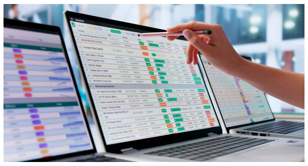

Compliance Update: SEC Moves to Rescind Pay-to-Play Rule for Investment Advisers

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We previously issued a client alert on the importance of the Securities and Exchange Commission's (SEC) pay-to-play rule, Rule 206(4)-5, in the current election season. Since then, the SEC has released its proposal to rescind its longstanding pay-to-play rule, which was adopted under the Investment Advisers Act of 1940, as amended, and governs political contributions made by investment advisers and their covered associates.

The SEC's rationale for the rescission is straightforward and unsurprising: undue complexity and burdens. In its proposal, published in the Federal Register on September 10, 2026, at 91 F.R. 57698, the SEC focused on four areas:

- First, Rule 206(4)-5 has led to the unintended consequence of investment advisers prohibiting all political contributions by their employees at the state and local level, which affects core political speech protected by the First Amendment.
- Second, Rule 206(4)-5 is operationally challenging to implement due to the overly broad definitions of covered associate and officials of government entities, as well as the substantial two-year look-back period for covered associates that solicit investment advisory business from government entities.
- Third, Rule 206(4)-5 may impose significant burdens that may not be justified by its benefits.
- Fourth, Rule 206(4)-5 lacks clarity and creates a *de facto* strict liability standard, which often means that small donations or foot faults potentially trigger the two-year prohibition on providing services for compensation.

If Rescinded, Compliance Obligations Remain

The SEC pointed out that it is not giving investment advisers a pass on pay-to-play practices. When contributions to government officials drive the award of contracts, rather than the competence and cost of investment advisers, such actions may result in public funds not being managed by the best available investment advisers or paying higher fees. Investment advisers engaging in pay-to-play practices have a conflict of interest with, and compromise their fiduciary duties to, their government clients and can defraud their government clients, prospective government clients, and public fund investors.

The SEC found that the existing requirements of the Investment Advisers Act can sufficiently address pay-to-play practices, given its prohibition on fraudulent, deceptive, and manipulative practices, the obligation of advisers to reasonably supervise advisory personnel, and the advisers' fiduciary duties. These requirements apply to investment advisers registered or required to be registered under Section 203 of the Investment Advisers Act, exempt reporting advisers, and foreign private advisers.

For investment advisers registered or required to be registered under Section 203, these requirements are bolstered by the compliance rule of 17 C.F.R. 275.206(4)-7 and the code of ethics rule of 17 C.F.R. 275.204A-1. The compliance rule requires advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Investment Advisers Act by the adviser and its supervised persons. The compliance rule also requires advisers to review, no less frequently than annually, the adequacy of those policies and procedures and the effectiveness of their implementation.

The code of ethics rule requires that the adviser's own code of ethics set forth the standard of business conduct that the adviser requires of all its supervised persons, while also requiring compliance with the adviser's fiduciary duties and federal securities laws.

What Investment Advisers Should Do Now

In light of the continuing prohibition on pay-to-play practices, investment advisers should continue to implement political contribution preclearance policies. Pending the SEC's final decision on its proposal, investment advisers should consider the following changes to their policies if Rule 206(4)-5 is rescinded:

- Cap contributions by covered associates to $2,000 per official of a government entity per election.
- Allow higher contribution amounts after a year has passed from the date the investment adviser entered into an investment management contract with the government entity, so long as the adviser has not solicited new or additional business from that government entity during that period.
- Allow higher contribution amounts to officials of government entities who only appoint another person who then participates in the selection of an investment adviser.
- Allow higher contribution amounts by an executive officer, including any vice president in charge of a principal business unit, division, or function, whose role does not involve soliciting business from government entities.
- Cap aggregate contributions by all covered associates at $20,000 to an official of a government entity per election.
- For covered associates who contribute more than $1,000 to an official of a government entity per election, prohibit solicitation of advisory business from officials of that government entity for six months after the contribution.
- For covered associates who intend to solicit more than $20,000 in contributions per election from third parties to an official of a government entity, prohibit solicitation of advisory business from officials of that government entity from the date of the first solicitation until six months after the election.
- Use a uniform six-month look-back period for all persons who become covered associates, regardless of the functions they perform.

If you have questions about your compliance obligations and preclearance policies with respect to political contributions, please contact the author or any attorney with FBT Gibbons' Fund Formation and Management team for further guidance.