FINDING
THE HIDDEN FEES
IN RETIREMENT ACCOUNTS

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Finding the Hidden Fees in Retirement Accounts

Popular Retirement Investment Options

It's inevitable. Sometime in your mid-to-late 60's, your prime earning years will slowly devolve into retirement. Accumulation segues into decumulation and then it's time for you to draw income from that nest egg that you built up during your youth. While most retirees will receive Social Security payments, for most of them (about 61%), these payments won't cover all their expenses. In order to find enjoyment and fulfillment in their Golden Years, many retirees rely on investment income to enhance their quality of life. [1, 2]

It's essential that you invest funds properly so that you can generate adequate income during retirement. Below are some of the most popular investment vehicles on the market today.

401(k) Plans

A 401(k) is a defined contribution plan that's offered by many employers. If you decide to participate in a 401(k) plan, you can pick a plan option that suits you best and then contribute a predetermined amount to the plan each month. Some employers match these contributions to sweeten the deal, but employees need to be aware of hidden fees associated with these accounts in order to protect their earnings. 401(k)'s are popular investment vehicles, but many investors are unaware of the potential losses that could negatively affect accumulations. [1, 7]

Individual Retirement Accounts (IRAs)

An Individual Retirement Account or IRA is an investment vehicle that's funded with taxable income that you can tuck away tax-free. It's a way to save retirement funds in a tax-advantaged way. Funds are held tax-free and taxes on IRA withdrawals are deferred until retirement when your income is lower and therefore you tax bracket is also lower. Many people open an IRA through a financial institution in addition to investing in a defined contribution plan such as a 401(k) in order to balance the pre-tax and post-tax benefits of investing. [1, 3]

There are three main types of IRAs for investors to choose from: traditional IRAs, Roth IRAs, and Rollover IRAs. Both traditional IRAs and Roth IRAs provide different tax benefits to investors. Rollover IRAs allow investors to contribute funds from another, qualified retirement investment vehicle. [3]

Traditional IRAs

A traditional IRA is set up on the investor's own behalf. Traditional IRAs allow investors to make contributions with funds that may be deductible on a tax return. Earnings grow tax-deferred. When the investor reaches retirement age, their annual earnings are usually much lower than when they were in their prime accumulation years. So the IRA withdrawals are taxed according to this lower tax-bracket which means that the investor pays a lot less in taxes. [3, 5]

Roth IRAs

Contributions to a Roth IRA come from funds that have already been taxed. Money in a Roth IRA account grows tax-free and under certain conditions, withdrawals that are made during retirement are also tax-free. [3]

Rollover IRAs

A Rollover IRA allows the investor to roll funds from another qualified retirement account into an IRA. A rollover allows certain eligible funds from an employer-sponsored retirement plan [such as a 401(k) or a 403(b)] to be moved into an IRA. [3]

Roth 401(k) Plans

A Roth 401(k) is special savings account that's sponsored by the investor's employer. Funds have already been taxed. As a result, Roth 401(k)'s are particularly well-suited for investors who think they'll be in a higher tax bracket during retirement than they are in the current time. There's a limit to how much can be contributed to Roth 401(k) plan each year. [4]

Simple IRAs

A Simple IRA (which stands for Savings Incentive Match Plan for Employees) is set up by a business owner on behalf of his or her employees. It can be set up by the owner, for the owner, if the owner of the business is a sole proprietor. Business owners as well as employees make contributions to a Simple IRA. Income tax on the funds are tax-deferred until they're withdrawn during retirement. [5]

SEP IRAs

A SEP IRA is an investment vehicle that was specifically designed for self-employed individuals and small business owners. This is a basic retirement account that resembles the Traditional IRA in many ways. Contributions are tax-deferred until they're withdrawn during retirement. [6]

References:

1 - https://www.aginginplace.org/7-best-retirement-plan-options/
2 - https://www.sensiblemoney.com/learn/best-retirement-investments-for-a-steady-stream-of-income/
3 - https://www.fidelity.com/building-savings/learn-about-iras/what-is-an-ira
4 - https://www.investopedia.com/terms/r/roth401k.asp
5 - https://www.investopedia.com/ask/answers/102714/what-are-differences-between-simple-ira-and-traditional-ira.asp
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Reviewing A Fund's Prospectus

A prospectus is a type of document that provides necessary information about an investment that's offered as shares to the public. This document may provide information about the company's structure, its strategies and strengths in the marketplace, financial insights from recent years, management information, and risks related to investing in the company, among other key pieces of information. The purpose of a prospectus is to give potential investors the most crucial investment details needed to make an educated decision about their purchase, but it's important for investors to know that not all fees and expenses are openly disclosed, especially in the case of prospectuses written for 401(k) plans and mutual funds. [1,6]

Here is a basic outline of the components of a prospectus:

- Company overview
- Products and services
- Management information
- Intended deal structure
- Company use of monetary proceeds
- Details on securities on investment offered to the public
- Financial performance information
- Investment Risks

Although both public and private companies now use the term "prospectus" to describe documents with information like that described above, the term is traditionally (and correctly) used to refer to informational documents for companies that are trading publicly. More and more, it's common to find private companies providing a prospectus; the equivalent document for private companies is called a "private placement memorandum (PPM)" or "offering memorandum". The prospectus (or PPM) is the most important go-to document for investors who are interested in a particular investment vehicle. Though not all of mutual fund and 401(k) fees are listed in a prospectus, the ones that are listed can give potential investors an idea of how much they'll be losing on their investment. It's an essential tool that all investors need to use when investigating a particular investment vehicle. [2]

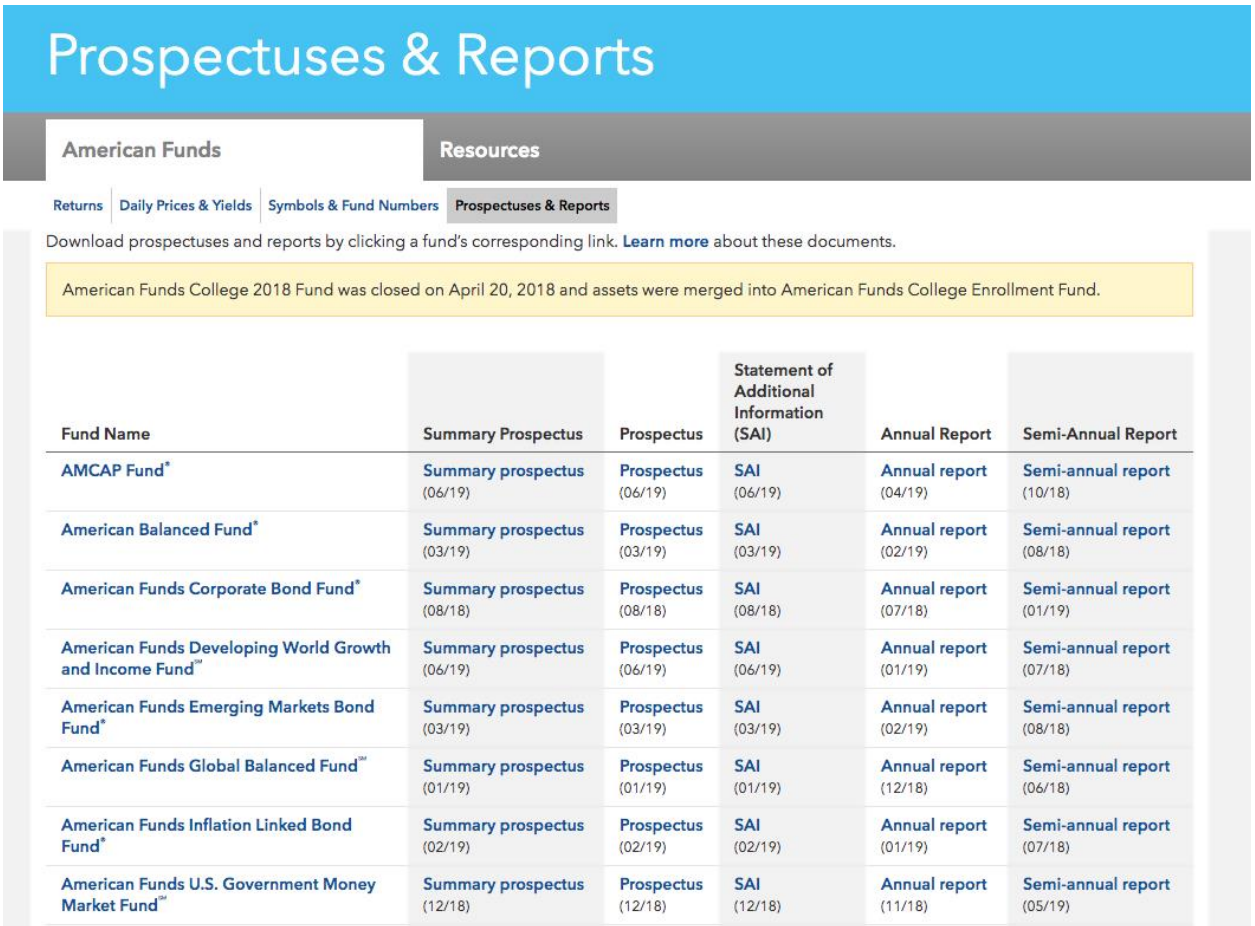
Finding Transparent Fee Disclosures in a Prospectus

How are fees disclosed in a prospectus?

Fees in a prospectus are disclosed in various ways, but it's common for a prospectus to include a section dedicated to fees, expenses, and other similar costs. The parts of a prospectus that discuss risks and benefits as well as the management and leadership sections may include information about fees. Investors should study these sections of the prospectus carefully before investing in a mutual fund. 401(k) investors must study the prospectuses for every fund offered in their plan. [7]

The Mutual Fund Prospectus

The mutual fund prospectus is a special kind of document that is used to describe potential risks and benefits of investment to potential customers. Because mutual funds generally involve more than one company or organization, they have a type of prospectus with a specific style and organization that suits this unique investment structure. [3]



Prospectuses & Reports

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Download prospectuses and reports by clicking a fund's corresponding link. **Learn more** about these documents.

American Funds College 2018 Fund was closed on April 20, 2018 and assets were merged into American Funds College Enrollment Fund.

Fund Name	Summary Prospectus	Prospectus	Statement of Additional Information (SAI)	Annual Report	Semi-Annual Report
AMCAP Fund®	Summary prospectus (06/19)	Prospectus (06/19)	SAI (06/19)	Annual report (04/19)	Semi-annual report (10/18)
American Balanced Fund®	Summary prospectus (03/19)	Prospectus (03/19)	SAI (03/19)	Annual report (02/19)	Semi-annual report (08/18)
American Funds Corporate Bond Fund®	Summary prospectus (08/18)	Prospectus (08/18)	SAI (08/18)	Annual report (07/18)	Semi-annual report (01/19)
American Funds Developing World Growth and Income Fund℠	Summary prospectus (06/19)	Prospectus (06/19)	SAI (06/19)	Annual report (01/19)	Semi-annual report (07/18)
American Funds Emerging Markets Bond Fund®	Summary prospectus (03/19)	Prospectus (03/19)	SAI (03/19)	Annual report (02/19)	Semi-annual report (08/18)
American Funds Global Balanced Fund℠	Summary prospectus (01/19)	Prospectus (01/19)	SAI (01/19)	Annual report (12/18)	Semi-annual report (06/18)
American Funds Inflation Linked Bond Fund®	Summary prospectus (02/19)	Prospectus (02/19)	SAI (02/19)	Annual report (01/19)	Semi-annual report (07/18)
American Funds U.S. Government Money Market Fund℠	Summary prospectus (12/18)	Prospectus (12/18)	SAI (12/18)	Annual report (11/18)	Semi-annual report (05/19)

At AmericanFunds.com, it's possible to find a list of all of the prospectuses for the various funds that this company offers. Other fund companies also list their prospectuses online or make them available through email inquiry or by contacting a broker.

Mutual fund prospectuses are generally composed of the following sections:

- **Investment strategy description -** This section provides insights into the exact investment strategy pursued by the fund manager or management company. It will inform potential investors about where their money may be invested should they choose to participate. [3]

- **Historical overview of expenses paid by shareholders -** Fees and other expenses may be illustrated in this section of the mutual fund prospectus. Some of the expenses that may be mentioned include 12-b-1 fees, transfer agent charges, and sales loads. [3]

- **Long-term performance comparison -** This part of the prospectus will inform potential investors about the mutual fund’s success in comparison to a benchmark, such as the Dow Jones Industrial Average. The prospectus may choose to justify its benchmark with additional information about the mutual fund. [3]

- **Investment risks -** Major risks with investing in a particular mutual fund will be illustrated in this section. Different types of mutual funds with different goals and histories may have different risks associated with investment, so investigate this section carefully. [3]

- **Management information -** This section will inform potential investors about the names, positions, and responsibilities of the directors, managers, and trustees who are in charge of and who represent the shareholders of the mutual fund. The range of investment for each of these individuals is also usually disclosed, along with the amount of money each individual is paid for their services. [3]

- **Portfolio turnover rate -** The portfolio turnover rate provides insights into the tax efficiency of the mutual fund. [3]

When investigating a mutual fund’s prospectus, take the time to look at the sections that detail fees and expenses, the manager’s reimbursement, and the overall risk of the investment. These sections are some of the most important for discovering hidden fees. Most mutual funds will provide their prospectuses on their website for the perusal of interested potential investors. Look closely at the expense ratio and the transparent fees associated with the fund up against the projected rate of return. Financial planners and advisors will often have access to these documents as well. [4]

The 401(k) Prospectus

The 401(k) prospectus is different from a regular prospectus that details information about one individual company and it also differs from a prospectus detailing information about one mutual fund. The fees hiding in a 401(k) plan can be well-concealed within umbrella terms and fees, especially within an annual 401(k) disclosure notice. It’s common for plan managers from the Department of Labor to bundle indirect fees with fund expense ratios, meaning that even if the direct fees are disclosed, there are certain other fees that investors may not be immediately aware of. [5]

In a 401(k) prospectus, investors are informed about information regarding how their investments will be used and when and how much they can withdraw. Investors are also told about which funds are included in the 401(k) plan. Because a 401(k) consists of multiple funds, investors would need to find the prospectuses for each fund in the plan in order to discover hidden fees and other key financial information. [7]

Investment objective The fund's investment objective is to provide you with growth of capital.

Fees and expenses of the fund This table describes the fees and expenses that you may pay if you buy and hold shares of the fund. In addition to the fees and expenses described below, you may also be required to pay brokerage commissions on purchases and sales of Class F-2 or F-3 shares of the fund. You may qualify for sales charge discounts if you and your family invest, or agree to invest in the future, at least $25,000 in American Funds. More information about these and other discounts is available from your financial professional, in the "Sales charge reductions and waivers" sections on page 27 of the prospectus and on page 64 of the fund's statement of additional information, and in the sales charge waiver appendix to this prospectus.

Shareholder fees (fees paid directly from your investment)

Share class:	A and 529-A	C and 529-C	529-E	T and 529-T	All F and 529-F share classes	All R share classes
Maximum sales charge (load) imposed on purchases (as a percentage of offering price)	5.75%	none	none	2.50%	none	none
Maximum deferred sales charge (load) (as a percentage of the amount redeemed)	1.00*	1.00%	none	none	none	none
Maximum sales charge (load) imposed on reinvested dividends	none	none	none	none	none	none
Redemption or exchange fees	none	none	none	none	none	none

Annual fund operating expenses (expenses that you pay each year as a percentage of the value of your investment)

Share class:	A	C	T	F-1	F-2	F-3	529-A
Management fees	0.27%	0.27%	0.27%	0.27%	0.27%	0.27%	0.27%
Distribution and/or service (12b-1) fees	0.24	1.00	0.25	0.25	none	none	0.22
Other expenses	0.11	0.15	0.15	0.17	0.15	0.06	0.20
Total annual fund operating expenses	0.62	1.42	0.67	0.69	0.42	0.33	0.69

Share class:	529-C	529-E	529-T	529-F-1	R-1	R-2	R-2E
Management fees	0.27%	0.27%	0.27%	0.27%	0.27%	0.27%	0.27%
Distribution and/or service (12b-1) fees	0.99	0.49	0.25	0.00	1.00	0.75	0.60
Other expenses	0.21	0.17	0.21	0.20	0.16	0.40	0.25
Total annual fund operating expenses	1.47	0.93	0.73	0.47	1.43	1.42	1.12

Share class:	R-3	R-4	R-5E	R-5	R-6
Management fees	0.27%	0.27%	0.27%	0.27%	0.27%
Distribution and/or service (12b-1) fees	0.50	0.25	none	none	none
Other expenses	0.21	0.16	0.18	0.11	0.06
Total annual fund operating expenses	0.98	0.68	0.45	0.38	0.33

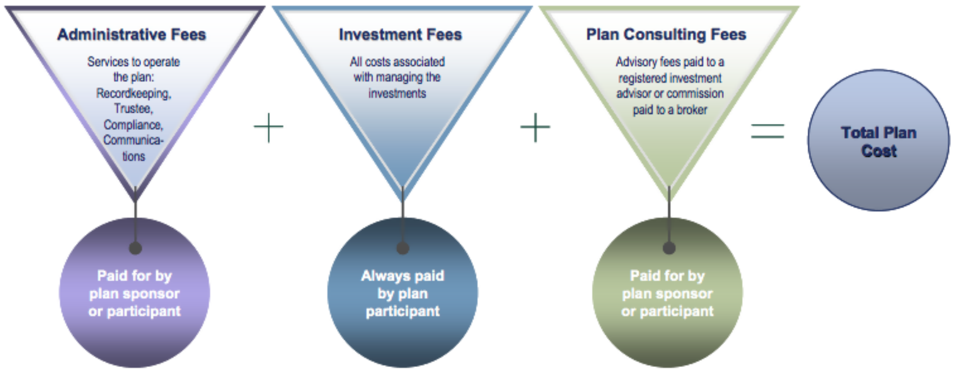
* A contingent deferred sales charge of 1.00% applies on certain redemptions made within 18 months following purchases of $1 million or more made without an initial sales charge. Contingent deferred sales charge is calculated based on the lesser of the offering price and market value of shares being sold.

1 The Growth Fund of America / Prospectus

This page details some of the fees charged to investors in the Growth Fund of America mutual fund.

How Fees Are Paid

Once the plan sponsor understands the necessary retirement plan components and the delivery of those services, the next step is to understand how fees are paid. Fees to consider include **Administrative** fees, **Investment** fees and **Plan Consulting** fees. Combined, these represent **Total Plan Cost**. Administrative and Plan Consulting fees may be paid by the plan sponsor or participant. Investment fees are always paid by participants (deducted from plan assets).



General Cost Observations

Several key factors can impact plan pricing. The larger the plan (in terms of assets), the lower the plan sponsor out-of-pocket (per participant) costs. Other factors to consider include:

- Number of plan participants
- Average account balance
- Service requirements
- Plan design features

According to Retirement Plan Advisory Group's proprietary research database, which includes fee metrics on more than four hundred RFP/Provider Analysis reports representing over 2,000 pricing scenarios, we have concluded that 95% of plan fees are paid for by plan participants. In most cases, Administrative fees are subsidized by the Investment fees, otherwise known as revenue sharing.

In this sample 401(k) prospectus, some additional fees are described. A graphic shows how the fees are paid and how these fees factor into the final cost and return on investment.

References:
1 - https://corporatefinanceinstitute.com/resources/data/public-filings/prospectus/
2 - https://www.prospectus.com/prospectus-finance/
3 - https://www.thebalance.com/what-is-a-mutual-fund-prospectus-357947
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7 - https://www.investopedia.com/ask/answers/100314/what-information-does-my-employer-have-give-me-regarding-my-401k-plan.asp

Common Mutual Fund and 401(k) Fees and Charges

Mutual Fund Costs and Fees

When you purchase a mutual fund, the costs involved may not always be straightforward or easy to decipher. Unlike buying a share of stock where the broker is paid a commission, mutual funds often involve an array of different fees, some that are easy to see and some that are hidden. Mutual funds are managed by professionals so there are additional expenses above and beyond just the broker's commission. And many of these fees are sometimes hidden, hard to calculate, or just hard to understand. So, if you decide to invest in a mutual fund, be sure you understand completely what you're paying for. About 73% of Americans have no idea how much they're paying in fees. [1, 14, 16]

Mutual Fund Categories

The fees associated with mutual funds can be sorted into two broad categories:

1. **Transaction fees -** These fees are paid when you purchase or sell shares in the mutual fund.
2. **Annual operating expenses -** These costs go toward maintaining your investment in the fund. [1]

Transaction Fees

The transaction fees associated with a mutual fund are typically the biggest cost not included in the expense ratio (see below under Annual Operating Expenses). Transaction fees include payments such as broker commissions, which can be costly, and these costs are passed along to shareholders. Transaction fees are hard to identify and they're not included in prospectuses. However, savvy investors can determine the transaction fees by looking for information in the "Statement of Additional Information". This is a document that most mutual fund companies only make available to investors upon request. 13

On the average, according to research conducted at Virginia Tech and the University of Virginia, mutual funds incur an average of 1.4% in trading costs annually in addition to the 1.3% average expense ratio. [14]

Sales Loads

A front-end sales charge (also known as a sales load) is a one-time charge that's paid by the investor at the time of investment. It's a commission paid to brokers, investment advisors, and financial planners. It is an avoidable expense if you shop specifically for mutual funds that have "no load". [3, 4]

The front-end loads are usually charged as a percentage of the total amount invested into the mutual fund. It usually ranges from 3.75% to 5.75%. For example, a front-end load of 4.75% on a $10,000 investment amounts to $475. [3, 4]

Lower front-end loads are assessed on bond mutual funds while higher loads are charged for equity based funds. Mutual fund Class A shares often carry a front-end load, but investors who pay up-front often pay lower expense ratios and no annual maintenance fee (which can increase along with the value of the fund). As the size of the investment increases, front-end loads are often discounted. Typically, the front end load is waived when the mutual fund is part of a 401(k) plan. [3, 4]

Purchase Fee

The purchase fee paid up-front by an investor to cover the cost of acquiring the shares is not paid to the broker, but rather to the fund itself. As such, it is not considered a sales load. The average one-time cost to purchase a mutual fund is $30. [1, 11]

Deferred Sales Charge (Load)

Deferred sales charges are fees that are charged to an investor if they redeem their investment before a pre-set amount of time. This charge was designed to discourage investors from removing their money from a mutual fund early. The typical deferred sales charge is 6% of the initial investment for the first year. Each year thereafter the deferred sales charge percentage gets less and less, but the purpose behind this charge remains the same: investors who sell funds early are punished. [5]

Deferred sales charges can have an insidious effect on the investor's final return. Besides the potential loss that investors suffer if they withdraw funds early, these fees also increase the overall cost of managing the mutual fund. If mutual fund managers pay a front-end sales load of 5% plus 0.5% annually to financial advisors or brokers to sell the fund to investors, mutual fund managers have a more difficult time making a profit from the fund. This problem is, of course, passed on to the investor. [5]

Another problem with the deferred sales charge is that it is motivating for advisors and brokers to on-board new investors to a mutual fund, but after the initial sale, the broker has little incentive to continue working for the investor. For investors, the deferred sales charges can mean that redeeming your funds can be costly should you have a need for cash before it matures. [5]

On an initial investment of $10,000 and a deferred sales charge of 6%, the total loss that an investor would suffer from removing their funds during the first year after investment is $600. This fee along with other fees can completely cancel out any potential earnings on the fund.

Redemption Fee

The redemption fee may also be known as the “back-end load”, a surrender charge, or a contingent deferred sales charge. [10]

When the shares from a mutual fund are sold, there is a redemption fee charged by the fund company to the investor. For this reason, redemption fees are also sometimes called “exit fees”, short-term trading fees” or “market timing fees”. [6, 7]

Mutual funds are meant to be a long-term investment vehicle; investors are discouraged from using market-timing to make a profit from these funds. While it’s legal to use market timing to decide when to remove money from a mutual fund, it’s frowned-upon and often a redemption fee is charged to discourage short-term trading behaviors. [6, 7]

Mutual fund companies usually charge a redemption fee within a specific period of time after purchase (e.g. 30, 180, or 365 days or even up to 60 months). If the investor removes their funds within 30 days after making the initial investment, they’re penalized with a redemption fee. Normally this charge is calculated against the ending share value. The percentage value of redemption fees is limited by the SEC to 2% or less. So, on a fund with an ending share value of $10,000, investors would be required to pay up to $200 in redemption fees. These funds would go back into the mutual fund’s assets. [6, 7, 8]

Exchange Fee

Exchange fees are charged when an investor decides to transfer their shares from one mutual fund to another that’s managed by the same company. The ability to exchange a mutual fund (exchange privilege) and the fees involved are usually discussed in the fund’s prospectus, and some mutual fund companies don’t charge a fee for exchanging shares. [9]

Investors may choose to exchange funds based on market conditions. Exchange privilege is common in companies that offer a number of different mutual fund options and the details of the fees involved are usually outlined in the prospectus. Often, the exchange can be completed at no cost, but investors should be wary of capital gains taxes that can eat into their profits. [9]

Annual Operating Expenses

Annual operating expenses are charged to cover the costs of your ongoing investment in the mutual fund. These expenses are sometimes summarized by the expense ratio (also known as the Management Expense Ratio or MER). The expense ratio is a calculation that summarizes the proportion of assets in the fund to expenses. It is not an expense itself. The numerator of this ratio is the sum of various operational and administrative expenses. The denominator is the average of the fund's assets and the ratio, once calculated, is is expressed as a percentage (a lower number is better). The MER is an important summary of the fund's quality. On average the MER is 1.3%. [1, 12, 13]

Investors are usually not directly billed for these costs, but rather, the expenses are paid for out of the fund's assets. So, though the investor is not billed directly for operating expenses, he or she is still indirectly paying the expense because the overall return on the fund is lower. [1]

Annual operating expenses usually appear in the prospectus under the heading "Annual Fund Operating Expenses". [1, 12]

The annual cost of operating a mutual fund varies from fund-to-fund and may consist of the following fees:

Management Fees

Management fees range on average from 0.5% to 2% of the mutual fund's assets. This fee covers the cost of paying top-earning professionals to manage the fund, but while 0.5% to 2% may seem like a small price to pay for professionals to manage the mutual fund portfolio, consider this:

> If a portfolio manager makes 1% of $500,000,000 (a small mutual fund), he or she makes $5,000,000 per year! Keep in mind that the mutual fund may or may not perform well, but the portfolio manager will still get paid for their services!

Higher management fees don't necessarily mean that the manager of the fund is highly skilled or that the fund will outperform other funds. In fact, the only guarantee that investors get when funds have higher management fees is a lower return on their investment.

Distribution and/or Service Fees

The distribution and service fees go toward broker commissions as well as advertising and promotion of the fund. These fees also covers the cost of buying and selling the holdings of the fund. Funds that have a high turnover ratio (the fund holdings are bought and sold often), lose a lot of money in fees. Less active funds with a lower turnover ratio have fewer fees and therefore fewer losses. [1]

12-b-1 fees

12-b-1 fees are service-oriented costs that go toward marketing the fund. Higher 12-b-1 fees do not translate into improved performance of the fund. When you pay 12-b-1 fees, you're actually paying for the fund to be advertised and marketed to new investors, so this cost does not actually benefit investors in any way. Usually, marketing the mutual fund involves sending prospectuses to new potential investors. While the SEC does not limit the size of the 12-b-1 fees, the rules of FINRA say that the marketing and distribution expenses are not to exceed 0.75% of the mutual fund's average net assets annually. [1, 2, 8]

A mutual fund with an average of $500,000,000 net assets would therefore spend $3,750,000 per year on advertising, marketing, and distribution expenses each year. The average cost to the investor annually is 0.13% which amounts to an average of $13/year for an investment of $10,000. Brokers are the ones who profit from 12-b-1 fees. [1, 2, 8]

Account Fee

An account fee is a maintenance fee that's usually charged on smaller shareholders of a mutual fund that's fallen below the minimum balance (typically a pre-set amount).

Other Expenses

Other expenses that might be charged to a mutual fund investor include shareholder service expenses that aren't included in the 12-b-1 fees, record-keeping expenses, legal expenses, custodial expenses, accounting expenses, transfer agent expenses, and other expenses related to administration. Some mutual funds keep these costs to a minimum (0.25%) while others rack up extravagant extraneous expenses that go as high as 2%. On the average, equity mutual fund investors pay between 1.3 to 1.5% while niche or international funds charge higher rates due to the higher transaction costs. [1]

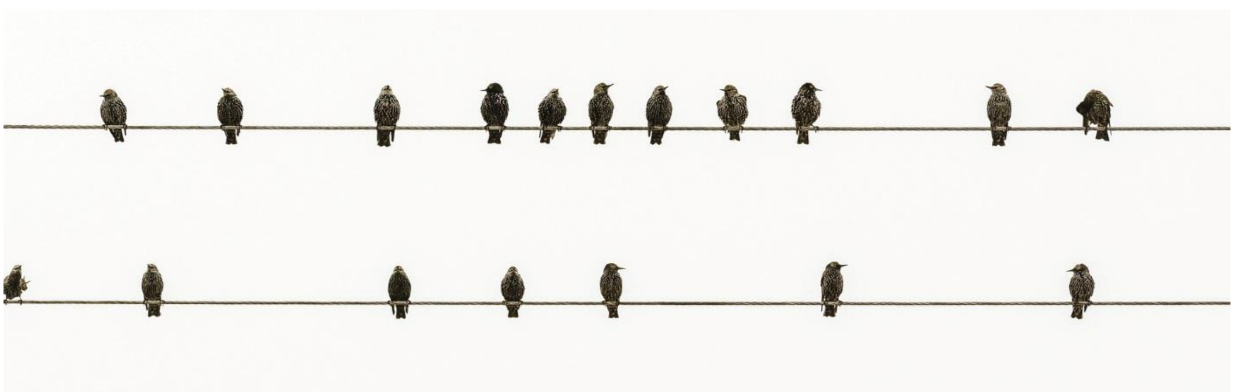
Total Annual Operating Expenses

The total annual operating expenses are an important consideration for 401(k) and mutual fund investors. All mutual fund costs ultimately reduce their returns and, in some cases, can even negate returns so look carefully at the various fees and expenses associated with a fund before buying in. [12]

If you invested $10,000 into a mutual fund with a front-end load (which is avoidable if you shop around for no-load funds), you could expect to pay between $375 and $575 as a commission to the financial advisor or broker. You should also expect to pay a purchase fee of approximately $30 to the mutual fund itself. **These up-front, one-time fees could amount to between $405 to $605 total.** [3, 4]

The annual operating costs for an investment of $10,000 would include both transaction fees at 1.4% ($140) and an average annual expense ratio of 1.3% ($130) for a grand total of $270/year. Investors pay an average of 2.7% in annual fees on mutual funds but the average interest rate on *money market mutual funds* were listed by Bankrate at a little more than 1.76% annually. The average *interest rate on high-yield mutual funds* was 7.5% according to U.S. News and World Report. [15]

Money market mutual fund investors clearly lose money each year on their investment (at an average rate of about 1%). High-yield mutual fund investors appear to make an annual return on their investment (7.5% - 2.7% = 4.8%), but don't forget that investors who have paid a front-end sales charge have already lost $375 to $575 + a $30 purchase fee ($405-$605) on investments of $10,000. And if they redeem their funds early, they may lose even more. In the first year, an investor in a high-yield mutual fund may make $480 on a $10,000 investment, but only after paying between $405 and $605 for shares. In its second year, the fund will make more as long as the investor doesn't move the funds or redeem them, but transaction costs will still interfere with the overall performance of the investment. [13, 14, 15]



401(k) Costs and Fees

401(k) plans often include several mutual funds along with stocks and other investment vehicles which means that investors must study all the various prospectuses for each investment to determine the costs and fees associated with each. Many Americans don't realize how fees can chip away at their earnings each year. The fees can go unnoticed, silently eroding away at investment accounts. Even a 1% fee can delete $70,000 from the average worker's final return so investors who decide to put their funds into a 401(k) need to do their due diligence and study the various fees associated with the account. [1, 17]

Many people look only at the recent performance of a retirement plan to decide whether or not to invest. At best, they glance at the total expenses associated with the fund but many costs associated with trading or the administration of the plan are completely hidden or carefully obscured in the fine print. A significant percentage of 401(k) investors have no idea that they're paying fees at all for their retirement plan. [17]

It can be daunting to try to understand all the fees associated with the various investment vehicles included in a 401(k), but remember, the goal here is simple: reduce fees and lower the cost of your investments to yield a better return. In the end, this can add up to substantially better returns on your investment. [17]

Plan Administration Fees

Plan administration fees cover the cost of accounting, legal and trustee issues, and general office administration. These are necessary services that keep the 401(k) alive, but many investors fail to realize that they're paying this fee out of their earnings each year. There are exceptions to this rule where employers pay the administration fees for their workers' 401(k) plans. [17]

Plan administration fees average around $50 per year, but on small accounts (of $1000, for example) that only grow at 5% per year, that $50 can completely wipe out any investment gains. So while $50 may seem insignificant, they can eat away at your average annual return since they're often charged year after year. [17]

Investment Advisory Fees

Retirement plans that are actively managed often charge an advisory fee as a percentage of your total 401(k) balance. The fee is charged annually even if your account took a big hit that year. So, if you have $100,000 in your 401(k) and the plan charges a 1% advisory fee, you'll lose $1000 per year for this service. On years when your 401(k) does well, advisory fees may seem insignificant, but on bad years, this fee can negate earnings.

Internal Expense Ratios

Expense ratios (discussed above) pertain to mutual funds held within a 401(k). They're some of the most overlooked expenses that investors gloss over when considering which 401(k) plan to buy, but these expenses can create a serious drag on the long-term growth of the plan.

And remember, the expense ratio is not a composite summary of all expenses for the fund. You have to add up all the expenses to figure out how much you're paying annually, up-front, and when the plan reaches maturity and you're ready to withdraw funds. [17]

Load Fees

It's easy to miss load fees or sales fees that are charged when you purchase a mutual fund. These mutual fund fees are discussed in more detail above, but remember, your 401(k) may include several mutual funds that each charge a load fee. So study these fees carefully and consider how they'll affect the bottom line. Some are charged up-front (front-end-loads) while others are charged after the fund matures and the investor begins withdrawing funds (back-end-loads). [17]

According to American Funds, front-end loads cost investors between 3% to 6% of their total investment. Back-end loads can cost 5% of an investment that has not matured yet, but this percentage goes down with time as the fund matures. [17]

The M&E (mortality, expense, and administration) fee is another biggie that many investors miss when they consider final returns. The industry average for M&E fees is 1.25%. So, after you add these fees up, you can see how they can kill your retirement plan. [17]

Bid-Ask Spread

The ***bid*** is the amount an investor is willing to pay for a particular security. The ***ask*** is the amount at which the investor is willing to sell. The bid and ask prices are never the same. The difference between these two numbers is the *spread*. The *spread* is the amount that your broker makes from doing the transaction. This fee can be between 0.01% to 20% depending on the trading volume. [17]

The **Bid-Ask Spread** is one of the most insidious fees associated with 401(k) plans. Anyone who trades individual stocks or exchange-traded funds (ETFs) as part of their 401(k) inevitably pays this fee. Even brokerage firms that say they're offering "free trades" are still charging their clients this fee. To keep it simple, the moral of this story is: avoid high spreads. [17]

Commissions

Many 401(k) investors are forking over commissions without realizing it. Commissions are paid to brokers when stocks, options, futures, or mutual funds are purchased. These fees are usually paid as a flat rate for each trade and you may pay the fee both when you buy the stock and when you sell it. On a $500 trade with a $10 commission fee charged when it's purchased and when it's sold, you'd have to make an additional 4% on the trade just to break even.

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How Transparent Fees and Charges Affect Your Investment

Fees can have an important impact on the value of your investment portfolio. As with all goods and services that you buy, investment products and services cost something. Many of these fees may seem negligible, but they can add up over time and have quite a significant impact on your portfolio. [1, 17]

When you choose a financial advisor or a specific investment to purchase, it's vital that you fully understand the fees you'll be charged. Take the time to compare these fees with the fees charged by other investment vehicles. In the long run, this strategy could save you thousands of dollars on your investments over time. [1, 17]

Mutual Funds: Hidden Fees and Charges

When you invest in mutual funds, some of the fees may be easy to see even when you're not looking for them. But others are much more difficult to see and understand. It's worth your time to do some sleuthing to find these fees and fully understand how they'll affect your bottom line over time. [2]

All mutual funds charge fees in order to pay managers to manage the fund and to give brokers the incentive to sell the fund to investors. But some of the fees can take a big bite out of the final return on your investment. While many investors believe that a high expense ratio is associated with mutual funds that will perform well, research has shown that this is not the case. [2]

When comparing one fund's expense ratio to another, it's important to realize that even small differences in fees can add up to a big differences in returns over time. For example, a $10,000 investment with a 10% return would net $10,800 each year with a 2% expense ratio. On the other hand, this same investment would net $10,950 per year with a 0.5% expense ratio. Over time, this 1.5% difference will make a significant difference in the return. [2]

Assets Under Management Fee

Assets Under Managements or AUM is defined as the total market value of investments that a person or business entity manages for clients. When used in the context of mutual funds, it refers to the amount of money that's handled regularly by the fund. Different companies vary in terms of the exact definition and formula of AUM, but this variable as a general rule is a measure used to evaluate investments alongside the performance and experience of mutual fund managers. A higher AUM is a positive indicator of quality and management experience. [4]

If an investor has invested $10,000 in a mutual fund, these funds become part of the AUM or the pool of funds that are handled on a regular basis. The mutual fund's manager is able to buy and sell shares to fulfill the fund's objective using all of the investments from all investors without having to get special permission to do so. [4]

The AUM can play an important role in the determination of fees. Many mutual funds charge management fees that are a fixed percentage of AUM. [4]

Management Fees

Management fees, also known as "hiring costs", are paid to the mutual fund's portfolio manager. These fees are calculated along with other variables to determine the expense ratio. On the average, management fees usually hover between 0.5-2%, but they can go as high as 3.2% (at the time of this writing). Mutual fund companies may raise these fees or lower them from one year to the next, but usually, the management fees stay close to the amount stated in the prospectus. [2,3]

Lower management fees are usually passively managed. Higher management fees often have a dedicated person or a staff of people who work to pick the best investments for the fund. Unfortunately, actively managed funds don't always perform better so investors don't always get what they pay for when they choose funds with a higher expense ratio. [2]

Investors may be led to believe that high management fees lead to higher-than-average returns, but research has shown that even expert portfolio managers don't always beat the market and, after high fees are incurred, investors rarely see higher-than-average returns on their investment. Indeed, the SEC states clearly that, "Higher expense funds do not, on average, perform better than lower expense funds." [3]

Wrap Fee

Wrap fees, also known as asset collection programs, investment management programs, asset management programs, separately managed accounts, and mini-accounts are a controversial charge by an investment manager or advisor that can include services such as investment advice, research, administrative activities, and brokerage. A wrap fee is basically a straightforward charge for a bundle of services rendered. Usually, it is a percentage of the AUM.

Wrap fees are controversial because they can be quite expensive ranging between 0.75-3%. For a fund that charges a wrap fee combined with the an expense ratio, the returns can be significantly reduced. However, for investors who plan to utilize their broker's full line of services, a wrap fee may be advantageous. For all other investors, it might be a cheaper option to pay an investment advisor for an unbundled arrangement.

Redemption Fees

A redemption fee may be charged to the investor when the funds are sold/redeemed. Not all funds charge a redemption fee, but when these fees are charged, they're paid directly to the fund. The SEC limits redemption fee charges to 2%. [3]

Redemption fees exist to discourage shareholders from selling their shares early. In some cases, these fees are only incurred during the first 30 days after the mutual fund is purchased, but in some cases, they can be incurred for up to a year. [2,3]

Exchange Fees

Exchange fees are closely related to redemption fees. These are fees that are charged to the investor when he/she transfers their holdings to another fund within the same fund family. Like redemption fees, exchange fees are charged on the value of the funds and, by mandate from the SEC, they can't be higher than 2%. [2,3]

Account Fees

Account fees are charged on smaller holdings when the fund falls below a pre-specified minimum balance. [3]

Purchase Fees

The purchase fee is paid up-front by the investor to cover the cost of acquiring shares for the mutual fund. It is not paid to the broker and so it differs from the sales load. [3]

Sale Broker Fees/Sales Load

A load is a sales charge that's paid by the investor to an intermediary such as a sales broker who distributes shares for the fund. [1]

Front-end Sales Load

Front-end sales loads are usually only incurred in A-share classes. This fee can go as high as 5.75% of the total investment, so it's important for investors to look closely at the front-end sales load (which is usually paid at the time of purchase). These charges are usually passed along to the sales broker. [1]

Back-end Sales Load (Contingent Deferred Sales Charge)

Back-end sales loads are usually found in B-share classes. These are deferred sales charges that occur when the investor sells his or her shares. This charge can go as high as 5% and it goes to the broker who sold you the investment. [1]

Expense Ratio

The expense ratio is the total percentage of a fund's assets that go toward administrative fees, advertising (12-b-1) costs, management fees, and other expenses. If a fund has an expense ratio of 1% annually, that means that 1% of the funds assets will go to cover expenses each year. Expense ratio does not include brokerage fees or sales loads. [6, 7]

Smaller mutual funds typically have a higher expense ratio because expenses are spread among fewer investors. Sales charges and the fund's management style can also impact the expense ratio. [6, 7]

The expense ratio is calculated by dividing the fund's Assets Under Management (AUM) by the operating expenses. Operating expenses diminish the fund's assets which ultimately reduces the return for investors. [7]

Components of the Expense Ratio

- The investment manager's fee
- Recordkeeping
- Custodial services
- Taxes
- Legal expenses
- Accounting and auditing fees
- 12-b-1 advertising and promotions fees

Conclusion

Before purchasing a particular mutual fund, be sure to consider the transparent fees carefully. These fees can significantly reduce your bottom line. And remember that beyond the obvious, transparent fees are hidden fees such as transaction costs (the costs associated with trading the securities within a mutual fund) that can actually be higher than the expense ratio. Indeed, tax inefficiencies (which are a common problem for mutual fund investors) can further reduce the final return on your investment by an average of about 1.1%. According to research by Morningstar, the higher the fees, the worse mutual funds perform, so investors who are mindful of the fees (both transparent and hidden) are more likely to fare well in terms of their return over time. [2, 8]

401(k)s: Hidden Fees and Charges

You should know that fees and charges associated with your 401(k) may be expressed as a dollar amount or as a percentage of the Assets Under Management (AUM). This percentage often lingers around 1% per year, but it can be more or it can be less. Investors need to know that these days you can find investments with AUM fees for less than 1% and it can be worth your time to shop around for one. [9]

As you research 401(k) options, always keep your eyes open for administration or recordkeeping fees along with investment, brokerage, or advisory fees. Once you've identified all of the expenses in a potential plan, you can assess how these fees will reduce your final returns. Below are specific fees to lookout for when you vet out a potential 401(k) as an investment vehicle: [9]

Direct Compensation

These fees are direct payments that are made to a provider for specific services that were rendered such as recordkeeping, advisory services, or administration of the plan. Direct compensation fees are usually paid as a flat dollar amount or as a percentage of the plan's assets.

Indirect Compensation/Revenue Sharing

These fees are collected from the plan's investments and passed through to other service providers. Indirect compensation fees include revenue sharing payments and they often represent most of the plan's total fees. [9]

Sub T/A Fees

Sub T/A fees are paid to a third party that's been subcontracted to do accounting of participant shares.

12-b-1 Fees

Over half of all 401(k) plans charge 12-b-1 fees. These are payments made to a broker for selling the fund along with the costs of ongoing servicing of the plan. [9]

Shareholder Servicing Fee

This fee is for services such as recordkeeping or administration. It is usually paid in addition to 12-b-1 fees. [9]

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Protecting Your Investments

There are many investment options that offer excellent returns without the various fees associated with mutual funds.

Individual Stocks

If you buy stock you're purchasing ownership of a publicly traded company. Some investment advisors claim that mutual funds are an easy way to diversify a portfolio for investors who'd rather not do research to learn about individual stocks. But unfortunately, many mutual fund investors fail to see how various fees can eat away at their returns until it's too late. While it's true that mutual funds provide a full portfolio of investments and a guarantee of diversification and individual stocks are purchased as shares for one company's profits, it's also true to say that there are fewer fees associated with individual stocks and the fees that are associated with an individual stock are typically much simpler and easier to comprehend than those associated with mutual funds. [1, 2]

Bonds

The most straightforward way to define a bond is to compare it to a loan. When you invest in a bond it's like you're loaning your money (with interest) to a government or business entity. These are more conservative investments because they are less volatile and it is often possible to calculate how much of a return you'll get at the end of the bond's term (when it reaches maturity). As such, they are considered less risky than individual stocks. However, bond values can diminish as interest rates rise and they're subject to changes in price and availability. [2]

Real Estate

While mutual funds have some benefits, real estate gives investors more control over what they purchase and how their investment is used. They also have more control over how much monthly income they can make from their investment. When you purchase real estate, you put your trust in yourself whereas purchasing a mutual fund involves placing trust in a mutual fund manager. [3]

An investment in real estate may mean purchasing a vacation rental and offering it up as a rental throughout the year or buying a second home that's leased for 12 months at a time. Some investors, in contrast, choose to buy fixer-uppers and flip houses, selling them at a profit. But in all cases, real estate requires an investment of time and sometimes sweat equity that isn't required by other investment vehicles. Investors must decide whether a real estate investment would suit them or not. But some investors really enjoy the tangibility of real estate investments in contrast to the intangible investment of a mutual fund. And many investors cite the tax benefits and appreciation of their property as pros that offer a suitable alternative to mutual funds or other investment options. [3]

Commodities

When you invest in commodities, you're investing in raw materials. Commodities include things like food (which are consumed directly) or the building blocks of other products such as timber, oil, gas, or precious metals such as silver or gold. There are several different ways for investors to invest in commodities. Experienced investors may choose to purchase physical raw commodities, but these investments are volatile and require a certain level of sophistication. Still other investors purchase commodity mutual funds. [4]

Though commodities investing can be a good choice for investors who wish to diversify their portfolio they can be extremely volatile and subject to things like global competition, world events, import controls, government regulations, and economic conditions. [4]

Annuities

Annuities have certain benefits in comparison with mutual funds. Both annuities and mutual funds involve an investment in a pool of money that's diversified as stocks, bonds, and cash. But while annuities and mutual funds share certain similarities, annuities are an insurance product that offer some specific guarantees to investors such as a guarantee of income or certain withdrawal benefits. [5]

There are different types of annuities including both variable and fixed annuities.

Variable Annuities

Variable annuities offer investors the opportunity to diversify through a sub-account that can invest in several different investment vehicles, similar to a mutual fund. However, variable annuities can offer certain withdrawal benefits that are not offered to mutual fund investors. [5] Variable annuities can be confusing. Investors regularly misunderstand what they are and they often miss the hidden fees associated with this investment vehicle. Be aware that there is more than one hidden fee to consider if you're dealing in variable annuities. These fees may exceed 1% of your account balance annually. [7]

Fixed Annuities

Fixed annuities offer the investor a specific interest rate in addition to the original principal. Interest is calculated as a fixed rate which is similar to a certificate of deposit. [5]

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Conclusion

A number of investors have been lured into believing that 401(k) and mutual funds offer an easy way to diversify their portfolio to hedge them against market volatility, but unfortunately, few realize that the fees associated with these funds can seriously diminish returns. There are a number of obvious, transparent fees that many investors fail to consider when purchasing a mutual fund as well as a number of hidden fees that are not listed in the prospectus. As such, investors need to read the prospectus carefully and do research before investing blindly in a mutual fund on the basis that it's an easy way to diversify their portfolio.

Mutual Funds and 401(k) accounts are part of many Americans' long term financial planning and seeking financial advisors, authorized agents, and insurance professionals is essential. Never make any decision without fully understanding all aspects of your decision and how it may affect your goals and plans. Planning should include any tax liability as well as current and future use of your available assets.

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