

FUNDamental QuickStudy: SEC Division of Examinations Issues Risk Alert on Economic Conflicts of Interest for Investment Advisers

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KEY POINTS

- The SEC's Division of Examinations published a June 9, 2026, Risk Alert identifying undisclosed economic conflicts of interest, inconsistent practices, and inadequate compliance programs as top examination concerns for registered investment advisers.
- Examiners found that advisers recommending cash sweep programs failed to disclose revenue-sharing arrangements with custodians and the availability of lower-cost, higher-yielding alternatives.
- Advisers receiving Rule 12b-1 fees, custodial credits, and interest rate markups without adequate disclosure were identified as a key source of undisclosed conflicts.
- Examiners cited violations of Advisers Act Rule 206(4)-7, finding that compliance programs lacked written policies addressing fee billing practices, revenue-sharing arrangements, and monitoring controls.
- The Division of Examinations characterized inadequate disclosure of economic conflicts as a core fiduciary concern, not a technical compliance shortcoming.

On June 9, 2026, the U.S. Securities and Exchange Commission's (SEC) Division of Examinations published a Risk Alert highlighting exam observations related to investment advisers' obligations concerning economic conflicts of interest and associated fee practices. The Risk Alert signals that examiners will be taking a closer look at the economic incentives that advisers and their financial professionals may have when recommending products, services, or account types to clients, including the source and structure of compensation and other economic benefits.

WHAT THE SEC OBSERVED

The Risk Alert highlights the following observations of examiners from their examinations of SEC-registered investment advisers:

1. Economic conflicts of interest that were undisclosed, or where the disclosures were incomplete or misleading.
2. Practices that were inconsistent with advisory agreements and disclosures.
3. Compliance programs that did not fully address economic conflicts of interest and risks.

FIVE KEY AREAS OF DEFICIENCIES IDENTIFIED

1. Cash Management Recommendations

Examiners observed that advisers recommending cash sweep programs — where clients' uninvested cash is automatically moved into interest-bearing accounts or money market funds — failed to adequately disclose:

- Revenue the advisers received from certain custodians based on the cash balances their clients held with those custodians.
- Incentives to recommend cash sweep vehicles that resulted in the greatest possible compensation to the adviser.
- Certain clients' cash balances were subject to the advisers' asset-based fees and/or the impact fees may have on their investment returns with respect to cash balances (including instances where clients generated negative returns due to the fees and expenses associated with these recommended cash management programs).
- Their only cash management recommendations were higher-cost money market funds participating in revenue-sharing arrangements with the adviser.
- The existence of lower-cost, higher-yielding share classes of the same funds that did not provide revenue sharing to the adviser.
- The economic incentive the revenue-sharing arrangement created for the adviser to recommend those funds over available alternatives.

2. Conflicts of Interest Associated With Other Revenue Opportunities

Examiners identified a broad range of undisclosed conflicts stemming from economic benefits received by advisers, including:

- Mutual fund share class selection: Advisers or affiliated broker-dealers received Rule 12b-1 fees from fund share classes when lower-cost share classes were available to clients, without adequate disclosure.
- Custodial credits and interest rate markups: Advisers failed to disclose custodial credits received, interest rate markups applied to client margin loans, or transaction fees marked up beyond what the clearing broker charged, and that the advisers would incur termination fees should they terminate such custody and clearing relationships.
- Affiliate relationships: Dually registered firms (operating as both an investment adviser and a broker-dealer) failed to disclose the economic conflicts created by their affiliate structure in client-facing materials.

3. Form ADV Disclosure Gaps

Examiners identified material gaps and inaccuracies in Form ADV disclosures, including:

- Incomplete or outdated disclosures in Items 10 and 12 regarding financial industry affiliations, brokerage practices, and compensation arrangements;
- Disclosures that were inconsistent with the adviser's actual business practices; and
- Failure to update Form ADV when material changes in conflicts arose.

4. Fee Billing Practices Inconsistent With Advisory Agreements

Examiners found recurring fee billing errors, including:

- Failure to refund prepaid fees upon client termination of the advisory relationship;
- Incorrect application of tiered fee schedules, including failure to apply breakpoints;
- Householding errors — failing to aggregate related accounts for fee calculation purposes, resulting in clients being overbilled; and
- Billing practices that were inconsistent with the methodology described in advisory agreements and Form ADV disclosures.

5. Weaknesses in Compliance Programs

Examiners identified violations of Advisers Act Rule 206(4)-7 (the Compliance Rule), observing that compliance programs were not reasonably designed to prevent violations related to economic conflicts of interest. Specific deficiencies included:

- Incomplete coverage of billing arrangements and revenue sharing in written policies and procedures;
- Conflicting internal documentation — policies that were inconsistent with actual practices; and
- Lack of fee-monitoring controls, including the absence of processes to detect billing errors, monitor tiered fee application, or ensure timely refunds.

KEY COMPLIANCE TAKEAWAYS

In light of the Risk Alert, investment advisers should consider the following action items:

- **Audit cash management practices.** Review all cash sweep and money market fund recommendations to assess whether revenue-sharing arrangements are fully disclosed, and whether lower-cost alternatives were considered and communicated to clients.
- **Review share class selection processes.** Confirm that share class selection policies address the availability of lower-cost share classes and that all 12b-1 fee arrangements are disclosed.
- **Update Form ADV.** Scrutinize Items 10 and 12 to ensure that financial industry affiliations, brokerage practices, and all compensation arrangements are disclosed completely, accurately, and consistently with current business practices.
- **Conduct a fee billing review.** Reconcile fee calculations against advisory agreements and disclosed methodologies. Identify any overbilling and remediate promptly, including issuing refunds for terminated accounts with prepaid fees.
- **Strengthen compliance programs.** Ensure written policies and procedures specifically address fee billing practices, revenue-sharing arrangements, and all identified conflicts. Implement monitoring controls and testing protocols to detect billing discrepancies on an ongoing basis.
- **Train financial professionals.** Ensure that personnel involved in making recommendations understand the firm's conflicts and the importance of acting in clients' best interests notwithstanding any economic incentives.
- **Assess advisory agreement terms.** Review liability disclaimers, hedge clauses, and assignment provisions for consistency with fiduciary obligations.

BOTTOM LINE

Economic conflicts of interest remain a top examination priority for the Division of Examinations, and the Division has indicated that inadequate disclosure of economic conflicts is viewed as a core fiduciary concern, not simply a technical compliance shortcoming. Advisers that fail to identify, disclose, and manage these conflicts risk

enforcement scrutiny and should act to rectify any potential issues.

As we have in the past, we will continue to monitor this matter and related developments and will provide future client updates as applicable. This publication is for guidance only and is not intended to be a substitute for specific legal advice. Please contact your Troutman Pepper Locke attorneys with any questions about how this Risk Alert may affect your firm.

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