Subject: SEC Focus: Hedge Clauses (Adviser Liability) and Custody Language in Client Agreements

Good Morning,

I wanted to flag a January 2026 SEC enforcement action and related risk alerts addressing ***adviser liability/hedge clauses*** and ***custody-related authority*** in retail investment advisory agreements. We recommend reviewing your client agreements and updating any provisions that could be viewed as limiting client rights or allowing the adviser to move client assets.

Hedge clauses / Adviser Liability language

The SEC's view is clear: broad hedge clauses generally do not belong in **retail** advisory agreements because clients may not understand they are giving up important rights. A more defensible approach is narrow language that preserves fiduciary duties and client rights, avoids broad "good faith" carve-outs, and limits third-party disclaimers to situations where the adviser did not act negligently or breach its fiduciary duty.

Custody language

The January 2026 action also flagged custody risk where agreement language could be read to let the adviser move client money or securities, even if the adviser did not believe it had custody in practice. The SEC focused on broad trading authorization and custodian-instruction language and took the position that this could trigger custody and the annual surprise exam requirement. Agreements should be narrowed to make clear the adviser cannot withdraw client funds or securities.

Exam expectations and remediation

In recent SEC exams, advisers have been expected to amend agreements addressing hedge clause and custody concerns. Depending on the terms, this may require negative consent, affirmative client consent, or new advisory contracts.

Given the SEC's recent focus, proactive cleanup is strongly encouraged.

Recommended next steps:

1. **Inventory agreement versions.** Confirm which advisory agreement templates are in use (you may have different versions depending on when clients onboarded).
2. **Identify and revise hedge clause language.** Remove or revise provisions that could be read as limiting fiduciary obligations or client rights (including broad "good faith" disclaimers and overly broad third-party liability disclaimers).
3. **Review custody-related authority.** Narrow any trading authorization/custodian instruction language so it expressly excludes any authority to withdraw client funds or securities.
4. **Use updated replacement language.** We have included a link to alternate language for hedge clause and custody updates based on current SEC exam expectations.

5. **Determine client consent approach.** Depending on current language, you may need client notice, signed consent, or a new agreement. The *attached document* provides examples and next steps.

We realize this is a significant undertaking but want you to be aware of the risk and remain aligned with SEC guidance.

We are not proactively updating client agreements because versions often vary by firm and may have been customized over time. If you email us with your current agreement, we can review and make suggested amendments.

If you have concerns about your agreement language, you may wish to consult legal counsel.

Please let us know if you have any questions.