Divergent Disclosures: Disclosure Discrepancies and Investor Adviser Misconduct

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January 2026

Abstract

Given the tremendous societal cost of investment advisor firm misconduct, the SEC has mandated that advisory firms provide two distinct sets of disclosures to help protect investors. One set of these disclosures is highly structured and seemingly filed for use by the SEC, while the other set disclosures contains narrative disclosures that are disseminated to current and potential clients through brochures. We examine whether differences across these two sets of disclosures are a meaningfully predictor of investment firm misconduct. Using large language models to measure disclosure divergence, we document that inconsistencies regarding broker selection increase the relative risk of a future SEC enforcement by 11.5%. Our findings are magnified when firms possess direct proprietary interests in client transactions and are concentrated among firms serving retail investors. Additional analyses suggest that inconsistencies may be linked to advisories that have incentives to intentionally suppress information. Collectively, our findings are consistent with divergent disclosures being a predictor of investment firm fraud.

JEL Classifications: G10, G18, G24, G28, M40, M48

Keywords: Financial Advisers, NLP, AI, Conflicts of Interest, Misconduct, Form ADV.

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Brian Miller gratefully acknowledges financial support from the Harold and Martha Whitcomb Professorship. The authors also gratefully acknowledge financial support from the Fisher School of Accounting and Warrington College of Business at the University of Florida.

1. Introduction

Investment advisory firms had over $146 trillion in regulatory assets under management in 2024 (SEC, 2025), serving as central intermediaries in capital markets. Because advisers exercise discretionary authority over client assets, agency conflicts in this sector can result in significant losses, particularly for unsophisticated investors who rely on advisers' representations when making financial decisions. Egan et al. (2019) estimate that adviser misconduct costs the industry nearly half a billion dollars annually, with mean settlements of approximately $550,000, indicating that such agency failures are significant. Unlike broker-dealers subject to a suitability standard, investment advisers operate under a fiduciary standard that obligates them to act in their clients' best interests. However, this duty does not necessarily prohibit actions where conflicts of interest may exist. Instead, the U.S. regulatory regime relies on mandated disclosure, requiring advisers to disclose potential conflicts of interest (COI), which theoretically allows regulators and investors to mitigate agency costs. To ensure transparency of potential COIs, disclosures are made through two primary documents: Form ADV Part 1, a structured dataset used by the Securities and Exchange Commission (SEC) for oversight, and Form ADV Part 2, a narrative brochure written in plain English for current and prospective clients. This study examines whether differences in disclosed information about COIs between these two reports is predictive of future investment advisor misconduct.

Although Form ADV Parts 1 and 2 differ in format and intended audience, they require advisers to disclose overlapping aspects of the same underlying business practices, particularly regarding conflict of interest where information is intended to be consistent (SEC, 2026). Despite this mandate, divergent disclosures often occur between the structured filing and the narrative brochure. Divergent disclosure can arise when a conflict is disclosed to the regulator but omitted from the client disclosure or vice versa. We contend that both types of divergent disclosure are likely indications of overall weak internal controls that could provide investment advisors with the opportunity to commit misconduct.

We employ the complete universe of Registered Investment Adviser Firms (RIAs) to examine the potential impact of conflicted disclosures. In this study, we focus on the RIA as the firm entity, distinct from the individual investment adviser representatives who are employed by the firm. We construct a sample of 21,634 unique firms from 2012 to 2024 with 141,157 firm-year observations. The average firm appears in the sample for approximately 6.5 years. While reporting discrepancies may exist across different disclosures in the reports, we focus specifically on agency conflicts related to Broker Selection and Affiliation. We select this particular conflict because it has the potential for direct financial impact on investors. In particular, it provides the authority to route trades to an affiliate, which enables advisers to profit from the transaction fees charged to their own clients. As such, this arrangement creates a direct incentive to prioritize the firm's revenue generation over the client's execution quality. Not surprisingly, the SEC's *November 2024 Risk Alert* identifies disclosure failures on conflicts of interest as one of the main adviser firm-specific risk factors (SEC, 2024b). As previously mentioned, although there may be inconsistencies in other disclosures across the two disclosure types, we focus exclusively on Broker Selection and Affiliation and hereinafter refer to these specific conflicts of interest divergences simply as "disclosure inconsistencies" or "inconsistencies."

On one hand, there are reasons to expect a positive relation between disclosure inconsistencies and misconduct. As previously mentioned, a divergence between a firm's checked boxes and its written narrative likely serves as a proxy for a weak internal control environment. As Ashbaugh-Skaife et al. (2008) document in the corporate setting, poor reporting quality is often symptomatic of deeper internal control deficiencies. In the advisory context, a firm that lacks the rigor to ensure consistent filings likely lacks the controls to prevent securities law violations (Dimmock and Gerken, 2012). Furthermore, these inconsistencies may reflect strategic ambiguity, where firms intentionally obscure conflicts of interest to mislead investors or regulators. In this view, the inability or unwillingness to provide consistent disclosures is a proxy for a broader organizational culture of non-compliance, consistent

with the SEC's finding that such disclosure failures are frequently paired with substantive compliance deficiencies (SEC, 2016).

On the other hand, it is also plausible that disclosure inconsistencies are uncorrelated with regulatory misconduct. In the complex regulatory environment of the investment advisory industry, divergences between structured data and narrative brochures may simply reflect the linguistic complexity required by regulatory templates (Loughran and McDonald, 2014) or administrative oversight or clerical errors (Liu et al., 2025). Furthermore, these discrepancies may stem from organizational segmentation in which distinct teams prepare materials for different audiences. Specifically, if the structured filing is completed by compliance staff for regulatory purposes while the narrative is separately drafted by investor relations for client consumption, the resulting divergence may reflect a coordination failure rather than strategic obfuscation. Consequently, if these inconsistencies are primarily driven by resource constraints or benign negligence, they would constitute operational friction rather than a valid predictor of fraud.

We find that 8.7% of RIA-year observations exhibit semantic divergences in the Broker Selection and Affiliation disclosure section between Form ADV Parts 1 and 2. More importantly, these divergent COI disclosures predict future misconduct. In terms of economic magnitude, we estimate that reporting a disclosure inconsistency is associated with a 11.5% increase in the relative risk of future enforcement, after controlling for firm characteristics and absorbing time-invariant firm heterogeneity.[1] Equally important, the magnitude of inconsistency predicts the severity of sanctions. That is, firms with high divergence are significantly more likely to face severe penalties, such as bars, suspensions, or revocations. Notably, while these inconsistencies predict federal regulatory actions, they do not anticipate civil or crim-

[1]This estimate reflects the marginal effect of a discrete shift from consistent to inconsistent disclosure ($\beta = 0.0053$) relative to the unconditional probability of enforcement (0.0461). If we instead apply the variance decomposition methodology of Breuer and deHaan (2024) to account for the rarity of within-firm disclosure changes, the effect remains economically meaningful. Specifically, a one within-firm standard deviation increase in inconsistency (0.2243) is associated with a 2.58% increase in the probability of enforcement.

inal litigation. This distinction is somewhat intuitive. Private litigation generally requires demonstrable economic damages (loss causation), and criminal prosecution requires proof of fraudulent intent. In contrast, SEC enforcement is often preventive or rules-based, targeting failures to maintain compliance infrastructure regardless of realized client outcomes. Our measure captures this soft' signal of procedural obfuscation—sufficient to trigger a regulatory examination for failure to supervise, but distinct from the hard' evidence of theft or massive financial loss typically required to attract plaintiffs' attorneys or federal prosecutors.

We next investigate whether the observed disclosure inconsistencies reflect scenarios where advisors have incentives to obfuscate information. First, we observe that the association between inconsistencies and misconduct becomes stronger when the advisory firm holds direct proprietary interests in its clients' transactions. This occurs because principal trading creates a conflict in which advisers can transfer losses to investors by transferring losses into client accounts (Fecht et al., 2018). Second, we find that our results are concentrated among firms serving retail investors, who face higher information-processing costs and weaker monitoring capabilities (Bloomfield, 2002; Hirshleifer and Teoh, 2003). Third, we show that the enforcement relevance of disclosure inconsistencies varies with advisers' regulatory disclosure choices. Specifically, inconsistencies are predictive of misconduct when advisers report conflicts of interest in SEC-facing disclosures (Part 1), but not when such conflicts are absent from Part 1 (SEC, 2026). Finally, we exploit the SEC's 2018 Share Class Selection Disclosure Initiative to distinguish between strategic obfuscation and weak internal controls. The initiative offered favorable settlement terms to advisory firms that voluntarily self-reported previously undisclosed conflicts in an effort to identify and promptly remedy widespread violations. We document a sharp decline in disclosure inconsistencies during this amnesty period, which is consistent with firms strategically correcting their filings. Accordingly, we observe no association between inconsistencies and misconduct during this window, as the disclosures were largely remediated before enforcement actions occurred. This response supports an obfuscation mechanism rather than internal control weaknesses because firms

unaware of their errors would be unlikely to respond to temporary self-reporting incentives. Collectively, these findings suggest that divergent disclosures may be linked to incentives for firms to obfuscate.

We next attempt to rule out the possibility that the underlying COI and not the divergent disclosure itself is driving our results. In particular, we find no evidence that the underlying agency conflicts, such as the use of affiliated brokers, predict future enforcement actions when the adviser consistently discloses the arrangement. This evidence suggests that the predictive power of our measure is driven by the divergence of the disclosure rather than the business model's inherent risk. We further mitigate selection concerns related to adviser size by estimating our specifications on samples balanced via coarsened exact matching (Iacus et al., 2012). Finally, we demonstrate generalizability by identifying economically significant inconsistencies in wrap fee and commission disclosures that serve as robust predictors of regulatory misconduct.

Finally, we implement a validation framework regarding our measurement and empirical design to help mitigate potential concerns with our primary results. First, we address measurement validity by restricting the Large Language Model to a classification task rather than a predictive one. Specifically, we instruct the model to evaluate semantic consistency solely between two filings submitted at the same point in time (t), without access to future enforcement outcomes ($t+1$). This design eliminates the risk of look-ahead bias, as the model measures the quality of the disclosure rather than forecasting the firm's fate (Kim et al., 2024). Furthermore, by utilizing the model's semantic reasoning capabilities, we surpass the limitations of traditional dictionary-based methods, which struggle to detect the subtle, context-dependent contradictions inherent in legal disclosures (Gilardi et al., 2023). We confirm the reliability of this measure through human audits that reveal high concordance with manual coding and by replicating our classification with alternative model specifications to ensure our inferences remain robust to idiosyncratic model artifacts.

This study informs the debate regarding the supervision of investment advisers by high-

lighting the limitations of disclosure-based regimes. This focus is particularly timely given the SEC's recent prioritization of disclosure consistency as a primary examination deficiency (SEC, 2024b). Unlike public corporations subject to mandatory external audits, investment advisers operate with limited third-party verification, which allows internal contradictions to persist undetected (Dimmock and Gerken, 2012; Brown et al., 2008). Our results indicate that, without independent validation, self-reported structured data can be unreliable, undermining the fiduciary premise that transparency alone mitigates agency risk. We document that disclosures are frequently internally contradictory. This pattern impedes investors' ability to provide informed consent and mirrors the strategic obfuscation observed in mutual fund fee disclosures (deHaan et al., 2021). Consequently, our findings suggest that relying on transparency is an inadequate substitute for prohibition without rigorous enforcement of consistency (SEC, 2019c).

2. Institutional Background and Hypothesis Development

2.1. The Dual-Disclosure Regime: Structured Data vs. Narrative

The regulation of Investment Advisers in the United States is predicated on the disclose-and-consent paradigm. Under the Investment Advisers Act of 1940, advisers act as fiduciaries and are generally permitted to engage in conflicted transactions, such as receiving third-party compensation or using client commissions for soft-dollar benefits, provided these conflicts are fully and fairly disclosed to clients. To facilitate this transparency, the SEC mandates a dual-disclosure framework via Form ADV.

Form ADV Part 1 serves as the primary tool for regulatory oversight. It consists of structured, check-the-box responses to questions about the adviser's business practices, assets under management, and disciplinary history. Because this data feeds directly into the SEC's risk assessment algorithms, advisers face significant pressure to ensure its accuracy to avoid triggering automated examination flags. In contrast, Form ADV Part 2 (the Brochure) is a

narrative document designed for client consumption. Written in plain English, it requires advisers to describe their fees, investment strategies, and conflicts of interest.

Ideally, these two documents should serve as perfect mirrors where every conflict identified in the structured data of Part 1 is accompanied by a detailed qualitative explanation in Part 2. Form ADV Part 1 functions as a structured instrument used by the SEC for risk scoring. In contrast, the Part 2 brochure is a narrative disclosure that often functions as a client-facing marketing document. This separation allows firms to technically comply with reporting requirements in the structured filing while simultaneously providing contradictory information in the other through conditional language or outright omission. We term these divergences semantic inconsistencies.

2.2. Conflicts of Interest: The Mechanism of Misconduct

Our analysis concentrates on inconsistencies related to Conflicts of Interest (COI), specifically the high-risk setting of Broker Selection and Affiliation (within Form ADV Item 8). We isolate this specific area because the authority to select execution venues represents the structural control point where an adviser's fiduciary duty to minimize costs most directly conflicts with the firm's financial incentives to generate additional revenue. Furthermore, regulators have explicitly identified the use of affiliated broker-dealers as a priority examination target, maximizing the likelihood that observed inconsistencies in this domain reflect material compliance failures rather than benign administrative noise.

Economically, the power to control execution venues serves as the prerequisite for self-dealing. This control operates through two primary channels defined in Form ADV Part 1, specifically the discretionary authority to select brokers (Item 8.C) and the ability to recommend brokers to clients (Item 8.E). These mechanisms enable the adviser to direct order flow to a "related person", which the SEC defines broadly to include any advisory affiliate, officer, director, or entity under common control with the adviser (SEC, 2024a). When an adviser exercises this discretion to select an affiliated broker-dealer (Item 8.D) or

uses their influence to steer clients to a recommended affiliate (Item 8.F), the firm effectively captures a double layer of compensation. This includes the standard advisory fee plus the transaction revenues, such as commissions, markups, or payment for order flow, generated by the affiliate. This structure introduces an incentive to prioritize the affiliate's volume requirements and profitability over the client's execution quality. Specifically, an adviser may tolerate wider spreads or inferior execution speeds, which are costs borne invisibly by the client, to ensure order flow remains within the corporate family. This constitutes a direct wealth transfer from the principal (client) to the agent (adviser), analogous to the agency costs observed in vertical integration.

From a regulatory perspective, the SEC has repeatedly flagged these brokerage arrangements as areas of systemic non-compliance. In its *2019 Fiduciary Interpretation*, the Commission explicitly categorized the use of affiliated brokers as a conflict that inherently compromises the duty of loyalty, stating that advisers must provide full and fair disclosure that is specific enough for clients to understand the magnitude of the conflict (SEC, 2019a). More recently, the Division of Examinations' August 2022 *Staff Bulletin on Conflicts of Interest* warned that firms continue to rely on generic disclosures for these arrangements. The Bulletin emphasized that advisers must disclose material limitations on their menu of execution options, specifically when they steer clients to affiliates or a limited range of brokers that provide revenue sharing (SEC, 2022). By focusing on Item 8, we ensure that our measure captures inconsistencies in the exact domain where the SEC has demanded the highest level of precision, thereby increasing the practical implications of our study and reducing the probability that our results are driven by immaterial clerical errors.

2.3. Disclosure Inconsistency and Misconduct

The relation between disclosure inconsistency and future regulatory misconduct is ex ante unclear, as it depends on the underlying driver of the divergence. One stream of literature suggests that disclosure inconsistencies may simply reflect noise or benign administrative friction. Loughran and McDonald (2014) argue that textual complexity and disorganization

in financial filings often stem from the rigid constraints of regulatory templates rather than informational content. Recent evidence from hedge fund disclosures similarly suggests that reporting discrepancies may signal operational constraints rather than misconduct (Liu et al., 2025). Similarly, Bushee et al. (2018) suggest that linguistic misalignments frequently arise from the extensive use of boilerplate language required by compliance mandates, rather than from strategic information suppression.

In the context of RIAs, particularly smaller firms with limited compliance budgets, maintaining perfect synchronization between the structured Part 1 and the narrative Part 2 can be costly. A firm might update its Part 1 filing to reflect a newly established brokerage affiliation but, due to bureaucratic lag or oversight, fail to immediately update the corresponding narrative brochure. Under this view, inconsistencies are clerical errors or minor administrative errors that reflect resource constraints rather than systemic malfeasance. If divergences are driven by benign neglect, they should be uncorrelated with substantive enforcement actions, which typically target fraud, theft, or significant breaches of fiduciary duty. Thus, this perspective implies that semantic inconsistencies are non-predictive noise.

Conversely, disclosure inconsistency may serve as a visible proxy for a weak internal control environment. The accounting literature has long established a link between reporting quality and internal controls. Ashbaugh-Skaife et al. (2008) document that firms with internal control deficiencies exhibit lower quality accruals, suggesting that the inability to report accurate information reflects a broader inability to monitor firm operations. Brown et al. (2008) further demonstrate that robust verification environments are necessary to prevent reporting errors from carrying over into other compliance domains.

Extended to the asset management context, Dimmock and Gerken (2012) find that operational red flags, such as failing to file forms on time, are robust predictors of investment fraud. They argue that the same lack of rigor that leads to administrative errors also facilitates an environment where misconduct can occur unchecked. If a firm lacks the internal controls to ensure consistent public filings, it is likely to lack the controls to prevent violations of the

Custody Rule, valuation standards, or trading restrictions. Under this competence view, inconsistency signals a breakdown in the compliance infrastructure, increasing the likelihood of future misconduct.

Beyond incompetence, inconsistency may reflect strategic obfuscation. Agency theory suggests that managers with high agency costs have an incentive to increase information asymmetry to mask rent extraction. The accounting literature provides ample evidence of this behavior: Li (2008) finds that managers of poorly performing firms use more complex language to obfuscate negative news, while Bonsall et al. (2017) demonstrate that "Plain English" violations (measured by the Bog Index) serve as a distinct mechanism to conceal reduced financial reporting quality. Similarly, in the mutual fund industry, deHaan et al. (2021) document that funds charging higher fees use more complex narrative disclosures to reduce price elasticity and confuse retail investors.

In our setting, an adviser operating under the moral hazard inherent in conflicted arrangements faces the challenge of satisfying distinct disclosure objectives. The firm must report structured data in Form ADV Part 1 to satisfy the SEC's automated risk-scoring algorithms, while simultaneously drafting narrative brochures in Part 2 to communicate with current and prospective clients. These dual channels create an environment where reporting incentives may diverge. Consequently, an adviser may provide contradictory information across the two filings—either to navigate regulatory constraints or to manage client perceptions. This creates an equilibrium of disclosure inconsistency, where the structured data and the narrative explanation fail to converge. For example, a firm might affirm a conflict in one document to satisfy a specific compliance requirement, yet deny or omit the same arrangement in the corresponding filing, thereby generating a signal of opacity regardless of which disclosure is factually accurate.

This theoretical concern is substantiated by regulatory jurisprudence, which confirms that such ambiguity constitutes a breach of the fiduciary standard. The D.C. Circuit's ruling in *The Robare Group, Ltd. v. SEC* (2019) explicitly framed such semantic discrepancies as vi-

olations of fiduciary duty. If inconsistencies reflect a deliberate strategy to obscure conflicts, they represent not just a signal of risk, but a direct manifestation of the deceptive practices that characterize fraudulent intent (SEC, 2019c). Both the weak internal controls and strategic obfuscation perspectives predict a positive association between disclosure inconsistency and misconduct. Whether driven by an inability to monitor operations (incompetence) or a desire to hide conflicts (malice), a divergence between an adviser's structured regulatory data and its client-facing narrative signals a heightened risk of compliance failure. We therefore formulate our primary hypothesis in the alternative:

H1: *There is a positive association between semantic inconsistencies in an investment adviser's regulatory filings and the probability of future regulatory misconduct.*

3. Empirical Strategy

3.1. Data Sources

Our main sample covers the period from 2012 to 2024.[2] We aggregate data from two primary sources to construct a comprehensive panel of Registered Investment Advisers (RIAs). First, we obtain structured regulatory data from Form ADV Part 1, which provides annual snapshots of adviser characteristics, including assets under management (*Total AUM*), staffing levels (*Rep Employees*), and detailed business practices such as discretionary authority and proprietary trading. We also source regulatory enforcement data from the Form ADV Part 1 data, which captures disciplinary actions, including civil, criminal, and regula-

[2]While Form ADV Part 2 disclosures date back to 2007, a major amendment to Part 2 was implemented in July 2010, substantially changing both the disclosure format and required content (Please see: https://www.sec.gov/files/rules/final/2010/ia-3060fr.pdf and https://iard.com/form-adv-part-2-iard-system-instructions). Part 2 disclosures prior to this revision differ substantially from the current (year 2026) disclosure structure. The revised Part 2 disclosures were largely first filed in 2011, and because our main analyses use lagged variables, we restrict the RIA-year panel to 2012 onward. In untabulated analyses, our main results and inferences remain unchanged when these earlier filings are included.

tory sanctions. Second, we scrape and process the narrative Form ADV Part 2 brochures, which contain the plain-English disclosures of investment strategies and conflicts of interest.[3] Although Part 2 follows a standardized structure based on SEC guidelines, it is a narrative disclosure with no explicit page or length limits.

We start with Part 1 filings to construct the full universe of RIA-year observations from 2011 to 2024 (179,993 observations).[4] We then merge the disclosure inconsistency measures, constructed from Parts 1 and 2, into the panel and drop observations with missing lagged inconsistency measures (151,428 observations). Finally, we drop observations for which any other variables required for the main analysis are missing, resulting in a final sample of 141,157 RIA-year panel observations. All continuous variables are winsorized at the 1st and 99th percentiles.

3.2. Measuring Inconsistency with AI

Our primary independent variable, *COI Inconsistent*, is constructed using a Large Language Model (LLM) to detect semantic contradictions between the structured data in Form ADV Part 1 and the narrative disclosures in Part 2. Figure 1 provides a schematic overview of this classification pipeline.

As illustrated, the process involves three distinct steps:

1. **Extraction:** For each firm-year, we extract the boolean responses from Form ADV

[3]For the original Form ADV Part 1 and Part 2 Data, please see: https://www.sec.gov/foia-services/frequently-requested-documents/form-adv-data and https://adviserinfo.sec.gov/adv.

[4]Before applying any substantive sample restrictions, we remove obviously erroneous RIA-year observations from the Form ADV Part 1 filings (Mamaysky and Zhang, 2025). Specifically, we drop: (1) filings with malformed or incomplete RIA identifiers; (2) filings in which reported total regulatory assets under management (AUM) and the total number of accounts are numerically identical; (3) filings exhibiting extreme and inconsistent year-over-year fluctuations in AUM or account counts. For example, we exclude RIA-year observations in which AUM exceeds $1 million and increases by more than tenfold within a single year while the number of accounts grows by less than 100%, followed by a collapse in AUM of more than tenfold within the subsequent one or two years. A symmetric rule is applied to identify anomalous spikes in account numbers without corresponding growth in AUM; (4) filings reporting more than 100,000 employees; and (5) three filings from a single RIA that falsely reported trillions of dollars in AUM and was later subject to SEC enforcement action (see https://www.sec.gov/enforcement-litigation/litigation-releases/lr-25848).

Part 1 that collectively define the firm's brokerage authority and execution practices (Input A). We specifically collect four variables, structured as two functional pairs (Appendix B provides a visual reference for these items using the Invesco case):

- *Discretionary Auth.* (Item 8.C.(3)) & *Discretionary Auth. Related* (Item 8.D): The first variable establishes the firm's *operational authority* to determine broker selection. The second variable specifies whether this authority includes the selection of a "related person," defining the scope of potential self-dealing.
- *Recommends Brokers* (Item 8.E) & *Recommends Brokers Related* (Item 8.F): Similarly, Item 8.E establishes the firm's *influence* in recommending brokers to clients, while Item 8.F identifies whether these recommendations involve affiliated entities.

Simultaneously, we extract the full narrative text of the Form ADV Part 2 brochure (Input B). Our prompting strategy specifically directs the model to examine Item 10 ("Other Financial Industry Activities and Affiliations") and Item 12 ("Brokerage Practices"). By strictly validating disclosures within these mandated sections, our measure adheres to SEC requirements; consequently, if a conflict is admitted in Part 1 but omitted from these designated narrative sections, we classify it as an inconsistency, reflecting the regulatory stance that material conflicts must be disclosed in the specific locations where investors are instructed to look.

2. **Prompting:** We employ a pre-trained LLM (Gemini 2.0 Flash) with the temperature parameter set to zero to ensure deterministic output. We utilize a verification-based prompting strategy that relies on *conditional logic instructions*. Rather than filtering the sample ex ante, we instruct the model to evaluate the narrative's consistency based on the specific factual assertions in the structured data. The prompt establishes a set of logical contradiction rules that trigger a flag only when the two documents are factually incompatible.

3. **Classification:** The model assigns a binary consistency flag based on the semantic

compatibility of the two inputs. We set the indicator *COI Inconsistent* to one if the model detects a disclosure inconsistency, defined as any scenario where: (1) the firm admits to a conflict in the structured filing but explicitly denies it in the narrative brochure; (2) the firm admits to a conflict in the structured filing but omits it entirely from the narrative; or (3) the firm denies a conflict in the structured filing but affirmatively discloses it in the narrative. Conversely, the observation is classified as consistent if the narrative accurately reflects the structured data. Appendix B illustrates a specific instance of type (1). In this example, the adviser affirms in Part 1 that it possesses discretionary authority and recommends brokers to clients. However, the firm contradicts this in Part 2 by explicitly stating "The Company has no arrangements with affiliated entities" in Item 10 and marking Item 12 (Brokerage Practices) as "Not Applicable."

3.3. Regression Specification

To test the hypothesis that semantic inconsistencies predict future misconduct, we estimate the following OLS regression model:

$$\text{Misconduct}_{i,t} = \alpha + \beta_1 \text{COI Inconsistent}_{i,t-1} + \gamma \text{Controls}_{i,t-1} + \eta_i + \delta_t + \epsilon_{i,t}$$

Where:

- $\text{Misconduct}_{i,t}$ is a binary indicator equal to one if firm i is reports an SEC enforcement action in year t. We examine *SEC Action* as the primary outcome, and further decompose this into specific types: *False Statement*, *Regulatory Violation*, *Restricted Activity*, *Order Entered*, and *Impose Penalty*.[5]

[5]We primarily measure *SEC Action* using Item 11.C of Form ADV Part 1. While advisers with disciplinary events are required to file a Disclosure Reporting Page (DRP ADV), we rely on the Part 1 disclosure because DRP information is incomplete and may be removed in certain circumstances (FINRA, 2022). A potential concern is that Item 11.C requires advisers to disclose whether the SEC or CFTC has ever taken

- COI Inconsistent$_{i,t-1}$ is our lagged AI-generated measure of disclosure inconsistency.
- Controls$_{i,t-1}$ is a vector of lagged firm characteristics to control for scale and complexity. This includes *Log(Total AUM)*, *Log(Rep Employees)*, *Discretionary Assets %*, *Non-US Assets %*, and indicators for *Broker-Dealer* affiliation, *Hybrid Advisor* status, and business *Complexity Indicator*.
- η_i and δ_t represent firm and year fixed effects, respectively, to absorb time-invariant firm heterogeneity and aggregate time trends.

Standard errors are clustered at the firm level in all specifications to account for serial correlation within advisers.

4. Results

4.1. Descriptive Statistics

Table 1 presents summary statistics for our sample of 141,157 firm-year observations.[6] The unconditional probability of a firm facing *SEC Action* in a given year is approximately 4.6%. When broken down by specific enforcement types, *Regulatory Violations* (4.4%), *Orders Entered* (4.0%), and *Impose Penalty* (4.4%) are the most common outcomes, while *Restricted Activity* (suspensions or bars) is rare (0.1%).

certain actions, which may result in the same historical misconduct being reported in multiple filings and mechanically inflating firm-year indicators of regulatory action. Although the rarity of *SEC Action* and the inclusion of firm fixed effects mitigate this concern, we further address it by constructing an alternative measure using DRP ADV data. Specifically, we retain cases in which sanctions are ordered and the case status is *final* or *on appeal*. When the same case (reference) is reported in multiple times, we retain the earliest filing date and reconstruct a firm-year indicator based on this information. Re-estimating our analyses using this alternative measure yields inferences that are largely consistent with our baseline results.

[6]The advisers in our sample collectively manage approximately $116.31 trillion in assets under management and include 13,736 RIAs in 2024. This level of coverage is comparable in magnitude to the $146 trillion in aggregate regulatory assets under management and 15,900 RIAs reported by the SEC for 2024, indicating that our sample captures a substantial portion (approximately 80-86%) of the U.S. investment advisory industry (SEC, 2025).

Our primary independent variable of interest, *COI Inconsistent*, identifies semantic divergences between Form ADV Part 1 and Part 2 regarding conflicts of interest. The mean of this variable suggests that such inconsistencies are relatively rare but present in the sample (8.7%). In terms of business practices, 65.6% of advisers report having discretionary authority (*Discretionary Auth.*$_{t-1}$) and 68.1% recommend brokers to clients (*Recommends Brokers*$_{t-1}$). A significant portion of the sample, 82.2%, reports having some form of proprietary interest in client transactions (*Any Proprietary Interest*$_{t-1}$).

4.2. Baseline Regressions: The Predictive Power of Inconsistency

Table 2 reports the results of our baseline OLS regressions estimating the relationship between disclosure inconsistency and future SEC enforcement actions. All specifications include firm (*RIA*) and year fixed effects, with standard errors clustered at the firm level.

In Column (1), we find support for our hypothesis. The coefficient on *COI Inconsistent* is positive and statistically significant ($\beta = 0.005, t = 2.910$), indicating that firms with inconsistent conflict disclosures are significantly more likely to face SEC enforcement in the subsequent year. In economic terms, this effect is substantial. Holding firm characteristics constant, the coefficient of 0.0053 implies that a disclosure inconsistency increases the annual probability of future enforcement by 0.53 percentage points. Relative to the unconditional sample mean of 4.61%, this corresponds to a 11.5% increase in the base risk of regulatory sanction.[7]

Columns (2) through (6) decompose the dependent variable into specific types of enforcement actions. The predictive power of inconsistency is most robust for *Regulatory Violations* ($\beta = 0.005, t = 2.745$), *Restricted Activity* ($\beta = 0.001, t = 2.398$), *Orders Entered*

[7]If we instead apply the variance decomposition methodology of Breuer and deHaan (2024) to account for the rarity of within-firm disclosure changes, the effect remains economically meaningful. Specifically, we decompose disclosure inconsistency into firm-level (between-firm) means and within-firm deviations, estimate the enforcement regression using only the within-firm component, and scale the resulting coefficient by the within-firm standard deviation of inconsistency. Using this approach, a one–within-firm standard deviation increase in inconsistency (0.2243) is associated with a 2.58% increase in the probability of enforcement. These results confirm that our findings are not driven by cross-sectional scaling artifacts.

($\beta = 0.005, t = 2.687$), and *Impose Penalty* ($\beta = 0.006, t = 3.041$). Interestingly, the coefficient for *False Statement* is positive but not statistically significant ($\beta = 0.002, t = 1.153$). This distinction suggests that by correctly checking the box on Form ADV Part 1, advisers may effectively shield themselves from explicit charges of making false statements. Consequently, the observed inconsistency likely occupies an area of regulatory ambiguity of strategic ambiguity where the disclosure is technically accurate in the regulatory database yet misleading in the client narrative, a divergence sufficient to trigger broader regulatory violations and penalties without meeting the strict legal threshold of a material misrepresentation.

4.3. Dynamic Specification and Timing of Misconduct

Having established the baseline average effect in Table 2, we next examine the dynamic nature of this relationship. A potential concern with our primary specification is reverse causality, specifically, the possibility that firms alter their disclosure behavior in anticipation of pending regulatory action, or that inconsistency is merely a symptom of a deteriorating compliance environment that is already generating misconduct.

To address this, we estimate a dynamic specification that includes leads and lags of the independent variable, allowing us to trace the timing of the effect over a 10-year window centered on the event ($t-4$ to $t+5$). The results are plotted in Figure 2, with the primary specification ($t+1$) identified by the solid black triangle (▲).

The figure illustrates two critical patterns. First, the coefficients on the lag terms ($t-4$ to $t-1$) are small in magnitude and statistically indistinguishable from zero. This lack of a pre-trend supports the parallel trends assumption and suggests that the elevated probability of misconduct does not precede the disclosure of inconsistency.[8]

[8]One natural concern with this test is that the results could be driven by differences in statistical power, as observations are trimmed in the early and later years of the sample due to the use of lagged and forward variables. Indeed, the sample size is largest for our main test at $t+1$ (141,157 observations) and substantially smaller for $t-4$ and $t+5$ (69,553 observations). To address this concern, we rerun the analysis using a semi-balanced panel that requires RIAs to appear at least 10 times. This restriction mitigates the imbalance

Second, the impact of the disclosure manifests rapidly. The predictive power emerges marginally in the concurrent year t ($\beta = 0.004$, $p < 0.10$) and reaches its peak in magnitude and significance in the year immediately following the disclosure ($t + 1$). In this primary specification, the coefficient reaches 0.005 ($p < 0.01$), indicating a substantial increase in the likelihood of SEC action. The effect exhibits persistence, remaining statistically significant at the 10% level through $t + 2$, before gradually dissipating.

Collectively, the absence of significant pre-trends combined with the sharp post-disclosure increase in misconduct risk provides robust evidence that the inconsistency variable is not simply capturing pre-existing regulatory scrutiny, but rather serves as a leading indicator of future enforcement actions.

4.4. Regulatory Jurisdiction and Sanction Severity

We further explore the nature of the misconduct predicted by our measure. Table 3 examines whether *COI Inconsistent* predicts actions by other regulatory bodies. The results reveal a clear localization of the effect. While *COI Inconsistent* is a robust predictor of SEC actions (as shown in Table 2), it does not significantly predict *Civil Court Actions* ($t = 0.284$), *SRO Actions* ($t = 1.306$), or *Criminal Actions* ($t = 0.508$). This test suggests that our measure specifically isolates regulatory compliance failures—the type of fiduciary breaches prioritized by the SEC—rather than the broader forms of fraud or theft typically targeted by private litigants or criminal prosecutors.

Table 4 examines the severity of sanctions using a ranked outcome variable.[9] We find that *COI Inconsistent* predicts not just the occurrence but the *severity* of SEC sanctions. The coefficient is positive and significant for the overall severity rank (Column 1) ($\beta = 0.020$,

in observations between $t+1$ (81,104 observations) and $t-4$ and $t+5$ (53,355 observations). Our inferences remain unchanged when using this alternative sample.

[9]RIAs are required to file an additional disclosure form (DRP ADV) if they have a disciplinary history. We first retain cases in which sanctions are ordered and have a status of *final* or *on appeal*. If a case (reference) is filed multiple times, we retain the case with the earliest filing date. We then classify sanctions by severity rank. If multiple cases exist for a given RIA-year, we retain the case with the highest-severity sanction. Please refer to Appendix A for detailed variable definitions and the ranking of sanction severity.

$t = 2.995$) and for punitive outcomes, such as monetary penalties (Column 6) ($\beta = 0.020$, $t = 3.161$). This indicates that inconsistent disclosers do not merely commit minor procedural errors; they are significantly more likely to face serious, escalated sanctions.

Collectively, our results presented in Sections 4.2 and 4.4 are consistent with inconsistencies reflecting either a fundamental deficiency in internal monitoring capabilities or a strategic effort to obscure material conflicts of interest. The localization of enforcement to the SEC suggests that inconsistent disclosures signal a specific breakdown in the compliance infrastructure rather than blatant theft or criminal fraud. Whether this divergence stems from a calculated strategy to obscure conflicts or a genuine inability to maintain accurate records, it represents a failure of the internal control environment that triggers specialized SEC intervention while falling short of the legal thresholds required for criminal or civil prosecution. Crucially, because these semantic discrepancies serve as soft signals of risk rather than clear evidence of fraud, they are inherently difficult to detect through manual examination. This underscores the need for the automated framework we propose, which can systematically identify these subtle indicators of malfeasance that are likely to evade traditional oversight.

4.5. Determinants of Disclosure Inconsistency

Having established that disclosure inconsistencies serve as a robust leading indicator of enforcement actions, we next examine the firm-level determinants of this signal. Analyzing the characteristics of inconsistent advisers allows us to discriminate between benign reporting errors arising from organizational complexity and substantive disclosure failures driven by either deficient internal controls or agency conflict. Table 5 presents the results of regressing our inconsistency indicator (Column 1) and the underlying conflicted practices (Columns 2 and 3) on lagged firm characteristics. Three primary findings emerge from this analysis.

First, the results are inconsistent with the explanation that disclosure divergences arise from administrative errors in complex firms. If inconsistency were a byproduct of orga-

nizational complexity, we would expect a positive association with the *Complexity Indicator*. Conversely, we document a statistically significant negative coefficient ($\beta = -0.025$, $t = -9.817$). This result suggests that operationally sophisticated firms likely possess superior internal control environments that ensure reporting consistency. By contrast, inconsistencies are concentrated among less sophisticated firms that lack such infrastructure, a finding that supports the assumption that those are driven by weak controls.

Second, the coefficients on firm size exhibit a divergence that is consistent with incentives to minimize transparency. We find that *Log(Total AUM)* is positively associated with inconsistency ($\beta = 0.004$, $t = 5.585$), whereas *Log(Rep Employees)* is negatively associated ($\beta = -0.006$, $t = -5.768$). This contrast suggests that resource constraints act as a binding friction on reporting quality, as evidenced by the negative coefficient on staffing. However, the positive association with AUM, holding human capital constant, indicates that the probability of inconsistency increases with the scale of assets under management. This pattern identifies a specific profile of firms with high agency incentives to obscure conflicts yet disproportionately low investment in compliance infrastructure.

Third, our analysis demonstrates that our inconsistency measure captures a construct distinct from the underlying opportunity to engage in conflicted transactions. Columns (2) and (3) show that *Broker-Dealer* ($\beta = 0.325$, $t = 16.793$ and $\beta = 0.419$, $t = 20.966$) and *Hybrid Advisor* ($\beta = 0.229$, $t = 32.020$ and $\beta = 0.233$, $t = 32.406$) status are robust predictors of engaging in conflicted practices. However, these characteristics do not positively predict the inconsistency of the associated disclosures in Column (1). Specifically, *Broker-Dealer* status is statistically insignificant ($\beta = -0.003$, $t = -0.453$), and *Hybrid Advisor* status is negatively associated with inconsistency ($\beta = -0.037$, $t = -14.865$). This orthogonality confirms that the inconsistency measure does not simply proxy for high-risk business models but instead isolates a distinct dimension of reporting quality and compliance culture.

Taken together, these determinants lead us to reject the benign noise explanation for disclosure inconsistencies in favor of agency-based explanations. The evidence suggests that

disclosure inconsistencies are not benign byproducts of operational complexity, but rather symptoms of a specific governance failure: inconsistencies are most prevalent among firms that possess the financial incentive to extract rents (high AUM) but lack the commensurate internal controls (low staffing and complexity) to ensure accurate disclosure.

5. Mechanism Validation

Combined with the baseline results in Section 4.2 and the determinants evidence in Section 4.5, our findings show no evidence supporting the view that inconsistencies reflect benign administrative frictions. That is, disclosure inconsistencies do not merely represent random reporting errors or clerical oversight. Instead, now a central challenge in interpreting our results is distinguishing between weak internal controls, which imply incompetence, and strategic obfuscation, which implies intent. While both mechanisms predict misconduct, they suggest distinct policy responses. In this section, we investigate these alternative interpretations by examining whether the observed disclosure inconsistencies are more prevalent in settings consistent with the (1) *Strategic Obfuscation* channel, where advisors may have incentives to obfuscate information, relative to the (2) *Weak Controls* channel.

5.1. Proprietary Interests in Client Transactions

We first examine whether the agency costs associated with inconsistencies are amplified when the adviser has a direct financial stake in client transactions. We focus on this setting because proprietary trading represents one of the most acute forms of agency conflict. Unlike generic fee-based conflicts, trading as a principal places the adviser in a zero-sum game with the client, creating direct incentives for front running, inventory dumping, or favorable trade allocation (SEC, 2019b).

Reflecting this heightened risk, Section 206(3) of the Investment Advisers Act imposes strict procedural requirements on principal transactions, viewing them as inherently susceptible to abuse. Prior literature similarly identifies proprietary trading as a primary mechanism

for wealth transfer from clients to advisers. For instance, Fecht et al. (2018) provide evidence that dual registered firms systematically offload underperforming assets from their proprietary portfolios to retail client accounts, thereby transferring losses to investors. Accordingly, if disclosure inconsistencies reflect strategic obfuscation rather than weak internal controls or benign reporting errors, their predictive power should be concentrated in settings where advisers face strong incentives to conceal conflicts.

Table 6 reports the results of interacting *COI Inconsistent* with various forms of proprietary interest. The results strongly support the risk amplification channel. We find that the predictive power of inconsistency is significantly stronger when the adviser trades for its own account ($\beta = 0.025$, $t = 2.283$) or recommends securities in which it has a financial interest ($\beta = 0.010$, $t = 2.772$).

The magnitude of these coefficients is substantial. Compared to the baseline effect ($\beta \approx 0.005$), the presence of proprietary trading activities increases the predictive power of our measure by a factor of five. This pattern suggests that disclosure inconsistency is not merely a manifestation of weak internal controls; rather, its association with misconduct is conditional on the underlying economic incentives. When firms possess both the opportunity to extract rents (via proprietary trading) and the opacity to hide it (via inconsistent disclosures), the probability of enforcement action reaches its peak. In this sense, the evidence is most consistent with strategic obfuscation as the dominant mechanism underlying the observed relationship.

5.2. Client Composition and the Consequences of Disclosure Inconsistencies

We next examine whether the economic consequences of disclosure inconsistencies vary with the intensity of exposure across different client types. If disclosure inconsistencies serve as an obfuscation mechanism, theory predicts that investors with limited attention or high information-processing costs will have greater difficulty detecting them (Bloomfield, 2002; Hirshleifer and Teoh, 2003). While quantitative signals (e.g., returns) are relatively easy

to process, identifying qualitative inconsistencies across disclosures requires costly textual analysis (Engelberg, 2008; Li, 2008). As a result, advisers may have greater scope to exploit less sophisticated retail investors. To test this implication, we examine whether the effect of disclosure inconsistencies depends on the presence of retail versus non-retail clients, as measured by *per capita* (i.e., the average level of assets under management per client within each group).

Table 7 reports the results. We find a pronounced asymmetry across client types. The interaction between disclosure inconsistency and retail client per capita (Column 1) is positive and statistically significant ($\beta = 0.343$, $t = 2.475$), indicating that the association between inconsistency and subsequent enforcement becomes stronger as an adviser's exposure to retail clients increases on a per-client basis.[10] In contrast, the interaction between inconsistency and non-retail client per capita (Column 2) is statistically insignificant ($\beta = 0.005$, $t = 1.348$). When both interaction terms are included simultaneously (Column 3), the difference between the two effects remains statistically significant ($p = 0.024$).

These findings indicate that disclosure inconsistencies are most consequential in environments where advisers have greater scope to extract rents from less sophisticated clients (Blankespoor et al., 2020; Cohen et al., 2022). When a larger share of an adviser's business is derived from retail clients on a per-client basis, limited investor sophistication may reduce the effectiveness of monitoring and market discipline (Bushee, 1998; Bartov et al., 2000; Aragon, 2007; Sharma, 2023). Therefore, disclosure inconsistencies are more likely to persist and potentially enable advisers to engage in opportunistic behavior. In such environments, the combination of limited investor scrutiny and elevated agency conflicts may increase the likelihood of regulatory intervention. By contrast, when client relationships are concentrated among sophisticated or institutional investors on a per-client basis, disclosure inconsistencies

[10]For completeness, we re-estimate the model by decomposing retail client exposure into detailed categories. The inferences are consistent with the aggregated analysis. Specifically, the interaction between disclosure inconsistency and retail client exposure, measured by per-capita assets held by individual and high-net-worth clients, remains positive and statistically significant ($\beta = 9.335$, $t = 1.658$; and $\beta = 0.238$, $t = 1.835$).

appear less predictive of enforcement outcomes. Overall, the results suggest that the economic consequences of disclosure inconsistencies depend critically on the composition and sophistication of an adviser's client base rather than on the mere presence of inconsistencies. These results reinforce the interpretation that disclosure inconsistencies capture intentional concealment.

5.3. SEC vs. Client Facing Disclosure Incentives

We further probe the strategic obfuscation channel by examining whether the predictive power of disclosure inconsistencies varies with advisers' regulatory disclosure choices in Form ADV Part 1. Because Part 1 is primarily reviewed by regulators (the SEC), whereas Part 2 is designed for client consumption, disclosure inconsistencies can arise in either direction (SEC, 2026). To assess whether the association between inconsistencies and enforcement is concentrated in a particular regulatory context, we decompose our inconsistency measure (*COI Inconsistent*) conditional on whether the adviser reports conflicts of interest in the structured Part 1 filing.

Table 8 reports the results. We find that disclosure inconsistencies are strongly predictive of subsequent SEC enforcement when advisers acknowledge conflicts of interest in Part 1 but provide inconsistent disclosures across filings (Column 1). Specifically, the coefficient on *COI Inconsistent [Part 1 COI > 0]* is positive and statistically significant ($\beta = 0.006$, $t = 3.193$). In contrast, disclosure inconsistencies are not predictive of enforcement when advisers report no conflicts of interest in Part 1 (Column 2), with the corresponding coefficient *COI Inconsistent [Part 1 COI = 0]* being statistically insignificant ($\beta = -0.008$, $t = -1.080$). When both decomposed measures are included simultaneously (Column 3), the difference between the two effects remains statistically significant at the 10% level ($p = 0.076$).

Although this test does not directly observe the direction of semantic divergence, the asymmetric pattern is informative. The results suggest that the enforcement relevance of disclosure inconsistencies is concentrated among advisers that are transparent in regulator-

facing disclosures (Part 1) but provide conflicting information in client-facing narratives (Part 2). This evidence is difficult to reconcile with weak internal controls. Instead, when viewed in conjunction with the client composition results in Section 5.2, the findings are most consistent with strategic obfuscation or concealment toward clients.

5.4. Strategic Obfuscation and Regulatory Amnesty

Finally, we exploit the SEC's 2018 Share Class Selection Disclosure (SCSD) Initiative as a plausibly exogenous shock to the cost of disclosing COI inconsistencies. The initiative targeted the failure to disclose conflicts associated with 12b-1 fees. Because these fees function as a primary compensation mechanism for routing client assets, the enforcement drive directly implicated the underlying agency incentives for "steering" and broker selection (Item 8). By offering amnesty from *civil monetary penalties* for self-reported violations, the SEC effectively lowered the cost of revealing previously obfuscated conflicts, thereby raising the relative cost of maintaining inconsistent disclosures.

This setting generates two testable predictions. First, if disclosure inconsistencies are a strategic choice rather than a random administrative failure, firms should rectify these inconsistencies when the expected penalty for concealment increases. Second, as strategic firms correct their filings, the remaining pool of inconsistent disclosures should increasingly be dominated by benign errors, attenuating the signal's predictive power.

We first visualize the aggregate response to the shock using a high-frequency event study. Figure 3 plots the monthly mean of disclosure inconsistency centered around the announcement of the SCSD Initiative in February 2018 ($t = 0$). The figure reveals a sharp discontinuity: immediately following the announcement, the inconsistency rate exhibits a distinct downward step. This immediate response confirms that the aggregate improvement in disclosure quality was driven by a fundamental shift in the cost-benefit analysis of reporting. Prior to the amnesty, the expected cost of maintaining an inconsistency was low due to enforcement ambiguity. The SCSD Initiative effectively raised this cost by replacing that

ambiguity with a credible threat of penalties for non-reporters. Faced with a higher "shadow price" of obfuscation, strategic firms rationally responded by correcting their filings to avoid the now-elevated risk of enforcement.

We confirm this result statistically by regressing the inconsistency indicator, *COI Inconsistent*, on indicators for the amnesty window. Consistent with strategic correction, we document a significant decline in the prevalence of inconsistencies during the treatment period. The coefficient on *Window Treat* is negative and statistically significant ($\beta = -0.007, t = -3.57$), indicating that advisers endogenously improved disclosure quality in response to heightened enforcement risk. This result confirms that semantic inconsistencies are responsive to regulatory incentives, contradicting the explanation that they are merely sticky administrative frictions.

Next, we examine the implications for the predictive content of the signal. Table 9 interacts *COI Inconsistent* with the amnesty period indicators. In Column (1), we find no significant pre-trends prior to the initiative. In Column (2), however, the interaction term is negative and significant ($\beta = -0.008, t = -2.489$), indicating that the predictive power of disclosure inconsistencies vanishes during the amnesty window.

To further examine the dynamic pattern underlying these estimates, we decompose the pre- and post-shock periods into annual indicators and estimate a flexible event-time specification. Figure 4 plots the resulting coefficients, illustrating the changes in the association between disclosure inconsistencies and subsequent misconduct from the pre-amnesty period through the post-amnesty years. Consistent with the results in Table 6, the estimates show no statistically significant relationship prior to the SCSD amnesty (2015, 2016, and 2017), a significant decline during the amnesty window, and a reversion toward zero in the post-amnesty period (2021, 2022, and 2023).

These results support a selection mechanism whereby the amnesty induced strategic advisers to reveal their conflicts, leaving the remaining pool of inconsistent filers composed primarily of firms with non-strategic, idiosyncratic errors. Once the amnesty concluded and

the specific incentives for self-reporting expired, the predictive relation returned to baseline levels (Column 3). Collectively, the observed reduction in the quantity of inconsistencies accompanied by a degradation in their signal quality provides robust evidence that disclosure inconsistencies serve as a strategic mechanism for obfuscation.

6. Additional Tests

6.1. The Disclosure Inconsistency vs. Risky Business Models

A critical concern in interpreting our results is the potential for endogeneity driven by omitted variable bias. Specifically, one might argue that our inconsistency measure acts merely as a proxy for an inherently "risky" or aggressive business model. Firms that utilize affiliated brokers or steer clients to related parties (the underlying conflicts in Items 8.D and 8.F) face structurally higher agency costs and deeper regulatory scrutiny than fee-only advisers. If these aggressive firms are both more prone to misconduct due to their incentive structures *and* more likely to have low-quality reporting, then the observed correlation would be spurious—driven by the underlying business risk rather than the disclosure divergence itself.

To rule out this "risky firm" explanation, we perform a falsification test in Table 10. We decompose the *COI Inconsistent* variable to separate the economic activity (the conflict) from the reporting quality (the disclosure). This design creates a precise counterfactual comparison: we distinguish between firms that engage in the same high-risk practice but differ in their transparency.

We focus on the two specific practices identified in Form ADV Part 1 that trigger our inconsistency measure: *Discretionary Authority* over broker selection (Item 8.D) and *Recommending Brokers* (Item 8.F). Both practices involve the use of "related persons," creating a direct mechanism for self-dealing. We interact these binary indicators with our consistency measure to isolate three groups: firms that do not have the conflict (the baseline), firms that

have the conflict but disclose it consistently (the "Transparent" group), and firms that have the conflict but describe it inconsistently (the "Obfuscating" group).

The results provide an interesting validation of the U.S. "disclose-and-consent" regulatory regime. As shown in Columns (1) and (4), the baseline coefficients for the conflicted practices themselves are statistically indistinguishable from zero. Simply possessing the authority to route trades to an affiliate or recommending a related broker does not, on average, predict future enforcement. This suggests that the underlying "risky business model" is not the primary driver of misconduct.

Instead, the risk is entirely concentrated in the subset of firms that engage in the practice but fail to disclose it honestly. In Columns (2) and (5), we find that the interaction terms for inconsistency are positive and highly significant. For discretionary authority, disclosure inconsistencies significantly increase misconduct risk ($\beta = 0.005, t = 2.400$); for broker recommendations, the effect is even stronger ($\beta = 0.006, t = 2.844$). Crucially, transparency appears to neutralize the risk inherent in these conflicts. When firms engage in these high-agency-cost practices and consistently describe them in their narrative brochures, the predictive power vanishes. The coefficients for the "Consistent" interactions in Columns (3) and (6) are insignificant and even negative ($\beta = -0.001, t = -0.279$ and $\beta = -0.003, t = -1.469$). This finding mitigates the endogeneity concern: if our measure were simply picking up aggressive firms, both the transparent and obfuscating groups would show elevated risk. The fact that only the inconsistent group predicts fraud confirms that the signal is not the conflict of interest itself, but the specific failure to disclose it.

6.2. The Role of Adviser Size

Another potential endogeneity concern is that our results are driven by adviser size, as misconduct is known to be more prevalent among larger investment advisers (Egan et al.,

2019).[11] To address the concern that size-related differences in enforcement propensity drive our main results, we implement coarsened exact matching (CEM) to balance observations on adviser size (Iacus et al., 2012; Aneja et al., 2025). Specifically, we conduct two CEMs: (1) matching RIA-years on continuous AUM (*Log(Total AUM)*) and (2) matching on AUM quartiles. We then re-estimate our main specification on the matched (reweighted) samples. The results and inferences remain unchanged. In untabulated analyses, the coefficient on *COI Inconsistent* remains positive and significant when matching on continuous AUM ($\beta = 0.005$, $t = 2.722$) or AUM quartiles ($\beta = 0.005$, $t = 2.879$). These findings suggest that the predictive relationship between disclosure inconsistencies and regulatory enforcement is unlikely to be driven by the disproportionate incidence of misconduct and disclosure inconsistencies among larger advisers.

To further address the concern that differences in observable firm-year characteristics (beyond advisor size) drive our findings, we use entropy balancing to construct a matched sample (Hainmueller and Xu, 2013; Hainmueller, 2012). Specifically, we reweight firm-years without disclosure inconsistencies so that the distribution of observable firm-level controls matches that of firm-years with disclosure inconsistencies. We then re-estimate our main specification using the entropy-balancing weights. In untabulated analyses, the coefficient on *COI Inconsistent* remains positive and statistically significant ($\beta = 0.003$, $t = 2.001$), mitigating concerns that our results are driven by differences in observable firm-year characteristics.

[11] Consistent with Egan et al. (2019), we observe that enforcement actions are more frequent among large advisers in our sample. When we split RIAs into quartiles based on average assets under management (AUM), the mean probability of an SEC enforcement action (*SEC Action*) increases monotonically from 2% in the first quartile to 10% in the largest quartile. However, disclosure inconsistencies (*COI Inconsistent*) are relatively evenly distributed across size groups, with the mean ranging narrowly between 8% and 9% across all AUM quartiles.

6.3. Generalizability: Inconsistencies in Fees and Brokerage

While our primary analysis focuses on the high-agency-cost domain of broker selection and related-party affiliations, we investigate whether the predictive power of disclosure inconsistency extends to other critical financial disclosures. Specifically, we apply our AI framework to detect semantic divergences in two additional areas: *Brokerage Commissions* and *Wrap Fee Programs*.

Table 11 presents the results. In Column (1), we examine *Brokerage Comm. Inconsistent*, which flags contradictions regarding transaction-based compensation. This includes instances where an adviser admits in the structured filing to receiving commissions (Item 5.E) or having discretionary authority to set commission rates (Item 8.C.4), yet denies these practices in the narrative brochure. The coefficient is positive and significant ($\beta = 0.005, t = 2.20$).

We prioritize this setting because transaction-based compensation, specifically revenue sharing via 12b-1 fees, represents a classic agency conflict known as "steering." As highlighted by the SEC's 2018 *Share Class Selection Disclosure Initiative*, advisers have a financial incentive to recommend mutual fund share classes that pay a distribution fee (12b-1) over lower-cost institutional classes of the exact same fund (SEC, 2018b). Because the economic rationale for this behavior is the extraction of third-party kickbacks at the client's expense, a disclosure inconsistency here often masks a breach of the duty of best execution. By admitting receipt of sales compensation in the structured filing (to satisfy the regulator) while denying or omitting it in the client narrative, the adviser effectively hides the fact that their investment advice is biased by external payments. Consequently, these disclosure inconsistencies serve as a robust predictor of future enforcement.

In Column (2), we restrict our analysis to the subsample of advisers who affirmatively report sponsoring or participating in a wrap fee program (Item 5.I) and examine *Wrap Fee Inconsistent*. This variable specifically captures instances in which the adviser affirms

the bundled nature of the program in the structured data but describes the fees in the narrative as unbundled or subject to material exclusions. The results are consistent with our technique's prediction of misconduct: the coefficient is positive, significant, and economically large ($\beta = 0.020, t = 2.04$).

We prioritize this setting because wrap fee programs have been identified by regulators as a primary locus of structural conflict. As highlighted in the SEC's 2016 Risk Alert, these arrangements create incentives for "reverse churning", where advisers charge a bundled fee but trade infrequently to minimize their own execution costs, and "cost-shifting," where advisers steer clients into higher-expense mutual funds to avoid transaction fees (SEC, 2016, 2018a). Because the economic rationale of a wrap account is the consolidation of trading and advisory costs, a disclosure inconsistency here often masks a duplicate fee structure scheme in which the client pays the wrap fee but is surreptitiously charged the transaction costs the fee was supposed to cover. Consequently, observing disclosure inconsistencies in this domain serves as an exceptionally strong signal of future enforcement action.

7. Conclusion

This paper introduces a novel application of AI to financial regulation. By measuring the semantic inconsistency between what investment advisers report to regulators (Form ADV Part 1) and what they tell clients (Form ADV Part 2), we identify a robust, ex-ante predictor of future misconduct. Our findings suggest that disclosure inconsistency is not merely a clerical error but a leading indicator of either a weak control environment or strategic obfuscation.

We document that firms with inconsistent conflict disclosures are significantly more likely to face SEC enforcement actions. The economic magnitude of this signal is substantial: holding firm characteristics constant, a disclosure inconsistency increases the relative risk of enforcement by 11.5%. This predictive power is highly specific to federal regulatory interventions, predicting SEC orders and penalties, while remaining orthogonal to civil or

criminal litigation. This suggests our measure captures a distinct failure in the regulatory compliance environment rather than the blatant forms of theft or fraud typically targeted by private litigants.

Our analysis supports an agency-based explanation for these inconsistencies. The evidence is inconsistent with the interpretation that divergences are merely benign administrative errors, as the predictive power of the signal is magnified when advisers possess direct proprietary interests in client transactions. Furthermore, we find that the inconsistencies largely disappeared during the SEC's 2018 Amnesty initiative, a period when the regulatory cost of truthfulness was reduced, suggesting that these inconsistencies reflect strategic behavior responsive to incentives rather than sticky operational friction.

Finally, our results highlight the limits of market discipline for less sophisticated investors. We document that the association between inconsistency and misconduct is concentrated among advisers serving retail clients, who face higher information-processing costs and weaker monitoring capabilities. This divergence underscores the challenges of the "disclose-and-consent" regime: while the information is public, its contradictory nature prevents effective monitoring by the very investors it is designed to protect. We establish the generalizability of our approach by showing that inconsistencies in other high-risk domains, such as transaction-based compensation and wrap fee programs, serve as similarly powerful predictors. For regulators, these findings imply that automated supervisory tools can act as an efficiency mechanism, identifying high-risk firms by detecting the specific disclosure inconsistencies that characterize strategic obfuscation.

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Appendix A Variable Definitions

This appendix provides definitions for the variables used in the analysis.

Variable	Description
Main Independent Variable	
COI Inconsistent	Binary indicator equal to one if the LLM detects a semantic contradiction regarding broker-related conflicts. Specifically, it flags instances where Form ADV Part 1 affirms related-party authority (e.g., *Discretionary Auth. = Yes* (Item 8.C.3), *Discretionary Auth. Related = Yes* (Item 8.D), *Recommends Brokers = Yes* (Item 8.E), or *Recommends Brokers Related = Yes* (Item 8.F)), while the Part 2 narrative brochure (Part 2 Item 10 *Other Financial Industry Activities* or Item 12 *Brokerage Practices*) either explicitly denies such affiliations or materially omits the required conflict disclosures—or *vice versa*.
Other Independent Variable	
Brokerage Comm. Inconsistent	Binary indicator equal to one if the LLM detects a semantic contradiction regarding brokerage-related compensation or benefits. Specifically, it flags instances where the adviser affirms in Form ADV Part 1 that they receive commission-based compensation for the sale of securities (e.g., Item 5.E.5) or possess discretionary authority to determine commission rates (e.g., Item 8.C.4), or report receiving research or other products or services ("soft dollar benefits") from a broker-dealer or third party in connection with client securities transactions (e.g., Item 8.G.1), while Part 2 narrative brochure (Part 2 Item 5 *Fees and Compensation* or Item 12 *Brokerage Practices*) explicitly denies the corresponding practice or omits required disclosure—or *vice versa*.
Wrap Fee Inconsistent	Binary indicator equal to one if the LLM detects a semantic contradiction regarding the adviser's participation in wrap fee programs. Specifically, it flags instances where the adviser affirms involvement in a wrap fee program in Form ADV Part 1 (e.g., Item 5.I), while the Part 2 narrative brochure (Part 2 Item 5 *Fees and Compensation*) contains contradictory language implying that fees are not bundled or that material unbundled costs exist, conflicting with the definition of the program reported in the structured filing—or *vice versa*.
SEC Enforcement Actions	
SEC Action	Indicator equal to one if the adviser reports any enforcement-related action initiated by the SEC or the CFTC (Item 11.C).
False Statement	Indicator equal to one if the adviser reports that the SEC or the CFTC found that the adviser or any advisory affiliate made a false statement or an omission of material fact (Item 11.C.1).
Regulatory Violation	Indicator equal to one if the adviser reports that the SEC or the CFTC found that the adviser or any advisory affiliate was involved in a violation of SEC or CFTC regulations or statutes (Item 11.C.2).
Restricted Activity	Indicator equal to one if the adviser reports that the SEC or the CFTC found that the adviser or any advisory affiliate caused an investment-related business to lose its authorization to do business or to be restricted (Item 11.C.3).
Order Entered	Indicator equal to one if the adviser reports that the SEC or the CFTC entered an order against the adviser or any advisory affiliate in connection with an investment-related activity (Item 11.C.4).

Impose Penalty	Indicator equal to one if the adviser reports that the SEC or the CFTC imposed a civil penalty or ordered the adviser or any advisory affiliate to cease and desist, be censured, or disgorge funds (Item 11.C.5).
Other Regulatory Actions	
Any Agency Action	Indicator equal to one if the adviser reports an action initiated by a regulatory agency other than the SEC or the CFTC (e.g., State regulators) (Item 11.D).
Civil Court Action	Indicator equal to one if the adviser reports any civil judicial action (Item 11.H).
SRO Action	Indicator equal to one if the adviser reports any action by a Self-Regulatory Organization (e.g., FINRA) or commodities exchange (Item 11.E).
Criminal Action	Indicator equal to one if the adviser reports any criminal regulatory action (Item 11.A or 11.B).
Sanction Severity Ranks	
Sanction Severity Rank	A categorical variable ranging from 0 to 7 representing the maximum severity of the sanction, where higher values indicate more severe penalties and 0 indicates no action. Specifically, sanctions are ranked as follows: *Censure* (1), *Monetary Sanction or Monetary Amount* (2), *Cease and Desist/Injunction* (3), *Disgorgement/Restitution* (4), *Suspension* (5), *Bar* (6), and *Revocation/Expulsion/Denial* (7). Applied to each enforcement type (e.g., *Any SEC Rank*, *False Statement Rank*, *Regulatory Violation Rank*, *Restricted Activity Rank*, *Order Entered Rank*, *Impose Penalty Rank*).
Part 2 Characteristics	
Number of Pages	Number of pages in the Form ADV Part 2 disclosure. If there are multiple filings in a given year, the median value is used.
Adviser Characteristics	
Log(Total AUM)	The natural logarithm of the adviser's total regulatory assets under management (Item 5.F.2c).
Log(Rep Employees)	The natural logarithm of one plus the number of employees registered with one or more state securities authorities as investment adviser representatives (Item 5.B.3).
Discretionary Assets %	The percentage of AUM over which the adviser has discretionary authority (Item 5.F.2a).
Non-US Assets %	The percentage of AUM attributable to non-United States clients (Item 5.F.3).
Broker-Dealer	Indicator equal to one if the adviser is actively engaged in business as a broker-dealer (Item 6.A.1).
Hybrid Advisor	Indicator equal to one if the adviser is not a broker-dealer but employs registered representatives of a broker-dealer or has any employee who is a registered representative of a broker-dealer (Items 6.A.2 or 7.A.1).
Complexity Indicator	Indicator equal to one if the adviser reports engagement in at least one complex business activity or affiliation, including advising a registered investment company; advising a pooled investment vehicle; acting as a sponsor, general partner, or managing member of a pooled investment vehicle; acting as a commodity pool operator, future commission merchant, real estate broker, insurance broker, banking institution, trust company, accountant, or lawyer; or selling products or services to advisory clients (Items 5.K.2-3, 6.A.3-14, 6.B.3, or 7.B).
Business Practices and Proprietary Interests	

Discretionary Auth.	Indicator equal to one if the adviser reports having discretionary authority to determine the broker-dealer to be used for client transactions (Item 8.C.3).
Discretionary Auth. Related	Indicator equal to one if the adviser answered "yes" to Item 8.C.3 above (*Discretionary Auth.*), and if any of the brokers or dealers selected are related persons (Item 8.D).
Recommends Brokers	Indicator equal to one if the adviser or a related person recommends brokers or dealers to clients (Item 8.E).
Recommends Brokers Related	Indicator equal to one if the adviser answered "yes" to Item 8.E above (*Recommends Brokers*), and if any of the brokers or dealers selected are related persons (Item 8.F).
Any Proprietary Interest	Indicator equal to one if the adviser reports any proprietary interest in client transactions (Item 8.A).
Trades for Own Account	Indicator equal to one if the adviser buys or sells securities for its own account that it also recommends to clients (Item 8.A.1).
Recommends with Interest	Indicator equal to one if the adviser recommends securities in which it or a related person has a material financial interest (Item 8.A.2).

Appendix B Examples of Disclosure Inconsistencies

This appendix illustrates a specific example of the disclosure inconsistencies analyzed in our study. Panel A presents the structured Form ADV Part 1A data for a sample firm, where the adviser affirmatively discloses having discretionary authority to select brokers (Item 8.C.3) and utilizing "related person" brokers (Item 8.D/F), indicating a clear self-dealing incentive. Panel B displays the corresponding narrative brochure (Form ADV Part 2A) for the exact same firm. Despite the admission in the structured filing, the narrative explicitly denies arrangements with affiliated entities in Item 10 and marks brokerage practices as "Not Applicable" in Item 12. This contradiction serves as our primary proxy for strategic obfuscation.

Panel A: Form ADV Part 1A (Structured Regulatory Filing)

Item 8 Participation or Interest in Client Transactions

In this Item, we request information about your participation and interest in your clients' transactions. This information identifies additional areas in which conflicts of interest may occur between you and your clients. Like Item 7, Item 8 requires you to provide information about you and your related persons, including foreign affiliates.

	Yes	No
C. Do you or any related person have discretionary authority to determine the:		
(3) broker or dealer to be used for a purchase or sale of securities for a client's account?	X	
D. If you answer "yes" to C.(3) above, are any of the brokers or dealers related persons?	X	
E. Do you or any related person recommend brokers or dealers to clients?	X	
F. If you answer "yes" to E. above, are any of the brokers or dealers related persons?	X	

Panel B: Form ADV Part 2A (Client Brochure)



Firm Brochure
(Part 2A of Form ADV)

Item 10

Other Financial Industry Activities and Affiliations

Financial Industry Activities

The Company is a registered investment adviser with the Securities and Exchange Commission.

The Japan branch of Invesco Global Real Estate Asia Pacific, Inc. is regulated by the Japan Financial Services Agency (the "**FSA**") and the Ministry of Land, Infrastructure, Transport and Tourism (the "**MLIT**"). In connection therewith, the Company maintains the following licenses and registrations in Japan: (i) Financial Instruments and Exchange Business Operator (Registration No. 583); (ii) Money Lending Business License (Registration No. 23938); (iii) Real Estate Transaction Business License (Registration No. 79625); (iv) Discretionary Transaction Agent License (Registration No. 78).

The Company has no arrangements with affiliated entities that operate as a broker-dealer, investment company, futures commission merchant, commodity pool operator or commodity trading adviser, banking or thrift institution, insurance company or agency and any entity that creates or packages limited partnerships.

Item 12

Brokerage Practices

Not Applicable.

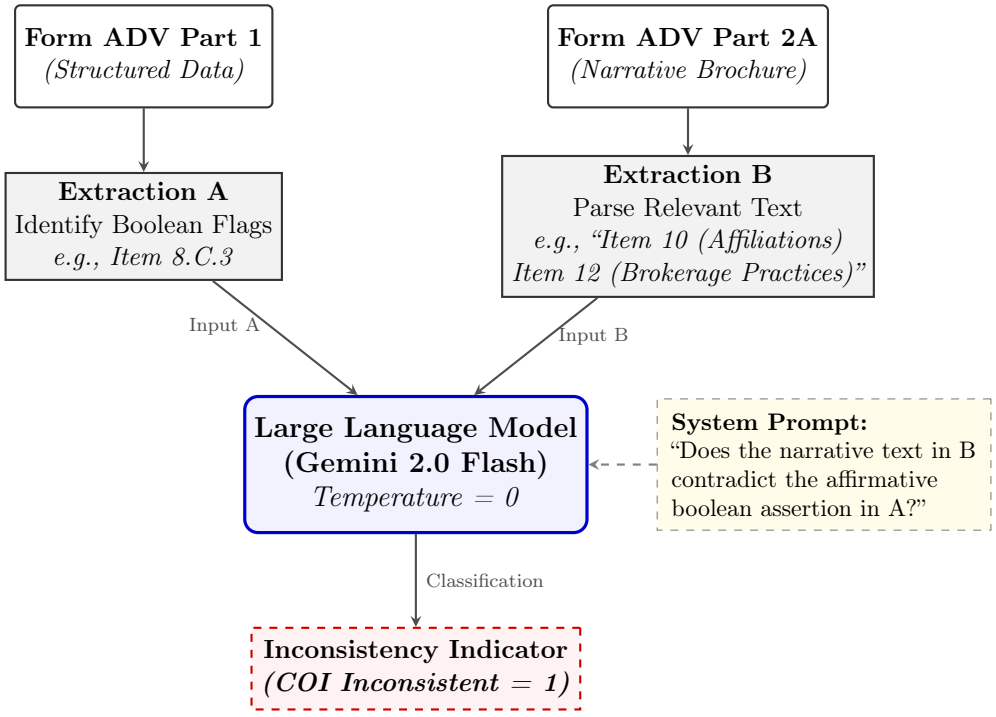


Figure 1. **AI-Based Inconsistency Detection Framework.** This figure illustrates the construction of our primary independent variable, *COI Inconsistent*. We extract structured boolean responses from Form ADV Part 1 (Input A) and corresponding narrative disclosures from Part 2 (Input B). A Large Language Model (LLM) compares these inputs using a strict validation prompt to detect semantic contradictions where the narrative denies or omits a conflict admitted in the structured filing.

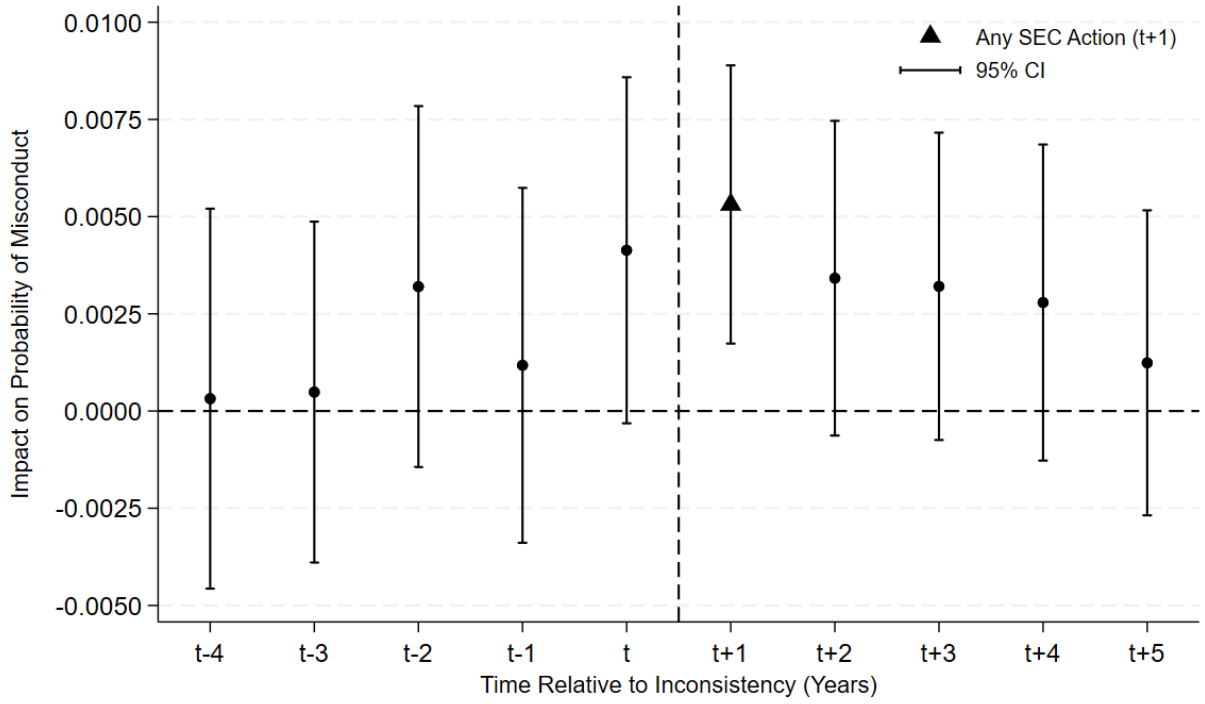


Figure 2. **Dynamic Predictability of Misconduct (Expanded Horizon).** This figure plots the estimated OLS coefficients of *COI Inconsistent* predicting *Any SEC Action* over a 10-year window centered on the disclosure event ($t-4$ to $t+5$). The solid black triangle (▲) represents our primary specification ($t+1$), corresponding to Column (1) of Table 2. Vertical bars indicate 95% confidence intervals. The coefficients for the pre-trend years ($t-4$ to $t-1$) are statistically insignificant, providing evidence against reverse causality. The predictive power emerges slightly in t ($\beta = 0.004$, $p = 0.069$), is the strongest in $t+1$ ($\beta = 0.005$, $p = 0.004$) and persists through $t+2$ ($p = 0.098$).

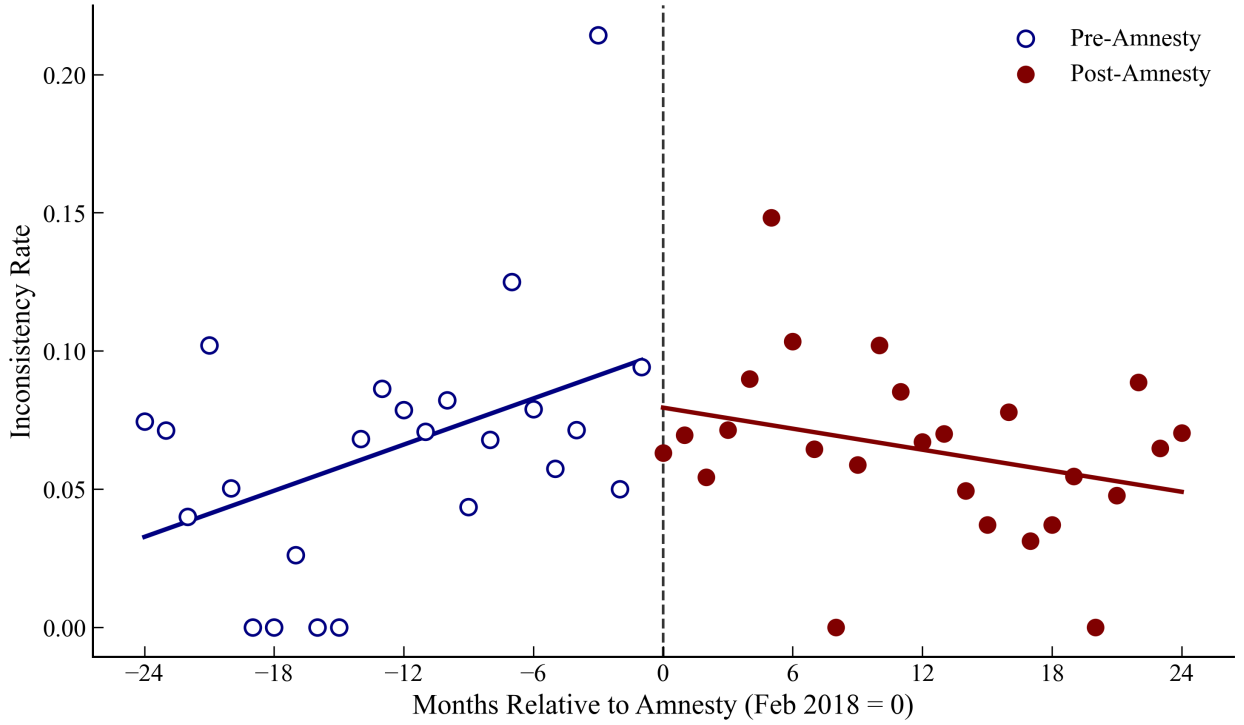


Figure 3. High-Frequency Event Study of Disclosure Inconsistency Around the Amnesty Announcement. This figure presents a monthly event study examining the impact of the SEC's Share Class Selection Disclosure (SCSD) Initiative on disclosure behavior. The horizontal axis represents time in months centered around the amnesty announcement, where $t = 0$ corresponds to February 2018. The vertical axis plots the monthly mean of *COI Inconsistent*, the rate of semantic divergences between Form ADV Part 1 and Part 2. Hollow circles (blue) represent the pre-amnesty period ($t < 0$), and solid circles (maroon) represent the post-amnesty period ($t \geq 0$). The solid lines represent linear fits estimated separately for the pre- and post-announcement periods. The sharp discontinuity at $t = 0$ illustrates that the amnesty effectively increased the expected cost of maintaining an inconsistency. By replacing enforcement ambiguity with a credible threat, the initiative raised the "price" of obfuscation, inducing an immediate structural break in disclosure practices as firms corrected their filings to avoid penalties.

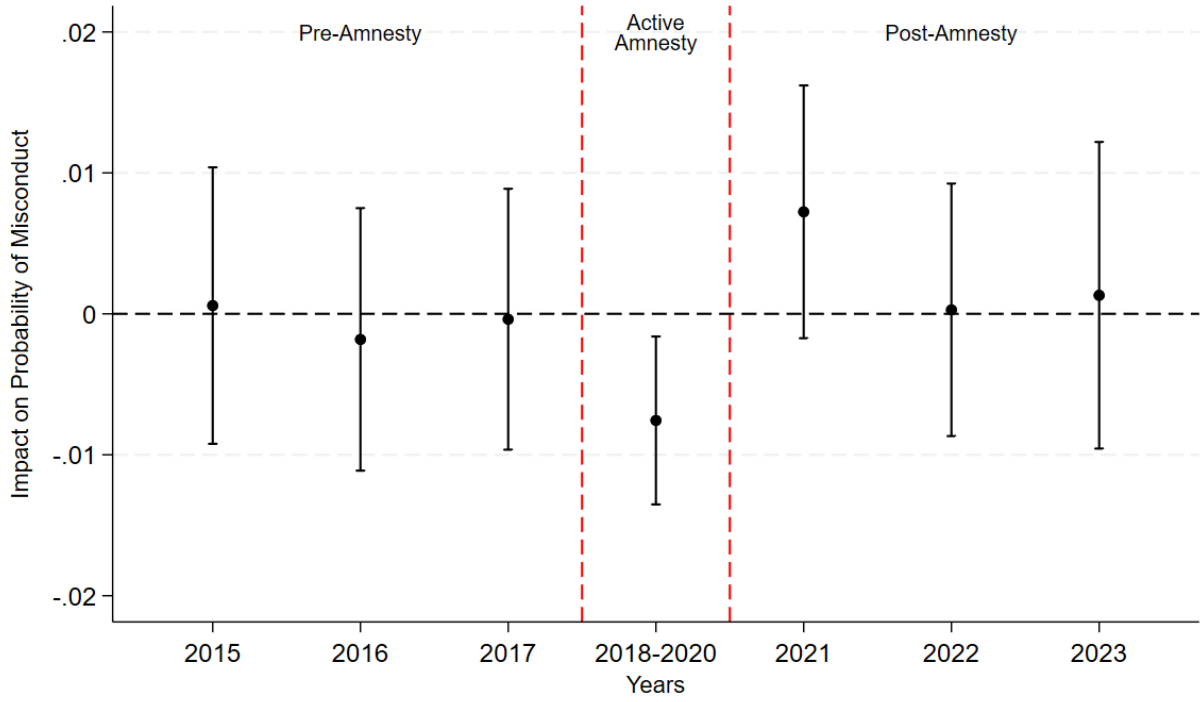


Figure 4. Temporal Pattern of Misconduct Around the Amnesty Period. This figure plots the estimated OLS coefficients from regressions of *Any SEC Action* on the interaction between lagged *COI Inconsistent* and windows surrounding the SEC's Share Class Selection Disclosure (SCSD) Initiative. The coefficients measure how the predictive association between prior conflicts and subsequent misconduct varies across years. Vertical bars indicate 95% confidence intervals. The estimates for the pre-amnesty period (2014–2017) are statistically indistinguishable from zero, indicating no differential pre-trend. During the amnesty window (2018–2020), which corresponds to Column (2) of Table 9, the coefficient becomes negative and statistically significant ($\beta = -0.008$, $p = 0.013$). This is consistent with a decline in the predictive content of conflict indicators as firms strategically self-reported under the amnesty. In the post-amnesty period (2021–2023), the coefficient reverts toward zero, suggesting that the temporary attenuation in predictive power dissipates once the regulatory incentive expires.

Table 1. Descriptive Statistics of Investment Adviser Misconduct and Characteristics

This table reports summary statistics for all variables used in the analysis. The sample consists of investment advisers registered with the SEC. The table reports binary indicators for SEC enforcement actions and actions by other regulatory bodies. It reports Part 2 disclosure characteristics and classifies SEC misconduct into specific types (Conflict vs. Non-Conflict). Finally, it reports lagged firm characteristics, business practices, and proprietary interest variables. All continuous variables are winsorized at the 1st and 99th percentiles. Please refer to Appendix A for variable definitions.

Variable	N	Mean	SD	Min	p25	p50	p75	Max
Disclosure Inconsistencies								
COI Inconsistent$_{t-1}$	141,157	0.087	0.282	0.000	0.000	0.000	0.000	1.000
Brokerage Comm. Inconsistent$_{t-1}$	141,157	0.140	0.347	0.000	0.000	0.000	0.000	1.000
Wrap Fee Inconsistent$_{t-1}$	141,157	0.024	0.154	0.000	0.000	0.000	0.000	1.000
SEC Enforcement Actions								
SEC Action$_t$	141,157	0.046	0.210	0.000	0.000	0.000	0.000	1.000
False Statement$_t$	141,157	0.015	0.121	0.000	0.000	0.000	0.000	1.000
Regulatory Violation$_t$	141,157	0.044	0.206	0.000	0.000	0.000	0.000	1.000
Restricted Activity$_t$	141,157	0.001	0.037	0.000	0.000	0.000	0.000	1.000
Order Entered$_t$	141,157	0.040	0.197	0.000	0.000	0.000	0.000	1.000
Impose Penalty$_t$	141,157	0.044	0.204	0.000	0.000	0.000	0.000	1.000
Other Regulatory Actions								
Any Agency Action$_t$	141,157	0.076	0.264	0.000	0.000	0.000	0.000	1.000
Civil Court Action$_t$	141,157	0.018	0.134	0.000	0.000	0.000	0.000	1.000
SRO Action$_t$	141,157	0.050	0.219	0.000	0.000	0.000	0.000	1.000
Criminal Action$_t$	141,157	0.012	0.110	0.000	0.000	0.000	0.000	1.000
Part 2 Characteristics								
Number of Pages$_{t-1}$	141,157	23.383	11.554	8.000	16.000	21.000	28.000	73.000
Adviser Characteristics								
Total AUM (in Billions)$_{t-1}$	141,157	4.100	14.930	0.007	0.155	0.366	1.356	115.730
Log(Total AUM)$_{t-1}$	141,157	20.069	1.789	15.725	18.858	19.717	21.028	25.475
Rep Employees$_{t-1}$	141,157	6.117	21.191	0.000	0.000	1.000	4.000	175.000
Log(Rep Employees)$_{t-1}$	141,157	0.966	1.124	0.000	0.000	0.693	1.609	5.170
Discretionary Assets %$_{t-1}$	141,157	0.866	0.279	0.000	0.912	1.000	1.000	1.000
Non-US Assets %$_{t-1}$	141,157	0.075	0.232	0.000	0.000	0.000	0.000	1.000
Broker-Dealer$_{t-1}$	141,157	0.031	0.173	0.000	0.000	0.000	0.000	1.000
Hybrid Advisor$_{t-1}$	141,157	0.188	0.391	0.000	0.000	0.000	0.000	1.000
Complexity Indicator$_{t-1}$	141,157	0.622	0.485	0.000	0.000	1.000	1.000	1.000
Business Practices and Proprietary Interests								
Discretionary Auth.$_{t-1}$	141,157	0.656	0.475	0.000	0.000	1.000	1.000	1.000
Recommends Brokers$_{t-1}$	141,157	0.681	0.466	0.000	0.000	1.000	1.000	1.000
Any Proprietary Interest$_{t-1}$	141,157	0.822	0.382	0.000	1.000	1.000	1.000	1.000
Trades for Own Account$_{t-1}$	141,157	0.080	0.272	0.000	0.000	0.000	0.000	1.000
Recommends with Interest$_{t-1}$	141,157	0.788	0.408	0.000	1.000	1.000	1.000	1.000

Table 2. Conflicts of Interest and SEC Enforcement Actions

This table examines the relationship between disclosed conflicts of interest and SEC enforcement actions. The dependent variables are binary indicators equal to one if the firm was subject to the specific SEC action indicated in the column header. The main independent variable, COI Inconsistent, is an indicator for disclosure inconsistencies regarding conflicts of interest. All independent variables are lagged by one year ($t-1$). Controls include firm size (AUM, employees), client composition, and business complexity. Standard errors are clustered at the firm level (t-statistics in parentheses). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Dependent Variable	*SEC Enforcement Type*					
	(1) SEC Action	(2) False Statement	(3) Regulatory Violation	(4) Restricted Activity	(5) Order Entered	(6) Impose Penalty
COI Inconsistent$_{t-1}$	**0.005*** **	**0.002**	**0.005*** **	**0.001** **	**0.005*** **	**0.006*** **
	(2.910)	**(1.153)**	**(2.745)**	**(2.398)**	**(2.687)**	**(3.041)**
Log(Total AUM)$_{t-1}$	-0.000	0.000	0.000	-0.000	-0.000	-0.000
	(-0.077)	(0.414)	(0.182)	(-1.002)	(-0.050)	(-0.196)
Log(Rep Employees)$_{t-1}$	0.002	0.004***	0.002	-0.000	0.002	0.002
	(1.190)	(2.973)	(1.167)	(-0.461)	(1.434)	(1.189)
Discretionary Assets %$_{t-1}$	0.007	0.006	0.007	0.001	0.007	0.007
	(1.250)	(1.604)	(1.284)	(0.750)	(1.394)	(1.294)
Non-US Assets %$_{t-1}$	-0.002	-0.005	0.001	0.002**	-0.002	-0.003
	(-0.419)	(-1.550)	(0.132)	(2.075)	(-0.506)	(-0.578)
Broker-Dealer$_{t-1}$	0.003	0.006	-0.004	-0.002	0.006	0.004
	(0.132)	(0.466)	(-0.237)	(-1.097)	(0.340)	(0.220)
Hybrid Advisor$_{t-1}$	0.016***	0.008***	0.016***	0.000	0.013***	0.016***
	(3.785)	(3.114)	(3.702)	(0.396)	(3.106)	(3.741)
Complexity Indicator$_{t-1}$	-0.003	-0.002	-0.001	-0.000	-0.002	-0.002
	(-1.286)	(-1.038)	(-0.558)	(-0.085)	(-1.065)	(-1.074)
Firm Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	141,157	141,157	141,157	141,157	141,157	141,157
R^2	0.724	0.643	0.724	0.635	0.727	0.718

Table 3. Misconduct by Regulatory Agency Type

This table reports regression results for misconduct actions initiated by regulatory bodies other than (or in addition to) the SEC. The dependent variables are binary indicators for actions by Any Agency, Civil Courts, Self-Regulatory Organizations (SROs), or Criminal authorities. The independent variable of interest is *COI Inconsistent*. All independent variables are lagged by one year ($t-1$). Controls include firm size, discretionary assets, and client composition. Standard errors are clustered at the firm level (t-statistics in parentheses). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Dependent Variable	*Regulatory Body / Action Type*			
	(1) Any Agency Action	(2) Civil Court Action	(3) SRO Action	(4) Criminal Action
COI Inconsistent$_{t-1}$	**0.002**	**0.000**	**0.002**	**0.001**
	(1.184)	**(0.284)**	**(1.306)**	**(0.508)**
Log(Total AUM)$_{t-1}$	0.005***	0.001	0.001	0.000
	(3.407)	(0.586)	(0.440)	(0.565)
Log(Rep Employees)$_{t-1}$	0.003**	-0.001	0.005***	0.001
	(2.233)	(-1.003)	(3.059)	(1.403)
Discretionary Assets %$_{t-1}$	0.004	-0.000	-0.001	-0.003
	(0.632)	(-0.030)	(-0.319)	(-0.969)
Non-US Assets %$_{t-1}$	0.027***	0.002	0.007	0.006**
	(4.722)	(0.662)	(1.577)	(1.961)
Broker-Dealer$_{t-1}$	0.055***	-0.004	0.046**	0.006
	(3.164)	(-0.486)	(2.327)	(0.744)
Hybrid Advisor$_{t-1}$	0.035***	0.007***	0.024***	0.002
	(6.499)	(3.365)	(5.600)	(0.892)
Complexity Indicator$_{t-1}$	-0.001	-0.001	-0.003	0.000
	(-0.304)	(-0.692)	(-1.232)	(0.063)
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Observations	141,157	141,157	141,157	141,157
R^2	0.818	0.753	0.823	0.674

Table 4. Severity of SEC Sanctions (Ranked)

This table examines the severity of SEC sanctions. The dependent variables are ranked variables representing the maximum severity of the specific sanction type, where higher values indicate more severe penalties. The independent variable is *COI Inconsistent*. All independent variables are lagged by one year ($t-1$). Standard errors are clustered at the firm level (t-statistics in parentheses). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Dependent Variable	*Sanction Severity Rank*					
	(1) SEC Rank	(2) False Statement Rank	(3) Regulatory Violation Rank	(4) Restricted Activity Rank	(5) Order Entered Rank	(6) Impose Penalty Rank
COI Inconsistent$_{t-1}$	**0.020*** **	**0.007**	**0.018*** **	**0.002**	**0.017*** **	**0.020*** **
	(2.995)	**(1.468)**	**(2.827)**	**(1.438)**	**(2.668)**	**(3.161)**
Log(Total AUM)$_{t-1}$	-0.005	0.001	-0.001	-0.000	-0.004	-0.004
	(-0.958)	(0.445)	(-0.270)	(-0.458)	(-0.770)	(-0.844)
Log(Rep Employees)$_{t-1}$	0.001	0.005	0.000	-0.000	0.002	0.001
	(0.254)	(1.312)	(0.086)	(-0.019)	(0.428)	(0.098)
Discretionary Assets %$_{t-1}$	0.009	0.010	0.009	0.003	0.012	0.008
	(0.539)	(0.968)	(0.531)	(1.071)	(0.725)	(0.452)
Non-US Assets %$_{t-1}$	-0.009	0.001	-0.000	0.006**	-0.005	-0.008
	(-0.505)	(0.067)	(-0.018)	(2.103)	(-0.278)	(-0.462)
Broker-Dealer$_{t-1}$	-0.045	-0.008	-0.062	-0.001	-0.056	-0.046
	(-0.714)	(-0.183)	(-1.029)	(-0.448)	(-0.959)	(-0.743)
Hybrid Advisor$_{t-1}$	0.034**	0.006	0.034**	-0.002	0.022*	0.034**
	(2.514)	(0.991)	(2.501)	(-0.437)	(1.684)	(2.503)
Complexity Indicator$_{t-1}$	-0.009	-0.001	-0.006	0.000	-0.007	-0.008
	(-1.134)	(-0.140)	(-0.771)	(0.051)	(-0.899)	(-1.048)
RIA Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	141,157	141,157	141,157	141,157	141,157	141,157
R^2	0.672	0.580	0.671	0.626	0.668	0.670

Table 5. Determinants of Disclosure Inconsistency and Conflicted Practices

This table presents a determinants test examining which underlying adviser characteristics are associated with disclosure inconsistencies and business practices. The dependent variable in Column (1) is *COI Inconsistent*, a binary indicator equal to one if the LLM detects a semantic contradiction regarding broker-related conflicts. Columns (2) and (3) model the specific conflicted practices identified in Form ADV Part 1: *Discretionary Auth. Related* (Indicator equal to one if the adviser affirms having discretionary authority to select related persons as brokers, Item 8.D) and *Recommends Brokers Related* (Indicator equal to one if the adviser affirms that they or a related person recommends related brokers to clients, Item 8.F). All independent variables are lagged by one year ($t-1$). Standard errors are clustered at the firm level (t-statistics in parentheses). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Dependent Variable:	(1) COI Inconsistent	(2) Discretionary Auth. Related	(3) Recommends Brokers Related
Log(Total AUM)$_{t-1}$	0.004***	0.007***	-0.000
	(5.585)	(5.499)	(-0.325)
Log(Rep Employees)$_{t-1}$	-0.006***	0.006***	0.026***
	(-5.768)	(3.263)	(12.302)
Discretionary Assets %$_{t-1}$	0.015***	0.029***	-0.010*
	(3.787)	(6.083)	(-1.871)
Non-US Assets %$_{t-1}$	0.006	0.041***	0.033***
	(1.346)	(6.687)	(5.979)
Broker-Dealer$_{t-1}$	-0.003	0.325***	0.419***
	(-0.453)	(16.793)	(20.966)
Hybrid Advisor$_{t-1}$	-0.037***	0.229***	0.233***
	(-14.865)	(32.020)	(32.406)
Complexity Indicator$_{t-1}$	-0.025***	-0.011***	-0.008***
	(-9.817)	(-3.926)	(-2.852)
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	No	No	No
Observations	136,529	141,157	141,157
R^2	0.008	0.206	0.248

Table 6. Proprietary Interest in Client Transactions

This table examines whether the predictive power of conflict inconsistency is amplified when the adviser engages in specific proprietary transactions (Form ADV Part 1, Item 11). We interact our inconsistency measure with indicators for having Any Proprietary Interest (Column 1), Trading for Own Account (Column 2), and Recommending Securities with Interest (Column 3). All independent variables are lagged by one year ($t-1$). Standard errors are clustered at the firm level (t-statistics in parentheses). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Dependent Variable:	(1) SEC Action	(2) SEC Action	(3) SEC Action
COI Inconsistent$_{t-1}$	0.001	0.003*	-0.003
	(0.197)	(1.951)	(-0.859)
Any Proprietary Interest$_{t-1}$	-0.001		
	(-0.279)		
COI Inconsistent$_{t-1}\times$ Any Prop. Interest$_{t-1}$	**0.006***		
	(1.659)		
Trades for Own Account$_{t-1}$		-0.001	
		(-0.091)	
COI Inconsistent$_{t-1}\times$ Trades for Own Account$_{t-1}$		**0.025****	
		(2.283)	
Recommends with Interest$_{t-1}$			-0.005
			(-1.155)
COI Inconsistent$_{t-1}\times$ Recommends with Interest$_{t-1}$			**0.010*****
			(2.772)
Controls	Yes	Yes	Yes
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Observations	141,157	141,157	141,157
R^2	0.724	0.724	0.724

Table 7. The Role of Investor Composition

This table examines whether the effect of disclosure inconsistency varies with the intensity of client exposure, measured by per-capita client assets. The dependent variable is *SEC Action*, a binary indicator equal to one if the firm was subject to the any SEC enforcement action. The interaction variable *Retail Per Capita* is the average of two per-client measures: (i) assets under management per individual client and (ii) assets under management per high–net-worth individual client. Similarly, *Non-Retail Per Capita* is defined as the average of per-client assets for all client categories other than individuals or high-net-worth individuals. *COI Inconsistent* is the indicator for disclosure contradictions in year $t-1$. All independent variables are lagged by one year. Standard errors are clustered at the firm level, and t-statistics are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

	Retail	**Non-Retail**	**Pooled Regression**
Dependent Variable:	(1) SEC Action	(2) SEC Action	(3) SEC Action
COI Inconsistent$_{t-1}$	-0.001	0.000	-0.001
	(-0.485)	(0.221)	(-0.339)
Retail Per capita$_{t-1}$	-0.342		-0.450
	(-1.315)		(-1.296)
COI Inconsistent$_{t-1}$× Retail Per capita$_{t-1}$ (a)	**0.343****		**0.418****
	(2.475)		**(2.275)**
Non-retail Per capita$_{t-1}$		0.004	0.004
		(0.769)	(0.198)
COI Inconsistent$_{t-1}$× Non-retail Per capita$_{t-1}$ (b)		**0.005**	**-0.001**
		(1.348)	**(-0.170)**
Controls	Yes	Yes	Yes
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Observations	42,296	57,585	34,189
R^2	0.877	0.886	0.881
Diff. Test (a) vs. (b) [p-value]			**[0.024]**

Table 8. Disclosure Inconsistencies Conditional on Part 1 COI Reporting

This table examines whether the association between disclosure inconsistencies and SEC enforcement varies with advisers' disclosures in Form ADV Part 1. We decompose the *COI Inconsistent* variable based on whether the adviser reports any conflict of interest related items in the Part 1 filing. The first component (*COI Inconsistent [Part 1 COI > 0]*) captures advisers that both report at least one conflict of interest item in Part 1 (Item 8.C.3; Item 8.D/E/F) and exhibit disclosure inconsistencies. The second component (*COI Inconsistent [Part 1 COI = 0]*) captures advisers that exhibit disclosure inconsistencies but report no conflict of interest related items in Part 1. All independent variables are lagged by one year. Standard errors are clustered at the firm level, and t-statistics are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

	Part 1 COI Reported	**Part 1 COI Not Reported**	**Pooled Regression**
Dependent Variable:	(1) SEC Action	(2) SEC Action	(3) SEC Action
COI Inconsistent [Part 1 COI > 0]$_{t-1}$ (a)	**0.006*** **		**0.006*** **
	(3.193)		**(3.180)**
COI Inconsistent [Part 1 COI = 0]$_{t-1}$ (b)		-0.008	-0.008
		(-1.080)	(-1.037)
Controls	Yes	Yes	Yes
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Observations	141,157	141,157	141,157
R^2	0.724	0.724	0.724
Diff. Test (a) vs. (b) [p-value]			**[0.076]**

Table 9. Strategic Obfuscation and Regulatory Amnesty

This table reports the results of interacting the disclosure inconsistency measure with specific time windows surrounding the SEC's Share Class Selection Disclosure (SCSD) Initiative. Column (1) tests a *Placebo* pre-shock window (Feb 2015–Feb 2018) to verify parallel trends. Column (2) tests the *Active Treatment* window (Feb 2018–Feb 2021), encompassing the announcement of the initiative and the subsequent settlement period. Column (3) tests the *Post-Shock* window (Feb 2021–Feb 2024) to test for effect persistence or dissipation. The dependent variable is *SEC Action*. *Shock Window* refers to the binary time-period indicator specific to each column. All independent variables are lagged by one year ($t-1$). Standard errors are clustered at the firm level (t-statistics in parentheses). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

	Placebo (Pre-Amnesty)	**Active Treatment** (Amnesty & Sweep)	**Post-Shock** (Return to Baseline)
	(1)	(2)	(3)
Dependent Variable:	SEC Action	SEC Action	SEC Action
COI Inconsistent$_{t-1}$	0.005***	0.007***	0.005**
	(2.789)	(3.390)	(2.320)
Shock Window	-0.008*	-0.001	-0.002
	(-1.906)	(-0.276)	(-0.518)
COI Inconsistent$_{t-1}$ × Shock Window	**-0.001**	**-0.008****	**0.004**
	(-0.183)	**(-2.489)**	**(1.002)**
Log(Total AUM)$_{t-1}$	-0.000	-0.000	-0.000
	(-0.076)	(-0.076)	(-0.076)
Log(Rep Employees)$_{t-1}$	0.002	0.002	0.002
	(1.189)	(1.184)	(1.196)
Discretionary Assets %$_{t-1}$	0.007	0.007	0.007
	(1.251)	(1.248)	(1.253)
Non-US Assets %$_{t-1}$	-0.002	-0.002	-0.002
	(-0.419)	(-0.422)	(-0.418)
Broker-Dealer$_{t-1}$	0.003	0.003	0.002
	(0.134)	(0.134)	(0.130)
Hybrid Advisor$_{t-1}$	0.016***	0.016***	0.016***
	(3.785)	(3.800)	(3.778)
Complexity Indicator$_{t-1}$	-0.003	-0.003	-0.003
	(-1.286)	(-1.284)	(-1.295)
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Observations	141,157	141,157	141,157
R^2	0.724	0.724	0.724

Table 10. Falsification test: Disentangling Business Risk from Disclosure Inconsistency

This table presents a falsification test to determine whether the predictive power of inconsistencies is driven by the underlying risk of the business model or the disclosure divergence itself. We decompose the *COI Inconsistent* variable into specific high-risk practices identified in Form ADV Part 1: Discretionary Authority over related brokers (Item 8.D, Columns 1-3) and Recommending related Brokers (Item 8.F, Columns 4-6). We isolate the effect of the conflict from the effect of the disclosure by decomposing the practice with our consistency indicator. This separates firms into three groups: those engaging in the practice (baseline), those engaging in the practice but describing it inconsistently (Inconsistent), and those engaging in the practice while describing it consistently (Consistent). All independent variables are lagged by one year ($t-1$). Standard errors are clustered at the firm level (t-statistics in parentheses). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

	Discretionary Authority			**Recommending Brokers**		
	(1)	(2)	(3)	(4)	(5)	(6)
Dependent Variable:	SEC Action	SEC Action	SEC Action	SEC Action	SEC Action	SEC Action
Discretionary Auth.$_{t-1}$	0.007					
	(1.332)					
Discretionary Auth. Inconsistent$_{t-1}$		**0.005****				
		(2.400)				
Discretionary Auth. Consistent$_{t-1}$			-0.001			
			(-0.279)			
Recommends Brokers$_{t-1}$				0.000		
				(0.076)		
Recommends Brokers Inconsistent$_{t-1}$					**0.006*****	
					(2.844)	
Recommends Brokers Consistent$_{t-1}$						-0.003
						(-1.469)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Firm Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	141,157	141,157	141,157	141,157	141,157	141,157
R^2	0.724	0.724	0.724	0.724	0.724	0.724

Table 11. Predictive Power of Other Disclosure Inconsistencies

This table examines the relationship between other types of disclosure inconsistencies and SEC enforcement actions. The dependent variable in both columns is *SEC Action*. The main independent variables are: (1) *Brokerage Comm. Inconsistent*: A binary indicator flagging semantic contradictions regarding brokerage-related compensation or benefits, including commission-based compensation or discretionary authority over commission rates (Items 5.E.5 and 8.C.4) or soft-dollar benefits (Item 8.G.1) and (2) *Wrap Fee Inconsistent*: A binary indicator flagging semantic contradictions regarding the adviser's participation in or management of wrap fee programs (Item 5.I). All independent variables are lagged by one year ($t-1$). Standard errors are clustered at the firm level (t-statistics in parentheses). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

	Brokerage Commissions	**Wrap Fees**
	(1)	(2)
Dependent Variable:	SEC Action	SEC Action
Brokerage Comm. Inconsistent$_{t-1}$	**0.005*** **	
	(2.954)	
Wrap Fee Inconsistent$_{t-1}$		**0.019** **
		(2.166)
Log(Total AUM)$_{t-1}$	-0.000	0.015*
	(-0.085)	(1.814)
Log(Rep Employees)$_{t-1}$	0.002	0.011**
	(1.180)	(2.171)
Discretionary Assets %$_{t-1}$	0.007	0.025
	(1.260)	(0.963)
Non-US Assets %$_{t-1}$	-0.002	-0.017
	(-0.411)	(-0.591)
Broker-Dealer$_{t-1}$	0.002	0.033
	(0.128)	(1.000)
Hybrid Advisor$_{t-1}$	0.016***	0.040***
	(3.738)	(4.108)
Complexity Indicator$_{t-1}$	-0.003	-0.024**
	(-1.338)	(-2.477)
Firm Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Observations	141,157	14,271
R^2	0.724	0.797