

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74994 / May 19, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31609 / May 19, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16543

In the Matter of

Richard Krill,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934 AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940,
MAKING FINDINGS, IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER, AND NOTICE OF
HEARING**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Richard Krill (“Krill” or “Respondent”) pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“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 him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934

and Section 9(b) of the Investment Company Act of 1940, Making Findings, Imposing Remedial Sanctions and a Cease-and-Desist Order, and Notice of Hearing, as set forth below.

III.

The Commission's public official files disclose that, at all relevant times, Lighthouse Financial Group, LLC ("Lighthouse" or "the firm") was registered with the Commission as a broker-dealer.

IV.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

SUMMARY

1. These proceedings arise out of materially inaccurate financial statements filed with the Commission by a former registered broker-dealer, Lighthouse. In preparing Lighthouse's financial statements for the year ended December 31, 2009 and calculating Lighthouse's net capital as of that date, Respondent Krill, Lighthouse's Financial and Operations Principal ("FinOp"), made several errors that caused the firm's reported net capital to be overstated by nearly \$5 million, or approximately 350%. These errors were the result of Krill's failure to exercise due care. Specifically, the financial statements were materially inaccurate in that they overstated the firm's assets, because its securities inventory as recorded in its financial statements was based on erroneous and inflated figures for the size of its positions in certain securities, and understated the firm's liabilities by omitting its liabilities to one of the broker-dealers through which it engaged in proprietary trading.

RESPONDENT

2. **Richard Krill**, age 57, of Whitehouse Station, New Jersey, was the FinOp and CFO of Lighthouse from November 2007 to August 2010. At all relevant times and currently, Krill has held a Series 27 license.

OTHER RELEVANT ENTITY

3. **Lighthouse** was registered with the Commission as a broker-dealer from August 2, 2000 until October 23, 2010. In December 2010, Lighthouse filed a petition for liquidation under the U.S. Bankruptcy Code. At all relevant times, Lighthouse's principal place of business was New York, New York. During the relevant period Lighthouse acted as an introducing broker for retail and institutional customers, engaged in proprietary trading and market-making, and acted as

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.

an underwriter or placement agent for equity and bond issuances. Lighthouse had clearing arrangements with several clearing brokers, including Penson Financial Services, Inc. (“Penson”), which at all relevant times was a registered broker-dealer with its principal place of business in Dallas, Texas.

LIGHTHOUSE’S MATERIALLY MISLEADING FINANCIAL REPORTS

Background

4. Beginning in November 2007, Krill served as Lighthouse’s FinOp and CFO and was responsible for preparing and filing Lighthouse’s financial and operational information on Form X-17A-5 (Financial and Operational Combined Uniform Single Reports (“FOCUS reports”)) and its annual audited financial statements. FOCUS reports and the annual audited reports contain, among other things, the broker-dealer’s financial statements and a computation of its net capital.

5. Section 15(c)(3) of the Exchange Act [15 U.S.C. § 78o(c)(3)] and Rule 15c3-1 thereunder [17 CFR 240.15c3-1] require that broker-dealers generally effecting transactions in securities “at all times have and maintain net capital.” The rule is designed to require a broker-dealer to maintain sufficient liquid assets to meet all obligations to customers and counterparties and have adequate additional resources to wind down its business in an orderly manner without the need for a formal proceeding if the firm fails financially. The net capital rule requires different minimum amounts of net capital based on the nature of a firm’s business and the method a firm uses in computing its net capital.

6. To compute its net capital for purposes of Rule 15c3-1, a broker-dealer first calculates its net worth, computed in accordance with generally accepted accounting principles, deducts the value of certain illiquid assets, and then adds back certain qualifying subordinated loans. The final step is to deduct certain specified percentages, or haircuts, from the market value of the securities or other inventory it holds in its proprietary accounts. Rule 15c3-1 prescribes differing haircut amounts for a variety of classes of securities and other allowable assets.

7. Section 17(e) of the Exchange Act [15 U.S.C. § 78q(e)] and Rule 17a-5 thereunder [17 CFR 240.17a-5] require registered broker-dealers to file with the Commission annual audited reports containing, among other things, the broker-dealer’s financial statements for the fiscal year, a calculation of its net capital at fiscal year-end, and a report of an independent auditor on the financial statements.

8. On February 24, 2010, Lighthouse filed an amended FOCUS report for the period ended December 31, 2009 (“December 09 FOCUS report”). On February 28, 2010, Lighthouse filed its audited annual report (“2009 Annual Audited Report”), which contained Lighthouse’s financial statements for the year ended December 31, 2009. The 2009 Annual Audited Report also contained Krill’s affirmation that, to the best of his knowledge and belief, the accompanying financial statements were true and correct.

9. The financial statements contained in both the December 09 FOCUS report and the 2009 Annual Audited Report (collectively, “December 09 Filings”) included the same misstated figures for Lighthouse’s assets, liabilities, and haircut deductions and overstated the firm’s net capital by approximately \$4.9 million, or approximately 350%. The overstatement of Lighthouse’s net capital in the December 09 Filings was primarily attributable to the following errors by Krill:

- a. First, Krill overstated the value of Lighthouse’s assets by incorrectly including approximately \$2,052,257 in long securities positions in the firm’s proprietary accounts at Penson,² and
- b. Second, Krill understated Lighthouse’s liabilities by omitting approximately \$2.3 million owed to Penson.³

10. Krill also erred in calculating the haircuts applicable to Lighthouse’s assets by using an incorrect formula for the haircut on the firm’s equity holdings and failing to take the correct haircuts on certain of the firm’s holdings, most significantly its holdings of foreign currency and foreign-denominated securities. These errors resulted in the application of understated haircuts to the firm’s overstated assets and thus further inflated the firm’s reported net capital.

Errors that Led to Krill’s Overstatement of the Firm’s Long Securities Positions and Understatement of its Liabilities to Penson

11. Krill’s overstatement of the total market value of Lighthouse’s long securities positions in its accounts at Penson was the result of his use of erroneous – and overstated – numbers of shares of fifteen securities held in five accounts. Krill calculated the total market value of Lighthouse’s inventory in those accounts to be \$3,489,971, whereas based on the actual size of the positions as shown in Penson’s records, the total market value of Lighthouse’s inventory in its Penson accounts was only \$1,437,714. Krill thus overstated the value of Lighthouse’s long securities positions by approximately \$2,052,257. Krill took no steps to verify the accuracy of the share quantities he was using.

12. The December 09 Filings also understated, by approximately \$2.3 million, Lighthouse’s payables to brokers as a result of Krill’s failure to include negative balances in a Lighthouse account at Penson. The account, named “Lighthouse Financial Group F/X Account” (“F/X account”), was one of several Lighthouse accounts at Penson that were used to hold deposits,

² The \$2,052,257 figure also takes into account a \$251,317 understatement of the firm’s long securities position that resulted from Krill’s failure to include any of the inventory in one of the firm’s proprietary accounts.

³ In addition to the amounts due to Penson discussed at paragraphs 11-16 below, this figure includes a \$113,002 understatement of Lighthouse’s exposure on short positions in Penson accounts.

resolve failed settlement transactions, and pay clearing balances. Positive balances in those accounts represented amounts *due from* Penson to Lighthouse while negative balances represented amounts *due to* Penson from Lighthouse.

13. The balances in the F/X account and other accounts described above appeared on a variety of Penson reports, including reports available through Penson’s website. For the amounts due to and from Penson on December 31, 2009, Krill relied on a report titled “balances” that he obtained from Penson’s website. That report (“Penson balances report”) showed only positive trade date balances, *i.e.* amounts *due from* Penson to Lighthouse. For the F/X account, the Penson balances report showed positive trade date balances, totaling \$2,284,644, associated with five currencies (the Danish Krone, the Euro, the Malaysian Ringgit, the Thai Baht, and the U.S. Dollar).

14. Krill knew or should have known that the Penson balances report omitted negative trade date balances – amounts due to Penson from Lighthouse – because the report on its face contained several indications that it did not reflect all of Lighthouse’s balances. First, the Penson balances report included a “Total Account Value” for the F/X account of negative \$29,840. The negative \$29,840 Total Account Value was the net value of the account, meaning that there were negative balances in the account that exceeded the total amount of the positive balances in the account by that amount. Specifically, the existence of a negative figure in the Total Account Value column for the F/X account indicated that in addition to the positive balances, there were negative balances in the account, *i.e.* monies due to Penson from Lighthouse totaling approximately \$2.3 million.

15. Second, the Penson balances report also showed the criteria by which it was generated. Those criteria included the account type, date, and “Amount.” The entry for “Amount” was “> = 0.00,” *i.e.* greater than zero. The Amount criteria thus showed that the inquiry used to generate the report was set to identify only those accounts which had trade date balances greater than zero, that is, amounts *due from* Penson to Lighthouse as of December 31, 2009. As a result of the greater-than-zero criteria, the inquiry excluded amounts *due to* Penson from Lighthouse on that date, *i.e.* Lighthouse liabilities.

16. Third, some of the securities Krill included in his erroneous calculation of the value of Lighthouse’s long securities positions traded in currencies that did not appear on the Penson balances report (*e.g.* the British Pound, the Japanese Yen, and the Indonesian Rupiah). This discrepancy should have alerted Krill to the possibility that Lighthouse’s F/X account might have balances in currencies that were not reflected on the Penson balances report he relied upon.

Krill’s Errors in the Haircut Calculations

17. Krill also made several errors in calculating the required haircut deductions for certain of the holdings in Lighthouse’s proprietary accounts that he included in the firm’s assets. These errors resulted in the application of understated haircuts to the firm’s overstated assets and thus further inflated the firm’s net capital reported in the December 09 Filings.

18. First, Krill erroneously calculated the haircut on Lighthouse's equity positions. Under the net capital rule, the haircut on equities for a broker-dealer such as Lighthouse is a function of the greater and lesser of the market value of the broker-dealer's long and short positions in equities.⁴ Krill calculated the total market value of Lighthouse's long equity positions to be \$4,184,057 and the total market value of its short equity positions to be \$1,672,544. Krill's worksheet shows that he incorrectly used the lesser market value in a portion of the calculation where he should have used the greater market value. As a result of this error, the haircut on Lighthouse's reported (and overstated) equities holdings was less than half of what it should have been.

19. Second, Krill failed to take required haircuts on Lighthouse's holdings in foreign-denominated securities and foreign currencies, among other assets, because he failed to apply the additional haircut applicable to foreign-denominated securities and failed to take any haircut at all on the firm's holdings of foreign currencies.⁵

20. Krill knew or should have known that foreign-denominated securities and foreign currencies were among the assets he included when calculating Lighthouse's reported net capital. The Pension balances report showed that some of the amounts Lighthouse was owed by Pension were in specified foreign currencies, and Krill knew or should have known that those balances were

⁴ Section 15(c)(3) of the Exchange Act [15 U.S.C. § 78o(c)(3)] and Rule 15c3-1(2)(vi)(J) thereunder [17 CFR 240.15c3-1(2)(vi)(J)] provide:

In the case of all securities or evidences of indebtedness, except those described in Appendix A, § 240.15c3-1a, which are not included in any of the percentage categories enumerated in paragraphs (c)(2)(vi)(A) through (H) of this section or paragraph (c)(2)(vi)(K)(ii) of this section, the deduction shall be 15 percent of the market value of the greater of the long or short positions and to the extent the market value of the lesser of the long or short positions exceeds 25 percent of the market value of the greater of the long or short positions, the percentage deduction on such excess shall be 15 percent of the market value of such excess.

⁵ Lighthouse was required to take a haircut of 6% of the U.S dollar equivalent of its holdings of the five major world currencies, including Euros. In addition, it was required to take a 20% haircut on the U.S dollar equivalent of its holdings of other currencies. *See* FINRA Interpretations of Financial and Operational Rules, Rule 15c3-1(c)(2)(vi)/(08), FINRA Regulatory Notice 13-44 (publishing a staff interpretation). The firm was also required to take haircuts (in addition to the required haircut for all equities) of the same percentages on its holdings of securities that traded in foreign currency. FINRA Interpretations of Financial and Operational Rules, Rule 15c3-1(c)(2)(vi)/(9), FINRA Regulatory Notice 13-44 (publishing a staff interpretation).

the result of Lighthouse's trading in foreign-denominated securities. Moreover, some of the securities Krill included in his erroneous calculation of the value of Lighthouse's long securities position were foreign-denominated, including a \$295,912 long position in a security denominated in Thai Baht and a \$208,190 short position in the same security; a \$182,899 long position in a security denominated in the Canadian Dollar; and positions of lesser value in securities denominated in the British Pound, the Euro, the Indonesian Rupiah, and the Japanese Yen. Despite these indicators, Krill failed to take required haircuts on Lighthouse's holdings in foreign-denominated securities and foreign currencies.

21. As a result of Krill's negligence in calculating the required haircut deductions, the haircuts on Lighthouse's holdings were understated, further inflating Lighthouse's net capital reported in the December 09 filings.

22. Lighthouse's FOCUS reports for the months of January, February, and May 2010 were also materially inaccurate because Krill failed to take the required haircuts on Lighthouse's holdings of foreign currency and its positions in foreign-denominated securities.

LEGAL ANALYSIS

Lighthouse's Violations

23. Section 17 of the Exchange Act requires registered broker-dealers to make and disseminate certain financial and operational reports. Rule 17a-3(a)(11) requires that every broker-dealer, among other things, make and keep a record of the computation of aggregate indebtedness and net capital, as of the trial balance date. "The requirements to make and keep required records encompass the requirement that such records be accurate." *Application of PennMont Securities*, Exchange Act Release No. 54434 (Sept. 13, 2006) (Commission opinion sustaining findings concerning violations of books and records and financial reporting provisions). Rule 17a-5(a) requires that certain broker-dealers file an annual audited report that contains the broker-dealer's year-end financial statements and a report on those statements by an independent auditor. Implicit in the requirement that a registered broker-dealer file financial reports is the requirement that the information contained in those reports be accurate. *See Nikko Securities Co. International, Inc.*, Exchange Act Release No. 32331 (May 19, 1993).

24. As described above, Lighthouse failed to make and keep certain accurate records pertaining to its net capital computations and failed to file accurate FOCUS reports for the months of December 2009 and January, February, and May 2010, and also failed to file an accurate annual audited report for the year ended December 31, 2009. The firm therefore violated Section 17 of the Exchange Act and Rules 17a-3(a) and 17a-5(a) thereunder.

Krill's Failure to Exercise Due Care Contributed to Lighthouse's Violations and Caused Lighthouse to Make Materially Inaccurate Statements in Reports Filed with the Commission

25. As a FinOp, Krill was charged, under FINRA Rule 1022, with the following duties, among others:

- final approval and responsibility for the accuracy of financial reports submitted to any duly established securities industry regulatory body;
- final preparation of such reports; and
- supervision and/or performance of the member's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of the [Exchange] Act.

Krill failed to meet his responsibility for the accuracy of Lighthouse's FOCUS reports and annual audited reports. He was, at a minimum, negligent in preparing those reports.

26. As a result of the conduct alleged above, Krill was a cause of Lighthouse's violations of Section 17 of the Exchange Act and Rules 17a-3(a) and 17a-5(a) thereunder.

27. As a result of the conduct alleged above, Krill willfully⁶ made, or caused Lighthouse to make, material misstatements in reports required to be filed with the Commission and thus committed acts enumerated in Exchange Act Section 15(b)(4)(A).

V.

Pursuant to this Order, Respondent agrees to additional proceedings in this proceeding to determine what, if any, disgorgement, prejudgment interest, and civil penalties against the Respondent, pursuant to Sections 21B and 21C of the Exchange Act, are in the public interest; and further, Respondent agrees to additional proceedings in this proceeding to determine whether, pursuant to Section 15(b) of the Exchange Act, it is in the public interest to bar the Respondent from participating in any offering of a penny stock, including acting as a promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer, or issuer for the purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock. In connection with such additional proceedings: (a) Respondent agrees that he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of

⁶ A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

VI.

In view of the foregoing, the Commission deems it appropriate, in the public interest and for the protection of investors to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and Section 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 17 of the Exchange Act and Rules 17a-3(a) and 17a-5(a) thereunder.

B. Respondent be, and hereby is:

suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter;

for a period of 12 months, effective on the second Monday following the entry of this Order.

VII.

IT IS FURTHER ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section V hereof shall be convened not earlier than thirty (30) days and not later than sixty (60) days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

VIII.

If Respondent fails to appear at a hearing after being duly notified, Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, prehearing conference or Rules 155(a), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rulemaking" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary