BARRON'S

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The fees mutual fund companies pay to have their funds available to investors at the big wire houses have dramatically increased.

What is the pleasure of your company worth? It's more than you think. For access to Morgan Stanley customers, a fund family must pay the firm at least $250,000, and up to 16 basis points (0.16%) of your investment in its funds.

The other big brokers love you, too. Wells Fargo pays up to 20 basis points for shelf space—a practice called revenue sharing; for UBS, up to 20 basis points; and for Merrill Lynch, a unit of Bank of America, up to 10 basis points. And there are extra payments. For $350,000 to $750,000, fund families can (and do) make special presentations to your broker and headline Morgan Stanley conferences. JPMorgan, Invesco, Goldman Sachs, and DWS Scudder have all done so in hopes that your broker might be predisposed to their funds when building your portfolio. (We hate to pick on Morgan Stanley. We do it only because its excellent client disclosures are so easy to find online.)

Many distributors have such legal, pay-to-play arrangements—at Schwab, the annual fee can reach 0.45% of average assets, but the minimum monthly fee doesn't exceed $2,000 a month, about a tenth of Morgan Stanley's rate. Smaller platforms charge less: LPL Financial charges up to 15 basis points and Edward Jones up to 7.5. But these fees are said to be up sharply among the wirehouses, which, since the crisis, want more reliable revenues as they face competition from the rise of independent advisors.

This has consequences for investors. The practice limits your choices to larger funds, which have a tougher time beating the market, and to higher-cost funds. That's right: Those costs may get passed on to you. "A good low-cost bond fund charges between 20 and 60 basis points," says Russel Kinnel, Morningstar's director of fund research. "If you have to share with an intermediary, you've made that just about impossible."

According to the top sales executive at a major mutual fund company, revenue-sharing arrangements at the big wirehouses have roughly doubled since the financial crisis. A Morgan Stanley spokesman says, "We would dispute any characterization that these fees have roughly doubled. They've been harmonized," as Morgan Stanley and Smith Barney integrated their platforms postcrisis. "It's in the best interest of our investors that our financial advisors are educated about the investments they offer." Moreover, "neither advisors nor branch managers are paid extra to sell" any specific funds.

There are benefits to the system, the wirehouses argue. Clients get seasoned mutual funds large enough to deal with the big flows that come with thousands of advisors selling the product. Says one financial-services marketing executive: "I will never get fired for putting my clients into BlackRock."

But you'll also have a hard time finding high-quality names like Longleaf Partners, Vanguard, and Dodge & Cox, which all eschew revenue-sharing arrangements. Plus, the greatest returns often come from smaller funds, especially those that can more nimbly navigate the higher-payoff small-stock universe. Consider Greenspring fund (ticker: GRSPX), an eclectic fund that ranges among smaller stocks and high-yield bonds, and has done well in difficult markets. Manager Chip Carlson hasn't pursued wirehouses because of those high flows: "If 100% of shareholders dollars [stays] invested in the fund, it would be the best thing for shareholders."