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CLIENT ALERT

An Election Season Refresher: Pay-to-Play Rule Implications for Investment Advisers

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With multiple gubernatorial, state legislative and other local elections approaching on November 4, 2025, investment advisers are reminded of the strict technical parameters governing political contributions under Rule 206(4)-5 of the Investment Advisers Act of 1940, also known as the "Pay-to-Play Rule." Even where the donation amount is seemingly insignificant and there is no intent to influence government officials with respect to publicly managed investments, the strict liability standard of the Pay-to-Play Rule means that consequences can be severe. Below we discuss particular issues for advisers to consider in the lead-up to this and future elections.

Overview of Rule 206(4)-5

Rule 206(4)-5 (the "**Rule**") under the Investment Advisers Act of 1940 (the "**Advisers Act**") applies to registered investment advisers and exempt reporting advisers, as well as investment advisers unregistered in reliance on Section 203(b)(3) of the Advisers Act. The Rule prohibits these advisers from receiving compensation for providing investment advisory services to a government entity for two years after an investment adviser or one of its covered

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associates makes a contribution over a *de minimis* threshold to an "official" of that government entity.[2] "Official" means any person holding, or running for, political office who at the time of the contribution has, or would have if elected, the ability to hire or influence the hiring of an investment adviser by a government entity, or the power to appoint someone with such ability.[3] A "covered associate" is broadly defined and covers executive officers, general partners, managing members or other similar individuals, employees who solicit government entities for the investment adviser and their supervisors, and any political action committee ("**PAC**") controlled by the adviser or any of the foregoing individuals.[4] The Rule does not apply to contributions below a *de minimis* level.[5] The Rule also contains a further prohibition on an investment adviser or its covered associates doing anything indirectly which, if done directly, would result in a violation of the Rule.[6] In connection with this part of the Rule, investment advisers should be mindful of contributions made by spouses and partners of covered associates that could be a violation of the Rule, and contributions to PACs where a covered associate has the ability to direct or cause the direction of the governance or operations of the PAC.[7]

Key Considerations for Investment Advisers

- **Definition of "Official."** A number of upcoming elections for officials have Pay-to-Play Rule implications, including the New York City mayoral election and the gubernatorial elections for New Jersey and Virginia. The office of Mayor of New York City has influence over selecting investment advisers and pooled investment vehicles for the New York City Pension Systems because the Mayor appoints at least one member of the New York City Pension Systems' five boards, which have influence over investment selection.[8] The Securities and Exchange Commission ("**SEC**") has previously pursued enforcement action with respect to the New York mayoral race.[9] The New Jersey Division of Investment, which manages all or a portion of the assets of seven public pension systems, is governed by the State Investment Council of New Jersey, some of whose members are appointed by the Governor of New Jersey.[10] The Governor of

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2 17 CFR 275.206(4)-5(a)(1)-(2).

3 17 CFR 275.206(4)-5(f)(6).

4 17 CFR 275.206(4)-5(f)(2).

5 *See* 17 CFR 275.206(4)-5(b). (Contributions are considered *de minimis* under the Rule if a covered associate who is a natural person makes contributions: (1) to officials for whom the covered associate was entitled to vote at the time of the contributions that in the aggregate do not exceed $350 to any one official, per election; or (2) to officials for whom the covered associate was not entitled to vote at the time of the contributions that do not exceed $150 to any one official, per election.)

6 17 CFR 275.206(4)-5(d).

7 *See* Id.*;* Securities and Exchange Commission, *Political Contributions by Certain Investment Advisers*, Release No. IA-3043 (July 1, 2010) at 49 n.165 and 55 n.189 and related text, available here ("**Adopting Release**"); Staff Responses to Questions About the Pay to Play Rule II.2. and II.5, available here.

8 *See* Teachers' Retirement System of the City of New York, Our Retirement Board, available here; NYC Employees' Retirement System, Board of Trustees, available here; New York City Police Pension Fund, Board Members, available here; New York City Fire Pension Fund, available here; New York City Board of Education Retirement System, Board of Trustees, available here.

9 Securities and Exchange Commission, *In the Matter of Starvest Management, Inc.*, Release No. 6129, available here (enforcing the Rule with respect to a $1,400 aggregate donation by covered associates of an investment adviser, resulting in a censure and $70,000 fine).

10 New Jersey Division of Investment, Members of the State Investment Council (Sept. 11, 2025), available here.

Virginia similarly appoints five members of the Board of Trustees of the Virginia Retirement System, the 14th largest pension fund in the U.S.[11]

- **Covered Associates Look Back.** Contributions are attributed to an adviser when made by a person within two years of becoming a covered associate of the adviser (or in certain cases of new covered associates, six months).[12] In effect, this means an adviser must "look back" to a covered associate's prior contributions to determine whether a two-year prohibition on compensation is required. This is critical for advisers when onboarding new employees, whose historical political contribution records must be collected and reviewed, and new government clients, who may be associated with officials to whom covered associates have previously made political contributions.

- **Types of Contributions.** A contribution is defined to include a gift, subscription, loan, advance, deposit of money, or anything of value made for the purpose of influencing an election for a federal, state or local office, including any payments for debts incurred in such an election or transition or inaugural expenses.[13] The definition of contribution is not limited to cash donations. However, the SEC would not consider as a contribution a donation of time by an individual, provided the adviser has not solicited the individual's efforts and the adviser's resources, such as office space and telephones, are not used.[14] In addition, the SEC would not consider as a contribution a charitable donation by an investment adviser to an organization that qualifies for any exemption from federal taxation under the Internal Revenue Code, or its equivalent in a foreign jurisdiction, at the request of an official of a government entity, such as a PAC or local political party.[15] However, advisers must still evaluate such charitable donations in light of the prohibition on indirect actions that would result in a violation of the Rule if done directly.

- **Soliciting Others.** The Rule prohibits investment advisers from coordinating or soliciting any person or PAC to make (i) any contribution to an official to which the adviser is providing or seeking to provide investment advisory services or (ii) any payment to a political party of a state or locality where the investment adviser is providing or seeking to provide investment advisory services to a government entity.[16] In practice, this restricts investment adviser personnel from fundraising activities that would be considered solicitation under the Rule.[17] For example, an adviser that consents to the use of its name on fundraising

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11 Code of Virginia § 51.1-124.20, available here.

12 *See* 17 CFR 275.206(4)-5(a)(1) (including among those covered associates whose contributions can trigger the two-year compensation time-out a person who becomes a covered associate within two years after the contribution is made) and 17 CFR 275.206(4)-5(b)(2) (excepting from the two-year look back those contributions made by a natural person more than six months prior to becoming a covered associate of the investment adviser unless such person, after becoming a covered associate, solicits clients on behalf of the investment adviser).

13 17 CFR 275.206(4)-5(f)(1).

14 Adopting Release at 46.

15 *Id*.

16 17 CFR 275.206(4)-5(a)(2)(ii).

17 *See* 17 CFR 275.206(4)-5(f)(10)(ii) (defining "solicit," with respect to a contribution or payment, as communicating, directly or indirectly, for the purpose of obtaining or arranging a contribution or payment.)

literature for a candidate would be soliciting contributions for that candidate, and an adviser that sponsors a meeting or conference that features a government official as an attendee or guest speaker and that involves fundraising for the government official would be soliciting contributions for that government official.[18]

- **Returned Contribution Exception.** While consequences for technical violations of the Rule can be severe, advisers have a limited opportunity to cure contributions to an official by a covered associate for whom that individual is not entitled to vote. The exception is only available where (1) the contributions do not exceed $350 to any official, per election, (2) the adviser discovered the contribution within four months of it being made and (3) the contribution is returned to the covered associate within 60 days of discovery.[19] There are limits on the number of times advisers may rely on this exception.[20] The SEC also may exempt an investment adviser from the two-year time-out following an application by an adviser.[21]

- **Policies and Procedures.** Investment advisers must develop and maintain policies and procedures reasonably designed to prevent violations of the Advisers Act, including the Rule.[22] As part of their policies, procedures and employee training, many advisers require pre-clearance of all political contributions for all employees, regardless of amount, similar to personal trading and gifts and entertainment approval processes. During election years, advisers may be well served to recirculate reminders and training to employees regarding their obligations with respect to the Rule.

Conclusion

Advisers are reminded that the Rule is "strict liability" and requires no evidence of actual quid pro quo or scienter, meaning advisers may be subject to significant fines and penalties for inadvertent violations. Given upcoming elections, and employees who may be eager to participate in the political process through volunteering, fundraising or donations, advisers are encouraged to revisit their Pay-to-Play Rule policies, procedures and training.

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18 Adopting Release at 93 n.328.

19 17 CFR 275.206(4)-5(b)(3).

20 *Id.*

21 17 CFR 275.206(4)-5(e).

22 17 CFR 275.206(4)-7.

Willkie has a dedicated team of attorneys with extensive knowledge and experience in all aspects of the Investment Advisers Act of 1940. We would be pleased to assist on your matters.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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