

ADMINISTRATIVE PROCEEDING  
BEFORE THE  
MARYLAND SECURITIES COMMISSIONER

IN THE MATTER OF:

\*

KH FUNDING COMPANY,

\*

and

\*

Case No. 2008-0159

ROBERT L. HARRIS,

\*

Respondents.

\*

\* \* \* \* \*

**CONSENT ORDER**

WHEREAS, the Maryland Division of Securities (the “Division”), pursuant to the authority granted by section 11-701 of the Maryland Securities Act, Title 11, Md. Code Ann., Corps. & Ass’ns (2007 Repl. Vol.) (the “Securities Act” or “Act”), in the course of reviewing a registration filing by KH Funding Company (“KH Funding”), initiated an investigation into the activities of its former employee Martin Angeli (“Angeli”) and possible violations of the Act by KH Funding and Robert L. Harris (“Harris”) (collectively “Respondents”); and

WHEREAS, based on the information presented by the Division, the Maryland Securities Commissioner (the “Commissioner”) has concluded that Respondents engaged in acts or practices constituting violations of the Act and the regulations promulgated under the Act; and

WHEREAS, Respondents consent to the Findings of Fact, to the jurisdiction of the Commissioner and to the imposition of sanctions, but neither admit nor deny the Conclusions of Law; and

WHEREAS, Respondents voluntarily waive any right to a hearing and appeal with respect to this Consent Order; and

WHEREAS, the Commissioner has determined that it is in the public interest to accept this Consent Order,

NOW THEREFORE, without the holding of a hearing in this matter, and upon consent of the parties hereto,

IT IS HEREBY AGREED AND ORDERED:

**I. JURISDICTION**

1. The Commissioner has jurisdiction in this proceeding and over Respondents pursuant to section 11-701.1 of the Act.

**II. RESPONDENTS**

2. Respondent KH Funding, is a Maryland corporation with a principal office located at 10801 Lockwood Drive, Suite 370, Silver Spring, Maryland 20901. KH Funding is a small company with fewer than ten employees.

3. Respondent Harris has been president, CEO and director of KH Funding since the company was incorporated in 1994. He has also served as acting CFO of the company from October 5, 2007 to the present. He resides in Montgomery County, Maryland.

**III. FINDINGS OF FACT**

The Commissioner finds the following facts.

4. KH Funding issues interest-bearing debt securities (“investor notes”) to investors and originates, acquires and services mortgage loans.

5. KH Funding filed a registration statement (Maryland File No. SR20060032) on June 28, 2006, and several amendments to that registration statement.

6. In the course of reviewing Post-Effective Amendments Nos. 2 and 3 to KH Funding’s June 2006 registration statement, the Division learned that its former Senior Vice

President Martin Angeli had been criminally charged by the Montgomery County State's Attorney's Office for allegedly stealing close to \$75,000 from an investor in KH Funding's debt securities. According to the application for statement of charges dated July 16, 2007, Angeli deposited into his own bank account at least eight checks intended for deposit into the client's account at KH Funding. The client wrote three of those checks to KH Funding; the other checks were third party checks.

7. As a result of the criminal charges, the Division looked into the role that Angeli had played at KH Funding and into KH Funding's investigation of the Angeli matter.

8. The Division's review of KH Funding's investigation of the charges against Angeli revealed that KH Funding and Harris accepted Angeli's characterization of the transactions as personal loans, despite the fact that three of the checks allegedly misappropriated were written to KH Funding. The Division's review also determined that KH Funding retained Angeli in his position as a senior vice president for nearly five months after the criminal charges were filed and more than one year after Respondents were made aware of the alleged theft. KH Funding has informed the Division that Angeli was prohibited from handling investor funds after his arrest. Harris was personally involved in KH Funding's investigation, which the Division believes was inadequate.

9. The Division's review also showed that KH Funding failed to obtain or maintain complete investor records, failed to take steps to reasonably handle certain investor funds and waived its own guidelines for handling investor accounts in a situation that the Division believes warranted a higher level of scrutiny. For example, KH Funding's files lack any subscription agreement or other account opening document with respect to an investor account opened with

the assistance of Angeli; KH Funding and Harris allowed Angeli, on behalf of his mother as purported owner of funds, to direct more than \$864,000 into this account; the Division believes that KH Funding did not take reasonable steps to confirm ownership of those funds and that these funds belong to someone other than Angeli's mother; and KH Funding and Harris permitted the account to hold far more funds than the \$250,000 maximum that KH Funding's policy generally allows for such short term demand accounts. The Division believes that these actions could subject KH Funding to potential legal consequences.

10. The Division believes that, due to a deficiency in KH Funding's record keeping, procedures for handling investor funds and controls over its personnel, it was possible for Angeli both to misappropriate funds intended for a KH Funding account and to direct misappropriated funds into a KH Funding account, which may result in financial liability to KH Funding to the detriment of its investors.

11. These lapses in financial controls are consistent with KH Funding management's conclusion that there were material weaknesses in KH Funding's internal control over financial reporting, as disclosed in its most recent Annual Report on Form 10-KSB.

12. Angeli met with and responded to inquiries from investors and potential investors even though he was not registered as an issuer agent of KH Funding.

13. The Securities Commissioner has issued an Order to Show Cause against Angeli alleging that he violated the anti-fraud provisions of the Securities Act in connection with his handling of transactions for two clients and acted as an unregistered broker-dealer agent.

14. On August 4 and September 5, 2008, KH Funding filed with the Division post-effective amendments for review and comment, which were signed by Harris, to its June 28,

2006 registration statement. Although these filings were not declared effective or used to sell investor notes, they did not disclose that KH Funding had not paid within a 30 day grace period after payments were due a number of investors who asked to redeem their notes or whose notes had matured.

16. The Trustee of the Indenture relating to the investor notes informed the Division that the Trustee expects KH Funding to promptly notify the Trustee if KH Funding fails to satisfy an investor note redemption request or maturity payment within 30 days after the date set for payment.

17. KH Funding did not promptly notify the Trustee that it had not paid some investors within 30 days after the dates set for redemption or maturity.

#### **IV. CONCLUSIONS OF LAW**

The Commissioner concludes that:

18. Angeli acted as an unregistered issuer agent of KH Funding in violation of section 11-401 of the Act.

19. Respondent KH Funding used Angeli to offer and sell its notes, in violation of section 11-402 of the Act.

20. Respondent Harris, as a control person of KH Funding, failed to recognize that Angeli needed to be registered as an issuer agent of KH Funding, and thus violated section 11-402 of the Act.

21. Respondent KH Funding violated section 11-303 of the Act by filing with the Division post-effective amendments to its registration statement on August 4 and September 5, 2008 that did not disclose the facts discussed above in Paragraphs 15 and 17.

## **V. CONSENT TO SANCTIONS**

Respondents each expressly agree and consent, and it is ordered that:

22. Respondents shall permanently cease and desist violating Section 11-402 of the Act.

23. Respondent KH Funding shall pay to the Office of the Attorney General a civil penalty of \$100,000. Collection of \$85,000 of that fine is waived in light of respondents' current financial condition. Respondent's payment has been submitted along with this Consent Order.

24. Respondent KH Funding shall disclose as a risk factor in future disclosure to investors and filings with the Division and the S.E.C. that there have been deficiencies in its record keeping, procedures for handling investor funds, controls over its personnel, and compliance with the notification requirements of the indenture.

25. Respondent KH Funding, in the event it does not pay investors within 30 days after the redemption due date or maturity date, shall notify the Indenture Trustee within two business days of the non-payment.

26. Respondent KH Funding shall retain an independent consultant to review the firm's record keeping practices and internal controls, and to make recommendations concerning its record keeping practices and internal controls. KH Funding shall provide the Division with a copy of the consultant's report no later than two months from the date of this Consent Order, and with a copy of any follow-up reports or correspondence showing the firm's implementation of the consultant's recommendations. The consultant shall also monitor KH Funding's compliance with its obligations when there is more than a 30 day delay in making payment in connection with investor notes after a redemption due date or maturity date. For three years following the

date of this Order, KH Funding shall report quarterly to the Division any such pending late payment on investor notes, including the number, the type of investor note, the dollar amount, and the date of redemption request or maturity.

27. Respondents shall comply fully with the Securities Act and the regulations promulgated thereunder.

#### **VI. CONSEQUENCES OF VIOLATION OF CONSENT ORDER**

If a Respondent fails to comply with any term of this Consent Order, the Division may institute administrative or judicial proceedings against the Respondent to enforce this Consent Order or to sanction the Respondent for violating an Order of the Commissioner, and may take any other action authorized under the Act or any other applicable law, including the issuance of fines or penalties as provided by the Act. The Respondent will receive notice and have an opportunity to argue that he or it has not materially violated the terms of this Consent Order. For the purpose of determining sanctions, the Findings of Fact and violations of the Act set forth in this Consent Order shall be deemed admitted, and may be introduced into evidence against the Respondent. To ensure that Respondents comply with this Consent Order, each of the Respondents hereby waives any limitations imposed by Section 5-107 of the Courts and Judicial Proceedings Article of the Annotated Code of Maryland on the Division's ability to bring an enforcement action for fines in court under this Consent Order for 12 months after the first anniversary of the date of this Consent Order.

#### **VII. MODIFICATION OF TERMS OF THIS CONSENT ORDER**

The terms of this Consent Order may only be modified by a subsequent order issued by the Commissioner.

**VIII. JURISDICTION RETAINED**

Jurisdiction shall be retained by the Commissioner for the purpose of enabling any party to this Consent Order to apply for such further orders and directions as may be necessary or appropriate for the construction or enforcement of this Consent Order.

The provisions of this Consent Order shall become binding when this Consent Order has been executed by each party and is issued by the Commissioner.

In the event that judicial intervention in this matter is sought by any party, Respondents consent to the jurisdiction of the Circuit Court for Baltimore City over any such proceeding and as to itself.

DATE OF THIS ORDER:

SO ORDERED:

November 6, 2008

**Commissioner's Signature is  
on File with Original Document**

\_\_\_\_\_  
Melanie Senter Lubin  
Securities Commissioner

**SIGNATURES CONTINUED**



CONSENTED TO:

KH Funding Company

By: \_\_\_\_\_

\_\_\_\_\_ Print name \_\_\_\_\_

Title: \_\_\_\_\_

On this \_\_\_ day of \_\_\_\_\_, 2008, personally appeared \_\_\_\_\_  
signer of the foregoing Consent Order, who did duly acknowledge to me that he was authorized  
to execute the same on behalf of KH Funding Company, and acknowledged the same to be his  
free act and deed.

\_\_\_\_\_  
Notary Public

My Commission Expires: \_\_\_\_\_

Seal:

CONSENTED TO:

\_\_\_\_\_  
Robert L. Harris

On this \_\_\_ day of \_\_\_\_\_, 2008, personally appeared Robert L. Harris, signer of the  
foregoing Consent Order, who did duly acknowledge his signature to be his free act and deed.

\_\_\_\_\_  
Notary Public

My Commission Expires: \_\_\_\_\_

Seal: