

# THE SEC LIMITS THE INTERNET ADVISER EXEMPTION

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## US Asset Management and Investment Funds Alert

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### BRIEF OVERVIEW

On 27 March 2024, the US Securities and Exchange Commission (SEC) adopted amendments (the [Amendments](#)) to Rule 203A-2(e) under the Investment Advisers Act of 1940 (Advisers Act). Rule 203A-2(e) is commonly known as the “Internet Adviser Exemption.” Originally adopted in 2002, advisers relying on the Internet Adviser Exemption are permitted to register with the SEC, even if they do not have enough assets under management or otherwise qualify for federal registration. The Amendments substantially narrow the Internet Adviser Exemption by:

- Eliminating the de minimis exception for non-internet clients;
- Mandating that advisers relying on the Internet Adviser Exemption maintain an “operational interactive website” at all times; and
- Reinforcing that the Internet Adviser Exemption is limited to advisers that provide only digital investment advisory services meaning that the advice itself is generated by the website's software-based models, algorithms, or applications.

The Amendments are in part an attempt to conserve SEC examination resources and a reaction to SEC concerns that many advisers claim reliance on the Internet Adviser Exemption without satisfying its conditions, and many of those advisers are not otherwise eligible for SEC registration.<sup>1</sup> The Amendments also reinforce that, while advisers increasingly are incorporating technology into their client interactions, interacting with clients through a website or mobile application is not a sufficient basis to rely on the Internet Adviser Exemption. The advice itself must be generated through the website, mobile application, or similar digital platform.

### KEY TAKEAWAYS

Advisers that are currently relying on the Internet Adviser Exemption should consider whether they meet the conditions to continue to qualify for the amended exemption.

If unable to rely on the Internet Adviser Exemption, advisers would need to consider altering their business model (e.g., by eliminating non-internet clients) to come within the amended exemption, evaluate whether they can rely on another basis for SEC registration, or register with one or more states.

## AMENDMENTS TO THE INTERNET ADVISERS EXEMPTION

### *De Minimis* Exception

Prior to the Amendments, advisers could rely on the Internet Adviser Exemption if, among other obligations, they provided investment advice to all of their clients exclusively through an interactive website, except they were permitted to provide investment advice to fewer than 15 non-internet clients during the preceding 12 months. The Amendments eliminate this *de minimis* exception. Consequently, the Amendments require that all client interactions occur exclusively through an operational interactive website.

Therefore, to the extent advisers currently relying on the Internet Adviser Exemption have non-internet clients, these advisers would need to consider their ability to continue to rely on the exemption or take action to amend their operations.

### **“Operational” Interactive Website**

The Amendments require that advisers relying on the Internet Adviser Exemption provide investment advice to all of their clients through “operational” interactive websites for the entire period during which they are relying on the exemption.

The Amendments renamed the term “interactive website” as “operational interactive website,” and defined it as a website, mobile application, or similar digital platform through which an adviser provides “digital investment advisory services” (discussed below) on an ongoing basis to more than one client (except during temporary technological outages of a *de minimis* duration).<sup>2</sup> In a change from the proposed rule, the SEC included in the definition any “similar digital platform” to keep the rule evergreen as technology changes.

The SEC noted that the addition of the term “operational” reinforces the amended rule's requirement that advisers must continue to be available at all times during which they rely on the Internet Adviser Exemption, except in the case of matters that do not relate to the provision of investment advice (e.g., to resolve technical issues, help clients navigate the website, or collect feedback).<sup>3</sup> This concept was added largely in response to SEC examination findings that some advisers registered in reliance on the Internet Adviser Exemption, but did not maintain an interactive website.

The amended rule permits advisers relying on the Internet Adviser Exemption to provide digital investment advisory services through any form of mobile application technology or similar digital platform. Furthermore, the SEC provided more clarity around the meaning of the phrase “ongoing basis” noting that advisers provide investment advice on an ongoing basis through their website if the advice is within the scope of the adviser-client relationship. We understand this to mean that although advisers relying on the Internet Adviser Exemption must provide advice on an ongoing basis to more than one client, the advice itself does not need to be continuous. Rather, the advice can be of limited duration (e.g., for a one-time financial plan) or a continuing discretionary relationship, so long as the advisers are each providing advice to more than one client at all times during which it is relying on the Internet Adviser Exemption.

### **“Digital Investment Advisory Services”**

Under the Amendments, advisers relying on the rule are limited to only providing “digital investment advisory services” to clients. A “digital investment advisory service” is one that provides investment advice to clients that is generated by the operational interactive website's software-based models, algorithms, or other applications based on personal information each client supplies through the interactive website.

The SEC further clarified that, to qualify for the exemption, the investment advice provided to clients must be “generated by” the website’s software-based model, algorithms, or applications. Therefore, any human-directed client-specific investment advice, even if delivered through electronic means, would not be eligible activity under the Internet Adviser Exemption. However, advice that is exclusively generated by an adviser’s website, that such adviser does not expand upon, is permissible under the amended exemption.

## FORM ADV

The SEC is also amending Form ADV to require advisers relying on the Internet Adviser Exemption as a basis for registration to represent on Schedule D that they have, among other things, an operational interactive website.

## EFFECTIVE AND COMPLIANCE DATES

The amendments will become effective 90 days after publication in the Federal Register.

The compliance date for the amended Internet Adviser Exemption is 31 March 2025. Advisers that are no longer eligible to rely on the amended Internet Adviser Exemption and do not otherwise have a basis for registration with the SEC, must withdraw their registration with the SEC by 29 June 2025 and register in one or more states. The SEC expects to cancel the registration of advisers that fail to withdraw their registration by this date.

## FOOTNOTES

<sup>1</sup> See *Observations from Examinations of Advisers That Provide Electronic Investment Advice*, Division of Examinations Risk Alert (Nov. 9, 2021), available at: <https://www.sec.gov/files/exams-eia-risk-alert.pdf>.

<sup>2</sup> Internet investment advisers may seek exemptive relief for technological outages of the operational interactive website that last longer than a *de minimis* duration. Such a request will be reviewed under the facts and circumstances and must meet the standard under section 206A of the Advisers Act.

<sup>3</sup> Advisers intending to rely on the Internet Adviser Exemption may, however, rely on current Rule 203A-2(c) of the Adviser Act (the 120-day rule) as an initial basis for registration with the SEC, subject to the Rule 203A-2(c) requirements.

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