

Trends in the Fees and Expenses of Mutual Funds, 2009

KEY FINDINGS

- **On average, fees and expenses incurred by investors in long-term mutual funds were unchanged in 2009.** Stock fund investors on average paid 99 basis points (0.99 percent) in fees and expenses, the same as in 2008. Fees and expenses for bond funds were also unchanged at 75 basis points.
- **Expense ratios of stock funds and bond funds averaged slightly higher in 2009.** The average expense ratio of stock funds rose 2 basis points to 86 basis points, after having declined the previous six years. Bond fund expense ratios rose 2 basis points to 65 basis points.
- **Rising expense ratios of long-term funds were offset by a decline in load fee payments by investors.** In 2009, the average maximum sales load on stock 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 on purchases through 401(k) plans.
- **The average fees and expenses of money market funds fell 4 basis points in 2009.** The average expense ratio on money market funds fell to 34 basis points in 2009 from 38 basis points in 2008.
- **Average expense ratios of funds of funds declined for the fourth consecutive year.** In 2009, the average expense ratio of funds of funds—mutual funds that invest in other mutual funds—fell 1 basis point to 91 basis points. Since 2005, the average expense ratio for investing in funds of funds has fallen 10 basis points.

MUTUAL FUND FEES AND EXPENSES HAVE DECLINED BY HALF SINCE 1990

Since 1990, the average fees and expenses paid by mutual fund investors have fallen by half (Figure 1). In 1990, investors on average paid 198 basis points (or \$1.98 for every \$100 in assets) to invest in stock funds.¹ By 2009, that figure had fallen to 99 basis points. Over the same period, the average fees and expenses paid by investors in bond funds dropped from 189 basis points to 75 basis points in 2009, a decline of 60 percent. Fees incurred by investors in money market funds dropped to 34 basis points, nearly 40 percent, from 1990 to 2009.

HOW ICI MEASURES AVERAGE MUTUAL FUND FEES AND EXPENSES

Investors in mutual funds incur two primary kinds of fees and expenses: sales loads and ongoing expenses. Sales loads are one-time fees that investors pay either at the time of purchase (front-end loads) or, in some cases, when shares are redeemed (back-end loads).

Ongoing expenses are paid from fund assets, and investors thus pay these expenses indirectly. Ongoing fund expenses cover portfolio management, fund administration and compliance, shareholder services, recordkeeping, distribution charges (known as 12b-1

fees), and other operating costs. A measure of ongoing expenses is the expense ratio: a fund's total expenses—disclosed in the prospectus and shareholder reports—expressed as a percentage of its assets.

Various factors affect a mutual fund's fees and 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.

Load funds are sold through financial intermediaries such as brokers and registered financial advisers. These professionals help

investors define their investment goals, select appropriate funds, and provide ongoing advice and service. Financial professionals are compensated for providing these services through some combination of front- or back-end loads and 12b-1 fees.

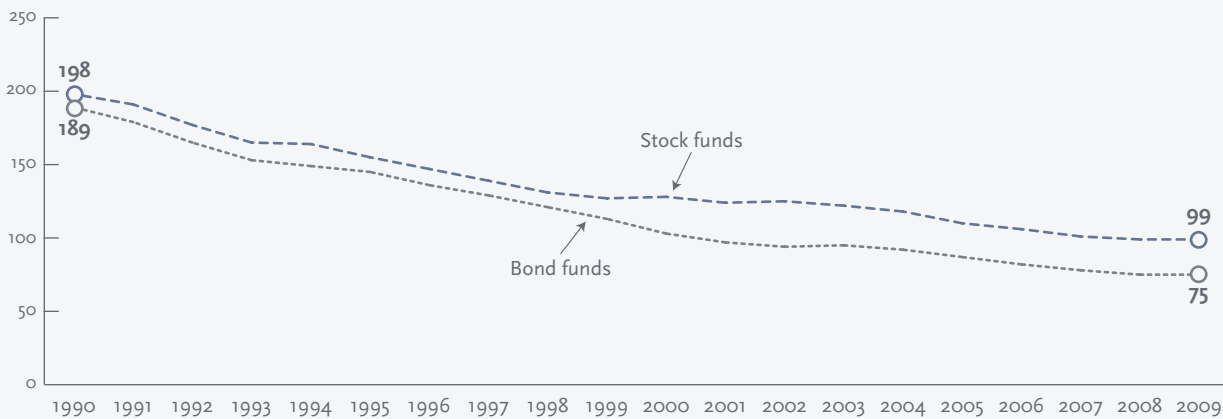
Investors who do not use a financial adviser (or who pay the financial adviser directly for services) purchase no-load funds, which have neither front- nor back-end load fees and have low or no 12b-1 fees. Because load funds include payments to brokers or other financial professionals, they typically have higher fees and expenses than no-load funds.

FIGURE 1

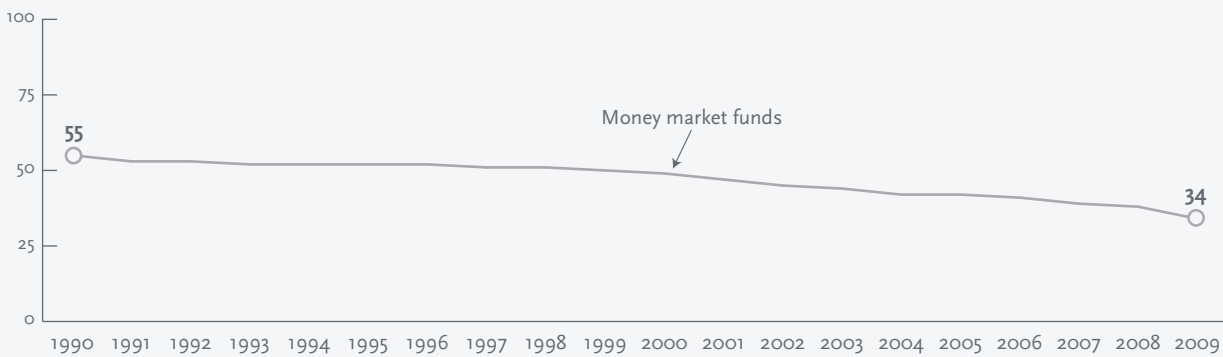
MUTUAL FUND FEES AND EXPENSES HAVE FALLEN BY HALF SINCE 1990

Basis points, 1990–2009

Stock funds and bond funds



Money market funds



Note: Fees and expenses are measured as an asset-weighted average; figures exclude mutual funds available as investment choices in variable annuities and funds of funds.

Sources: Investment Company Institute and Lipper

To understand trends in the cost of owning mutual funds, it is helpful to combine one-time sales loads and ongoing expenses in a single measure. ICI does this by adding a fund's annual expense ratio to an estimate of the annualized cost that investors pay for one-time sales loads.² In order to summarize the fees and expenses that shareholders incur, ICI uses an asset-weighted average.³

In addition, in order to assess appropriately the fees and expenses incurred by individual shareholders in long-term funds, the analysis 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 institutional share classes 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.⁴

For money market funds, this study provides a breakdown of the fees and expenses by retail and institutional share classes. This is appropriate because a large portion of the assets in money market funds are attributable to institutional investors such as corporations, municipalities, endowments, and other institutional investors investing for their own accounts.

STOCK FUNDS

The average fees and expenses paid by stock fund investors remained unchanged in 2009 at 99 basis points. The average expense ratio of stock funds rose 2 basis points (Figure 2), but that increase was offset by a decline in load fees paid by stock fund investors.

FIGURE 2

LOAD FEES AND EXPENSE RATIOS FOR MUTUAL FUNDS

Basis points, 1990–2009

Year	Stock funds			Bond funds			Money market funds
	Fees and expenses	Load fees (annualized)	Total expense ratio	Fees and expenses	Load fees (annualized)	Total expense ratio	Total expense ratio
1990	198	99	100	189	100	89	55
1991	191	90	100	179	90	89	53
1992	177	76	101	165	77	87	53
1993	165	65	101	153	69	85	52
1994	164	59	105	149	63	85	52
1995	155	51	104	145	58	86	52
1996	147	46	102	136	51	85	52
1997	139	41	98	129	46	84	51
1998	131	35	96	121	39	82	51
1999	127	33	94	113	34	79	50
2000	128	29	98	103	26	76	49
2001	124	25	99	97	22	75	47
2002	125	25	100	94	21	73	45
2003	122	23	99	95	21	74	43
2004	118	23	95	92	20	72	42
2005	110	20	90	87	17	70	42
2006	106	18	88	82	15	67	41
2007	101	16	85	78	13	65	39
2008	99	15	84	75	12	63	38
2009	99	13	86	75	10	65	34

Note: Fees and expenses, one-time load fees, and total expense ratio are measured as asset-weighted averages. Figures exclude mutual funds available as investment choices in variable annuities and funds of funds.

Sources: Investment Company Institute and Lipper

In 2009, payments for load fees by stock fund investors fell 2 basis points. The drop reflects an increased volume of sales of load funds that were entitled to a discounted load fee (see “Understanding the Decline in Load Fee Payments” below). For example, in 2009, the average maximum sales load charged by stock funds was 5.3 percent (Figure 3). However, owing to sales of fund shares with load fee

discounts, the average sales load actually paid by fund investors was just 1.0 percent, down slightly from 1.1 percent in 2008.

From 2003 to 2008, the average expense ratio of stock funds fell each year. In 2009, however, the average expense ratio of stock funds rose 2 basis points to 86 basis points (Figure 2). Given recent market developments, this increase was not unexpected.⁵

FIGURE 3

FRONT-END SALES LOADS THAT INVESTORS PAY ARE WELL BELOW MAXIMUM FRONT-END LOADS THAT FUNDS CHARGE

Percentage of purchase amount

	Maximum front-end sales load	Average front-end sales load that investors actually incurred
1990	5.0	3.9
1995	4.7	2.5
2000	5.1	1.4
2001	5.1	1.2
2002	5.1	1.3
2003	5.2	1.3
2004	5.3	1.4
2005	5.3	1.3
2006	5.3	1.2
2007	5.3	1.2
2008	5.3	1.1
2009	5.3	1.0

Note: 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 prospectuses. The average actually incurred is the maximum sales load multiplied by the ratio of total front-end sales loads collected by stock funds as a percentage of new sales of shares by such funds. Figures exclude mutual funds available as investment choices in variable annuities and funds of funds.

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

During the stock market downturn that lasted from early 2000 to early 2003, the average expense ratio of stock funds temporarily rose several basis points. This largely reflected the sharp decline in the assets of stock funds during that downturn. Certain fund costs (transfer agency fees, accounting and audit fees, directors fees, and various other fees) tend to be relatively fixed in dollar terms. As the assets of stock funds fell, those relatively fixed dollar fees contributed proportionally more to the expense ratios of stock funds. When the stock market began to recover in early 2003, the assets of stock funds rebounded, and stock fund expense ratios resumed a downward trend.

During the most recent stock market downturn, which began in October 2007 and lasted through early 2009, the assets of stock funds again declined markedly, with the same effect; the relatively fixed expenses of funds contributed proportionally more to fund expense ratios, boosting fund expense ratios.

This rise in fund expense ratios, as during the market downturn earlier in the decade, seems likely to be temporary. The stock market declined sharply in early 2009, then in March 2009 began a recovery that lasted through the end of the year. The assets of equity mutual funds recovered with the stock market rally, rising from \$3.1 trillion in February 2009 to \$5.0 trillion by December 2009. Even with that sharp recovery, however, the average assets of equity funds over calendar year 2009 measured \$4.1 trillion, well below the average of \$5.3 trillion over calendar year 2008. As a result, the average expense ratios of equity funds, measured over the entire calendar year of 2009, rose relative to 2008.

If equity fund assets were to remain at their level of December 2009 (\$5.0 trillion) throughout calendar year 2010, the assets of equity funds would average about the level seen in 2008, with the expectation that fund expense ratios would decline commensurately.

UNDERSTANDING THE DECLINE IN LOAD FEE PAYMENTS

Over time, load fee payments have declined very substantially as a proportion of the total fees investors incur in mutual funds. Load fees now contribute considerably less than fund expense ratios to the total fees investors pay to invest in mutual funds. For example, load fees now contribute just 13 basis points to the annualized cost of investing in stock funds, while fund expense ratios contribute 86 basis points. In 1990, by contrast, load fees and expense ratios contributed virtually equally (about 100 basis point each) to the costs of investing in stock funds. This decline in load fees paid reflects several developments.

First, the ways mutual funds are sold have changed. In the 1980s and early 1990s, mutual funds were sold largely through stock brokers. Load fees were a primary means of compensating brokers for the investment advice and service they provided to investors. Over time, however, brokers and other financial professionals who sell mutual funds have increasingly been compensated through “asset-based” fees (assessed as a percentage of the assets that the financial professional manages for an investor).⁶ 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 from the fund, but passes the bulk of that fee to the financial professionals serving fund investors. Alternatively, investors who want advice may purchase no-load funds with the help of a financial professional, then directly pay the professional a fee (typically an asset-based fee) for his or her services. Either way, the increased use of asset-based fees to compensate financial professionals has resulted in lower front-end load fee payments.

Second, the increasingly significant role of mutual funds in helping investors save for retirement has contributed to the decline in load fees paid as a percentage of fund assets. Some portion of share purchases made through 401(k) plans has gone to funds that normally charge front- or back-end load fees.⁷ However, load funds often waive sales loads on purchases made through 401(k) plans. As a result, the total dollar amount of load fees paid by investors has declined over time relative to the assets in load funds.

Third, even for purchases made outside of retirement plans, load funds typically offer significant load fee discounts called “breakpoints” for initial purchases above a given dollar amount or when cumulative purchases exceed pre-specified levels. For example, in 2009, among domestic equity funds (excluding sector funds) that charged a front-end load fee, investors most commonly incurred a front-end load of 5.75 percent of initial share purchases up to \$50,000 (Figure 4). For larger initial purchases—or cumulative purchases that over time exceeded \$50,000—investors paid a lower front-end load fee, with the front-end load fee declining with total dollars invested. For example, in 2009, for purchases between \$50,000 and \$100,000, investors most commonly paid a front-end load fee of 4.5 percent of the amount invested. In most cases, front-end load fees are waived altogether for purchases over \$1 million. Fee breakpoints thus help reduce investors’ load fee payments as a percent of share purchases, which contributes to a reduction in load fees paid as a percent of assets.

FIGURE 4

FRONT-END LOAD FEES AND ASSOCIATED FEE BREAKPOINTS

Most frequently occurring values¹

2009		1999		1999 adjusted for inflation ²	
Cumulative dollar purchases (fee breakpoints)	Front-end load fee ³	Cumulative dollar purchases (fee breakpoints)	Front-end load fee ³	Cumulative dollar purchases (fee breakpoints)	Front-end load fee ³
\$ 0 to \$49,999	5.75	\$ 0 to \$49,999	5.75	\$ 0 to \$38,499	5.75
\$50,000 to \$99,999	4.5	\$50,000 to \$99,999	4.5	\$38,500 to \$76,999	4.5
\$100,000 to \$249,999	3.5	\$100,000 to \$249,999	3.5	\$77,000 to \$191,499	3.5
\$250,000 to \$499,999	2.5	\$250,000 to \$499,999	2.5	\$192,500 to \$384,999	2.5
\$500,000 to \$999,999	2.0	\$500,000 to \$999,999	2.0	\$385,000 to \$769,999	2.0
\$1,000,000 or more	0.0	\$1,000,000 or more	0.0	\$770,000 or more	0.0

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 Fee breakpoints are adjusted for inflation by taking the fee breakpoints available in 1999 and multiplying by the Consumer Price Index in December 1999 and dividing by the Consumer Price Index in December 2009.

³ The front-end load fee is a percentage of purchase amount.

Sources: Investment Company Institute, U.S. Bureau of Labor Statistics, and Morningstar

Fourth, fee breakpoints have interacted with inflation to reduce the real (inflation-adjusted) cost to investors of load fees. As Figure 4 shows, the most common front-end load fees and associated fee breakpoints have not changed since 1999. However, over the 10-year period from 1999 to 2009, the consumer price level rose almost 30 percent. Thus, in 2009, investors could in real terms achieve a given breakpoint with a considerably smaller investment than they could in 1999. This too has likely contributed to a reduction in load fees paid as a percentage of dollars invested.

BOND FUNDS

The average fees and expenses that shareholders paid for investing in bond funds were unchanged in 2009 at 75 basis points (Figure 2). Among bond funds, the annualized cost of load fee payments declined 2 basis points, offsetting a 2 basis point rise in the average expense ratio of bond funds.

The rise in the average expense ratio of bond funds, in contrast with that of stock funds, did not stem from a drop in the assets of bond funds. Indeed, averaged over the calendar year, the assets of bond funds rose \$200 billion in 2009, as investors sought the attractive returns seen in long-term fixed-income securities.⁸ The rise in the average expense ratio of bond funds instead was owed primarily to actions taken by tax-exempt bond funds during the financial

crisis. The tax-exempt bond market, like many other financial markets, came under severe stress during the financial crisis, and the prices of tax-exempt bonds generally declined. Rather than selling securities into depressed markets to meet various needs, some tax-exempt bond funds established and drew down committed lines of credit with banks. The commitment fees for establishing these lines, as well as the interest costs of borrowing against such lines, added to the expenses of these funds, boosting the industrywide average expense ratio of all bond funds. This strategy, while costly, ultimately proved beneficial to fund shareholders, as the tax-exempt bond funds following this strategy were generally the very best performing tax-exempt bond funds in 2009.

MONEY MARKET FUNDS

The fees and expenses of money market funds averaged 34 basis points in 2009, a drop of 4 basis points from 2008 (Figure 2). From 1990 to 2009, the fees and expenses of money market funds declined 21 basis points, a reduction of 38 percent.

The average expense ratio of money market funds declined last year both as a result of a decline in expense ratios among individual funds, as well as an increase in the market share of institutional money market funds. In 2009, the average expense ratio of retail money market funds declined 3 basis points,

while that of institutional money market funds fell 1 basis point (Figure 5). In addition, institutional money market funds continued to gain market share in 2009, and by year-end 2009, they held more than two-thirds of the assets of all money market funds (Figure 6). Because institutional money market funds tend to have lower expense ratios than retail money market funds (reflecting the fact that retail funds serve more investors with smaller average account balances), the increase in the market share of institutional money market funds helped to lower the industrywide average expense ratio of all money market funds.

FIGURE 5

EXPENSE RATIOS OF INSTITUTIONAL AND RETAIL MONEY MARKET FUNDS

Basis points, 1999–2009



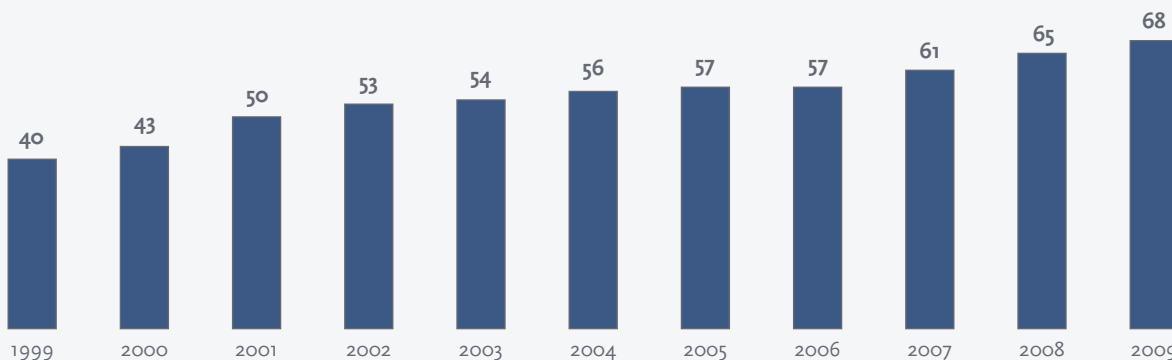
Note: Expense ratios are measured as an asset-weighted average; figures exclude mutual funds available as investment choices in variable annuities and funds of funds.

Sources: Investment Company Institute and Lipper

FIGURE 6

MARKET SHARE OF INSTITUTIONAL MONEY MARKET FUNDS

Percentage of assets of all money market funds, 1999–2009



Source: Investment Company Institute

FUNDS OF FUNDS

Funds of funds are mutual funds that invest in other mutual funds.⁹ The market for funds of funds has expanded considerably in recent years. By the end of 2009, there were 936 funds of funds with \$674 billion

in assets (Figure 7). Almost 90 percent of the assets of funds of funds are in hybrid funds of funds, which are funds that invest in a mix of stock, bond, and hybrid mutual funds.

FIGURE 7

FUNDS OF FUNDS HAVE GROWN RAPIDLY IN RECENT YEARS

Number of funds of funds

	Total	Equity	Hybrid	Bond	Memo	
					Lifestyle ¹	Lifecycle ²
1996	45	24	19	2	9	0
1997	94	41	48	5	30	3
1998	175	75	91	9	60	7
1999	212	83	115	14	78	8
2000	215	86	119	10	88	9
2001	213	85	123	5	86	15
2002	269	104	159	5	115	15
2003	302	112	184	5	115	26
2004	380	111	259	5	123	64
2005	475	129	334	12	160	91
2006	609	161	430	13	201	154
2007	723	174	537	12	222	220
2008	867	182	667	16	240	285
2009	936	172	744	15	235	339

Total net assets of funds of funds, billions of dollars

	Total	Equity	Hybrid	Bond	Memo	
					Lifestyle ¹	Lifecycle ²
1996	\$13.4	\$4.6	\$8.7	\$0.1	\$2.4	\$0.0
1997	21.5	7.6	13.8	0.1	5.9	0.3
1998	35.4	12.2	23.0	0.1	11.8	2.8
1999	48.3	18.7	29.5	0.2	17.0	5.4
2000	56.9	16.2	40.5	0.2	20.0	7.2
2001	63.4	15.8	47.3	0.3	21.5	10.7
2002	69.0	14.5	53.9	0.6	24.4	13.5
2003	123.1	28.6	93.6	0.9	43.0	23.7
2004	199.6	41.8	156.7	1.1	71.9	40.5
2005	306.0	58.6	246.8	0.7	116.1	66.0
2006	471.0	96.4	372.8	1.8	171.2	108.1
2007	639.8	116.2	520.5	3.1	220.2	174.9
2008	489.3	76.2	409.5	3.6	164.1	153.4
2009	673.5	73.2	595.9	4.4	216.9	242.5

¹A lifestyle mutual fund maintains a predetermined risk level and generally contains "conservative," "aggressive," or "moderate" in its name.

²A lifecycle mutual fund is a hybrid fund that typically rebalances to an increasingly conservative portfolio as it approaches and passes the fund's target date, which is usually included in the fund's name.

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

Source: Investment Company Institute

Much of the growth in funds of funds stems from investor interest in lifestyle and lifecycle mutual funds. Lifestyle funds, also known as “target risk” funds, maintain pre-determined asset allocations and usually contain “conservative,” “moderate,” or “aggressive” in the funds’ names.

Lifecycle funds—also known as “target date” funds—adjust their asset allocations over time in a pre-specified way. Typically, the fund provides investors more exposure to fixed income and cash as it approaches and passes the target date, which is usually mentioned in the fund’s name.

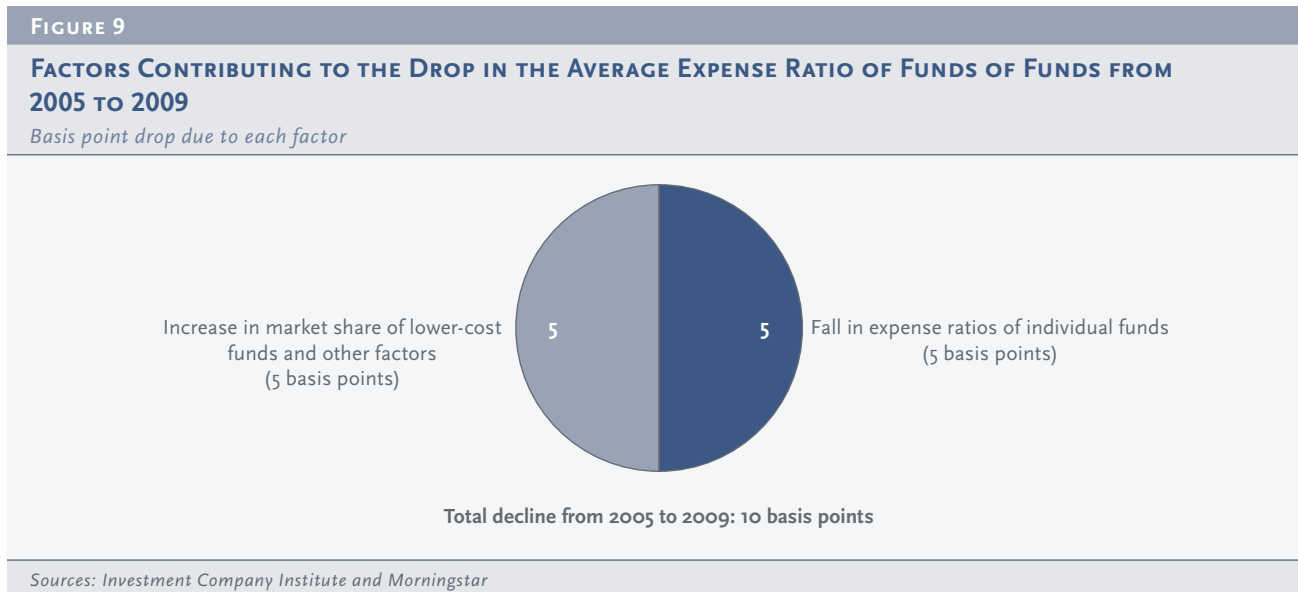
These features have made lifestyle and lifecycle funds especially attractive for individuals saving for retirement in 401(k) plans and IRAs.¹⁰ Lifestyle and lifecycle funds of funds account for 61 percent of the total number and 68 percent of the total assets of funds of funds (Figure 7).

From 2005 to 2009, the average expense ratio of funds of funds fell from 101 basis points to 91 basis points (Figure 8).¹¹ Half of that 10 basis point drop is explained by declines in the expense ratios of individual funds of funds over the period (Figure 9); the other half reflects a shift by investors toward lower-cost funds of funds, as well as other factors.¹²

FIGURE 8
TOTAL EXPENSE RATIOS OF FUNDS OF FUNDS
Basis points

	Asset-weighted average	Simple average	Median
2005	101	156	152
2006	96	144	139
2007	94	144	135
2008	92	138	129
2009	91	135	126

Sources: Investment Company Institute and Morningstar



NOTES

- ¹ Stock funds includes both equity mutual funds and balanced/hybrid mutual funds. Balanced and hybrid funds that are funds of funds are analyzed separately along with all funds of funds in the discussion at the end of this report.
- ² For more details, see Rea and Reid 1998.
- ³ Except where noted, fees and expenses reported in this study are measured as asset-weighted averages. An asset-weighted average is the appropriate way to measure the fees that investors actually pay through mutual funds. Simple averages overstate the fees and expenses of funds in which investors hold few dollars.
- 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 and to help reduce costs.
- ⁵ See the discussion on potential future trends in fund expense ratios in Collins and Roth 2009.
- ⁶ See, for example, Damato and Pessin 2010.
- ⁷ For an analysis of 401(k) plan mutual fund assets by share class, see Holden and Hadley 2009.
- ⁸ In addition, some of the flow to bond funds likely was attributable to investors' demands for funds of funds. These funds, which invest in underlying mutual funds (including bond mutual funds) have grown rapidly in recent years. Some portion of these inflows has been used to purchase shares of underlying bond funds.
- ⁹ Some funds of funds also invest in exchange-traded funds.
- ¹⁰ As of September 2009, 42 percent of lifestyle mutual fund assets and 86 percent of lifecycle mutual fund assets were held in IRAs and DC retirement plans. See Investment Company Institute 2010.
- ¹¹ An SEC 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 the expenses that it 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"). The expense ratios in Figure 8 include both the direct and indirect expenses of funds of funds.
- ¹² The contribution analysis in Figure 9 is determined by first calculating the amount by which the asset-weighted average expense ratio of funds of funds changed from 2005 to 2009 as the result of changes in the expense ratios of individual funds of funds, while holding their assets constant as of 2005. This factor contributed 5 basis points of the 10 basis point decline in the average expense ratio of funds of funds over the period (labeled in Figure 9 as "Fall in expense ratios of individual funds"). By definition, the remaining 5 basis points must owe to an increase in the market share of lower expense ratio funds of funds, or to a net reduction in the average expense ratio of funds of funds because the expense ratios of newly created funds were lower on average than the expense ratios of funds of funds that were merged or liquidated over the period (labeled in Figure 9 as "Increase in market share of lower-cost funds and other factors").

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