

# KKR CAPITAL MARKETS LIMITED PILLAR 3 DISCLOSURES

DECEMBER 2011

KKR

# KKR Capital Markets Limited Pillar 3 Disclosures

## 1. Background

The European Union Capital Requirements Directive sets out the regulatory framework governing the amount of capital which must be maintained by credit institutions and investment firms. In the UK the directive has been adopted by the Financial Services Authority (“FSA”) within the General Prudential Sourcebook and the Prudential Sourcebook (“BIPRU”) for banks, building societies and investment firms.

The regulatory framework comprises three Pillars:

- Pillar 1 sets out the minimum capital requirements that a firm is required to meet;
- Pillar 2 requires the firm to assess the amount of capital that would be adequate to cover the risks that the firm is or may be exposed to (Internal Capital Adequacy Assessment Process); and
- Pillar 3 requires the firm to disclose its risk management strategies, policies and processes, capital resources, capital requirements and the firm’s approach to assessing capital adequacy.

The purpose of this document is to provide the Pillar 3 disclosures required in BIPRU Chapter 11. The requirements provide for the omission of one or more of the required disclosures if such information is considered to be immaterial, proprietary or confidential.

KKR Capital Markets Limited (“KCML” or the “Firm”) is a private limited company authorised by the UK Financial Services Authority (the “FSA”) as a full scope BIPRU investment firm. KCML is an indirect subsidiary of Kohlberg Kravis Roberts & Co L.P. (“KKR”), a Delaware entity. KKR is a US Securities and Exchange Commission (“SEC”) registered investment advisor.

The firm’s activities are divided into 2 separate lines of business: (i) KCML Capital Markets, which is responsible for carrying out capital markets activities in Europe and (ii) KCML CPG, which is responsible for marketing the funds (the “KKR Funds”) managed and advised by KKR in Europe.

## 2. Scope of Application

KCML is regulated by the FSA on a stand-alone basis and is not subject to consolidated supervision. The Pillar 3 disclosures contained within this document therefore apply to KCML on an individual basis.

## 3. Risk Management

Our risk management policies and processes are comprehensive and proportionate to the nature and scale of KCML’s activities.

The KCML Board of Directors has ultimate responsibility for the wider risk management of the Firm and has appointed a member of the KCML Board of Directors as the Head of Risk Management with the responsibility for implementing and maintaining risk management within KCML.

The KKR Global Risk Committee is responsible for identifying, prioritizing and monitoring risk for the firm on a global basis and is accountable to KKR’s Management Committee, which is responsible for KKR’s global operations. One member of the KCML Board of Directors is a member of the Global Risk Committee.

## Business risk

The following risks are considered to be the most significant business risks:

- **Risk of underwriting pressure on the balance sheet and changes in market conditions and the possibility of poor underwriting decisions.** Underwriting risk is controlled and managed by ensuring that all new underwriting transactions are approved by the Underwriting Committee. KCML considers the risks in its business carefully and seeks to reduce and mitigate risks so as to ensure it maintains an appropriate capital position.
- **Risk regarding the ability to attract and retain appropriate investors into the KKR Funds and management of investor relations.** To manage the risk regarding the ability to attract and retain appropriate investors into the KKR Funds and to successfully manage investor relations, a team of individuals with solid experience in capital raising and investor relations performs marketing activities for the KKR Funds and manages investor relationships.

## Operational risk

Operational risk includes a risk of loss resulting from inadequate or failed internal processes relating to human resources, legal, compliance, information technology, financial reporting, public affairs, tax, insurance and office management. KCML has processes and controls in place to manage and mitigate operational risks and, as a result, operational risks are not considered to be net material risks to the business.

## Credit and market risk

KCML does not have material exposures to credit risk and no material net exposures to market risk.

## 4. Capital Resources and Capital Adequacy

KCML obtained regulatory approval in 2008. As at 30 November 2011, KCML’s capital resources were comprised of Tier 1 capital only, which included share capital and audited accumulated losses

but does not take into account the unaudited profits of the Firm occurring subsequent to such date.

CAPITAL POSITION AS OF 31 DECEMBER 2011 (AMOUNTS IN £'000)	
ORDINARY SHARES	4,050
CAPITAL CONTRIBUTION	6,174
ACCUMULATED LOSSES	3,192
TIER I CAPITAL	13,416

In addition, KCML and certain of its affiliates, through KCML's direct parent company, currently have access to substantial capital resources.

## 5. Minimum Capital Requirement

As at 30 November 2011 KCML's Pillar 1 operational risk capital requirement was £1,101k. The operational risk capital requirement is calculated using the basic indicator approach.

## 6. Oversight

The Directors monitor the ongoing compliance of the firm with its capital requirements and assess the impact on capital adequacy of each deal prior to approval. This ensures that the firm maintains adequate capital to cover its credit, market and operational risks at all times.

## 7. Internal Capital Adequacy Assessment Process ("ICAAP")

KCML conducts an internal assessment of the amount of capital that is considered adequate to cover the risks facing the firm's current and future activities.

Determination of the business strategy for the Firm includes the projection of financial profitability, capital resources and capital requirements. The key risks to which the business is or might be exposed are considered along with the amount of capital that would be considered adequate to cover the Firm in the event that those risks were to crystallize. In addition, the economic environment and the impact of adverse economic conditions on the Firm's profitability and capital position are considered, as well as the actions that management would take in those situations.

## 8. Remuneration Code

KCML is subject to the FSA's rules on remuneration. The rules are contained in the FSA's Remuneration Code located in the SYSC Sourcebook of the FSA's Handbook. The Remuneration Code ("the RemCode") covers an individual's total remuneration both fixed and variable. KCML offers a fixed base salary to its employees and also a variable remuneration, which is dependent on individual and business performance. KCML is responsible for funding the remuneration of employees of its Capital Markets division. Individuals in the CPG group and certain support and control personnel are employed by Kohlberg Kravis Roberts & Co Ltd ("KKRL"). As such KKRL is responsible for their remuneration.

KCML's policy is designed to ensure compliance with the RemCode and the Firm's compensation arrangements:

- Do not encourage excessive risk taking;
- Are consistent with and promote effective risk management;
- Include measures to avoid conflict of interest;
- Are in line with the Firm's business strategy, objectives and interests.

The RemCode requires authorised firms to apply principles of proportionality when establishing and applying their remuneration policies. The FSA applies the proportionality by categorising firms into four tiers. KCML falls into tier three and as such this disclosure is made in line with the requirement of a tier three firm.

The remuneration of the KCML Board members is approved by the KKR Management Committee with the assistance of KKRL's human resource department, having regard to the principles laid out in the Firm's Remuneration Policy Statement and the Firm's Conflict of Interest Policy. Similarly, remuneration for other KCML employees is overseen by the KCML Board, in line with the strategic guidelines and decisions of the wider KKR Capital Markets business and KKR Management Committee, with the assistance of KKRL's human resources.

Appropriate measures are taken to ensure that Support and Control Employees are not placed in a position where their activities could be directly linked to an increase in their variable Remuneration. In addition to reporting to the KCML's CEO, the Support and Control Employees have independent reporting lines to the Global Head of the relevant Support and Control function who may have the primary input on the Support and Control Employee remuneration.

Remuneration is made up of fixed and variable elements. Variable remuneration is discretionary and is awarded based on performance against a number of financial and non-financial metrics, in each case taking appropriate consideration of all regulatory guidance, the function of the relevant employees and the impact of their actions on the risk profile of the Firm. Variable remuneration is paid in cash and in certain cases in common units of KKR, which may be subject to a deferral process.

As at 31 December 2011 there were eight personnel classified as 'Code Employee', including five individuals who are not solely dedicated to KCML and consequently the majority of their remuneration is in respect of work undertaken for other firms within KKR in the UK and they are not paid by KCML. All eight personnel are classified as Senior Management within the Firm.

For the year ended 31 December 2011, total remuneration payable to Senior Management who are involved in the KCML business was £3.4m. This figure is split £1.2m for fixed remuneration and £2.2m for variable remuneration.