Independent Directors Council
Promoting Excellence in Fund Governance

Institute Economist Discusses Fund Fees

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Washington, DC, November 16, 1998 - At a conference today addressing economic developments and issues in the mutual fund industry, Investment Company Institute Chief Economist John Rea presented the results of research on trends in the ownership cost of equity mutual funds.

Costs Have Declined by One Third

Text of sound bite:

"The most important finding from the Institute's study is that the cost of investing in equity funds declined by over one third between 1980 and 1997. In addition, the study found evidence pointing to the presence of economies of scale among equity funds. I should point out that these findings conflict with all stated views that equity fund costs are rising and that equity funds either do not have economies of scale or they do not show through to an investment cost."

Defining Total Shareholder Cost

Text of sound bite:

"Total shareholder cost has three important features. First, it includes all major costs involved in purchasing and holding mutual fund shares. By way of contrast, discussions of fees and expenses typically focus on just the expense ratio thereby ignoring the sales load. This oversight is important as roughly two out of every three retail investors primarily purchase mutual funds through sources offering load funds. Total shareholder cost rather than the expense ratio would therefore be the measure of significance to the majority of fund investors."

Shareholder Costs in 1997 = 1.49%

Text of sound bite:

"In 1980, total shareholder cost of all equity funds stood at an estimated 2.25%. This means that each purchase of equity shares in 1980 cost the buyer on average 2.25% of the initial investment. In 1997, the cost of investing in equity funds was down to 1.49%, a drop of over 1/3. Other aggregate measures such as asset weighted average, the simple average, and the median also declined significantly between 1980 and 1997."

Evidence of Economies of Scale

Text of sound bite:

"Estimates of total shareholder cost provide evidence of economies of scale among equity funds… that is funds with large assets tend to have lower expense ratios than funds with small assets. The level of the operating expense ratio for each fund drops significantly as assets increase, falling from 1.25% for the smallest group to .64% for the largest group. The relationship between operating expense ratios and assets also is similar for newly established funds and older funds, suggesting that fund size more than fund age is crucial to operating efficiency."