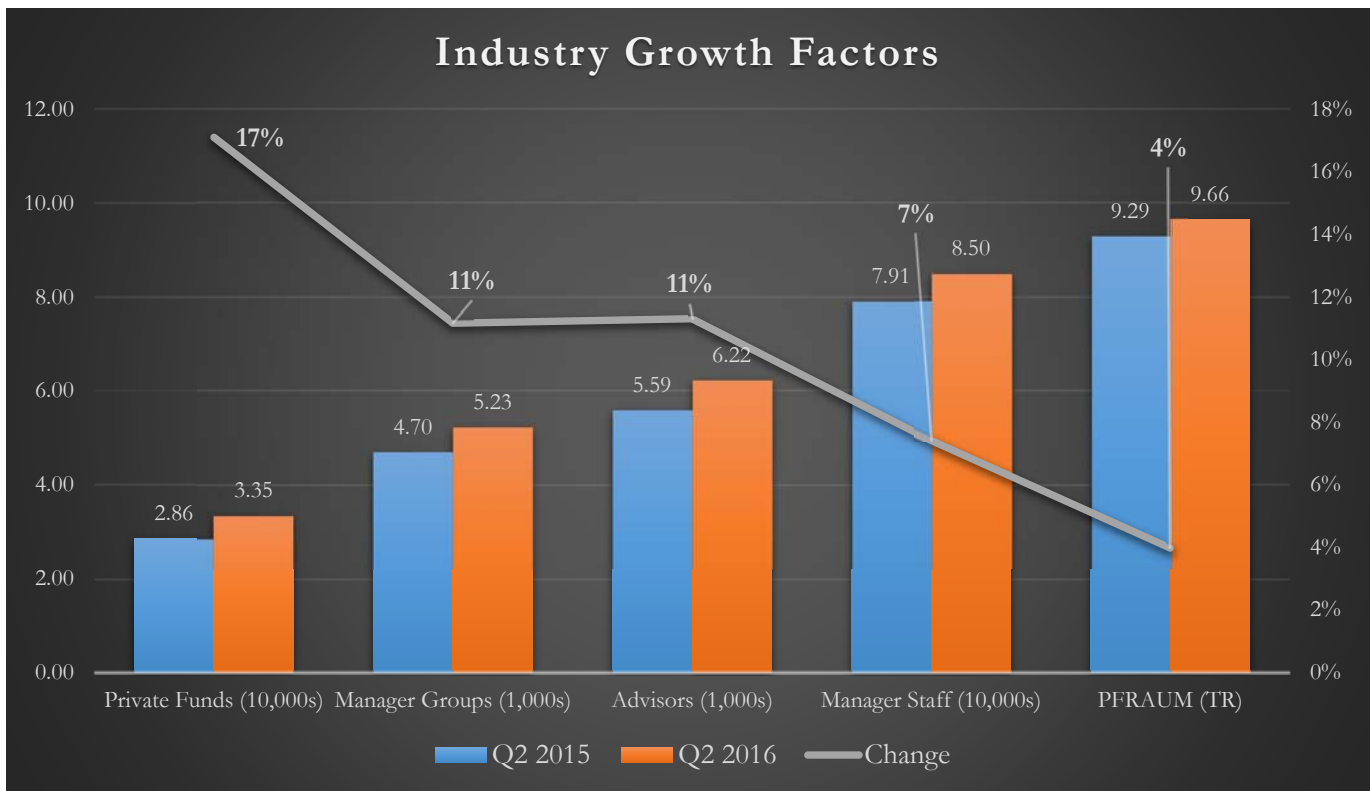
Alternative Industry Growth

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The number of Private Funds grew 17%, Alternative Managers and Advisors grew 11% and Private Fund Assets under Management³ grew 4%.

The industry is growing much greater than one hears by listening to selective sources. Convergence sees broad-based growth in alternative assets despite reduced leverage, weaker hedge fund performance returns, fund closures and increased industry regulation.

Banks continue to reduce their balance sheets and are shedding alternative asset management and proprietary trading businesses. Institutional Investors continue to deal with low US interest rates and negative interest rates abroad and Pension Plans around the globe are faced with severely underfunded plans, making alternative investment attractive to investors seeking better returns from asset classes less correlated with traditional equity and fixed income markets.

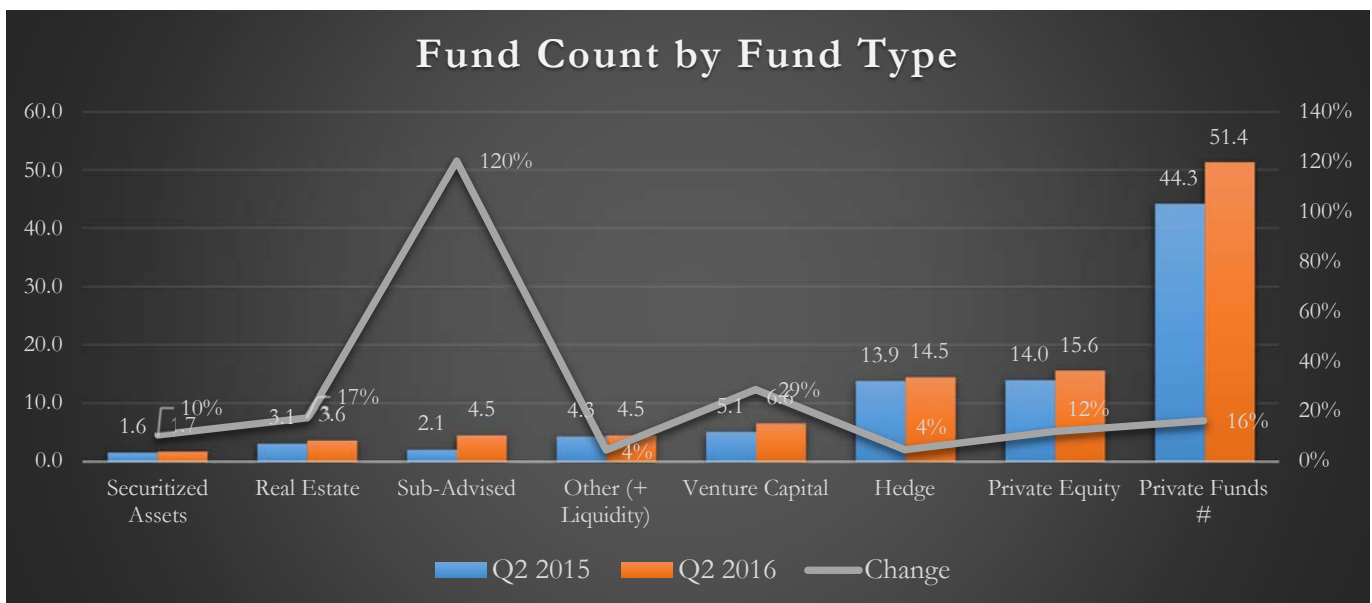
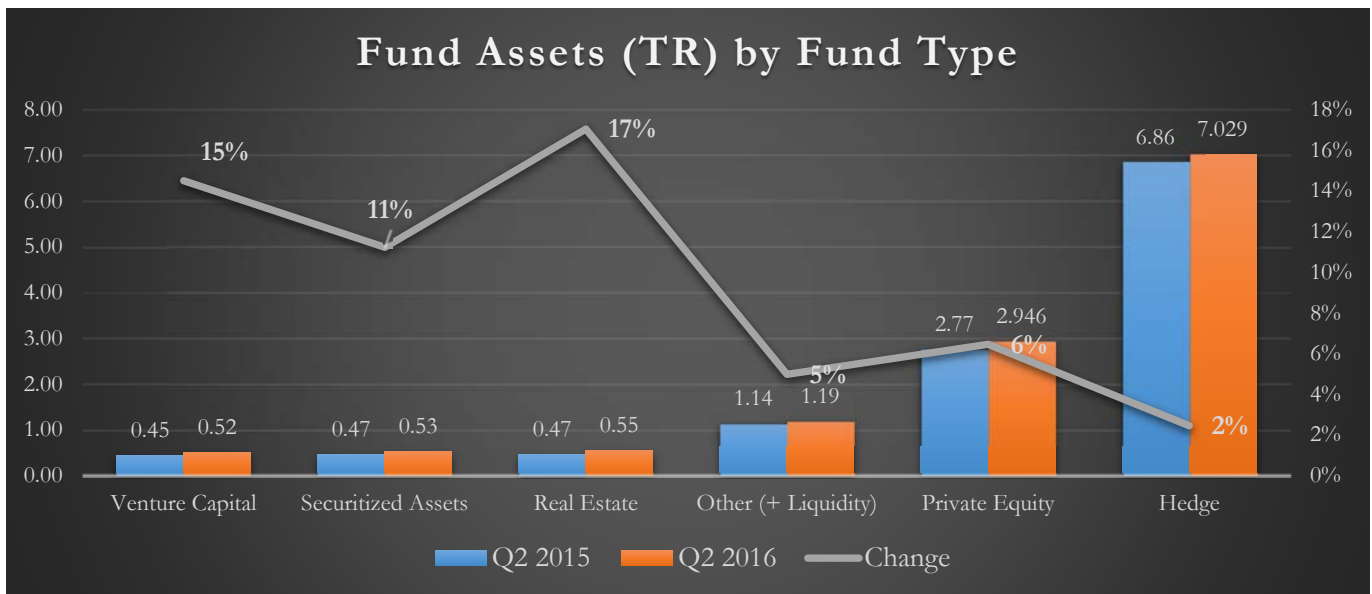


³ Regulatory assets under management includes the value of securities portfolios for which an Advisor provides continuous and regular supervisory or management services as of the date of filing this Form ADV without deducting the value of liabilities or other debt.

Alternative Industry-Fund Type Profile

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Hedge Funds assets continue to represent the largest pool of alternative assets at \$7.029 trillion, growing 2% above Q2 2014. Based on reported Hedge Fund NAV of \$2.9 trillion, average leverage across the industry is approximately 2.42x invested capital. Real Estate assets grew the greatest with 17% growth in asset value and Venture Capital funds grew 15%. Private Equity represent the largest number of funds with 15,600, growing 12%, while PE assets grew 6%.

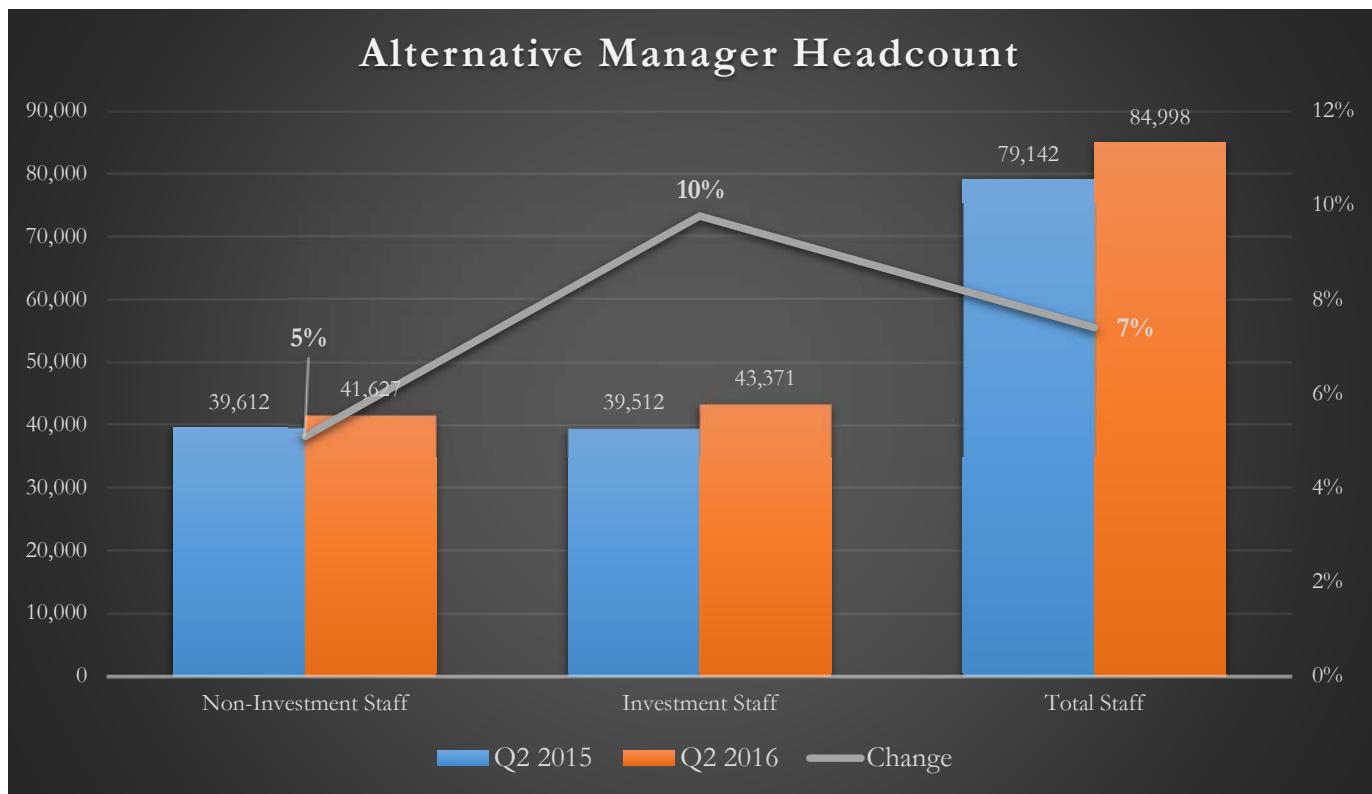


Alternative Industry-Headcount

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Manager headcount rose 7% driven by a 5% increase in non-Investment Staff and a 10% increase in Investment staff. The large increase in Investment staff is attributable to the significant increase in Venture Capital funds which typically have lower levels of non-investment staff when they initially launch.

Non-investment staff hiring continues to be driven by business complexity, increased regulatory pressures and greater investor demands for more frequent reporting and additional transparency into their business models.



Higher headcount does not necessarily mean that an Advisor has too many people. Advisors need to establish the rationale for staff levels and determine what level of staffing is needed to support business growth, meet best practices and support investor and regulatory requirements.

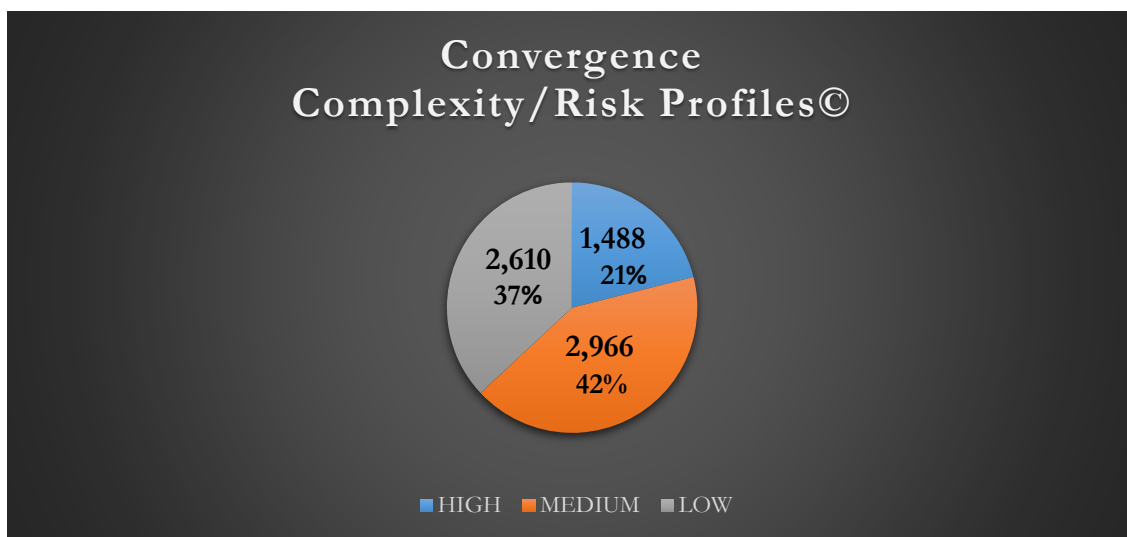
Convergence will help you compare your headcount levels to your peers by working with you to select peers with similar complexity levels.

Alternative Industry- Complexity/Risk Profile©

Convergence Insights

Convergence created a proprietary complexity/risk profiling methodology to assign each Manager in our database a Complexity/Risk Profile©. We measure the level of operating risk⁴ by assessing the aggregate complexity/risk created by 40 different factors that define a Manager's business model.

At the end of Q2 2016, 63% of alternative Managers in our database have been assigned a Medium-High Complexity/Risk Profile©. Higher levels of complexity mean higher levels of operating risk and in this inaugural Complexity/Risk Profile© we want to share with Managers and Investors alike the implications of our Complexity/Risk Profile© methodology.



The Manager's investment and non-investment processes should correlate to quality levels found in the "Capability Maturity Model" (CMM) framework described in the table below. Meaning, we would expect to see CMM Level 4 and in some cases Level 5 procedures in place at those Managers with high complexity/risk profiles.

CMM Level	CMM Levels Defined:	CMM Levels Described:
Level 1	Initial	Processes are ad hoc, or actually few processes are defined
Level 2	Repeatable	Basic processes established and there is a level of discipline to stick to these processes
Level 3	Defined	All processes are defined, documented, standardized and integrated into each other
Level 4	Managed	Processes are measured by collecting detailed data on the processes and their quality
Level 5	Optimized	Continuous process improvement is adapted & in place, driven by quantified feedback

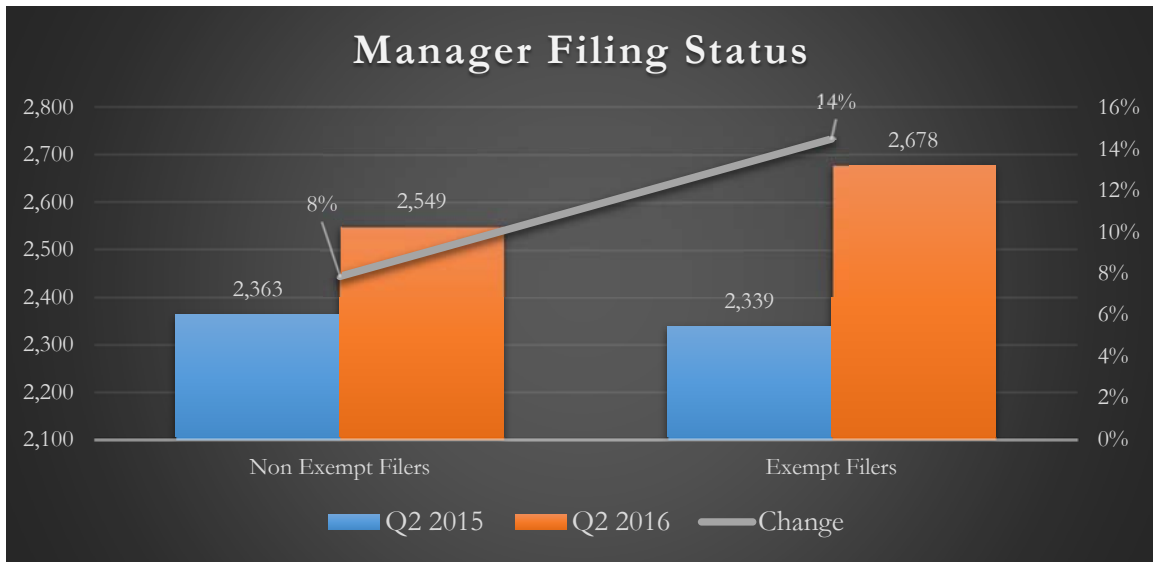
We would expect Managers with Medium-High Complexity Profiles to use service providers who have demonstrated experience with Managers possessing similar complexity/risk profiles. Convergence can evaluate the complexity/risk profiles of your service providers using our "Best Fit" analytical tools and your CMM level through our Advisory Services.

⁴ The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. – Basel II

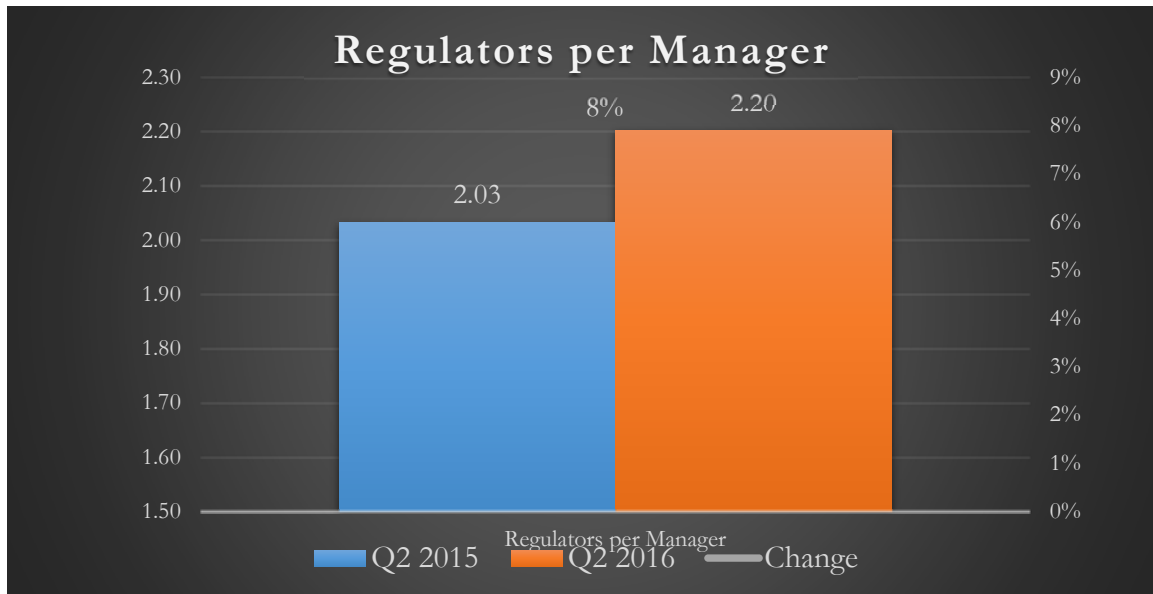
Alternative Industry-Manager Registration and Regulator Profile

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Managers of alternative assets who are non-exempt registrants increased by 8% while the number of exempt filers increased 14%. This change was driven by the large increases in Venture Capital and Real Estate Advisors filers.



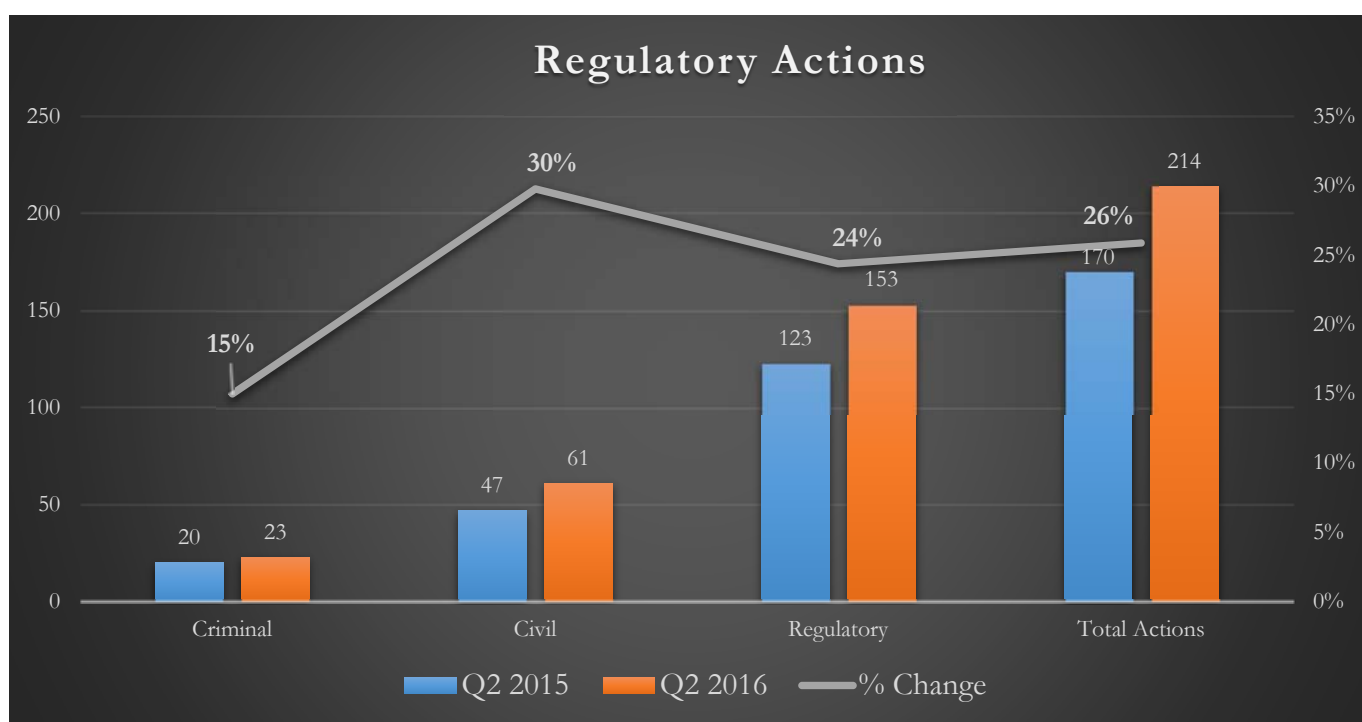
The number of regulators disclosed by Managers increased 8%. This change was driven by the number of Managers that opened non-US offices and/or added new lines of business regulated by different US Regulators.



Alternative Industry-Regulator Actions Profile

Convergence Insights

Total regulatory actions disclosed by Managers grew 26%. Criminal, Civil and Regulatory Actions increased 15%, 30% and 24%, respectively. The SEC has made it quite clear that they will continue their efforts to review more Advisors. The SEC spoke at the Institutional Investor CFO/COO Roundtable in April and stated that they would step up their scrutiny in the following areas 1) Cyber Security, 2) Expense Disclosures, 3) Filing Frequency, 4) Business Continuity and 5) Conflicts of Interest. The SEC Head of Enforcement in the Midwest stated “we are very surprised by the lack of action taken by Advisors to improve their ADV expense disclosures” and “we are concerned about the conflicts between Advisors and affiliated and non-affiliated broker-dealers.”



Convergence encourages Advisors to call us to discuss how your expense and broker-dealer disclosures contrast against industry standards. Our database of expense disclosures across over 4,000 Advisor ADVs indicate that the SEC could cite up to 70% of them for the following issues:

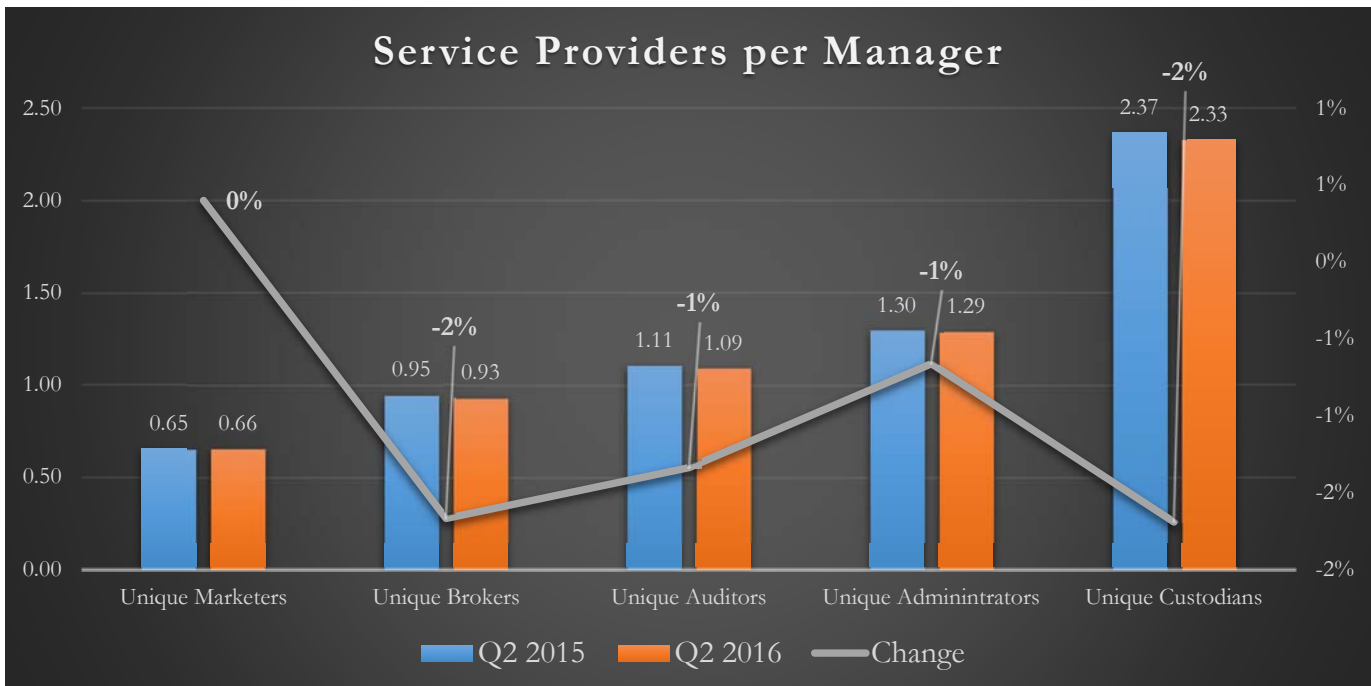
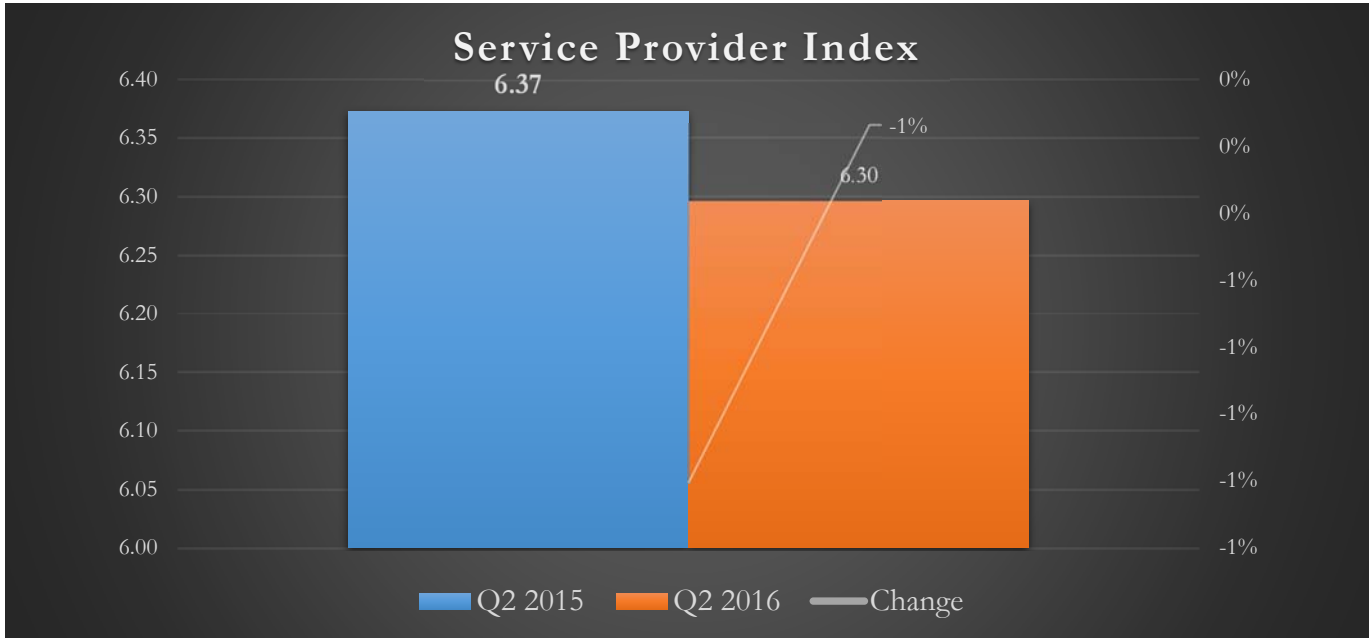
- 1) Incomplete*
- 2) Inconsistent*
- 3) Lack of Clarity*
- 4) Lack of Specificity*

Recent enforcement actions in each of these areas confirms our concerns. Please note that most Advisors use external Counsel and Compliance firms to prepare fund documents and help them complete and file their Form ADV. Convergence can provide you with a complete view of market practices, something that can help you understand the compliance risks you may be facing.

Alternative Industry-Service Providers

Convergence Insights

The Convergence Service Provider Index declined by 1% driven by the large number of mergers taking place in the Fund Administration and Fund Auditor markets. These transactions reduced the average number of Fund Administrators and Fund Auditors by 1% each. We observed a decline in the number of Prime Broker and Custodians which consistent with Banks shedding smaller clients.

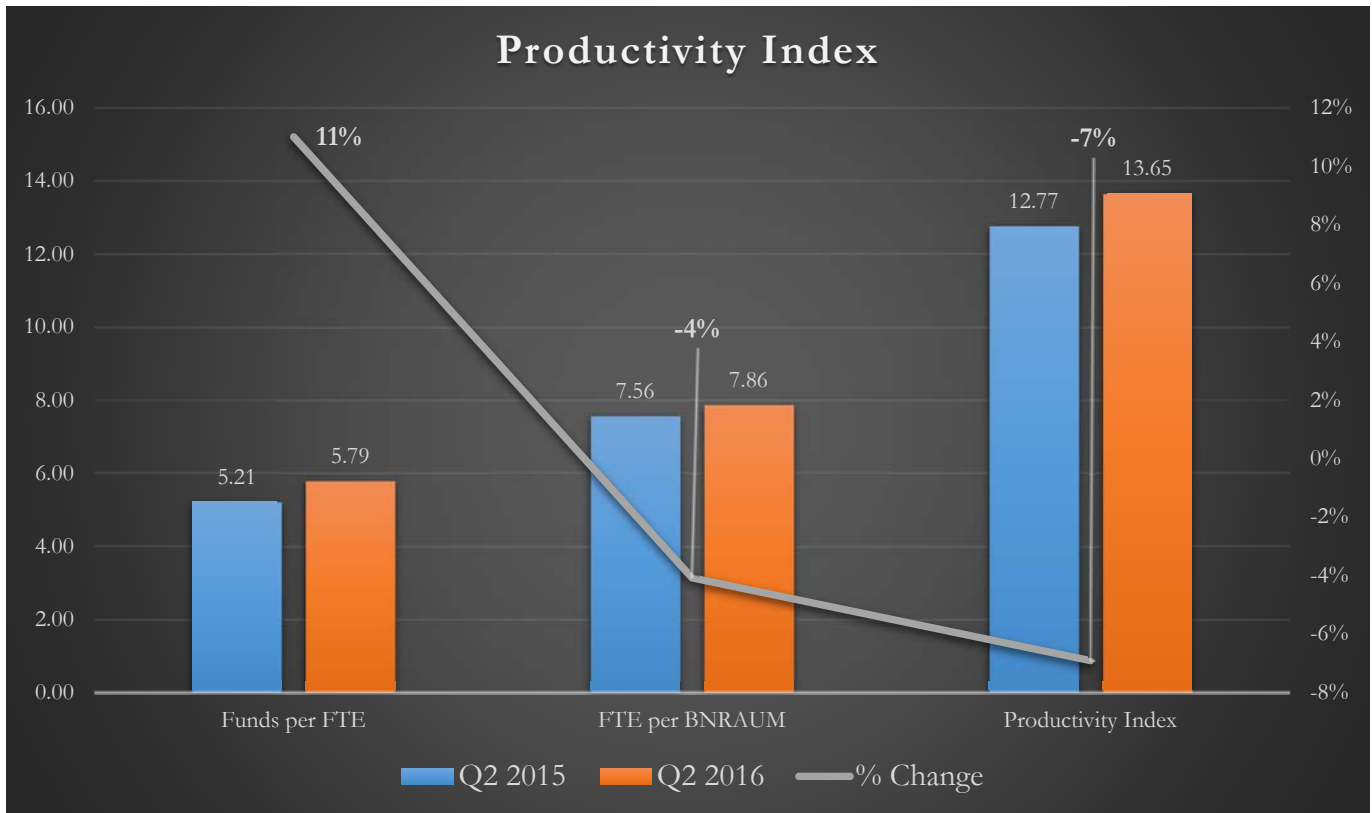


Alternative Industry-Operating Productivity

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Operating Productivity declined 7% driven by a 4% productivity decline in Manager Headcount per BNRAUM, and a corresponding 11% gain in the Number of Accounts per Headcount.

Manager Assets grew at a slower pace than headcount which increased the amount of staff per BNRAUM. Lower asset growth is driven by lower performance, fund closures, fund redemptions and/or lower leverage levels. An increase in Total Accounts per FTE shows that Managers increased accounts at a far greater pace than hiring levels. We believe this is driven by improved operating scale, meaning Managers are able to launch additional accounts with fewer incremental staff driven by better use of service providers, improved technology and better internal processes.



Convergence can help you understand your productivity relative to leaders in the market and help you determine ways to improve your overall productivity levels. If you are aware of these market leaders, you may be able to learn how they are generating productivity levels that can reduce risk and increase net management fees.