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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

[Release No. IA-6354; File No. S7-13-23]

RIN 3235-AN31

Exemption for Certain Investment Advisers Operating Through the Internet

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is proposing amendments to the rule under the Investment Advisers Act of 1940 that exempts certain investment advisers that provide advisory services through the internet ("internet investment advisers") from the prohibition on Commission registration, as well as related amendments to Form ADV. The proposed amendments are designed to modernize the rule's conditions to account for the evolution in technology and the investment advisory industry since the adoption of the rule.

DATES: Comments should be received on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's internet comment form (https://www.sec.gov/rules/proposed.shtml); or
- Send an email to rule-comments@sec.gov. Please include File Number S7-13-23 on the subject line.

Paper Comments:

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-13-23. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method of submission. The Commission will post all comments on the Commission's website (https://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Operating conditions may limit access to the Commission's Public Reference Room. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Blair B. Burnett, Senior Counsel, Investment Company Rulemaking Office; Michael Schrader, Senior Counsel, Chief Counsel's Office; or Sirimal R. Mukerjee, Senior Special Counsel, or Melissa Roverts Harke, Assistant Director, Investment Adviser Rulemaking Office, Division of Investment Management, at (202) 551-6787 or IArules@sec.gov, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is proposing for public comment amendments to 17 CFR 275.203A-2(e) ("rule 203A-2(e)") under the Investment Advisers Act of

1940 ("Advisers Act" or "Act") [15 U.S.C. 80b-1 *et seq.*] and corresponding amendments to 17 CFR 279.1 (Form ADV) under the Advisers Act.[1]

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[1] 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any section of the Advisers Act, we are referring to 15 U.S.C. 80b, at which the Advisers Act is codified, and when we refer to rules under the Advisers Act, or any section of these rules, we are referring to title 17, part 275 of the Code of Federal Regulations [17 CFR part 275], in which these rules are published.

G. Solicitation of Comments
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I. BACKGROUND

We are proposing amendments to rule 203A-2(e) ("Internet Adviser Exemption") under the Advisers Act. The Internet Adviser Exemption provides an exemption from the prohibition on registration with the Commission that may otherwise affect certain advisers seeking to register with us. The proposed amendments are designed to modernize the Internet Adviser Exemption's conditions to account for the evolution in technology and the investment advisory industry since the adoption of the rule over twenty years ago. The proposal would also amend Form ADV to conform certain instructions and definitions to the amended rule and would also require additional representations regarding an internet investment adviser's reliance on the rule.

On January 1, 1997, the National Securities Markets Improvement Act of 1996 ("NSMIA") amended the Advisers Act to divide the responsibility for regulating investment advisers between the Commission and state securities authorities.[2] Congress allocated to state securities authorities the primary responsibility for regulating smaller advisory firms and allocated to the Commission the primary responsibility for regulating larger advisers.[3] Section 303 of NSMIA amended the Advisers Act to include section 203A[4] to effect this division of responsibility by generally prohibiting advisers from registering with the Commission unless they either have assets under management of not less than $25 million or advise a registered investment company,[5] and preempt state adviser statutes regarding registration, licensing, or qualification as to advisers registered with the Commission.[6] Advisers prohibited from

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[2] National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (1996) (codified in various sections of 15 U.S.C.).

[3] *See* S. Rep. No. 293, 104th Cong., 2d Sess. 3-4 (1996) ("Senate Report"), at 4.

[4] Pub. L. 104-290, Sec. 303; *see also* section 203A of the Advisers Act [15 U.S.C. 80b-3a].

[5] Section 203A(a)(1) of the Advisers Act [15 U.S.C. 80b-3a(a)(1)].

[6] Section 203A(b) of the Advisers Act [15 U.S.C. 80b-3a(b)].

registering with the Commission remain subject to the regulation of state securities authorities.[7] The "$25 million assets under management" test was designed by Congress to distinguish investment advisers with a national presence from those that are essentially local businesses.[8] Congress expressed that its goal in enacting the statute was to more efficiently allocate the Commission's limited resources by allowing the Commission to concentrate its regulatory responsibilities on larger advisers with national businesses, and to reduce the burden to investment advisers of the overlapping and duplicative regulation between Federal and State regulators.[9] Congress furthered this objective on July 21, 2010 with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[10] which amended certain provisions of the Advisers Act, including section 203A, to, among other things, reallocate primary responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers—*i.e.*, subject to certain exceptions, those that have between $25 million and $100 million of assets under management.[11]

Congress has recognized, however, that it would be more efficient to regulate some advisers at the Federal level despite managing less than the minimum thresholds in assets under management and gave the Commission authority to enable advisers to register with us if the

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7 Section 222 of the Advisers Act [15 U.S.C. 80b-18a]. The prohibition in section 203A against registration with the Commission applies to advisers whose principal office and place of business is in a United States jurisdiction that has enacted an investment adviser statute. *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 1633 (May 15, 1997) [62 FR 28112 (May 22, 1997)], at text accompanying n.83.

8 *See* Senate Report, *supra* note 3, at 4-5 ("The states should play an important and logical role in regulating small investment advisers whose activities are likely to be concentrated in their home state.").

9 *See* Senate Report, *supra* note 3, at 2-4 (stating "[r]ecognizing the limited resources of both the Commission and the states, the Committee believes that eliminating overlapping regulatory responsibilities will allow the regulators to make the best use of their scarce resources to protect clients of investment advisers.").

10 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

11 Unlike a small adviser, a mid-sized adviser is not prohibited from registering with the Commission: (i) if the adviser is not required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; (ii) if registered, the adviser would not be subject to examination as an investment adviser by that securities commissioner; or (iii) if the adviser is required to register in 15 or more states. *See* section 410 of the Dodd-Frank Act; section 203A of the Advisers Act.

prohibition would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of [section 203A]."[12] In exercising this authority, the Commission in 2002 adopted the Internet Adviser Exemption, which relieves certain advisers that provide advisory services primarily through the internet from the burdens of multiple state regulation and allows them to register with the Commission.[13]

A. Current Rule 203A-2(e)

The Internet Adviser Exemption was designed to create a narrow exemption from the prohibition on registration for certain advisers ("internet investment advisers"), which typically do not manage the assets of their clients or advise a registered investment company, and thus do not meet the statutory thresholds for registration with the Commission.[14] These advisers, therefore, "do not fall neatly into the model assumed by Congress when it added [s]ection 203A to the Act to divide regulatory authority over advisers."[15] The Commission concluded that, "as applied to these advisers, the application of the prohibition on Commission registration would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of [section 203A]."[16] Under the current Internet Adviser Exemption, an adviser is exempt from the prohibition on Commission registration if the adviser:

- Provides investment advice to all of its clients exclusively through an interactive website, except it may provide investment advice to fewer than 15 clients through other means during the preceding 12 months;

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12 Section 203A(c) of the Advisers Act [15 U.S.C. 80b-3a(c)]. *See also* Senate Report, *supra* note 3, at 5 and 15.

13 *See* Exemption for Certain Investment Advisers Operating Through the Internet, Investment Advisers Act Release No. 2028 (Dec. 12, 2002) [67 FR 19500 (Dec. 18, 2002)], at section I ("2002 Adopting Release"). The exercise of our exemptive authority enables registration with the Commission and preempts most state law with respect to the exempted advisers that register with us. *See* rule 203A-2.

14 *See* 2002 Adopting Release, *supra* note 13. The Commission originally adopted the Internet Adviser Exemption as rule 203A-2(f) and redesignated it as rule 203A-2(e) effective Sept. 19, 2011. *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3221 (June 22, 2011) [76 FR 42949 (July 19, 2011)] ("2011 Redesignation").

15 2002 Adopting Release, *supra* note 13, at section II (citing Section 203A(c)).

16 *Id.*

- Maintains a record demonstrating that it provides investment advice to its clients exclusively through an interactive website in accordance with the limits described in the bullet point above; and
- Does not control, is not controlled by, and is not under common control with, another investment adviser registered with the Commission solely in reliance on an adviser registered under the Internet Adviser Exemption.

As the 2002 Adopting Release explained, absent the Internet Adviser Exemption, internet investment advisers would likely incur the burden of temporarily registering in multiple states and later withdrawing. State investment adviser registration statutes generally obligate advisers to register in every state in which the adviser obtains more than a *de minimis* number of clients. The 2002 Adopting Release reasoned that because internet investment advisers provide investment advice to their clients through an interactive website, they are likely to have no physical local presence in a community or state, with little or no in-person contact with advisory clients. Accordingly, the adviser's clients can come from any state, at any time. As a result, an internet investment adviser would have to, as a practical matter, register in multiple states to ensure that its registration will be in place when or if it obtains the requisite number of clients from any particular state. Further, an internet investment adviser may subsequently become eligible for an existing exemption under 17 CFR 275.203A-2(d) ("rule 203A-2(d)"), permitting Commission registration for advisers otherwise obligated to register in at least 15 states, but typically not before the adviser had already incurred the burden of registering, and potentially deregistering, in multiple states.[17]

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[17] 17 CFR 275.203A-2(d). An investment adviser relying on the multi-state exemption would not be eligible for that exemption until the adviser had obtained the requisite number of clients in 15 states to trigger its registration obligations in those states. Under the rule, an investment adviser relying on this exemption must represent that it has reviewed its obligations under state and Federal law and has concluded that it is required to register as an investment adviser with the securities authorities of at least 15 states. At the time the Internet Adviser Exemption was adopted, the "multi-state adviser exemption" enabled an investment adviser who was required to register as an investment adviser with 30 or more states to register with the Commission. *See* 2002 Adopting Release, *supra* note 13, at section II.A. Effective September 19, 2011, the

From the adoption of the Internet Adviser Exemption through December 31, 2022, approximately 845 advisers have relied on the exemption as a basis for registration with the Commission.[18] Of these advisers, 718 initially registered exclusively in reliance on the Internet Adviser Exemption. As of December 31, 2022, approximately 256 advisers were relying exclusively on the Internet Adviser Exemption. The exemption has been used with increasing frequency recently, with 149 of the 256 advisers relying exclusively on the exemption registering after 2015.

B. Need for Reform and Overview of Rule Proposal

The asset management industry has experienced substantial growth and change since the rule was adopted over twenty years ago. Assets under management have more than quadrupled since the adoption of the rule.[19] Similarly, since the adoption of the rule advisers are increasingly using technology to interact with clients, including through email, websites, mobile applications, investor portals, text messages, chatbots and other similar means.[20] The use of technology is now central to how many investment advisers provide their products and services to clients.[21] For example, the growth of services available on digital platforms, such as those offered by online

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Commission amended the multi-state exemption to enable Commission registration for advisers otherwise obligated to register in at least 15 states, rather than 30 states, and renumbered the multi-state exemption rule 203A-2(e) as rule 203A-2(d). *See* 2011 Redesignation, *supra* note 14, at section II.A.5.c and n.118.

18 Based on analysis of Form ADV data.

19 There were approximately $23.6 trillion regulatory assets under management among registered investment advisers as of Dec. 2003 and approximately $115 trillion assets under management as of Dec. 2022. Based on analysis of Form ADV data.

20 *See, e.g.*, Andrew Osterland, *Technology is redefining that client-financial advisor relationship* (Oct. 14, 2019), https://www.cnbc.com/2019/10/14/technology-is-redefining-that-client-financial-advisor-relationship.html ("Easy-to-use client portals have become essential to provide investors with the ability to see their accounts, exchange secure emails with their advisor and share documents.").

21 We note that the Commission is also proposing rules requiring broker-dealers and investment advisers to eliminate or neutralize certain conflicts of interest associated with their use of technologies that optimize for, predict, guide, forecast, or direct investment-related behaviors or outcomes, directly or indirectly. These proposed rules derive, in part, from the Commission's recognition that investment advisers in their interactions with investors are increasingly using, among other technologies, predictive data analytics, artificial intelligence, including machine learning, deep learning, neural networks, natural language processing, and large language models, as well as other technologies that make use of historical or real-time data, lookup tables, or correlation matrices. *See* Conflicts of Interest Associated with the Use of Predicative Data Analytics by Broker-Dealers and Investment Advisers, Investment Advisers Act Release No. 6353 (July 26, 2023).

brokerage firms and robo-advisers, has multiplied the opportunities for retail investors, in particular, to invest in and trade securities. This increased accessibility has been one of the many factors associated with the increase of retail investor participation in U.S. securities markets in recent years.[22] Concomitant with the growth in assets under management and the broader evolution and adoption of technology in the investment advisory industry, we have seen an uptick in the number of advisers seeking to rely on the Internet Adviser Exemption.[23] We recognize that investment advisers are increasingly utilizing a wide range of technologies in their businesses. The Internet Adviser Exemption, however, was intended as a narrow exemption for entities that are in the business of *exclusively* providing investment advice through an interactive website.[24]

Our examination staff has observed numerous compliance deficiencies by advisers relying on the rule.[25] For example, in 2021 the staff noted that, "[n]early half of the [examined] advisers claiming reliance on the Internet Adviser Exemption were ineligible to rely on the exemption, and many were not otherwise eligible for SEC-registration."[26] As part of the

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22 *See, e.g.*, Maggie Fitzgerald, *Retail Investors Continue to Jump Into the Stock Market After GameStop Mania*, CNBC (Mar. 10, 2021), https://www.cnbc.com/2021/03/10/retail-investor-ranks-in-the-stock-market-continue-to-surge.html (providing year-over-year app download statistics for Robinhood, Webull, Sofi, Coinbase, TD Ameritrade, Charles Schwab, E-Trade, and Fidelity from 2018-2020, and monthly figures for Jan. and Feb. 2021); John Gittelsohn, *Schwab Boosts New Trading Accounts 31% After Fees Go to Zero*, Bloomberg (Nov. 14, 2019), https://www.bloomberg.com/news/articles/2019-11-14/schwab-boosts-brokerage-accounts-by-31-after-fees-cut-to-zero (noting that Charles Schwab opened 142,000 new trading accounts in Oct., a 31% jump over Sept.'s pace).

23 Based on Form ADV data, the number of advisers relying exclusively on the exemption has grown from approximately 107 advisers as of Dec. 2015 to 256 advisers as of Dec. 2022.

24 *See* 2002 Adopting Release, *supra* note 13, at section II.A.

25 *See* Observations from Examinations of Advisers that Provide Electronic Investment Advice (Nov. 9, 2021), https://www.sec.gov/files/exams-eia-risk-alert.pdf ("Risk Alert"). Staff documents (including those cited herein) represent the views of Commission staff and are not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved the content of these documents and, like all staff statements, they have no legal force or effect, do not alter or amend applicable law, and create no new or additional obligations for any person.

26 *Id.* at 8. The Risk Alert noted that this has been a common finding for many years. *Id*. at n.28. The Commission has cancelled the registration of advisers claiming reliance on the Internet Adviser Exemption for not satisfying the requisite conditions and also brought actions against them. *See, e.g.*, Ajenifuja Investments, LLC; Order Cancelling Registration Pursuant to Section 203(h) of the Investment Advisers Act of 1940, Investment Advisers Act Release No. 5110 (Feb. 12, 2019) ("Ajenifuja") (finding that the adviser was registered as an internet investment adviser for over three years and in that time period did not

examinations described in the Risk Alert, the staff observed advisers relying on this exemption that did not have an interactive website. In addition, the staff observed advisers relying on this exemption that provided advisory personnel who could expand upon the investment advice provided by the adviser's interactive website or otherwise provide investment advice to clients, such as financial planning, outside of the adviser's interactive website.[27] Advisers registered under rule 203A-2(e) providing advice to 15 or more clients other than through the adviser's interactive website during the preceding twelve months may not rely on this exemption.[28]

Moreover, the Internet Adviser Exemption is unavailable to an internet investment adviser if another adviser in a control relationship with the internet investment adviser relies on the internet investment adviser's registration under the rule as the basis for its own registration.[29] The staff observed that some advisers' affiliates were operating as unregistered investment advisers, because the affiliates were operationally integrated with the registered advisers, and the Internet Adviser Exemption prohibited those affiliates from relying on the internet investment adviser's registration as a basis for their own registration.[30]

As discussed above, the exemption has been used with increasing frequency recently.[31] At the same time, the frequency of registration withdrawals and cancellations of internet

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have an interactive website and did not demonstrate any other basis for registration eligibility); Strategic Options, LLC; Order Denying a Request for Hearing and Cancelling Registration Pursuant to Section 203(h) of the Investment Advisers Act of 1940, Investment Advisers Act Release No. 5689 (Feb. 24, 2021) (finding that since its registration in 2015, the registrant has not had, and does not have, any clients for which it provides investment advice through an interactive website). *See also* In re. RetireHub, Inc., Investment Advisers Act Release No. 3337 (Dec. 15, 2011) (settled) ("RetireHub") (alleging that the adviser was never an internet investment adviser because, over the course of its registration, it did not provide investment advice exclusively through an interactive website, advised more clients than permitted through personal contact, or both).

27 Risk Alert, *supra* note 25, at 8.

28 *See* rule 203A-2(e)(1)(i).

29 *See* rule 203A-2(e)(1)(iii); *see also* 2002 Adopting Release, *supra* note 13 (discussing that this provision is meant to address the concern that an internet investment adviser intent on evading the restrictions on non-internet clients under the rule might attempt to organize a subsidiary firm to serve its non-internet clients, and assert rule 203A-2(b) as a basis to register the subsidiary with the Commission, even though the subsidiary does not manage the minimum amount of client assets required for registration with the Commission).

30 *See* Risk Alert, *supra* note 25, at 8.

31 *See supra* note 23.

investment advisers also has increased since the rule's adoption, which has affected the cumulative growth in the number of advisers relying on the Internet Adviser Exemption.[32] For example, approximately 64 percent of the advisers withdrawing their registration under the rule have done so since 2017, while only approximately 36 percent of the withdrawing advisers did so from the rule's adoption in 2002 through 2016.[33]

Given that internet investment advisers may have characteristics that distinguish them from other types of investment advisers contemplated by Congress when it added section 203A to the Act, the Commission established a "narrow exemption," allowing certain investment advisers to register with the Commission despite managing less than the minimum threshold in assets under management.[34] This narrow exemption was intended to divide regulatory authority over advisers that, unlike state-registered advisers, have no local presence and whose advisory activities are not limited to one or a few states.[35] While some advisers have used the exemption as intended, others have used this exemption by registering with the Commission while failing to satisfy the conditions of the exemption. As discussed above, some of these advisers have not provided investment advice to any clients through an interactive website, in some cases for three or four years.[36] Advisers with very limited or zero clients are more akin to local businesses that can be effectively regulated by one or a few states, consistent with Congress's intent in NSMIA's amendments to the Advisers Act.[37] Moreover, some of the advisers relying on this exemption

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32 As an example, the Commission has cancelled the registration of internet investment advisers after finding the firms are no longer in existence, not engaged in business as an investment adviser, or prohibited from registering as an investment adviser under section 203A of the Act (and related rules). *See supra* note 26. The Commission also has revoked the registration of an internet investment adviser on the basis that it was ineligible to rely on the exemption. *See* In re. Boveda Asset Management, Inc., Investment Advisers Act Release No. 6016 (May 6, 2022) (referencing *SEC v. Boveda Asset Management, Inc. and George Kenneth Witherspoon, Jr.*, 1:21-cv-05321-SCJ (N. D. GA) (Apr. 27, 2022) ("Boyeda")).

33 Based on analysis of Form ADV data.

34 *See supra* note 14 and accompanying text.

35 *See* 2002 Adopting Release, *supra* note 13, at section II.

36 *See supra* note 26.

37 *See also infra* section III.B.2, stating that as of Dec. 2022, 266 advisers rely on the internet adviser exemption. Of those advisers, 101 (38%), report zero clients. The median number of reported clients is six. The data comes from Form ADV filings received by the Commission through Mar. 31, 2023.

provided advisory personnel who could expand upon the investment advice provided by the adviser's interactive website or otherwise provide investment advice to clients without consideration of the 15 non-internet clients per 12-month period de minimis exception within the Internet Adviser Exemption.[38] Certain of these advisers have failed to produce copies of books and records required for advisers relying on the exemption, including books and records necessary to demonstrate compliance with the exception for providing non-interactive website-based advice to fewer than 15 clients in a 12-month period.[39] The number of registration applications and approvals under this exemption have increased, while the number of cancellations, withdrawals, and registration reliance changes resulting from an inability to meet the conditions of the rule also increased. Accordingly, in 2021 the Commission issued a request for information and comments on the Internet Adviser Exemption, among other areas.[40]

We believe that the "narrow exemption" created over twenty years ago should be amended to reflect its intended, narrow use in light of technological advances and changes in the investment adviser industry.[41] In addition, this would further the investor protection objectives that Congress expressed when designing section 203A of the Advisers Act by better allocating the Commission's limited oversight and examination resources to those advisers that should be subject to national rules.[42] In light of these observations and as discussed in more detail below, we are proposing certain targeted amendments to rule 203A-2(e) with certain corresponding amendments to Form ADV.

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38 *See* RetireHub, *supra* note 26 (finding that RetireHub employed on-campus representatives at the university who were made available to provide investment advice to university employees).

39 *See* Boyeda, *supra* note 32 (finding that the firm violated section 204(a) of the Advisers Act by failing to furnish to the Commission copies of books and records that the firm was required to make, keep, and provide to representatives of the Commission pursuant to an examination).

40 *See* Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches, Exchange Act Release No. 92766 (Aug. 27, 2021) [86 FR 49067 (Sept. 1, 2021)] ("2021 RFC"). The Commission received numerous comments in response to the 2021 RFC, which we considered in developing this proposal. Comment letters received in response to the 2021 RFC are available at: https://www.sec.gov/comments/s7-10-21/s71021.htm.

41 *See supra* note 21 and accompanying text.

42 *See supra* note 9.

II. DISCUSSION

A. Proposed Amendments to Rule 203A-2(e)

Using the authority provided by section 203A(c) of the Act, we are proposing amendments to the Internet Adviser Exemption to reflect developments since the adoption of the rule. The amendments we are proposing to the Internet Adviser Exemption would require internet investment advisers relying on the Internet Adviser Exemption to at all times have an "operational" interactive website.[43] We also are proposing to eliminate the *de minimis* exception in the current rule that permits internet investment advisers to have fewer than 15 non-internet clients in any 12-month period. In light of the widespread use of the internet, as well as the relative ease of building and maintaining a website and applications, we propose requiring that internet investment advisers have an operational interactive website at all times during which the internet investment adviser relies on the Internet Adviser Exemption. We also propose that this exemption should only be available to those advisers that provide advice exclusively to clients through an operational interactive website.

The Commission intended the Internet Adviser Exemption to be a narrow exemption for certain investment advisers that did not fall neatly within the framework established by Congress to divide regulatory authority between state regulators and the Commission.[44] The proposed amendments would adapt the rule to the broader evolution in technology and the marketplace, and would better align current practices in the investment adviser industry with the narrow exemption that was intended to reflect the allocation of responsibility for regulating investment advisers set forth by Congress under NSMIA and the Dodd-Frank Act. In addition, the proposed amendments would enhance investor protection through more efficient use of the Commission's limited oversight and examination resources by more appropriately allocating Commission

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43 *See* proposed rule 203A-2(e)(1)(i).

44 *See supra* note 24.

resources to advisers with national presence and allowing smaller advisers with sufficient local presence to be regulated by the states.

1. Operational Interactive Website

The current Internet Adviser Exemption requires, among other things, that an internet investment adviser provide investment advice to all of its clients exclusively through an interactive website, except that the investment adviser may provide investment advice to fewer than 15 clients through other means during the preceding 12 months.[45] The rule defines "interactive website" to mean a website in which computer software-based models or applications provide investment advice to clients based on personal information each client supplies through the website. We are proposing the following targeted amendments:

- First, we are proposing to amend the "interactive website" defined term to "operational interactive website."
- Second, we are proposing to define an "operational interactive website" to mean a website or mobile application through which the investment adviser provides digital investment advisory services on an ongoing basis to more than one client (except during temporary technological outages of a *de minimis* duration).
- Third, we are proposing to define "digital investment advisory service" as investment advice to clients that is generated by the operational interactive website's software-based models, algorithms, or applications based on personal information each client supplies through the operational interactive website.
- Finally, we are proposing to require that an internet investment adviser provide advice through an operational interactive website at all times during which the internet investment adviser relies on the Internet Adviser Exemption.

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[45] *See* rule 203A-2(e)(1)(i).

The amendments are designed to modernize the definitions and to adapt the rule more broadly to the evolution of the asset management industry.

The proposed amendments specify that an internet investment adviser must provide digital investment advisory services through its website on an ongoing basis to more than one client. We understand that unforeseen technological issues outside of the control of an adviser occur at times. We also understand that websites may be temporarily inoperable due to periodic maintenance to ensure that the website performs optimally. Accordingly, we have incorporated into the definition of "operational interactive website" a hardship clause that allows an internet investment adviser to satisfy the rule despite temporary technological outages of the operational interactive website of a *de minimis* duration. The proposed amendments also specify that the requirement to provide an operational interactive website would apply at all times during which the adviser relies on the Internet Adviser Exemption (*i.e.*, at the time of the adviser's registration and at all times an adviser is registered in reliance on the amended Internet Adviser Exemption).[46] Currently, the Internet Adviser Exemption does not specify that an interactive website be "operational," whether at the time of registration or otherwise. Further, in the 2002 Adopting Release, the Commission did not specify the timing of when the interactive website must be operational, though no grace period exists under the current rule.[47] With advances in technology since the adoption of the rule more than twenty years ago,[48] we believe that advisers

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[46] In the case of an existing registered investment adviser seeking to change its registration to rely on the Internet Adviser Exemption, the adviser would be required to have an operational interactive website at the time in which it begins relying on the rule.

[47] *See* Ajenifuja, *supra* note 26 (finding that rule 203A-2(e) does not contain a grace period). The Commission stated in the 2002 Adopting Release: "Nor is it likely Internet Investment Advisers could rely on rule 203A-2(d) [redesignated as rule 203A-2(c), *see* 2011 Redesignation, *supra* note 14 to carry them through an initial period of operation without state registration in anticipation of eligibility under the multi-state exemption. If an adviser relying on [redesignated] rule [203A-2(c)] has not become eligible for SEC registration within 120 days, it must withdraw its registration." 2002 Adopting Release, *supra* note 13, at section IV.A. Given advances in technology, we preliminarily believe that internet investment advisers should be able to develop, test, and deploy an operational interactive website and begin serving clients within 120 days.

[48] *See generally*, Max Roser, Hannah Ritchie and Edouard Mathieu, *Technological Change* (Mar. 2022), https://ourworldindata.org/technological-change (compiling statistics of technological growth); Martin

seeking to rely on the Internet Adviser Exemption can use the 120-day rule to develop, test, and launch an operational interactive website and obtain initial clients by the time the 120-day temporary registration expires.[49] Moreover, the requirement that an internet investment adviser must provide digital investment advisory services through its website on an ongoing basis to *more than one client* is intended to reflect that advisers with zero or one client are more akin to local businesses that can be effectively regulated by a state, consistent with Congress' intent in NSMIA's amendments to the Advisers Act.

The proposed definition of "operational interactive website" is also designed to specify the rule's application to advisers' use of technology, including their use of mobile applications, in connection with their eligibility to rely on the rule.[50] Thus, the proposed changes would expressly permit an internet investment adviser to use mobile applications to provide investment advice to clients.[51] It is appropriate to allow internet investment advisers using mobile applications to interact with advisory clients to rely on the Internet Adviser Exemption because clients increasingly access services, including investment advisory services, through mobile applications,[52] and mobile applications can provide interactive functionality similar to the

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Armstrong, *How Many Websites Are There?* (Aug. 6, 2021), https://www.statista.com/chart/19058/number-of-websites-online/ (showing growth from inception of the internet to approximately 1.88 billion websites in 2021); Total Number of Websites (accessed July. 11, 2023), https://www.internetlivestats.com/total-number-of-websites/ (identifying, among others, 38,760,373 websites in 2002 and 1,106,671,903 websites in 2023).

49 If the adviser is initially relying on rule 203A-2(c) as a basis for registration ("120-day rule"), the interactive website would need to be operational within 120 days of the adviser's registration. For example, an adviser could register with the Commission in anticipation of reliance on the Internet Adviser Exemption by using the 120-day rule, have 0 clients with no website, and within 120 days create an operational interactive website and obtain more than one client, then file an amendment to its Form ADV indicating that it has become eligible for the Internet Adviser Exemption.

50 *See* proposed rule 203A-2(e)(2).

51 The term "mobile application" generally, refers to a software application developed primarily for use on wireless computing devices, such as smartphones and tablets. *See, e.g.*, techopedia, Mobile Application (Mobile App) (Aug. 7, 2020), https://www.techopedia.com/definition/2953/mobile-application-mobile-app ("techopedia").

52 *See* Sarah Perez, *Majority of Digital Media Consumption Now Takes Place in Mobile Apps*, TechCrunch (Aug. 21, 2014) ("[M]obile apps [. . .] eat up more of our time than desktop usage or mobile web surfing, accounting for 52% of the time spent using digital media. Combined with mobile web, mobile usage as a whole accounts for 60% of time spent, while desktop-based digital media consumption makes up the remaining 40%."); *see generally*, Hannah Glover, *'Healthy Paranoia' Drives Innovation at Vanguard* (June

functionality of websites.[53] By including mobile applications in the definition of "operational interactive website," internet investment advisers will have broad flexibility to design the interactive website in a manner that best suits their needs and their clients' needs. We understand that mobile applications use various methods of communication, including, for example, push notifications, in-app messages, and similar forms of electronic communication. The amended rule would permit any form of mobile application technology through which the investment adviser provides digital investment advisory services.

We also are proposing to define "digital investment advisory services" as "investment advice to clients that is generated by the operational interactive website's software-based models, algorithms, or applications based on personal information each client supplies through the operational interactive website."[54] The proposed definition is designed to address that, like the current rule, an adviser must provide investment advice exclusively through an interactive website. However, the proposed definition would specify that the generation of such advice could include advice that is generated by software-based algorithms in addition to software-based models or applications, in each case, based on personal information each client supplies through the interactive website. We understand that advisers are increasingly using algorithms to generate investment advice in order to provide clients with cost-effective and tailored advice and

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17, 2016), https://www.ignites.com/c/1385943/158263?referrer_module=searchSubFromFF&highlight=%22mobile%20applications%22 ("Next on the horizon is mobile applications. When you travel [outside of the U.S.], you see how PC-centric technology does not exist anywhere else[.] In the future, [. . . [i]t's going to be all about the phone. Companies without easy-to-use, yet powerful, apps will be left behind [. . . .]") (internal quotations omitted).

53 *See, e.g.*, techopedia, *supra* note 51 ("Mobile applications frequently serve to provide users with similar services to those accessed on PCs."); *see, e.g.*, Fundfire, *What Are Major IT Trends in Wealth Mgmt?* (Oct. 15, 2012), https://www.fundfire.com/c/422571/47531?referrer_module=searchSubFromFF&highlight=%22mobile%20applications%22 ("Dedicated mobile applications for smartphones and tablets can enable unified digital communication between advisors and their clients – a combination of email, chat, voice and video.").

54 *See* proposed rule 203A-2(e)(2). Personal information provided by the internet client generally should consist of information relevant to the client's financial situation, level of financial sophistication, investment experience, and financial goals and objectives. *See also* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 5248 (June 5, 2019), at 12-14 (discussing an adviser's duty of care, which includes a duty to provide advice that is in the best interest of the client).

the definition encompasses this use.[55] The proposed amendments would specify that the investment advice to clients must be "generated by" the website's software-based models, algorithms, or applications.[56] Like the current rule,[57] this new definition is designed to reflect that an adviser's personnel are not permitted to generate, modify, or otherwise provide client-specific investment advice through the operational interactive website or otherwise.[58] Said differently, human-directed client-specific investment advice, delivered through electronic means, would not be eligible activity under the Investment Adviser Exemption. The use of the internet or other electronic media to communicate with clients is not, alone, a sufficient basis for an adviser to rely on the exemption.[59]

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55 *See, e.g.*, Investment Adviser Association, *2020 Evolution Revolution* (2020), at 8, https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/resources/Evolution_Revolution_2020_v8.pdf (noting that by 2020, ''two of the top five advisers as measured by number of non-high net worth individual clients served [were] digital advice platforms, representing 7.5 million clients, an increase of 2.7 million clients from [the prior year].''); Robo-Advisers, IM Guidance Update No. 2017-02 (Feb. 2017), https://www.sec.gov/investment/im-guidance-2017-02.pdf ("Robo-Advisers Guidance"); Akin Ajayi, *The Rise of the Robo-Advisers* (July 16, 2015), https://www.credit-suisse.com/about-us-news/en/articles/news-and-expertise/the-rise-of-the-robo-advisers-201507.html ("Robo-advisers – to use the suitably futuristic moniker adopted as a description for these services – are investment services driven by automated customer service and an investment strategy governed by computer algorithms. A clutch of start-ups, largely located in the United States but spreading to Europe and Asia, have emerged over the last few years.").

56 As a fiduciary, investment advisers have a duty to make full and fair disclosure of all material facts to, and to employ reasonable care to avoid misleading, clients. Given the unique aspects of an internet investment advisers' business models and because client relationships may occur with limited, if any, human interaction, internet investment advisers generally should consider the most effective way to communicate to their clients the limitations, risks, and operational aspects of their advisory services. For example, internet investment advisers generally should effectively disclose to clients, among other matters, that an algorithm is used to manage individual client accounts with a description of the particular risks inherent in the use of an algorithm to manage client accounts.

57 *See* 2002 Adopting Release, *supra* note 13, at section II.A.1 ("[T]he exemption is for advisers that provide investment advice to their Internet clients 'exclusively' through their interactive Web sites. An adviser relying on the exemption may not use its advisory personnel to elaborate or expand upon the investment advice provided by its interactive Web site, or otherwise provide investment advice to its Internet clients, except as permitted by the *de minimis* exception discussed below.").

58 This excludes human involvement and input other than to the degree necessary for technological oversight and management of a website's software-based models, algorithms, or applications. *But see* Comment Letter of Morningstar, Inc. (Oct. 1, 2021) (recommending, in response to the 2021 RFC, that the Commission should modify the Internet Adviser Exemption to explicitly permit human interaction for "certain types of information"— for example, costs, allocations, financial education — "as long as the actual asset allocation is conducted by the algorithm.").

59 This treatment is unchanged from the current rule. *See* 2002 Adopting Release, *supra* note 13, at section II.A.1 ("The rule is thus not available to advisers that merely use Web sites as marketing tools or that use Internet vehicles such as E-mail, chat rooms, bulletin boards and webcasts or other electronic media in communicating with clients…expansion of the rule to include such activities as suggested by some commenters could undermine NSMIA's allocation of regulatory responsibility over smaller advisers to state securities authorities.").

The proposed amendments would not prohibit advisory personnel from all interactions with advisory clients. Advisory personnel could continue to assist clients with technical issues in connection with the use of the website (*e.g.*, accessing the website, *etc*.), including by assisting clients with explanations of how the algorithm generating the investment advice was developed or operates. Advisory personnel generally should be able to perform those services telephonically, through email, live electronic chats, and similar forms of electronic communication. As discussed below, the amended rule would not permit advisory personnel to provide investment advice of any kind to a client.

We also are proposing that an adviser relying on the rule as a basis for registration must represent on Schedule D of its Form ADV that, among other things, it has an operational interactive website.[60] This representation is similar to the representation that advisers relying on the multi-state exemption make on their Form ADV.[61] This representation would also assist Commission staff in connection with its review of existing registrations and registration applications for compliance with the rule and, as applicable, for possible deregistration for an inability to meet the conditions of the rule. This amendment would require internet investment advisers, as an initial matter and periodically thereafter, to provide an additional affirmative representation on Form ADV that more clearly notes the requirements of the exemption, thus reinforcing the conditions of the exemption for the internet investment adviser.

We request comment on all aspects of the proposed amendments relating to the requirements for internet investment advisers to have an operational interactive website and related amendments to Form ADV, including the following:

1. Should we amend the interactive website definition to "operational interactive website," as proposed? Do commenters agree that the interactive website should be

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60 *See* proposed rule 203A-2(e)(1)(iv).

61 Rule 203A-2(d)(2)(i).

operational at all times an adviser is registered with the Commission and relying on the Internet Adviser Exemption?

2. Does the hardship clause in the proposed definition of interactive website reasonably account for temporary outages? Should planned periods of inoperability, such as planned maintenance, be included, as proposed? Are there other instances in which an adviser intentionally takes an interactive website offline that should be explicitly discussed in the release? The proposed hardship clause specifies that the outages must be de minimis in duration? Should the rule text specify a particular time period instead, such as less than 6 hours, 12 hours, or 24 hours?

3. Should the exemption specify what it means to provide investment advice "exclusively" through the operational interactive website? If so, how? Is it sufficiently clear that the amended rule is not designed to prevent advisory personnel from assisting clients with technical issues or from explaining how the adviser's algorithm works? Are there any circumstances not accounted for in the amended rule in which advisory personnel interact with clients without engaging in digital investment advisory services?

4. Do commenters agree that advisers seeking to rely on the proposed exemption could develop, test, and launch an operational interactive website within 120 days? Are there certain web-development issues that are unique to the investment adviser industry that would prevent the launch of an operational interactive website within 120 days?

5. Do commenters agree that advisers seeking to rely on the proposed exemption could develop a test interactive website that is not accessible to the public that subsequently could be made accessible to the public, including advisory clients, and become an operational interactive website at the time of registration as an internet investment adviser or within 120 days of registration under the 120-day rule?

Generally, do commenters agree that initial registration in reliance on the 120-day rule may not be challenging for advisers in the way that it may have been when the Commission adopted the Internet Adviser Exemption?

6. Is the requirement that an internet investment adviser must provide digital investment advisory services through its website on an ongoing basis to *more than one client* appropriate? Should we require that the internet investment adviser provide digital investment advisory services to "one or more clients" instead? Alternatively, should we require a *de minimis* number of clients or some other exact number of clients (*e.g.* "no fewer than 6 clients" to align with section 222 of the Advisers Act)?

7. Should we include mobile applications in the definition of interactive website, as proposed? Do commenters agree that customers increasingly access investment advisory services through mobile applications? Do commenters agree that mobile applications can provide interactive functionality similar to the functionality of websites?

8. Are there other technologies similar to websites and mobile applications that commenters believe should be included in the definition of operational interactive website? For instance, should the definition include computer programs or software, which may not be a website or a mobile application? Alternatively, should the definition include a broader reference to "digital platform" or some other language instead of "website or mobile application"?

9. Would requiring an affirmative representation on Schedule D to Form ADV that an adviser relying on the Internet Adviser Exemption has an operational interactive website, as proposed, be useful for advisers by reinforcing the conditions of the proposed rule? Why or why not?

10. Generally, is there a need for the Internet Adviser Exemption given the changes in technology and wide use of websites and/or mobile applications by investment advisers to advertise and provide investment advisory services?

2. Elimination of *De Minimis* Non-Internet Client Exception

The current rule includes a *de minimis* exception that permits an internet investment adviser to provide investment advice to fewer than 15 non-internet clients during the preceding 12 months.[62] We are proposing to amend the rule to remove this *de minimis* exception, such that an internet investment adviser must provide advice to all of its clients exclusively through an interactive website.[63]

The Commission included the non-internet client *de minimis* exception so that internet investment advisers would not lose their ability to rely on the Internet Adviser Exemption as a result of providing advice to a small number of clients through means other than an interactive website.[64] In considering whether to retain the *de minimis* exception in this rule, we took into account the basis of the narrow exception, and the Commission's experience administering the rule. We preliminarily believe, as discussed below, that there is not the same need for this exception now as at the time we originally adopted it. Accordingly, under these proposed amendments, if an internet investment adviser is advising non-internet clients, it would not be exempted from the registration rules that otherwise apply to all investment advisers and should

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62 *See* rule 203A-2(e)(1)(i).

63 *See* proposed rule 203A-2(e)(1)(i). *But see* Comment Letter of Wilson Sonsini Goodrich & Rosati, P.C. (Oct. 4, 2021) ("Wilson Sonsini Comment Letter") (asserting, in response to the 2021 RFC, that the current rule is not permissive enough with respect to the advising of non-internet clients, further suggesting that the Internet Adviser Exemption should be available to any investment adviser that provides investment advice solely through the internet to at least 51% of its customers").

64 2002 Adopting Release, *supra* note 13, at section I. When the Commission initially adopted the fewer than 15 client *de minimis* exception, the Commission noted its similarity to the (then-existing) "private adviser exemption" which, subject to certain additional conditions, exempted from the requirement to register with the Commission any adviser that during the course of the preceding 12 months, had fewer than 15 clients. That exemption was repealed by Section 403 of Dodd-Frank. *See* 2011 Redesignation, *supra* note 14, at n.4.

more properly be regulated by a state (or states) or the Commission (using a different basis for registration), as applicable.

In addition, certain internet investment advisers may be able to register with the Commission using separate bases for registration. As such, an internet investment adviser would be less likely today to lose its ability to remain registered with the Commission as a result of taking on a client that would disqualify the adviser from relying on the Internet Adviser Exemption. As of December 31, 2022, ten advisers are dually registered with the Commission under both the Internet Adviser Exemption and another basis for registration.[65] For example, contrary to the practice of internet investment advisers at the time the Commission adopted the Internet Adviser Exemption,[66] our staff has observed that the operations of certain investment advisers that provide advice over the internet have changed such that they now manage assets of their internet clients.[67] Accordingly, depending on assets under management, certain internet investment advisers may be eligible—or required—to register with us.[68] In addition, due in part to the evolution of technology, investment advisers can appropriately manage advertisements, account openings, and similar operations, and, as a consequence, be able to better control in which states they may be required to register. Since the adoption of the rule over 20 years ago, it has become more common for internet businesses to implement technology that targets and tracks the locations in which they offer services.[69] Moreover, the Dodd-Frank Act reduced the

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65 Based on analysis of Form ADV data.

66 *See* 2002 Adopting Release, *supra* note 13, at section IV.A. (stating that "Internet Investment Advisers typically would not initially be eligible to register with us, as they do not manage the assets of their Internet clients.").

67 *See, e.g.*, Robo-Advisers Guidance, *supra* note 55 ("Robo-advisers, which are typically registered investment advisers, use innovative technologies to provide discretionary asset management services to their clients through online algorithmic-based programs."). Robo-advisers typically do not rely on the Internet Adviser Exemption when they are eligible for Commission registration based on regulatory assets under management.

68 *See, e.g.*, rule 203A-1.

69 *See* John T. Holden, Marc Edleman, *A Short Treatise on Sports Gambling and the Law: How America Regulates its Most Lucrative Vice*, 907 Wisconsin Law Review (2020), https://wlr.law.wisc.edu/wp-content/uploads/sites/1263/2021/10/15-Holden-Edelman-To-Print.pdf (illustrating this in the context of

minimum number of states in which an adviser would be required to register before becoming eligible for the multi-state exemption, making it more likely that an adviser would be eligible for the multi-state exemption earlier and more easily than at the time of adoption of the Internet Adviser Exemption in 2002.[70] Taken together, these regulatory and technological changes make the *de minimis* exception in the Internet Adviser Exemption less necessary than at the time we originally adopted the exemption.[71]

We request comment on the proposed elimination of the *de minimis* exception in the Internet Adviser Exemption:

11. Should the *de minimis* exception for non-internet clients be eliminated, as proposed? If so, should those internet investment advisers registered in reliance on the Internet Adviser Exemption prior to the adoption of the final rule continue to be able to rely on the *de minimis* exception? Do commenters agree that there is less of a need for this exception today than there was when it was originally adopted?
12. For internet investment advisers that currently provide advice outside an interactive website, to what types of clients are you providing this advice, and how does this advice differ from advice provided through the interactive website?
13. As an alternative to the proposal, should the *de minimis* exception remain at 15 as in the current rule? Should it be higher or lower? If, unlike as proposed, it should remain at 15 or some alternative number, is it consistent with the policy goals of the

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online gambling platforms and stating that "any company that is licensed to operate an online sportsbook must limit access to individuals physically located within the state where they have received their license. To illustrate this point, if a company has a license to operate an online sportsbook in New Jersey, that company may accept bets from any individual of legal age (other than self-excluded or prohibited individuals) that is physically located in New Jersey at the time of placing the bet. By contrast, even a licensed New Jersey online sportsbook may not accept bets from people, including New Jersey residents, who are physically located outside of New Jersey at the time of the attempted bet. Therefore, it is critical that any licensed online sportsbook implement proper geo-tracking technology to ensure that all bettors are based in permissible locations.").

70 *See* Dodd-Frank Act, Section 410 (amending section 203A of the Advisers Act to enable a mid-sized adviser to register with the Commission if it would be required to register in 15 or more states).

71 *See* rule 203A-2(d). As noted above, technological advances related to website development would better allow advisers to effectively utilize the 120-day rule in anticipation of reliance on the multi-state exemption relative to at the time we originally adopted the Internet Adviser Exemption.

rule that an adviser relying on the rule should be permitted to advise a greater number of non-internet clients than internet clients during the specified timeframe? If, unlike as proposed, it should remain at 15 or some alternative number, should the rule require an equal or greater number of minimum internet clients? If the rule were to retain a *de minimis* exception, rather than specifying the exception as a numerical limit, should we instead require that the *de minimis* exception be a proportion of the number of internet clients an internet investment adviser has? For example, should an internet investment adviser be permitted to have a maximum of 51% of its clients as non-internet clients, as suggested by one commenter, or some greater or lesser percentage? [72] Would such an approach be consistent with the policy goals of the rule of balancing the burdens of multiple state registration requirements and the national presence for internet investment advisers with the Advisers Act's allocation of responsibility for regulating smaller advisers to state securities authorities? Would there be benefits to advisers from this approach and would those benefits justify the potential challenges in oversight? Should the *de minimis* exception be based on some other framework or calculation?

14. If we were to retain a *de minimis* exception, should we add a question to Form ADV, asking how many non-internet clients the adviser had during the last fiscal year? Would this reporting requirement help internet investment advisers in their compliance and/or record keeping obligations with respect to the conditions of the exemption as currently constituted?

15. Are there changes to the exemption that might help to encompass those investment advisers that provide advice through the internet while ensuring that advisers that otherwise are not eligible for registration with the Commission and that use the

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[72] Wilson Sonsini Comment Letter.

internet only as a marketing tool, for example, remain subject to state registration? Should the Commission create a registration exemption that reflects investment advisers' current use of technology in providing investment advice in a better way than the Internet Adviser Exemption?

16. Should we adopt changes to the recordkeeping requirement? For example, should the recordkeeping requirement require advisers to record the frequency of communication with clients?

17. Should we retain the Internet Adviser Exemption, or should we remove it in its entirety? In light of the other bases for registration that may be available to internet investment advisers, do commenters believe that the rule is necessary? Could these advisers simply rely on another applicable exemption (*e.g.*, the multi-state exemption, mid-sized adviser, related adviser)? Would eliminating the Internet Adviser Exemption and instead causing these advisers to rely on the multi-state exemption to register with the Commission better achieve our goals of only allowing advisers with a larger number of internet clients with a true national presence to register with us? Do commenters believe that certain advisers relying on the rule could instead register with the Commission based on having sufficient assets under management or an ability to rely on another exemption for registration? Do commenters believe that enough advisers rely on the rule to warrant the relative cost of oversight required for these advisers by our Staff?

18. Is there any particular topic or issue that advisers encounter in complying with the Internet Adviser Exemption currently, or that they would encounter in complying with the proposed amendments to the exemption, that should be addressed by Commission guidance? Would the proposed amendments create excessive reliance on the Internet Advisers Exemption? If so, how?

III. ECONOMIC ANALYSIS

A. Introduction

We are mindful of the costs imposed by, and the benefits obtained from, our rules. Section 202(c) of the Advisers Act provides that when the Commission is engaging in rulemaking under the Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider whether the action will promote efficiency, competition, and capital formation, in addition to the protection of investors.[73] The following analysis considers the likely significant economic effects that may result from the proposed amendments to rules and forms, including the benefits and costs to clients and investors and other market participants as well as the broader implications of the proposed amendments for efficiency, competition, and capital formation.

Where possible, the Commission quantifies the likely economic effects of its proposed amendments. However, the Commission is unable to quantify certain economic effects because it lacks the information necessary to provide estimates or ranges of costs. For instance, data that separately captures the number of non-internet clients or the types of internet clients an adviser has is generally unavailable.[74] Further, in some cases, quantification would require numerous assumptions to forecast how investment advisers and other affected parties would respond to the proposed amendments, and how those responses would in turn affect the broader markets in which they operate. In addition, many factors determining the economic effects of the proposed amendments would be investment adviser-specific. Investment advisers vary in size and sophistication, as well as in the products and services they offer. Even if it were possible to calculate a range of potential quantitative estimates, that range would be so wide as to not be informative about the magnitude of the benefits or costs associated with the proposed amendments. Many parts of the discussion below are, therefore, qualitative in nature. As

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[73] 15 U.S.C. 80b-2(c).

[74] Information on number of clients, such as that described *supra* section I.B. is generally developed during adviser examinations.

described more fully below, the Commission is providing a qualitative assessment and, where practicable, a quantified estimate of the economic effects.

B. Baseline and Affected Parties

The amended rule would amend the definitions used in the existing Internet Adviser Exemption, which allows internet investment advisers to register with the Commission. The application of this exemption, along with other applicable rules, determines which advisers the Commission regulates and which advisers may fall under state regulation. The entities potentially affected by the proposed amendments include all advisers that are currently relying on the Internet Adviser Exemption, or are contemplating becoming an internet investment adviser under the current or proposed definition; their clients and affiliated parties; and users of Form ADV data.

1. Regulatory Baseline

The NSMIA divided regulatory responsibility for advisers between the Commission and the states, where larger advisers with national presence are regulated by the Commission and smaller advisers with sufficient local presence are regulated by the states.[75] Currently, subject to certain exceptions, only advisers that advise a registered investment company or have assets under management above $100 million are allowed to register with the Commission. All other advisers may be subject to state regulation and may be required to register with one or multiple states.[76]

However, section 222(d) of the Advisers Act [15 U.S.C. 80b–18a(d)] provides that no law of any state "shall require an investment adviser to register with the securities commissioner of the State" if the adviser "(1) does not have a place of business located within the State; and (2) during the preceding 12-month period, has had fewer than 6 clients who are residents of that State." State law varies, and states may exempt from state regulation certain advisers with a

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[75] *See supra* notes 2, 3, and the relevant discussion in section I.

[76] *See supra* note 7; section 222 of the Advisers Act.

place of business in that state if the adviser has a sufficiently low number of clients.[77] Depending on the location of the adviser and the number and location of its clients, an adviser not eligible for Commission registration might need to register with no state, or with up to 14 states.[78] States may also require advisers to file copies of their Commission filings with the state (notice filings) even if state registration is not required.[79]

Certain exemptions allow advisers to register with the Commission if state registration becomes unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A of the Act.[80] The multi-state exemption is one such exemption: it allows advisers that would otherwise have to register with 15 or more states to register with the Commission instead.[81] The current Internet Adviser Exemption similarly allows Commission registration for advisers that conduct their business predominantly over the internet and by the nature of their business have national presence. That is, their clients may come from multiple states, but they may not advise a registered investment company or have sufficient assets under management to be able to register with the Commission. To alleviate the burden of potentially registering with numerous states for business conducted over the internet, the Commission created in 2002 the exemption found in rule 203A-2(e).[82] Under current rule 203A-2(e), Commission registration is

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77 *See, e.g.,* N.Y. Gen. Bus. Law § 359-eee(a)(5) (excluding from the definition of "investment adviser" a person that has sold investment advisory services to fewer than 6 persons in the state, in the preceding 12 months); N.J. Stat. Ann. § 49:3-56.9(g)(1) (exempting from registration as an investment adviser a person that does not have more than 5 clients in the state, in a 12-month period); Ill. Admin. Code tit. 14 § 130.805b) (exempting from registration as an investment adviser any investment adviser that had no more than 5 clients in the state, in the preceding 12 months); Ga. Comp. R. & Regs. R. 590-4-4-.13(1)(b) (exempting from registration an investment adviser that had fewer than 6 clients in the state, in the preceding 12 months).

78 Advisers that would otherwise have to register with 15 or more states may register with the Commission using the multi-state exemption. *See supra* note 13 and section I for the relevant discussion. For information on the number of state-registered investment advisers, *see, e.g.*, NASAA, NASAA 2022 Investment Adviser Section Annual Report (Apr. 2022), https://www.nasaa.org/wp-content/uploads/2022/06/2022-IA-Section-Report-FINAL-updated-05192022.pdf.

79 15 U.S.C. 80b-3a note [Pub. L. 104-290, section 307, "Continued State Authority"]. *See, e.g.*, Neb. Rev. St. sec. 8-1103(2)(b); N.H. Rev. Stat. sec. 421-B:4-405; 7 TX Admin. Code § 116.1.(b)(2).

80 15 U.S.C. 80b-3a(c).

81 *See* 2002 Adopting Release, *supra* note 13, and section I, for the relevant discussion.

82 *See* 2002 Adopting Release, *supra* note 13, and the relevant discussion in section I.A of this release. The

allowed for an investment adviser that provides advice to all of its clients exclusively through an interactive website, except that the investment adviser may provide investment advice to fewer than 15 clients through other means during the preceding 12 months. Rule 203A-2(e) also requires the internet investment adviser to maintain records demonstrating that it meets the conditions of rule 203A-2(e)(1)(i).[83]

2. Current Use of the Internet Adviser Exemption

As of December 2022, there were 15,360 registered investment advisers with $115,050 billion regulatory assets under management. Of these, 256 (1.7%) with a combined total of $2.94 billion in regulatory assets under management (0.003%) exclusively relied on the Internet Adviser Exemption, while 10 advisers were dually registered with the Commission under both the Internet Adviser Exemption and another basis for registration. The total number of advisers claiming use of the Internet Adviser Exemption was 266, 190 of which were small entity registered investment advisers.[84]

As of December 2022, registered internet investment advisers had on average 5,506 clients, with a minimum of 0 clients, reported by 101 advisers, and a maximum of 522,345 clients.[85] The median number of clients for all advisers using the exemption was 6, indicating that the distribution is highly skewed. As of December 2022, 101 advisers (38% of 266) reported advising 0 clients, 5 advisers (1.9% of 266) reported advising 1 client, and 37% of internet investment advisers (98 of 266) advised 2 to 100 clients. Only 18 advisers (7% of 266) reported advising more than 5,000 clients. Figure 1 demonstrates that 40% of internet advisers have fewer than 2 clients.

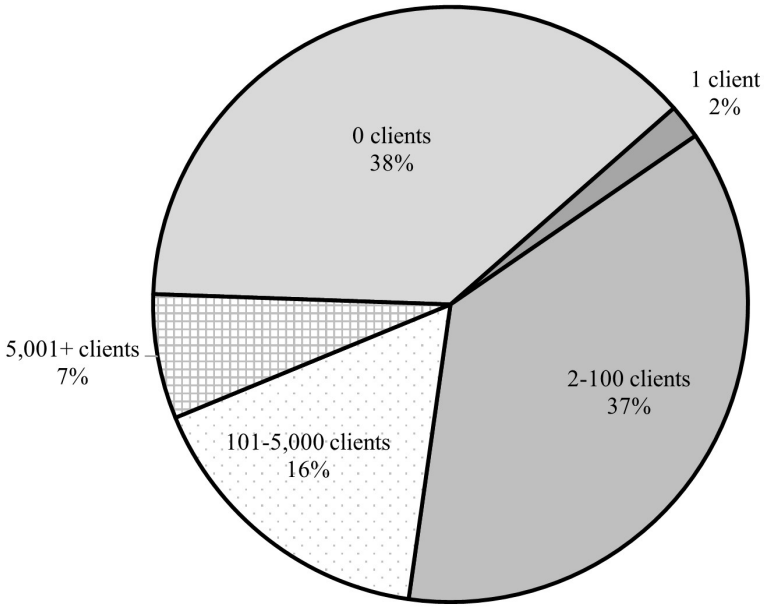
2002 Adopting Release described the exemption as "providing relief to certain investment advisers who, unlike state-registered advisers, have no local presence and whose advisory activities are not limited to one or a few states." At that time, the threshold for the multi-state exemption was registration in 30 states rather than 15.

83 *See* rule 203A-2(e)(1)(ii); relevant discussion in *supra* section I.A.

84 The data comes from Form ADV filings received by the Commission through Mar. 31, 2023. Small entity investment advisers are advisers with less than $25 million in regulatory assets under management.

85 The data comes from Form ADV filings received by the Commission through Mar. 31, 2023.

Fig. 1: Number of Clients Reported by Internet Advisers



Data source: Form ADV filings received by the Commission through Mar. 31, 2023.

The largest categories of clients that internet investment advisers currently have are: non-high net worth individuals, pension plans, and high net worth individuals.[86] The distribution of these client types among all internet advisers is as follows:

Table 1: Largest Categories of Clients: Distribution Across All Internet Advisers

Type of client	Mean clients per adviser
Non-high net worth individuals	5,085
Pension plans	261
High net worth individuals	2

Data source: Form ADV filings received by the Commission through Mar. 31, 2023.

The low median, relative to the average, is an indication of skewed distribution within the population of internet advisers. If the dataset is reduced to only those 204 advisers with 100 or fewer clients, the distribution of clients in these categories is as follows:

Table 2: Largest Categories of Clients for Internet Advisers with 100 or Fewer Clients

Type of client	Mean clients per adviser
Non-high net worth individuals	6.3

86 The instructions of Form ADV specify that the category "individuals" includes trusts, estates, and 401(k) plans and IRAs of individuals and their family members but does not include businesses organized as sole proprietorships. "High Net Worth Individual" is defined as an individual who is a qualified client or who is a "qualified purchaser" as defined in section 2(a)(51)(A) of the Investment Company Act of 1940.

Pension plans	0.1
High net worth individuals	0.7

Data source: Form ADV filings received by the Commission through Mar. 31, 2023.

The data indicate that the majority of clients using internet advisers are non-high net worth individuals.

We do not have information on the states in which these clients are located. Advisers using the Internet Adviser Exemption might also be eligible for the multi-state exemption if they have clients in 15 or more states.[87] But, we would expect that relatively few advisers with the option to use either exemption would choose the Internet Adviser Exemption instead of the multi-state exemption, because the multi-state exemption is less restrictive: it does not limit advice provided through non-internet means, as the Internet Adviser Exemption does. This suggests that advisers using the Internet Adviser Exemption most likely do not have the option of using the multi-state exemption instead. We invite public comment on this topic.

Similarly, we cannot estimate how many advisers currently using the Internet Adviser Exemption would potentially be subject to regulation by multiple states if they did not elect to use the exemption. State law varies, and regulation would depend on the location of the adviser's place of business and the location of their clients.[88] In light of the substantial number of internet investment advisers with only a few clients, however, it is likely that many of the advisers currently relying on the exemption would, if not registered using the exemption, be subject to registration in not more than one state.[89] Additionally, advisers now may be able to use

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87 The multi-state exemption became more widely available after the creation of the current Internet Adviser Exemption, because of the change from a minimum of 30 states to a minimum of 15. Thus, the burden of registering in numerous states was lessened, compared to what it had been when the current exemption was developed.

88 For example, the Uniform Securities Act would, if adopted by the relevant state, require an investment adviser to register with the state unless the adviser has no place of business in the state and no more than 5 clients in the state other than certain types of clients described in the Uniform Securities Act. UNIF. SEC. ACT OF 2002 (rev. 2005), sec. 403(b). As of July 2023, 21 states and territories had adopted the 2002 version of the Uniform Securities Act and 5 states had adopted an earlier version. *2002 Securities Act Enactment History*, UNIF. LAW COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=8c3c2581-0fea-4e91-8a50-27eee58da1cf, *last visited July 10, 2023.*

89 The 2002 rule contemplated internet advisers potentially having clients that "can come from any state, at

technology and targeting advertisement in such a way as to limit the number of clients from certain states thereby reducing the state regulation burden.[90]

In the instances where state law does not require the adviser to register with a state, for example because the adviser has fewer than the *de minimis* number of clients in the state, registration with the Commission represents an additional compliance burden that some internet investment advisers appear to be voluntarily assuming. Moreover, where state law would require a Commission-registered adviser to make notice filings with one or more states, the combination of Commission registration and state notice filings may also represent an additional, voluntarily assumed compliance burden as compared to registering directly with those states.[91] Because some advisers choose to register with the Commission despite the potential additional compliance burden, we assume that some advisers perceive value in Commission registration as compared to state registration.

Based on observations of Commission staff conducting examinations, we think some investors may believe that registration with the Commission confers a reputational advantage or appeals to potential clients. Other possibilities include the intent to obtain clients in multiple states in the future, or avoidance of individual state registration requirements such as bond and invoicing requirements. We invite public comment on the location of internet investment advisers and their clients, application of state law to internet investment advisers, reasons to seek the Internet Adviser Exemption, and other relevant topics.

3. Increased Reliance on the Internet Adviser Exemption

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any time, without the adviser's prior knowledge" and thus potentially necessitating registration in all states. 2002 Adopting Release, *supra* note 13, at 77622. However, the significant number of currently registered internet investment advisers with one or fewer clients would not face that risk. Additionally, as noted *supra*, note 69 and surrounding text, today's investment advisers are better able to control in which states they may be required to register.

90 *See* section II.A.2 for a relevant discussion.

91 The cost of notice filing is often the same as the cost of registering with the state. *See* INVESTMENT ADVISER REGISTRATION DEPOSITORY, *IA Firm State Registration/Notice Filing Fee Schedule* (Jan. 13, 2023), https://www.iard.com, under the tab "Fees & Accounting." We invite public comment on the cost of state registration and notice filing fees.

Use of the Internet Adviser Exemption has increased since its adoption, especially in recent years.[92] The number of investment advisers using the exemption at the end of 2022 (that is, 266 advisers) was almost 18 times larger than it was in December 2003, one year after the exemption was put in place, when there were 15 such advisers.[93] The value of regulatory assets under management for advisers exclusively relying on the Internet Adviser Exemption at the end of 2022 was $2.94 billion,[94] or 0.003% of total adviser registered assets under management. The average regulatory assets under management per adviser for internet investment advisers (about $64.11 million) was 165 times larger than it was in December 2003 when advisers using the exemption had on average about $0.39 million of registered assets under management per adviser. Further, from 2003 to 2022, 440 unique registered investment advisers that had indicated in their prior ADV filing they were utilizing the internet adviser registration basis withdrew and filed a total of 475 Forms ADV-W.[95] Note that the number of withdrawals has increased, for example, there were 69 ADV-W filings by internet investment advisers between 2003 and 2012 and 387 ADV-W filings between 2013 and 2022.[96] This increase could suggest erroneous registration, as discussed later in this analysis.

Technology use in the advisory industry has also changed. For example, while the 2002 Adopting Release stated that internet investment advisers might not be fully operational within 120 days of registration,[97] today websites and associated services are more common, more website development services are available on the market, and new technologies, such as mobile

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92 *See supra* note 23 (number of advisers relying exclusively on the exemption grew from 107 in 2015 to 256 in 2022).

93 The 2002 Adopting Release used a figure of 20 eligible advisers in its analysis, acknowledging that the number of eligible firms would likely grow. 2002 Adopting Release, *supra* note 13, at 77623.

94 Accounting for inflation using CPI calculator (https://www.bls.gov/data/inflation_calculator.htm), this number is 1.83 billion in Dec. 2003 dollars.

95 The filing of 475 Forms ADV-W includes singular investment advisers that utilized the Internet Adviser Exemption on a non-continuous basis (*e.g.*, investment advisers that registered, withdrew, registered again, and subsequently withdrew).

96 Based on analysis of Form ADV data available through Mar. 31, 2023.

97 Exemption for Certain Investment Advisers Operating Through the Internet, Investment Advisors Act Release No. 2091 [67 FR 77619 (Dec. 18, 2002)], at 77622.

applications that can generate advice, have emerged as well.[98] Currently, different options are available on the market to develop a website, from using website builder programs for an average upfront cost of about $200 and maintenance cost of about $50 per month, to hiring a website designer for an average upfront cost of about $6,000 and maintenance cost of about $1,000 per year.[99]

As discussed in section I.A, the Commission adopted rule 203A-2(e) to alleviate, for a narrow set of advisers with national presence, the burden of having to register in multiple states as a result of providing internet advice. The increase in its use, especially among advisers that would not be subject to registration in more than one state, or that appear to have advised no clients in several years, suggests the exemption may currently be used in ways that were not intended by the 2002 rule.

In addition, the Commission's examination program has identified multiple instances of compliance issues relating to advisers relying on the exemption without an interactive website, or providing advisory personnel who could expand upon the investment advice provided by the adviser's interactive website or otherwise provide investment advice to clients, such as financial planning.[100] The frequency of registration withdrawals has increased as well: as discussed previously in the baseline, the number of withdrawals by internet investment advisers between 2013 and 2022 (387) was over five times larger than the number of withdrawals between 2003 and 2012 (69).[101]

C. Benefits and Costs and Effects on Efficiency, Competition, and Capital Formation

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98 *See supra* note 20 and surrounding text. *See also* Alex Padalka, *RIAs Depend on Tech for Client Communications, Growth*, FIN. ADVISOR IQ (Dec. 10, 2021), https://www.financialadvisoriq.com/c/3402044/435734/rias_depend_tech_client_communications_growth?preview=1.

99 These estimates are available from Lucy Carney, *How Much Does a Website Cost in 2023? (Full Breakdown)*, WEBSITEBUILDEREXPERT (Apr. 26, 2023), https://www.websitebuilderexpert.com/building-websites/how-much-should-a-website-cost/.

100 *See* Risk Alert, *supra* note 25; *see also supra* note 26 and surrounding text.

101 Based on the analysis of Form ADV data available through Mar. 31, 2023.

1. Benefits

The proposed amendments to the Internet Adviser Exemption are designed to modernize the exemption and address technological and other industry developments that have occurred since 2002, and to respond to observations about the use of the exemption that were not available when the exemption was first put in place.[102] Further, as discussed in more detail below, the proposed changes to the definitions in the rule are designed to better align regulatory authority between the Commission and the states and improve investor protection. The proposed amendments would:

1. Specify that the exemption is available to an investment adviser that provides investment advice to all of its clients exclusively through an operational interactive website at all times during which the investment adviser relies on the exemption found in section 275.203A-2(e).
2. Modernize the meaning of "interactive website" by:
    - Adding the term "digital investment advisory service," defined to mean investment advice to clients that is generated by the website's algorithms as well as the software-based models and applications covered by the existing rule;
    - Adding a reference to mobile applications;
    - Requiring more than one client to which the adviser provides digital investment advisory services on an ongoing basis;
    - Adding the word "operational," thus changing the term to "operational interactive website"; and
    - Adding an exception to the operational interactive website requirement for "temporary technological outages of a *de minimis* duration."
3. Eliminate the *de minimis* exception allowing fewer than 15 non-internet clients;

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[102] *See supra* section I.B for a relevant discussion.

4. Require advisers to make a representation of eligibility on Schedule D of Form ADV (in addition to checking the appropriate box in Item 2.A.(11) of Form ADV).

These changes are intended to modernize the Internet Adviser Exemption, retain its intended narrow scope, and minimize opportunities for advisers to misuse the exemption to register with the Commission without meeting its conditions.

Augmenting the definition of "interactive website" to include the new defined term "digital investment advisory service" would capture the increasing variety of technological methods by which internet investment advisers provide advice using the internet. Additionally, the proposed addition of the terms "mobile application" and "algorithms" would better align with technological advances in the industry. Advisers increasingly make use of various mobile applications to interact with the clients, and use algorithms to generate investment advice.[103] The improved definition thus would allow internet investment advisers that rely on mobile applications to generate advice to use the Internet Adviser Exemption, potentially reducing their burdens associated with multiple states' registrations and regulations. Further, internet investment adviser clients would be able to benefit from being able to rely on mobile applications and algorithms, which offer a convenient means of interaction between the adviser and its clients. Additionally, including an exception for temporary technological outages of a *de minimis* duration should help accommodate occasional technological issues with the website or mobile application so the internet investment adviser is not required to frequently withdraw and re-register due to minor or temporary technical difficulties or planned maintenance.

To the extent advisers may be registering with the Commission in order to market themselves to potential clients, the proposed changes should help avoid misleading clients. For instance, advisers without an "operational" website would be excluded from the pool of advisers eligible for the Internet Adviser Exemption. This would avoid clients contracting with an adviser

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[103] *See supra* section II.A.1, specifically note 55 and surrounding text.

that is relying on the Internet Adviser Exemption for registration whose website cannot be used to provide investment advice. To the extent any investors may be led to believe that an adviser relying on the Internet Adviser Exemption for registration has national presence and conducts its business via the internet, while this is not in fact the case, the proposed amendments could help avoid the possibility of investors using a type of adviser they did not intend to use.

The proposed amendments would remove the *de minimis* exception for non-internet clients, preventing advisers with any non-internet clients from relying on the Internet Adviser Exemption. Removing the exception better services the narrow-intended scope of the Internet Adviser Exemption.[104] This amendment would assist Commission staff in conducting examinations of internet advisers, because it can be difficult to identify the instances of advice given and the exact number of clients that received advice through means other than an operational interactive website.

Additionally, the proposed amendments requiring advisers to represent their Internet Adviser Exemption eligibility on Schedule D of Form ADV should reduce the number of erroneous registrations and subsequent withdrawals. Currently, prospective advisers need only check a box on Form ADV indicating they "are an internet adviser relying on rule 203A-2e" but the proposed change to Form ADV would include a separate text description of the actions the adviser must have taken to become or remain eligible for the Internet Adviser Exemption.[105] Listing the required elements of eligibility for the Internet Adviser Exemption should explicitly state for the registrants the requirements that they must meet in order to qualify, and which they are certifying that they have met when they file Form ADV.[106] We also anticipate that by

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104 *See supra* section II.A.2.

105 Schedule D of Part 1A of Form ADV currently is submitted in a structured (*i.e.*, machine-readable), XML-based data language specific to that Form, so the additional information that would be required on Schedule D under the proposed rule amendments would also be structured.

106 This amendment would also assist Commission staff in connection with its review of existing registrations and registration applications for compliance with the rule and, as applicable, for possible deregistration for inability to meet the conditions of the rule.

avoiding erroneous registration, ineligible registrants would avoid expending time and effort on dealing with withdrawals, and corresponding legal fees.

Currently, the Internet Adviser Exemption does not require an adviser to have a minimum number of clients. Requiring that digital investment advisory services be provided on an ongoing basis to more than one client would better align with the original goal of the exemption, which was to provide relief from multiple state registration requirements for advisers with a national presence via the internet. Advisers with one or zero clients cannot be considered entities with national presence requiring relief from a state registration burden. Further, advisers with zero clients that effectively do not conduct advisory business but are able to register as internet investment advisers may be misleading potential future clients to believe they are providing advisory business via the internet.

2. Costs

The proposed amendments may adversely affect some advisers. The proposed amendments would specifically require that the website be "operational," and advisers may incur a cost of developing a website or withdrawing their Commission registration if their website is not operational. Advisers should already have an interactive website and the Commission does not currently recognize a grace period to develop a website, beyond the separate, rule 203A-2(c) exemption for an investment adviser expecting to be eligible for Commission registration within 120 days, so the proposed amendments should not require new website development costs.[107]

Advisers that choose to withdraw their Commission registration must file form ADV-W. The current burden estimate to file form ADV-W is 0.75 hour per respondent,[108] implying a cost of withdrawal of $319 per adviser.[109] The costs to file this form may vary between advisers and

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107 *See supra* note 49.

108 *See*, *e.g.*, Submission for OMB Review; Comment request; Extension: Rule 203-2 and Form ADV-W, 88 FR 37913 (Jun. 9, 2023) (describing the burden associated with the previously approved collection of information under OMB Control No. 3235-0313).

109 0.75 hour * $425 = $319. The maximum total cost of withdrawals assuming all 256 currently registered

may be larger than this estimate for some. In addition, depending on their location and the scope and nature of their activities (if any), advisers that withdraw from Commission registration might need to register with one or more states. Also, to the extent some clients value Commission registration and select advisers based on their Commission registration status, advisers could lose clients as a result of withdrawal; however, we do not have information that would allow us to predict the size or magnitude of this effect.[110] We request public comment on this topic.

Adding the term "mobile applications" and the term "digital investment advisory service" still may not prevent some non-internet advisers from relying on the exemption by claiming to provide mobile application or website-generated advice or "digital investment advisory service" when in fact the advice involves some human input.[111] Such advisers are likely to incur costs of withdrawing their Commission registration.

Internet investment advisers that rely exclusively on the Internet Adviser Exemption and have non-internet clients, as is currently allowed, would be affected by the proposed amendments because they could no longer rely on the exemption as a basis for registering with the Commission. Human-directed advice provided by electronic means would not be eligible for the exemption. These advisers may be required to register with one or more states if their total number of clients in any given state exceeds five and the state requires registration.[112]

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internet investment advisers relying exclusively on the Internet Investment Adviser Exemption have to withdraw is 0.75 hour * $425 * 256 = $81,600. Assuming only 101 currently registered internet investment advisers with zero clients and 5 advisers with one client will have to withdraw, the total estimated cost is 0.75 hour * $425 *106 = $33,788. The $425 compensation rate used is the rate for a Sr. Operations Manager in the SIFMA Report on Management & Professional Earnings in the Securities Industry – 2013 (Oct. 7, 2013), adjusted for inflation using the Bureau of Labor Statistics' Consumer Price Index inflation calculator, modified to account for a 1,800-hour work-year, and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

110 *See supra* note 65 and surrounding text (discussion of dual basis registration).

111 *See, e.g.*, the findings in RetireHub, *supra* note 26.

112 *See* section 222(d) of the Advisers Act. We are unable to quantify the costs of registering with the States, beyond state registration fees, because the registration requirements and forms, and the corresponding time spent by firms, vary by each state and there is no available data to make such estimates. The average of state registration fees is $224, *see supra* note 91.

Similarly, the proposed amendments are designed to focus on advisers that exclusively advise through the internet. Advisers currently relying on the Internet Adviser Exemption may need to change the way they communicate with or deliver services to their clients or rely on a different basis for Commission registration, if available. For example, internet investment advisers that provide advice via means other than an interactive website or with some human input might have to change their communication with clients in order to continue to rely on the exemption. In some cases, such advisers may either have to withdraw their registration or lose some of their clients as well if the clients require more than digital investment advisory services in order to remain with the specific adviser. Further, the clients may have to switch to a different adviser. As discussed in section III.B, internet investment advisers typically advise non-high net worth individual clients. In addition to the cost associated with finding a new adviser, switching to a different adviser may represent a cost increase for such clients if the new adviser has higher fees.

Finally, the proposed additional representation of eligibility on Schedule D of Form ADV may increase the time and effort advisers expend when filing Form ADV. However, as discussed in the PRA, such costs are expected to be minimal.[113]

Some of the costs associated with advisers having to register with multiple states are alleviated by the fact that the state registration burdens assessed when the exemption was originally implemented have declined since 2002, as now the advisers may be able to rely on other available exemptions or more easily meet registrations thresholds in order to register with the Commission. For example, as discussed in the baseline, the multi-state exemption threshold was decreased from 30 to 15, making it easier for advisers to qualify for this exemption. Further, as discussed in the baseline, advisers relying on the Internet Adviser Exemption now tend to have more registered assets under management on average per adviser and some may be able to

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[113] *See supra* section IV.C.

reach the minimum threshold on the registered assets under management sooner in order to qualify for the Commission registration.[114]

The proposed change would render ineligible for the exemption all the currently registered internet investment advisers with one or zero clients. This would reduce the current population of exemption-eligible advisers by approximately 40%, unless those advisers obtained additional clients.[115] While reducing the number of advisers relying on the exemption is not a goal of the proposal, a reduction would reflect the narrow scope of the Commission's exemptive rule.[116]

3. Effects on Efficiency, Competition, and Capital Formation

We do not anticipate any significant effects on efficiency, competition, and capital formation, as the proposal represents a minor change of the exemption parameters and is not intended to conceptually change the exemption or the original intended division of the regulatory authority over investment advisers between the Commission and the states. As discussed in the baseline, the number of advisers potentially affected by the proposed change is small, and does not represent a significant portion of the population of investment advisers or their clients.

The proposed amendments may have a positive effect on competition and capital formation as they are designed to modernize the rule to recognize advances in technology and digital services employed by the investment advisory industry. Specifying that internet investment advisers may use technology, such as mobile applications, that can better fit their clients' needs should improve client-adviser interactions, and the quality of the services provided, and could encourage client participation.

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114 *See also* a related discussion in section II.A.2.

115 *See* previous discussion in baseline on the number of internet investment advisers with zero (101) and one (5) client out of 266 total internet investment advisers.

116 2002 Adopting Release, *supra* note 13, at 77621; 15 U.S.C. 80b-3a(c) (allowing exemptions from the limits on Commission registration when those limits "would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of this section").

However, the positive effects discussed above could be lessened by the fact that certain proposed amendments, such as the removal of the current *de minimis* exception, could adversely affect adviser-client interactions by preventing internet investment advisers from relying on the Internet Adviser Exemption when providing, to any client, advice beyond digital investment advisory services. In some cases, advisers may need to choose between retaining their Commission registration (if they rely solely on the Internet Adviser Exemption) or continuing to provide human-directed advice as is allowed under the current wording of the exemption. This may lead to advisers losing some clients who value both Commission registration and human-directed advice and thus affect competition in the investment adviser market.

D. Reasonable Alternatives

1. Allowing Fewer Non-Internet Clients

As an alternative to removing the *de minimis* provision that allowed internet investment advisers to have 15 or fewer non-internet clients, the Commission considered reducing that number, for example, by setting a defined maximum of non-internet clients, such as five. Reducing the maximum to five could strengthen the link between the Internet Adviser Exemption and the internet advisory business, while retaining an adviser's flexibility to accommodate a small number of customers who seek advice beyond mere website output allowed under the proposed amendment to the exemption.

However, as discussed in section II.A.2, if an internet investment adviser is advising non-internet clients, it should not be exempted from the registration rules that otherwise apply to all investment advisers and should more properly be regulated by a state (or states) or the Commission (using a different basis for registration), as applicable. This alternative may require advisers to keep additional records tracing instances in which clients received advice beyond the model generated output. Such cases may be hard to identify because, as discussed earlier in the Economic Analysis, it may not always be clear when some human input was involved and to

what extent. This alternative may thus result in a greater number of erroneous registrations and subsequent withdrawals as compared to the current rule.

The Commission also considered variations, such as defining a maximum number of non-internet clients as a percentage of the adviser's total number of clients. Under this variation, however, the maximum number of non-internet clients could be quite large for advisers with many clients, implying sufficient local presence to register with one or more states, while remaining quite small for investors with few clients and still limiting their interactions with clients. This may not be fair, efficient or reflect the originally intended allocation of adviser regulation responsibilities between the Commission and the states: for example, advisers with a large number of non-internet clients in a given state are more likely to have a local presence in the state as opposed to a national presence.

2. Alternative Definitions of "Interactive Website"

The Commission also considered adding a different minimum number of clients to the definition of "interactive website." A larger number of clients would help limit Commission registration to those advisers with a national presence. Requiring a larger minimum number of clients to qualify for the exemption would exclude advisers that are not otherwise eligible for Commission regulation, but that obtain one or a few clients with sole purpose of relying on the exemption. This would work against the originally intended division of regulatory authority between the Commission and the states. A larger minimum number of clients may, however, disadvantage advisers with a small clientele or advisers which are at the early stages of starting their advisory business.

Further, the definition of "interactive website" could use a term other than "operational," such as "functioning" or "working," to highlight the requirement that the website can be used by the clients or prospective clients to interact with adviser or obtain advising services. These alternative terms could simplify the rule text. However, such terms may be less technical and more prone to potentially inconsistent interpretations across advisers.

Further, the definition of "interactive website" could use a definition of the term "digital investment advisory services," other than "investment advice to clients that is generated by the operational interactive website's software-based models, algorithms, or applications based on personal information each client supplies through the operational interactive website." For example, the definition of the term could be less specific, such as "investment advice to clients that is generated based on personal information each client supplies through an operational interactive website." This alternative does not specify the type of technology used to generate advice, which allows more flexibility in technology use by internet investment advisers. However, this may result in non-internet advisers attempting to rely on the Internet Adviser Exemption by referencing a technology that is not typically used to provide investment advice via internet.

3. Eliminating the Internet Adviser Exemption

As another alternative, the Commission considered eliminating the Internet Adviser Exemption. With the proliferation of internet tools and their frequent use by all types of advisers, the distinction might no longer be valuable. In addition, specifically defining the bounds of the exemption may remain difficult, as evolving industry practices could quickly make rule definitions stale. New innovations and new ways of communication with the clients, which are not accounted for by the current or proposed exemption definitions, could render the exemption unavailable to some internet investment advisers who adopt those new technologies. Further, as discussed in the section on costs, erroneous registrations associated with the rule can create additional costs for advisers due to registration withdrawals. Eliminating the exemption would eliminate these issues.

However, eliminating the exemption would result in certain costs. Advisers that currently rely on the exemption would no longer be able to use it, and therefore would not be eligible to register with the Commission unless they meet the criteria of another exemption. Losing Commission registration would impose costs: for example, the adviser may lose some clients or

may need to comply with state regulation requirements, as discussed in the Costs section. Further, losing a basis for Commission registration would require the adviser to file form ADV-W. We estimate the burden to file Form ADV-W to withdraw from registration as 0.75 hour per respondent.[117] Assuming 256 currently registered internet investment advisers relying exclusively on the Internet Adviser Exemption would have to withdraw from registration, the total cost of filing Form ADV-W is estimated as $81,600.[118]

This alternative may also result in advisers losing some clients to the extent clients value Commission registration. Such clients would have to seek a different adviser and may face higher fees as well as switching costs as discussed above.[119] Further, losing Commission registration may result in advisers having to register in multiple (up to 14) states and be subject to the appropriate state regulations until they become eligible under a different rule or exemption, which would create a burden, especially for new and small advisers.[120]

Such costs, however, would likely be small as the advisers exclusively using the Internet Adviser Exemption comprise a very small portion of the relevant market (as discussed previously, 1.7% of the total number of advisers and 0.003% of the total assets under management). Moreover, state registration fees are typically the same as state notice filing fees,[121] so to the extent the adviser is already paying notice filing fees in the states where it would need to register, the difference in filing fees should be *de minimis*.

Request for Comment

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117 *See supra* note 108 and accompanying text.

118 $425 * 0.75 hour per respondent * 256 advisers. The $425 compensation rate is calculated as described *supra*, note 109.

119 As discussed previously in the costs section, we are unable to quantify these costs due to a lack of data on such clients and the new advisers they may have selected. We invite public comment on this topic.

120 *See* relevant discussion in section III.C.2. As stated previously in the Costs discussion, we are unable to quantify the costs of registering with the States, beyond state registration fees ($224 on average across states), because the registration requirements and forms, and the corresponding time spent by firms, vary by each state and there is no available data to make such estimates.

121 *See supra* note 91.

19. What additional qualitative or quantitative information should be considered as part of the baseline for the economic analysis of the proposals?
20. Do commenters agree with our characterization of the estimated benefits, burden hours, and costs? Please explain and supplement with data or estimates if available.
21. Are the effects on competition, efficiency, and capital formation arising from the proposed amendments accurately characterized? Please explain, and provide data or estimates if available.
22. Please provide data, if available, on the number of currently registered advisers that do not have an operational interactive website.
23. Please provide data, if available, on the cost of setting up and maintaining an operational interactive website.
24. Please provide data, if available, on the number of non-internet clients of registered internet investment advisers.
25. Please provide data, if available, on the location of internet investment advisers and their clients.
26. Please provide data, if available, on the application of state law to internet investment advisers.
27. For what reasons do investment advisers seek to use the Internet Adviser Exemption?
28. Please provide data, if available, on the types of internet clients of registered internet investment advisers. What type of clients seek or prefer internet advisers? Do clients prefer internet advisers registered with the Commission?
29. How would clients react if a previously-registered adviser was no longer registered with the Commission? How would current clients react if an internet adviser could no longer provide advice by means other than a website?

30. Please provide data, if available, on the number of clients that may have to switch to a different adviser as a result of the proposed amendments.

31. Please provide data, if available, on the clients an adviser may lose as a result of withdrawing from registration with the Commission, as well as the new advisers the clients may have selected.

32. Are there known technological advances in advisory business other than "models," "algorithms," or "applications" generated advice that should be included in "digital investment advisory service" definition? Please explain.

33. Is there a better term than "operational," which can be used in the definition of "interactive website"? Are there alternatives to the proposed items in the definition of "interactive website"?

34. Please provide any available estimates or data that can help estimate the average costs of state registrations, and of state notice filings.

35. Please provide any available data regarding the advisers that currently rely on the Internet Adviser Exemption and will likely need to withdraw from registration with the Commission. How many of those advisers may face multiple state registrations if the exemption is eliminated?

IV. PAPERWORK REDUCTION ACT

A. Introduction

Our proposal would result in new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[122] The proposed amendments would have an impact on the current collection of information burdens of rule 203A-2(e) and Form ADV under the Act. The existing collections of information that we are proposing to amend are: (i) "Exemption for Certain Investment Advisers Operating Through the Internet (Rule 203A-

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[122] 44 U.S.C. 3501 *et seq*.

2(e))" (OMB control number 3235-0559); and (iii) "Form ADV" (OMB control number 3235-0049). The Commission is submitting these collections of information to the OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

We discuss below these proposed amendments and new collection of information burdens. Responses provided to the Commission in the context of its examination and oversight program concerning the proposed amendments to rule 203A-2(e) subject to the provisions of applicable law. Responses to the disclosure requirements of the proposed amendments to Forms ADV are not kept confidential.

B. Rule 203A-2(e) Recordkeeping Requirement

The amended rule would require an internet investment adviser to provide investment advice to all of its clients exclusively through an operational interactive website,[123] and would require advisers registering with the Commission under the exemption to maintain a record demonstrating that the adviser's advisory business has been conducted through an operational interactive website in accordance with the rule.[124] Although most advisers registering under the rule usually generate the necessary records in the ordinary conduct of their internet advisory business, the recordkeeping requirement of rule 203A-2(e) nonetheless may impose a small additional burden on these advisers. We estimate this recordkeeping burden to amount to an average of four (4) hours annually per adviser.[125]

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123 *See* proposed rule 203A-2(e)(1)(i).

124 *See* proposed rule 203A-2(e)(1)(ii). Under the proposed rule, as under the current rule, advisers would need to maintain records of their compliance with the rule. The proposed change to remove the *de minimis* exception does not result in an increase in the burden under the current rule but it has been accounted for in our estimated burden for the proposed rule.

125 The adviser would need to demonstrate that all of its clients obtain investment advice from the firm exclusively through an operational interactive website. Internet advisers that conduct their business exclusively through interactive websites and whose employees never directly communicate with clients would likely need to spend very little time documenting their compliance with the condition. An adviser that has personnel that assist clients directly (whether through email, chatbots, telephonically, or otherwise) with administrative functions like accessing the website may need to spend more time.

We estimate the number of respondents to this information collection to be 266 advisers.[126] Accordingly, we estimate the total recordkeeping burden hours for all rule 203A-2(e) advisers to be 1,064 hours.[127] We estimate that the total monetized cost to each internet adviser to comply with the recordkeeping provision of rule 203A-2(e) would be approximately $1,700,[128] and that the total monetized cost for the 266 advisers relying on this exemption at this time would be $452,200.[129]

C. Form ADV

We are proposing amendments to Form ADV Part 1A, Schedule D, requiring advisers to indicate on Schedule D that, if applying for registration with the Commission, the adviser will provide—and if amending its existing registration and is continuing to rely on the Internet adviser exemption, that it has provided—investment advice to all of its clients exclusively through an operational interactive website.[130] These changes are designed to provide information to the Commission in connection with the registration and annual amendments to Form ADV filed by internet investment advisers and would assist Commission staff in connection with its review of existing registrations and registration applications for compliance with the rule and, as applicable, for possible deregistration for an inability to meet the conditions of the rule. We do not believe that these ministerial amendments to Form ADV requiring a very small number of

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126 This estimate is based on information reported by advisers through the Investment Adviser Registration Depository ("IARD"). Based on IARD data as of Dec. 31, 2022, of the approximately 15,360 SEC-registered advisers, 266 checked Item 2.A(11) of Part 1A of Form ADV to indicate their basis for SEC registration under the Internet Adviser Exemption. This estimate may be overinclusive to the extent that advisers currently registered in reliance on the exemption, including, but not limited to, those that currently have one or fewer clients, are not able to satisfy the requirements of the proposed amendments. The estimate may be underinclusive to the extent that additional advisers seek to rely on the Internet Adviser Exemption, whether due to the industry's increased reliance on technology or otherwise.

127 Four (4) hours x 266 advisers = 1,064 hours.

128 We estimate the cost at a rate of $425 per hour. The compensation rate for the current approved information collection used is the rate for a Sr. Operations Manager in the Securities Industry and Financial Markets Association's Report on Management & Professional Earnings in the Securities Industry 2013 updated for 2023, and is modified to account for an 1,800-hour work-year and inflation and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. 4 hours x $425 per hour = $1,700.

129 1,064 hours x $425 per hour = $452,200. We do not expect advisers to incur any external cost burden in connection with this information collection because advisers registering under the rule would generate the necessary records in the ordinary course of their advisory businesses.

130 *See* proposed rule 203A-2(e)(1)(iv).

advisers to check a box make any substantive modifications to any existing collection of information requirements or impose any new substantive recordkeeping or information collection requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). Accordingly, we are not revising any burden and cost estimates in connection with these amendments.

D. Total hour burden associated with proposed amendments to rule 203A-2(e)

We estimate investment advisers that would be subject to the amended rule would incur a total annual hour burden resulting from the collections of information discussed above of approximately 1,064 hours, at a monetized cost of $452,200.[131] The total external burden costs would be $0.

A chart summarizing the various proposed components of the total annual burden for investment advisers with custody of client assets is below.

Rule 203A-2(e) Description of New Requirements	No. of Responses	Internal Burden Hours	External Burden Costs
Final Estimates for Internet Investment Advisers under Rule 203A-2(e)			
Annual burden for making records sufficient to demonstrate compliance with rule.	266	1,064 (4 hours per adviser)	0
Annual burden for making representations on Form ADV, Part 1A, Schedule D.	*De Minimis*	*De Minimis*	0

We estimate the total burden under proposed 203A-2(e) to amount to an average of four (4) hours annually per adviser. This estimate is identical to the estimate of the per-adviser burden under current 203A-2(e). We believe that the only differences in burden hours and internal monetized costs between current 203A-2(e) and proposed 203A-2(e) will be determined by the number of advisers subject to the proposed rule.

E. Request for Comments

[131] This estimate is based upon the following calculation: 1,064 hours x $425.

We request comment on whether our estimates for burden hours and any external costs as described above are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

In addition to these general requests for comment, we also request comment specifically on the following issues:

36. Our analysis relies upon certain assumptions, such as that 266 advisers will rely on the Internet Adviser Exemption and that it will take advisers approximately 4 hours per year to comply with the recordkeeping requirements proposed. Do commenters agree with these assumptions? If not, why not, and what data would commenters propose?

37. Our analysis relies upon the assumption that internet investment advisers will incur no meaningful burden to make the proposed representations on Form ADV, Part 1A, Schedule D. Do commenters agree with this assumption? If not, why not, and what burden hours and costs would commenters propose?

The agency is submitting the proposed collections of information to OMB for approval. Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Vanessa A. Countryman,

Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090, with reference to File No. S7-13-23. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release; therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-13-23, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549-2736.

V. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") in accordance with section 3(a) of the Regulatory Flexibility Act[132] regarding our proposed rule.

A. Reason for and Objectives of the Proposed Action

1. Proposed Amendments to Rule 203A-2(e)

We are proposing amendments to the Internet Adviser Exemption, which we adopted in 2002. The current Internet Adviser Exemption generally requires an adviser to:

- Provide investment advice to all of its clients exclusively through an interactive website, except that the investment adviser may provide investment advice to fewer than 15 clients through other means during the preceding twelve months; and
- Maintain records for a period of not less than five years demonstrating compliance with the conditions of the rule.

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[132] 5 U.S.C. 603(a).

The proposed changes to the Internet Adviser Exemption are designed to reflect the evolution in technology and advisory industry since the adoption in the rule. In addition, the proposed changes are designed to better reflect the allocation of authority between the Federal government and States that Congress intended under NSMIA and the Dodd-Frank Act and enhance investor protection through more efficient use of the Commission's limited oversight and examination resources by more appropriately allocating Commission resources to advisers with national presence and allowing smaller advisers with sufficient local presence to be regulated by the states.

Specifically, the rule would require an internet investment adviser to provide investment advice to all of its clients exclusively through an operational interactive website at all times during which the adviser relies on the Internet Adviser Exemption. The rule's definition of interactive website would be amended to "operational interactive website" and would be expanded to include mobile applications; the definition would also be amended to define operational interactive website as one through which the investment adviser provides digital investment advisory services on an ongoing basis to more than one client (except temporary technological outages of a *de minimis* duration).[133] The amended rule would also remove the current rule's *de minimis* exception,[134] which exception allows advisers relying on the rule to provide advice to fewer than 15 clients through means other than an interactive website during the preceding 12 months. As under the current rule, the amended rule would require advisers to comply with the requirement to maintain certain records in accordance with amended rule 203A-2(e)(1)(ii). The reasons for, and objectives of, the proposed amendments are discussed in more detail in sections I and II, above. The burdens of these requirements on small advisers are discussed below as well as above in sections III and IV, which discuss the burdens on all

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133 *See* proposed rule 203A-2(e)(2). For purposes of the rule, "digital investment advisory service" would be defined as investment advice to clients that is generated by the operational interactive website's software-based models, algorithms, or applications based on personal information each client supplies through the operational interactive website. *See id.*

134 *See* rule 203A-2(e)(1)(i).

advisers. The professional skills required to meet these specific burdens are also discussed in section IV.

2. Proposed Amendments to Form ADV

The amended rule would also require an adviser to make representations on its Form ADV, Part 1A, Schedule D, indicating that it satisfies the requirements of the rule. This representation is similar to the representation that advisers relying on the multi-state exemption make on their Form ADV and would assist Commission staff in connection with its review of registration applications and deregistrations of advisers that are not in compliance with the rule. The reasons for, and objectives of, the proposed amendments are discussed in more detail in sections I and II, above. The burdens of these requirements on small advisers are discussed below as well as above in sections III and IV, which discuss the burdens on all advisers. The professional skills required to meet these specific burdens are also discussed in section IV.

B. Legal Basis

The Commission is proposing to amend rule 203A-2(e) and amend Form ADV under the authority set forth in sections 203A(c) and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3a(c) and 80b-11(a)].

C. Small Entities Subject to the Rule and Rule Amendments

In developing these proposals, we have considered their potential impact on small entities that would be subject to the proposed amendments. The proposed amendments would affect a relatively small number of investment advisers registered with the Commission, including some small entities.

Under Commission rules, for the purposes of the Advisers Act and the RFA, an investment adviser generally is a small entity if it: (1) has assets under management having a total value of less than $25 million; (2) did not have total assets of $5 million or more on the last day of the most recent fiscal year; and (3) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25

million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year. Our proposed amendments would not affect most investment advisers that are small entities ("small advisers") because they are generally registered with one or more state securities authorities and not with the Commission. Under section 203A of the Advisers Act, unless subject to an exemption such as the Internet Adviser Exemption, most small advisers are prohibited from registering with the Commission and are regulated by state regulators. Based on IARD data, we estimate that as of December 31, 2022, approximately 489 SEC-registered advisers are small entities under the RFA.

1. Small entities subject to amendments to the internet adviser rule

As discussed above in section III (the Economic Analysis), the Commission estimates that based on IARD data as of December 31, 2022, approximately 266 investment advisers would be subject to the amended rule and the related proposed amendments to Form ADV. Of the approximately 489 SEC-registered advisers that are small entities under the RFA, 190 would be subject to the proposed amendments to rule 203A-2(e) and the corresponding amendments to Form ADV.

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

1. Proposed amendments to rule 203A-2(e)

The proposed amendments to rule 203A-2(e) would impose certain reporting and compliance requirements on investment advisers relying on the exemption for registration with the Commission, including those that are small entities. As under the current rule, all internet investment advisers, which we estimate to be 266 advisers,[135] would be required to comply with the proposed rule's requirement to maintain records in accordance with amended rule 203A-2(e)(1)(ii).[136] The proposed requirements and rule amendments, including compliance, reporting,

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[135] Based on IARD data as of Dec. 31, 2022.

[136] Proposed 203A-2(e)(1)(ii) is identical to current 203A-2(e)(1)(ii) except for a conforming change to reflect the proposed requirement that the interactive website be "operational."

and recordkeeping requirements, are summarized in this IRFA (section V.A., above). All of these proposed requirements are also discussed in detail, above, in sections I and II, and these requirements and the burdens on respondents, including those that are small entities, are discussed above in sections III and IV (the Economic Analysis and Paperwork Reduction Act Analysis, respectively) and below. The professional skills required to meet these specific burdens are also discussed in section IV.

As discussed above, approximately 489 small advisers were registered with us as of December 31, 2022, and we estimate that 190 of those small advisers registered with us would be subject to the proposed amendments (38.9% of all registered small advisers). As discussed above in our Paperwork Reduction Act Analysis in section IV above, the proposed amendments to rule 203A-2(e) under the Advisers Act would create an annual burden of approximately 4 hours per adviser, or 760 hours in aggregate for small advisers.[137] We therefore expect the annual monetized aggregate cost to small advisers associated with our proposed amendments to the Internet Adviser Exemption would be $323,000.[138]

2. Proposed amendments to Form ADV

Proposed amendments to Form ADV would impose certain reporting and compliance requirements on investment advisers relying on the rule to register and remain registered with the Commission, including those that are small entities. An adviser relying on the rule as a basis for registration would be required to represent on Schedule D of its Form ADV that it provides investment advice to all of its clients exclusively through an operational interactive website.[139] An adviser registered under the rule and continuing to rely on the rule as a basis for its registration would be required to make a representation that it has provided investment advice to

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137 190 small advisers x 4 hours.

138 We estimate the cost at a rate of $425 per hour. The compensation rate for the current approved information collection used is the rate for a Sr. Operations Manager in the Securities Industry and Financial Markets Association's Report on Management & Professional Earnings in the Securities Industry 2013 updated for 2023, and is modified to account for an 1,800-hour work-year and inflation and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. 760 hours x $425= $323,000.

139 *See* proposed rule 203A-2(e)(1)(iv).

all of its clients exclusively through an operational interactive website.[140] The proposed requirements and rule amendments, including recordkeeping requirements, are summarized above in this IRFA (section V.A). All of these proposed requirements are also discussed in detail, above, in section II, and these requirements and the burdens on respondents, including those that are small entities, are discussed above in sections III and IV (the Economic Analysis and Paperwork Reduction Act Analysis) and below. The professional skills required to meet these specific burdens are also discussed in section IV.

Our Economic Analysis (section III above) discusses these costs and burdens for respondents, which include small advisers. As discussed above in our Paperwork Reduction Act Analysis in section IV above, the proposed amendments to Form ADV would not increase the annual burden for advisers and would have no annual monetized cost.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap, or conflict with the proposed rule amendments.

F. Significant Alternatives

The RFA directs the Commission to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. We considered the following alternatives for small entities in relation to our proposed amendments to rule 203A-2(e) and the corresponding proposed amendments to Form ADV: (i) differing compliance or reporting requirements that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the amended rule for such small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposals, or any part thereof, for such small entities.

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140 *See id.*

Regarding the first and fourth alternatives, the Commission believes that establishing different compliance or reporting requirements for small advisers, or exempting small advisers from the proposed rule, or any part thereof, would be inappropriate under these circumstances. Because the protections of the Advisers Act are intended to apply equally to clients of both large and small firms, it would be inconsistent with the purposes of the Advisers Act to specify differences for small entities under the proposed amendment to rule 203A-2(e) and Form ADV. As discussed above, the proposed amendments are intended to better reflect the allocation of authority between the Federal government and States that Congress intended under NSMIA and the Dodd-Frank Act and would enhance investor protection through more efficient use of the Commission's limited oversight and examination resources by more appropriately allocating Commission resources to advisers with national presence and allowing smaller advisers with sufficient local presence to be regulated by the states. We believe that these benefits should apply to clients of smaller firms as well as larger firms. In addition, as discussed above, our staff would use the corresponding information that advisers would report on the proposed amended Form ADV to help determine compliance with the rule and to help prepare for examinations of investment advisers. Establishing different compliance or reporting requirements for large and small advisers relying on the Internet Adviser Exemption would negate these benefits and would be inconsistent with our mandate to provide a system of public disclosure of investment adviser information. An internet investment adviser that is a small entity, however, by the nature of its business, would likely spend fewer resources in maintaining records and completing Form ADV and amendments than a larger adviser. Regarding the fourth alternative, specifically, the Commission has considered exempting small advisers from the proposed rule. Such an exemption would be inconsistent with the intended purpose of the proposal, which, in part, is to provide regulatory relief from multiple state regulatory requirements. Small advisers are one of the primary beneficiaries of this exemption.

Regarding the second alternative, we believe the current proposal is clear and that further clarification, consolidation, or simplification of the compliance requirements is not necessary. As discussed above, the amended rule would require an internet investment adviser to (i) provide investment advice to all of its clients exclusively through an operational interactive website, (ii) maintain records demonstrating that it provides investment advice to its clients exclusively through an operational interactive website,[141] and (iii) represent on Schedule D of its Form ADV that it provides investment advice to all of its clients exclusively through an operational interactive website.[142] These provisions would better reflect the allocation of authority between the Federal government and States that Congress intended under NSMIA and the Dodd-Frank Act and would enhance investor protection through more efficient use of the Commission's limited oversight and examination resources by more appropriately allocating Commission resources to advisers with national presence and allowing smaller advisers with sufficient local presence to be regulated by the states. Further, our proposal to require the representation on Schedule D of Form ADV would assist the Commission's examination and enforcement capabilities, including assessing compliance with rules, and therefore, it would provide important investor protections.

Regarding the third alternative, we determined to use design standards because we determined that removing the *de minimis* exception and requiring internet investment advisers to exclusively advise internet clients to be a design standard necessary to better reflect Congress's intent under NSMIA and the Dodd-Frank Act.

G. Solicitation of Comments

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141 *See* proposed rule 203A-2(e)(1)(i) and (ii). As with the current rule, the proposed rule amendments would provide that an internet investment adviser does not control, is not controlled by, and is not under common control with, another investment adviser registered with the Commission solely in reliance on an adviser registered under the Internet Adviser Exemption. *See* rule 203A-2(e)(1)(iii); proposed rule 203A-2(e)(1)(iii).

142 *See* proposed rule 203A-2(e)(1)(iv).

We encourage written comments on the matters discussed in this IRFA. We solicit comment on the number of small entities subject to proposed amendments to rule 203A-2(e) and related amendments to Form ADV, as well as the potential impacts discussed in this analysis; and whether the proposal could have an effect on small entities that has not been considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

VI. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[143] we must advise OMB whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposed rule amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

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[143] Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. 601).

STATUTORY AUTHORITY

The Commission is proposing to amend rule 203A-2(e) and amend Form ADV under the authority set forth in sections 203A(c) and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3a(c) and 80b-11(a)].

List of Subjects in 17 CFR Parts 275 and 279

Reporting and recordkeeping requirements; Securities.

Text of Proposed Rules and Rule and Form Amendments

For the reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for part 275 continues to read as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

* * * * *

Section 275.203A-2 is also issued under 15 U.S.C. 80b-3a.

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2. Amend § 275.203A-2 by revising paragraph (e) to read as follows:

§ 275.203A-2 Exemptions from prohibition on Commission registration.

* * * * *

(e) *Internet investment advisers.* (1) An investment adviser that:

(i) Provides investment advice to all of its clients exclusively through an operational interactive website at all times during which the investment adviser relies on this paragraph (e);

(ii) Maintains, in an easily accessible place, for a period of not less than five years from the filing of a Form ADV that includes a representation that the adviser is eligible to register with the Commission under this paragraph (e), a record demonstrating that it provides investment

advice to its clients exclusively through an operational interactive website in accordance with the limits in paragraph (e)(1)(i) of this section; and

(iii) Does not control, is not controlled by, and is not under common control with, another investment adviser that registers with the Commission under paragraph (b) of this section solely in reliance on the adviser registered under this paragraph (e) as its registered adviser.

(2) For purposes of this paragraph (e), "operational interactive website" means a website or mobile application through which the investment adviser provides digital investment advisory services on an ongoing basis to more than one client (except during temporary technological outages of a *de minimis* duration). For purposes of this rule, "digital investment advisory service" is investment advice to clients that is generated by the operational interactive website's software-based models, algorithms, or applications based on personal information each client supplies through the operational interactive website.

(3) An investment adviser may rely on the definition of client in § 275.202(a)(30)-1 in determining whether it is eligible to rely on this paragraph (e).

PART 279—FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

3. The authority citation for part 279 continues to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, *et seq.,* Pub. L. 111-203, 124 Stat. 1376.

4. Amend Form ADV (referenced in § 279.1) by:

a. In the instructions to the form, Form ADV: Instructions for Part 1A, by revising 2.i.;

b. In the Glossary of Terms by:

i. Redesignating paragraphs 14. through 42. as paragraphs 15. through 43.; and paragraphs 43. through 65. as paragraphs 45. through 67.; and

ii. Adding new paragraphs 13. and 44.;

c. In Part 1A, revising Item 2.A.(11); and

d. In Part 1A, Schedule D, by adding Section 2.A.(11).

Note: Form ADV is attached as Appendix A to this document. Form ADV will not appear in the Code of Federal Regulations.

By the Commission.

Dated: July 26, 2023.

Vanessa A. Countryman,

Secretary.

Note: The following appendix will not appear in the Code of Federal Regulations.

Appendix A—Form ADV

FORM ADV (Paper Version)

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Form ADV: Instructions for Part 1A

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2. Item 2: SEC Registration and SEC Report by Exempt Reporting Advisers

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i. **Item 2.A.(11): Internet Adviser.** You may check box 11 only if you are eligible for the Internet adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(e). If you check box 11, you must complete Section 2.A.(11) of Schedule D. You are eligible for this exemption if:

• You provide investment advice to all of your *clients* exclusively through an operational interactive website at all times during which you rely on rule 203A-2(e). Other forms of online or Internet investment advice do not qualify for this exemption;

• You maintain a record demonstrating that you provide investment advice to your *clients* exclusively through an operational interactive website in accordance with these limits.

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GLOSSARY OF TERMS

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13. **Digital Investment Advisory Service**: Investment advice to *clients* that is generated by the *operational interactive website*'s software-based models, algorithms, or applications based on personal information each *client* supplies through the *operational interactive website*.

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44. **Operational Interactive Website**: A website or mobile application through which the investment adviser provides *digital investment advisory services* on an ongoing basis to more than one *client* (except during temporary technological outages of a de minimis duration).

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PART 1A

* * * * *

Item 2. * * *

* * * * *

(11) are an **Internet adviser** relying on rule 203A-2(e);

If you check this box, complete Section 2.A.(11) of Schedule D.

* * * * *

Schedule D

* * * * *

SECTION 2.A.(11) Internet Adviser

If you are relying on rule 203A-2(e), the Internet adviser exemption from the prohibition on registration, you are required to make a representation about your eligibility for SEC registration. By checking the appropriate box, you will be deemed to have made the required representation.

If you are applying for registration as an investment adviser with the SEC or changing your existing Item 2 response regarding your eligibility for SEC registration, you must make this representation:

□ I will provide investment advice to all of my clients exclusively through an operational interactive website.

If you are filing an annual updating amendment to your existing registration and are continuing to rely on the Internet adviser exemption for SEC registration, you must make this representation:

□ I have provided and will continue to provide investment advice to all of my clients exclusively through an operational interactive website.

* * * * *

[FR Doc. 2023-16287 Filed: 7/31/2023 8:45 am; Publication Date: 8/1/2023]