Mutual Fund Fees and Expenses

Mutual funds provide a variety of investment-related services and benefits that help make saving and investing simple, accessible, and affordable. These benefits and services, however, come with a cost. The fees shareholders pay cover the costs of managing a fund's portfolio of securities and producing account statements, computerized account services, recordkeeping, legal services, printing, and mailing. Some mutual fund fees also compensate an investment professional for services rendered, especially the advice provided in helping an investor select a fund to meet investment goals.

The Two Types of Mutual Fund Costs

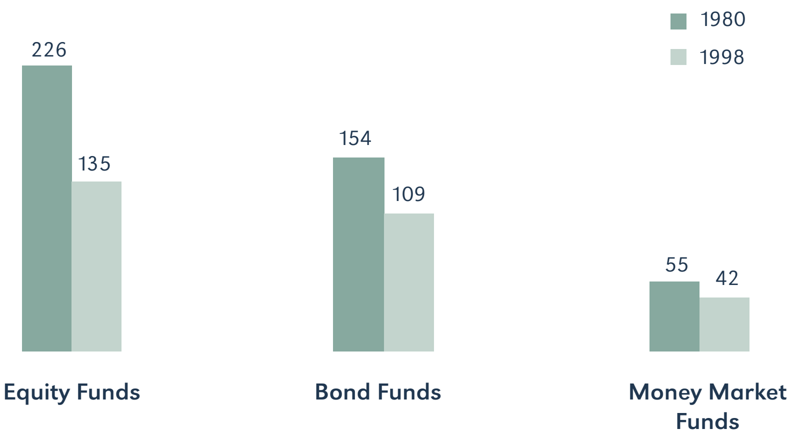
Mutual fund fees generally fall into two categories: shareholder fees and annual operating expenses.

Shareholder Fees

Investors may or may not pay shareholder fees. A "front-end load," for example, is an industry term for a fee that some funds charge when an

Average Cost of Investing in Mutual Funds*

(basis points)



**Sales-weighted averages of total shareholder cost ratios for individual funds.*

investor buys shares. This sales charge, or "load," usually compensates an investment professional for his or her services, especially for the advice he or she provides in selecting a fund to meet an investor's goals. By law, it may not exceed 8.5 percent of the initial investment, although most funds that charge these fees charge far less than the maximum.

Some funds charge a "back-end load" (also called a deferred sales charge), when an investor sells shares. This charge is an alternative way to compensate financial professionals for their services. A common type of back-end load, a contingent deferred sales charge, typically is calculated as a percentage of the net asset value or offering price at the time of purchase and applies only for the first few years that an investor owns a fund. The fee decreases incrementally, usually 1 percent per year, until it disappears if an investor does not sell the shares over a specified period of years.

No-load funds do not have front-end or deferred sales charges. Like all mutual funds, however, no-load funds also charge annual operating expenses.

Classes of shares. A fund may offer different "classes" of shares, such as Class A, Class B, and Class C. Share classes represent ownership in the same mutual fund, but offer different ways of paying the associated costs. The way an investor pays for fund shares depends on the share class owned. Share classes were created to help an investor choose a payment structure that best suits his or her investment needs and preferences.

Class A shares, for example, generally have a front-end sales charge (or "load"). Class B shares often have a 12b-1 fee (see below) and a deferred sales charge. Class C shares may charge a higher 12b-1 fee, but no front-end or deferred sales charges. Some funds offer still other share classes, such as a class sold without a sales charge for tax-deferred retirement plans.

Annual Operating Expenses

All funds have annual operating expenses that investors pay for the ongoing costs of running a fund and other services. These expenses, along with most other charges, are shown in a fund's prospectus, expressed as a percentage of the fund's average net assets and referred to as "total operating expenses."

The management fee. The largest component of a fund's total operating expenses usually is its management fee, an ongoing charge paid to an investment adviser who manages the fund's assets and selects its portfolio of securities.

The 12b-1 fee. Some funds pay a 12b-1 fee, which is named for a rule under the Investment Company Act of 1940 that authorizes mutual funds to pay for distribution expenses, such as compensating sales professionals, directly from a fund's assets.

By law, 12b-1 fees used to pay distribution expenses cannot exceed 0.75 percent of a fund's average net assets per year. There is also a lifetime cap based on a fund's overall sales. In addition, a fund may also pay a service fee of up to 0.25 percent of average net assets each year to compensate sales professionals for providing ongoing services to investors or their accounts.

A "no-load" fund may pay a 12b-1 fee of up to 0.25 percent of average net assets each year.

Oversight of Fees

The fees that a mutual fund charges shareholders are subject to ongoing oversight and review by the fund's board of directors, including its independent directors. Directors have a responsibility under the law to protect the interests of shareholders.

A mutual fund's directors annually review the fees paid to manage the fund. Any increase in these fees must be approved by fund shareholders and a majority of the fund's independent directors.

The SEC requires that a fund's board and a majority of its independent directors annually approve the 12b-1 fee. Any increase in a 12b-1 fee must also be approved by shareholders.

Fee Disclosure

Mutual fund fees are subject to more exacting regulatory standards and disclosure requirements than any comparable financial product offered to investors.

Investors can easily discern all the fees a fund charges by looking at a standardized fee table at the front of a fund's prospectus (see pages 28-29). The table lists all fees charged by a fund and allows easy comparison of the costs of one fund versus another.

In addition, because mutual funds buy and sell securities, they incur brokerage costs. Because these costs vary and are difficult to predict, they are not included in the fee table. However, they are included in any computations of a fund's performance that appears in advertising.

How Mutual Fund Fees Affect Investment Return

Mutual fund fees and charges affect an investor's return from the fund, but neither higher nor lower expenses guarantee better performance.

A fund with lower expenses may perform better than a fund with higher expenses. And the opposite may be true. Certain types of funds may have higher expenses because they require additional work by their managers. Investors may also pay higher fees for funds that provide extra shareholder services, such as toll-free telephone numbers, Internet access, checkwriting, and automatic investment plans.

Mutual Fund Fee Table Required by Federal Law

(example is hypothetical)

Maximum Sales Charge (Load) Imposed on Purchases—The maximum "front-end load" or sales charge that may be attached to the purchase of mutual fund shares. This fee compensates a financial professional for his or her services. By law, this charge may not exceed 8.5 percent of the investment, although most fund families charge less than the maximum.

Maximum Deferred Sales Charge (Load)—The maximum "back-end load" or sales charge that a fund may impose when shares are redeemed or sold; an alternative way to compensate financial professionals for their services. A common type of deferred sales charge is a "contingent deferred sales charge," which typically applies for the first few years of ownership, declining until it disappears.

Maximum Sales Charge (Load) on Reinvested Dividends—The maximum fee charged by a fund when dividends are reinvested in the purchase of additional shares. Most funds do not charge a fee for this service. Beginning in April 2000, new funds were prohibited from charging this fee.

Redemption Fee—Like a contingent deferred sales charge, this fee is another type of back-end charge when an investor redeems shares. Unlike contingent deferred sales charges, this fee is paid to the fund. It covers costs, other than sales costs, involved with a redemption. The fee is expressed as a dollar amount or as a percentage of the redemption price.

Exchange Fee—This fee may be charged when an investor transfers money from one fund to another within the same fund family.

Account Maintenance Fee—This fee may be charged by some funds, for example, to maintain low-balance accounts.

Shareholder Fees are charged directly to an investor for a specific transaction, such as a purchase, redemption, or exchange.

Shareholder Fees

Maximum Sales Charge (Load) Imposed on Purchases	**4.5%**
Maximum Deferred Sales Charge (Load)	**None**
Maximum Sales Charge (Load) on Reinvested Dividends	**None**
Redemption Fee	**None**
Exchange Fee	**None**
Annual Account Maintenance Fee	**None**

Annual Fund Operating Expenses reflect the normal costs of operating a fund. Unlike transaction fees, these expenses are not charged directly to an investor but are deducted from fund assets before earnings are distributed to shareholders.

Annual Fund Operating Expenses

Management Fees	**0.47%**
Distribution (12b-1) Fees	**0.21%**
Other Expenses	**0.36%**
Total Annual Fund Operating Expenses (Expense Ratio)	**1.04%**

Example

This example is intended to help an investor compare the cost of investing in different funds. The example assumes a $10,000 investment in the fund for one, three, five, and ten years and then a redemption of all fund shares at the end of those periods. The example also assumes that an investment returns 5 percent each year and that the fund's operating expenses remain the same. Although actual costs may be higher or lower, based on these assumptions an investor's costs would be:

1 year	**$552**
3 years	**$771**
5 years	**$1,013**
10 years	**$1,730**

Management Fees—This is a fee charged by a fund's investment adviser for managing the fund's portfolio of securities and providing related services.

Distribution (12b-1) Fees—This fee, if charged, is deducted from fund assets to pay marketing and advertising expenses or, more commonly, to compensate sales professionals. By law, 12b-1 fees cannot exceed 1 percent of a fund's average net assets per year. The 12b-1 fee may include a service fee of up to 0.25 percent of average net assets per year to compensate sales professionals for providing services or maintaining shareholder accounts.

Other Expenses—These expenses include, for example, fees paid to a fund's transfer agent for providing fund shareholder services, such as toll-free phone communications, computerized account services, website services, recordkeeping, printing, and mailing.

Total Annual Fund Operating Expenses (Expense Ratio)—This represents the sum of all a fund's annual operating costs, expressed as a percentage of average net assets. Total annual fund operating expenses are also known as the fund's expense ratio.

Example of the effect of expenses on a $10,000 investment is a hypothetical illustration required by the SEC to be included in every fund's fee table. It is presented in a standardized format and based on specified assumptions (five percent annual return, expenses unchanged) in order to make it easier for investors to compare different funds' fees.

Recent Studies Find Mutual Fund Costs Dropping

The results of Investment Company Institute studies released in 1999 suggest that the average cost of investing in mutual funds has declined significantly, and that a substantial majority of equity fund shareholder accounts appear to have benefited from economies of scale.

Trends in the Costs of Fund Investing

Shareholders continue to benefit from intense competition in the mutual fund industry, according to the results of Institute research. "Mutual Fund Costs, 1980-1998" found across-the-board decreases in total shareholder costs incurred during the 1980s and 1990s. The research revealed several key findings:

1) The total cost of investing in all types of funds has declined over time. The average total cost of investing in equity funds decreased by approximately 40 percent between 1980 and 1998, to 1.35 percent of each dollar invested in 1998 from 2.26 percent in 1980. The average total cost of investing in bond funds decreased by about 30 percent for the same period, to 1.09 percent of each dollar invested from 1.54 percent. The average total cost of investing in money market funds decreased by 24 percent, to 0.42 percent from 0.55 percent.

2) The decline in the level of average cost of funds does not depend on a narrow range of low-cost funds. Even after excluding low-cost index and institutional funds, and the equity funds offered by the three largest mutual fund complexes, a downward trend in mutual fund costs holds true. Removing all of these groups of funds from the analysis still resulted in a 27 percent decrease in total shareholder cost between 1980 and 1998.

Economies of Scale in the Mutual Fund Industry

Institute research also examined whether equity fund operating expenses—on a fund-by-fund basis—reflect economies of scale. An Institute paper based on the research, "Operating Expense Ratios, Assets, and Economies of Scale in Equity Mutual Funds," yielded two key findings on economies of scale at the individual fund level:

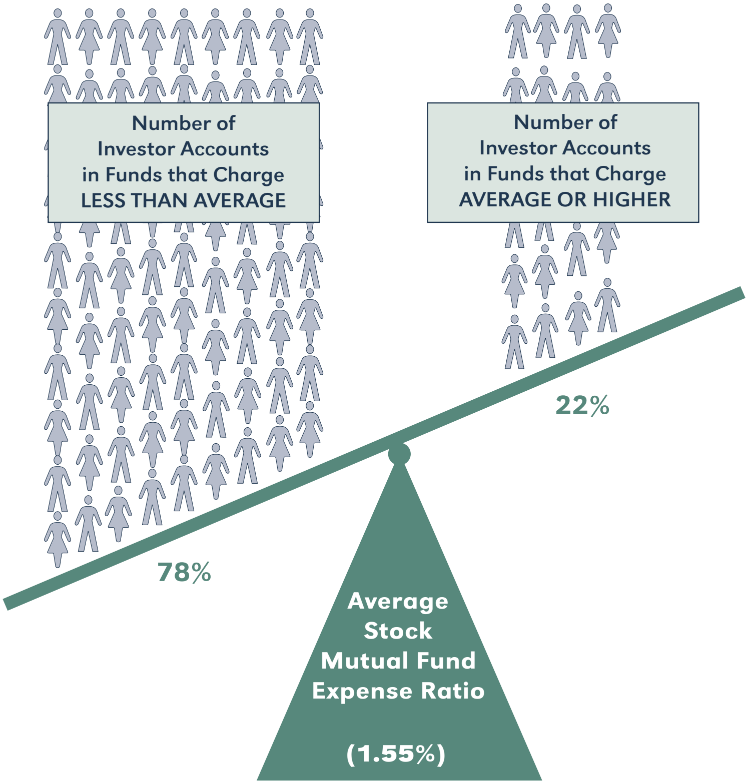
1) Large equity funds generally have lower operating expense ratios than small equity funds. Of the 2,643 equity funds examined for 1998, the average operating expense ratio of funds with assets of $5 billion or more was nearly 50 percent lower than the average for funds with assets of $250 million or less.

2) Operating expense ratios of individual equity funds have generally declined over time as their assets have grown. The study examined 497 equity funds with assets exceeding $500 million. These funds account for 74 percent of all equity fund shareholder accounts and 71 percent of equity fund assets. Of these 497 funds, 368, or 74 percent, had lower operating expense ratios in 1998 than they did in their first full year of operation when they were appreciably smaller in size.

See the Institute's website for our most recent study of trends in shareholder costs (www.ici.org/pdf/per05-04.pdf) and economies of scale in the mutual fund industry (www.ici.org/pdf/per05-05.pdf).

Most Investor Accounts Are in Lower-cost Equity Funds

An estimated 78 percent of equity fund shareholder accounts were invested in stock funds with annual expense ratios below the average for all stock funds, according to 1998 data.



Source: Morningstar Principia™ Software, 6/30/98; Investment Company Institute