

DENVER  
**BUSINESS  
JOURNAL**

VOL. 56 NO. 24

Dec. 24-30, 2004

32 PAGES \$2.00

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**InnoVest**  
Portfolio Solutions LLC

## Mutual funds have responsibilities

In light of the recent, highly publicized mutual fund scandals, investor confidence has declined in the mutual fund industry and in fund managers.

Because investors need more information to protect themselves, we sought to evaluate funds on what we felt to be key, fundamental fiduciary responsibilities that illustrate a fund's commitment to its shareholders. We gathered information through our own manager questionnaires, and through Morningstar, which has done a solid job of compiling and analyzing the data.

Key drivers include:

- **Regulatory Issues** - Has the manager or firm had any regulatory problems in the last three years? If a firm is in the midst of or has faced regulatory violations, it should be a red flag to investors and speaks to the overall ethical conduct of individuals in the firm.

- **Board Independence** - Does the board's composition exhibit a high degree of independence? Are there any conflicts of interests? Such conflicts have been a catalyst for many of the recent mutual fund scandals. We often have seen this role become increasingly difficult if the board lacks true independence, thereby calling its decision-making motives into question.

- **Compensation** - Does the manager's compensation align with the interest of the shareholders? We prefer to see that managers have a portion of their compensation tied to long term performance. However, it was also important in our analysis to understand what benchmark is being used and the details of



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TODD**

this performance based pay structure.

- **Corporate Culture** - Is the culture of the asset management firm conducive to sound fiduciary practices? This is more subjective information. But we thought several key factors should be analyzed: (1) The firm's willingness to close funds at appropriate asset levels. (2) Its use of redemption fees. (3) Its shareholder communications. (4) Turnover of key personnel. (5) Does the firm have a tendency to launch "trendy" funds simply to build its asset base?

- **Board Member Investment Requirements** - Do the board members invest a significant portion of their compensation in the funds for which they serve? If a board member has a reasonable portion of that income invested, that should help align with the interests of the shareholders.

- **Manager's Investment in the Fund** - Does the manager invest a significant portion of their own money in the fund? A manager should have strong conviction in their process and be willing to "eat their own cooking." If a manager is invested alongside the investors he/she is far more likely to share the same interests.

- **Fees** - Is the stated expense ratio below that of the median manager within the style category? We felt it was particularly important to know because it speaks to whether a fund is more aligned with the interest of investors or with firm stakeholders.

Though these intangibles shouldn't be used exclusively in selection of a fund, they should be incorporated with traditional analysis and thereby provide important considerations for investors.

**Richard Todd** is a consultant and principal of InnoVest Portfolio Solutions in Greenwood Village. Reach him at 303-694-1900 or richt@innovestinc.com