THE RESEARCH REPORT

A NEWSLETTER BY INNOVEST SUMMER | 2012

NEW CLIENTS

Innovest was recently selected to provide investment consulting services for:

Ehrhardt Keefe Steiner & Hottman

National Cable Television Cooperative, Inc.

St. Vrain Valley School District

*It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one and in the Client Spotlight are listed with their approval and permission.

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CHARITABLE GIVING AND FAMILY VALUES—IMPACTING GENERATIONS FOR YEARS TO COME

Richard Todd, Principal, CEO

One of the more enjoyable aspects of working with both families and non-profit organizations is seeing the philanthropic impact that families have made not only with the current generation, but with instilling their legacy of charity for many generations.

Exposing your family to the immense social needs that exist and the importance of giving to others—instilling a "charitable instinct"—can be an invaluable family gift that can mold descendants for many generations.

Many charitable strategies are simple and inexpensive, while others take years of planning. The examples below outline strategies that can have a very positive impact on a family's character. If a multitude of these strategies are utilized, a tremendous gift will be made to those in need and the virtuousness of a family will be set in bronze for generations.

TEACH SAVING AND CHARITY WITH CHILDREN'S ALLOWANCES

As the children's allowances were distributed by the parents of one family, 10% went to the charity bank, 10% to the saving bank, and the balance was allocated for spending—typically after a review of the completion of weekly chores. This approach not only helped instill the virtues of generosity, charity, diligence and justice, along with a host of others in their children, but immediately helped the children create solid financial values. A couple of times a year, this family would discuss their charity bank and determine where the next gift would go—whether to the homeless, school, museum, or church.

FAMILY VOLUNTEERING

The gift of a volunteering family benefits not only the recipients, but can be an excellent relationship building exercise as well. Team work, hard work, civic and charitable responsibility are all valuable to children's character formation. Families have had great experiences in clearing trails together, working at a food bank, making sandwiches for the homeless, visiting a nursing home, and volunteering at Special Olympics. These activities can be experiences that will never be forgotten. One close friend of Innovest discussed the tough times she had growing up and the many gifts she received from others that helped form her need to help others and share her success with those who were suffering from difficult circumstances. Notably, her gifts

are often anonymous, allowing her recipients to maintain their dignity.

DEVELOPING THE CHARITABLE INSTINCT IN GRANDCHILDREN

Sherman & Howard estate planning attorney Greg Denson recently discussed an impressive approach that his client used to instill philanthropic values in their grandchildren. Money for annual gifts was set aside by the grandparents to make donations to causes that the children thought were worthwhile. Their only criterion was that the gift had to be a tax-deductible donation. Money was also set aside for a "communal pot" for additional giving. Together the grandchildren would research the causes that they were passionate about, and presentations would be made to the grandparents for their approval. The grandparents had the goals of not only instilling generosity and exposing them to societal needs, but bringing the extended family closer together, fostering teamwork, and developing confidence in giving presentations.

SUPPORTING ORGANIZATIONS THAT TEACH CHILDREN PHILANTHROPY

Community First Foundation (CFF) and its donors have funded the philanthropy kiosk at Young AmeriTowne at Belmar, a program of the Young Americans Center for Financial Education. As a result of the successful program, philanthropy content was built into the curriculum to help school districts and teachers prepare students planning to participate in field trips to Young AmeriTowne, where students come together to operate a town comprised of 17 businesses. As part of this experience, the students were encouraged to research previously selected charities and donate a portion of their businesses' "profits" through the philanthropy kiosk which stands in the center of Young AmeriTowne. CFF also worked to engage high school students' participation in the West Chamber Serving Jefferson County's Youth Leadership program to assist in identifying local charities for the Young AmeriTowne program. In this way, two different age groups participated in the process. At the end of the program year, CFF provided matching dollars so that the designated charities received a check from the students at a ceremony attended by representatives from the nonprofits. Perhaps these young people will teach their parents a thing or two about charity as well!

DONOR ADVISED FUNDS AND FAMILY FOUNDATIONS

Combining estate planning techniques and philanthropy can be a powerful aide in developing a charitable instinct in families. Family Foundations and Donor Advised Funds can be positive experiences for families working together for a common mission.

A Family Foundation is a private, non-profit organization that manages a financial fund. Founded and funded by a family or its business, and preserved by family members, a majority of the directors are usually family members. A Donor Advised Fund (DAF) is also funded by a family or business, and is housed and administered at a public charity that manages charitable donations on behalf of the donor. A DAF is easy to establish and can be a lower-cost alternative, depending on the size, than a Family Foundation.

Ray Sutton, Managing Partner of the Denver office of Baker & Hostetler has seen DAFs and Foundations work like a charm. "I've seen families travel to Africa to physically work in hospitals, schools, research labs, etc., which their generosity supports. I've also seen families carve out areas of interest where individual family members may find their own interests to support."

Donor Advised Funds can control a family's future of giving while providing ownership to children, extended family, and specific gifts. One family created a Donor Advised Fund at the Catholic Foundation. While the Catholic Foundation requires that two-thirds of the gifts from the DAF support the local Catholic Church and ministries, one-third can go to outside causes, as long as they are not contrary to the values of the Church. The Catholic Foundation also introduced the family to organizations in need of support. The foundation helped the family to set up a formal board of family members, and to write bylaws that outlined their giving priorities—the Church, education, the poor, and athletics. Each family member was responsible for making one gift to an organization that was approved by the family and the Catholic Foundation. This approach was to control into perpetuity by both the original document and the Catholic Foundation, as well as to maintain exactly what the family wanted in preserving their legacy and promoting their values. In addition, the family helped form a family "culture of giving" that has a great probability of being extended to future generations.

A Family Foundation can provide total family control, engage children, and create a lasting legacy. One Colorado Family formed a foundation to provide support to middle-income families sending their children to Catholic schools. The children were actively engaged in the early stages of the mission, and today the grandchildren are becoming actively involved with their Foundation. These grandchildren are making a difference in

the lives of many students and forming charitable virtues that would make their grandparents proud, but not surprised. It was all part of their family plan.

Leadership skills can emerge as well, according to Dolly Garlo, RN, JD, expert on creating legacies, and President of Thrive! Inc. Children and young adults "need examples of the type of leadership that focuses both on and beyond the bottom line." There is no more influential example than that of a parent! Those visionary parental leaders who are dedicated to creating legacy of giving will create leadership characteristics in their children.

According to Garlo, those leadership characteristics include:

- An ability to see beyond problems
- Showing a genuine interest in people
- Asking questions and then really listening to answers
- Taking the time to really know people and look for the best in them
- Keeping 'hope alive' during difficult times
- Being willing to risk
- Making people feel valued by appreciating every contribution and contributor
- Believing people want to be great
- Seeing strength in differences and soliciting other points of view
- Working to develop talent, and
- Creating a place for people to grow

"The world needs more of these attributes to combine purpose and profitability and take the world in a more positive, collaborative, and humane direction," according to Garlo. We agree.

Philanthropy obviously can have a giant impact on those in need. Getting children involved in a mission can be a tremendous tool to form strong character, leadership skills, and a charitable instinct. The beauty is that there is a high likelihood that children will take a similar approach with their own children and grandchildren. What a better way to form a tremendous legacy—developing the next generation of philanthropists!

THE WHO'S WHO OF RETIREMENT PLAN FIDUCIARIES

Gordon Tewell, CFA, CPC, Principal

Fiduciaries to retirement plans come in several types each with a range of responsibilities. The goal of this article is to provide definitions of the various types of plan fiduciaries and to help clarify the roles of each of these fiduciaries.

A plan's fiduciaries will ordinarily include the trustee, investment advisers, all individuals exercising discretion regarding investments and the administration of the plan, all members of a plan's administrative committee (if it has such a committee), and those who select committee officials.

A plan must have at least one fiduciary (a person or entity) named in the written plan, or through a process described in the plan, as having control over the plan's operation, but in many cases plans may have several named fiduciaries. In some cases the decision making involved in operating a retirement plan make the person or entity performing them a fiduciary.

Prescribed fiduciaries for plans include "named fiduciaries" under ERISA: the ERISA section 3(21) named fiduciary; the ERISA section 3(16) plan administrator and the ERISA section 403(a) Trustee as well as the retained fiduciaries, the 3(21) Non-Discretionary Fiduciary and the Section 3(38) Investment Manager.

NAMED FIDUCIARIES

The ERISA Section 3(21) Named Fiduciary
The ERISA section 3(21) Named Fiduciary is the main fiduciary for a qualified retirement plan. This is the named fiduciary that has power over all other plan fiduciaries, whether a named fiduciary, a retained or appointed fiduciary, an advice-giving fiduciary (whether to a plan or the participants in the plan) or a functional fiduciary.

In a typical defined contribution plan, the plan sponsor or more accurately, an employee of the plan sponsor, is named in the plan document as the 3(21) fiduciary. The 3(21) fiduciary is the named decision-maker, not an advisor. This fiduciary has responsibility for selecting, evaluating and monitoring all plan fiduciaries and service providers to the plan.

The 3(21) Named Fiduciary must understand and adhere to principles of fiduciary prudence, and despite possible conflicts of interest due to in most cases that they will be an employee of the sponsoring employer, they are bound by the key tenets of fiduciary responsibility including acting in the sole interest of the plan participants and beneficiaries.

The ERISA Section 3(16) Plan Administrator
The ERISA section 3(16) plan administrator should not be confused with the outsourced, recordkeeper, administrator, or third party administrator for a plan. In the typical defined contribution plan, either the plan sponsor or another employee employed by the plan sponsor is named as the 3(16) plan administrator.

This plan administrator is the center of

communications for the plan. For example, it has responsibility for providing important plan information to plan participants such as disclosures, Summary Plan Descriptions, and other notices and statements. In addition, the plan administrator has statutory responsibility for ensuring that all filings with the federal government such as form 5500s are made in a timely manner.

Additionally, whenever someone needs to communicate with the plan, those communications are directed to the 3(16) plan administrator. The 3(16) is in charge of all communications with plan participants, the government, and any other communications to or from the plan.

The ERISA Section 403(a) Trustee
The ERISA section 403(a) Trustee is named in the plan documents as the fiduciary solely responsible and liable for the plan's investment options. More explicitly, the ERISA section 403(a) Trustee is "a person or a group of persons recognized as having exclusive authority and discretion over the management and control of plan assets."

A lot of confusion is created within the industry over the concept of the trustee. The confusion stems from common name used between an ERISA 403(a) Trustee and a "directed trustee" holding the assets of a qualified retirement plan in trust. The two roles are significantly different; one is a named fiduciary under ERISA with authority and discretion over the management and control of plan assets, while the other holds plan assets with no discretionary authority under ERISA.

RETAINED FIDUCIARIES

An ERISA Section 3(21) Non-discretionary Fiduciary
A non-discretionary 3(21) Fiduciary provides ERISA-defined advice to a plan sponsor and/or to plan participants. The non-discretionary fiduciary has the duty of loyalty to put the interests of its clients first by providing expert advice commensurate with that of a "prudent expert."

Unlike the3(38) investment manager, the non-discretionary 3(21) fiduciary does not have the power to unilaterally change plan investment options or plan service providers and must work with the named fiduciaries listed above to make these changes.

An ERISA Section 3(38) Investment Manager
An ERISA section 3(38) Investment Manager is not typically named in the plan document. Instead, it is retained via a written contract either directly by the plan sponsor or by the 3(21) Named Fiduciary. A 3(38) Investment Manager has discretionary responsibility to select, monitor and replace a plan's investment options. The plan sponsor or the 3(21) Named Fiduciary has the duty to ensure that the initial decision to appoint a 3(38) Investment Manager was prudent and that such decision continues to be prudent through a monitoring function.

3(21) OR 3(38)?

If you were to merely read ERISA, you would likely conclude there are differences in the potential liability being assumed under each of the last two roles. An investment advisor, by definition, provides advice to the ultimate decision-maker; in contrast, an investment manager manages the fund's assets on a discretionary basis.

These statutory differences are sometimes used to assert that investment advisors have no legal liability because they are providing non-discretionary advice, while investment managers shield plan sponsors from legal liability by acting with discretion. Upon closer examination, however, these theoretical differences are not distinct.

While section 405(d)(1) of ERISA does provide plan trustees with immunity from the investment manager's acts or omissions, section 405(d)(2) makes it clear that immunity does not extend to any act taken by the trustee. More importantly, the Department of Labor has held that if an employer retains an investment manager, the employer is responsible to monitor the manager to ensure that it is handling the plan's investments prudently and in accordance with the engagement.

As a result, it would be inconsistent to maintain that the engagement of an investment manager under section 3(38) completely relieves a plan from any potential responsibility and, thus, liability for the plan's investment decisions. It is clear that ERISA plan sponsors, if they decide to engage an investment manager, have a duty to prudently select the manager and regularly review the manager's activities. As with any legal duty, a breach may result in personal liability.

On the other hand, it is equally illogical to claim an investment advisor incurs no legal risk in providing advice to a plan. Under the "prudent man standard of care" any plan fiduciary is required to act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters.

However, securing an independent assessment from a financial advisor is not a complete defense to a charge of imprudence. Instead the fiduciary must

investigate the expert's qualifications, provide the expert with complete and accurate information, and make certain that reliance on the expert's advice is reasonably justified under the circumstances.

Therefore, just as with the delegation to an investment manager, the plan must conduct proper due diligence before retaining an investment advisor and evaluate the reasonableness of the advisor's proposed plan of action. Plan sponsors should consider the adviser's experience, skill and level of expertise, in addition to their desire to take on exposure to potential liability.

NON-PROFIT CLIENT SPOTLIGHT
ROCKY MOUNTAIN PBS

Rocky Mountain PBS, Colorado's only statewide television network, celebrates its 56th anniversary on the air this year. The network began in Denver in 1956 as Colorado's first public television station, and more than 1.5 million people throughout Colorado, Wyoming, Nebraska, and New Mexico tune in to Rocky Mountain PBS each week to view premier programming from documentaries to concerts to children's programming to lifelong learning opportunities for all ages.

In addition to providing award-winning programming, Rocky Mountain PBS builds community partnerships that support their mission to inform, educate, enlighten, and entertain. This mission is primarily supported through contributions from viewers and community organizations. Currently, RMPBS has more than 55,000 members and 200 business and community partners.

When Rocky Mountain PBS was first introduced to Colorado viewers, its mission and goal was to improve content and provide diversity at a time when most television programming was being broadcast by just three national networks. In the changing times since the station's launch, much is different – but RMPBS has remained a cornerstone in Colorado broadcasting and a trusted source of high-quality, thought-provoking television programming. Through RMPBS's community partnerships and rich support of many local and national initiatives, it remains an integral part of our Colorado landscape.

*It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one and above in the spotlight are listed here with their approval and permission.

AROUND THE FIRM

WELCOME

In our ongoing commitment to add talented and dedicated people to Innovest's team and to maintain the highest level of service to our clients, we are pleased to welcome Brian Kinsella to our family this quarter.

In his role as Research Analyst at Innovest, Brian is a member of Innovest's Due Diligence Group, responsible for both qualitative and quantitative manager due diligence. Other responsibilities include building performance reports for clients and conducting asset allocation studies.

Prior to joining Innovest, Brian worked for GVC Capital, a boutique investment bank in Denver, where he analyzed and valued micro- and nano-cap companies. Prior to GVC Capital, Brian worked for SEI, a financial services firm based outside Philadelphia. He was primarily responsible for client service and sales support for the company's third-party accounting and administration unit, serving some of the largest wealth managers in the world.

Brian graduated from Boston College with a Bachelor of Science, double majoring in finance and marketing. While attending Boston College, he played lacrosse and was a two-time MCLA All-American. Brian also holds an MBA from the University of Colorado with a concentration in finance. While receiving his MBA, Brian helped coach the University of Colorado Men's lacrosse team. Welcome, Brian!

This summer, Innovest also welcomes two talented interns to our family: Spencer Fronk and McLane Ritzel. Spencer is a junior at Denison University and McLane is a junior at Yale University. Welcome, Spencer and McLane! Libby Patch, Marketing Intern, continues to support the marketing team as she pursues her degree from University of Denver.

NEW SABBATICAL PROGRAM

This summer, Innovest launched a sabbatical program, offering one-month, fully paid sabbaticals to principals of the firm who have completed five years of employment. Steve Karsh, Principal and Director, was on sabbatical the month of June, and

Wendy Dominguez, President, will take a sabbatical in September.

Not only does the program represent an innovative addition to the work/life balance goals embedded in our culture, but the larger goal is for those taking sabbaticals to return to Innovest revitalized, with new ideas and a fresh perspective. At the same time, sabbaticals open opportunities for other employees to cross-train and obtain significant experience by assuming responsibilities they may not otherwise have the opportunity to undertake. We are excited about the program chiefly because of the tremendous benefit to our clients: Our clients will gain a stronger team with greater depth of experience.

RECENT EVENTS

In April, Innovest partnered with Denver Compensation and Benefits and Sherman & Howard to host "2012: The Perfect Storm of Fiduciary Liability". The event featured John Mayers, Regional Director at the Department of Labor and a panel discussion with Kathy Odle, Kim Schultz, and Wendy Dominguez. The event was designed to provide specific insight into the DOL's audit practices and provide a forum for attendees to learn about audit selection and procedures. The event was attended by more than 50 people.

On June 22, members of the Innovest team and our families supported Art for the Nations, a Christian organization dedicated to providing art supplies for children across the nation and in 80 countries. Since 2008, Art for the Nations has given out enough supplies for over 100,000 children to create their own works of art. Art for the Nations, proposed and organized by Innovest Analyst Kathy Lalone, is the first of five volunteer projects planned for the Innovest Team in 2012.

In July, Donna Patch assumed the role of President for the Western Pension Benefits Denver Chapter. The WP&BC strives to create an environment where pension & benefits professionals can expand their knowledge, share their ideas and network with other professionals. For over 30 years, the Denver Chapter has created a forum for pension & benefits professionals to share their expertise.

We know that we can make the greatest impact on our Colorado community by supporting causes that are important to our neighbors, employees, and clients. We are proud to be a community-focused firm and to serve our neighbors by providing financial and volunteer support to more than 50 non-profit organizations throughout the year.

For more information about Innovest's charitable donation projects, visit our Building Community page on our website (www.innovestinc.com).

Donna Patch, President of the Western Pension and Benefits Denver Chapter, will attend and moderate several sessions at the annual Western Benefits Conference in Seattle on July 15-18. The conference, designed with an emphasis on issues important to plan sponsors and their advisors, provides an opportunity for dialogue among private-sector experts and government officials to learn best practices and share their experiences about the latest industry developments.

In September, Innovest will partner with several firms to sponsor the Colorado Public Plan Coalition's Annual Conference. Richard Todd will present, "Effective Management of Portfolio Volatility in Uncertain Markets" at the conference this year. This non-profit organization provides education and networking opportunities for administrators of Colorado public plans and facilitates a forum for exchange of information and advancement of sound practices.

Remember to check out Innovest's Blog at www.innovestinc.com/blog/. Continually updated with articles and commentaries from our most trusted sources, our blog features Innovest's insights on the economy and financial markets.

EMPLOYEE SPOTLIGHT

JULIE KENNEDY, ANALYST

At Innovest Julie is responsible for preparing Investment Policy Statements, quarterly performance reports, account rebalancing, and preparing alternative investment documents. She works closely with clients and supports both the operations and research teams at Innovest.

WHERE IS YOUR HOMETOWN?

I'm from Sudbury, Ontario, Canada. Throughout my life, I've lived in several cities in Canada including Three Rivers, Quebec; Montreal, Quebec; and Toronto, Ontario. I also lived in Ohio prior to moving to Colorado. I've lived in Colorado for 29 years, so I consider it my home away from home.

WHAT DO YOU LIKE BEST ABOUT WORKING AT INNOVEST?

I love the wonderful people I work with. I also really enjoy the work I do – especially the quarterly performance reports. I get a real sense of accomplishment from reviewing the data and then pulling it all together for our clients each quarter.

HOW DO YOU GIVE BACK TO THE COMMUNITY?

I officiate swim meets during the year, and I've been doing that for seven years. The meets are a wonderful opportunity for me to interact with kids of all ages and celebrate their athletic talent. The State meet is one of the most exciting each year – the competition level is amazing!

One of the most rewarding things for me is to participate in the Innovest charitable donation functions and volunteer events. My favorite volunteer opportunity in the recent past has been the Denver Rescue Mission. We had a lot of fun volunteering that day, and it was heartwarming to feel like I made a difference, even for a day, in someone's life.

WHAT ARE YOUR HOBBIES AND INTERESTS?

I like to read, garden, and swim. I also enjoy scrapbooking, being outside, and weekly Sunday dinners with my family.

TELL US ABOUT YOUR FAMILY.

My husband John and I have been married for 30 years. We have two boys, Shayne, who is an auto mechanic and optician, and Jason, who is a plumber. Jason recently got married to his girlfriend Sarah, who graduated this Spring from Metro State. Buckley, our Old English Sheep Dog, is also a member of the family. I have three sisters who all live in Canada, and I try to visit them every year.

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