

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2639 / August 23, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12737

In the Matter of

**FOLGER NOLAN FLEMING DOUGLAS
CAPITAL MANAGEMENT, INC.,
NEIL C. FOLGER and
DAVID M. BROWN,**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER PURSUANT TO
SECTIONS 203(e), 203(f) AND 203(k) OF
THE INVESTMENT ADVISERS ACT OF
1940**

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 pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Folger Nolan Fleming Douglas Capital Management, Inc., Neil C. Folger and David M. Brown (collectively, “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have each 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 them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Order”), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds that:

Summary

1. This matter concerns disclosure and best execution violations, and failure to make and keep certain books and records, by Folger Nolan Fleming Douglas Capital Management, Inc. ("Folger Nolan Capital Management"), a registered investment adviser formerly known as Folger Nolan Fleming Douglas, Incorporated ("Folger Nolan"). From January 1, 2002, through April 1, 2004, Folger Nolan Capital Management was a division within Folger Nolan which, at the time, was a dually registered broker-dealer and investment adviser. During this time period, the general practice of registered representatives associated with Folger Nolan's broker-dealer was to refer existing customers seeking investment advisory services to Folger Nolan's registered investment adviser ("referred clients"). Folger Nolan entered into agreements with these advisory clients to send their trades through Folger Nolan's broker-dealer. Folger Nolan charged these referred clients commission rates that averaged more than twice that of advisory clients not referred from Folger Nolan's broker-dealer ("non-referred clients"), without disclosing to clients other custody and execution options such as using a lower cost discount broker. In addition, Folger Nolan did not disclose the firm's potential conflict of interest in receiving referrals from registered representatives, specifically that the investment adviser might be reluctant to recommend a lower cost broker-dealer to avoid jeopardizing the flow of future referrals.

2. As a result, referred clients paid significantly higher commissions with little corresponding benefit, and therefore Folger Nolan violated its duty to seek to obtain best execution for its clients. By failing to disclose its potential conflict of interest and other brokerage options, and by failing to seek to obtain best execution, Folger Nolan breached its fiduciary duty to its clients and thereby violated Section 206(2) of the Advisers Act, and caused its clients to pay excess commissions of at least \$213,528.

3. Folger Nolan also failed to make and keep records of agreements with certain of its advisory clients evidencing their selection of Folger Nolan's brokerage unit for custody and trade execution in violation of Section 204 of the Advisers Act and Rule 204-2(a)(10) thereunder. Respondents Neil C. Folger and David M. Brown, both Senior Vice Presidents and Portfolio Managers at Folger Nolan, were responsible for making and keeping the agreements and, therefore, aided and abetted and caused the books and records violations.

Respondents

4. **Folger Nolan Fleming Douglas Capital Management, Inc.**, incorporated in January 2006, and located in the District of Columbia, is a registered investment adviser and wholly-owned subsidiary of a holding company that, in turn, is wholly owned by Folger Nolan

Fleming Douglas, Incorporated, a registered broker-dealer. Prior to forming a separate legal entity to provide advisory services in January 2006, Folger Nolan had been a dually registered broker-dealer and investment adviser providing investment advisory services through a separate division since 1978. Folger Nolan Capital Management has over 250 client accounts with more than \$316 million in assets under management. The majority of its clients have longstanding relationships with registered representatives of Folger Nolan's broker-dealer.

5. **Neil C. Folger**, age 45, resides in Bethesda, Maryland. He is a Senior Vice President and Portfolio Manager of Folger Nolan Capital Management.

6. **David M. Brown**, age 45, resides in Vienna, Virginia. He is also a Senior Vice President and Portfolio Manager of Folger Nolan Capital Management.

Facts

7. From 1978 until January 2006, Folger Nolan was a dually registered broker-dealer and investment adviser, primarily conducting business out of one office. The firm initially began offering investment advisory services principally to serve the needs of existing Folger Nolan brokerage customers. As a dually registered entity, Folger Nolan typically received a management fee of one percent on advisory client assets under management of up to \$1 million and 50 basis points on assets over \$1 million, and also received brokerage commissions on advisory client trades placed through the firm's broker-dealer.

8. During the relevant time period, Folger and Brown were portfolio managers at the investment adviser, and they jointly oversaw the day-to-day operations of the investment adviser.

9. The general practice of registered representatives associated with Folger Nolan's broker-dealer was to refer customers seeking investment advisory services to Folger Nolan's investment adviser. Nearly all of Folger Nolan's advisory clients were referred from registered representatives associated with its broker-dealer and had been customers for many years.

10. From at least January 1, 2002 to April 1, 2004, Folger Nolan entered into agreements with its advisory clients to designate a broker-dealer for the custody of assets and execution of trades. Custody and trade execution for referred clients remained at Folger Nolan on similar terms as had previously been negotiated between the referred client and the registered representative. With few exceptions, almost all non-referred advisory clients also agreed to the selection of Folger Nolan's broker-dealer for custody and trade execution but, as described in this Order, these clients paid lower commissions.

11. Although Folger Nolan's referred and non-referred advisory clients selected Folger Nolan's broker-dealer for custody and trade execution, during the relevant time period Folger Nolan failed to adequately explain the full range of factors that should be considered by a client in selecting a broker that would enable clients to make an informed selection, including the possibility of placing trades through a lower cost discount brokerage firm.

12. Folger Nolan did offer non-referred advisory clients a “house account” commission rate on trades placed through its broker-dealer, which was significantly less than the full service commission rate typically charged to customers of its broker-dealer and which was comparable to the published rates of a major discount broker. However, Folger Nolan did not offer the “house account” rate to referred clients. As a result, referred clients paid an average commission rate per share of more than twice that of non-referred clients. Despite the higher rate, referred clients did not receive better quality execution, nor did they receive better trading prices than non-referred clients.

13. Moreover, during the relevant time period, Folger Nolan failed to disclose to the referred clients that the firm had a potential conflict of interest between its interest in continuing to receive future referrals from registered representatives associated with its broker-dealer and its duty to seek to obtain best execution for its advisory clients.

14. Folger Nolan did not conduct any systematic review of execution quality for its clients. Despite the disparity in execution costs between referred and non-referred clients, prior to April 2004, Folger Nolan did not reevaluate its advisory clients’ brokerage placement or commission charges unless the client raised an objection. Members of Folger Nolan’s advisory group met regularly with clients to review portfolios and objectives, but did not periodically and systematically review brokerage arrangements for purposes of analyzing each client’s quality of trade execution.

15. As a result of Folger Nolan’s failure to disclose the availability of other brokerage options, its failure to disclose its conflict of interest in receiving referrals, and its failure to review its clients’ quality of trade execution, Folger Nolan’s referred clients paid at least \$213,528 more in commissions than they otherwise would have paid if their trades had been placed through a discount broker or through the Folger Nolan broker-dealer but based on the house account commission schedule.

16. The Commission staff requested that Folger Nolan produce the brokerage agreements it had entered into with its advisory clients designating Folger Nolan’s broker-dealer for custody of assets and trade execution. However, Folger Nolan only produced written agreements for fewer than one-half of its clients. Folger and Brown were jointly responsible for entering into agreements with new clients and ensuring that those agreements were adequately maintained.

17. Upon being informed by the Commission’s staff of its disclosure and best execution failures, Folger Nolan revised its disclosures and implemented enhancements to its systems, policies and procedures to monitor price and execution quality on client transactions.

Violations

18. As a result of the conduct described above, Folger Nolan Capital Management, formerly Folger Nolan, willfully¹ violated Section 206(2) of the Advisers Act, which prohibits conduct by an investment adviser that operates as a fraud or deceit.

19. As a result of the conduct described above, Folger Nolan Capital Management, formerly Folger Nolan, willfully violated Section 204 of the Advisers Act, and Rule 204-2(a)(10) promulgated thereunder, which require that investment advisers registered with the Commission make and keep certain books and records. Rule 204-2(a)(10) requires that registered investment advisers “make and keep true, accurate and current . . . [a]ll written agreements . . . entered into by the investment adviser with any client or otherwise relating to the business of such investment adviser as such.”

20. As a result of the conduct described above, Folger and Brown willfully aided and abetted and caused Folger Nolan Capital Management’s violations of Section 204 of the Advisers Act, and Rule 204-2(a)(10) promulgated thereunder. Folger and Brown willfully aided and abetted and caused Folger Nolan Capital Management to fail to maintain accurate or current written agreements relating to the brokerage arrangements of its clients.

Remedial Efforts

21. In determining to accept the Offers, the Commission considered remedial acts promptly undertaken by Respondents and cooperation afforded the Commission staff.

Undertakings

22. Respondents undertake pursuant to Rule 1101 of the Commission’s Rules on Fair Fund and Disgorgement Plans [17 C.F.R. 201.1101], and in consultation with the staff of the Commission, to develop a plan to distribute the disgorgement and prejudgment interest as provided for in the Order (“Distribution Plan”), which shall be submitted to the Commission within 60 days for notice in accordance with Rule 1103 [17 C.F.R. 201.1103]. Following a Commission order approving a Distribution Plan, as provided in Rule 1104 [17 C.F.R. 201.1104], Respondents shall take all necessary and appropriate steps to assist the Commission-appointed Administrator of the final Distribution Plan. Respondents shall bear the costs of administering and implementing the final Distribution Plan on a joint and several basis.

23. Deadlines. For good cause shown, the Commission’s staff may extend any of the procedural dates set forth in paragraph 22, above.

¹ “Willfully” as used in this Order means intentionally committing the act which constitutes the violation. Cf. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. The Respondents are hereby censured.
- B. Respondent Folger Nolan Capital Management cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 204 of the Advisers Act and Rule 204-2(a)(10) promulgated thereunder.
- C. Respondents Folger and Brown cease and desist from committing or causing any violations and any future violations of Section 204 of the Advisers Act and Rule 204-2(a)(10) promulgated thereunder.
- D. It is further ordered that Respondent Folger Nolan Capital Management shall, within ten days of the entry of this Order, pay disgorgement in the amount of \$213,528 and prejudgment interest in the amount of \$31,393, for a total amount of \$244,921 to the Securities and Exchange Commission. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Folger Nolan Capital Management as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Daniel M. Hawke, Securities and Exchange Commission, Philadelphia District Office, Mellon Independence Center, 701 Market Street, Suite 2000, Philadelphia, PA 19106.
- E. It is further ordered that Respondent Folger Nolan Capital Management shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Folger Nolan Capital Management as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Daniel M. Hawke, Securities and Exchange Commission, Philadelphia District Office, Mellon Independence Center, 701 Market Street, Suite 2000, Philadelphia, PA 19106.
- F. 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, Respondents agree that they shall not, after offset or reduction in any Related Investor Action based on Respondent Folger Nolan Capital Management's payment of disgorgement in this action, argue that they are entitled to, nor shall they further benefit by offset or reduction of any part of Respondent Folger Nolan Capital Management's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they 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 United States Treasury. 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 Respondents 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.

G. Respondents shall comply with the undertakings enumerated in Paragraph 22 above.

By the Commission.

Nancy M. Morris
Secretary