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Trends in the Expenses and Fees of Mutual Funds, 2012

KEY FINDINGS

- » **On average, expense ratios incurred by investors in long-term mutual funds declined in 2012.** Equity fund investors, on average, paid 77 basis points (0.77 percent) in expenses, down 2 basis points from 2011. Expenses of bond funds declined 1 basis point to 61 basis points.
- » **Expense ratios of money market funds fell in 2012.** The asset-weighted average expense ratio of money market funds was 17 basis points in 2012, 4 basis points less than in 2011. Expense ratios on money market funds have fallen sharply in the past few years as the great majority of funds waived expenses to ensure that net returns to investors remained positive in the current low interest rate environment.
- » **In 2012, the average expense ratio paid by investors in funds of funds—mutual funds that invest in other mutual funds—decreased 3 basis points to 81 basis points.** The total expense ratio of funds of funds includes the expenses that a fund pays directly out of its assets as well as the expense ratios of the underlying funds in which it invests. Since 2005, the average expense ratio for investing in funds of funds has fallen 20 basis points.
- » **Expense ratios of target date mutual funds were 58 basis points in 2012, down from 67 basis points in 2008.** Two factors likely played a role. First, assets in target date mutual funds have tripled since 2008, lowering fund expense ratios through economies of scale. Second, a greater concentration of assets in lower-cost target date mutual funds pushed down the average expenses of these funds.
- » **In 2012, average expense ratios for actively managed bond funds, index bond funds, and index equity funds all fell.** The average expense ratio of actively managed equity funds, having declined 4 basis points in 2011, was unchanged. Since 1998, the average expense ratio of actively managed equity funds has declined 10 basis points, while that of equity index funds fell 12 basis points.

- » **Load fee payments have decreased.** In 2012, the average maximum sales load on equity funds offered to investors was 5.3 percent. But the average sales load investors actually paid was only 1.0 percent, owing to load fee discounts on large purchases and fee waivers, such as those on purchases through 401(k) plans. Average load fees paid by investors have fallen nearly 75 percent since 1990.
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Mutual Fund Expense Ratios Continue to Decline

Fund expenses cover portfolio management, fund administration and compliance, shareholder services, recordkeeping, certain kinds of distribution charges (known as 12b-1 fees), and other operating costs. A fund's expense ratio, which is disclosed in the fund's prospectus and shareholder reports, is the fund's total annual expenses expressed as a percentage of the fund's net assets. As opposed to sales loads, fund expenses are paid from fund assets.

Various factors affect a mutual fund's expenses, including its investment objective, its level of assets, the average account balance of its investors, the range of services it offers, fees that investors may pay directly, and whether the fund is a "load" or "no-load" fund (see "Understanding Mutual Fund Load Fees" on page 16).

Over the past two decades, on an asset-weighted basis, average expenses* paid by mutual fund investors have fallen significantly (Figures 1 and 2).¹ In 1993, investors on average incurred expenses of 107 basis points, or \$1.07 for every \$100 in assets, to invest in equity funds. By contrast, expenses averaged 77 basis points for equity fund investors in 2012, nearly 30 percent lower than in 1993. During that period (1993 to 2012), the expense ratios of bond funds dropped 27 percent to 61 basis points, while hybrid fund expense ratios went from 96 basis points to 79 basis points, an 18 percent decrease.² Expenses incurred by investors in money market funds dropped 67 percent, from 52 basis points in 1993 to 17 basis points in 2012.^{3, 4}

Equity Funds

Expense ratios of equity funds declined for the third straight year, following a rise of 3 basis points in 2009. This pattern is not unexpected, given recent stock market developments and the nature of fund expenses. Expense ratios often vary inversely with fund assets. Certain fund costs—such as transfer agency fees, accounting and audit fees, and directors' fees—are more or less fixed in dollar terms, regardless of fund size. When fund assets rise, these fixed costs become smaller relative to those assets. As fund assets fall, the fixed costs contribute relatively more (as a percentage of assets) to a fund's expense ratio.

During the stock market downturn from October 2007 to March 2009, the assets of equity funds decreased markedly (Figure 3, dashed line with an inverted scale), leading expense ratios to rise slightly in 2009. As the stock market has recovered, stock fund assets have rebounded and expense ratios have fallen. Since 2010, equity fund assets have grown by 6 percent, and, inversely, expenses have fallen 6 basis points.

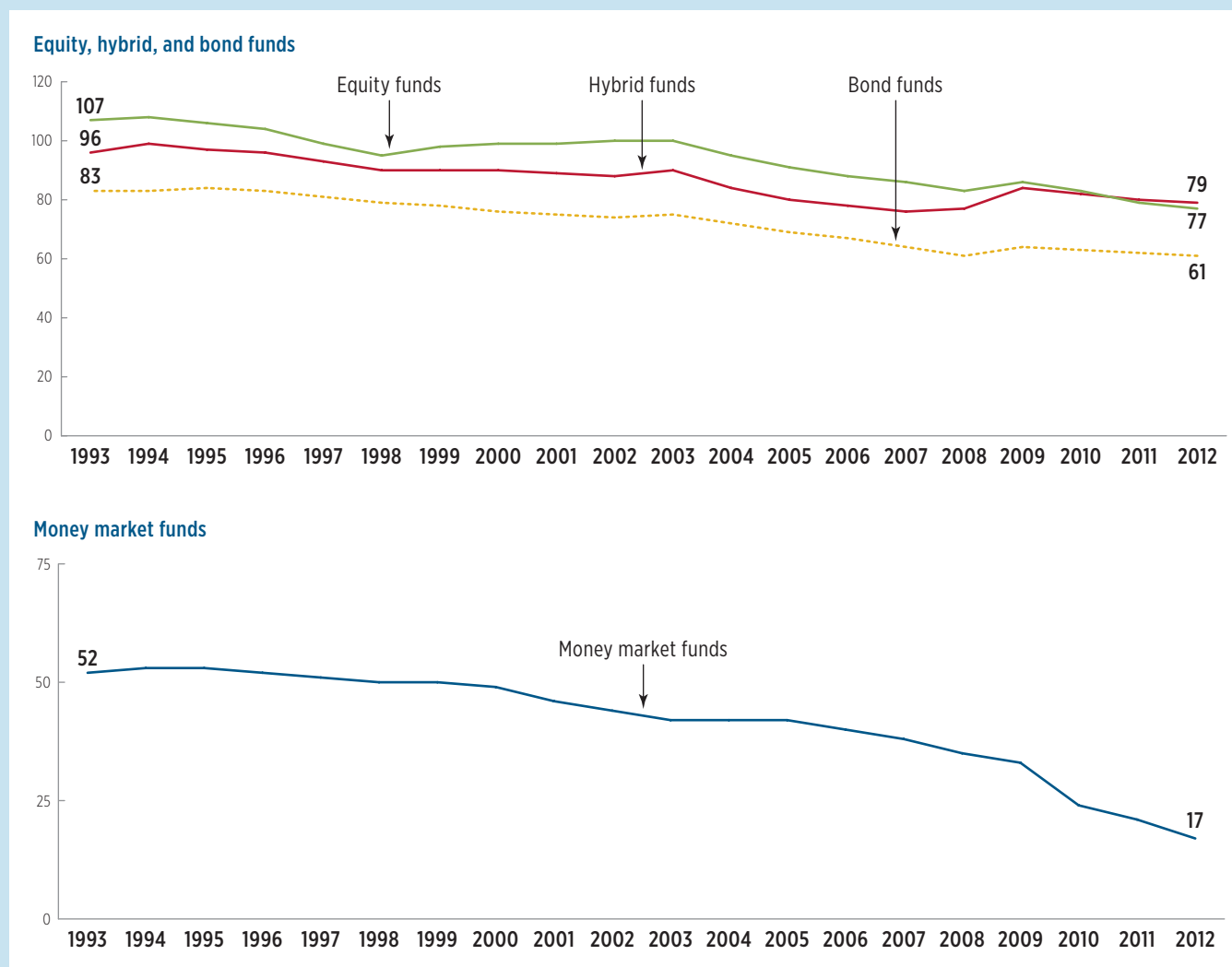
Another factor lowering the average expenses of long-term funds has been a shift by investors toward no-load share classes, particularly institutional no-load share classes, which tend to have lower-than-average expense ratios. This is due in large part to a change in the way investors compensate brokers and other financial professionals (see "Mutual Fund Load Fees" on page 15).

* In this paper, unless otherwise noted, average expenses are calculated on an asset-weighted basis. See note 1 on page 21.

FIGURE 1

Mutual Fund Expense Ratios Have Fallen

Basis points, 1993–2012



Note: Expense ratios are measured as an asset-weighted average; figure excludes mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Lipper

Hybrid Funds

The average expense ratios of hybrid funds also continued a pattern of decline after a sharp rise in 2009. Hybrid funds invest in a mix of equities and bonds. These funds have experienced double-digit asset growth in three of the last four years, expanding 18 percent in 2012 alone. From December 2009 to December 2012, the net assets of hybrid funds rose from \$698 billion to \$991 billion, a 42 percent increase. This increase was accompanied by a 5 basis point drop in average expenses over that period.

Bond Funds

The average expenses that shareholders paid for investing in bond funds fell by 1 basis point in 2012, to 61 basis points (Figure 2). Bond funds have experienced four years of strong asset growth—assets totaled \$3.4 trillion at the end of 2012, up 19 percent from year-end 2011. As with equity and hybrid funds, growth in fund assets put downward pressure on the expense ratios of bond funds. Recently, three other factors have also shaped bond fund expense ratios.

FIGURE 2

Total Expense Ratios for Mutual Funds Have Fallen

Basis points, 1993–2012

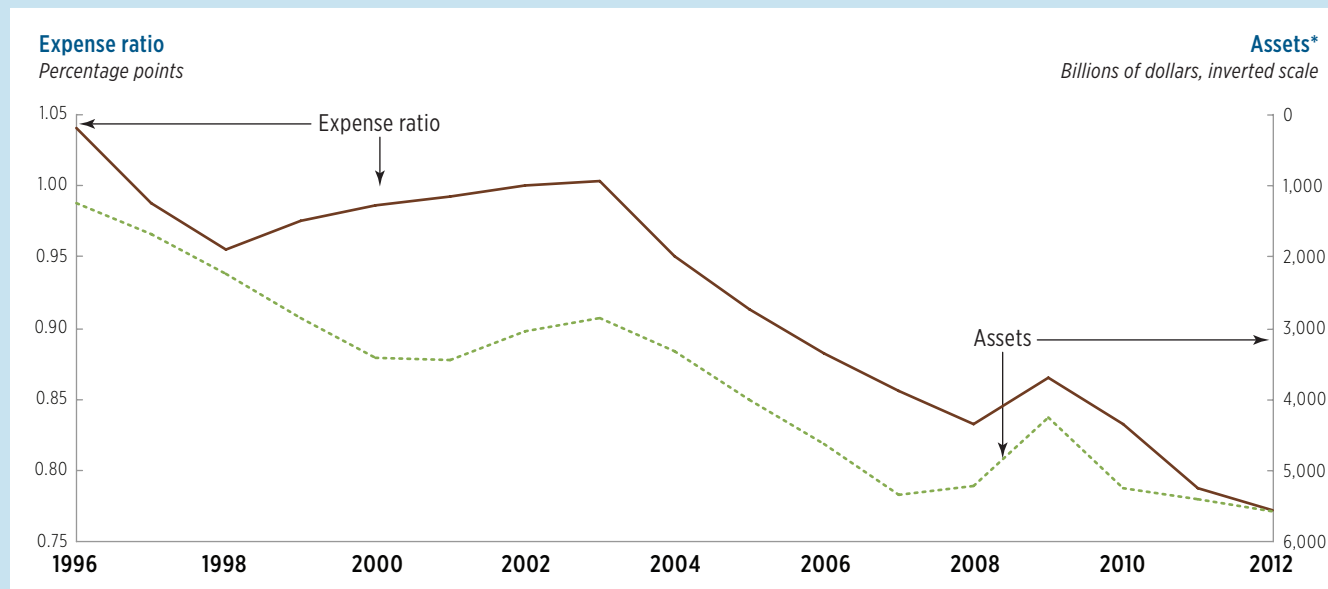
Year	Equity funds	Hybrid funds	Bond funds	Money market funds
1993	107	96	83	52
1994	108	99	83	53
1995	106	97	84	53
1996	104	96	83	52
1997	99	93	81	51
1998	95	90	79	50
1999	98	90	78	50
2000	99	90	76	49
2001	99	89	75	46
2002	100	88	74	44
2003	100	90	75	42
2004	95	84	72	42
2005	91	80	69	42
2006	88	78	67	40
2007	86	76	64	38
2008	83	77	61	35
2009	86	84	64	33
2010	83	82	63	24
2011	79	80	62	21
2012	77	79	61	17

Note: Total expense ratios are measured as an asset-weighted averages. Figures exclude mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Lipper

FIGURE 3

Equity Fund Expense Ratios Are Inversely Related to Equity Fund Assets



*Figure excludes assets of mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds. Assets are plotted as a two-year moving average.

Sources: Investment Company Institute and Lipper

First, since 2009, strategic income bond funds, particularly those with lower costs, have received a substantial portion of new sales. These multisector and often multicountry funds have attracted investors seeking yield in a low interest rate environment. In 2012, strategic income bond funds received net new cash flow of over \$114 billion, and assets grew by 17 percent. The average expense ratio of this investment category is 6 basis points lower than that of bond funds in general. Additionally, those strategic income bond funds with expenses of less than 61 basis points received roughly 80 percent of the category's cash flow in 2012. These factors put downward pressure on the average expense ratio of bond funds.

Second, bond fund expense ratios were pushed down by investor demand for mortgage-backed bond funds. These funds invest primarily in mortgage-backed securities issued by government-sponsored enterprises such as Fannie Mae, Freddie Mac, and Ginnie Mae, whose yields have recently exceeded those on Treasury securities. In part because of these attractive yields, investors added \$30 billion in new cash to mortgage-backed bond funds in 2012. Assets in mortgage-backed bond funds, boosted by strong investor demand, grew 46 percent in 2012. The average expenses of these funds were 11 basis points less than the average for all bond funds. As a result, the strong investor appetite for these funds helped lower the average expense ratio of all bond funds.

Third, the downward pressure on bond fund expenses has been tempered by continued investment in global/international bond funds. Since 2010, investors, seeking higher yields available in a number of foreign markets, increased their holdings of global/international bond funds. Such funds generally are more costly to manage than bond funds with a domestic orientation and thus have above-average expense ratios (90 basis points on average). Money continued to flow into global/international bond funds in 2012 (net new cash flow into these funds was \$38 billion in 2012). Absent this factor, average bond fund expense ratios would have fallen even more.

Index Funds

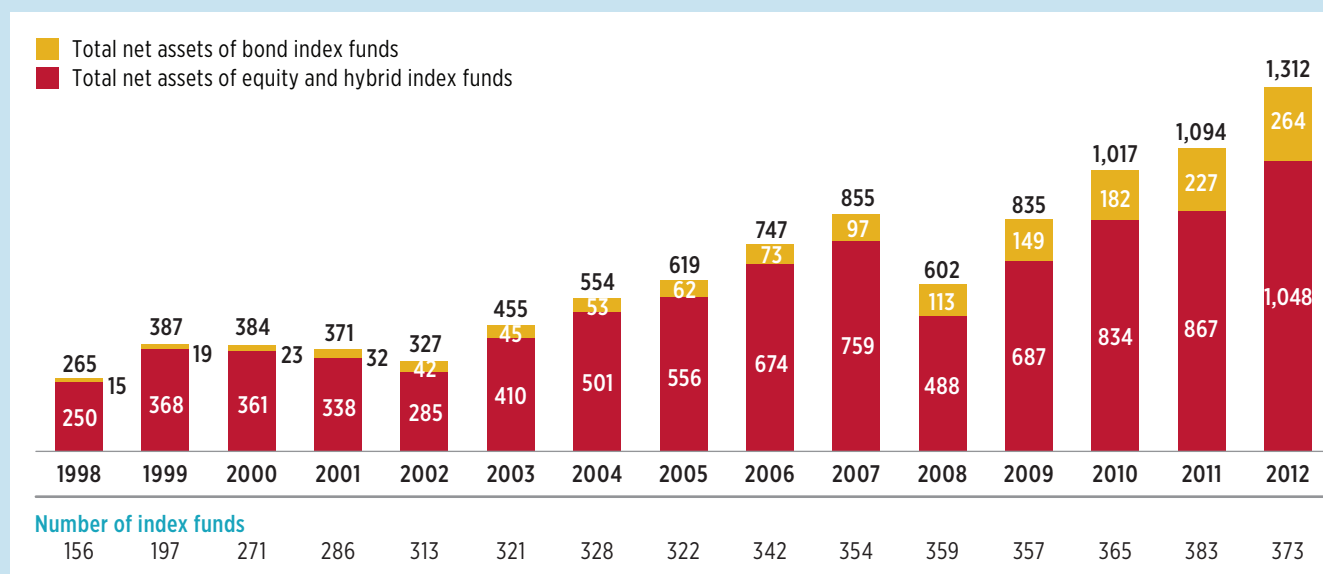
Growth in index funds has contributed to the decline in equity and bond fund expense ratios. Index fund assets have grown substantially in the past 15 years, from \$265 billion in assets in 1998 to \$1.3 trillion in 2012 (Figure 4). Investor demand for indexed bond funds has grown in the past few years, but 80 percent of index fund assets are invested in equity and hybrid index funds, the vast majority of which are in equity index funds.⁵

Index funds tend to have lower-than-average expense ratios for several reasons. The first is their approach to portfolio management. An index fund generally seeks to mimic the returns on a specified index. Under this approach, often referred to as passive management, portfolio managers buy and hold all, or a representative sample of, the securities in their target indexes.

FIGURE 4

Total Net Assets and Number of Index Funds* Have Increased

Billions of dollars, year-end, 1998–2012



*Index fund data exclude funds that invest primarily in other funds.

Note: Components may not add to the total because of rounding.

Source: Investment Company Institute

By contrast, under an active management approach, managers have more discretion to increase or reduce their exposure to sectors or securities within their investment mandate. This approach offers investors the chance to enjoy superior returns. However, it also entails more-intensive analysis of securities or sectors, which can be costly.

A second reason index funds tend to have lower average expense ratios is their investment focus. Historically, the assets of equity index funds have been concentrated most heavily in “large-cap blend” funds that target U.S. large-cap indexes, notably the S&P 500 index. Assets of actively managed funds, on the other hand, have been more spread out among stocks of varying capitalization, international regions, or specialized business sectors. Managing portfolios of mid- or small-cap, international, or sector stocks is generally acknowledged to be more expensive than managing portfolios of U.S. large-cap stocks.

Third, index funds are larger on average than actively managed funds, which helps reduce fund expense ratios through economies of scale. In 2012, the average equity index fund had assets of over \$1.7 billion, compared with \$393 million for the average actively managed equity fund.

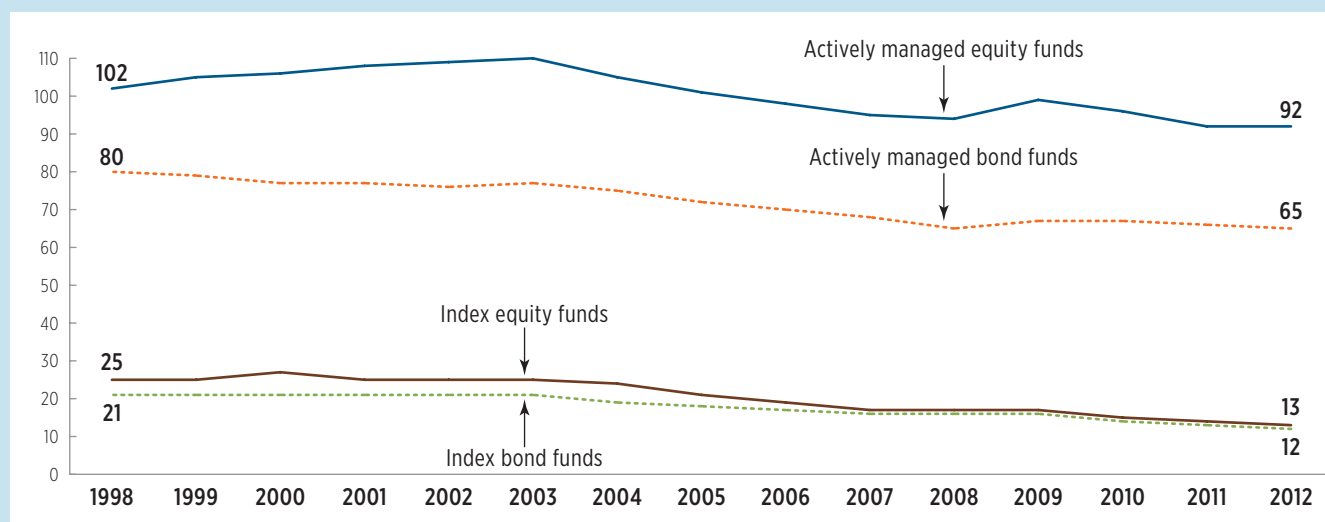
Finally, index fund investors who seek the assistance of financial professionals may pay for that service out-of-pocket, rather than through the fund’s expense ratio (see “Mutual Fund Load Fees” on page 15). Actively managed funds more commonly bundle those costs in the fund’s expense ratio.

These reasons, among others, help explain why index funds generally have lower expense ratios than actively managed funds (Figure 5). Note, however, that both index and actively managed funds have contributed to the decline in the overall average expense ratios of mutual funds shown in Figure 1.

FIGURE 5

Expense Ratios of Actively Managed and Index Funds

Basis points, 1998–2012



Note: Expense ratios are measured as an asset-weighted average; figures exclude mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Lipper

The average expense ratios incurred by investors in both index and actively managed funds have fallen, and by roughly the same amount. For example, from 1998 to 2012 the average expense ratio of index equity funds fell 12 basis points, compared with a reduction of 10 basis points for actively managed equity funds. Similarly, the average expense ratios of index and actively managed bond funds have fallen 9 and 15 basis points, respectively.

In part, the downward trend in the average expense ratios of both index and actively managed funds reflects the tendency of all investors to purchase lower-cost funds. Investor demand for index funds is disproportionately concentrated in the very lowest cost funds. For example, in 2012, 61 percent of the assets of index equity funds were held in funds with expense ratios that were among the lowest 10 percent of all equity index funds (Figure 6). This phenomenon is not unique to index funds, however. As Figure 6 shows, since 2002 the proportion of assets in the lowest-cost actively managed funds also has risen.

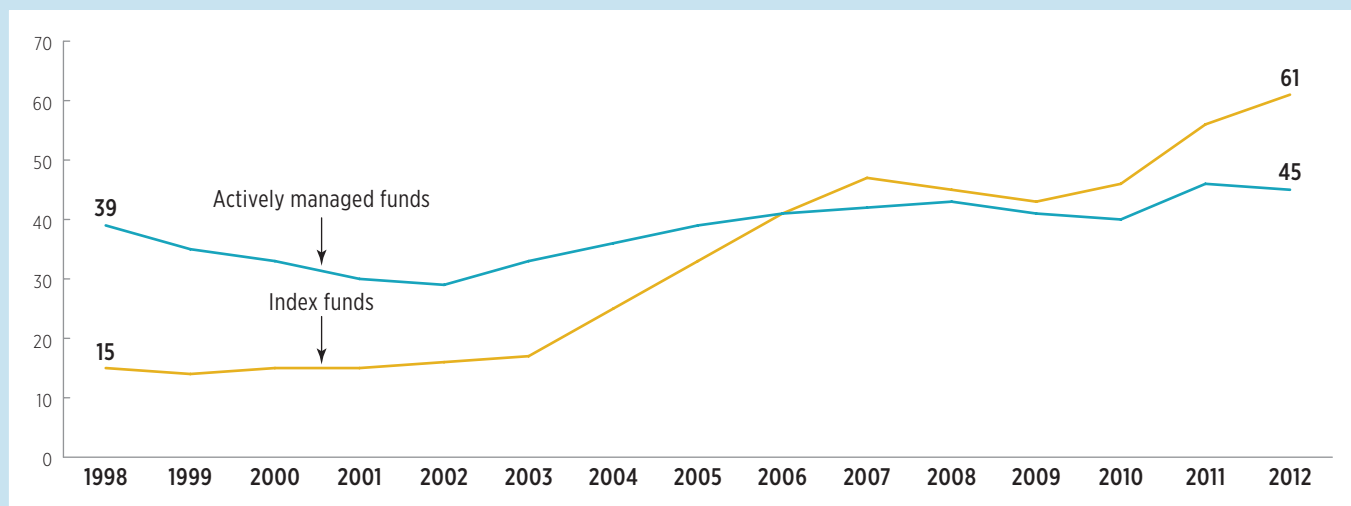
Money Market Funds

The average expense ratio of money market funds was 17 basis points in 2012, a drop of 4 basis points from 2011 (Figure 2).⁶ In fact, money market fund expenses have fallen every year since 2005.

Until 2009, the declining average expense ratio of money market funds largely reflected an increase in the market share of institutional share classes of money market funds (Figure 7). Because institutional share classes serve fewer investors with larger average account balances, they tend to have lower expense ratios than retail share classes of money market funds (Figure 8). Thus, the increase in the institutional market share helped reduce the industrywide average expense ratio of all money market funds.

FIGURE 6

Percentage of Total Net Assets Held in Equity Funds with Expense Ratios in the Lowest Decile 1998–2012



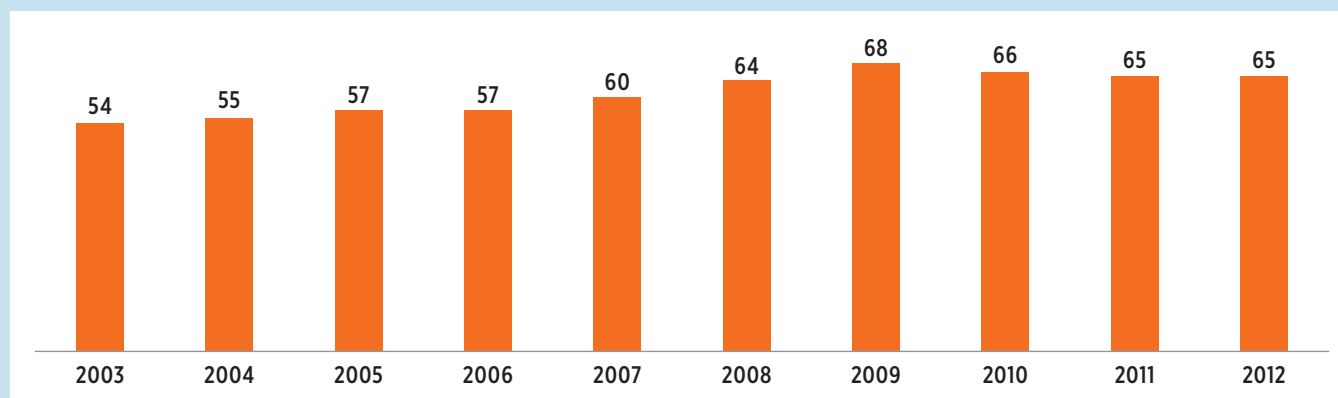
Note: The lowest decile is based on the distribution of fund expense ratios in 2012 and is fixed across time.

Sources: Investment Company Institute and Lipper

FIGURE 7

Market Share of Institutional Share Classes of Money Market Funds

Percentage of assets of all money market funds, 2003–2012

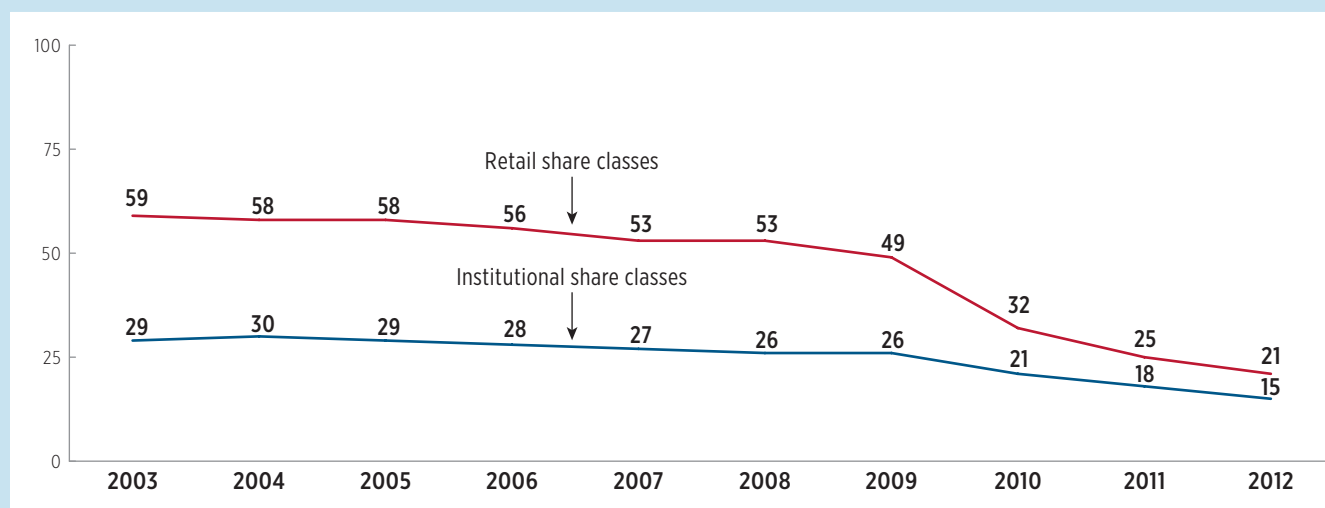


Source: Investment Company Institute

FIGURE 8

Expense Ratios of Institutional and Retail Money Market Fund Share Classes

Basis points, 2003–2012



Note: Expense ratios are measured as an asset-weighted average; figure excludes mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Lipper

By contrast, the market share of institutional share classes of money market funds dropped slightly in 2010 and 2011 (to 65 percent from 68 percent in 2009) and held steady in 2012. This indicates that other factors pushed down the expense ratios of these funds. Primarily, the steep plunge in the average expense ratio of money market funds reflects developments stemming from the current low interest rate environment.

In 2007 and 2008, to stimulate the economy and respond to the financial crisis, the Federal Reserve sharply reduced short-term interest rates. By early 2009, the federal funds rate and yields on U.S. Treasury bills hit historic lows, both hovering just above zero. Yields on money market funds, which closely track short-term interest rates, also tumbled (Figure 9). The average gross yield (the yield before deducting fund expense ratios) on taxable money market funds has remained below 25 basis points since February 2011.

In this setting, money market fund advisers increased expense waivers to ensure that fund net yields (the yields after deducting fund expense ratios) did not fall below zero.

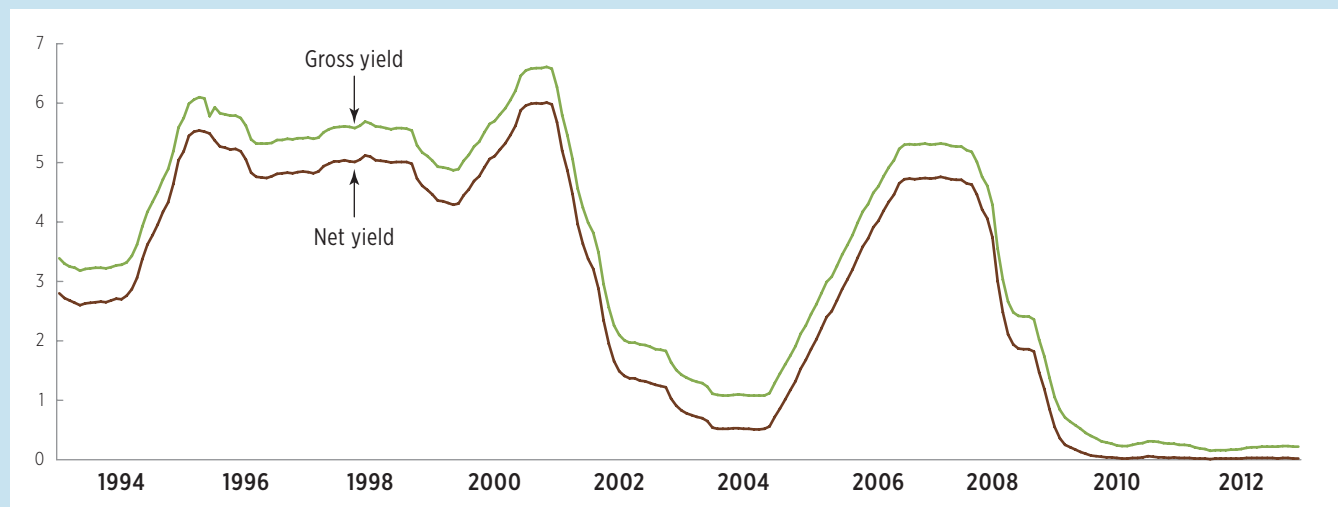
Waivers raise a fund's net yield by reducing the expense ratio that investors incur. Historically, money market funds have often waived expenses, usually for competitive reasons. For example, in 2006, before the onset of the financial crisis, 60 percent of money market fund share classes were waiving expenses. By the end of 2012, 97 percent of money market fund share classes were waiving at least some expenses (Figure 10).

Expense waivers are paid for by money market fund advisers and their distributors, who forgo profits and bear more, if not all, of the costs of running money market funds. Money market funds waived an estimated \$4.8 billion in expenses in 2012, nearly four times the amount waived in 2006 (Figure 11). These waivers substantially reduced revenues of fund advisers. If gross yields on money market funds rise, advisers may reduce or eliminate waivers, which could cause expense ratios on money market funds to rise somewhat. Finally, in 2012, assets in lower-cost money market funds increased. This movement of assets into lower-cost funds likely contributed to the reduction in the average expense ratio of money market funds.

FIGURE 9

Taxable Money Market Fund Yields

Percent, monthly, January 1993–December 2012

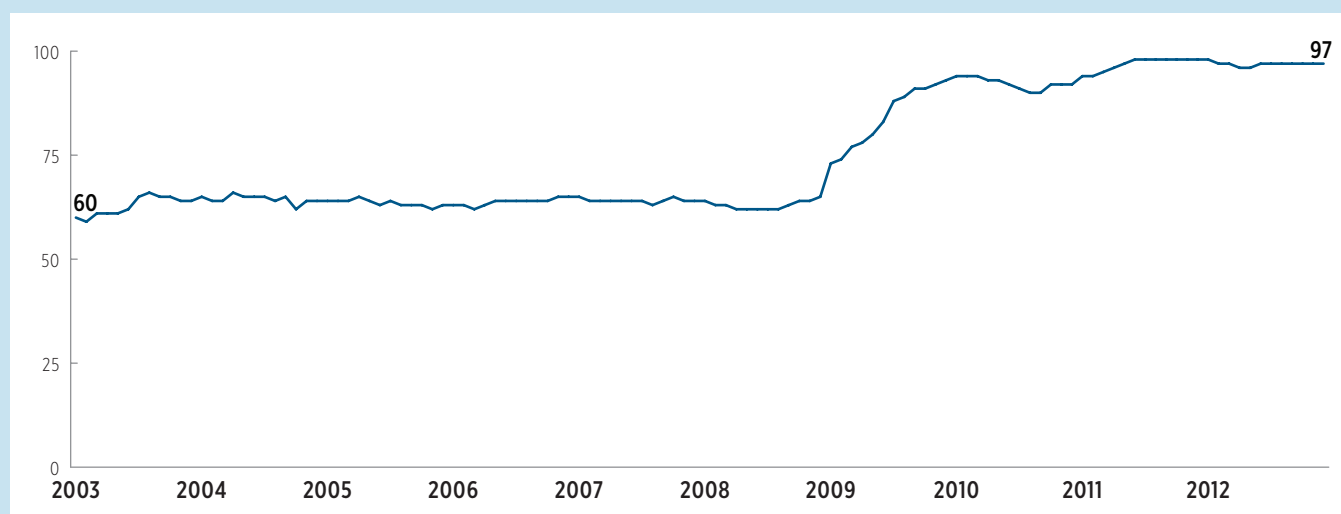


Source: iMoneyNet

FIGURE 10

Percentage of Money Market Fund Share Classes That Waive Expenses Has Risen Substantially

Percent, monthly, January 2003–December 2012

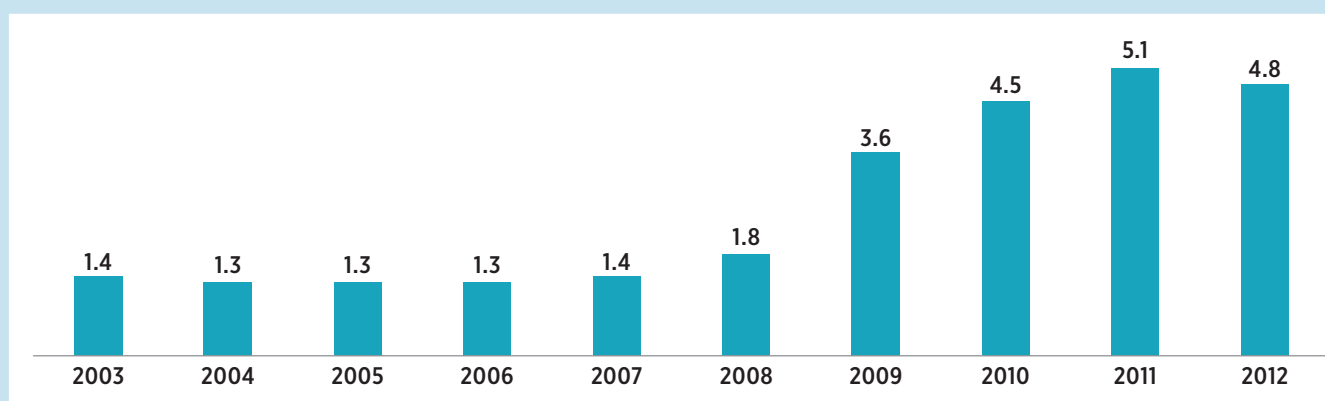


Sources: Investment Company Institute and iMoneyNet

FIGURE 11

Money Market Funds Waived an Estimated \$4.8 Billion in Expenses in 2012

Expense waivers, billions of dollars, 2003–2012



Sources: Investment Company Institute and iMoneyNet

Funds of Funds

Funds of funds are mutual funds that invest in other mutual funds.⁷ The market for funds of funds has expanded considerably in recent years. By the end of 2012, there were 1,156 funds of funds with \$1,282 billion in assets (Figure 12). Approximately 90 percent of the assets of funds of funds are in hybrid funds of funds, which are funds that invest in a mix of equity, bond, and hybrid mutual funds. From 2005 to 2012, the average expense ratio of funds of funds fell from 101 basis points to 81 basis points, a reduction of nearly 20 percent (Figure 13).⁸

Target Date Mutual Funds

Much of the growth in funds of funds stems from investor interest in target date mutual funds (96 percent of target date mutual funds are funds of funds and 36 percent of funds of funds are target date mutual funds). Target date mutual funds invest in a mix of bonds and stocks, adjusting the allocation of fund assets over time. Typically, a target date mutual fund provides investors more exposure to fixed income and less to equity as it approaches and passes the target date, which is usually mentioned in the fund's name.

Assets in target date mutual funds have tripled since 2008. At year-end 2012, target date mutual funds had assets of \$481 billion (Figure 14). Much of this expansion owes to the features of target date mutual funds, such as diversification across asset classes and automatic rebalancing according to a changing risk profile. These features are especially attractive for individuals saving for retirement in 401(k) plans and IRAs.⁹ Additionally, target date funds are often a default option for 401(k) plans under the Pension Protection Act of 2006 (PPA).¹⁰ As a result, in recent years, newly hired employees were more likely to invest their 401(k) contributions in target date funds. For example, at year-end 2011, 40 percent of the account balances of recently hired participants in their twenties was invested in target date funds, compared with 35 percent in 2010 and 16 percent in 2006.¹¹

FIGURE 12

Funds of Funds Have Grown Rapidly in Recent Years*Number of funds of funds, 2005–2012*

Year-end	Total	Equity	Hybrid	Bond
2005	475	98	369	8
2006	603	127	469	7
2007	720	129	584	7
2008	858	131	716	11
2009	949	138	799	12
2010	985	151	814	20
2011	1,087	161	899	27
2012	1,156	167	953	36

Total net assets of funds of funds, billions of dollars, 2005–2012

Year-end	Total	Equity	Hybrid	Bond
2005	306.0	49.7	256.0	0.4
2006	469.6	83.6	385.3	0.8
2007	637.0	103.7	532.4	0.9
2008	486.6	66.5	418.8	1.3
2009	679.9	58.5	619.3	2.1
2010	916.9	84.1	820.2	12.6
2011	1,041.6	84.5	936.6	20.5
2012	1,281.5	97.5	1,148.7	35.4

Note: Components may not add to the total because of rounding.

Source: Investment Company Institute

FIGURE 13

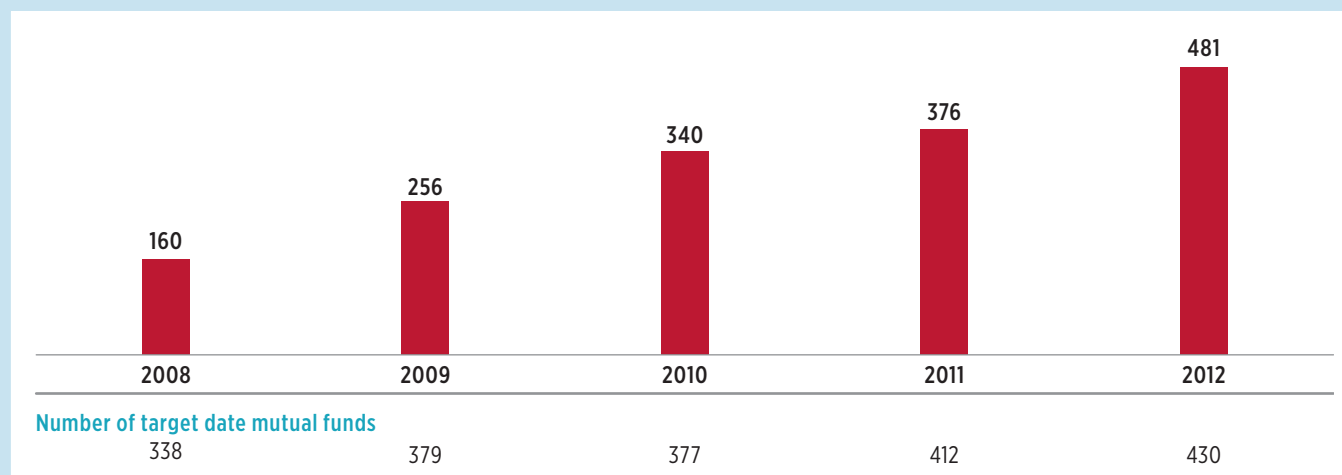
Total Expense Ratios of Funds of Funds*Basis points, 2005–2012*

	Asset-weighted average	Simple average	Median
2005	101	156	152
2006	96	144	139
2007	94	144	135
2008	89	140	134
2009	91	138	130
2010	87	134	128
2011	84	131	124
2012	81	130	119

Note: Morningstar is the data source for 2005–2007 information. Investment Company Institute is the data source for 2008–2012 assets. Lipper is the data source for 2008–2012 expense ratios.

Sources: Investment Company Institute, Lipper, and Morningstar

FIGURE 14

Target Date Mutual Fund Assets Have Increased*Billions of dollars, year-end, 2008–2012*

Note: Funds that invest primarily in other funds are included.

Sources: Investment Company Institute

The steep increase in the assets of target date mutual funds over the past several years has been accompanied by a decline in these funds' average expense ratios. As noted, in any type of fund, asset growth may lead to lower fund expense ratios through economies of scale. Target date mutual fund assets grew by 28 percent in 2012, and expenses fell from 61 basis points in 2011 to 58 basis points in 2012 (Figure 15). In addition, as with other fund types, investors tend to hold lower-cost target date funds. For example, in 2012, more than three-quarters of target date mutual fund assets were concentrated in funds with expense ratios in the lowest quartile. These factors have driven down the average expenses incurred by target date mutual fund investors.

Mutual Fund Load Fees

Many mutual fund investors pay for the services of a financial professional. These professionals typically devote time and attention to prospective investors before investors make an initial purchase of funds and other securities. Usually, the professional meets with the investor, identifies goals, analyzes the investor's existing portfolio, determines an appropriate asset allocation, and recommends funds to help achieve the investor's goals. Financial professionals also provide ongoing services, such as periodically reviewing investors' portfolios, adjusting asset allocations, and responding to customer inquiries.

FIGURE 15
Total Expense Ratios of Target Date Mutual Funds
Basis points, 2008–2012

	Asset-weighted average	Simple average	Median
2008	67	123	118
2009	67	120	114
2010	65	114	111
2011	61	111	109
2012	58	107	104

Sources: Investment Company Institute and Lipper

Understanding Mutual Fund Load Fees

Investors in mutual funds incur two primary kinds of expenses and fees: fund expenses and sales loads. Whereas fund expenses are paid indirectly from fund assets throughout the year, sales loads are one-time fees that investors pay either at the time of purchase (front-end loads) or when shares are redeemed (back-end loads).

Funds with load fees (load funds) are sold through financial professionals such as brokers and registered investment advisers. These professionals help investors define their investment goals, select appropriate funds, and provide ongoing service. Financial professionals are compensated for providing these services through some combination of front- and back-end loads—also known as contingent deferred sales loads (CDSL)—and 12b-1 fees, the latter of which are included in a fund's expense ratio. Investors who pay their financial professionals directly for services or who do not use a financial professional purchase no-load funds, which have neither front- nor back-end load fees and have low or no 12b-1 fees.

Various factors affect the load fees that an investor pays. For example, many load funds offer at least three share classes within the same fund: most commonly A, B, and C share classes. To invest in A shares, the investor typically pays a higher front-end load but incurs a lower expense ratio because the share class either has a low or no 12b-1 fee. With a B share, an investor pays no front-end load, but for a number of years incurs a higher expense ratio because the share class has a higher 12b-1 fee. In addition, if the shareholder redeems his or her shares before a set date (generally seven to eight years), the shareholder may be required to pay a load fee (a back-end load). With C shares, an investor typically pays neither a front-end load nor a back-end load, but incurs a higher ongoing expense ratio because the share class has a higher 12b-1 fee.

Front-end load fees also are influenced by the size of an investor's initial purchase. For example, an investor who purchases the front-end load share class of a fund might expect to pay a front-end load fee of 5.75 percent of the initial purchase, if the initial purchase is less than \$50,000 (Figure 16). This would commonly decrease to 4.5 percent for an initial purchase of \$50,000 to \$99,999, or for purchases that accumulate over time to those amounts. Typically, for initial purchases of \$1 million or more (or cumulative purchases of that amount or more), an investor would pay no front-end load fee in an A share class. Some fund providers also offer to discount load fees when an investor has total balances exceeding a given amount in all of that provider's funds, even if the investor makes a small purchase, such as \$5,000, in one of the provider's funds that the investor previously did not own.

FIGURE 16

Front-End Load Fees and Associated Fee Breakpoints

Most frequently occurring values,¹ 2012

Cumulative dollar purchases Fee breakpoints	Front-end load fee ²
\$0 to \$49,999	5.75
\$50,000 to \$99,999	4.50
\$100,000 to \$249,999	3.50
\$250,000 to \$499,999	2.50
\$500,000 to \$999,999	2.00
\$1,000,000 or more	0.00

¹ “Most frequently occurring values” are modal values for load fees and breakpoints among all domestic equity (excluding sector funds) that charged a front-end load fee.

² The front-end load fee is a percentage of purchase amount.

Sources: Investment Company Institute and Morningstar

Thirty years ago, fund shareholders usually compensated financial professionals for their assistance through a front-end load—a one-time, up-front payment for current and future services. Since then, that structure has changed significantly in a number of ways.

One important element has been a marked reduction in load fees paid by mutual fund investors. The maximum front-end load fee that shareholders might pay for investing in mutual funds has remained nearly constant since 1990 (Figure 17). However, front-end load fees that investors actually paid have declined from nearly 4 percent in 1990 to roughly 1 percent in 2012. This in part reflects the increasing role of mutual funds in helping investors save for retirement. Purchases made through defined contribution plans, such as 401(k) plans, have sometimes gone to funds that normally charge front-end load fees, but funds often waive load fees on purchases made through retirement plans. Moreover, front-end load funds offer volume discounts, waiving or reducing load fees for large initial or cumulative purchases (see “Understanding Mutual Fund Load Fees” on the previous page).

Another important element in the changing distribution structure of mutual funds has been a shift toward asset-based fees. Asset-based fees are assessed as a percentage of the assets that the financial professional manages for an investor, rather than as a percent of the dollars initially invested. Increasingly, brokers and other financial professionals who sell mutual funds have been compensated through asset-based fees.¹² Investors may pay these fees indirectly through a fund’s 12b-1 fee, which is included in the fund’s expense ratio. The fund’s underwriter collects the 12b-1 fee, passing the bulk of it to the financial professionals serving fund investors. Alternatively, investors may pay the professional an asset-based fee directly. In such cases, the professional would normally recommend the purchase of no-load mutual funds, those that have no front-end or back-end load and a 12b-1 fee of 0.25 percent or less.

FIGURE 17

Front-End Sales Loads That Investors Paid Were Well Below Maximum Front-End Loads That Funds Charged

Percentage of purchase amount, selected years

	Maximum front-end sales load*			Average front-end sales load that investors actually incurred*		
	Equity	Hybrid	Bond	Equity	Hybrid	Bond
1990	5.0	5.0	4.6	3.9	3.8	3.5
1995	4.8	4.7	4.1	2.5	2.4	2.1
2000	5.2	5.1	4.2	1.4	1.4	1.1
2001	5.2	5.2	4.2	1.2	1.2	1.0
2002	5.3	5.3	4.2	1.3	1.3	1.0
2003	5.3	5.1	4.1	1.3	1.3	1.0
2004	5.3	5.1	4.1	1.4	1.4	1.1
2005	5.3	5.3	4.0	1.3	1.3	1.0
2006	5.3	5.2	4.0	1.2	1.2	0.9
2007	5.4	5.2	4.0	1.2	1.1	0.9
2008	5.4	5.2	4.0	1.1	1.1	0.8
2009	5.4	5.2	3.9	1.0	1.0	0.8
2010	5.4	5.2	3.9	1.0	1.0	0.8
2011	5.3	5.2	3.9	1.0	1.0	0.7
2012	5.3	5.2	3.9	1.0	1.0	0.7

*The maximum front-end sales load is a simple average of the highest front-end load that funds may charge as set forth in their prospectus. The average actually paid is estimated from first calculating the total front-end sales loads collected by funds divided by the total maximum loads that the funds could have collected based on their new sales that year. This ratio is then multiplied by each fund's maximum sales load. The resulting value is then averaged across all funds.

Note: Figure excludes mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute, Lipper, and Strategic Insight Simfund

In part because of the trend toward compensating financial professionals with asset-based fees, assets in front-end and back-end load share classes have fallen in recent years while those in level-load, other load, and no-load share classes have increased substantially.¹³ For example, in the past five years, front-end and back-end load share classes have experienced outflows totaling \$456 billion (Figure 18) and gross sales of back-end load share classes have dwindled almost to zero (Figure 19). As a result, the assets in these types of share classes fell from \$2,377 billion in 2007 to \$1,920 billion in 2012 (Figure 20).

In contrast, level load, other load, and no-load share classes have seen net inflows and rising asset levels over the past 10 years. Since 2007, level load and other load share classes—both of which have a 12b-1 fee (i.e., an asset-based fee) of more than 0.25 percent—have experienced modest inflows and growth in assets.

No-load share classes—those with neither a front-end nor a back-end load fee and a 12b-1 fee of no more than 0.25 percent—have accumulated the bulk of the inflows to long-term funds in the past 10 years. In 2012, no-load share classes accounted for 61 percent of the assets of long-term funds compared with 49 percent in 2003.

FIGURE 18

Net New Cash Flow Was Greatest in No-Load Institutional Share Classes*Billions of dollars, 2003–2012*

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
All long-term mutual funds	\$216	\$210	\$192	\$227	\$224	-\$225	\$389	\$242	\$26	\$196
Load	49	49	31	38	15	-145	30	-42	-121	-23
Front-end load ¹	33	46	41	42	19	-104	2	-58	-101	-67
Back-end load ²	-20	-40	-47	-47	-42	-39	-24	-27	-23	-15
Level load ³	28	20	17	20	24	-12	30	20	-6	5
Other load ⁴	8	22	20	24	15	10	22	23	9	54
No-load⁵	125	125	143	165	184	-54	330	276	169	247
Retail or general purpose	81	90	66	71	60	-113	128	45	-47	-16
Institutional	44	35	77	93	124	59	202	231	216	263
Variable annuities	42	36	18	24	25	-26	29	8	-21	-28

¹ Front-end load > 1 percent. Primarily includes A shares; includes sales where front-end loads are waived.² Front-end load = 0 percent and CDSL > 2 percent. Primarily includes B shares.³ Front-end load ≤ 1 percent, CDSL ≤ 2 percent, and 12b-1 fee > 0.25 percent. Primarily includes C shares; excludes institutional share classes.⁴ All other load share classes not classified as front-end load, back-end load, or level load. Primarily includes retirement share classes known as R shares.⁵ Front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

Note: Components may not add to the total because of rounding. Data exclude mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Lipper

FIGURE 19

Gross Sales Were Concentrated in No-Load Share Classes*Billions of dollars, 2003–2012*

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
All long-term mutual funds	\$1,711	\$1,635	\$1,740	\$2,009	\$2,529	\$2,414	\$2,375	\$2,699	\$2,856	\$2,957
Load	593	528	563	623	716	668	616	636	604	634
Front-end load ¹	423	362	392	443	509	481	432	440	433	398
Back-end load ²	65	47	33	27	23	20	10	7	4	3
Level load ³	88	82	83	93	105	97	111	110	96	101
Other load ⁴	17	37	55	60	78	70	62	79	70	131
No-load⁵	873	871	952	1,129	1,493	1,438	1,489	1,745	1,943	2,030
Retail or general purpose	559	573	599	704	899	794	816	915	940	926
Institutional	314	298	353	425	594	644	673	830	1,003	1,104
Variable annuities	245	237	225	258	320	308	270	319	309	293

¹ Front-end load > 1 percent. Primarily includes A shares; includes sales where front-end loads are waived.² Front-end load = 0 percent and CDSL > 2 percent. Primarily includes B shares.³ Front-end load ≤ 1 percent, CDSL ≤ 2 percent, and 12b-1 fee > 0.25 percent. Primarily includes C shares; excludes institutional share classes.⁴ All other load share classes not classified as front-end load, back-end load, or level load. Primarily includes retirement share classes known as R shares.⁵ Front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

Note: Gross sales exclude reinvested dividends. Components may not add to the total because of rounding. Data exclude mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Lipper

FIGURE 20

Total Net Assets of Long-Term Funds Were Concentrated in No-Load Shares*Billions of dollars, 2003–2012*

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
All long-term mutual funds	\$5,362	\$6,194	\$6,864	\$8,059	\$8,916	\$5,771	\$7,797	\$9,028	\$8,936	\$10,352
Load	1,956	2,222	2,409	2,783	2,977	1,844	2,334	2,573	2,344	2,630
Front-end load ¹	1,360	1,567	1,720	2,014	2,173	1,373	1,745	1,873	1,741	1,881
Back-end load ²	356	334	271	241	204	102	98	78	50	39
Level load ³	214	252	284	334	373	235	326	378	364	424
Other load ⁴	26	68	133	194	228	134	165	243	189	286
No-load⁵	2,604	3,031	3,416	4,052	4,591	3,073	4,332	5,164	5,341	6,324
Retail or general purpose	1,853	2,159	2,390	2,785	3,060	1,915	2,641	3,007	2,969	3,385
Institutional	752	873	1,026	1,267	1,532	1,157	1,691	2,157	2,373	2,939
Variable annuities	802	941	1,039	1,225	1,347	855	1,131	1,292	1,250	1,397

¹ Front-end load > 1 percent. Primarily includes A shares; includes sales where front-end loads are waived.² Front-end load = 0 percent and CDSL > 2 percent. Primarily includes B shares.³ Front-end load ≤ 1 percent, CDSL ≤ 2 percent, and 12b-1 fee > 0.25 percent. Primarily includes C shares; excludes institutional share classes.⁴ All other load share classes not classified as front-end load, back-end load, or level load. Primarily includes retirement share classes known as R shares.⁵ Front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

Note: Components may not add to the total because of rounding. Data exclude mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Lipper

Within no-load funds, the assets of both retail/general purpose share classes and institutional share classes have grown considerably in the past 10 years. However, assets in no-load institutional share classes have grown faster, so that institutional share classes comprised 46 percent of the assets of no-load share classes in 2012, compared with 29 percent in 2003.

Some movement toward no-load funds can be attributed to “do-it-yourself” investors. However, two other factors likely explain the majority of the shift. First, sales of no-load share classes through sales channels that compensate financial professionals with asset-based fees outside of mutual funds (for example, through mutual fund supermarkets, discount brokers, fee-based professionals, and full-service brokerage platforms) have increased. Second, assets and flows to institutional no-load share classes have been bolstered by 401(k) plans and other retirement accounts, which are often invested in institutional no-load share classes. The shift toward no-load share classes has been an important factor driving down the average expense ratio of mutual funds.

Conclusion

This study examines recent trends in the expenses and fees of mutual funds. Expense ratios of equity, bond, and hybrid funds declined in 2012 owing to reductions in the expense ratios of individual funds, an increase in the demand for index funds, and a continuing shift by investors in both actively managed and index funds toward lower-cost funds. Expense ratios of money market funds declined sharply as assets migrated toward lower-cost funds and funds continued to waive large portions of expenses. Waiving expenses helps offset the effects of the current low interest rate environment on a fund’s net yield.

Additional Reading

- » **“The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2010.”** Investment Company Institute.
www.ici.org/pdf/per17-04.pdf
- » ***Defined Contribution/401(k) Fee Study.*** Investment Company Institute.
www.ici.org/pdf/rpt_09_dc_401k_fee_study.pdf
- » **“The U. S. Retirement Market, Fourth Quarter 2012.”** Investment Company Institute.
www.ici.org/research/stats/retirement/ret_12_q4
- » **ICI Resources on 401(k) Plans.** Investment Company Institute.
www.ici.org/401k
- » **ICI Resources on 12b-1 Fees.** Investment Company Institute.
www.ici.org/rule12b1fees

Notes

- ¹ ICI uses asset-weighted averages to summarize the expenses and fees that shareholders pay through mutual funds. In this context, asset-weighted averages are preferable to simple averages, which would overstate the expenses and fees of funds in which investors hold few dollars. ICI weights each fund's expense ratio by its end-of-year assets.
- ² Funds that invest primarily in other funds are not included in this section and are analyzed separately in a later section.
- ³ To assess the expenses and fees incurred by individual shareholders in long-term funds, the analysis throughout this paper includes both retail and institutional share classes of long-term mutual funds. Including institutional share classes is appropriate because the vast majority of the assets in the institutional share classes of long-term funds represent investments made on behalf of retail investors, such as through defined contribution (DC) plans, individual retirement accounts (IRAs), broker-dealers investing on behalf of retail clients, 529 plans, and other accounts such as omnibus accounts (for a definition of omnibus accounts see next note).
- ⁴ When an investor purchases shares of a mutual fund through a brokerage firm, the broker often registers the purchase with the mutual fund under the broker's name in a pooled (omnibus) account, which is known as registering in “street name.” Brokers do this for operational convenience to help reduce costs.
- ⁵ Exchange-traded funds (ETFs) are excluded from this analysis.
- ⁶ Investors generally do not pay sales loads for investing in money market funds.
- ⁷ Some funds of funds also invest in ETFs.
- ⁸ A Securities and Exchange Commission rule addressing funds of funds, adopted in 2006, requires a fund of funds to report a total expense ratio in its prospectus fee table that accounts for both direct and indirect expenses. The total expense ratios shown in Figure 13 account for both the expenses that a fund pays directly out of its assets (sometimes called direct expenses), as well as the expense ratios of the underlying funds in which it invests (often called acquired fund fees or indirect expenses).
- ⁹ As of December 2012, 91 percent of target date mutual fund assets were held in IRAs and DC retirement plans. See Investment Company Institute 2013, “The U. S. Retirement Market, Fourth Quarter 2012.”

¹⁰ When plan participants are automatically enrolled or otherwise do not specify how their contributions should be allocated among plan investment choices, the plan sponsor is permitted to invest the monies in a qualified default investment alternative (QDIA). The Pension Protection Act of 2006 (PPA) mandated that QDIAs must include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both. The Department of Labor QDIA regulation (29 CFR 2550.404c-5) permitted three types of investments that may be used as long-term QDIAs: target date funds (also called lifecycle funds); balanced funds; and managed accounts. These may be mutual funds, collective investment trusts, or separately managed accounts. This section of this paper focuses only on target date mutual funds.

¹¹ In the EBRI/ICI 401(k) database, from which this statistic was generated, “funds” include mutual funds, collective investment trusts, separately managed accounts, and any pooled investment products invested in the security indicated. See Holden, VanDerhei, and Alonso 2008; Holden et al. 2011; and Holden et al. 2012.

¹² See, for example, Damato and Pessin 2010.

¹³ A level load is a combination of an annual 12b-1 fee (typically 1 percent) and a contingent deferred sales load fee (also often 1 percent) imposed by funds when shares are sold within the first year after purchase.

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