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SEC Enforcement Action, Examinations Risk Alert Signal Continued Focus on Conflicts of Interest

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On consecutive days in June, the U.S. Securities and Exchange Commission underscored that it will continue to prioritize how conflicts of interest are handled by investment advisers. On June 8, the SEC brought a settled enforcement action alleging that an adviser failed to disclose certain financial conflicts of interest and did not adequately implement policies and procedures related to such conflicts. On June 9, the SEC's Division of Examinations (EXAMS) issued a risk alert outlining a host of "observations" resulting from its reviews of the incentives that advisers may have to recommend certain products, services or account types to their clients that could lead to "economic conflicts of interest."

The twin announcements demonstrate that, despite Chair Paul Atkins' emphasis on fighting intentional fraud and characterization of materiality as his "north star," the SEC will continue to police conflicts of interest in the absence of scienter, and regardless of whether they are characterized as material.

The Enforcement Action

On June 8, the SEC announced settled charges against Foundations Investment Advisors, LLC


Courtesy photos

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and its majority owner and former chief executive officer for, among other things, failing to disclose conflicts of interest related to financial arrangements with certain affiliated advisers that impacted investment recommendations that Foundations made to its clients, according to the SEC. The SEC said the undisclosed conflicts of interest included:

- the CEO's "economic interest in a Foundations' sub-adviser ... that provided an investment model portfolio to Foundations' clients, a portfolio that included an exchange-traded fund (ETF) that another adviser ... managed;"
- "Foundations having an expense sharing agreement with [the other adviser] related to

four other exchange-traded funds that gave Foundations an incentive to recommend these products to clients;" and

- "affiliations between Foundations' former chief investment officer ... , [the other adviser], and [another] entity that acted as a sub-adviser to Foundations and for the ETF."

Further, the SEC stated in the order that found the CEO personally traded the ETF while serving as CEO and with knowledge that the ETF was recommended to clients by the sub-adviser.

As a result of the alleged undisclosed conflicts and the CEO's trading, the SEC said it concluded that the adviser and the CEO negligently breached their fiduciary duties in violation of Section 206(2) of the Investment Advisers Act of 1940. The settlement order also stated that the adviser had failed to properly implement its compliance policies—including those related to conflicts of interest—in violation of Adviser's Act Rule 206(4)-7.

Foundations and the CEO admitted no wrongdoing in agreeing to the settlement order, which included a cease-and-desist order and a censure, as well as a disgorgement payment and prejudgment interest and civil penalties which totaled more than $1.5 million.

The action came just weeks after the SEC's newly appointed director of enforcement, David Woodcock, underscored in his first public remarks that, among other priorities, "in the investment adviser space, the Enforcement Division ... will continue to pursue matters involving ... undisclosed conflicts of interest." Prior to Woodcock's remarks, Atkins and other SEC officials repeatedly highlighted investment adviser breaches of fiduciary duty as a priority of the SEC's enforcement program.

In addition, during the SEC's 2025 fiscal year but not since then, the Atkins Commission brought several such actions involving undisclosed or inadequately disclosed conflicts of interest grounded in mere negligence. Almost a year later, this action demonstrates that such matters continue to be a priority for the SEC, perhaps particularly in cases like this one, where the order indicates that the respondents benefited financially from their conduct.

Lawyers for investment advisers may observe that the Foundations order does not allege that the undisclosed conflicts of interest were material—that there was a substantial likelihood that a reasonable Foundations client would have considered the undisclosed facts important, given the total mix of information available, in making an investment decision. The text of a settled order cannot, however, change the legal requirement that in order to support a breach of fiduciary duty claim, an undisclosed conflict must be material. The Foundations order therefore provides no legal authority for any argument to the contrary.

The Risk Alert

The day after announcing settled charges against Foundations, the SEC issued a risk alert, titled "Examinations Observations of Investment Adviser Obligations Related to Economic Conflicts of Interest," which emphasizes the fiduciary obligations of registered investment advisers under the Advisers Act in the context of conflicts of interest. The bulk of the alert discusses observations around disclosure deficiencies related to specific categories of conflict of interest.

Specifically, the risk alert identifies undisclosed conflicts arising from adviser recommendations that clients invest cash assets into interest-bearing accounts that generate economic benefits to the adviser. The alert flags other revenue-generating opportunities for advisers that create conflicts, including those resulting from recommendations around custodial credits, margin lending, transaction markup fees, and mutual fund share class selection. Additionally, the alert notes misstatements and omissions in advisers' form ADV brochures, particularly with respect to compensation arrangements and economic incentives that influence broker-dealer selection.

The alert also mentions observations related to adviser practices that were inconsistent with advisory agreements and disclosures, including improper fee billing resulting from failures to calculate fees consistent with agreements and disclosures, assessing fees for services not rendered, and failing to refund unearned fees. Finally, the alert outlines some observations about advisers' compliance programs, and in particular their policies and procedures, related to conflicts of interest.

Although EXAMS has regularly highlighted conflicts of interest in its published Examination Priorities and mentioned them generally in other risk alerts, the alert provides detailed observations about certain conflict-of-interest disclosure inadequacies that it has seen during actual exams of RIAs.

Importantly, the June 9 alert makes no mention of state of mind—intent, recklessness, or even negligence—and refers to materiality only a few times. To the extent that the alert merely suggests best practices for advisers, these omissions are less important. However, in the context of an actual SEC exam, and particularly in the event of a deficiency letter, counsel for investment advisers should note that to be actionable under the Advisers Act, allegations of undisclosed conflicts of interest must be supported by at least negligence and must be material.

Conclusion

This one-two combination from the commission sends a clear message. Both the EXAMS and enforcement staff will continue to closely scrutinize conflicts of interest disclosures, particularly those regarding any economic incentives related to client recommendations.

To get ahead of such scrutiny during an exam, lawyers for advisers should consider recommending that their clients enhance their procedures for identifying material conflicts of interest and training of personnel on such procedures, and review and update as appropriate their disclosures and related policies and procedures. Should EXAMS identify conflicts of interest-based disclosure deficiencies, to help avoid a potential referral to Enforcement about such deficiencies, or if faced with an actual enforcement inquiry, counsel should be prepared to emphasize the scienter and materiality requirements to the staff.

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