SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

[Release No. IA–2028; File No. S7–10–02]

RIN 3235–AI15

Exemption for Certain Investment Advisers Operating Through the Internet

AGENCY: Securities and Exchange Commission (the ''Commission'').

ACTION: Proposed rules.

SUMMARY: The Commission is publishing for comment rule amendments under the Investment Advisers Act of 1940 that would exempt certain investment advisers that provide advisory services through the Internet from the prohibition on Commission registration set out in section 203A of the Act. The effect of the amendments would be to permit these advisers to register with the Commission instead of with state securities authorities. The amendments are designed to alleviate the burden of multiple state regulation on advisers whose business is unconnected with any particular state and for whom multiple state regulation would be a hardship.

DATES: Comments must be received on or before June 6, 2002.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–10–02; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Electronically submitted comment letters also will be posted on the Commission's Internet website: *http://www.sec.gov.*[1]

FOR FURTHER INFORMATION CONTACT: Marilyn Barker, Senior Counsel, or Jennifer L. Sawin, Assistant Director, at (202) 942–0719 or *IArules@sec.gov,* Office of Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0506.

[1] We do not edit personal or identifying information, such as names or e-mail addresses, from electronic submissions. Submit only information you wish to make publicly available.

SUPPLEMENTARY INFORMATION: The Commission is requesting public comment on proposed amendments to rule 203A–2 (17 CFR 275.203A–2) and to Part 1A of Form ADV (17 CFR 279.1), both under the Investment Advisers Act of 1940 (15 U.S.C. 80b) (''Advisers Act'' or ''Act'').

I. Background

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 the state securities authorities.[2] Congress allocated to state securities authorities the primary responsibility for regulating smaller advisory firms that are essentially local businesses, and allocated to the Commission the primary responsibility for regulating larger advisers.[3] Section 203A of the Advisers Act[4] effects this division by generally prohibiting advisers from registering with us unless they either have assets under management of not less than $25 million or advise a registered investment company,[5] and preempts state adviser statutes as to advisers registered with the Commission.[6] Advisers prohibited from registering with us 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 recognized, however, that some advisers should be regulated at the federal level even though they have assets under management of less than $25 million, and gave us authority to permit advisers to register with us if the prohibition would be ''unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes' of section 203A.[9] In exercising this authority, we relieve advisers from the burdens of multiple state regulation.[10]

We recently have been asked, by advisers that provide their services through interactive websites and by their counsel, whether we might use our exemptive authority to permit these advisers to register with us.[11] These types of advisers, which we will call Internet Investment Advisers, provide substantially all of their advisory services through interactive websites. Clients visiting these websites answer on-line questions about their finances, investment objectives and investment time horizon, risk tolerance, and investment restrictions. The Internet Investment Adviser's computer-based application or platform—an algorithm—processes and analyzes the client's responses to generate the personalized investment advice that is communicated to the client through the website.[12] The interactive website may be reached at any time by persons residing in any state or outside the United States.

Most Internet Investment Advisers are not eligible to register with us. They do not have assets under management or advise a registered investment company, and thus do not meet the statutory thresholds for registration with us.

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

[3] *See* s. Rep. No. 293, 104th Cong., 2d Sess. 3–4 (1996) (hereafter Senate Report) at 4 (''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.'').

[4] 15 U.S.C. 80b–3a.

[5] Section 203A(a)(1) of the Advisers Act (15 U.S.C. 80b–3a(a)(1)). Rule 203A–1(a)(1) increases the assets under management threshold from $25 million to $30 million for registration with the Commission. (17 CFR 275.203A–1(a)(1). Upon reaching the $30 million threshold, advisers must register with us. Advisers having assets under management between $25 million and $30 million may opt to register with us. [17 CFR 275.203A–1(a)(2)].

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

[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 note 83. Currently, 49 states have investment adviser statutes, as do the District of Columbia, Puerto Rico and Guam. Investment advisers in Wyoming and the United States Virgin Islands, which do not have adviser statutes, register with us.

[8] *See* Senate Report at 4–5.

[9] Section 203A(c) of the Advisers Act (15 U.S.C. 80b–3a(c)). *See* Senate Report at 5. Section 203A was designed to allow the Commission to better use its limited resources by concentrating its regulatory responsibilities on larger advisers with national businesses, and to reduce the burden to investment advisers of the overlapping and duplicative regulation (that existed prior to enactment of NSMIA) by preempting state investment adviser statutes, thus subjecting large advisers with national businesses to a single regulatory program administered by the Commission. *See* Senate Report at 2–4.

[10] The exercise of our exemptive authority permits registration with the Commission and preempts state law with respect to the exempted advisers that register with us.

[11] We recognize that other advisers use the Internet in other ways. For example, other advisers may use websites for marketing purposes. *See infra* Section II of this Release. The proposed rule amendment, however, does not address these other Internet uses.

[12] *See* Andrew Willmott, *Legg Mason Nurtures Mass Affluent,* FUNDfire, Dec. 12, 2001; Caren Chesler, *Technology A Must In Managed Account Mart,* FUNDfire, July 27, 2001.

Further, most of these advisers either do not qualify to use our existing exemptive rules or, as discussed below, cannot use the exemptions effectively.

Our multi-state adviser exemption permits an adviser that does not meet the statutory thresholds to register with us if, among other things, it would otherwise have to register with the securities authorities of at least 30 states.[13] The exemption was designed to permit Commission registration for advisory firms that had offices and clients in multiple states.[14] Internet Investment Advisers, however, do not have multiple offices; their multiple state registration obligations turn solely on the residences of their clients. Because an Internet Investment Adviser's clients can come from anywhere, and in any number at any time, as a practical matter, the adviser may need to register in all the states and wait until it has a registration obligation in 30 states before registering with us and canceling its state registrations.[15]

As discussed above, Congress gave us authority to permit investment advisers to register with us when the prohibition would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A.[16] Internet Investment Advisers, which were not in business when NSMIA was enacted in 1996, appear to be the type of advisory firm for which Congress envisioned we would exercise this authority. Other small advisers with few or no assets under management typically rely on face-to-face contact between clients and advisory personnel at the firm's offices. They are local businesses serving the geographical area in which the office is located. In contrast, Internet Investment Advisers have no physical presence in a community or state. Clients of Internet Investment Advisers have little or no in-person contact with the firm or its personnel, and obtain the adviser's services only through a website. Their activities are, by their nature, not confined to one or a few states that have a distinct regulatory interest in the advisers' operations. In addition, the cost of registering temporarily in all state jurisdictions acts as an impediment to launching these businesses. Requiring these advisers to register in multiple states would appear to be unfair to them and a burden on their interstate commerce. Therefore, we are proposing to amend our exemptive rules to permit these advisers to register with the Commission.

II. Discussion

Proposed rule 203A–2(f) would exempt an adviser from the prohibition on Commission registration if the adviser conducts substantially all of its advisory business through an interactive website on the Internet.[17] Advisers registering with us under the new exemption[18] would be required to keep records demonstrating that they meet the conditions of the rule.[19]

We have drafted the proposed rule to make it unavailable to advisers that merely have websites as marketing tools or that use Internet vehicles such as E-mail, chat rooms, bulletin boards and webcasts or other electronic media to communicate with clients.[20] Eligibility for the exemption would turn on whether the adviser conducts substantially all of its advisory business through an interactive website. We define ''interactive website'' in the proposed rule as a website in which computer software-based models or applications provide investment advice to clients based on information that each client supplies through the website.[21] We define the term ''substantially all'' in the proposed rule to mean that at least 90 percent of the investment adviser's clients obtain advice exclusively through the interactive website.[22]

We request comment on the terms of the proposed rule:

- Does the proposed rule differentiate adequately between advisers that merely use the Internet to market their business and those that conduct substantially all of their advisory business through the Internet?
- Will the test for ''substantially all'' appropriately limit the use of the rule, or are there alternative tests that we should consider?
- The rule would require that 90% of the adviser's clients obtain their investment advice exclusively through the interactive website. Is 90% of clients the appropriate percentage? If not, what higher or lower percentage should we consider?
- Should we require that these clients obtain all of their advice from the adviser through the interactive website? Alternatively, should we consider permitting an adviser to use the rule even if these clients obtain less than all of their advice through the website? If so, what proportion should we require? How would the adviser measure that proportion? What burden would this measurement place on the adviser?
- We estimate that as many as 20 advisers may currently be eligible for the exemption provided by the proposed rule amendments. Is this estimate reasonable?
- We believe that demand for Internet Investment Advisers' services may grow in the next several years, perhaps as part of the growing demand for advice to pension plan participants. Is this expectation reasonable? How many new Internet Investment Advisers are likely to form to meet any increases in demand?
- Are there other types of investment advisers '' without assets under management but operating in many states '' that face similar burdens? How many of these advisers are there? In how many states do they typically register? Should we also consider exempting them from section 203A?

III. Request for Comment

Any interested persons wishing to submit written comments on the proposed rule amendments that are the

[13] 17 CFR 275.203A–2(e). An investment adviser relying on this exemption must represent that it has reviewed its obligations under state and federal law and has concluded that is would be required to register as an investment adviser with the securities authorities of at least 30 states. Following registration with us, the investment adviser continues to be eligible for the exemption as long as it can annually represent that it would be required to register in at least 25 states.

[14] The multi-state exemption codified exemptive orders that permitted large accounting firms that offered financial planning services to register as advisers with the Commission even though they did not manage assets.

[15] In addition to the multi-state exemption, rule 203A–2 (17 CFR 275.203A–2) provides four other exemptions under which advisers register with the Commission, none of which may be available to Internet Investment Advisers. One of these exemptions permits a newly-formed adviser to register with us if the adviser is not already registered or required to be registered with the Commission or with a state securities authority, and the adviser has a reasonable expectation that, within 120 days, it will be eligible to register with us under a different basis. Rule 203A–2(d) (17 CFR 275.203A–2(d). This rule was designed for use principally by new advisory firms that have been ''spun-off'' from existing portfolio management firms and therefore can reasonably expect to have at least $25 million in assets under management within 120 days, and by advisers to new mutual funds that are expected to be operational within 120 days. Internet Investment Advisers, however, typically must register early in their development and testing phase in order to secure venture capital, and typically need more than 120 days to complete development and testing. Many may not even be fully operational within 120 days after registering.

[16] *See supra* note 9 and accompanying text.

[17] Proposed rule 203A–2(f)(1)(i).

[18] A new box would be added to Item 2 of Part 1A of Form ADV for these advisers to indicate their eligibility to register with the Commission.

[19] Proposed rule 203A–2(f)(1)(ii).

[20] Internet use of some kind is very common among advisers. Over half of SEC-registered advisory firms, for example, report having at least one web address. A rule permitting all advisers using the Internet to register with the Commission could effectively undo NSMIA's division of regulatory responsibilities between the Commission and the states.

[21] Proposed rule 203A–2(f)(2)(i).

[22] Proposed rule 203A–2(f)(2)(ii).

subject of this release, or to submit comments on other matters that might have an effect on the proposals described above, are requested to do so. Commenters suggesting alternative approaches are encouraged to submit proposed rule text.

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission also is requesting information regarding the potential impact of the proposed rule amendments on the economy on an annual basis. Commenters should provide empirical data to support their views.

IV. Cost-Benefit Analysis

A. Background

The Commission is sensitive to the costs and benefits imposed by its rules. Proposed rule 203A–2(f) under the Advisers Act would permit certain investment advisers that provide advisory services through interactive Internet websites to register with the Commission rather than with the state securities authorities. These investment advisers cannot currently register with the Commission because they do not meet the Act's statutory thresholds, that is, they do not have $25 million or more of assets under management and do not advise registered investment companies.[23] Unlike most state-registered advisers, Internet Investment Advisers have no local presence and their activities are not confined to one or a few states; the nature of the Internet makes these advisers' services available to clients in all states, and an adviser's state registration obligations could be triggered without warning within a single day or hour when six or more clients from a single state obtain personalized investment advice from the adviser's interactive website.[24] As a practical matter, therefore, Internet Investment Advisers need to register in all states to avoid violating state laws.[25]

Congress gave us authority to permit advisers to register with us even though they do not meet the statutory threshold if the prohibition would be unfair, a burden on interstate commerce, or otherwise inconsistent with NSMIA's regulatory division between the states and the Commission. We have used this authority to adopt exemptive rules to permit Commission registration of advisers that did not meet the statutory thresholds in section 203A. The rule amendment we are proposing today is designed to alleviate the substantial burden of multiple state registration and regulation for Internet Investment Advisers by permitting these advisers to register with the Commission.

Since most Internet Investment Advisers do not currently register with us, we have limited data on the number of investment advisers that would qualify at this time for the proposed exemption. Based on news articles, however, and for purposes of the Paperwork Reduction Act, we have estimated that perhaps as many as 20 firms would currently be eligible for the new exemption.

- Comment is requested on our estimate of the number of investment advisers likely to register with the Commission under the proposed rule.
- Commenters are requested to provide views and empirical data relating to the number of these advisers.

B. Benefits

The proposal would benefit Internet Investment Advisers by relieving them of the costs they would otherwise incur if they were required to comply with the registration and other regulatory requirements of 49 states. As discussed earlier, Internet Investment Advisers, as a practical matter, would have to register in all states and then wait until their registration obligations are triggered in at least 30 states before becoming eligible for Commission registration under our multi-state exemption in rule 203A–2(e). [26] Adviser regulations and requirements are not uniform and may even be contradictory from state to state. Based on recent discussions with counsel familiar with state adviser registration and regulatory issues, we estimate the cost to an Internet Investment Adviser of complying with the registration and other regulatory requirements of 49 states to be approximately $50,000 annually.[27] The benefit of the proposed rule is therefore estimated to total as much as $1 million annually for the 20 advisers that may be eligible for the new exemption at this time.[28] Moreover, subjecting these advisers to the cost of registering temporarily in all state jurisdictions and to multiple state regulation acts as an impediment to launching these businesses. The proposed rule would benefit the advisers industry by removing this barrier, and may enable more firms to offer these types of Internet-based services.

The benefits of the proposed rule would also include the savings to the affected advisers from the cost of examinations by multiple states' regulators, as well as the savings to state securities authorities that would no longer examine these firms.

C. Costs

Proposed rule 203A–2(f) would impose certain costs on advisers relying on the exemption. The Commission estimates that the total cost to each Internet Investment Adviser to comply with the recordkeeping provision of the proposed rule would be approximately $138.80,[29] such that the total cost for the 20 advisers that may be eligible for the new exemption at this time would be $2,776.[30]

D. Form ADV

We have not included the benefits or costs associated with filing Form ADV,[31] nor benefits or costs associated with the Investment Adviser Registration Depository (IARD). Form ADV is used by the states as well as by the Commission to register investment advisers, such that all advisers registering with either the Commission or a state complete a single Form ADV; advisers may file the form with the Commission or with one or more states. Shifting an Internet Investment

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[23] These statutory thresholds were imposed in NSMIA, which divided responsibility for regulating investment advisers between the Commission and the state securities authorities.

[24] Exceeding state-established de minimis numbers for advisory clients may trigger state registration requirements. The national de minimis standard in section 222(d) of the Advisers Act (15 U.S.C. 80b–18a(d), however, preempts state minimums that are lower than six clients resident in that state during a 12-month period.

[25] At this time, 49 states have investment adviser statutes, as do the District of Columbia, Puerto Rico and Guam. Wyoming and the United States Virgin Islands currently do not have investment adviser statutes. Advisers that maintain their principal places of business in those two jurisdictions must register with the Commission.

[26] 17 CFR 275.203A–2(e). Advisers relying on the multi-state exemption must be required to register with the securities authorities of at least 30 states. After registering with us, multi-state advisers continue to be eligible for the exemption as long as they can represent annually that they would be required to register in at least 25 states.

[27] This figure includes the costs of responding to multiple states' comments on filings, as well as the cost of complying with multiple and often disparate state regulations. It does not, however, include the time to complete Form ADV initially and the fees to file Form ADV through the IARD, as discussed below. This figure also does not include state registration fees.

[28] $20 \times 50{,}000 = 1{,}000{,}000$.

[29] The Commission estimated this figure by multiplying the burden hours to comply with the proposed rule's recordkeeping requirements (4 hours) by an average hourly compensation rate of $34.70. This compensation rate includes overhead and is the rate for an operations supervisor outside of New York City, based on a 2000 study by the Securities Industry Association. The estimate of burden hours is based on the Commission's submission for the proposed rule under the Paperwork Reduction Act and reflects recent discussions with counsel familiar with advisers' recordkeeping issues. *See infra* Section V. of this Release.

[30] $20 \times 138.8 = 2{,}776$.

[31] 17 CFR 279.1 (Form ADV).

Adviser's registration from the states to the Commission, therefore, does not change their basic filing requirement.[32] Similarly, state-registered advisers as well as advisers registered with the Commission make their Form ADV filings electronically through the IARD and pay the attendant filing fees.[33] Shifting an Internet Investment Adviser's registration from the states to the Commission does not change this filing process or the IARD filing fees.

E. Request for Comment

- The Commission requests comment on the potential costs and benefits identified in this release, as well as any other costs or benefits that may result from the proposal.
- We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional costs and benefits.

V. Paperwork Reduction Act

A. Recordkeeping

Proposed rule 203A–2(f) would exempt, from the prohibition against Commission registration, certain investment advisers that provide advisory services through the Internet. The proposed rule includes a recordkeeping provision, and therefore contains a new ''collection of information'' requirement within the meaning of the Paperwork Reduction Act of 1995.[34] The Commission staff needs and will use this collection of information in its examination and oversight program. The proposed rule requires advisers registering under the rule to maintain a record demonstrating that substantially all of their advisory business has been conducted through an interactive website. Although we anticipate that most advisers registering under the proposed rule would generate the necessary records in the ordinary conduct of their Internet advisory business, the recordkeeping requirement of proposed rule 203A–2(f) may impose a small additional burden on these advisers. We estimate that this recordkeeping burden should not exceed an average of 4 hours annually per adviser, for a total burden of 80 hours annually.[35]

- We request comment whether the estimate of our recordkeeping burden is reasonable.

The Commission is submitting the collection of information to the Office of Management and Budget (''OMB'') in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information is ''Exemption for Certain Investment Advisers Operating Through the Internet'' under the Advisers Act. 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 control number. The collection of information is mandatory, and responses are not kept confidential. The likely respondents to this information collection would be investment advisers that meet the conditions of the proposed rule and register with us.

B. Form ADV

In addition, the proposal would amend Form ADV to add a new category of advisers eligible for Commission registration. The proposed rule therefore would increase the number of advisers that file Form ADV and annual amendments to Form ADV with the Commission. The title for this existing collection of information is ''Form ADV'' under the Advisers Act. 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 control number. The form contains currently approved collection of information numbers under OMB control number 3235–0049 (expires June 30, 2003), and the Commission is submitting the amendments to this collection of information to the Office of Management and Budget (''OMB'') in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The collection of information is found at 17 CFR 275.203–1, 275.204–1, and 279.1. This collection of information also is mandatory. Responses are not kept confidential. The likely new respondents to this information collection would be the investment advisers that meet the conditions of the proposed rule and register with us.

As new respondents,[36] these advisers will increase the total burden under Form ADV, but an Internet Investment Adviser's burden for completing Form ADV would not differ from that for current registrants.[37] The currently approved burden of the collection of information under Form ADV is 46,466 hours, and the current average burden for each form is 9.402 hours.[38] We estimate that approximately 20 Internet Investment Advisers would register with the Commission under the proposed rule,[39] and that each of these advisers would file one complete Form ADV and one amendment annually.[40] The increase in the total annual burden for this collection of information would therefore be 455 hours,[41] for a total revised burden of 46,921 hours.[42]

- We request comment whether these estimates are reasonable.

C. Request for Comment

Any information received by the Commission related to the proposed rule amendments would not be kept confidential. Pursuant to 44 U.S.C.

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[32] Advisers registered with the Commission, however, complete only Part 1A of Form ADV, while advisers registered with the states must complete both Parts 1A and 1B.

[33] Advisers pay filing fees to NASD Regulation, Inc., which operates the IARD system. The filing fees include an initial set-up fee and an annual fee, each of which varies based on the adviser's assets under management. Because Internet Investment Advisers generally do not manage client assets, we expect that they will be eligible for the lowest fee levels of $150 for the initial set-up fee and $100 for the annual fee. See Investment Advisers Act Release No. 1888 (July 28, 2000) (65 FR 47807 (Aug. 3, 2000)) (''Advisers Act Release No. 1888'').

[34] 44 U.S.C. 3501–3520.

[35] 4 hours × 20 advisers = 80 hours. This estimate is based on recent discussions with counsel familiar with advisers' recordkeeping issues. The recordkeeping requirement does not require extensive data on usage of the website, nor does it specify how an adviser should maintain its records to meet this condition of the proposed rule. The adviser would need only to demonstrate that 90 percent of its clients obtain their investment advice from the firm exclusively through the website. We note that Internet Investment Advisers that conduct their business exclusively through interactive websites would likely need to spend very little time documenting their compliance with the condition. An adviser that also meets in person with some clients or communicates with them through other means may need to spend more time.

[36] We note that, because the states as well as the Commission use Form ADV, these advisers will be new respondents for purposes of the Commission's collection of information requirements, but not new users of Form ADV.

[37] The proposed amendments would add a new box to Item 2 of Part 1A of Form ADV, so that Internet Investment Advisers could indicate their eligibility for Commission registration. All advisers registering with the Commission must indicate their eligibility by checking at least one box, so the addition of the new box for Internet Investment Advisers will not change the burden of completing the form.

[38] *See* Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act Release No. 1862 (April 5, 2000) (65 FR 20524 (April 17, 2000)) (''Advisers Act Release No. 1862''). The current average burden per response includes 9,100 filings of the complete form at 22 hours each, plus 13,250 amendments requiring 0.75 hours each. (((9100×22) + (13250×.75))/22350=9.402).

[39] Our staff has examined approximately six advisers that registered with us and whose business is substantially Internet-based. Because most Internet Investment Advisers are not yet eligible to register with us, however, we believe that there may be as many as 20 firms that could register under the proposed new exemption.

[40] The currently approved burden for this collection of information estimates that most advisers registering with the Commission for the first time will file one amendment per year.

[41] 22 hours to complete a new Form ADV × 20 Internet Investment Advisers = 440 hours. 0.75 hours per amendment × 20 amendments = 15 hours. 440 + 15 = 455.

[42] 46,466 + 455 = 46,921.

3506(c)(2)(B), the Commission solicits comments to:

- 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;
- Evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information;
- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
- 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.

Persons wishing to submit comments on the collection of information requirements 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, Room 3208, Washington, DC 20503, and also should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609 with reference to File No. S7–10–02. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives the comment 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. S7–10–02, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW, Washington, DC 20549.

VI. Initial Regulatory Flexibility Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis (''IRFA'') regarding proposed rule 203A–2(f) in accordance with section 3(a) of the Regulatory Flexibility Act. [43]

A. Reasons for Proposed Action

Section 203A(a) of the Investment Advisers Act of 1940 generally prohibits an investment adviser from registering with the Commission unless the adviser either has at least $25 million of assets under management or is an adviser to a registered investment company. Internet Investment Advisers do not meet the statutory thresholds for registration with us and do not qualify to use our existing exemptive rules. Section 203A(c) of the Advisers Act gives us authority to permit investment advisers to register with us when the prohibition of section 203A(a) would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A.[44] Without this proposed rulemaking relief, Internet Investment Advisers, as a practical matter, may be left with the burden of registering in 49 states, waiting until their registration obligations accrue in at least 30 states, and then registering with the Commission under the multi-state exemption of rule 203A–2(e) and withdrawing the state registrations. The proposed rule would eliminate the unnecessary burden of these temporary state registrations by permitting these advisers to register with us.

B. Objectives and Legal Basis

The objective of the proposed amendments is to alleviate the burden of multiple state regulation on investment advisers that conduct substantially all of their advisory business through interactive websites. Proposed rule 203A–2(f) would achieve this objective by providing these advisers with an exemption from the prohibition on Commission registration. We are proposing this rule pursuant to our authority under section 203A(c) of the Act.[45] Section 203A(c) of the Act gives us the authority, by rule or regulation upon our own motion, or by order upon application, to permit registration with us of any person or class of persons to which 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.

C. Small Entities Subject to Proposed Rule

Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is considered a small entity if it: (i) Has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) 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 $5 million or more on the last day of its most recent fiscal year.[46] The Commission estimates that approximately 20 investment advisers will likely be eligible to register with us under the proposed rule, and it is probable that all of these approximately 20 investment advisers will be small entities.[47]

- Comment is requested on the number of Internet Investment Advisers that are likely to be small entities.
- Commenters are requested to provide views and empirical data relating to the number of these advisers that would be considered small entities.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed rule would impose certain new recordkeeping requirements on Internet Investment Advisers. The proposed rule would not impose any other new or additional reporting or compliance requirements on these advisers, and would significantly reduce certain compliance burdens for these advisers by eliminating the need for these advisers to comply with multiple state regulations. As discussed earlier, most or all of these advisers would likely be small advisers. Under the proposed rule, Internet Investment Advisers would be required to maintain in an easily accessible place a record demonstrating that substantially all of their advisory business has been conducted through an interactive website. The Commission believes that the recordkeeping requirement contained in the proposed rule would not impose a significant burden on Internet Investment Advisers, including small advisers. [48]

The Commission believes that the proposed amendment to Item 2 of Part 1A of Form ADV would have no measurable effect on Internet Investment Advisers, including small advisers. A new box would be added to

[43] 5 U.S.C. 603(a).

[44] *See supra* note and accompanying text.

[45] 15 U.S.C. 80b–3a(c).

[46] 17 CFR 275.0–7(a).

[47] Internet Investment Advisers generally do not manage assets and therefore will not likely have any assets under management. These firms are also generally start-up businesses and may have limited assets; only one of the Internet-based firms our staff has examined reported having total assets of $5 million or more. Consequently, we believe that most, if not all, of the advisers registering with us under the proposed rule will be small entities.

[48] Recordkeeping is already mandated for all Commission-registered advisers, including small advisers, under rule 204–2. (17 CFR 275.204–2.) The Commission has estimated, for purposes of the Paperwork Reduction Act, that compliance with the recordkeeping requirements of the proposed rule would take no more than 4 hours annually on average.

Item 2 for Internet Investment Advisers to indicate their eligibility to register with the Commission. An adviser registering with the Commission under the proposed rule would simply check that new box when completing Form ADV.

E. Duplicative, Overlapping, or Conflicting Federal Rules

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

F. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities, including (i) establishing different compliance or reporting requirements or timetables that take into account the resources available to small advisers; (ii) clarifying, consolidating, or simplifying compliance and reporting requirements under the proposed rule for small advisers; (iii) using performance rather than design standards; and (iv) exempting small advisers from coverage of all or part of the proposed rule.

Regarding the first alternative, the Commission has considered establishing different compliance or reporting requirements for small advisers. Establishing different compliance or reporting requirements 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 completing Form ADV and amendments, and pay lower filing fees, than a larger adviser.

Regarding the second alternative, the Commission has attempted to clarify and simplify compliance and reporting requirements under the proposed rule for all advisers, including small advisers. It does not appear that the proposed rule can be formatted differently for small advisers and still achieve its stated objective of providing relief from multiple state regulation. The proposal has been designed particularly to benefit Internet Investment Advisers, which are, we believe, generally small entities.

With respect to the third alternative, the proposed rule would permit advisers to use performance rather than design standards to meet certain requirements under the Act. The proposal, for example, does not specify the means by which an adviser must maintain its records to satisfy the recordkeeping requirements of the proposed rule.

Regarding the fourth alternative, 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 is to provide regulatory relief from multiple state regulatory requirements. Small advisers are the primary intended beneficiaries of this rulemaking relief.

The Commission has considered the above alternatives in the context of the proposed rule, and, after taking into account the resources available to Internet Investment Advisers that are small entities and the potential burden the proposal could place on these advisers, has concluded that the alternatives would not accomplish the stated objectives of the proposal.

G. Solicitation of Comments

We encourage written comments on matters discussed in this IRFA.

- In particular, how many small entities would be affected by the proposed rule?
- What burdens would the proposed rule impose on small advisers?
- Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact.

VII. Statutory Authority

We are proposing rule 203A–2(f) pursuant to our authority set forth in section 203A(c) of the Investment Advisers Act of 1940. [49] Section 203A(c) of the Act gives us the authority, by rule or regulation upon our own motion, or by order upon application, to permit registration with us of any person or class of persons to which 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.

List of Subjects in 17 CFR Parts 275 and 279

Investment advisers, Reporting and recordkeeping requirements.

Text of Proposed Rule Amendments

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulation is proposed to be amended as follows:

[49] 15 U.S.C. 80b–3a(c).

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

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

Authority: 15 U.S.C. 80b–2(a)(11)(F), 80b–2(a)(17), 80b–3A, 80b–4, 80b–6(4), 80b–6a, 80b–11, unless otherwise noted.

* * * * *

2. Section 275.203A–2 is amended by adding paragraph (f) to read as follows:

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

* * * * *

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

(i) Conducts substantially all of its advisory business through an interactive website on the Internet; and

(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 paragraph (f)(1)(i) of this section, a record demonstrating that substantially all of its advisory business has been conducted through an interactive website.

(2) For purposes of this section:

(i) *Interactive website* means a website in which computer software-based models or applications provide investment advice to clients based on information each client supplies through the website.

(ii) *Substantially all* means that at least 90 percent of the investment adviser's clients obtain their investment advice from the adviser exclusively through the interactive website.

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.*

4. Form ADV (Referenced in § 279.1), Part 1A, Item 2 is amended by revising the introductory text of paragraph A, paragraph A.(10) and A.(11), and by adding paragraph A.(12) to read as follows:

Note: The text of Form ADV does not and the amendment will not appear in the Code of Federal Regulations.

Form ADV

* * * * *

Part 1A

* * * * *

Item 2 SEC Registration

* * * * *

A. To register (or remain registered) with the SEC, you must check at least one of the Items 2.A(1) through 2.A(11), below. If you are submitting an annual updating amendment to your registration and you are no longer eligible to register with the SEC, check Item 2.A(12). You:

* * * * *

☐ (10) are an Internet investment adviser relying on rule 203A–2(f);

☐ (11) have received an SEC order exempting you from the prohibition against registration with the SEC.

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

☐ (12) are no longer eligible to register with the SEC.

* * * * *

5. Form ADV (Referenced in § 279.1), Schedule D is amended by revising the heading ''Section 2.A(10)'' to read ''Section 2.A(11)''.

By the Commission.

Dated: April 12, 2002.

Margaret H. McFarland,

Deputy Secretary.

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