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How Much Hidden Fund Fees Cost You

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Mutual funds remain one of the best investment vehicles for individual investors, but many shareholders are unaware of the hidden fees that are being paid to large, traditional brokers for overseeing mutual fund investments in their accounts.

Don't get me wrong—I love mutual funds. They provide investors with professional management and the ability to diversify assets at a reasonable cost. More than 90 million Americans use mutual funds to help them achieve their financial goals, from saving for retirement to socking money away for a child's college education.

Unfortunately, not all mutual funds have the same fee structure. Funds purchased through large brokerages are subject to a number of extra fees, some of which are hidden. These fees are typically paid to encourage brokers to sell certain funds to their customers, assuming they are suitable investments.

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These extra fees are not charged if you buy stocks or bonds through your broker, in which case you pay a commission on each purchase or sale, or an annual asset-based fee for advice. When you buy a mutual fund, however, you pay the broker an upfront or ongoing sales commission, as well as the add-ons.

The Hidden Fees

Here is what you are paying your brokerage firm over and above your mutual fund sales commissions:

Shareholder servicing fee. Under current regulatory rules, a mutual fund can pay a broker up to 0.25 percent of your assets for "servicing" your account. If you have a $30,000 account balance, that's $75 a year.

Account maintenance fee. A broker charges an average of $20 to "maintain" each mutual fund in your account. This fee is paid annually by a mutual fund to your broker. If you hold four mutual funds, your broker is being paid $80 a year.

Revenue-sharing fee. This is a fee the management company of each mutual fund pays the broker for "marketing." It can range between 0.10 percent and 0.40 percent of your assets, so a 0.20 percent fee is generating $60 a year from a $30,000 account. This is a hidden cost, but you can be sure you're paying it.

If you add up all the fees in my example, your broker is receiving as much as $215 a year to oversee four mutual fund investments.

If you chose to buy the same four funds directly from a fund, you would not pay the extra fees, and your fund's cost would be about $40 a year, or an average of $10 for each fund for record-keeping. Subtract $40 from $215, and you are paying as much as $175 a year in extra fees by investing through a broker for every $30,000 you have in mutual funds.

The Hidden Cost

This may not sound like much money, but these fees add up to more than 50 basis points, or 0.58 percent of your assets each year, on average. If you expect to earn 5 percent a year on your investments, remember that these extra fees mean you are losing out on 10 percent of whatever that 5 percent return equals in asset gains.

And these fees are of course on top of sales commission or other ongoing fees you paying your broker for advice and counsel.

This is all quite expensive for individual investors, and the exact amounts are typically hidden or poorly explained. You can learn more about the fees in the disclosure documents you get from mutual funds and your broker. But you probably need to be a securities lawyer to understand what's really going on.

(*Read More:* **The Dilemma of the Do-Nothing Fund Investor**)

Most of the fee information is typically in a fund prospectus' statement of additional information—the last place investors look, if they even review fund materials. Many investors now receive a summary prospectus, with links to full prospectus and the statement of additional information online. Some information is also disclosed on a broker's website.

These extra fees are quietly taken out of your investments each year. The costs you are assuming eventually show up in the performance of the mutual funds that your broker has recommended. Some of these funds still do reasonably well, but many others don't, and they are burdened by this expensive cost structure.

Doing Your Fund Fee Homework

Smart investors can protect themselves by doing their own research on fund performance and costs, so they are not accepting recommended funds without independent due diligence.

Investors also should call on regulators to look into this problem. Some good news is that the Securities and Exchange Commission is examining brokerage fees to determine whether they are being used primarily to push certain mutual funds. The agency has a new chairman, Mary Jo White, and this should be one of her priorities.

But don't wait for the SEC to act.

Learn more about what your broker is receiving in fee income for your mutual fund investments and evaluate whether the services are worth it, given your investment needs.

If you invest in traditional "no-load" funds, you are ahead of the game and in the minority. If you use a discount brokerage platform or fund supermarket, your fee burden should be appreciably lower than the high-cost brokerage model described above.

For investor still using traditional brokers, ask why these fees are charged for your mutual funds, while stock and bond investments don't generate comparable fees. You will feel better that you are asking all the right questions—but don't be surprised if you don't like the answers.

Niels Holch is the executive director of the ***Coalition of Mutual Fund Investors****, an Internet-based shareholder advocacy organization established to represent the interests of individual mutual fund investors in Washington, D.C.*