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The Rule That Never Caught a Crook: The SEC Moves to Repeal the Pay-to-Play Rule - K&L Gates

On 3 September 2026, the Securities and Exchange Commission (SEC) proposed to rescind, in its entirety, Rule 206(4)-5 under the Investment Advisers Act of 1940 (Advisers Act), commonly known as the "pay-to-play" rule, along with the related recordkeeping requirements in Rule 204-2(a)(18).1 For more than 15 years, the rule has barred an investment adviser from receiving compensation from a state or local government client for two years after the adviser, or certain of its executives and employees, contributes more than a small amount to an official who can influence the hiring of advisers for that client.

The SEC now says the rule operates as a de facto strict liability regime in which small "foot faults" trigger severe consequences, and it has led many firms simply to ban employee political giving. In the SEC's current view, the Advisers Act antifraud provisions, an adviser's fiduciary duty, the compliance rule, and the code of ethics rule are likely sufficient to address pay-to-play without a separate rule.2 SEC Chairman Paul Atkins put it more directly: The SEC is not the nation's elections regulator.3

This proposed rescission is important because it would replace a bright-line rule with a principles-based regime. That is largely good news, but it is not the end of pay-to-play compliance. Advisers will still need policies tailored to their own risks, and a dense web of state, local, and self-regulatory organization (SRO) requirements will remain. Advisers should therefore maintain their existing programs while the proposal is pending and, following any final rescission, carefully consider appropriate modifications rather than simply eliminating their current controls.

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The Road to the Rule: Scandals, the MSRB, and the States

"Pay-to-play" refers to making political contributions or other payments to public officials in order to win government business. The concern is simple. When contributions, rather than skill and price, drive decisions on who manages government money, in particular retirement plans, these plans may end up with weaker managers and higher fees, and the retirees and taxpayers who invest in those plans bear the cost.

The first federal approach to prohibit "pay-to-play" in the investment space came in the **municipal bond market**. In 1994, after reports that dealers were contributing to officials who could influence the choice of underwriters, the **SEC approved Municipal Securities Rulemaking Board (MSRB) Rule G-37**. Rule G-37 generally bars a dealer from doing municipal securities business with an issuer for two years after the dealer or certain of its personnel contribute to an official of that issuer. In 1995, the US Court of Appeals for the DC Circuit (DC Circuit) upheld Rule G-37 against a First Amendment challenge in *Blount v. SEC*. Rule G-37 became the template for everything that followed.

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