

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940

Release No. 4494 / August 24, 2016

ADMINISTRATIVE PROCEEDING

File No. 3-17491

In the Matter of

WL ROSS & CO. LLC

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 WL Ross & Co. LLC (“WL Ross” or “WLR” 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 and are not binding on any other person or entity in this or any other proceeding.

SUMMARY

1. These proceedings arise from the failure of private equity fund adviser WL Ross to disclose its fee allocation practices to certain private equity funds it advised (the “WLR Funds”) and their investors, which resulted in the WLR Funds paying higher management fees between 2001 and 2011. Respondent WL Ross is a private equity firm that focuses on investing in and restructuring financially distressed companies. WL Ross provides investment advisory services to the WLR Funds, as well as to other private equity funds, co-investment vehicles, and separately managed accounts. WL Ross also provides advisory and other services to certain portfolio companies in which its clients invest. The limited partnership agreements (the “LPAs”) governing the WLR Funds contemplate that WL Ross may receive fees from the portfolio companies for certain services that WL Ross provides from time to time. These fees, as defined in the relevant LPAs for the WLR Funds, include break-up, origination, commitment, broken deal, topped bid, cancellation, monitoring, closing, financial advisory, investment banking, director or other transaction fees (collectively, “Transaction Fees”).

2. The LPAs provide that the quarterly management fees payable by the WLR Funds to WL Ross “shall be reduced” by an amount equal to 50% (or 80%, depending on the particular fund’s LPA) of “any” Transaction Fees received by WL Ross during the prior quarter from portfolio investments of the WLR Funds. Accordingly, WL Ross allocates a percentage of the Transaction Fees it receives from the portfolio companies to the WLR Funds in order to offset the quarterly management fees payable by the WLR Funds. The WLR Funds’ governing documents, however, do not disclose how Transaction Fees shall be allocated when multiple WLR Funds and other co-investors are invested in the same portfolio company.

3. Between 2001 and 2011, WL Ross adopted a Transaction Fee allocation methodology that resulted in WLR retaining a significant amount of those fees for itself rather than allocating them to the WLR Funds for the purpose of offsetting the management fee. Specifically, WL Ross allocated Transaction Fees that it earned from portfolio investments to the WLR Funds based upon their relative ownership percentages of the portfolio company without disclosing this practice. As a result, WL Ross retained for itself that portion of the Transaction Fees that was based upon co-investors’ relative ownership of the portfolio company, without subjecting such fees to any management fee offsets. WLR did not disclose to the WLR Funds and to the Funds’ limited partners that it would allocate Transaction Fees according to the above allocation methodology, and that WLR construed the ambiguous provisions in the relevant LPAs in its own favor rather than the WLR Funds’ favor. If WL Ross had instead adopted a methodology requiring the allocation of all Transaction Fees pro rata among the investing WLR Funds (and other WLR funds that also had offset provisions) and offset the WLR Funds’ management fees accordingly, the WLR Funds (and other WLR funds that also had offset provisions) would have received the benefit of all Transaction Fees received by WL Ross. WL Ross received approximately \$10.4 million more in management fees using the selected methodology than if it had allocated Transaction Fees pro rata among the WLR Funds for management fee offset purposes during the relevant time period.

4. WLR did not disclose to the WLR Funds, their Advisory Boards, and to the Funds’ limited partners that it would allocate Transaction Fees to the WLR Funds based on the Funds’ relative ownership percentages of the portfolio company and that WLR retained that

portion of the Transaction Fees that was based upon the relative ownership percentages of the portfolio company attributable to co-investors. As a result, WLR omitted material information concerning its fee allocation practices in violation of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

RESPONDENT

5. WL Ross & Co. LLC, a Delaware limited liability company, is a private equity firm that was founded in 2000. WL Ross registered as an investment adviser with the Commission in April 2007. WL Ross is headquartered in New York, New York. Since 2006, WL Ross has been wholly owned by Invesco Private Capital, Inc., a subsidiary of Invesco Ltd., a publicly traded company (collectively, “Invesco”). WL Ross provides investment advisory services to the WLR Funds and other private equity funds, as well as to separately managed accounts and co-investment vehicles. According to its most recent Form ADV filing as of April 21, 2016, WL Ross has approximately \$4.6 billion in assets under management.

RELEVANT ENTITIES

6. WLR Recovery Fund, L.P.; WLR Recovery Fund II, L.P.; Invesco Mortgage Recovery Feeder Fund, L.P.; WLR IV PPIP Co-Invest, L.P. and WLR Whole Loan Fund, L.P. (collectively, the “WLR Funds”) are each Delaware limited partnerships and private investment funds formed to make investments in a variety of assets. None of the WLR Funds is registered with the Commission in any capacity. WL Ross provides investment advisory services to all of the WLR Funds.

FACTS

A. Background

7. WL Ross is a New York-based private equity firm that advises the WLR Funds and other private equity funds, as well as separately managed accounts and co-investment vehicles, with a focus on investing in and restructuring financially distressed companies. The limited partners in the WLR Funds include pension funds, university endowments and other large institutional investors, and high net worth individuals. The limited partners typically commit a specified amount of capital to a fund for its use to make qualifying investments during the investment period of the fund. Each WLR Fund has an Advisory Board, comprised of certain limited partners, to advise regarding conflicts of interest, valuations of securities and other issues.

8. Each WLR Fund is governed by an LPA setting forth the rights and obligations of its limited partners, including their obligations to pay advisory and other fees and expenses to WL Ross pursuant to a separate management agreement between the fund and WL Ross. Among other fees and expenses, WL Ross charges each WLR Fund an annual advisory or management fee, which generally ranges from 0.75% to 1.5% of committed capital during the investment period.

9. From time to time, WL Ross also receives Transaction Fees directly from certain portfolio investments of the WLR Funds for providing monitoring, financial advisory, and other services, as contemplated by the LPAs in certain circumstances. The Transaction Fees paid by portfolio companies to WL Ross are in addition to the management fees paid by the WLR Funds to WL Ross. WL Ross allocates a percentage of the Transaction Fees it receives from the portfolio companies to the WLR Funds in order to offset the quarterly management fees payable by the WLR Funds. The offset percentage is set forth in each fund's LPA. All of the WLR Fund LPAs provide for a 50% management fee offset with the exception of the WLR Recovery Fund, L.P. ("Fund I"), which provides for an 80% management fee offset.

10. The LPA provisions concerning the management fee offsets for the WLR Funds are all substantially similar to the language in the WLR Recovery Fund II, L.P. LPA, which provides at Section 5.03, Management Fees, that:

The Management Fee shall be reduced in any given quarter by an amount equal to fifty percent (50%) of any break-up, origination, commitment, broken deal, topped bid, cancellation, monitoring, closing, financial advisory, investment banking, director or other transaction fees received by the General Partner or any Affiliate thereof during the prior quarter from Portfolio Investments.²

11. WLR omitted material information regarding how Transaction Fees shall be allocated when multiple WLR Funds and co-investors are invested in the same portfolio company.

B. WL Ross' Historical Transaction Fee Allocation Practice

12. WL Ross' Transaction Fee allocation practice originated in 2001 in connection with the allocation of co-investment fees arising from a certain transaction (the "2001 Transaction").³ In 2001, WL Ross formed a special purpose limited partnership ("SPLP") for the sole purpose of investing in the 2001 Transaction. The SPLP was comprised of three WLR funds - Asia Recovery Fund, L.P., Asia Recovery Co-Investment Partners, L.P. (collectively, "Asia Funds"), and Fund I - as well as other co-investors. Together, Fund I and the two Asia Funds contributed approximately 40% in capital to the SPLP, while the co-investors contributed the remaining 60% in capital. Upon acquiring the portfolio company, the SPLP co-investors paid WL Ross a one-time \$3.9 million fee as compensation for negotiating, advising and structuring the 2001 Transaction.

13. Allocating the entire \$3.9 million co-investment fee to each of the three funds in the 2001 Transaction would have resulted in WL Ross providing total management fee offsets to the funds greater than the actual co-investment fee it received in connection with the

² "Portfolio Investments" is defined in the LPA as "assets of the Partnership" that are invested in securities of companies.

³ Although WL Ross later determined that the LPAs did not require that co-investment fees paid to WL Ross by co-investors be allocated to the WLR Funds for offset purposes, it devised the allocation practice at the time of the 2001 Transaction and applied it consistently to both co-investment fees and Transaction Fees until 2014.

transaction.⁴ WL Ross instead determined to allocate the \$3.9 million co-investment fee to the two Asia Funds and Fund I based on their relative ownership percentages of the portfolio company. Because the three funds collectively owned 40% of the portfolio company, WL Ross allocated 40% of the \$3.9 million co-investment fee to the funds (approximately \$1.6 million), and then offset the funds' management fees according to the fee offset percentages specified in each fund's LPA (80% for Fund I, 50% for each Asia Fund), resulting in a combined management fee offset of \$962,000 for the three funds.

14. By interpreting the ambiguous language in the relevant LPAs as permitting it to adopt this allocation methodology, WL Ross retained 60% of the fee that was based on the co-investors' 60% ownership share of the portfolio company. If WL Ross instead had adopted a methodology allocating all of the fees pro rata among the investing WLR funds, the three WLR funds investing in the 2001 Transaction would have received management fee offsets totaling \$2.35 million rather than the \$962,000 they actually received.⁵

15. Beginning with the 2001 Transaction and through 2011, WL Ross consistently allocated Transaction Fees it received from portfolio investments to the WLR Funds according to their ownership percentages of the portfolio companies. If WL Ross had instead allocated Transaction Fees pro rata between the investing WLR Funds, the WLR Funds would have received a larger credit for purposes of management fee offsets. By retaining the portion of the Transaction Fees allocable to co-investors' relative ownership share of the portfolio companies, WL Ross received approximately \$10.4 million in additional management fees from the WLR Funds during the ten-year period between 2001 and 2011.

16. As noted above, WLR did not disclose how to allocate Transaction Fees when multiple WLR funds and co-investors are invested in a portfolio company. WL Ross did not disclose to the WLR Funds, the Funds' Advisory Boards, or the Funds' limited partners its chosen practice of allocating Transaction Fees based upon the WLR Funds' relative ownership percentages of the portfolio company. As a result, the WLR Funds, their boards, and limited partners may not have been aware that the WLR Funds did not receive that portion of the Transaction Fees allocable to co-investors' ownership percentages of the portfolio companies, or that WL Ross retained for itself that portion of the Transaction Fees instead.

C. 2014 OCIE Examination, WL Ross' Remediation, and Implementation of New Allocation Methodology

⁴ Using that approach, WL Ross would have been required to allocate fee offsets to Fund I of \$3.12 million (80% of \$3.9 million) and fee offsets to the two Asia Funds of \$1.95 million each (50% of \$3.9 million), totaling \$7.02 million in management fee offsets on the \$3.9 million co-investment fee received by WL Ross.

⁵ Fund I held approximately 14% and the two Asia Funds collectively held approximately 26% of the three funds' combined 40% ownership in the 2001 Transaction. If WLR had adopted a pro rata allocation methodology, Fund I would have been allocated approximately 35% (or 14% of 40%) of the \$3.9 million co-investors' fee, or \$1.4 million, and the two Asia Funds collectively would have been allocated 65% (or 26% of 40%) of the \$3.9 million fee, or \$2.5 million. Those allocations would then have been subject to the offset provisions of the LPAs, and the funds would have received management fee offsets of \$1.1 million (Fund I, 80% offset), and \$1.25 million (Asia Funds, 50% offsets), for a combined management fee offset of approximately \$2.35 million between the three funds.

17. In 2014, staff from the Commission’s Office of Compliance Inspections and Examinations (“OCIE”) conducted an examination of WL Ross. In reviewing management fee and fee offset data produced to the OCIE staff, WL Ross determined to revisit the methodology used to allocate Transaction Fees to WLR Funds that had invested with co-investors in portfolio companies. On August 20, 2014, WL Ross brought the issue to the attention of the OCIE staff.

18. After conducting an internal review, WL Ross voluntarily proposed and adopted a new methodology allocating all Transaction Fees received from a portfolio company pro rata across the WLR Funds that participated in the portfolio investment and recognized that it had not done so in the past. WL Ross then voluntarily retroactively applied this methodology to recalculate all historical management fees and offsets dating back to the inception of the funds. WLR adopted this new methodology even for its later funds where the LPAs specifically contemplated the use of the older methodology. WL Ross submitted its reimbursement calculations for review and verification to the WLR Funds’ independent auditor, as well as to Invesco’s Internal Audit Group, an independent accounting firm, and a forensic accounting firm.

19. WL Ross voluntarily reimbursed the WLR Funds approximately \$10.4 million in management fees and \$1.4 million in interest during the course of the OCIE exam and the staff’s investigation as a result of retroactively applying its corrected Transaction Fee allocation methodology to the inception of the funds. WL Ross also disclosed the new methodology and reimbursement to the WLR Funds’ investors in a series of written communications and meetings.

20. Since the OCIE exam, WL Ross has voluntarily taken a number of actions to strengthen its controls and compliance systems. WL Ross hired a new Chief Compliance Officer (“CCO”) and the CCO now participates in all of WL Ross’ key committees. WL Ross also engaged an independent accounting firm to perform an internal controls review of its back-office functions, and implemented the firm’s recommendations for enhancements to its processes and internal controls, including to the expense review and approval process and the tracking and monitoring of Transaction Fees.

21. WL Ross also implemented new controls concerning the review and approval of expense reimbursements and fee offsets. In December 2014, WL Ross revised the Expense Processing and Allocation Policy it had adopted in 2011. Under the revised policy, management fee calculations as well as Transaction Fees from portfolio investments and related fee offset calculations must be reviewed and approved by the Chief Financial Officer and the Expense Review Group, a new group comprised of senior management, the Chief Financial Officer, and legal and compliance representatives, to ensure appropriate allocations and compliance with the relevant fund offering documents and agreements.

VIOLATIONS

22. As a result of the conduct described above, WL Ross 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. 1999) (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.*

23. As a result of the conduct described above, WL Ross violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which 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.” A violation of Section 206(4) and the rules thereunder does not require scienter. *Steadman*, 967 F.2d at 647.

WL ROSS ’ COOPERATION AND REMEDIAL EFFORTS

24. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by WL Ross and cooperation afforded the Commission staff, including WL Ross’ self-reporting of the Transaction Fee allocation issue to the OCIE staff, WL Ross’ voluntary determination to revise its fee allocation methodology, and WL Ross’ voluntary reimbursement, with interest, of \$11,873,571 in management fee credits resulting from its retroactive application of the revised allocation methodology to the inception of the WLR Funds.

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 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)-8 thereunder.

B. Respondent shall, within ten (10) days of entry of this Order, pay a civil money penalty in the amount of \$2.3 million to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Securities Exchange Act of 1934. 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 WL Ross 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 Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

By the Commission.

Brent J. Fields
Secretary