

[Do You Understand the Fees Charged by Your Mutual Funds? Probably Not.](#)

Posted: 08 Aug 2009 07:31 AM PDT

In a July 31, 2009 article, Sam Mamundi of Marketwatch.com discussed the hidden sales fees charged by mutual funds. As noted in the article, the majority of retail funds are sold through brokerages, and each brokerage firm levies a range of charges to the fund for every sale. The cost of these agreements is passed on to investors.” These charges come in a variety of forms, including “revenue sharing agreements” and 12b-1 fees.

Many broker-dealers have revenue sharing agreements with mutual fund companies. Under these agreements, the broker-dealers are paid a percentage of the mutual fund sales they generate by the mutual fund companies. Each firm negotiates its own rates of revenue sharing with each mutual fund company.

Over the past few years, there have been lawsuits involving revenue sharing agreements. These cases were brought against broker-dealers and were largely based upon the premise that these undisclosed fees created a conflict of interest because the firms’ brokers (and also the broker-dealers) had a financial incentive to push the funds managed by the companies with whom the broker-dealer had an agreement, and not based upon their clients’ best interests.

Although mutual fund companies specifically report the amount of 12b-1 fees they charge against shareholders in their annual and semi-annual reports, the amount of money charged to shareholders for these revenue sharing agreements are not specifically disclosed. In fact, as noted in the Marketwatch.com article:

“There’s no direct rule requiring funds or brokerage firms to disclose revenue-sharing deals. Funds simply have to state that they pay for these deals, and often that’s tucked away at the back of a prospectus — which many investors don’t read before they buy into a fund.”

The Securities and Exchange Commission is also reportedly looking into the issue of hidden mutual fund sales fees. In her testimony before the Subcommittee on Financial Services and General Government on June 2, 2009, SEC Chairperson Mary Schapiro stated:

I also have asked the staff to prepare a recommendation on rule 12b-1, which permits mutual funds to use fund assets to compensate broker-dealers and other intermediaries for distribution and servicing expenses. These fees, with their bureaucratic sounding name and sometimes unclear purpose, are not well understood by investors. Yet in 2008, rule 12b-1 was used to collect over \$13 billion in investors’ funds out of fund assets. It is essential, therefore, that the SEC engage in a comprehensive re-examination of rule 12b-1 and the fees collected pursuant to the rule. If issues relating to these fees undermine investor interests, then we at the SEC have an obligation to step in and adjust our regulations.

President Obama is also focusing on this issue. In a June White Paper (will open in Adobe Acrobat), the President noted that for the country to rebuild trust in our markets, we need strong and consistent regulation and supervision of consumer financial services and investment markets.” To that end, President Obama recommended stronger regulations to improve the transparency, fairness, and

appropriateness of consumer and investor products and services.” In order to accomplish this goal, the President has set out to increase the power of the SEC so that the agency is better equipped to protect consumers and investors. Whether this will be enough is yet to be determined.

Undisclosed fees and revenue sharing agreements are another example of conflicts of interest between Wall Street firms and Main Street investors. Unfortunately, stockbrokers and financial advisors often lose sight of their clients’ goals and, as a result, their clients suffer unnecessary losses in the value of their IRAs, 401(k)s, college savings plans, or other investments accounts.

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