Independent Directors Council
Promoting Excellence in Fund Governance

In 2011, Investors Paid Lower Average Expense Ratios for Equity, Bond, and Hybrid Mutual Funds

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Several Factors Contribute to the Continuation of the Overall Trend

Washington, DC, April 23, 2012 - Investors paid on average lower expense ratios in 2011 than in 2010 for long-term mutual funds, including equity, bond and hybrid funds, according to an annual ICI report on fund fees and expenses. An expense ratio is the fund's total annual expenses expressed as a percentage of a fund's net assets. The decline in expense ratios was largely driven by three factors:

- A decline in the expense ratios of individual funds
- The continuing shift by investors in actively managed and index funds toward lower cost funds
- The continuing increase in the demand for index funds

The ICI study, *Trends in the Expenses and Fees of Mutual Funds, 2011*, found that the average expense ratio paid by equity fund investors was 79 basis points, down 4 basis points from 2010. The asset-weighted average expense ratio for bond funds fell 2 basis points, to 62 basis points in 2011. During the last two decades, on an asset-weighted basis, average expense ratios for equity funds have fallen by 20 percent.

"The average expense ratio paid by investors in any mutual fund category is influenced by multiple factors, which can include fund growth coupled with economies of scale, as well as industry competition and investors gravitating towards lower cost funds," said Sean Collins, ICI's Senior Director of Industry and Financial Analysis. "This study shows the cumulative impact of such factors across the long-term fund landscape."

Expense Ratios of Equity and Bond Funds Declined

According to the ICI study, the average asset-weighted expense ratios of equity funds declined in 2011, following a decline in 2010 and an increase in 2009. This three-year pattern is not unexpected given recent stock market developments and the fact that fund expense ratios often vary inversely with fund assets, because fixed fund expenses are spread across a larger asset base. In short, mimicking the stock market, assets of equity funds initially declined in 2009, but then recovered in 2010 and 2011.

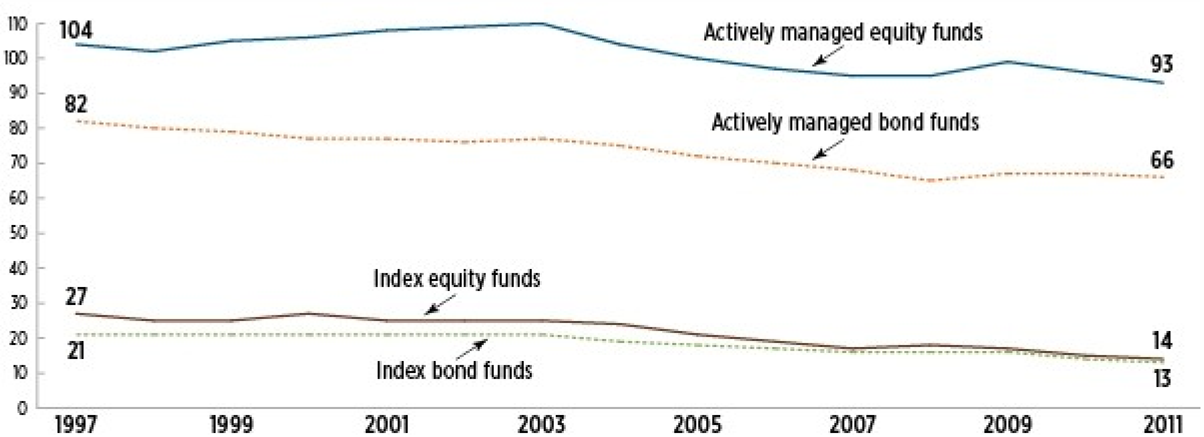
Expense ratios for bond funds also fell in 2011, in part because strong inflows and returns boosted assets, which allowed fund expenses to be spread over more assets. Lower bond fund expense ratios last year can also be attributed to the Federal Reserve announcements that short-term interest rates were likely to remain very low through 2014. Possibly as a result of these announcements, money flowed into longer-term and mortgage-backed bond funds. Expense ratios of these funds tend to be lower than average.

Investors Paid Less for Both Actively Managed and Index Mutual Funds

The study also shows that the average expense ratios investors paid for both actively managed and index mutual funds decreased, as seen in the chart below. From 1997 to 2011, the asset-weighted average expense ratio of actively managed equity funds fell 11 basis points, and the asset-weighted average expense ratio for index equity funds declined 13 basis points. Similarly, the average expense ratios of actively managed and index bond funds fell 16 and 8 basis points, respectively.

Expense Ratios of Actively Managed and Index Funds

Basis points, 1997–2011



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

Investor Demand for Index Funds Continued to Increase

Another factor contributing to the declines in expense ratios paid by investors in long-term mutual funds was a continuation of the recent trend of growing investor demand for index mutual funds. Index funds' expense ratios are generally lower than those of actively managed funds. Assets in index mutual funds grew from $170 billion in 1997 to $1.1 trillion by year-end 2011.

Money Market Funds' Expense Ratios Drop, Reflecting Low Interest Rates, Fund Fee Waivers

The study also finds the average expense ratios of money market funds fell 3 basis points in 2011, following a sharp decline of 9 basis points in 2010. The decline in both cases can be attributed to significant increases in the number of funds waiving expenses and, in some cases, an increase in the amount of the waiver, both of which help ensure that net returns to investors remained positive in the face of very low interest rates. If and when short-term interest rates rise from their current historic lows, advisers may reduce or eliminate waivers, and money market fund expense ratios could rise.

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 or when shares are redeemed.

There has been a marked decline in load fees paid by mutual fund investors. While the maximum front-end load fee that shareholders might pay for investing in mutual funds has remained nearly constant since 1990, the front-end load fees that investors actually paid have declined from nearly 4 percent in 1990 to 1 percent in 2011. This in part reflects flows into 401(k) plans, which are often invested in funds that waive load fees on purchases made through these plans.

ICI Methodology

In this unique annual study, ICI evaluates fee trends uses asset-weighted averages to summarize the expenses that shareholders actually pay through mutual funds. Simple averages, by contrast, would overstate the expenses of funds in which investors hold few dollars.
