

Understanding Investment Fees and Expenses

The following information provides a basic overview of investment fees and expenses. It is not intended to substitute for the advice of a retirement plan investment professional.

Fees and expenses vary between investment companies and investments. An informed participant in a defined contribution plan reviews these costs as a routine part of managing a retirement account. The fund prospectus and the investment company's online materials offer significant information to help you in this review.

Generally, these costs are not itemized on your statement and are deducted from your investment returns before returns (loss or gain) are posted to your account.

Plan Administration

The daily operation of a retirement plan involves expenses for basic administrative services, such as recordkeeping (account activity) and custodial (establish and maintain the plan) fees. Investment companies may charge an asset-based fee, a percentage of your total assets the company manages for you.

Financial Advisory Services

Investment companies may charge a fee for investment advisory services to help you design your personalized portfolio. Advisory services are offered online, in-person, and/or through an objective third-party company.

Mutual Funds

Mutual funds may charge a front-end load (sales charge on your fund purchase), a back-end load/redemption fee (sales charge on your fund sale), and in-service transfer fees (transferring assets between different approved investment companies). Mutual funds also may charge 12b-1 fees, which are defined under the Investment Company Act of 1940. These fees are ongoing fees paid out of your assets to pay sales commissions, advertising, and other promotional costs.

Variable Annuities

A variable annuity is an insurance product that is funded by variable investments. Variable annuities may carry insurance-related charges including the insurance component, mortality risk charges, and the cost of issuing and administering contracts. An insurance company may charge withdrawal/surrender and transfer fees when a participant terminates a contract or makes a withdrawal before the contract term expires.¹

¹ May 2004, Understanding Retirement Plan Fees and Expenses, U.S. Department of Labor Employee Benefits Security Administration

Expense Ratio

An expense ratio, also known as management expense ratio, is the percentage of total fund assets used to cover expenses associated with the operation of a mutual fund. This amount is taken out of the fund's assets and lowers the return that fund holders achieve. These expenses include management fees and operating expenses. Although expense ratios are important, it can be misleading to focus on one measurement without also identifying key factors that influence that measurement. Here are factors that affect the calculation of the investment expense ratio.

- *A fund's asset size:* As fund assets increase, the expense ratio typically declines.
- *A fund's investment category:* Specialty funds have higher expense ratios than equity funds, which, in turn, have higher expense ratios than bond funds. International funds have higher expense ratios than comparable domestic funds.
- *Whether a fund is an index fund or an institutional fund:* Index funds and funds that are available only to institutional investors generally have lower expense ratios than other types of funds.
- *Asset size of the fund group:* On average, members of the smallest fund families have higher expenses than other funds. Funds that are part of large fund families (in terms of asset-size) tend to have lower expense ratios than funds that are part of small fund families. These findings may reflect economies for the investment adviser generally.
- *Amount of portfolio turnover:* Funds with higher portfolio turnover tend to have higher expense ratios.²

Basis Points (BPS)

A basis point is a unit equal to 1/100th of 1%. (1% charge = 100 basis points; 0.01% = 1 basis point). Basis points are used in calculating the cost (such as administrative fees, expense ratios, etc.) for a financial instrument. Basis points may be used to indicate the change in the value of a financial instrument, also.

² December 2000 Division of Investment Management: Report on Mutual Fund Fees and Expenses, U.S. Securities and Exchange Commission

Understanding the Prospectus

Before you purchase shares of any mutual fund, make sure you are equipped with information about that fund's goals, strategies, fees, expenses and level of risk. This information, and more, is available to you in a single document – the fund prospectus.

It's no secret that the size of a prospectus and the type of information inside can be hard to tackle. But don't be too overwhelmed. Here is a brief overview of a prospectus, why it is important, and what items you may want to pay particular attention to, although it is recommended that you review the full prospectus before making an investment decision.

Know the Basics

A prospectus is a formal document, required by the Securities and Exchange Commission (SEC), that describes the details of a fund. The prospectus is a legally binding contract between the fund and the fund holder. It's easy to get lost in all the legal jargon and miss the information that matters most.

- **Investment objectives.** The prospectus outlines the fund's goals and it describes the types of securities the fund will purchase in order to achieve its goals. With this information, you can determine whether the fund is in line with your personal investment strategy.
- **Level of risk.** This section assesses the risks associated with the securities a fund holds. This information will help you determine if you are comfortable with these risks.
- **Cost of the fund.** This section is extremely important to consider because fees and expenses reduce your total investment return. In this section of the prospectus, you will find information on any sales load charges, 12b-1 fees, and the expense ratios.
- **Past performance.** The prospectus reports the fund's performance for the past 10 years, or since its inception date if the fund is less than 10 years old. This information can be used to compare the fund's performance with that of its index. *The fund's past performance is no guarantee of future results.*
- **Fund management.** The prospectus provides information about the current fund manager's investment strategy. You may consider how the fund's management will affect fees and returns, the length of time the fund manager has been managing the fund, and how long the fund has been in operation.
- **Withdrawal, transfer, and distribution restrictions.** Some funds may impose restrictions on transfers, withdrawals, and distributions. These restrictions are disclosed in the prospectus.