Mutual Fund Fees and Discounts

There are many advantages to investing in mutual funds – professional management, diversification, liquidity, convenience, and ease of recordkeeping. In fact, for many investors, mutual funds are the best and only option for diversification and professional management. As an investor protection benefit, all U.S. funds are subject to regulation and oversight by the U.S. Securities and Exchange Commission (SEC).

With any investment, it is important that you understand how management fees, expenses, sales charges, and discounts affect your investment and return. Herein lies another advantage of mutual funds: the legal requirement for complete disclosure of all fees. A mutual fund's fees and expenses are explained in the fund's prospectus, under the heading "Shareholders Fees," in table form and easily understood descriptions. Loads (sales charges) and related discounts must also be disclosed. The purpose is for you, the investor, to use this information to make the most appropriate decision for your future.

You may ask, why should this matter to me? It matters because fees, for instance, can be the heaviest drag on mutual fund returns for investors. A wise investor will pay attention to these fees to insure that he or she will be getting the best return possible for their investment. For example, a fee difference of just 1% (from 1% to 2%) for a $100,000 investment earning 8% annually can reduce that investment's value by $70,000, or approximately 13%, over a 20-year period. As illustrated, fee differences can have a significant impact on the size of your nest egg, even to the extent of delaying your retirement.

Selecting the appropriate fund to meet your investment objectives, of course, involves much more than looking at fees. You also need to consider the fund's investment objective and policies, its risks, and the types of services offered by the fund. Before investing in a mutual fund, you should read the fund's prospectus carefully to learn about the fund's risk and return relationship and it's goals and investment types in order to determine if they match your own. While an investor should not choose a mutual fund based solely on the fees charged, should you find more than one mutual fund that meets your goals, the fund with the lower fees will likely result in the higher investment value.

<u>'Loads' and Annual Operating Expenses</u>

Looking specifically at mutual fund fees and expenses, mutual fund investors need to be familiar with loads and annual operating expenses. Mutual funds are sold as either 'load' or 'no-load' funds. A load fund is typically sold through a financial professional whereby the 'load' is essentially a sales charge, or commission, that compensates the professional for his or her services. Similarly, a fund may offer different "classes" of shares, such as Class A, Class B or Class C. Share classes represent ownership in the same mutual fund. There are generally three types of loads and three different "classes" of shares.

<u>Front-end loads</u>, or Class A shares, incur a sales charge when fund shares are purchased. The amount of the load is based on the amount of your investment. For equity funds, the

commission charges range from 2.5% to 6.75% with most being 5.75%. Commission charges for fixed income funds from 1% to 6.25% with most being 4.5%. Back-end loads, or a Contingent Deferred Sales Charge (CDSC), incur a sales charge when you sell mutual fund shares. The amount of the back-end load, referred to as Class B shares, usually decreases the longer you own the shares. These commissions may be as high as 5% of your account balance if the shares are only held for a short time. A level load, or Class C shares, has an annual sales charge that is typically 1% of your account balance. Loads will generally reduce the return on an investment by the percentage rate charges. If you are responsible for paying a broker or investment advisor separate management fees, it may be inappropriate for them to also recommend loaded funds (double fees). Another option is a no-load mutual fund. These funds have no sales charges and can generally be purchased directly from the investment company. These types of funds are frequently utilized by investment advisors or brokers who charge a separate management fee for their services, or by investors who self direct their own investments. For additional information on mutual fund classes (Class A, Class B and Class C), visit the National Association of Securities Dealers site at www.nasdr.com/alert_mfclasses.htm, or the US Securities and Exchange Commission site at www.sec.gov/answers/mffees.htm.

Annual operating expenses are a cost that owners of mutual fund shares must think about. The general operation of a mutual fund involves costs, and those operating costs are passed on to the shareholders. Referred to simply as operating expenses, these fees are calculated as a percentage of the fund's total assets. Typical operating fees include a management fee (to cover the cost of managing the portfolio), 12b-1 fees (to cover sales and marketing expenses), and redemption fees (a fee incurred if you sell your shares within a defined time period). Fees vary by mutual fund, and not all mutual funds charge each fee. Mutual fund companies set their own fees; however, the National Association of Securities Dealers, Inc. (NASD) does impose limits on some fees. Again, a wise investor will put forth the effort to understand the fees and expenses in a mutual fund to insure that he or she is getting the best return possible for their investment. As noted previously, the difference between funds can have a significant impact on the investor's total returns.

What Are Breakpoints?

Breakpoints are purchase levels at which discounts on sales charges become available to mutual fund purchasers. While perhaps familiar with fees and operating expenses, many investors may be unaware of these fee discounts offered by some mutual fund companies. In fact, the National Association of Securities Dealers (NASD) and the Securities and Exchange Commission (SEC) have been concerned that some investors have been denied certain mutual fund discounts and are therefore overpaying expenses with regard to their mutual funds. The NASD has issued an investor alert with regards to this concern, in an effort to help investors understand fee discounts. From the NASD Investor Alert, *Mutual Fund Breakpoints: A Break Worth Taking*, "mutual funds often offer discounts on front-end sales charges or loads for larger investments." The alert further states, "when your dollar amount of mutual fund purchases reaches a specified level, called a breakpoint, you are entitled to pay a smaller sales load. For example, a mutual fund might charge you a front-end sales load of 5.75% for all purchases of less than $50,000, but reduce the load to 4.5% for investments between $50,000 and $99,999, and further reduce or eliminate the sales load for even larger investments. Typically, there are several breakpoints, and if you invest more and reach each of these thresholds, the greater the reduction in the sales load." In essence, you are rewarded with a smaller sales charge for investing more money.

But there is more, this break in front-end sales loads is not just based on a single mutual fund transaction. You may also be entitled to the discount based on rights of accumulation or by using letters of intent. Rights of accumulation allow you to combine both your current and previous fund transactions in order to reach the breakpoints. A letter of intent allows you to state that you are intending to invest an amount that will trigger the breakpoint discount if you can't invest it all immediately. The rules regarding this option vary by mutual fund company, and all companies incorporate the ability to charge if you do not meet the specification of the letter of intent. In either case you can usually include mutual fund transactions in related accounts, in different mutual fund classes (Class A, B or C), in different mutual funds that are part of the same fund family, or held through another financial professional to reach the breakpoint.

Investor Protection

Not only are there organizations such as the NASD, the SEC, and the Virginia Division of Securities looking out for investor's interests, there are also a number of ways you, as an investor, can protect yourself with regards to mutual fund fees and specifically breakpoints. First, understand the fees and breakpoints. A financial professional is obligated to inform you of these; however, if you make self-guided purchases you will be responsible for this knowledge yourself. If your financial professional does not explain these adequately, then ask! Second, review your mutual fund holdings. Before making another purchase, review your holdings to determine where you might benefit the most from fee discounts. And third, keep your financial professional informed. Be sure you tell your financial professional about all of your mutual fund holdings and those of your family (spouse or dependent children), including holdings at other brokers or with the mutual fund itself. Failure by your financial professional to utilize known breakpoint discounts is inappropriate, and you should bring it to their attention. If the matter is not resolved, contact the Virginia Division of Securities, the US Securities and Exchange Commission, and/or the National Association of Securities Dealers (refer to the contact information below).

For more information regarding mutual fund breakpoints, we strongly encourage investors to refer to the NASD Investor Alert *Mutual Fund Breakpoints: A Break Worth Taking* at www.nasdr.com/alert_breakpoint.htm.

Virginia Division of Securities

www.scc.virginia.gov/srf/index.aspx

P.O. Box 11967
Richmond, Virginia 23218
804-371-9187 (phone)
804-371-9911 (fax)
Complaint Form - www.scc.virginia.gov/srf/index.aspx

U.S. Securities and Exchange Commission

www.sec.gov
SEC Headquarters
450 Fifth Street, NW
Washington, DC 20549
Office of Investor Education and Assistance
(202) 942-7040 (phone)
Complaint Form - www.sec.gov/complaint.shtml

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