UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 6691 / September 10, 2024

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 4517 / September 10, 2024

ADMINISTRATIVE PROCEEDING
File No. 3-22104

In the Matter of

HI2 INVESTMENT MANAGEMENT, LLC

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Hi2 Investment Management, LLC ("Hi2 Manager" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. Between May 2016 and July 30, 2024, Hi2 Manager was a registered investment adviser. Between 2018 and 2023, Hi2 Manager had custody of client assets in seven private funds accounts it advised, but Hi2 Manager failed to comply with its obligations under Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder (the "Custody Rule") for five of those funds for multiple years. Hi2 Manager failed to distribute to investors within the required time period audited annual financial statements prepared in accordance with Generally Accepted Accounting Principles ("GAAP") and audited by a PCAOB-registered independent public accountant, and Hi2 Manager otherwise failed to comply with the Custody Rule. In some instances, Hi2 Manager failed to obtain or deliver annual financial statements audited by a PCAOB-registered independent public accountant altogether, and in others, Hi2 Manager delivered audited annual financial statements to investors years later, in response to the Staff's investigation. In total, since 2018, Hi2 Manager violated the Custody Rule on 17 occasions. Hi2 Manager also failed to adopt and implement written policies and procedures reasonably designed to prevent the foregoing violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, in violation of Rule 206(4)-7 of the Advisers Act (the "Compliance Rule").

Respondent

2. Respondent Hi2 Manager is a Delaware limited liability company with its principal office and place of business in New York, New York. Hi2 Manager was registered with the Commission as an investment adviser between May 2016 and July 30, 2024. On July 30, 2024, Hi2 Manager filed to become an exempt reporting adviser. At all relevant times, Hi2 Manager owned the general partner of, and served as investment adviser to, each of the seven funds for which Hi2 Manager had to comply with the Custody Rule: Hi2 GP, LLC; Hi2 Cayman Fund SPC Series A; Hi2 Cayman Fund SPC Series B; Hi2 U.S. Fund, L.P. - Series A; Hi2 U.S. Fund, L.P. Series B; Hi2 Venture Fund I LP; and Hi2 Venture Fund II LP (collectively, "the Hi2 Funds"). In its most recent Form ADV filed on May 6, 2024, Hi2 Manager reported a total of approximately $52 million in regulatory assets under management. Hi2 Manager is managed by its founder and indirect owner, who also serves as Hi2 Manager's Chief Compliance Officer.

Facts

3. Hi2 Manager was founded in 2015 and its primary investment strategy involves lending to high-risk marketplaces. For example, Hi2 Manager lends to automobile inventory lenders in New York City and to emerging markets in Southeast Asia and Africa. Hi2 Funds investors purchase payment-dependent notes issued by a Hi2 Fund, the proceeds of which are applied to make loans to platform lenders and the repayment of which is dependent upon the platform lender repaying the Hi2 Fund. Platform lenders, like the automotive inventory lenders, in turn make loans that are expected to generate returns sufficient to pay back the Hi2 Funds and allow the Hi2 Funds to repay investors. Upon maturity of a payment-dependent note, to the extent the Hi2 Fund received payment from the platform lender, investors can either receive their principal back with interest, or they can elect to roll over the principal and interest into a new investment loan with a platform lender. Hi2 Manager serves as the investment adviser to each of

the Hi2 Funds, and Hi2 Manager owns the general partner of each of the Hi2 Funds, which general partner is controlled by Hi2 Manager's founder, indirect owner, and Chief Compliance Officer. Hi2 Manager receives a two percent management fee from investors and is entitled to a 20% performance fee. The Hi2 Funds accounted for virtually all of Hi2 Manager's regulatory assets under management.

4. The Custody Rule is designed to protect investment advisory clients from the misuse or misappropriation of their funds and securities. It requires that registered investment advisers who have custody of client funds or securities implement an enumerated set of requirements to prevent loss, misuse, or misappropriation of those assets.

5. An investment adviser has custody of client assets if it holds, directly or indirectly, client funds or securities, or if it has any authority to obtain possession of those assets, including, among other things, by acting as a managing member of a limited liability company or a general partner of a limited partnership. *See* Rule 206(4)-2(d)(2) of the Advisers Act. The Custody Rule also considers an adviser to have custody of client assets if a related person of the adviser has custody, such as when an adviser owns or serves as the general partner of a partnership that holds client assets, provided that the partnership or corporation's custody is in connection with the advisory services provided by the adviser. *See* Rule 206(4)-2(a)(6), (b)(6)(i). Hi2 Manager owned the general partner of each of the Hi2 Funds. Hi2 Manager therefore had custody of the assets of the seven Hi2 Funds.

6. Pursuant to the Custody Rule, an investment adviser who has custody of client assets must, among other things: (1) ensure that a qualified custodian maintains the client assets; (2) notify the client in writing of accounts opened by the adviser at a qualified custodian on the client's behalf; (3) have a reasonable basis for believing that the qualified custodian sends account statements at least quarterly to clients, except if the client is a limited liability company or a limited partnership for which the adviser or a related person is a managing member or general partner, the account statements must be sent to each member or limited partner; and (4) ensure that client funds and securities are verified by actual examination each year by an independent public accountant at a time chosen by the accountant without prior notice or announcement to the adviser (*i.e.* a surprise examination). *See* Rules 206(4)-2(a)(1) – (5).

7. The Custody Rule provides an alternative to complying with the requirements of Rules 206(4)-2(a)(2), (3) and (4) for investment advisers to limited partnerships, limited liability companies, or other pooled investment vehicles, such as the Hi2 Funds. The Custody Rule provides that an investment adviser "shall be deemed to have complied with" the independent verification requirement and is not required to satisfy the notification and account statements delivery requirements with respect to a fund if the fund is subject to audit at least annually and "distributes [the fund's] audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners . . . within 120 days of the end of [the fund's] fiscal year" ("Audited Financials Alternative"). *See* Rule 206(4)-2(b)(4). The accountant performing the audit must be an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board. *See* Rule 206(4)-2(b)(4)(ii). An investment adviser to a pooled investment vehicle that fails to meet the requirements of the Audited Financials Alternative would need to satisfy all of the requirements of

Rule 206(4)-2(a)(2) – (4), including a surprise examination, in order to avoid violating the Custody Rule.

8. Since fiscal year 2018, Hi2 Manager has repeatedly failed to provide timely annual audited financial statements for five Hi2 Funds or otherwise comply with the requirements of the Custody Rule. In some cases, Hi2 Manager failed to obtain and provide annual audited financial statements from a PCAOB-registered independent public accountant altogether, and in other cases, Hi2 Manager failed to provide investors with audited financial statements within 120 days of the end of the fund's fiscal year. For example, between fiscal years 2018 and 2021, Hi2 GP, LLC was audited by a public accountant that was not registered with the PCAOB. As another example, between fiscal years 2019 and 2022, audited financial statements for Hi2 Cayman Fund SPC Series B were delivered to investors between 171 and 1,266 days late, depending on the specific fiscal year. In total, between fiscal years 2018 and 2023, Hi2 Manager violated the Custody Rule on 17 occasions with respect to five Hi2 Funds.

9. In addition, Hi2 Manager failed to comply with the requirement that every investment adviser registered with the Commission adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder. *See* Rule 206(4)-7(a). Hi2 Manager's written policies and procedures never referenced the Custody Rule, despite the fact that it had custody of all of its clients' funds and securities. As such, Hi2 Manager's written policies and procedures failed to describe any measures that Hi2 Manager needed to implement to comply with its obligations under the Custody Rule, which is a violation of the Compliance Rule.

Violations

10. Section 206(4) of the Advisers Act prohibits an investment adviser from engaging in acts, practices or courses of business that are fraudulent, deceptive, or manipulative, as may be defined by the Commission in rules and regulations promulgated under the statute. Proof of scienter is not required to establish a violation of Section 206(4) of the Advisers Act and the rules thereunder. *See SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992).

11. Rule 206(4)-2 provides that it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of Section 206(4) for a registered investment adviser to have custody of client assets unless the adviser complies with the Custody Rule. Among other things, Rule 206(4)-2 requires registered investment advisers with custody of client funds or securities to have independent public accountants conduct surprise examinations of those client funds or securities, or to have private fund clients timely distribute to their investors annual audited financial statements prepared in accordance with GAAP.

12. Rule 206(4)-7 requires, among other things, that an investment adviser registered with the Commission adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and rules thereunder.

13. As a result of the conduct described above, Hi2 Manager willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder.

Hi2 Manager's Remedial Efforts

14. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff, including timely completion and distribution of audited financial statements for fiscal year 2023 for all currently active Hi2 Funds but one, the retention of a compliance consultant to amend its written policies and procedures to increase compliance with the Custody Rule, and prompt adoption of changes to Hi2 Manager's policies and procedures in an effort to prevent future violations.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Hi2 Manager's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Hi2 Manager cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rules 206-4(2) and 206-4(7) promulgated thereunder;

B. Respondent Hi2 Manager is censured.

C. Respondent Hi2 Manager shall, within 21 days of the entry of this Order, pay a civil money penalty in the amount of $75,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Hi2 Manager as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Tejal Shah, Division of Enforcement, Securities and Exchange Commission, 100 Pearl Street, Suite 20-100, New York, NY 10019.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary