

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4980 / August 9, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18633

In the Matter of

**KNOWLEDGE LEADERS
CAPITAL, 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 Knowledge Leaders Capital, LLC (“Knowledge Leaders” 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. This matter relates to Knowledge Leaders' use of client commissions under Section 28(e) of the Securities Exchange Act of 1934 ("Exchange Act"), commonly called "soft dollars," to purchase approximately \$1 million in research over a three-year period from a firm affiliated with an individual that was, at the time, the Managing Director of Knowledge Leaders and also functioned as its chief investment officer ("CIO"). While the Knowledge Leaders Management Committee approved the CIO's company as a soft dollar recipient and approved the payments made to the CIO's company for use of its research software, Knowledge Leaders failed to identify (and as a result, failed to disclose to clients) the financial conflicts of interest created by Knowledge Leaders using soft dollars to pay a company owned and controlled by Knowledge Leaders' CIO. As a result, Knowledge Leaders violated Section 206(4) and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act in connection with the identification and disclosure of conflicts of interest relating to the use of soft dollars.

2. In spring 2017, Knowledge Leaders, at the direction of its CIO (who had by then become the majority owner of Knowledge Leaders and its Chief Executive Officer ("CEO")), self-reported the above conduct to the Commission staff. At the time of the self-report, at the CIO's direction, Knowledge Leaders had already undertaken significant remedial measures, which are described more fully below, and subsequently cooperated with the Commission staff's investigation. Among other facts, the Commission considered the seriousness of the misconduct, which took place over three years, and Knowledge Leaders' self-report, cooperation, and remedial measures, all of which were done at the direction of the CIO, in determining the appropriate resolution in this case.

Respondent

3. **Knowledge Leaders Capital, LLC**, a Colorado limited liability company based in Denver, Colorado, has been registered with the Commission as an investment adviser since 2008. Knowledge Leaders was organized as a limited liability company in 2006 under the original name Gavekal Capital, LLC and changed its name to Knowledge Leaders in March 2017. Knowledge Leaders has been majority owned by its CIO since mid-2016. As of December 31, 2017, Knowledge Leaders had approximately \$497 million in assets under management, all of which were managed on a discretionary basis.

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.

Background

4. In 2011, the CIO began developing, through a separate company he owned and controlled, research software containing a proprietary algorithm that assisted portfolio managers in making investment decisions (the “Software”).

5. In early 2012, Knowledge Leaders, at the direction of its CIO, began using the Software and making payments to the CIO’s separate company. As both the Knowledge Leaders CIO and the owner of the Software, the CIO determined the amount Knowledge Leaders paid for using the Software, which was \$50,000 in 2012. While the CIO made the decision for Knowledge Leaders to use and pay for the Software, the Knowledge Leaders Management Committee, which included the firm’s CIO, Chief Compliance Officer (“CCO”), and Trading and Operations Manager (collectively, the “Management Committee”), were aware of the payments. At that time, Knowledge Leaders did not use soft dollars to pay for the Software.

6. By late 2012, the Software had become more integral to Knowledge Leaders’ investment process, and the firm began to consider using soft dollars under Section 28(e) of the Exchange Act to pay for the Software. The Management Committee was responsible for decisions relating to soft dollars. The Management Committee determined that payments made to the CIO’s company for the Software were eligible to be made with soft dollars. Accordingly, starting in the first quarter of 2013, Knowledge Leaders began using soft dollars to pay for the Software.

7. From January 2013 through January 2016 (the “Relevant Period”), the Management Committee met quarterly to review, among other items, the soft dollar credit recipients and payment amounts. The Management Committee approved the amount of soft dollars used to pay for the Software during these meetings.

8. The soft dollars paid to the CIO’s company increased significantly during the Relevant Period, purportedly as a result of upgrades to the Software and an increased importance of the Software to Knowledge Leaders’ investment process. In the first quarter of 2013, Knowledge Leaders paid \$24,000 for the use of the Software. During the Relevant Period, at the direction of the CIO and with the approval of the Management Committee, the amount paid for the Software to the CIO’s company increased four times: (i) to \$48,000 in the third quarter of 2013; (ii) to \$62,500 in the first quarter of 2014; (iii) to \$75,000 in the third quarter of 2015; and (iv) to \$400,000 in the last quarter of 2015. The final \$400,000 payment was purportedly for the last quarter of 2015 and a portion of 2016 as well. In total, during the Relevant Period, Knowledge Leaders paid the CIO’s company \$994,000 using soft dollars.

9. During the Relevant Period, Knowledge Leaders failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder in connection with identification and disclosure of conflicts of interest. Knowledge Leaders had a written supervisory manual and Code of Ethics that required Knowledge Leaders and its personnel to disclose potential or actual conflicts of interest when dealing with clients. Aside from these, however, Knowledge Leaders had no other compliance policies and procedures addressing conflicts of interest and Knowledge Leaders did not have an adequate

process in place to identify or disclose conflicts of interest or any training regarding identifying or disclosing conflicts of interest.

10. As a result, during the Relevant Period, Knowledge Leaders failed to identify, and therefore failed to disclose, the conflicts of interest arising from (a) the CIO's ownership and control of the soft dollar recipient and the CIO's control of Knowledge Leaders by virtue of his senior position as CIO, and (b) the CIO's role in both determining the price charged by his company for the Software and approving the amount paid by Knowledge Leaders as a member of the Management Committee.

Violations

11. As a result of the conduct described above, Knowledge Leaders violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require a registered investment adviser to, among other things, "[a]dopt and implement written policies and procedures reasonably designed to prevent violation" of the Advisers Act and its rules.

Respondent's Remedial Efforts

12. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Knowledge Leaders and cooperation afforded the Commission staff.

13. When the CIO also became the CEO and majority owner of Knowledge Leaders in mid-2016, the CCO suggested Knowledge Leaders seek outside counsel to review the firm's compliance and policies and procedures given the change in control. The CIO approved this request and outside compliance counsel was hired. During its review, outside compliance counsel identified the issue related to the undisclosed conflict of interest with the soft dollar payments to the CIO's company. Immediately after the conflict was identified, the CCO recommended and the CIO approved the retention of counsel to conduct an internal investigation.

14. When the internal investigation confirmed the undisclosed conflict, Knowledge Leaders, at the CIO's direction, notified the firm's clients of the undisclosed conflict of interest related to the soft dollar payments to the CIO's company. The CIO also approved returning to clients all money used, with interest, for the soft dollar payments to the CIO's firm.

15. Additionally, as a result of the internal investigation, Knowledge Leaders took several steps to strengthen its compliance. Knowledge Leaders restructured its compliance reporting structure, including hiring a new CCO and changing the reporting structure so the CCO reports to a newly-formed Executive Committee. Knowledge Leaders, with the assistance of outside counsel and a compliance consultant, developed new policies and procedures to prevent future violations. Knowledge Leaders hired new external legal and compliance counsel to provide on-going guidance and support. Knowledge Leaders also retained an outside compliance consultant to conduct a comprehensive review of its compliance policies and procedures ("third-party consultant"). The third-party consultant provided a report regarding its review, including recommendations, to Knowledge Leaders in November 2017 ("2017 Report").

16. In July 2017, the CIO directed Knowledge Leaders to voluntarily self-report the conduct to Commission staff. Knowledge Leaders then cooperated with the staff's investigation.

Undertakings

Knowledge Leaders has undertaken to:

1. Within sixty (60) days of the date of the issuance of this Order, adopt all recommendations made by the third-party consultant in the 2017 Report; provided, however, that within thirty (30) days of the date of the issuance of this Order, Respondent may advise the third-party consultant in writing of any recommendation that it considers to be unnecessary, outside the scope of this Order, unduly burdensome, or impracticable. Respondent need not adopt any such recommendation at that time, but instead may propose in writing to the third-party consultant and the Commission staff an alternative policy or procedure designed to achieve the same objective or purpose. Respondent and the third-party consultant shall engage in good-faith negotiations in an effort to reach agreement on any recommendations objected to by Respondent. In the event that the third-party consultant and Respondent are unable to agree on an alternative proposal within thirty days (30) days of the date of the issuance of this Order, Respondent shall abide by the determinations of the third-party consultant. Respondent shall advise the Commission staff in writing that it has adopted all recommendations made by the third-party consultant in the 2017 Report within thirty (30) days of its adoption of all recommendations by the third-party consultant in the 2017 Report.
2. Within 360 days of the date of the issuance of this Order, retain the services of an independent consultant different from the third-party consultant that completed the 2017 Report, not unacceptable to the staff ("Independent Consultant"), and:
 - a) Provide to the Commission staff a copy of the engagement letter detailing the scope of the Independent Consultant's responsibilities. The Independent Consultant's compensation and expenses shall be borne exclusively by Respondent.
 - b) Require the Independent Consultant to conduct a comprehensive review of Respondent's policies, procedures, and practices related to assessing conflicts of interest and disclosure thereof (the "Independent Consultant's Review"). Respondent shall require that the Independent Consultant's Review begin no later than 360 days from the date of the issuance of this Order and be completed no later than 450 days from the date of the issuance of this Order.
 - c) Require the Independent Consultant, within 480 days from the date of the issuance of this Order, to issue a detailed written report (the "Consultant Report") to Respondent (a) summarizing the Independent Consultant's Review and (b) making recommendations, where appropriate, to revise Respondent's policies, procedures, and practices related to assessing conflicts of interest and disclosure

thereof so that they are reasonably designed to prevent violations of the federal securities laws. Respondent shall require the Independent Consultant to provide a copy of the Consultant Report to the Commission staff when issued.

- d) Adopt, as soon as practicable, all recommendations of the Independent Consultant in the Consultant Report; provided, however, that within thirty (30) days of the issuance of the Consultant Report, Respondent may advise the Consultant in writing of any recommendation that it considers to be unnecessary, outside the scope of this Order, unduly burdensome, or impracticable. Respondent need not adopt any such recommendation at that time, but instead may propose in writing to the Independent Consultant and the Commission staff an alternative policy or procedure designed to achieve the same objective or purpose. Respondent and the Independent Consultant shall engage in good-faith negotiations in an effort to reach agreement on any recommendations objected to by Respondent. In the event that the Independent Consultant and Respondent are unable to agree on an alternative proposal within thirty (30) days of the issuance of the Consultant Report, Respondent shall abide by the determinations of the Independent Consultant.
- e) Require the Independent Consultant, within 540 days from the date of the issuance of this Order, to submit a written final report (the "Final Report") to the Commission staff. The Final Report shall (a) describe the review the Independent Consultant made of Respondent's policies, procedures, and practices; (b) set forth the conclusions reached and the recommendations made by the Independent Consultant, as well as any proposals made by Respondent as described in subpart 2d above; (c) describe how Respondent has implemented / is implementing the Independent Consultant's recommendations; (d) certify that the Independent Consultant agrees with Respondent's adoption and implementation of its recommendations; and (e) include an opinion of the Independent Consultant on whether Respondent's revised policies, procedures, and practices related to assessing conflicts of interest and disclosure thereof and their implementation and enforcement by Respondent are reasonably designed to prevent violations of the federal securities laws.
- f) Take all necessary and appropriate steps to adopt and implement all recommendations contained in the Final Report by no later than 570 days from the date of the issuance of this Order. Respondent shall notify the Independent Consultant and Commission staff in writing when the recommendations have been implemented.
- g) Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide

that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

- h) Certify, in writing, compliance with the undertakings set forth above as listed in Item 1 and 2 of the “Undertakings” section of this Order. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Jason J. Burt, Assistant Regional Director, Asset Management Unit, Denver Regional Office, Securities and Exchange Commission, Byron G. Rogers Federal Building, 1961 Stout Street, Suite 1700, Denver, Colorado, 80294, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.
- i) Respondent may apply to the Commission staff for an extension of the deadlines described above before their expiration and, upon a showing of good cause by Respondent, Commission staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate. The procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday the next business day shall be considered to be the last day.

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 Knowledge Leaders cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

B. Respondent Knowledge Leaders shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$50,000 to the 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 Knowledge Leaders 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 Jason J. Burt, Assistant Regional Director, Asset Management Unit, Denver Regional Office, Securities and Exchange Commission, Byron G. Rogers Federal Building, 1961 Stout Street, Suite 1700, Denver, Colorado, 80294.

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.

D. Respondent Knowledge Leaders shall comply with the undertakings enumerated in Section III above.

By the Commission.

Brent J. Fields
Secretary