REGULATORY UPDATE:

The SEC Settles an Enforcement Action Involving Adviser Fiduciary Violations

By Randy Randall, Senior Partner
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INTRODUCTION:

On October 30, 2026, the SEC Division of Enforcement announced that it had settled an enforcement case against a registered investment adviser providing services primarily to retail clients.[1] The SEC found that the adviser breached its fiduciary duty to its retail advisory clients by:

- Failing to fully and fairly disclose its conflicts of interest involving its affiliated broker-dealer's receipt of revenue sharing compensation; and
- Including a "hedge clause," that contained misleading statements in its retail advisory agreements regarding the scope of the adviser's unwaivable fiduciary duty.

The SEC also found that the adviser breached Rule 206(4)-7 under the Advisers Act because it failed to implement its written policies and procedures related to its hedge clause.

KEY TAKEAWAYS:

- Consistent with its recently published Exam Priorities[2] and other recent guidance,[3] the SEC continues to aggressively pursue cases involving adviser violations of fiduciary duties to clients.
- It is critical to disclose all revenue received, particularly in cases involving compensation received by or from affiliated parties, and to fully disclose any conflicts of interest arising from any such payments. Firms should carefully review all revenue sources and work with compliance or counsel to identify and disclose potential conflicts of interest. The revenue in this case was not received directly by the adviser, but by its affiliated broker-dealer which shared common ownership and management with the adviser.
- It is not possible to contractually waive fiduciary duties to clients, and the SEC will closely review advisory contracts for potential violations. In this case the SEC found that a hedge clause, "when read in its entirety" violated the antifraud provisions of the Advisers Act despite the fact that is expressly provided that '[n]othing in this Agreement waives or limits any rights that Client has under applicable federal or state securities laws". Advisers should carefully review all hedge clauses in client agreements to ensure that they do not run afoul of regulatory requirements.
- It is also important to ensure that firms follow through on steps taken to correct to examination deficiencies. The SEC will follow up and will find violations if agreed corrective action is not taken.

THE DETAILS:

[1] https://www.sec.gov/files/litigation/admin/2026/ia-7031.pdf
[2] https://www.sec.gov/files/2027-exam-priorities.pdf
[3] https://www.sec.gov/files/observations-ia-obligations-related-economic-conflicts-interest-060926.pdf

The SEC found that the adviser breached its fiduciary duty to its retail advisory clients by failing to fully and fairly disclose the actual and potential conflicts of interest arising from compensation paid to its affiliated broker-dealer and, as a result, advisory clients could not make an informed decision to consent to the conflicts of interest or reject them. The payments in question were margin interest and cash sweep program revenue sharing payments. The SEC also found that the adviser used improper hedge clauses in advisory agreements with retail clients. The adviser also failed to take agreed corrective action resulting in compliance rule violations.

Margin Interest

The adviser's affiliated broker-dealer entered into a clearing agreement with an unaffiliated clearing firm that provided that clients, including the adviser's advisory clients, were charged interest based on the client's margin balance, or the amount of the outstanding loan against the value of the investments in the client's margin account. Pursuant to the clearing agreement, the affiliated broker-dealer also marked up the interest rate paid on margin balances above the base rate charged and kept the additional interest as compensation.

According to the SEC, this additional compensation gave the adviser an incentive to recommend that its advisory clients borrow on margin. The adviser did not disclose that its affiliated broker-dealer was marking up the margin interest rates and receiving those amounts as compensation for balances held in clients' margin accounts, nor did it disclose the actual and potential conflicts of interest associated with the margin interest received as compensation.

Cash Sweep Revenue Sharing Arrangement

Under the clearing agreement the affiliated broker-dealer also received compensation referred to as "distribution assistance" based on the balances of the adviser's advisory clients in certain money market funds used as cash sweep vehicles. The clearing agreement provided that the affiliated broker-dealer could place client funds in different types of cash sweep money market funds, including money market funds that would result in distribution assistance payments to the affiliated broker-dealer based on the amount of the adviser's clients' investments in those funds, and money market funds that did not result in distribution assistance payments.

The adviser did not disclose the receipt of the distribution assistance payments by its affiliated broker-dealer. In addition, it did not disclose its conflicts of interest associated with the revenue that that its affiliated broker-dealer received based on the assets of adviser's advisory clients invested in cash sweep money market funds.

Limitation of Liability Provision

Language in an advisory agreement that purports to limit the adviser's liability under the agreement is commonly referred to as a "hedge clause." Whether a particular hedge clause is misleading is a facts-and-circumstances determination. On June 5, 2019, the SEC published an interpretation[4] that provided that "there are few (if any) circumstances in which a hedge clause in an agreement with a retail client would be consistent with [ ] antifraud provisions, where the hedge clause purports to relieve the adviser from liability for conduct as to which the client has a non-waivable cause of action against the adviser provided by state or federal law. Such a hedge clause generally is likely to mislead those retail clients into not exercising their legal rights, in violation of the antifraud

[4] https://www.sec.gov/files/rules/interp/2019/ia-5248.pdf

provisions, even where the agreement otherwise specifies that the client may continue to retain its nonwaivable rights."

The adviser used a hedge clause in two of its standard advisory agreements with retail clients that provided:

> To the greatest extent permitted by applicable law, Adviser will not be liable for any error of judgment or mistake of law or for any loss arising out of any investment or for any act, omission or conduct [in the management of Client's Account/undertaken by Adviser in connection with this Agreement], including, without limitation, any legal expenses incurred in investigating or defending any demands, charges or claims with respect to the Account, except to the extent that a court of competent jurisdiction or an arbitration panel, in a final non-appealable judgment or order, finds such error or mistake or loss or other action, omission or conduct to have resulted from the gross negligence, willful malfeasance or violation of applicable law by Adviser in the performance of Adviser's duties or obligations under this Agreement.
> . . .
> Nothing in this Agreement waives or limits any rights that Client has under applicable federal or state securities laws.

In spite of the disclaimer related to "applicable federal or state securities laws" the SEC found that the hedge clause "when read in its entirety", is inconsistent with an adviser's fiduciary duty because it may mislead [the adviser's] retail advisory clients into not exercising their non-waivable legal rights".

Compliance Program Failures

The adviser was subject to an SEC examination in June of 2023 that raised the hedge clause issue, presumably in the form of a finding in a deficiency letter. In response to the finding, the adviser adopted written policies and procedures prohibiting its advisory agreements from containing a hedge clause or similar provision that "is likely to lead a client to believe that the client has waived, in any way, any available right of action the client may have against [the adviser] under federal and/or state securities laws." Despite these updates to its written policies and procedures, the adviser failed to revise its Client Agreements.

Violations Found

As a result of the failure to disclose the margin interest and cash sweep revenue sharing arrangement, as well as the use of the improper hedge clause, the SEC found that the adviser willfully violated Section 206(2) of the Advisers Act, which makes it unlawful "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

The SEC also found that the adviser's failure to take corrective action in response to the June 2023 examination findings violated Section 206(4) and Rule 206(4)-7 under the Advisers Act.

The adviser was censured and required to pay disgorgement and a penalty.

About Randy Randall: *Randy Randall is a Senior Partner at Helios and a seasoned compliance executive and securities attorney with more than 35 years of experience advising investment advisers, broker-dealers, and investment companies. Before joining Helios, Randy spent almost two decades at William Blair, where he served as Chief Compliance Officer and Counsel for the firm's Investment Management business. He counsels and advises clients on SEC and FINRA regulatory matters, compliance program design, governance, and complex legal and regulatory issues affecting the investment management industry.*