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Six questions to ask your broker



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Your mutual fund portfolio is a disaster, and your broker has a new boat in his driveway. Coincidence? Maybe not. Revelations of kickbacks, inflated sales charges and improper trading have shaken investors' faith in their brokers and the fund industry. Regulators are working on reforms, but those changes could be months away. In today's *Managing Your Money*, USA TODAY'S **Sandra Block, Christine Dugas** and **John Waggoner** suggest key questions to ask a broker before you invest in a mutual fund.



1. How many mutual funds do you offer? Is there a preferred group among them?

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Unless you specify, full-service brokers often offer funds from preferred company lists. Brokers promote listed funds, saying the firm has done extensive research. Ask how a fund qualifies for the list and how often it's updated, says fund consultant Geoff Bobroff.

Also ask whether the fund company is paying the brokerage firm - either in cash or through increased trading business - to get on the list.

You can buy many no-load funds through discount brokers without paying a commission. But you pay indirectly for the privilege: Discount brokers charge the funds anywhere from 0.20% to 0.35% to sell them commission-free. The money the funds pay, in turn, adds to a fund's expenses.

2. Are there special sales incentives that you will receive for selling me this fund?

It's not illegal for brokers to receive payments for touting a mutual fund company's funds, but they're supposed to disclose such arrangements. A recent survey by the Securities and Exchange Commission ([news - web sites](#)) found that only about half of firms receiving payments tell their clients.

Before you buy a fund recommended by your broker, ask him why he prefers that particular fund over others in its category, says Mary Schapiro, vice chairman for the National Association of Securities Dealers, the self-regulatory arm of the brokerage industry.

3. How much do I have to invest to reach the "breakpoint" and pay a lower commission?

Breakpoints are discounts on upfront mutual fund sales commissions, or "loads." They typically apply to investments that exceed \$50,000, although some kick in at just \$25,000. The more you invest, the larger the discount. For example, a 5.75% commission might drop to 5.5% above a certain breakpoint. **(Related chart: Breakpoints affect earnings)**

An investigation last year by the NASD found that brokers failed to give investors promised discounts in about a third of fund sales. In many cases, the NASD said, the omission was inadvertent because calculating breakpoints has become increasingly complex. Many fund companies calculate breakpoints using the total number of shares you own in a fund, not just those in a particular brokerage account. Others will count your entire investment in a fund family, not just

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classes: A, B and C.

With A shares, you pay an upfront commission, and lower annual fees than those charged by other share classes. B shares have no upfront sales charge. The fund company pays the broker's commission, and you repay the fund with an annual marketing fee. The fee gradually declines and usually disappears after about six years. C shares charge no upfront load, but you pay higher annual fees for as long as you own the fund.

For many investors, particularly those who qualify for breakpoints, A shares are a better deal. But B shares might be more profitable for your broker. B shares have no breakpoints, so you don't get any discounts. They also carry a deferred sales charge, which penalizes investors who sell within the first six to seven years.

A recent study by Edward O'Neal, of Wake Forest University, concluded that B shares are rarely a better deal. For large investors, A shares are less expensive because of breakpoints, he concluded. Investors who plan to hold their shares for eight years or more are also better off with A shares, even if they don't qualify for breakpoints, O'Neal says. Short-term investors who aren't eligible for breakpoints fare better with C shares than B shares, he says.

5. Is there a redemption fee on this fund? How does it work?

Redemption fees are intended to discourage frequent trading - often called market timing. The fees also are designed to compensate the fund for the higher trading and administrative costs generated by frequent traders.

Market timers typically trade in and out of international funds to exploit "stale" prices due to time differences. The practice is legal but might violate fund rules. It can give market timers a profit at the expense of long-term shareholders.

Redemption fees have been common on international funds and funds that focus on certain industry sectors, says Jeff Keil, vice president at fund-tracker Lipper. Some funds have charged investors a 1% to 2% fee if they sell shares within six months to two years of the initial purchase, Keil says.

In response to the mutual fund trading probe by regulators, the fund industry's trade group, the Investment Company Institute, recently proposed a 2% redemption fee on most mutual funds for a minimum of five days following purchases.

6. Has the fund's parent company been implicated in the mutual fund scandal? If so, why are you recommending it?

Since the mutual fund scandal ignited in September, some fund firms have been hit with civil or criminal charges. Regulators have accused them of late trading, market timing or abusive sales practices. Others have voluntarily confessed trading irregularities.

Because brokers might have a conflict of interest, you should question them closely on why they would recommend a fund from a scandal-tainted company. And you might want to consult an independent source for more information.

Fund researcher Morningstar is monitoring the investigation and has issued recommendations. The comments are available on www.morningstar.com.

Russ Kinnel, chief analyst at Morningstar, says that several factors go into the recommendations:

one fund.

Make sure your broker has complete information about your investments, including retirement plans, college savings plans and accounts shared with family members. Ask your broker if there's anything else you can do to reduce the sales charge, Schapiro says. You might be able to get a discount by agreeing to contribute more money over the next year or two.

Unscrupulous brokers sometimes try to bypass breakpoints. Some will divide your money among several funds, keeping each investment below the breakpoint, says Andrew Stoltmann, a Chicago securities attorney. The best way to determine whether you're getting all the discounts you're due is to read the fund's prospectus, Stoltmann says.

4. Why are you proposing I buy this particular class of mutual fund shares?

When you buy a mutual fund through a broker, you're typically offered a choice of three share

- How serious and widespread are the infractions, and how much money did investors lose?
- What is the firm's long-term record?
- What reforms has the company instituted?

Ron Rogé, a fee-only financial planner from Bohemia, N.Y., has advised his clients to avoid many of the scandal-plagued firms. "The attitude at the top of many companies is that it's OK to do anything to make money," he says. "They forgot that they are fiduciaries for investors."

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