

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5096 / December 26, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18958

In the Matter of

Lightyear Capital LLC,

Respondent.

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

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Lightyear Capital LLC (“Lightyear” 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 Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. Respondent Lightyear is a registered investment adviser that manages “flagship” private equity funds (“Flagship Funds”) as well as employee funds (“Employee Funds”) which invest alongside the Flagship Funds. Lightyear focuses its investments in financial services companies (each, a “Portfolio Company”). In connection with the acquisition of certain Portfolio Companies, co-investors are also permitted to provide equity capital to invest in the deal. These proceedings arise from Lightyear’s failure to properly allocate certain expenses to the Employee Funds and co-investors and its failure to properly offset management fees in connection with undisclosed “fee-sharing agreements” with certain co-investors.

2. In addition, Lightyear failed to adopt written policies and procedures reasonably designed to prevent these violations of the Advisers Act and also failed to adopt and implement written policies and procedures related to a representation found in each of the Limited Partnership Agreements of its Flagship Funds which stated that Lightyear would seek to have prospective portfolio companies bear the cost of broken deal expenses.

3. By virtue of this conduct, Lightyear violated Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder.

Respondent

4. **Lightyear Capital LLC (“Lightyear”)** is a Delaware Limited Liability Company with its principal place of business in New York City. Founded in 2000, Lightyear is a private equity investment adviser that has been registered as an investment adviser with the Commission since March 30, 2012. Lightyear currently manages, among others, the private equity funds of Lightyear Fund II, L.P., Lightyear Fund III, L.P., Lightyear Fund IV, L.P., Lightyear Co-Invest Partnership II, L.P., and Lightyear Co-Invest Partnership III, L.P. As of December 31, 2017, Lightyear had approximately \$2.27 billion in regulatory assets under management.

Other Relevant Entities

5. **The Flagship Funds (The Lightyear Fund, L.P.; Lightyear Fund II, L.P.; Lightyear Fund III, L.P.; Lightyear Fund IV, L.P.)** are Delaware Limited Partnerships formed in 2000, 2005, 2010, and 2015 respectively to make private equity investments. These private equity funds are Lightyear’s Flagship Funds. As of December 31, 2017, the Flagship Funds had approximately \$2.11 billion in regulatory assets under management.

6. **The Employee Funds (Lightyear Co-Invest Partnership, L.P.; Lightyear Co-Invest Partnership II, L.P.; Lightyear Co-Invest Partnership III, L.P.)** are Delaware Limited Partnerships formed in 2001, 2006, and 2011 respectively. These Employee Funds were created to facilitate co-investments by employees of Lightyear on a side-by-side basis with investments made by the Flagship Funds. As of December 31, 2017, the Employee Funds had approximately \$3.7 million in regulatory assets under management.

FACTS

Background

7. Lightyear, a private equity firm, has advised multiple private equity funds, including four Flagship Funds and three Employee Funds managed on behalf of the firm's employees. The Flagship Funds' Limited Partners include pensions, other institutional investors, and high net worth individuals. The Employee Funds invest side-by-side on a proportional basis with the Flagship Funds. The objective of each Flagship Fund is to generate capital appreciation by making investments in Portfolio Companies. In connection with the acquisition of certain Portfolio Companies, after Lightyear determines the appropriate size of a prospective investment by its Flagship Funds and Employee Funds, co-investors are permitted to provide additional equity capital to invest in the deal. A set of three documents primarily governs investments in each of the Flagship Funds: a Limited Partnership Agreement ("LPA"), a Private Placement Memorandum, and an Investment Advisory Agreement (collectively, the "Organizational Documents"). In addition, each of the Flagship Funds has an Advisory Committee ("Advisory Committee") established to, among other things, approve or disapprove conflicts of interest between a Flagship Fund and the general partner of such Flagship Fund, an affiliate of Lightyear.

Allocation of Expenses to Flagship Funds

8. Lightyear launched its first Flagship Fund in 2000 and its first Employee Fund in 2001. From that time through 2016, Lightyear allocated certain expenses, including broken deal, legal, consulting, insurance and other expenses solely to the Flagship Funds. Although the Organizational Documents disclosed that the Flagship Funds would be allocated expenses incurred in connection with potential or actual Flagship Fund investments, Lightyear did not disclose in the Organizational Documents or elsewhere that the Employee Funds would not be allocated a proportional share of such expenses. Lightyear should have disclosed this conflict of interest in the Organizational Documents or obtained approval from the Flagship Funds' Advisory Committees. Instead, Lightyear failed to disclose in the Organizational Documents or elsewhere that the Flagship Funds would pay all of the expenses in connection with the transactions, despite the fact that the Employee Funds participated in and benefitted from the transactions. Lightyear also failed to obtain approval from the Flagship Funds' Advisory Committees for this practice. In the absence of such disclosure or approval, Lightyear should have allocated the proportional share of such expenses to the Employee Funds. The failure to allocate such expenses to the Employee Funds and the allocation of those expenses to the Flagship Funds benefitted Lightyear's Employee Funds at the expense of the Flagship Funds. As a result of Lightyear's conduct, from approximately 2000 through 2016, the Flagship Funds paid approximately \$167,000 more in expenses than they should have paid.

9. In addition to Employee Funds which invested in Portfolio Companies alongside the Flagship Funds, certain co-investors were permitted at times to invest in particular Portfolio Companies. These co-investors similarly were not allocated their proportional share of certain post-closing expenses despite participating in and benefiting from Lightyear's private equity

investments. Although the Organizational Documents disclosed that the Flagship Funds would be allocated expenses incurred in connection with potential or actual Flagship Fund investments and permitted the general partner of the Flagship Funds to negotiate different investment terms for co-investors, Lightyear did not disclose in the Organizational Documents or elsewhere that co-investors would not be allocated a proportional share of such expenses. In the absence of such disclosure, Lightyear should have either allocated the proportional share of such expenses to the co-investors or borne those costs itself. The failure to allocate such expenses to co-investors and the allocation of those expenses to the Flagship Funds benefitted co-investors at the expense of the Flagship Funds. As a result of Lightyear's conduct, from approximately 2000 through 2016, the Flagship Funds paid approximately \$221,000 more in expenses than they should have paid.

Fee-Sharing Agreements

10. In connection with its funds' investments in Portfolio Companies, Lightyear often entered into "advisory agreements" whereby Lightyear provided services to the Portfolio Company in exchange for advisory fees. According to the Organizational Documents governing the Flagship Funds, advisory fees received by Lightyear from Portfolio Companies would offset the management fees paid by the Flagship Funds.

11. Between 2010 and 2012, Lightyear entered into fee-sharing agreements with certain co-investors regarding three of the Flagship Funds' Portfolio Companies. Pursuant to these agreements, Lightyear agreed to share a portion of the advisory fees it received from the Portfolio Companies with the co-investors.

12. Between 2010 through 2015, approximately \$1 million from two of these Portfolio Companies was paid to co-investors. The co-investors provided no services to the Portfolio Companies for these fees. Sharing advisory fees with co-investors reduced the management fee offset and thus increased the management fees paid by the Flagship Funds. In addition, because the payments were generally paid by the Portfolio Companies directly to the co-investors, the Limited Partners of the Flagship Funds had no way of knowing that the Flagship Funds did not receive the management fee offset that they would have received absent the fee-sharing agreements. While the Flagship Fund LPAs permitted the general partner of the Flagship Funds to negotiate different investment terms for co-investors, Lightyear did not disclose either the fee-sharing agreements or the payments in the Organizational Documents or elsewhere. Lightyear's failure to disclose these agreements and failure to provide the Flagship Funds with the relevant management fee offsets benefitted the co-investors at the expense of the Flagship Funds. As a result of this conduct, between 2010 through 2015, the Flagship Funds did not receive approximately \$1 million in management fee offsets.

Compliance Policies and Procedures

13. As a registered investment adviser, Lightyear is subject to the rules under the Advisers Act, including the requirement to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

14. Lightyear failed to adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act or its rules in connection with how it allocated fees and expenses until May 2017. Lightyear also did not adopt any written policies and procedures governing the application of the management fee offsets in connection with the fee-sharing agreements it entered into with co-investors. In addition, Lightyear failed to adopt and implement policies and procedures in connection with a representation made in the Organizational Documents of the Flagship Funds concerning broken deal expenses. Specifically, despite language in each Flagship Fund's LPA that stated that Lightyear would "seek to have prospective portfolio companies bear the cost of the Partnership Broken Deal Expenses," Lightyear did not, in fact, seek to recoup broken deal expenses from prospective portfolio companies.

Violations

15. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, Lightyear violated Section 206(2) of the Advisers Act.

16. Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to "[m]ake any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle" or "engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle." As a result of the conduct described above, Lightyear violated Section 206(4) of the Advisers Act, and Rule 206(4)-8 thereunder.

17. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder. As a result of the conduct described above, Lightyear violated Section 206(4) of the Advisers Act, and Rule 206(4)-7 thereunder.

OCIE Examination and Lightyear's Cooperation

18. Beginning in December 2016, staff from the Commission's Office of Compliance Inspections and Examinations ("OCIE") conducted an exam of Lightyear. The exam concerned, among other things, Lightyear's expense allocation and fee-sharing practices. In determining to accept the Respondent's Offer, the Commission considered the full reimbursements going back to 2001, with interest, that Lightyear proactively made for the benefit of the Flagship Funds during

the pendency of, and just after the exam, and before being contacted by the Division of Enforcement staff. The Commission also considered the cooperation Lightyear afforded the staff throughout the investigation.

IV.

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

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

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act, and Rules 206(4)-7 and 206(4)-8 thereunder.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$400,000 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 shall 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 Lightyear Capital LLC as the 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 Lara S. Mehraban, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 200 Vesey Street, Suite 400, New York, NY 10281.

C. 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.

Brent J. Fields
Secretary