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The ABCs of Mutual Fund Share Classes

When investing in a mutual fund, you may have the opportunity to choose among several share classes, most commonly Class A, Class B, and Class C. This multi-class structure offers you the opportunity to select a share class that is best suited to your investment goals. The only differences among these share classes typically revolve around how much you will be charged for buying the fund, when you will pay any sales charges that apply, and the amount you will pay in annual fees and expenses.

Understanding fees and expenses

Before you can compare share classes, you need to understand the costs that are associated with mutual funds, since these costs are usually deducted from the money you've invested and can affect the return of your investment over time.

Typically, mutual fund costs consist of sales charges and annual expenses. The sales charge, often called a load, is the broker's commission deducted from your investment when you buy the fund or when you sell it. The annual expenses cover the fund's operating costs, including management fees, distribution and service fees (commonly known as 12b-1 fees), and general administrative expenses. The expenses are generally computed as a percentage of your assets and then deducted from the fund before the fund's returns are calculated.

So which share class should you choose? The answer to that depends on two factors: how much you want to invest and your investment time horizon.

Class A shares

Class A shares may appeal to you if you're considering a long-term investment in a large number of shares. When you purchase Class A shares, a sales charge, called a front-end load, is typically deducted upfront, reducing the amount of your investment. Suppose you decide to spend $35,000 on Class A shares with a hypothetical front-end 5% sales load. You will be charged $1,750, and the remaining $33,250 will be invested.

However, Class A shares also offer you discounts, called breakpoints, on the front-end load if you buy shares in excess of a certain dollar amount. Typically, a fund will offer several breakpoints; the more you invest, the greater the reduction in the sales load. For example, a mutual fund may charge a load of 5% if you invest less than $50,000, but reduce that load to 4.5% if you invest at least $50,000 but less than $100,000. This means that if you invest $49,000, you'll pay $2,450 in sales charges, but if you invest $50,000 (i.e., you reach the first breakpoint), you'll pay only $2,250 in sales charges.

Comparing Share Classes

	Class A shares	**Class B shares**	**Class C shares**
Front-end load	Initial sales charge. Can be reduced or eliminated by breakpoint discounts.	None	None
Contingent deferred sales charge (CDSC)	None	Declines over several years	Typically lower than Class B, and eliminated after 1 year
12b-1 fees	Typically lower than Class B and C shares	Typically higher than Class A shares	Typically higher than Class A shares
Converts to Class A shares	N/A	After several years, thereafter reducing expenses	Generally Class C shares don't convert to Class A shares

Do your homework

- *Before investing in a mutual fund, carefully consider its investment objectives, risks, fees, and expenses, which are contained in the prospectus available from the fund. Review the prospectus carefully, including the discussion of fund classes and fees and how they apply to you.*
- *Make sure you understand how to take advantage of breakpoints.*
- *Compare the fees and expenses of different fund classes, to see how different share classes can affect your return. Take into account your investment amount, how long you plan to hold the fund, and the expenses and share load per share class.*
- *Review your holdings regularly. Stay informed about possible upcoming changes, such as an impending breakpoint, or when any Class B shares you may own are scheduled to convert to Class A shares.*
- *To take advantage of all breakpoint discounts, tell your broker about (a) your holdings within the mutual fund, and those of your family, (b) your holdings with other brokers, and (c) any additional purchases you may have in mind.*

You may also qualify for breakpoint discounts by signing a letter of intent to purchase additional shares within a certain period of time (generally 13 months), or by combining your current purchase with other investment holdings that you, your spouse, and/or your children have within the same fund or family of funds (called a right of accumulation). Since rules vary, read your fund's prospectus to find out how you may qualify for available breakpoint discounts, or contact your financial professional for more information.

Also, 12b-1 fees on Class A shares tend to be lower than those of other share classes, reducing your overall costs. This may make Class A shares more attractive if you wish to hold the fund for a long time.

Class B shares

Class B shares may appeal to you if you wish to invest a smaller amount of money for a long period of time. Unlike Class A shares, there is no up-front sales charge, so all of your initial investment is put to work immediately. Instead, Class B shares have a back-end load, often called a contingent deferred sales charge (CDSC), that you pay when you sell your shares. The load usually decreases over time (typically 6 to 8 years), although this varies from fund to fund. By the end of the time period no sales charge applies. At that stage your shares may convert to Class A shares.

For example, suppose you invest $5,000 in Class B shares, with a 5% CDSC that decreases by 1% every year after the second year. If you sell your shares within the first year, you will pay 5% of the value of your assets or the value of the initial investment, whichever is less. If you hold your shares for 6 years, the CDSC will be reduced to zero.

Before you purchase Class B shares, however, make sure that this investment fits in with your overall goals. Class B 12b-1 fees can be considerably higher than those for Class A shares, so the cost of investing large amounts over time might be more than you would like. In addition, you don't benefit from the breakpoint discounts available with Class A shares, and you must pay the CDSC if you sell your Class B shares within the time limit. You should also keep track of when your shares convert to Class A shares, especially if your account has been transferred from one broker to another.

Class C shares

When you purchase Class C shares, a front-end load is normally not imposed, and the CDSC is generally lower than for Class B shares. This charge is reduced to zero if you hold the shares beyond the CDSC period (typically 12 months). For those reasons Class C shares may be appropriate if you have a large amount to invest and you intend to keep the fund for less than 5 years.

However, the 12b-1 fees are greater for Class C shares than for Class A shares. Unlike Class B shares, these expenses will not decrease during the life of the investment, because C Class shares generally don't convert to Class A shares. Also, no breakpoints are available for large purchases.