

# Fundamentals

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## Total Shareholder Cost of Mutual Funds, 2003

The cost of buying equity funds and money market funds was down slightly in 2003, while the cost of buying bond funds remained unchanged. The purchase cost of mutual funds, known as total shareholder cost, incorporates all of the major fees and expenses that mutual fund investors pay when purchasing funds. Total shareholder cost includes annual fees and expenses for portfolio management, fund administration, shareholder

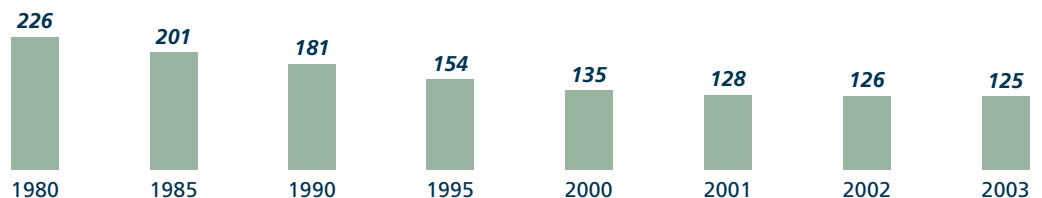
servicing, and distribution (under a Rule 12b-1 plan), as well as a portion of any sales load. Unlike ongoing annual fees and expenses, a sales load is a one-time payment that must be converted into the equivalent of an annual payment made over the lifetime of a fund investment. Thus, total shareholder cost is the sum of the annualized sales load and fund expenses, expressed as a percentage of new purchases over the course of a year.<sup>1</sup>

figure 1

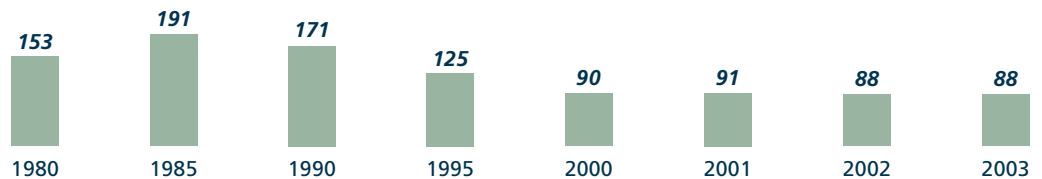
### Total Shareholder Cost\* of Mutual Funds, Selected Years

(basis points)

#### Equity Funds



#### Bond Funds



#### Money Market Funds



\*Sales-weighted average of total shareholder cost for individual funds.

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<sup>1</sup> See John D. Rea and Brian K. Reid, "Trends in the Ownership Cost of Equity Mutual Funds," *Perspective*, Vol. 4 No. 3, November 1998 (www.ici.org/pdf/per04-03.pdf), for a detailed description of the computation of total shareholder cost.

Total shareholder cost of equity funds was 125 basis points or 1.25 percent in 2003 (Figure 1). That is, the sum of fund expenses and annualized loads incurred by buyers of equity funds in 2003 amounted to 1.25 percent of the dollar volume of their purchases of new shares during the year. The purchase cost was down slightly from 126 basis points in 2002, which was a modest continuation of a downward trend in cost over the past two decades. Historically, the downward trend in the total shareholder cost of equity funds has been driven by a decline in distribution cost. The one basis point drop in 2003, however, resulted from an equivalent one basis point decline in the expenses of equity funds, net of 12b-1 fees (labeled “operating expense” in Figure 2).<sup>2</sup> The distribution cost of equity funds remained flat in 2003 at 37 basis points.

The purchase cost of bond funds remained constant in 2003, at 88 basis points. While the operating expense of bond funds rose two basis points, from 55 to 57, their distribution cost dropped by the same amount, from 33 to 31 basis points, resulting in no net change in the cost of purchasing bond funds.

Total shareholder cost of money market funds dropped one basis point in 2003, from 34 to 33. That decline owed to a one basis point drop in the operating expense of money market funds. Distribution cost (which for money market funds includes only the 12b-1 fee<sup>3</sup>) was unchanged from its 2002 level of three basis points.

figure 2

### Components of Total Shareholder Cost of Equity, Bond, and Money Market Funds, Selected Years

(basis points)

	Equity Funds					Bond Funds					Money Market Funds <sup>1</sup>				
	1980	2000	2001	2002	2003	1980	2000	2001	2002	2003	1980	2000	2001	2002	2003
<b>Total Shareholder Cost</b>	226	135	128	126	125	153	90	91	88	88	55	42	36	34	33
Operating Expense <sup>2</sup>	77	89	88	89	88	71	60	57	55	57	55	36	32	31	30
Distribution Cost	149	46	40	37	37	82	30	34	33	31	0	6	4	3	3
Memo: 12b-1 Fee	0	22	20	18	19	0	13	17	18	17	0	6	4	3	3

<sup>1</sup>Total shareholder cost of money market funds is computed without including the annuitized sales load. Few money market funds charge sales loads and those that do typically are part of a package of bond and equity load funds. The package of funds is designed to allow the investor to transfer between funds without incurring any additional sales charge beyond that associated with the initial purchase. In this arrangement, few investors are likely to purchase a money market fund with a load as a stand-alone or long-term investment. Inasmuch as the definition of total shareholder cost entails the expected cost over the holding period, it is unlikely that an investor initially purchasing a money market fund would regard the sales load as part of the expected cost of purchasing the money market fund. For this reason, the annuitized sales load is not included in the measurement of total shareholder cost. As a practical matter, the quantitative effect of excluding the annuitized sales load is negligible.

<sup>2</sup>Operating expenses include expenses used to support investment management, fund administration, and shareholder servicing.

**note:** Total shareholder cost, distribution cost, operating expense, and 12b-1 fee are all measured as sales-weighted averages.

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<sup>2</sup>Distribution expenses are used primarily to compensate financial professionals for distributing mutual fund shares. Operating expenses pay for portfolio management, administration, and general shareholder servicing.

<sup>3</sup>Money market funds typically do not charge sales loads; hence, annual 12b-1 fees are the sole component of money market fund distribution expenses.