

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4131 / June 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16656

In the Matter of

Kohlberg Kravis Roberts & Co.
L.P.,

Respondent.

**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**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Kohlberg Kravis Roberts & Co. L.P. (“KKR” 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:

SUMMARY

1. Respondent Kohlberg Kravis Roberts & Co. L.P. is a private equity firm that specializes in buyout and other transactions. KKR advises and manages its main or "flagship" private equity funds ("Flagship PE Funds") along with co-investment vehicles and other accounts that invest with these funds in buyout and other transactions. During the relevant period of 2006 to 2011, the KKR 2006 Fund L.P. (the "2006 Fund") was KKR's largest private equity fund with \$17.6 billion in committed capital. From 2006 to 2011, KKR's Flagship PE Funds invested \$30.2 billion in 95 transactions, while KKR co-investment vehicles and other KKR affiliated vehicles invested \$4.6 billion, including \$750 million by KKR executive co-investment vehicles. The 2006 Fund invested over \$16.5 billion during the period primarily in opportunities in North America.²

2. Over the same period, KKR incurred \$338 million in diligence expenses related to unsuccessful buyout opportunities and other similar types of expenses ("broken deal expenses"). Under the 2006 Fund limited partnership agreement (the "LPA"), KKR was permitted to allocate to the 2006 Fund, or be reimbursed by it for, "all" broken deal expenses that were "incurred by or on behalf of" the 2006 Fund. During the period, KKR allocated broken deal expenses based on the geographic region of the potential deal. Accordingly, KKR allocated broken deal expenses related to North American opportunities to the 2006 Fund. Pursuant to fee sharing arrangements with its Flagship PE Funds during the period, KKR typically bore 20% of all broken deal expenses. However, KKR did not allocate broken deal expenses to KKR co-investors from 2006 to 2011 except for a partial allocation to certain co-investors in 2011. Nor did KKR expressly disclose in the LPA or related offering materials that it did not allocate broken deal expenses to KKR co-investors, as described below, even though these co-investors

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.

² This Order focuses on conduct with respect to the KKR 2006 Fund L.P. Other KKR Flagship PE Funds investing during the relevant period from 2006 to 2011 operated similarly to the 2006 Fund and the dollar amounts reflected herein, unless otherwise noted, reflect relevant amounts for all of KKR's Flagship PE Funds that were investing during this period.

participated in and benefited from KKR's sourcing of private equity transactions. As a result of the absence of such disclosure, KKR misallocated \$17.4 million in broken deal expenses between its Flagship PE Funds and KKR co-investors during the relevant period, and, thus, breached its fiduciary duty. KKR also did not adopt and implement a written compliance policy or procedure governing its fund expense allocation practices until 2011. By virtue of this conduct, Respondent KKR violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

RESPONDENT

3. **Kohlberg Kravis Roberts & Co. L.P.**, a Delaware limited partnership, is a private equity firm that was founded in 1976. KKR registered as an investment adviser with the Commission in October 2008. KKR is headquartered in New York, New York. KKR & Co. L.P. (NYSE: KKR), a publicly traded company, is KKR's parent company. During 2006 to 2011, KKR managed a number of private equity funds, including the 2006 Fund.

RELEVANT PARTY

4. **KKR 2006 Fund L.P.**, a Delaware limited partnership, had its first closing on July 31, 2006. The 2006 Fund is one of KKR's main or "flagship" private equity funds. The 2006 Fund actively invested primarily in North American private equity transactions from July 2006 to 2012, with follow-on investments continuing thereafter.

FACTS

KKR's Private Equity Funds

5. KKR primarily advises and sources potential investments for its Flagship PE Funds and other advisory clients that invest capital for long-term appreciation through controlling ownership of portfolio companies or strategic minority positions in them. As of December 31, 2014, KKR had over \$51 billion in assets under management in its private equity line of business.

6. KKR's Flagship PE Funds pursue investment strategies that are focused on investing in buyout and other opportunities primarily in one of three designated regions: North America, Europe or Asia. The 2006 Fund was KKR's largest and most

active flagship fund during the period 2006 to 2011. The 2006 Fund has to date invested over \$17 billion in a total of 42 portfolio companies.

7. The limited partners in KKR's private equity funds include many large pension funds, university endowments and other large institutional investors and high net worth individuals. As limited partners, these investors commit and subsequently contribute a specified amount of capital to a fund for its use to make qualifying investments during a specified period, which is usually six years.

8. KKR provides investment management and administrative services to its private equity funds. KKR charges its funds a management fee, which generally ranges from 1% to 2% of committed capital during the fund's investment period. As a general partner in its private equity funds, KKR also receives a profits interest or carried interest of up to 20% of the net profits realized by the limited partners in the funds.

9. KKR enters into management or monitoring agreements with certain of its portfolio companies pursuant to which it receives periodic fees for providing management, consulting and other services to the companies. KKR also receives transaction fees for providing financial, advisory and other services in connection with specific transactions. KKR typically shares a portion of these fees with its Flagship PE Funds based on their proportional ownership of the underlying portfolio companies. KKR shares a portion of the fees with its Flagship PE Funds as a credit against the management fee that KKR charges them. Similarly, KKR shares with its Flagship PE Funds any break-up fees that it may receive from the termination of potential transactions based on the intended amount of a fund's proposed investment.

10. KKR's Flagship PE Funds are entitled to invest at least a minimum amount in every portfolio investment within its investment strategy under the applicable LPAs. The 2006 Fund had a specified minimum portfolio investment level of \$600 million at its inception before the threshold was lowered to \$250 million in 2009.

KKR Co-Investors

11. Beyond capital from its Flagship PE Funds, KKR raises capital from co-investors for its private equity transactions. For all KKR transactions regardless of size, the Flagship PE Fund limited partnership agreements (the "LPAs") reserve a percentage of fund portfolio investments for its executives, certain consultants and others. KKR establishes dedicated co-investment vehicles for its executives, certain consultants and others to make co-investments (the "KKR Partner Vehicles"). The 2006 Fund's LPA

reserved up to 5% of every portfolio investment for KKR executives and up to 2.5% for certain consultants and others. These vehicles invested on a deal-by-deal basis with no specified committed capital. During the relevant period, these vehicles did not receive a share of monitoring, transaction or break-up fees.

12. When the size of a private equity transaction exceeds a Flagship PE Fund's specified minimum investment level and any additional amounts determined to be appropriate for that fund's investment objectives, the LPAs contemplate that KKR may obtain additional capital necessary to complete the transaction from co-investors. For certain co-investors, KKR has established and manages separate co-investment vehicles or similar investment account arrangements independent of any specific transactions ("KKR Co-Investment Vehicles"). The KKR Co-Investment Vehicles invest in private equity transactions alongside the Flagship PE Funds either on a committed or non-committed capital basis. The committed capital vehicles generally invest with KKR's Flagship PE Funds in all eligible co-investment opportunities consistent with the vehicles' investment mandates. The non-committed capital vehicles invest on a discretionary basis in eligible co-investment opportunities.

13. Additionally, KKR sponsored a publicly traded partnership that it established and managed independently of any specific private equity transactions. KKR offered co-investment opportunities to this publicly traded partnership from 2006 to 2008, as well as co-invested capital from its own balance sheet in one transaction in 2011 (collectively, with "KKR Partner Vehicles" and "KKR Co-Investment Vehicles," the "KKR Co-Investors").

14. When KKR requires more capital to complete a private equity transaction beyond what is available from its Flagship PE Funds and the KKR Co-Investors, KKR syndicates additional capital with respect to specific transactions to third-party investors, limited partners in its funds and participants in KKR Co-Investment Vehicles (collectively, the "Syndicated Co-Investors"). As Syndicated Co-Investors, these limited partners in KKR's funds and other participants in KKR Co-Investment Vehicles are interested in making additional investments beyond what they are allocated in the ordinary course of KKR's general sourcing of transactions. Syndicated Co-Investors are therefore not included within the term "KKR Co-Investors."

15. From 2006 to 2011, KKR Co-Investors invested \$4.6 billion alongside the \$30.2 billion invested by KKR's Flagship PE Funds. KKR Partner Vehicles invested \$750 million of the \$4.6 billion, while the other KKR Co-Investors invested the

remaining \$3.9 billion. KKR Partner Vehicles invested in almost every transaction during the period, while the other KKR Co-Investors collectively invested in many of the transactions that exceeded the applicable flagship fund's minimum investment level.

Broken Deal Expenses

16. KKR incurs significant expenses to source hundreds of potential investment opportunities for its Flagship PE Funds and KKR Co-Investors but consummates only a few of them each year. KKR is reimbursed directly from portfolio companies for the expenses incurred in connection with successful transactions. KKR is reimbursed for broken deal expenses through a different mechanism described below.

17. Broken deal expenses include research costs, travel costs and professional fees, and other expenses incurred in deal sourcing activities related to specific "dead deals" that never materialize. Broken deal expenses also include expenses incurred by KKR to evaluate particular industries or geographic regions for buyout opportunities as opposed to specific potential investments, as well as other similar types of expenses.

18. Consistent with other LPAs during the relevant period, the 2006 Fund LPA requires the fund to pay "all" broken deal expenses "incurred by or on behalf of" the fund "in developing, negotiating and structuring prospective or potential [i]nvestments that are not ultimately made."

19. KKR is reimbursed for broken deal expenses through fee sharing arrangements with its funds. Consistent with other LPAs during the relevant period, pursuant to the 2006 Fund LPA and the accompanying Management Agreement between KKR and the 2006 Fund, KKR shared a portion of its monitoring, transaction and break-up fees with the 2006 Fund. More specifically, KKR reduced its management fee by 80% of the 2006 Fund's proportional share of those fees after deducting broken deal expenses. Accordingly, KKR received 20% of those fees, and economically bore 20% of broken deal expenses. The 2006 Fund in turn received 80% of those fees, and economically bore 80% of the broken deal expenses.

20. While KKR bore 20% of broken deal expenses pursuant to the 2006 Fund LPA fee sharing arrangement during the period, neither the 2006 Fund's LPA nor any other offering materials related to the 2006 Fund included any express disclosure that KKR did not allocate broken deal expenses to KKR Co-Investors even though those vehicles participated in and benefited from KKR's general sourcing of transactions.

KKR's Historical Broken Deal Expense Allocations

21. From 2006 to 2011, KKR incurred approximately \$338 million in broken deal expenses. KKR allocated broken deal expenses based on the geographic region where the potential deal was sourced. For example, KKR allocated broken deal expenses related to potential North American investments to the 2006 Fund. However, prior to 2011, KKR did not allocate or attribute any broken deal expenses to KKR Co-Investors.

22. In June 2011, KKR recognized during an internal review that it lacked a written policy governing its broken deal expense allocations. From July to October 2011, KKR drafted a policy to memorialize its expense allocation methodology at the time. Before 2011, KKR had not considered whether to allocate or attribute broken deal expenses to KKR Co-Investors because in its view the Flagship PE Funds bore all broken deal expenses less the portion of those expenses that KKR bore pursuant to its fee sharing provisions with the applicable funds.

23. While drafting its fund expense allocation policy, KKR considered whether to allocate or attribute broken deal expenses to KKR Co-Investors. KKR decided at the time to allocate some share of broken deal expenses to several committed capital co-investment vehicles. For its fiscal year ending December 31, 2011, KKR allocated \$333,500 of broken deal expenses to those co-investment vehicles.

24. In October 2011, KKR engaged a third-party consultant to review the firm's fund expense allocation practices. At the time, there was public awareness of heightened regulatory scrutiny on the private equity industry.

25. Effective January 1, 2012, KKR revised its broken deal expense allocation methodology in the wake of the third-party consultant's review of KKR's fund expense allocation practices. In addition to committed capital co-investment vehicles, KKR's new allocation methodology began in 2012 to allocate or attribute a share of broken deal expenses to KKR Partner Vehicles and other KKR Co-Investors. KKR's new methodology considered a number of factors, including the amount of committed capital, the amount of invested capital, and the percentage of transactions in which KKR Co-Investors were eligible to participate given the Flagship PE Funds' minimum investment rights. The new allocation methodology is not a subject of this Order.

OCIE Compliance Examination

26. In 2013, staff from the Commission's Office of Compliance Inspections and Examinations ("OCIE") conducted an examination of KKR. One area of the examination concerned KKR's fund expense allocation practices. During the examination, KKR refunded its Flagship PE Funds, including the 2006 Fund, a total of \$3.26 million in certain broken deal expenses that KKR had allocated to them from 2009 to 2011. The \$3.26 million represents a total of \$4.07 million in broken deal expenses less the portion of those expenses borne by KKR pursuant to its fee sharing arrangements with the applicable funds. KKR refunded the \$3.26 million to the Flagship PE Funds in the first quarter of 2014.

Misallocation of Broken Deal Expenses to Flagship PE Funds

27. Prior to the adoption by KKR of its new allocation methodology and except for partial allocations to certain committed capital co-investors in 2011, KKR did not allocate any share of broken deal expenses to KKR Co-Investors, whether paid by the KKR Co-Investors or KKR, for the relevant period even though KKR Co-Investors participated in and benefited from KKR's general sourcing of transactions. Nor did KKR expressly disclose in the LPAs or related offering materials that it did not allocate or attribute any broken deal expenses to KKR Co-Investors. As a result of the absence of such disclosure, KKR misallocated \$17.4 million in broken deal expenses between its Flagship PE Funds and KKR Co-Investors during the relevant period, and, thus, breached its fiduciary duty as an investment adviser. The \$17.4 million represents the sum total of \$22.5 million in broken deal expenses for the relevant period as calculated based on a methodology consistent with KKR's post-2012 allocation methodology less the portion of those expenses borne by KKR pursuant to its fee sharing arrangements with the applicable funds.

Deficient Compliance Policies and Procedures

28. In October 2008, KKR registered with the Commission as an investment adviser and became subject to the applicable Advisers Act rules governing registered investment advisers, including Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. KKR did not adopt and implement a written compliance policy or procedure governing its broken deal expense allocation practices until 2011.

VIOLATIONS

29. As a result of the conduct described above, Respondent violated Section 206(2) of the Advisers Act, which prohibits an investment adviser, directly or indirectly, from 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) 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.*

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

KKR’S REMEDIAL EFFORTS

31. In determining to accept the Offer, the Commission considered remedial acts taken by KKR and cooperation afforded by KKR to Commission staff during the OCIE compliance examination and subsequent 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 Sections 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. Respondent shall 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 Rule 206(4)-7 thereunder.
- B. Respondent shall pay disgorgement and prejudgment interest as follows:
 - a. Respondent shall pay a total of \$18,677,409 consisting of disgorgement of \$14,165,968 and prejudgment interest of \$4,511,441 (collectively, the “Disgorgement Fund”) to compensate the 2006 Fund

and the other Flagship PE Funds that invested in private equity transactions from 2006 to 2011 pursuant to the provisions of this Subsection B. The disgorgement amount of \$14,165,968 represents: (i) \$17,421,168 of broken deal expenses which is net of the percentage of those expenses borne by KKR pursuant to its fee sharing arrangements with the applicable funds less (ii) the 2014 refund of \$3,255,200 which is net of the percentage of those expenses borne by KKR pursuant to its fee sharing arrangements with the applicable funds;

- b. Within ten (10) days of entry of this Order, Respondent shall deposit the full amount of the Disgorgement Fund into an escrow account acceptable to the Commission staff and shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. If timely deposit of the Disgorgement Fund is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600;
- c. Respondent shall be responsible for administering the Disgorgement Fund. Respondent shall distribute the amount of the Disgorgement Fund to the applicable funds as a credit against or other effective reduction of certain fees or other amounts that the funds would otherwise be obligated to pay to KKR or that KKR would otherwise be entitled to receive. Within 30 days of the entry of this Order, KKR shall submit a proposed distribution to the staff for review and approval. The proposed distribution will include the names of the applicable funds and payment amounts. The distribution of the Disgorgement Fund shall be made in the next fiscal quarter immediately following the entry of this Order but no later than within 90 days of the date of the Order based on a methodology that is consistent with KKR's current broken deal expense allocation methodology. If Respondent does not distribute any portion of the Disgorgement Fund for any reason, including factors beyond Respondent's control, Respondent shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury. Any such payment shall be made in accordance with Section IV.C below;

- d. Respondent agrees to be responsible for all tax compliance responsibilities associated with distribution of the Disgorgement Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondent and shall not be paid out of the Disgorgement Fund; and
 - e. Within 120 days after the date of the entry of the Order, Respondent shall submit to the Commission staff a final accounting and certification of the disposition of the Disgorgement Fund not unacceptable to the staff, which shall be in a format to be provided by the Commission staff. The final accounting and certification shall include: (i) the amount paid or credited to each fund; (ii) the date of each payment or credit; (iii) the check number or other identifier of money transferred or credited to the fund; and (iv) any amounts not distributed to be forwarded to the Commission for transfer to the United States Treasury. Respondent shall submit the final accounting and certification, together with proof and supporting documentation of such payments and credits in a form acceptable to Commission staff, under a cover letter that identifies Kohlberg Kravis Roberts & Co. L.P. as the Respondent in these proceedings and the file number of these proceedings to Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, New York Regional Office, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, New York, 10281, or such other address the Commission staff may provide. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request. Once the Commission approves the final accounting, Respondent shall pay any amounts that have not been distributed to the Commission for transmittal to the United States Treasury.
- C. Respondent shall, within ten (10) days of the entry of this Order, pay a civil monetary penalty in the amount of \$10 million to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with the 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 Kohlberg Kravis Roberts & Co. L.P. 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 Marshall Sprung, Co-Chief Asset Management Unit, Division of Enforcement, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA 90071.

By the Commission.

Brent J. Fields
Secretary